SUSTAINABLE FINANCE, PRIVATE SECTOR AND JUST TRANSITION

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CONTENTS

LIST OF **ACRONYMS**

ADB	Asian Development Bank
AfDB	African Development Bank
AFL-CIO	American Federation of Labor and Congress of Industrial Organizations
BoP	Bottom of the Pyramid
CBI	Climate Bonds Initiative
CCOO	Commissiones Obreras
CCRT	Catastrophe Containment and Relief Trust
COP	Conference of the Parties
CPI	Climate Policy Initiative
CSO	Civil Society Organisations
CSR	Corporate Social Responsibility
DSSI	Debt Service Suspension Initiative
EIB	European Investment Bank
ESG	Environmental, Social and Governance
EU	European Union
EU GBS	European Green Bond Standard
FDI	Foreign Direct Investment
G20	Group of Twenty
GBP	Green Bond Programme
GCF	Green Climate Fund
GDP	Gross Domestic Product
GHG	Greenhouse Gas
HRDD	Human Rights Due Diligence
IB	Inclusive Business
IBM	Inclusive Business Models
IBRD	International Bank for Reconstruction and Development
ICFTU	International Confederation of Free Trade Unions
IFC	International Finance Corporation
ILO	International Labour Organization
IMF	International Monetary Fund
ITUC	International Trade Union Confederation
IUCN	International Union for Conservation of Nature
JRC	Joint Research Centre
JTA	Just Transition Alliance
KPI	Key Performance Indicators
LNG	Liquefied natural gas
NDC	Nationally Determined Contributions
NFRD	Non-Financial Reporting Directive
OECD	Organisation for Economic Co-operation and Development
OSH	Occupational safety and health
SBN	Sustainable Banking Network
SBT	Science Based Targets
SDG	Sustainable Development Goals
SIDS	Small Islands Developing States
SLLPs	Sustainability Linked Loan Principles
SPT	Sustainability Performance Targets
SSLs	Sustainability-linked Loans
TEG	Technical Expert Group on Sustainable Finance
UNEP	United Nations Environment Programme
UNFCCC	United Nations Framework Convention on Climate Change
UNGPs	United Nations Guiding Principles on Business and Human Rights
USA	United States of America

INTRODUCTION

The EU wants to be a worldwide leader in the promotion of economically, environmentally and socially sustainable development, as the way to address the planetary crisis and especially to fight climate change. The European Green Deal is Europe's structural response and new growth strategy that sets out ambitious targets to transform the EU into a modern, resource-efficient and competitive economy[1] where:

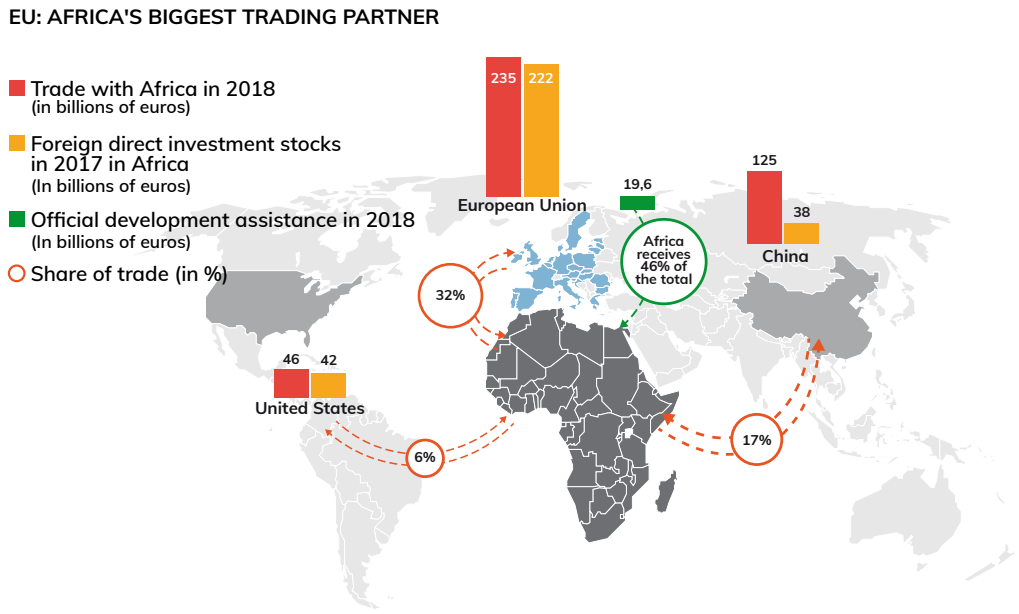
- Carbon Neutrality (zero net emissions of greenhouse gases) by 2050;
- Economic growth is successfully decoupled from resource use;
- Environment and natural capital are protected, sustainably managed and restored;
- The well-being of citizens is protected from environment-related risks and impacts;
- No person and no place are left behind.

With this gigantic initiative, the EU aims to expand its role as leader of international efforts, and in conjunction with our partners, address environmental challenges and promote the implementation of ambitious environment, climate and energy policies across the world. As such, Europe intends to implement bilateral and multilateral mechanisms to help partners to transition towards more sustainable development pathways, but it should also consider potential unwanted negative impacts.

Contrary to popular belief, the EU has been and still remains Africa's leading economic partner, so any change in Europe's priorities will have impacts on Africa's economies.

1 European Commission (2021). Green Alliances and Partnerships. European Commission. https://ec.europa.eu/international-partnerships/topics/green-deal_en

FIGURE 1
EU trade with Africa



Source: Caslin, (2020)[2]

The EU is the principal destination of African Exports (surpassing even the intraregional African trade), with the added bonus that Europe's imports are more diverse than the USA's and China's imports, not being limited to raw materials, but there is also a growing trend in importing products from Africa's nascent industry sector (Kappel, 2021[3]).

European investment in Africa is also extremely important for the continent. For instance, in 2017, direct investment from Europe amounted to 222 billion euros (capital stock), five times more investment than from the USA (42 billion euros) and China (38 billion euros). British, French, Dutch and Italian companies are the most important European investors in the African continent. Despite the fact that, in the last ten years, Chinese Foreign Direct Investment (FDI) has been increasing sharply (while the USA's has been decreasing), until recently the gap between the EU's and China's investment has been getting larger rather than smaller. This is largely the result of the increasing volumes of Italian and Dutch investment, which compensates for the decline in France's and UK's FDI (Kappel, 2021).

On the environmental side, Africa is at the forefront of the two biggest environmental crises the world currently faces, Climate Change and Loss of Biodiversity.

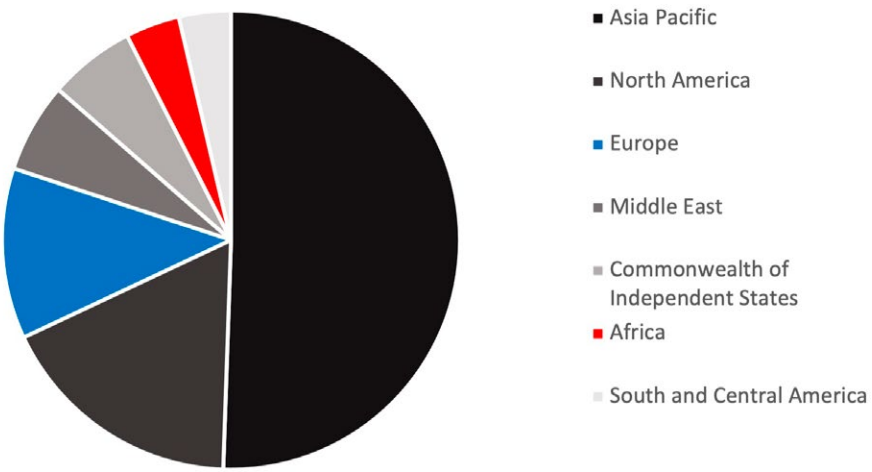
Although Africa's impact on Green House Gases emission is currently extremely reduced (projection models estimate that this will change if nothing is done), the continent is at extreme risk of suffering the brunt of the impacts of climate change.

The last available data for global GHG gases emissions (2019) shows that Africa was responsible for almost 4% of global emissions, while Europe emitted 12%.

2 Caslin, O. (2020, July 29). *EU wants to keep its status as one of Africa's largest trading partners*. The Africa Report. https://www.theafricareport.com/34293/eu-is-one-of-africas-largest-trading-partners/

3 Kappel, R. (2021). Redefining Europe-Africa relations. Friedrich-Ebert-Stiftung Africa Department, January 2021. - (Together towards justainability) Einheitssacht.: Europa - Afrika . - Electronic ed.: Berlin : FES, 2021. ISBN 978-3-96250-799-2. at: http://library.fes.de/pdf-files/bueros/bruessel/17306.pdf

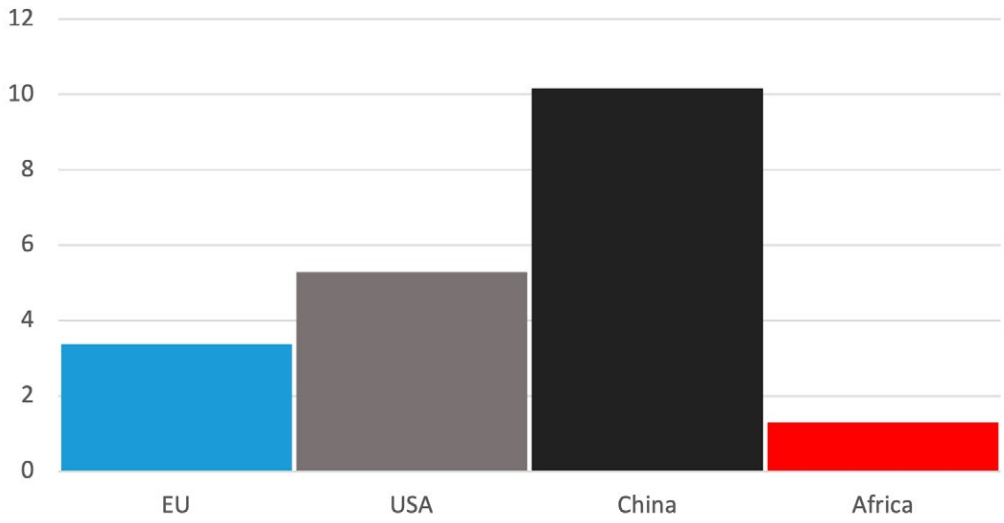
FIGURE 2
2019 Global GHG Emissions



Source: Produced combining data available on the Statista website.

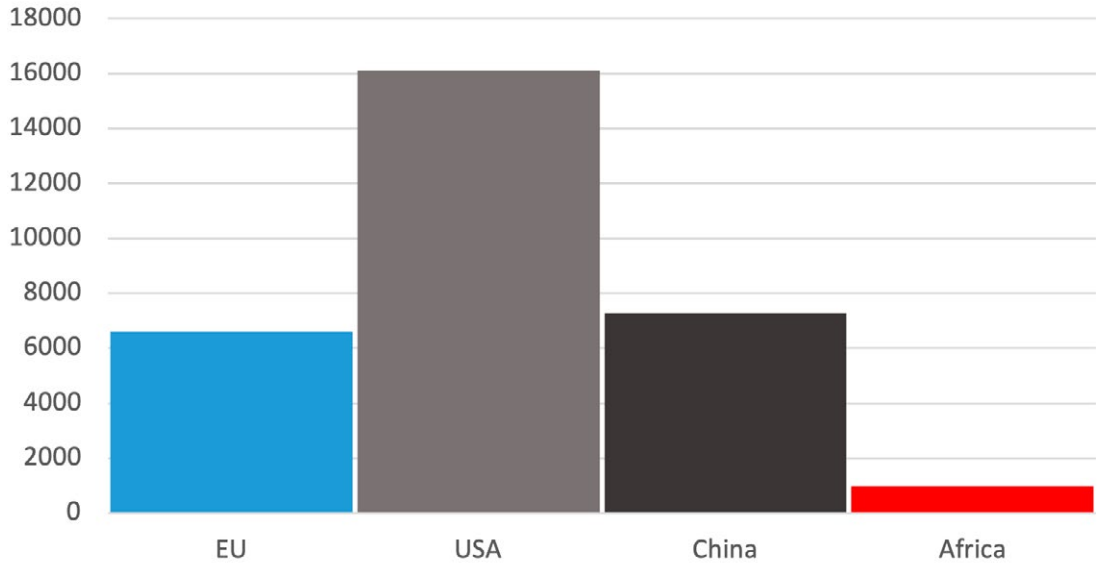
If we compare emission data from Africa with the EU and the two biggest individual contributing countries (China and the USA) the contrast is even starker, especially if we consider per capita emissions.

FIGURE 3
GHG Emissions in giga tonnes of CO2



Source: Produced combining data available on the Statista website.

