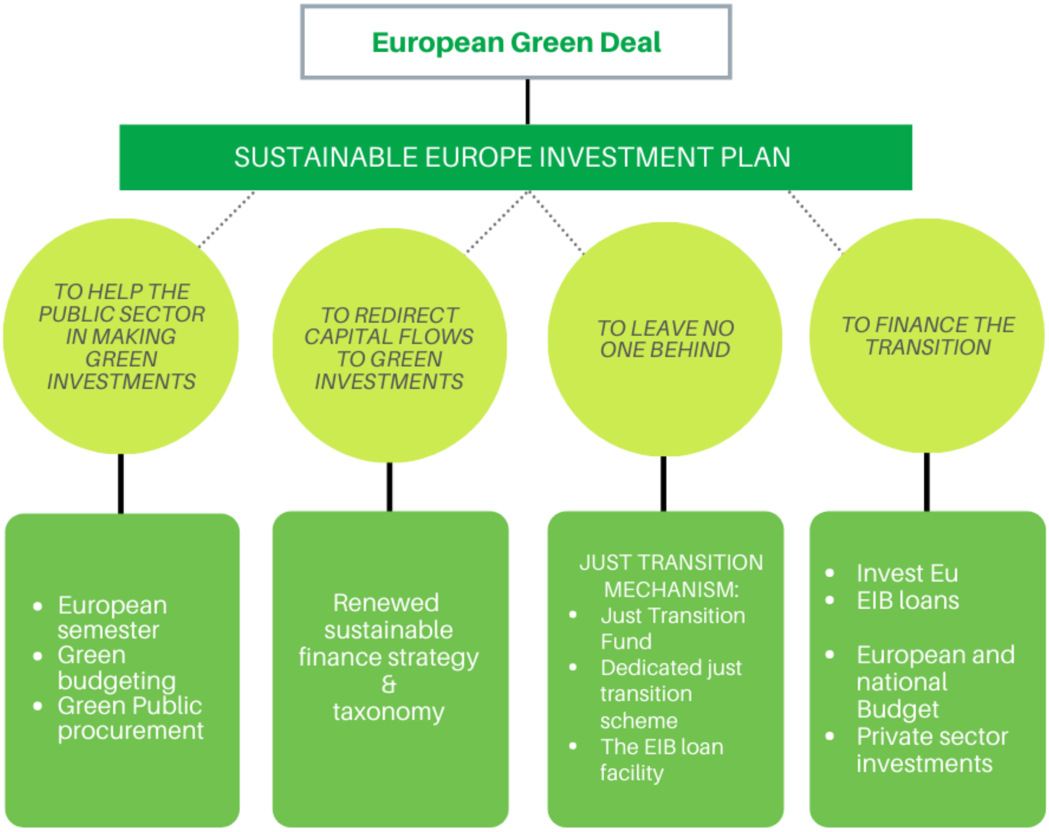
In depth analysis: local finances in the Green Deal

The European Commission presented on December 2019 the communication on the European Green Deal, which fixed a roadmap for making the EU's economy more sustainable in order to reach climate neutrality by 2050. In order to accompany this transition towards a greener Europe, significant investments are needed. For this reason, the Green Deal also includes an investment strategy that was presented in January. The European Green Deal Investment Plan, also known as **Sustainable Europe Investment Plan** (SEIP), is the Green Deal financial arm and it is supposed to mobilize at least €1 trillion in sustainable investments over the next decade. In this plan, multiple opportunities to facilitate regional and local investments are mentioned in order to help local actors through the transition.



1. The Sustainable Europe Investment Plan

The Sustainable Europe Investment Plan (SEIP), as investment pillar of the Green Deal, has three main objectives:

a) It will increase funding for the transition through the EU budget and associated instruments, in particular InvestEU;
b) It will facilitate sustainable investments for public and private investors;
c) It will provide support and technical assistance to public administrations and project promoters in identifying, structuring and executing sustainable projects and to access sources of finance.

In addition, the SEIP covers the amounts used under the Just Transition Mechanism, which will help the most affected regions during the transition to a greener economy.

In this context, the European Investment Bank will become the Union's climate bank: in fact, it will gradually increase the share of its financing dedicated to climate action and environmental sustainability to reach 50% of its operations in 2025.

2. InvestEu

InvestEu is part of and complementary to the Sustainable Europe Investment Plan. It will provide an EU budget guarantee to partially cover the risk of financing and investing operations, which will leverage new investments. The InvestEU Fund will support four policy areas: sustainable infrastructure; research, innovation and digitisation; small and medium-sized businesses; and social investment and skills.

Some investments needed for the transition entail more risk than the private sector can bear alone. In this situation, public funds can be used in a targeted manner to de-risk projects and attract private financing. For example, Member States will be able to use the budgetary guarantee to deliver on climate-related cohesion policy objectives in their territories and regions.

InvestEu will dedicate at least 30% of mobilized investments to climate and environment-related projects. In addition, it will contribute to the Just Transition Mechanism with a new dedicated InvestEU scheme (see the chapter below about the second pillar of the Just transition Mechanism).