FIGURE 4
Per capita Emission in Kg of CO2



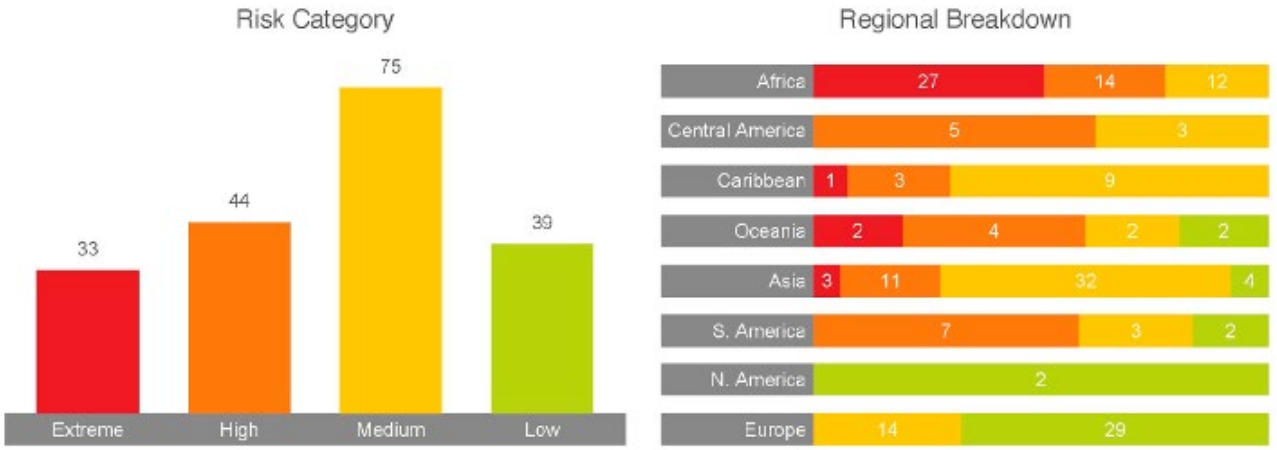
Source: Produced combining data available on the Statista website.

Regarding the vulnerability to climate change, the Germanwatch Global Climate Risk Index[4] is one of the most widely accepted analysis tools, which is based on the MunichRe NatCatSERVICE, one of the most reliable data sets available on the impacts of extreme weather events and associated socio-economic data (and although the index should not be considered a comprehensive climate vulnerability scoring, it represents one important piece in the overall puzzle of climate-related impacts and the associated vulnerabilities). The index focuses on extreme weather events such as storms, floods and heatwaves but does not take into account important slow-onset processes such as rising sea levels, glacier melting or ocean warming and acidification.

Developing countries are particularly affected by the impacts of climate change. They are hit hardest because they are more vulnerable to the damaging effects of a hazard but have lower coping capacity. Eight out of the ten countries most affected by the quantified impacts of extreme weather events in 2019 belong to the low- to lower-middle income category. Half of them are Least Developed Countries. The last data processed (2019) show that 3 of the top 5 most affected countries are in Africa.

4 https://germanwatch.org/en/cri.

FIGURE 5
Risk distribution for 191 countries



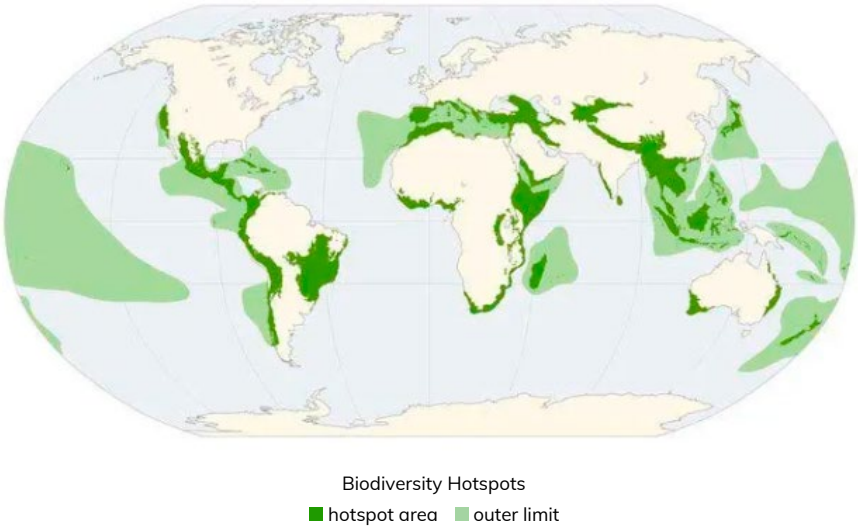
Source: Eckstein et al, 2021[5]

Africa still contains remarkable biodiversity, including collections of large mammals that are the most intact on Earth. However, species abundance is in decline and the threats to species are increasing. In 2014, 6 419 animals and 3 148 plants in Africa were recorded as threatened with extinction on the IUCN Red List (compared with 1 700 animal and 1 003 plant species in Europe, and Europe has been much more thoroughly studied). Of all freshwater species in Africa, 21 per cent are recorded as threatened, and 45 per cent of freshwater fish and 58 per cent of freshwater plant species are over-harvested (IUCN 2014). Overall, the combined populations of African vertebrate species are calculated to have declined by around 39 per cent since 1970 (IUCN 2014[6]).

5 Eckstein, David, Vera Künzel and Laura Schäfer. 2021. "Global Climate Risk Index 2020, Who Suffers Most from Extreme Weather Events? Weather-Related Loss Events in 2019 and 2000 to 2019." Berlin: 487 Germanwatch.

6 International Union for Conservation of Nature and United Nations Environment Programme World Conservation Monitoring Centre (2014). The World Database on Protected Areas. Cambridge, UK

FIGURE 6
World's biodiversity hotspots



Source: Mittermeier et al, 2011[7]

The importance of Africa for the conservation of global biodiversity is further strengthened when we consider that it encompasses 8 of the 36 biological hotspots (regions that have very high levels of biodiversity and endemic species in habitats that are at risk of degradation) that exist in the world, while Europe only has one - the Mediterranean Basin (Mittermeier et al, 2011).

The transition towards a green and carbon neutral economy will have considerable a impact not only on the environment, but also on the social conditions of the populations, both in Europe and in Europe's partner countries. Therefore, we should also take into account that the fragility and uncertainty of Africa's economy are directly translated into the social conditions and systems that are available for African citizens. This has been made obvious by the impact of the Covid 19 pandemic.

As the health crisis (aggravated by the limitations of most of the African states' health systems) progresses, an economic crisis has set in (made worse by the fact that Africa continues to be a major provider of raw materials for the world's economy, but it does not produce most of the industrial products that any modern society needs to function), the current and future impacts have become obvious. According to OECD, although poverty rates had been slowly increasing in Africa since the beginning of the SDG period (less than 1% in the previous years), from 2019-2020, the number of people living in extreme poverty in Africa was projected to increase by 40 million (8%), from 480 to nearly 520 million Africans, with the following year expected to be as challenging as the start of the new decade[8]. In 2021, extreme poverty is forecasted peak with a further 2% increase, making the achievement of SDG 1 by the end of this decade more unlikely than ever before, especially in Africa.

Taking all this into account, there is a need to explore some of the roads ahead for the implementation of the European Green Transition, as there is still time to ensure that no one is left behind in this transition, especially those that are more vulnerable and less prepared for the changes that need to be implemented.

7 Mittermeier RA, Turner WR, Larsen FW, Brooks TM, Gascon C (2011) Global biodiversity conservation: the critical role of hotspots. In: Zachos FE, Habel JC (eds) Biodiversity hotspots: distribution and protection of conservation priority areas. Springer, Heidelber.

8 Tong, B. (2020, October 12). COVID-19 has pushed extreme poverty numbers in Africa to over half a billion. OECD Development Matters. https://oecd-development-matters.org/2020/10/12/covid-19-has-pushed-extreme-poverty-numbers-in-africa-to-over-half-a-billion/

REDUCING THE RISKS OF DEBT IMPACTING ON THE IMPLEMENTATION OF A GREEN TRANSITION IN AFRICA

Paris Agreement

The focal point of the global green transition that Europe intends to lead is the fight against climate change, and the central piece of the puzzle to solve the climate crisis is the Paris Agreement.

Signed in 2015, the Paris Agreement is a milestone international agreement that was approved by nearly all nations (currently 197) to jointly address climate change and its negative impacts. The agreement intends to significantly reduce global greenhouse gas emissions in an effort to limit the global temperature increase in this century to 2 degrees Celsius above preindustrial levels, while pursuing the means to limit the increase to 1.5 degrees. The agreement contains pledges from all major emitting countries to cut their GHG pollution and to reinforce those commitments over time. More importantly, the pact provides a pathway for developed nations to assist developing nations in their climate mitigation and adaptation efforts, and it strives to create a framework for the transparent monitoring, reporting, and ratcheting up of countries' individual and collective climate goals.

NDCs

The Paris Agreement is anchored on individual Nationally Determined Contributions (NDC), non-binding national sets of actions, presented by each country, that include climate related targets for greenhouse gas emission reductions, policies and measures governments propose to implement in response to climate change and as a contribution to achieve the global targets.

NDCs were the key to securing the adoption of the Paris Agreement in 2015 and also are instrumental to implementing it over the next decades. They have three key features. **First,** NDCs are universal: virtually every country that is a party to the United Nations Framework

Paris Agreement 3 Goals

1. To limit the average global temperature rise to well below 2°C above preindustrial levels and pursue efforts to limit this increase to 1.5°C.
2. To increase the ability to adapt to the adverse effects of climate change and foster climate-resilient and low greenhouse gas emissions development, in a manner that does not threaten food production.
3. To make financial flows consistent with a pathway toward low greenhouse gas emissions and climate-resilient development.

Convention on Climate Change (UNFCCC) has submitted an NDC (Pauw et al 2020[9]). **Second**, NDCs give countries significant flexibility to tailor their ambitions to national circumstances and priorities, with the different countries having widely varying GHG emissions, vulnerabilities, capacities and levels of development, combined with the limited guidance for NDC formulation provided by the Conference of the Parties, which led NDCs to vary in scope and content (Mbeva & Pauw, 2016[10]). **Third**, the Paris Agreement imposes cycles of review and updating (every five years), which are designed to ensure that NDCs become more ambitious over time (Pauw et al 2020).

This is the point where things start to get really complicated. Within the NDCs there are **two types of targets: unconditional and conditional**. The **first type** are the ones the country proposes to achieve regardless of external support, usually these are the simpler ones. The **second type** usually includes the more ambitious goals and is dependent on access to international financial support and technology transfer. The difference between the two types can be quite extensive, and the ultimate success of the Paris Agreement depends on fulfilling those conditional pledges (and, even then, further ambition is needed).

An analysis of the INDCs (the precursors of the NDCs) submitted to the UNFCCC registry showed that 78% of them contained explicitly conditional contributions of some form (Pauw et al 2020), with most of the developing countries opting to include both types of targets within the same NDC.

TABLE 1

NDC measures – Examples from Cabo Verde

	Unconditional	Conditional
Energy	100% access to the electricity grid by 2017	-
	30% penetration of Renewable Energies by 2025	35% Renewable Energy penetration by 2018
		50% Renewable Energy penetration by 2020
		100% Renewable Energy penetration by 2025
Energy Efficiency	10% reduction in energy requirements compared to the baseline scenario by 2030	20% reduction in energy requirements compared to the baseline scenario by 2025

9 W. P. Pauw, P. Castro, J. Pickering & S. Bhasin (2020) Conditional nationally determined contributions in the Paris Agreement: foothold for equity or Achilles heel?, Climate Policy, 20:4, 468-484, DOI: 10.1080/14693062.2019.1635874

10 Mbeva, K., & Pauw, W. P. (2016). Self-differentiation of countries' responsibilities: Addressing climate change through intended nationally determined contributions (Discussion Paper 4/2016). Bonn: German Development Institute / Deutsches Institut für Entwicklungspolitik (DIE).

Financing the transition

This need for climate finance had already been identified before the COP21, when in 2009, at a UN summit in Copenhagen, wealthy countries (while resisting calls to directly compensate poorer nations that are harmed by their carbon emissions) agreed to channel $100 billion a year to these countries to help them deal with climate change. The pledge, usually described as developed nations mobilizing finance for developing ones, aimed to reach this target by 2020; and so the GCF (Green Climate Fund) was set up as one of the ways to distribute the money.

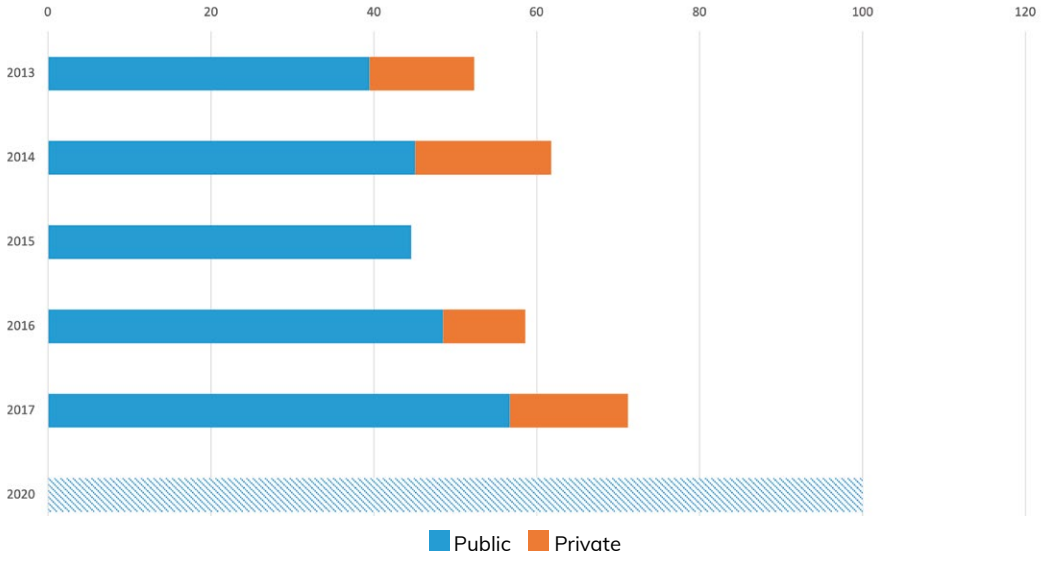
How much is being financed?

The GCF was expected to assume greater importance after Paris, but it still has not mobilised more than a fraction of the initial goal, with developed countries still preferring other options to assist developing nations. A decade after Copenhagen, arguments still rage over whether the $100-billion goal is close to being met — in part because negotiators never agreed what kind of financing counts, as some estimates include loans and private finance leveraged by public money, for instance, whereas others say only direct grants, a much smaller sum, should be included.

While estimates by the OECD set the level of climate financing that flowed to developing countries at 62 billion USD in 2014[11], India rebutted, calling the OECD a "club of the rich countries" reporting "inflated" numbers, and that just $2.2 billion in climate finance had been spent, because funds transferred from other development or aid budgets, should not count (Yeo 2019). In 2018 Oxfam suggested that public climate-finance flows were in the $16 billion to $21 billion range for 2015–16, arguing that only grants, and not loans, should be counted (Yeo 2019).

The OECD put public spending at $56.7 billion in 2017, leveraging an additional $14.5 billion in private finance, for a total of $71.2 billion, so even the broadest accounting of climate finance still places the goal posts far away.

FIGURE 7
Finance from Developed Countries to Developing Countries



Source: Adapted from Yeo 2019.

11 OECD (2015), "Climate finance in 2013-14 and the USD 100 billion goal". *OECD/CPI.*

What is being financed?

But it's not just a question of volume of financing; at least as important is where the money is spent. Overall, renewable-energy systems and sustainable transport take the biggest share of climate financing, with adaptation projects being very poorly funded (according to the CPI, they receive just $22 billion a year, compared with $436 billion for mitigation activities[12]). Also, private funds seldom flow towards adaptation projects, because, while renewable-energy projects have a good rate of return, adaptation projects — building sea walls and infrastructure upgrades — are much harder to build a business case around before presenting them to a private-sector player.

Who is being financed?

Another problem with the current climate finance initiatives is that the flow of money is clearly governed by traditional "for profit" priorities, with actual "need or effectiveness" having a very secondary role in the decision-making processes. For instance, in 2017, donors say that almost 60 billion dollars were transferred to developing countries to finance climate projects (although civil society organisations estimate the actual value was in the 19 to 22.5 billion range).

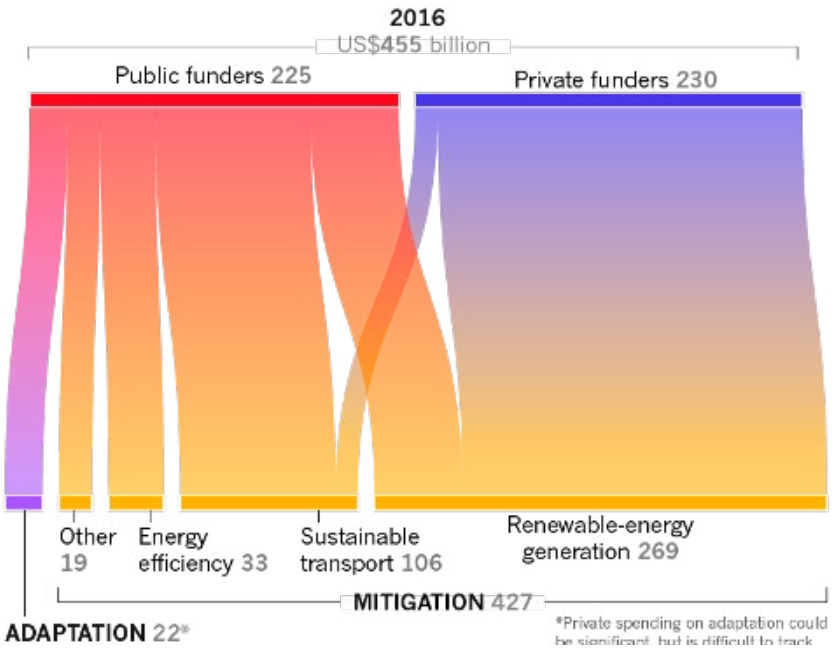
According to Oxfam's Climate Shadow Report 2020 (Carty et al, 2020[13]), only 20% of these funds were directed to the Least Developed Countries and only 3% went for SIDS (Small Islands Developing States).

How is financing being processed?

The last crucial aspect of this climate finance conundrum is how the financing is actually processed (because there are various types of financial instruments available,

FIGURE 8

Finance from Developed Countries to Developing Countries



Source: Adapted from Yeo 2019.

12 Yeo, S. (2019, September 17). Where climate cash is flowing and why it's not enough. Nature. https://www.nature.com/articles/d41586-019-02712-3

13 Taplin, D., Clark, H., Collins, E., & Colby, D. (2013). Technical papers: a series of papers to support development of theories of change based on practice in the field. ActKnowledge and the Rockefeller Foundation: New York, USA.

including grants, concessional loans, non-concessional loans, equity, etc.).

According to Oxfam, globally, 80% of the approved volume of projects is financed by loans, but these vary greatly across the board, including within EU countries and institutions (Carty et al, 2020).

For a long time, civil society has defended that climate finance in the form of loans, especially the non-concessional loans[14] should not be counted the same way as other types of climate finance. The CSOs have campaigned extensively, pressuring donors to favour grants as the form of support to climate transition in developing countries, because this will create significant benefits in the form of strengthened debt sustainability and increased fiscal space to achieve the countries' development objectives.

TABLE 2

Reported bilateral public climate finance and grant equivalent estimates for major donors (2017–2018 annual average)

Donor	Bilateral total as reported ($M)	Grants	Concessional loans	Non-concessional loans	Equity	Other
Denmark	159	98.8%	0.0%	0.0%	1.2%	0.0%
EU institutions (excl. EIB)	3157	100%	0.0%	0.0%	0.0%	0.0%
France	4778	3.3%	74.2%	16.1%	0.0%	6.3%
Germany	7026	36.4%	41.1%	22.5%	0.0%	0.0%
Netherlands	364	100%	0.0%	0.0%	0.0%	0.0%
Spain	263	37.0%	8.0%	55.0%	0.0%	1.0%
Sweden	438	99.7%	0.0%	0.0%	0.0%	0.3%

Adapted from Carty et al, 2020.

14 Loans that are conceded in close to market terms, as opposed to concessional loans, which are extended on terms substantially more generous than market loans, for instance with interest rates below those available on the market or with grace periods, or a combination of the two.

Debt – a roadblock for the global green transition

Climate Debt

For a long time, social movements and academics have claimed that there is an "ecological debt" that rich countries and elites owe to impoverished countries, due to the environmental impact and resource pillage that colonial and neo-colonial dynamics have inflicted on their territories and communities. The concept of ecological debt is based on the idea of environmental justice: "If all the inhabitants of the planet have the right to the same quantity of resources, those who use more resources have a debt to the others". This "ecological debt" has therefore been accumulated "on account of ecologically unequal exchange, damage from toxic exports, and the disproportionate use of carbon sinks and reservoirs". It therefore contains what has been conceptualised as "climate debt" or "carbon debt" – a historical debt that most polluting economies have acquired due to their disproportionate contribution to carbon and other greenhouse emissions. The use of this concept brings a historical dimension to discussions of climate emergency and climate finance. Based on the climate debt concept, the contributions of industrialised countries to climate finance, in the form of new resources as well in the form of public debt cancellation, would not be considered as charity or aid, but as a moral obligation and a repayment of an existing historical debt.

Adapted from Fresnillo (2020)[15]

The transition that Europe champions needs to be global, so the EU wants not only to clean up its economy and be a leader a nd an example for the rest of the world, but also help others clean up their economies. However, even taking into account every new and alternative instrument that promises to help the developing countries finance the transition of their economy, there is an 8 trillion-dollar debt elephant in the middle of the room.

The debt of low and middle-income countries in the Global South has been increasing steadily for years. However, the situation has worsened considerably recently, because 2020 was a singular year with circumstances deteriorating for almost all countries in the world, as a direct consequence of the recession triggered by the coronavirus crisis. As a result, the number of critically indebted countries in the Global South has significantly risen again to 132 out of 148 countries in 2020 (Brodbeck, 2021)[16], an increase of 8 from the previous year, and the situation of those countries which were already critically indebted has grown worse. Twenty-one countries are in partial default, while others are on the verge of defaulting (Brodbeck, 2021).

TABLE 3

Number of critically indebted countries

Year	2017	2018	2019	2020
Countries	119	122	124	132

Data from Brodbeck, 2021

15 I. Fresnillo (2020). A tale of two emergencies - The interplay of sovereign debt and climate crises in the global south. Bruxelles. Eurodad.

16 N. Brodbeck – edit (2021). Global Sovereign Debt Monitor 2021. Bonn. Erlassjahr.

The pandemic has had a particularly negative impact on developing countries and emerging economies. Even though the coronavirus pandemic is a global phenomenon, poorer countries have less fiscal space and fewer reserves with which to mitigate the consequences for both health and economy. One of the most severe results of the lockdowns and other restrictions imposed on public life is the dramatic decline suffered by the economy of the Global South. Falling commodity prices have led to revenue losses, particularly for commodity-exporting countries like Zambia, Mozambique and Angola. Tourism as a major source of revenue, as well as key export trade supply chains, have come to a halt, and the volume of remittances sent home by migrants working abroad has dropped substantially (greatly impacting small island nations like Cabo Verde or São Tomé e Príncipe). In many places, this revenue loss has been compensated by borrowing.

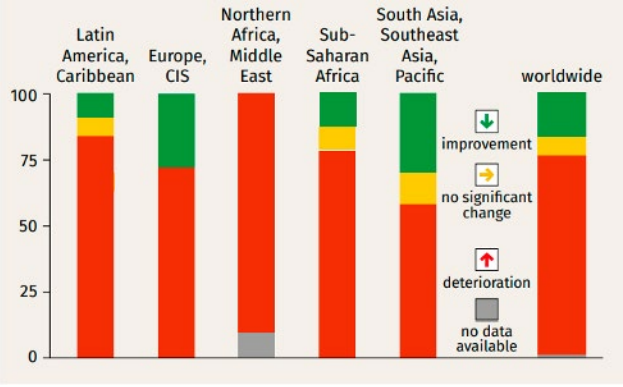
By the end of 2020, twenty-one countries were in partial default in relation to at least some of their foreign creditors, which include some cases where the creditors consider their debtors to be in default, while the debtors themselves do not consider this to be the case, since they consider the payment demands made to be unjustified. Of these 21 countries, more than half (11) are African countries.

Furthermore, the number of countries whose debt indicators have significantly deteriorated since 2016 exceeds by a very large margin the combined total of those countries with indicators that have remained the same or even improved. This is true for all regions of the world, but it is especially critical for Africa and Latin America. Although a number of initiatives have been proposed or even implemented to "assist" countries in financial difficulties, namely IMF's debt relief initiative (CCRT) and the G20 Debt Service Suspension Initiative (DSSI), freeing up urgently needed funds so as to enable the poorest countries to respond to the Covid crisis, the mere size of the payments of debt services incurred by those countries continues to be staggering, and the actual effect of these initiatives in the face of the size of the global debt has been compared by the civil society to "trying to bail out the Titanic with a bucket".