InvestEU will also play an important role in promoting sustainability practices among public and private investors. The Commission will put forward a climate tracking methodology for measuring the contribution of specific financing and investment operations to the climate and environmental objectives. In addition, it will put in place a method for 'sustainability proofing', on the basis of which promoters of projects above a certain size will be required to estimate the "green impact" of those projects. These methods will be applied by all InvestEU Implementing Partners (the EIB Group, National Promotional Banks and Institutions, International Financial Institutions) and will also be the reference point for private investors and financial intermediaries participating in the programme. These methods will use of the EU-wide classification system for environmentally sustainable economic activities, the "**EU taxonomy**" (find below more information about the taxonomy)

Finally, the InvestEU programme will provide technical assistance and advisory support through the **InvestEU Advisory Hub** that will help public and private project promoters identify, develop and implement green investment projects. **Jaspers**, the joint Commission-European Investment Bank initiative for project development for Structural Funds, will be part of the Hub. Relevant advisory initiatives under the InvestEU Advisory Hub could include the continuation of European Local Energy Assistance programme under the InvestEU Advisory Hub to support local sustainable energy and clean transport projects. It could also include other advisory initiatives under the Sustainable Infrastructure Window providing support for designing the financing and investment operations of sustainable projects in key infrastructure areas (transport, energy, environment, broadband and digital connectivity). Specific attention will also be paid to technical assistance for projects promoting natural capital and nature-based solutions. At the same time, the **InvestEU Portal** will continue to provide for EU businesses and project promoters in search of financing the visibility and networking with investors worldwide.

3. The Just Transition Mechanism

The Just Transition Mechanism (JTM) is part of the SEIP, and it is a targeted tool that aims to create the necessary investments in those territories mostly dependent on the fossil fuel, for whom the transition to a low carbon economy will be more difficult. It includes financing from the EU budget, co-financing from the Member States and contributions from InvestEU and the EIB. It includes three pillars:

a) The Just Transition Fund (included as one of the Cohesion Policy Funds in the EU budget and subject to the Common Provision Regulation)
b) The Dedicated just transition scheme under InvestEU
c) The EIB loan facility

In order to channel the money to the right projects, the JTM will also provide technical assistance for Member States through a **Just Transition Platform**, which will be managed by the Commission. The JTM will also include a strong governance framework centered on territorial just transition plans.

The second and third pillar are particularly relevant in the context of facilitating local financing and investments.

- The second pillar: the dedicated just transition scheme (under InvestEU)

The dedicated just transition scheme aims to attract private investments that can benefit the most affected regions and that can help their economies to find new sources of growth. For example, it could include projects for energy and transport infrastructure, including gas infrastructure and district heating, decarbonisation projects, economic diversification of the regions, social infrastructure and skills.

The scheme will operate according to the principles that define InvestEU, whereby a portion of the financing under InvestEU will be focused on the just transition objectives. However, the final use of InvestEU will be demand-driven and will depend on the project pipeline, but the absorption capacity of the regions concerned will be taken into account.

Under the InvestEU Programme, the InvestEU Fund contains a Member State compartment for each policy window (sustainable infrastructure, innovation, SMEs, social investments) Based on the Commission's proposal, Member States may contribute up to 5% of the funds under shared management to the Member State compartment to benefit from the EU guarantee. Member States will be able to contribute part of their Just Transition Fund allocation to support investment through guaranteed loans or equity via their Member State compartment. Tailored advisory support to develop the pipeline of projects will also be provided.

Finally, its **geographical coverage** will be broader than the Just Transition Fund, financing projects not only in just transition territories, but also outside (if these projects are key to the transition for territories targeted as beneficiary of the JTF). This is relevant in particular for transport or energy infrastructure projects that improve the connectivity of the just transition territories. Investments pursuing the just transition objectives can count toward climate objectives and contribute to the achievement of the 30% climate objectives set out for the InvestEU Programme.

- The third pillar: the European Investment Bank (EIB) loan facility

The public sector loan facility with the EIB will offer concessional loans to the public sector. Through its preferential funding conditions, the EIB loan facility aims to support public sector investment to help the just transition territories and to facilitate their transition to climate neutrality.

The supported investments will include energy and transport infrastructure, district heating networks, energy efficiency measures including renovation of buildings, social infrastructure, and other sectors as well. The EU support could take the form of an interest rate subsidy or an investment grant, financed from the EU budget, which will be blended together with loans extended by the EIB to municipal, regional and other public authorities.

The support under the public loan facility will be complementary to the products offered by the InvestEU dedicated just transition scheme. It will apply to projects, which do not sufficiently generate market streams of revenue and that otherwise would not get financed without a subsidy element.

Its **geographical coverage** will be the same as under the InvestEU just transition scheme, so it could be used for projects in the regions with an approved transition plans but also in projects benefiting those regions. It will also include advisory support in order to help generate project pipeline.