To all these related problems we must add climate-induced loss and damage. Although the developed world continues to not want to discuss the subject and take into account the loss and damage that developing nations have faced in the past, the problem continues in the minds of policy makers and in the lives of the population, especially in the Global South. Loss and damage are projected to increase in decades to come, with the loss range varying according to the rise in temperature. This is not only loss resulting from extreme climate events; slow onset climate change events will also lead to increased damage, for instance, in the form of rising sea levels, glacier melts, thawing permafrost, species extinction and soil salinity (Hirsch,2021[17]). Future loss and damage for developing countries is estimated at 428 billion USD annually in 2030, and at USD 1.67 trillion in 2050, if global temperatures rise by 3°C.

FIGURE 9

Debt trend (by region and worldwide, in %)



Source: Brodbeck, 2021

17 Hirsch, T. (2019). Climate Finance for Addressing Loss and Damage: How to Mobilize Support for Developing Countries to Tackle Loss and Damage. Brot für die Welt.

Mozambique highlights the intersection between debt and climate change

Mozambique, one of the poorest countries in the world and already sinking under huge debts, including secret loans that the government had not disclosed, was devastated by two cyclones in 2019 (Idai and Kenneth) – the damage amounted to around half the country's national budget. The UN humanitarian appeal totalled $620m (less than half of it had been funded in 2020). As a result, Mozambique was forced to take on an IMF loan of 118 million USD to begin rebuilding (all this before Covid 19). After disasters, countries often have to finance rebuilding and recovery through loans, increasing their debt burden and squeezing public services. It is the poorest people who are hardest hit – especially women, who as primary caregivers tend to fill the gaps in public services.

Source: Financial Data extracted from IMF (2019)[18].

According to Eurodad, in developing countries, the share of government revenues that go into paying foreign debts nearly tripled between 2011 and 2020, reaching a staggering 17.4 per cent (Fresnillo, 2020)[19]. According to a study by Klusak et al (2021)[20], this will get even worse in the future, as only the most favourable scenarios — with complete implementation of everything within the Paris Agreement — will eliminate the risk of climate-induced sovereign downgrades on the cost of sovereign debt. This effect may begin to be seen as soon as 2030 and will continue to worsen and could end up leading to a 4 to 9 fold increase the annual interest payments on sovereign debt by 2100, under the worse case scenarios.

And it is under these conditions that developing countries are expected to implement ambitious climate change programmes and national green transitions. Extreme action must be taken if Europe wants to assist developing countries escape this vicious cycle that intertwines debt, lack of resilience and climate damage. Lately, there have been several proposals from economists and debt relief advocates to address the problem. The details vary greatly, but in one way or another all of them call for rich countries and private creditors to offer debt relief, so countries can use those funds to transition away from fossil fuels, adapt to the effects of climate change, or obtain financial reward for the natural assets they already protect, such as forests and wetlands.

Recommendations

Addressing the relationship between debt and climate change is mandatory to successfully implement the green transition, but this is easier said than done, because there is a need to implement concrete measures and, probably more importantly, promote changes in the mindset that moves European and global economy.

First, there is a need to **recognise** that the simultaneous impact of the pandemic and the climate emergencies is an **extraordinary occurrence and, as such, there is a need for extraordinary measures to prevent a continent wide meltdown of the African countries' national debts**. Most of the measures that were conceived for a pre-pandemic scenario are either inapplicable in today's world or would fall incredibly short of what developing countries in Africa and in the rest of the world need.

18 IMF (2019, April 19). IMF Executive Board Approves US$118.2 Million Rapid Credit Facility Assistance to the Republic of Mozambique in the Wake of Cyclone Idai. IMF. https://www.imf.org/en/News/Articles/2019/04/19/pr19121-republic-mozambique-imf-exec-board-approves-rapid-credit-facility-assistance-cyclone-idai

19 Fresnillo, I. (2020). Out of service: How public services and human rights are being threatened by the growing debt crisis. *Eurodad*.

20 Klusak,P., Agarwala, M., Burke, M., Kraemer,M., Mohaddes , K. (2021). Rising temperatures, falling ratings: The effect of climate change on sovereign creditworthiness. CAMA Working Paper.

There is also the need to **recognise and address** one of the biggest elephants in the middle of the Paris Agreement room, that most African countries (and other developing nations) **will not be able to implement the Nationally Determined Contributions** that they proposed within the Paris Agreement without a **substantial increase in aid from developed nations**, especially the European Union — aid that needs to be financial, but which also includes technology transfer and capacity building.

While developing nations and the larger global civil society are already demanding further assistance from rich nations, it is important to remember that most developed nations' contributions still fall very short of their agreed targets. Therefore, the **EU countries must comply** with their committed **funding level in climate finance agreements**. It is also indispensable that funds and assistance be channelled in the form of **grants and not loans that will further lock developing nations in a cycle of debt** related poverty.

The increasing focus of public aid for use to potentiate private investment has led to the channelling of most funds to projects with faster returns, instead of strategic long-term projects. This is clear in the preference of support of mitigation projects instead of adaptation projects. Therefore**, multilateral and bilateral funding for developing countries must increasingly focus on adaptation instead of mitigation**, which is more easily financed with market instruments.

There is a need for **far greater transparency** of climate finance at a global level, and the **EU should champion** this in all international forums. Therefore, at the next COP, the EU should start by pushing parties to agree on a **fixed set of rules and accounting standards under the UN Framework Convention on Climate Change** (UNFCCC). These rules should reflect the real value to the developing nations of the funds provided (grants cannot be counted in the same way as loans).

Another of the demands that the global civil society has been making for years now is that the developed nations must stop rebranding all Official Development Aid as climate aid by using the broadest definition possible (for instance, Japan still classifies the support of some projects involving "clean" coal as climate related aid). The **EU countries need to remember** and remind other developed nations **that the commitment in the Paris Agreement was for additional funding, not for the re-branding of traditional ODA**.

However, the most important recommendation is one that has been made by the civil society and advocacy groups for years before the pandemic and that became even more important with the deteriorating debt outlook. The persisting weaknesses of the current disorderly, opaque, and inequitable way in which sovereign debt crises are resolved has been thoroughly exposed, so there is an absolute need for a **global debt workout mechanism under the auspices of the United Nations**. Therefore, the **European Union should champion** the introduction of this debt workout mechanism, following the 10 civil society principles for sovereign debt resolution proposed by the civil society in 2019[21].

21 Eurodad (2020). We can work it out: 10 civil society principles for sovereign debt resolution. Eurodad. https://d3n8a8pro7vhmx.cloudfront.net/eurodad/pages/523/attachments/original/1590689165/We_can_work_it_out.pdf?1590689165

SUSTAINABLE FINANCE IN AFRICA

– The Case for Green Bonds

Africa makes a small contribution to global CO2 emissions (around 4%) but is among the regions that are most vulnerable to the negative impacts of climate change (Burke et al. 2009[22]; Ritchie and Roser 2019[23]; Schlenker and Lobell 2010[24]; IPPC 2018[25]). The negative effects are evident in areas such as agriculture, water supply, labour productivity and conflicts. The high exposure to climate change is not compensated by a strong adaptation capacity, due to low investments and the weakness of institutions and governance.

Significant financial resources are required to adapt to climate change risks and to develop a sustainable and inclusive development path. The low level of available public finance, even when we consider international aid (ODA and environmental aid) transfers, conditioned by a looming external debt crisis, does not allow for an adequate investment effort to face the urgent needs. An ambitious contribution from private sector finance is commonly considered imperative if significant progress is to be made (Marbuah, G.2020)[26]. At same time, the infrastructure gaps that need to be closed present an opportunity for governments and private sector actors to integrate sustainability into the design and execution of development projects. There is a considerable number of projects and industries in need of green financing. According with the best estimates available, at least 600 million people in Africa do not have access to electricity[27], and the continent lags behind the other continents in the efforts towards the renewable energy path.

22 Burke, M.B., Miguel E., Satyanath, S., Dykema, J.A., and Lobell, D.B., (2009). Warming increases the risk of civil war in Africa. Proceedings of the National Academy of Sciences 106(49), 20670–20674.

23 Ritchie, H. and Roser, M. (2019). CO2 and greenhouse gas emissions: Our world in data, Updated December. https://ourworldindata.org/co2-and--other-greenhouse-gas-emissions.

24 Schlenker, W., and Lobell, D.B. (2010). Robust negative impacts of climate change on African agriculture.Environmental Research Letters 5(1), 014010–014018.

25 Intergovernmental Panel on Climate Change (2018). Summary for policymakers. In: Masson-Delmotte V, Zhai P, Pörtner HO, Roberts D, Skea J, Shukla PR, et al., (eds). Global warming of 1.5°C. Geneva: World Meteorological Organization. Available at: https://www.ipcc.ch/sr15/chapter/spm/

26 Marbuah, G. (2020). Scoping the Sustainable Finance Landscape in Africa. Stockholm Sustainable Finance Centre, Stockholm. http://rgdoi.net/10.13140/RG.2.2.24387.84000

27 IEA (2019). Africa Energy Outlook 2019. *IEA - International Energy Agency*. Paris.

There are also huge infrastructure deficits in transport, the provision of clean water and sanitation, flood protection, irrigation and roads. A recent World Bank study revealed that Africa has the biggest gaps in access to urgently needed expansion of critical infrastructure compared to any other region (Rozenberg and Fay 2019[28]). However, only a small fraction of global climate finance flows to Africa and at current trends, investment levels will be too low to achieve many of the SDGs. Only 4% of climate finance flows (US$ 331 billion) reached sub-Saharan Africa in 2013 (Obine 2020[29]; LSEG Africa Advisory Group 2018[30]; Duru and Nyong 2016[31]). The volume of bilateral climate finance to the Africa region, however, has seen a consistent increase in recent years from US$7.7 billion in 2013 to US$16.5 billion in 2017 (OECD 2018[32]; Marbuah, G.2020).

A recent IMF study found that low-income states, including those in Africa, have a funding gap of at least half a trillion US dollars for financing the SDGs that will need to be closed by 2030. This gap corresponds to an average of "15 percentage points of their GDP" (Gaspar et al. 2019). The AfDB previously estimated that the cost of climate change adaptation alone in Africa would be US$ 20–30 billion per year over 10 to 20 years. This amount does not include the more than US$ 70 billion needed to meet existing development and poverty alleviation needs (AfDB 2011[33]; Marbuah, G.2020).

Green Bond History & Global Trends

The financial gap to implement the United Nations 2030 Agenda for Sustainable Development, including the 17 Sustainability Development Goals (SDGs) adapted in September 2015, represents a USD 2.5 trillion annual deficit[34]. This includes the need for funding from pension funds, insurance companies and retail investors[35].

The finance sector is also increasingly seen as vital for accelerating the transition to sustainability and climate neutrality, as there is a need to mobilize large amounts of private capital in order to meet the investment needs for achieving the climate targets of the Paris Agreement. Notably, asset owners are also stepping up in response to climate change (Forsbacka, 2021)[36]. One example is the Net-Zero Asset Owner Alliance, an alliance of the world's largest pension funds and insurers (representing 2 trillion USD in assets) committing to carbon-neutral investment portfolios by 2050 in one of the boldest actions yet to decarbonize the global economy.

In this sense, corporate climate targets are a part of the polycentric architecture of the Paris Agreement (Faria and Labutong 2019[37]). In this polycentric approach to climate governance, non-state actors such as corporations complement the legal and policy frameworks set by the UNFCCC (Chan, Brandi, and Bauer 2016). There is evidence suggesting that, among other innovative financial instruments, the green bonds can make a considerable contribution to achieving the

28 Rozenberg, J. and Fay, M. (2019). Beyond the gap: How countries can afford the infrastructure they need while protecting the planet. Sustainable Infrastructure. Washington, DC: World Bank. © World Bank. https://openknowledge.worldbank.org/handle/10986/31291

29 Obine, N.I. (2020). Green bonds: A catalyst for sustainable development in Nigeria. In: W. Leal Filho (eds) Handbook of Climate Change Resilience Springer, Cham pp. 1859–1882. https://doi.org/10.1007/978-3-319-71025-9_106-1

30 LSEG Africa Advisory Group (2018). Developing the green bond market in Africa. London Stock Exchange Group, London, England.

31 Duru, U. and Nyong, A. (2016). Why Africa needs green bonds. Africa Economic Brief, AEB, 7(2), 1–7. African Development Bank, Abidjan, Cote d'Ivoire.

32 OECD (2018). Climate finance from developed to developing countries: 2013–2017 public flows. OECD Publishing, Paris.

33 AfDB (2011). The cost of adaptation to climate change in Africa. An African Development Bank report. Abidjan, Cote d'Ivoire, October. https://www.afdb.org/fileadmin/uploads/afdb/Documents/Project-and-Operations/Cost%20of%20Adaptation%20in%20Africa.pdf

34 2 UN Press release, 25 September 2019, UN webpage https://www.un.org/press/en/2019/dsgsm1340.doc.htm

35 3 Petri Gornitzka, Charlotte, Wilson, Gavin E.R., Charting the course for SDG financing in the decade of delivery, World Economic Forum, 21 January 2020 https://www.weforum.org/agenda/2020/01/unlocking-sdg-financing-decade-delivery/

36 Forsbacka, K. (2021) Moving towards Green : Transition and Sustainability-linked Bonds. February 2021. Retrieved from http://urn.kb.se/resolve?urn=urn:nbn:se:ltu:diva-82364

37 Faria, P. C. S., & Labutong, N. (2019). A description of four science-based corporate GHG target-setting methods. *Sustainability Accounting, Management and Policy Journal.*

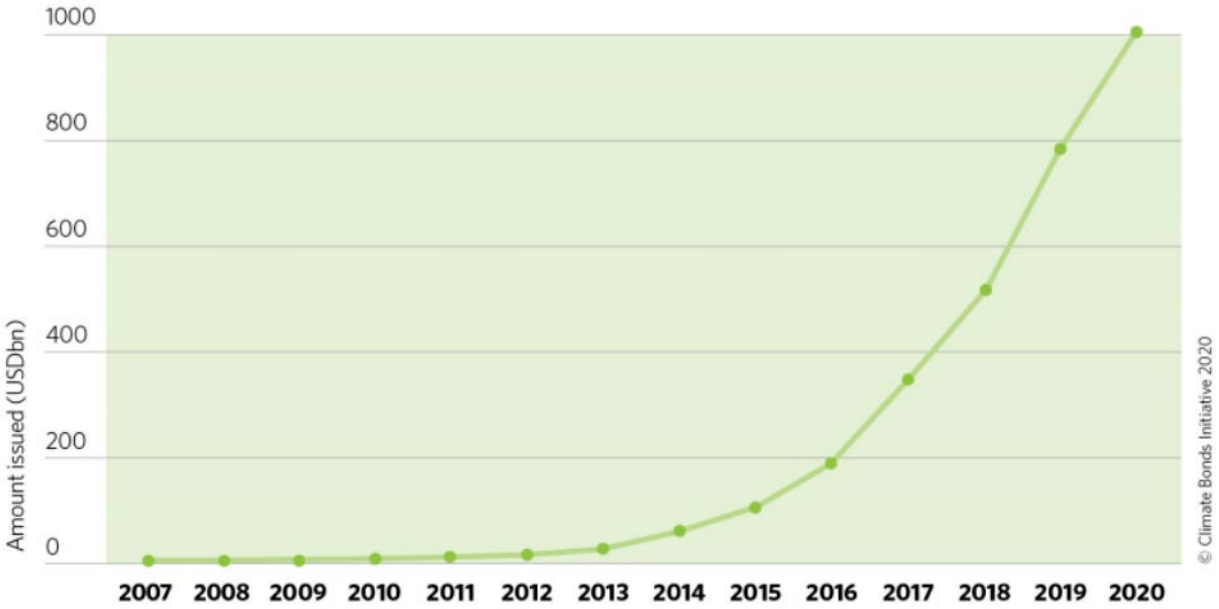
Paris Agreement and the Sustainable Development Goals (Tolliver, Keeley, and Managi 2019[38]).

The green finance market has reached its most substantial milestone yet, with 1,002 trillion USD in cumulative issuance since market inception in 2007, according to the Climate Bonds Green Bond Database. The trillion milestone was passed in early December 2020. (Jones, L., 2020).[39]

Global annual issuance of green debt has increased each year since 2007 to the 2019 record of 266.1 billion USD (adjusted from initial 255 billion). Green instruments have originated from a record sixty-seven nations and multiple supranational institutions (Jones, L., 2020).

Despite the impact of COVID19, 2020 market issuance stood at 222.8 billion USD as of December 13th (Jones, L., 2020).

FIGURE 10
The $1 Trillion: Cumulative Progression



Source: Climate Bonds Data Intelligence Reports: Latest Figures. Posted: Dec 15, 2020 by Liam Jones

38 Tolliver, C., Keeley, A. R., & Managi, S. (2019). Green bonds for the Paris agreement and sustainable development goals. *Environmental Research Letters*, *14*(6), 064009.

39 Data and information adapted from: Jones, L. (2020). $1Trillion Mark Reached in Global Cumulative Green Issuance: Climate Bonds Data Intelligence Reports: Latest Figures. 15 December 2020. Available at: https://www.climatebonds.net/2020/12/1trillion-mark-reached-global-cumulative-green-issuance-climate-bonds-data-intelligence

Major Milestones - from 600 million to 1 trillion

Green bonds debuted in financial markets in 2007 with the seminal EIB (European Investment Bank) issuance totalling an initial 600 million euro (roughly 807 million USD). In the 13 years since, according to the Climate Bonds Initiative (CBI), the average annual growth rate is a staggering 95%.

By the end of 2015, the cumulative 100 billion USD mark had been reached, with growth accelerating towards the trillion-dollar mark in the five years since. The milestone of 100 billion USD in annual issuance was met in November 2017 during COP23 in Bonn, providing a boost in market perception that green bonds were becoming a mainstream product and a vital contributor to climate finance and reaching the Paris Agreement objectives. (Jones, L., 2020).

1 trillion-dollar Distribution – Sector, Region and Issuer

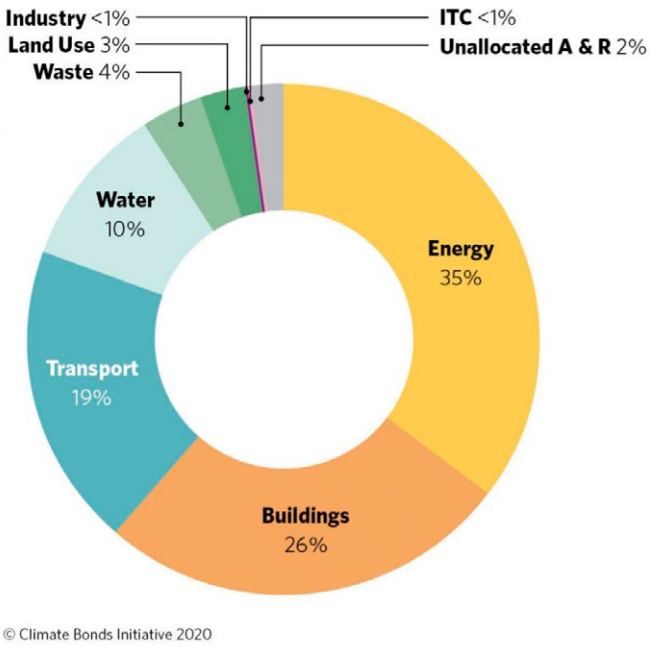
Investment in the Energy Sector comprises the largest component of the trillion dollars, at 354.7 billion USD, followed by Low Carbon Buildings with 263.5 billion USD and Transport in third place with 190.7 billion USD issued. Water infrastructure is in 4th place and Waste Management is 5th (Jones, L., 2020).

FIGURE 11

Green Bond milestones

Source: Climate Bonds Data Intelligence Reports: Latest Figures. Posted: Dec 15, 2020 by Liam Jones

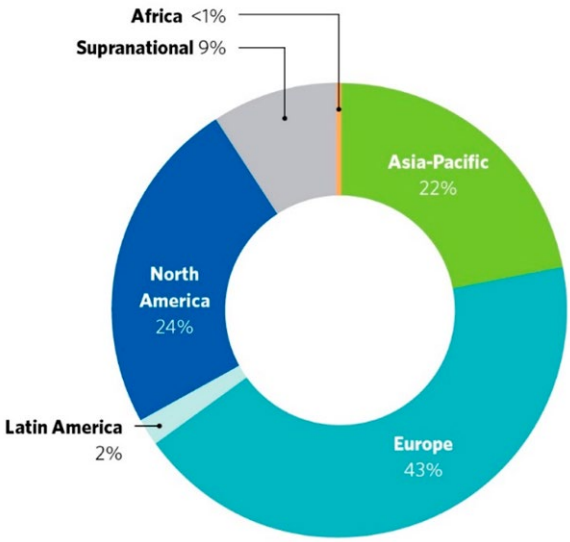
FIGURE 12
The $1 trillion: Use of proceeds



Source: Climate Bonds Data Intelligence Reports: Latest Figures. Posted: Dec 15, 2020 by Liam Jones

Europe is at the top of the podium for green issuance with 432.5 billion USD, and North America is second highest with 237.6 billion USD. The Asia-Pacific region is third with 219.3 billion USD issued, while Latin America and the Caribbean (LAC) has issued 20 billion USD. **Only 3.5 billion USD of green issuance is from Africa**. Also 90 billion USD has originated from supranational organisations, and the vital role of multilateral development banks (MDB) and development finance institutions (DFI) in supporting initial issuances and market development is acknowledged.

FIGURE 13
The $1 trillion: regions



Source: Climate Bonds Data Intelligence Reports: Latest Figures. Posted: Dec 15, 2020 by Liam Jones

FIGURE 14
Green bond world distribution

Source: Source: Climate Bonds Data Intelligence Reports: Latest Figures. Posted: Dec 15, 2020 by Liam Jones

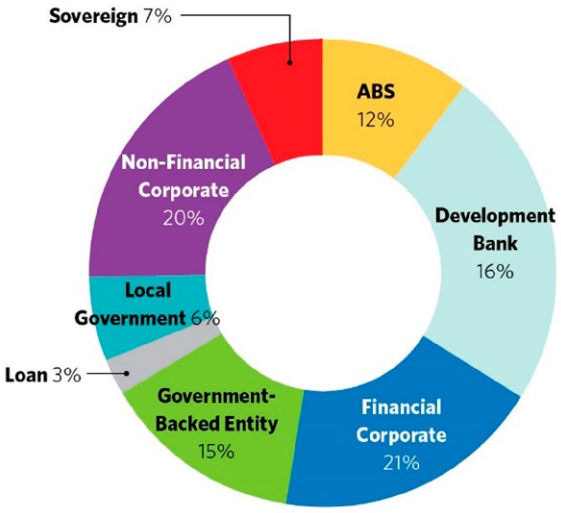
Financial Corporates are the largest source of issuance at 205.6 billion USD, with Non-Financial Corporates next with 205 billion USD, followed then by Development Banks with 158.8 billion USD. Only after these top 3 issuers, which account for 57% of the total value, do public entities start to appear, with Government-Backed Entities and Local Governments accounting for 21% of the market share.

Asset-Backed Securities (ABS) comprise 116.2 billion USD and green loans account for a further 28.9 billion USD of the market, with signs of growth, particularly in Asia.

Countries are also starting to issue sovereign green bonds with 71.5 billion USD issued in 2020. More than 20 countries have used these financial instruments, including several European (Belgium, France, Germany, Hungary, etc.) and African (Egypt, Nigeria, Seychelles, etc.) countries.

FIGURE 15

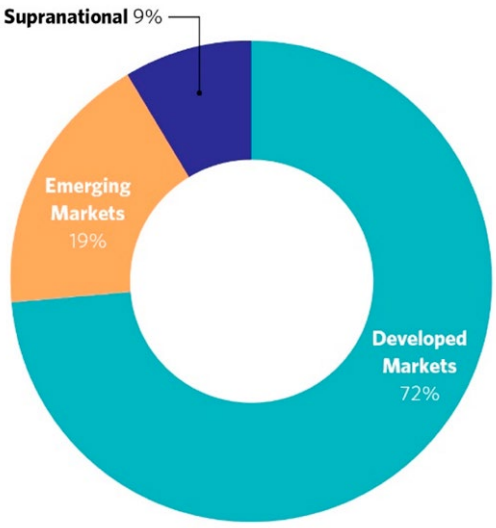
Green bond types of issuers



Source: Climate Bonds Data Intelligence Reports: Latest Figures. Posted: Dec 15, 2020 by Liam Jones

FIGURE 16

Green bond market types



Source: Source: Climate Bonds Data Intelligence Reports: Latest Figures. Posted: Dec 15, 2020 by Liam Jones

Market Breakdown

Developed Markets dominate green issuance at 719.5 billion USD, with Emerging Markets accounting for 193.4 billion USD and the Supranational organisations contributing 90 billion USD towards the cumulative total.

The African Case

Stakeholders

Following the issuance of the first African green bond in South Africa — the first issuance from an emerging market — bond issues from five further states have added to the list of market participants. South Africa, Morocco and Nigeria have been taking the lead in this drive. They are at an advanced stage, having developed their national frameworks, and are taking bold initiatives to develop the green bond market. Nigeria, for instance, is currently the only climate certified sovereign green bond issuer in Africa, while South Africa has issued a number of municipal green bonds. The cities of Cape Town and Johannesburg are the only municipal green bond issuers in Africa. Namibia and the Seychelles have also issued green bonds. In addition to municipalities, the role of corporate issuers, financial institutions and agencies is also more significant than state/governmental issuances in Africa. South Africa's state-owned agency, the Industrial Development Corporation, was the first to issue green bonds (US$ 700 million) from emerging markets in 2012 (Marbuah, G.2020).