The Commission will table a legislative proposal to set up this new public sector loan facility in the following months.

4. The Renewed sustainable finance strategy

The Commission will present a renewed sustainable finance strategy in the third quarter of 2020 that **aims at redirecting capital flows to green investments**. It will focus on three areas:

1. It will encourage sustainable investments. This will be possible thanks to the **taxonomy**, an important tool for classifying environmentally sustainable activities. At the same time, companies and financial institutions will need to increase their disclosure on climate and environmental data so that investors are fully informed about the sustainability of their investments. For this, the Commission will review the Non-Financial Reporting Directive;
2. It will help investors and companies by making it easier for them to identify sustainable investments and ensuring that they are credible. This could be done via clear labels for retail investment products and by developing an EU green bond standard;
3. Climate and environmental risks will be managed and integrated into the financial system.

- The European taxonomy

The Regulation establishing a framework to facilitate sustainable investment, the EU taxonomy, will be an important instrument of the renewed sustainable finance strategy as it is used to determine if an economic activity can be considered as environmentally sustainable.

While initially designed for private investors, the taxonomy will be relevant for local governments because the Commission wants to explore how the **EU taxonomy can be used by the public sector in the context of the European Green Deal**, beyond InvestEU. The Commission considers that it is important that there is convergence of standards between the private sector and the public banks/entities, for example the European Investment Bank.

5. Tools to help the public sector in making sustainable investments

a) *The European Semester*

Public actors are the main investors in some key sectors which could have a cross-border nature and spill-over effects across Member States, for example for infrastructure and public services. In this context, the Commission needs to play a coordinating role at the EU level. For this purpose, the European Semester can provide a good framework for the coordination of economic and employment policies that will facilitate the necessary investment for the green transition.

The European Semester identifies of investment priorities and barriers in each Member State, with country reports matching the available sources of financing through EU funds with the country-specific challenges identified in the reports. In order to direct investments to the most sustainable projects, the EU Commission intends to include environmental sustainability as an integral part of the country reports under the European Semester as of 2020.

b) *The initiatives to screen and benchmark green budgeting practices of the Member States and of the EU*

National budgets could play a key role in the transition thanks to a greater use of green budgeting tools, which could help to redirect public investment, consumption and taxation to green priorities. For this reason, the Commission intends to work with the Member States to screen and benchmark green budgeting practices in order to assess to what extent annual budgets and medium-term fiscal plans take the environment into account, and learn from best practices.

The **review of the European economic governance framework** will include a reference to **sustainable public investment** in the context of the quality of public finance. A debate on how to improve EU fiscal governance has been lunched the 5th February; the outcome will form the basis for any possible future steps including how to treat green investments within EU fiscal rules, while preserving safeguards against risks to debt sustainability.

c) *Green Public Procurement*

The Commission will propose minimum mandatory green criteria or targets for public procurements in sectorial initiatives, EU funding or product-specific legislation. This minimum criteria will become the common parameter for identifying 'green purchases'. Because of this, the collection of comparable data from public buyers and the setting of a common base for assessing the impact of green public procurements will be possible.

Public authorities across Europe will be encouraged to integrate green criteria and use labels in their procurements. The Commission will provide support with guidance, training activities and the dissemination of good practices. Furthermore, life-cycle-costing methodologies should be applied by public buyers whenever possible.

A "Sustainable Procurement Screening" will also help public investors to make use of all the possibilities to green their procurements and to guarantee the sustainability of the project and the respect of the highest environmental standards throughout the supply chain.

6. Other

- State aid framework

The State aid guidelines will be revised by 2021 to reflect the policy objectives of the European Green Deal and to provide an updated framework for public authorities to reach these objectives.

These rules will help the transition by supporting the right types of investment and aid amounts. As part of this, the Commission will also consider further procedural facilitation to approve State aid for just transition regions.

- Horizon Europe

Horizon Europe, in synergy with other EU programs, will play an important role in leveraging national public and private investments. At least 35% of the budget of Horizon Europe will fund new solutions for climate, which are relevant for implementing the Green Deal. The full range of instruments available under the Horizon Europe program will support the research and innovation efforts needed. Four 'Green Deal Missions' will help deliver large-scale changes in areas such as adaptation to climate change, oceans, cities and soil. Partnerships with industry and Member States will support research and innovation on transport, including batteries, clean hydrogen, low-carbon steel making, circular bio-based sectors and the built environment.

Indicative timeline

2020	- The Commission will prepare the delegated acts on the climate change objectives of the EU Taxonomy - The Commission will table a legislative proposal to set up the new public sector loan facility - The Commission will establish an EU Green Bond Standard and explore how this standard, as well as other enabling frameworks, can increase public and private finance for sustainable investments. - Initiatives to screen and benchmark green budgeting practices of the Member States and of the EU - Q3 2020: after the public consultation, the Commission will present the renewed sustainable finance strategy
2021	- Revision of the State Aid Guidelines - End of 2021: The Commission will prepare the delegated acts on the other environmental objectives of the EU taxonomy