International financial and development institutions are among the strongest stakeholders. The AfDB, the IBRD and another member of the World Bank Group member, the IFC, are among the small number of important players in the green bond market in Africa. These multilateral development banks and development finance institutions have: (a) directly invested in green bonds issued by other African entities; (b) issued green bonds themselves and used the proceeds to finance climate friendly projects and other projects with positive environmental impacts; (c) supported issuers from Africa in issuing bonds; or (d) assisted with capacity building. The IFC, for example, has been actively involved in capacity building with regulators, central banks and stock exchanges (through the Sustainable Banking Network), as well as other financial sector players, using training programmes and technical assistance. The World Bank provided similar support to the Government of the Seychelles with the development and issuance of the world's first "blue bond".

State of the Market in Africa

As of October 2019, green bonds in excess of 2 billion USD had been issued in Africa (see Table below). This figure excludes supranational entities but includes state/government, agency, city/municipality and corporate issuances to finance various climate-aligned projects and others of environmental value. Thus far, 17 bonds have been issued in six states across the continent. This trend for market participation is predicted to grow more quickly as more states express an interest in joining in the future. Of the 17 green bond issues, approximately 35% by value (422 million USD) was climate certified. They included the Nigerian Government's first African sovereign issuance. South Africa leads the way with a cumulative US$ 1.56 billion of green bonds issued since 2012, which corresponds to 74% of the total value of all issuances directly emanating from Africa. Entities in Morocco and Nigeria have been responsible for 17% and 6% of bond issues by value, respectively, having issued eight green bonds between them. Altogether, Kenya, Namibia and the Seychelles have issued US$ 61 million worth of green bonds in single issues of varying sizes. It is interesting to note that state/governmental issuances made up only 11% of the value of total issuances in 2014–2019. The largest share is accounted for by financial institutions and municipal issuers, with 26% each, while corporates and agencies issued 20% and 17%, respectively, in the same period (Marbuah, G.2020).

In terms of the use made of the proceeds from green bonds, we note that energy-related projects have so far accounted for the largest share of the cumulative amount invested. Specifically, renewable energy and energy efficiency related projects have accounted for 47% of the use of proceeds (988 million USD), followed by green buildings (39% or 822 million USD) and water related projects 6% (116 million USD). The remaining 9%

(181 million USD) has supported "other projects", a category that includes investments in green transport, waste management, land use change and protecting marine resources, as well as those with a clear adaptation and resilience focus (Marbuah, G.2020).

The outlook for the green bond market in Africa is promising. It is likely that many more states will consider or are already considering issuing green bonds to fund climate-related initiatives, given the urgency to take action on mitigation and adaptation, as well as to finance other sustainability related projects in the future. Multilateral development banks such as the AfDB are taking initiatives in investment forums across the continent to discuss the potential for green finance instruments such as green bonds to deliver the SDGs and the intended nationally determined contributions linked to the Paris Agreement.

TABLE 4
Africa's cumulative Green Bond issues as of October 2019

Country	Green Bonds	Amount (US$m)	First Issuance	Certified Climate Bonds	Certified Climate Bond Amount (US$)	Use of Proceeds
Kenya	1	41	Sep. 2019	Yes-1	41	Buildings
Namibia	1	5	Dec. 2018	-	-	Energy, buildings, transport, water, waste, land use, adaptation & resilience
Seychelles	1	15	Oct. 2018	-	-	land use & marine resources
Nigeria	4	136	Dec. 2017	Yes-2	71	Energy, transport, water, land use
Marroco	4	356	Nov. 2016	Yes-1	117	Energy and buildings
South Africa	6	1,554	Apr. 2012	Yes-2	193	Energy, buildings, transport, water, waste
Total	**17**	**2,107**	**-**	**6**	**422**	**-**

Source: Climate Bonds Initiative, October 2019. Adapted from Marbuah, G.2020.

Trends in Rules and Guidelines Development

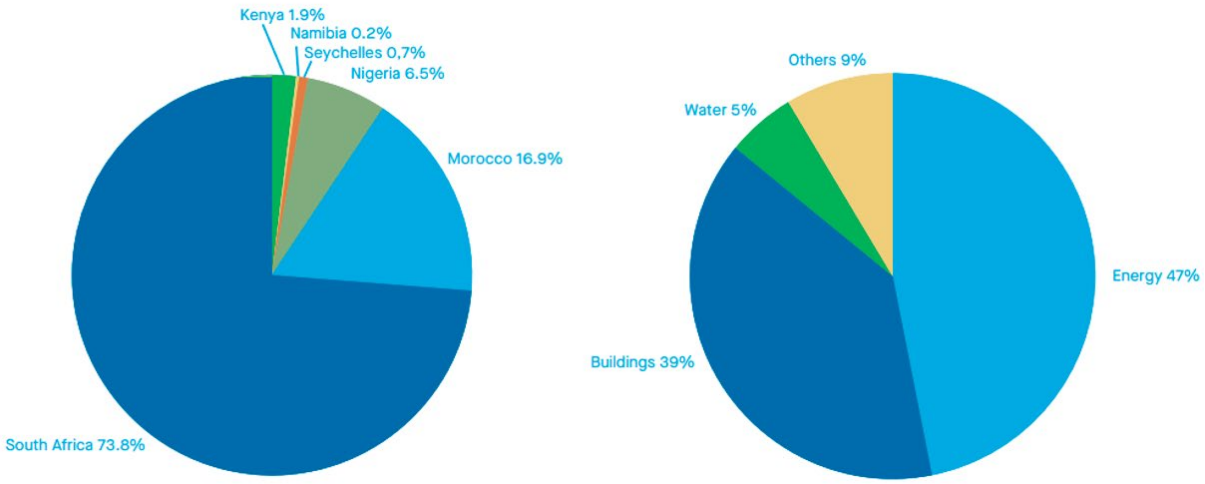
There is a growing awareness of the need to tackle climate change. Commitments from national governments and private sector actors and other sustainability-related concerns are among the key drivers of the growing interest in and appetite for green finance instruments, such as green bonds, in a growing number of African states. The green bond market thrives on the rules, guidelines and regulations that are often initiated by the public sector or other strategic stakeholders. Current trends with regard to the concept of sustainable finance, and especially green bonds in Africa, predict a likely positive transformation, albeit from a low base.

There have been a number of developments in terms of taxonomies and guidelines developed by existing or potential entrants in the green bond market in Africa.

It is impossible to overstate the importance of nationally defined frameworks, rules/guidelines and definitions that are consistent with known international principles and standards, examples of which are the Climate Bond Initiative for climate-related certification of green bonds, and the Green Bond Principles. The importance of such frameworks can be gleaned from the example of China. Despite its late entry into the market in 2015, China became the leading issuer of green bonds in the following year and has consistently ranked among the top three along with the US and the European Union (EU) ever since. This feat was achieved on the back of aggressive investment in the development of a catalogue of national guidelines that covered 40% of global issuances in 2016 (LSEG Africa Advisory Group 2018). At the regional level, the EU has a taxonomy and action plan on sustainable finance.

FIGURE 17

Share of total green bond issues by state (left) and use of proceeds by sector (right)



Source: Climate Bonds Initiative, October 2019. Adapted from Marbuah, G.2020.

While international frameworks such as the Green Bond Principles are considered the "gold standard" or a benchmark, regulators and stock exchanges around the world still perceive national guidelines and regulations as important for growing and developing domestic markets for green bonds (SBN 2018)[40]. The sustainable banking network (SBN) acknowledges these frameworks as important pillars in developing domestic markets and they are included in the assessment milestones for its members, which include the African states that have issued green bonds. The national frameworks take cognizance of specific contexts and circumstances in setting rules and regulations for the successful development of domestic green finance markets and the subsequent issuance of green bonds. The outputs from these processes should be frameworks that are aligned with national development priorities (goals and needs) and drive the much-needed development of African states' green bond markets. Technical aspects such as design and implementation mechanisms, and specific mandatory disclosure requirements for investors, regulators and financial industry actors — such as banks, among others — are important elements of developing robust frameworks to guide the market (Marbuah, G.2020).

As noted above, very few African states have issued green bonds. Morocco, South Africa and Nigeria have played significant roles in developing the green bond market through various initiatives and developing national frameworks. Egypt and Ghana are at the early stages of becoming Sustainable Banking Network members and have made commitments to push their respective banking sectors to adopt sustainable (green) banking principles. Both states have initiated activities to boost their preparations for adopting rigorous sustainable finance principles in order to be able to issue green debt in the future. Initiatives include awareness raising and knowledge sharing through stakeholder engagement, dialogue on policies and/or principles, and timelines for framework development and the definition of these policies and principles (SBN 2019). According to the most recent SBN assessment conducted in June 2019, while Egypt, Tunisia and Ghana are in the preparatory, policy formulation stage, Kenya, Morocco, Nigeria and South Africa are advancing with implementation (Marbuah, G.2020)

40 SBN (2019). Global progress report of the Sustainable Banking Network: Innovations in policy and industry actions in emerging markets. International Finance Corporation, Washington, DC, USA. October.

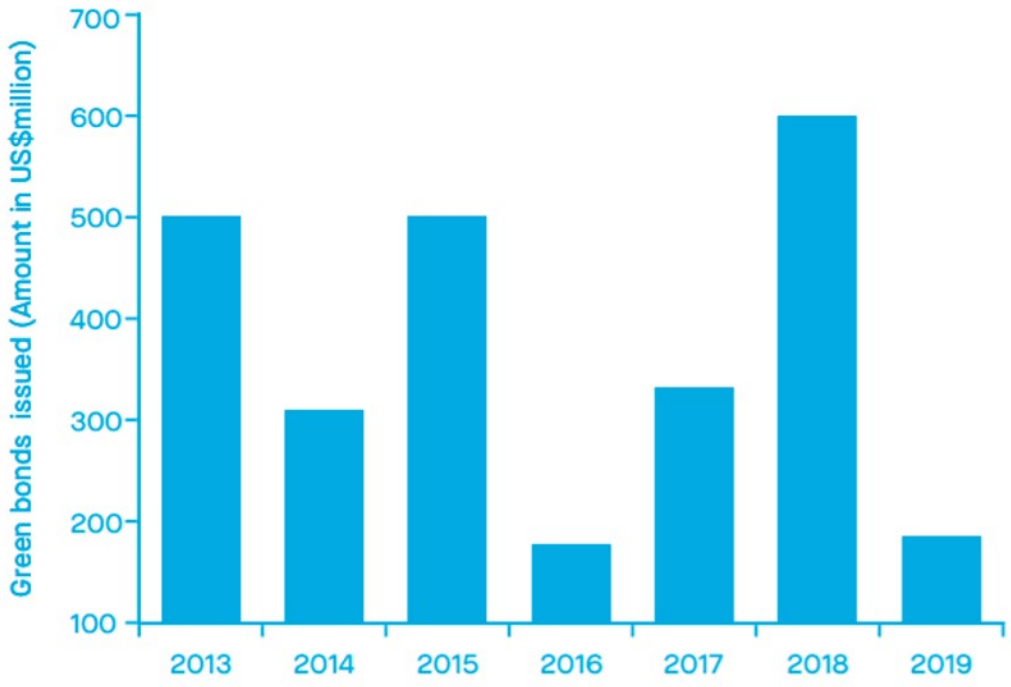
African Development Bank Case Study

The AfDB has played an active role in mobilising capital to support sustainable and inclusive green growth in Africa. About 12 billion USD was mobilised between 2011 and 2015 to support climate-friendly projects.

Turning to the use of the proceeds from the AfDB's green bonds across the continent, there has been a significant application of investible funds in energy efficiency and solar energy projects (14 solar projects in total). Sizeable allocations have also been made to clean transport, water and wastewater management, and hydropower projects. Since 2013, 48 eligible projects have been identified as green investments in the AfDB's green bond portfolio database. Morocco appears to have been the major recipient, with financing allocated to 10 projects on solar power, wind power, energy efficiency and clean transport, among other things.

FIGURE 18

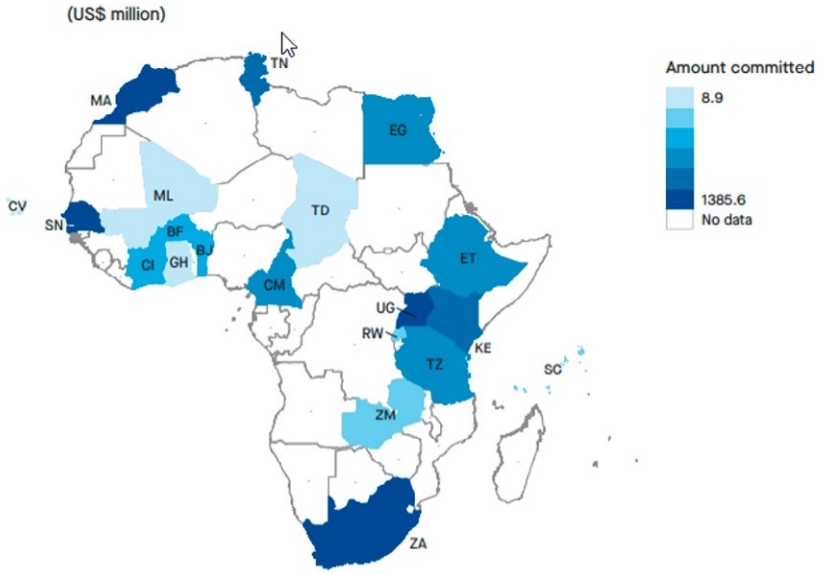
Value of green bonds issued by the AfDB (USD million)



Source: Data from the Environmental Finance Bond database. Adapted from: from Marbuah, G.2020, fig.7, p.18.

FIGURE 19

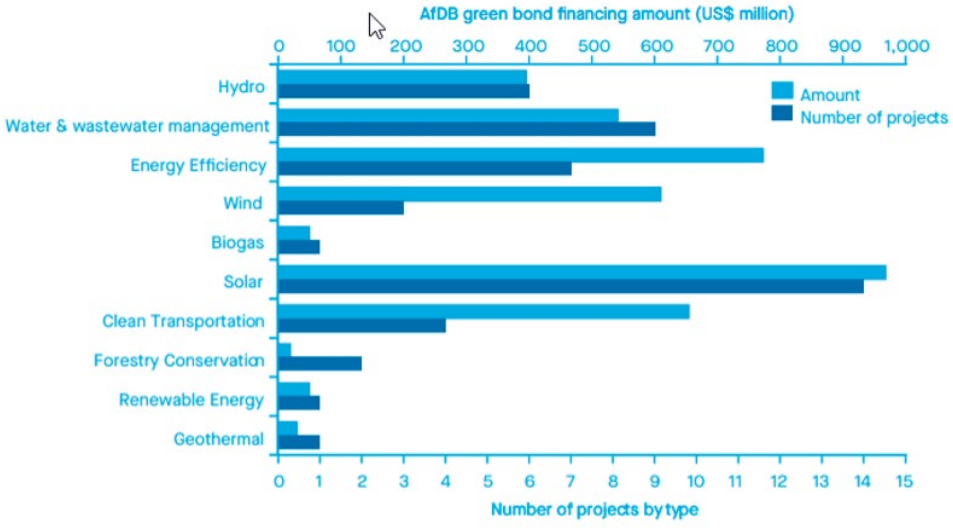
AfDB financing commitment for eligible projects in its green bond portfolio



Source: AfDB green bond portfolio database, 2013–2019. Adapted from: from Marbuah, G.2020.

FIGURE 20

AfDB financing commitment for eligible projects in its green bond portfolio



Source: Data sourced from AfDB green bond portfolio database, 2013–2019. Adapted from: from Marbuah, G.2020, fig.8, p.19.

Barriers to the development of the green bond market in Africa

Green bonds are commonly considered a useful tool for mobilising additional capital to finance sustainability challenges in Africa, but the uptake there has been low for a number of reasons. It is both promising and encouraging that various existing frameworks have made it possible for some African states to issue green bonds in recent years. Nonetheless, the existing literature and stakeholders have identified many obstacles to increasing the pace of development of the African green bond market (Kidney 2019[41]; Benhida and Mounsif 2019[42]; LSEG Africa Advisory Group 2018; Marbuah, G.2020).

Frameworks

There is a general lack of a clear understanding of what "green" constitutes. This may be linked to the lack of convergence in frameworks, guidelines or rules and of a shared understanding. In addition, the processes and criteria for issuing green bonds are not uniform across Africa. Even where guidelines exist, many are not aligned with or fail to meet international standards (LSEG Africa Advisory Group 2018). It is possible that what may be considered green in one African market might not pass the checklist in another, given the various stages of development of green bond markets (Kidney 2019; Benhida and Mounsif 2019; LSEG Africa Advisory Group 2018; Marbuah, G.2020). This confusion is not peculiar to the nascent African green bond market.

Despite the significant progress made on several fronts internationally, not all frameworks have been harmonised. The EU's development of a taxonomy for sustainable economic activity has now come part of the way, but it is still a work in progress. Its relevance and impact in the African context are still unclear. The lack of clear guidelines on the developing African green bond market is likely to deter many potential investors and issuers from entering the market.

There is also a reputational risk for domestic and international institutional investors where policy inconsistencies or doubts about the use of proceeds contribute to issuers' failure to protect investments against greenwashing. South Africa is the only African state with a sustainable finance taxonomy in development (SBN 2019). As noted above, Johannesburg's first emerging market green municipal/city bond was a self-labelled bond with no external verification. Accreditation standards followed in the case of the City of Cape Town (LSEG Africa Advisory Group 2018; Marbuah, G.2020).

Capacity

The dynamics of developing a green bond market are complex and require sound technical expertise. There is a general lack of capacity in Africa, especially within the regulatory agencies and stock exchanges, to effectively handle all the nuanced technical complexities involved in the design of verification and eligibility criteria for green assets, and of robust reporting standards, among other things. Even where there is adequate capacity in place, Africa is far from having a framework for common transparency practices. For example, there are no common rules or standards applicable to the use of green bond proceeds or to reporting. Thus, in the absence of technical support to build capacity, many of the practical issuance requirements and reporting standards will be a significant problem for regulators across the continent to deal with. The issue of lack of capacity transcends regulatory agencies. According to recent studies, capacity is lacking even among many domestic banks and some stock exchanges, thereby constraining their ability to help issuers to develop green bonds (Kidney 2019; Benhida and Mounsif 2019; Marbuah, G.2020).

Supporting Regulation

There is also either a lack of or insufficient supporting regulation to enable the market to take off at a reasonable pace and continue to thrive. Despite the impressive economic growth recorded by many African states in recent years (before Covid 19), several vulnerabilities remain within the financial sector. A resilient and robust economy and financial sector performance supported by robust regulatory policies are necessary conditions

41 Kidney, S. (2019). Findings of a mapping research on green bond market development in SBN member countries. SBN Green Bond Working Group, IFC Sustainability Webinar Series, February. www.ifc.org/sustainabilitywebinars

42 Benhida, J. and Mounsif, Y. (2019). Green bonds in Morocco: The regulator's perspective. SBN Green Bond Working Group, IFC Sustainability Webinar Series, February. www.ifc.org/sustainabilitywebinars

for absorbing shocks and mitigating risks while also supporting complementary initiatives such as the green bond market (Marbuah, G.2020).

Does size matter?

The size of green bond issues is a significant driver of growth of the market. It is a signal to investors about potential investment opportunities. However, many of the eligible pipeline projects and assets in Africa identified and verified as green do not reach the size threshold required to attract a significant investor base. There is also insufficient demand for green bonds among local investors and issuers, possibly due to a low level of awareness of the opportunities for investing in green projects/assets or even a lack of understanding of how the entire market works (Marbuah, G.2020).

Where are the verifiers?

To fully meet the international standards stipulated in the Green Bond Principles — or related benchmarks such as pre issuance review for labelling — an independent second opinion assessment is often required to verify that asset identification and selection meet eligibility criteria, and those of the use of proceeds and impact reporting. This external service does not come cheap as Second Party Opinion and external reviewers are accredited private sector consultants or entities offering services that are not locally accessible. There are no known qualified verifiers in Africa capable of offering such services. The cost of issuing a green bond in the light of such additional transaction costs linked to independent external verification could deter potential issuers and thus slow the pace of growth of the nascent green bond market in Africa (Marbuah, G.2020).

Is the journey worth it?

Beyond what is reported by issuers, there is currently little or no evidence that green bond issues have mobilised the capital needed for sustainability-related investments. Empirical data cannot be generated without a carefully designed impact evaluation set in a specific context. This lack of a clear demonstration of the costs and benefits of green bonds could hinder the development of the market in Africa. Rigorous and robust empirical evidence is needed to convince stakeholders to scale up take-up (Marbuah, G.2020).

Lack of incentive structure

According to recent studies, unlike in China and the US, there is a shortage of fiscal incentives attached to green bonds in Africa. Currently, only Kenya provides fiscal incentives for issuing infrastructure bonds, although there is some optimism that tax incentives will be introduced in other African states in the future (Kidney 2019; LSEG Africa Advisory Group 2018; Marbuah, G.2020).

Recommendations to improve the capacity of green bond issuance in Africa

The Stockholm Environmental Institute, has presented a set of recommendations towards mitigating the current fragilities (Marbuah, G.2020). We list the most pertinent ones:

- **Develop the capacity of all stakeholders through training, dialogue, cooperation, research, and investment in data and knowledge sharing**. Governments, auditors, local governments, corporate entities, banks, advisers/deal managers, reviewers, regulators and stock exchanges will all require training to sustain the demand and develop the market for green bonds in Africa. Multilateral agencies could facilitate this process by providing both technical and financial support. Effective collaboration can generate opportunities to mobilise a significant number of actors to issue green bonds in larger volumes and of greater value.

- The processes supporting the green bond market should reflect local market conditions and **involve local stakeholders in the design and rollout of appropriate national guidelines, regulations and rules**. No single, universally accepted framework can satisfy every context in Africa. Guidelines should be as simple and robust as possible, with sovereign backing and international support, for example through guarantees, to build the trust and policy credibility needed to attract a significant investor base. The spotlight must be put on the need for the EU to consider working with African stakeholders towards the adaptation of the current EU Taxonomy and EU GBS to the reality and priorities of African partners.

- **Conduct research and trials on fiscal incentives to assess whether they stimulate interest and demand for green bonds in Africa.** For example, could governments give tax credits/breaks to industries for decarbonisation by issuing green bonds to finance or refinance their projects? This would not be straightforward, and questions remain around the design of such a policy intervention, whether there is sufficient capacity or fiscal space to provide subsidies (especially in the pandemic context currently experienced around the globe), the benefits of doing so, and so on. For example, governments could cover the cost of second party opinions/verification for issuers. Another option for African governments might be to build the capacity of private sector investors interested in transforming their production processes away from massive fossil fuel use by providing guarantees on green bond issuance to scale up investments in low-carbon industries.

- **Identifying the quality of the pipeline of projects (either green or perhaps brown) that require (re) financing to transition towards green and structuring such deals will be critical**. The current portfolio of eligible pipeline projects and assets is likely to be of insufficient quality or quantity to attract large-scale capital flows through green bond investments in Africa (Kidney 2019). Africa might need to apply a variant of "shades of green criteria" when identifying and classifying its green assets. The shades of green concept was introduced by CICERO (Second Opinion Consultancy) to address a key drawback of the green bond principles/standards (CICERO Shades of Green, n.d.[43]). The green bond principle simply classifies a bond as green or not, with no room for any differentiation. CICERO's methodology (see next chapter for details), however, uses three levels of grading as part of its second opinion assessment to classify projects against the long-term environmental impact of green bond investments: "Dark Green", "Medium Green" and "Light Green". This classification is an essential source of information for investors on the quality of green bonds and their impact on the environment.

- **For the green finance market to thrive, a prudent mix of fiscal and monetary policy will be important in many African economies in order to maintain investor confidence.** The macroeconomic instability inherent in many African economies — especially regarding recent episodes of upside risks around high debt distress and debt sustainability concerns after years of debt build-up — could have cascading effects on investment flows of unpredictable proportions. An economy experiencing solvency challenges, for example, might have its credit rating downgraded, which would send a negative signal to the investor community to hold onto its funds or even look for a location where investors can be assured of a lower probability of future sovereign default, and hence be guaranteed a return on investments, be they green or conventional bonds.

- Perhaps the most sensitive recommendation is justified by the unsustainability of the current levels of debt in African countries. **International Partners, with leadership from the EU, should address this challenge, supporting African partners in the abatement of "brown" and unfair debt**, in order to create room for fresh green investments and promote a just transition.

43 CICERO Shades of Green. (n.d.). CICERO Shades of Green. CICERO Shades of Green. Retrieved June 30, 2021, from https://cicero.green/

Are Green Bonds an Effective Tool Against Climate Change?

Pushing forward the Agenda 2030 and the Paris Agreement, the EU launched its Action Plan in March 2018 (the Action Plan). The Action Plan includes the: i) reorientation of capital flows towards sustainable investment; ii) integration of Environmental, Social and Governance (ESG) risks into risk management and decision-making; and iii) fostering transparency and long-termism.[44] The EU Commission President, Ursula von der Leyen, presented the European Green Deal, which sets out how to make Europe the first climate-neutral continent by 2050. The European Green Deal is the EU roadmap for transforming the EU into a modern resource-efficient and competitive economy without net GHG emissions by 2050. The Green Deal also emphasises the key role that the private sector plays in financing the green transition.[45] The EU Commission has adopted a package of measures implementing several key actions announced in the Action Plan, such as the proposed Taxonomy Regulation[46], a regulation on climate benchmarks and benchmark ESG disclosure[47]. The EU is also promoting a voluntary EU Green Bond Standard (EU GBS) clarifying the green bond label and climate benchmarks and improved corporate disclosure of climate-related information, under the Action Plan[48].

This efforts from the EU are more than justified due to the lack of a fully developed theoretical and empirical understanding of the role of green bonds in corporate transition to carbon neutrality (Linnenluecke, Smith, and McKnight 2016[49]; Maltais and Nykvist 2020[50]). For this reason it is necessary to assess whether green bond issues are associated with an effective reduction in total and direct emissions by the non-financial companies, or if the green bond market still lacks transparency, risking being accused of greenwashing.

Contributing to this debate, the JRC – Joint Research Centre, supporting the European Commission, presented a recent technical paper (Fatica and Panzica, 2020)[51]. The authors' main conclusion **supports the association of green bonds with a reduction in carbon intensity at the company level (non-financial companies). The results are mixed when pooling all bonds together**, but once focused on non-refinancing bonds, they find strong evidence of this association. Compared to conventional bond issuers with similar financial characteristics and environmental ratings, non-refinancing firms borrowing on the green segment show a decrease in the carbon intensity of their assets, up to two years after the bond issuance. This holds for both total and direct emissions and is consistent with an increase in the volume of environmentally friendly activities due to new projects. The authors also found a larger reduction in emissions in the case of green bonds subject to external review, as well as those issued after the Paris Agreement.

The authors conclude, «*the results strongly corroborate the view that green bond issues signal a credible commitment towards climate-friendly company behaviour. Otherwise said, our evidence is clearly not consistent with the 'greenwashing' argument. If greenwashing prevails, green bonds are unlikely to have any real impacts that are beneficial to the environment. Moreover,*

44 EU Commission Sustainable finance: Commission's Action Plan for a greener and cleaner economy, 8 March 2018, https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52018DC0097&from=EN, http://europa.eu/rapid/press-release_IP-18-1404_en.htm?locale=en (Action Plan)

45 See, inter alia Brussels, 11.12.2019 COM(2019) 640 final Communication from the Commission to the European Parliament, the European Council, the Council, the European Economic and Social Committee and the Committee of the Regions, The European Green Deal (The EU Green Deal) https://ec.europa.eu/info/sites/info/files/european-green-deal-communication_en.pdf

46 The Taxonomy Regulation was published in the Official Journal of the European Union on 22 June 2020 (https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32020R0852&from=EN

47 The regulation on benchmarks empowers the Commission to adopt delegated and implementing acts to specify how competent authorities and market participants shall comply with the obligations laid down in the regulation. The regulations and technical documents can be retrieved at: https://ec.europa.eu/info/law/benchmarks-regulation-eu-2016-1011/amending-and-supplementary-acts/implementing-and-delegated-acts_en#200717

48 See the Usability Guide TEG Proposal for an EU Green Bond Standard (March, 2020), available at: https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/documents/200309-sustainable-finance-teg-green-bond-standard-usability-guide_en.pdf

49 Linnenluecke, M. K., Smith, T., & McKnight, B. (2016). Environmental finance: A research agenda for interdisciplinary finance research. *Economic Modelling*, 59, 124-130.

50 Maltais, A., & Nykvist, B. (2020). Understanding the role of green bonds in advancing sustainability. *Journal of Sustainable Finance & Investment*, 1-20.

51 Fatica, S. and Panzica, R., Green bond as a tool against climate change? Luxembourg: Publications Office of the European Union, 2020, ISBN 978-92-76-22105-0, doi:10.2760/24092, JRC121894

the stronger results that we obtain once we exclude securities issued for refinancing purposes provide further supporting evidence of the link between green financial choices and an increase in green fixed capital. As such, our findings point to the relevance of green bonds in the broader context of firms' climate commitment. » (Fatica, S., et al., 2020, p.24).

We will not discuss the reliability and robustness of the methodology used by the JRC authors to support their findings. In point of fact, the report does not fully disclose the full data and does not show evidence of assessing the scientifically based indicators used to report the companies' contribution to climate targets, especially the ones that were not externally verified.

Science Based Targets

In effect, corporate climate targets, which are voluntary, can support national and international climate goals governed by international climate agreements. However, in order to ensure that they do so, these targets need to be "science-based" meaning anchored to an overall budget limiting "unsustainable performance" using a systems perspective recognising planetary boundaries (Haffar and Searcy 2018[52]).

Concretely, science-based targets (SBTs) have been proposed as a tool for corporate entities to set emission reduction targets that are in line with a scientifically determined emission budget allowable under a 2°C or 1.5°C warming scenario (Walenta 2020[53]). How SBTs are set depends on the methods and principles used to allocate the overall emissions budget to companies (Bjørn et al. 2017[54]; Haffar and Searcy 2018; Krabbe et al. 2015[55]).

Furthermore, research indicates that **green bonds do not seem to move capital from unsustainable to sustainable investments** (Forsbacka, 2021). A 2016 study suggested that the green bond market does not help stimulate green investments by reducing the cost of capital for green projects. Rather, evidence suggested that this does not occur. According to Shislov, Morel and Cochran, there seems to be a "repackaging" of bonds that would most likely have been issued as traditional products (Shislov, Morel, Cochran 2016[56]). The empirical study among investors and issuers of green bonds on the Swedish market confirmed this result and showed that respondents do not find that, as a financial instrument, green bonds play a large role in shifting capital from unsustainable to sustainable investments.

Our scepticism in face of the overall optimistic conclusions of the JRC is, however, mainly based on the lack of transparent and comparable post issuance reporting. These **informational gaps increase the risk of greenwashing and hinder the green bond market scaling** (Forsbacka and Vulturius 2019[57]). A recent review also found that less than half of issuers report on the allocation of proceeds and the climate impact of their green bonds (CBI 2019[58]).

We do agree that climate targets, particularly those that are science-based, are a viable tool for companies and investors to reduce their exposure to reputational and financial risk brought by the transition to a carbon- free economy (SBTi 2019[59]). Nevertheless,

52 Haffar, M., & Searcy, C. (2018). Target-setting for ecological resilience: Are companies setting environmental sustainability targets in line with planetary thresholds?. *Business Strategy and the Environment*, 27(7), 1079-1092.

53 Walenta, C. A., Courtois, C., Kollmannsberger, S. L., Eder, M., Tschurl, M., & Heiz, U. (2020). Surface Species in Photocatalytic Methanol Reforming on Pt/TiO2 (110): Learning from Surface Science Experiments for Catalytically Relevant Conditions. *ACS Catalysis*, 10(7), 4080-4091.

54 Bjørn, A., Bey, N., Georg, S., Røpke, I., & Hauschild, M. Z. (2017). Is Earth recognized as a finite system in corporate responsibility reporting?. *Journal of Cleaner Production*, 163, 106-117.

55 Krabbe, O., Linthorst, G., Blok, K., Crijns-Graus, W., Van Vuuren, D. P., Höhne, N. & Pineda, A. C. (2015). Aligning corporate greenhouse-gas emissions targets with climate goals. *Nature Climate Change*, 5(12), 1057-1060.

56 Shishlov, Igor, Romain Morel, and Ian Cochran, Beyond Transparency: Unlocking the Full Potential of Green Bonds., Institute for Climate Economics Report, (2016) https://www.I4ce.Org/Download/Unlocking-the-Potential-of-Green-Bonds/

57 Forsbacka, K., & Vulturius, G. (2019). A Legal Analysis Of Terms and Conditions For Green Bonds: Focus on the Financial Markets in the Nordics. *Europarättslig tidskrift*, 3, 397-442.

58 CBI. 2019. Post-Issuance Reporting in the Green Bond Market. London: Climate Bonds Initiative. https://www.climatebonds.net/files/reports/cbi_post-issuance-reporting_032019_web.pdf.

59 SBTi. (2019). Foundations of Science-Based Target Setting Version 1.0. https://sciencebasedtargets.org/wp-content/uploads/2019/04/foundations-of-SBT-setting.pdf.

we also recognise the need for policy action to reduce the risk of greenwashing and "to situate the green bond market within planetary boundaries" (Tuhkanen and Vulturius 2020[60]).

In their recent empirical analysis of the twenty largest European green bond issuers in 2018, Tuhkanen and Vulturius showed a disconnect between issuers' climate targets and their green bond frameworks and shortcomings in issuers' post-issuance reporting. We will briefly summarise their main results, conclusions and recommendations.

Findings related to climate targets and Green Bond Reporting:

- Five out of twenty companies had no climate targets whatsoever;
- Of the fourteen companies with targets, seven companies had short-term targets (through 2025), eleven companies had long-term targets (2025+), and five companies had both, only two companies had a 2050 target.
- Only seven out of twenty issuers report on how they allocate green bond proceeds on a project-level and only six report the share of green bonds financing for individual projects. The data also shows that less than half of the issuers report on the share of green bond proceeds used for financing versus refinancing of green projects.

Shortcomings in reporting practices:

- Only eight companies disclose if proceeds have been used to refinance already existing projects with previously reported emission reductions.
- There is a lack of information about the share of green bond financing at the project level.
- There is mismatching information about the 'use of proceeds' and impact.
- Lack of reporting of project or portfolio co-ownership can be another issue to attribute emission reduction to green bond financing.
- There is variation in the methodologies that companies use to measure avoided greenhouse gas emissions. All issuers calculate avoided emissions from renewable energy based on the average national or regional emission factor, but only EDF considers lifecycle emissions. Also, only three issuers mention that they use the Greenhouse Gas (GHG) Protocol and the UNFCCC's methodology for measuring emission reduction from investments in renewable energy or energy efficiency.
- Related to the issue of lack of harmonized methodology to measure the impact of green bond financing is the absence of third-party verification of allocation and impact reporting of half of all issuers.

The six key shortcomings in issuers' reporting practices make it difficult to attribute reported avoided emissions to green bond financing. "These limitations in reporting practices carry a high risk of double counting of avoided emissions. Specifically, lack of information about methodology, third-party verification and project co-ownership could mean that avoided emissions from a shared project are claimed by multiple owners" (Tuhkanen and Gregor Vulturius 2020:18). The reporting drawbacks also make it difficult to understand whether the green bonds offer any additionality compared to conventional debt finance.

These conclusions are convergent with the doubts raised in a 2018 discussion paper from the 2nd Investment Initiative: "We currently lack evidence to conclude that as currently designed UoP GB ('Use of Proceeds" green bonds) contribute — or can without further enhancement contribute — to scaling up the investments in green projects» (Dupre, S., et al., 2018[61]).

60 Tuhkanen, H., & Vulturius, G. (2020). Are green bonds funding the transition? Investigating the link between companies' climate targets and green debt financing. *Journal of Sustainable Finance & Investment*, 1-23.

61 Dupre, S., Posey, T., Wang, T., Jamison, T. (2018). Shooting for the Moon I an Hot Air Balloon? Measuring how Green Bonds Contribute to Scaling Investments in Green Projects. A discussion paper. 2° Investment Initiative. May, 2018. Paper available at: https://2degrees-investing.org/wp-content/uploads/2020/01/2018-Green-bonds-updated-paper.pdf

Recommendations to foster the transparency and the additionality of green bonds

From their findings, Tuhkanen and Gregor Vulturius offer a set of recommendations. We call on the EU, international organisations and country and market regulators to build from these recommendations in order to foster the transparency and the additionality of green bonds.

- Future political action on green bonds should force issuers to be explicit about how they want to use green bonds in their transition towards carbon neutrality. The proposed EU GBS is an important step in that direction but needs implementation. According to the proposal, issuers must report on the environmental impacts using metrics and thresholds that are developed in the EU Taxonomy of sustainable economic activities.
- Harmonised impact methodologies are key in ensuring that post-issuance reports of green bonds become more credible and comparable. In this sense, we advise the EU to make extra efforts of harmonisation with other international initiatives, setting common minimum agreed and comparable frameworks, metrics and methodologies.
- A common set of impacts, together with third-party verification of impact reporting is also a basic requirement to build trust in the market and reduce the risk of greenwashing.
- A policy framework for accurate measurement and reporting of GHGs to clearly signal to the private sector a stringent mandatory GHG emission control and global market-based instrument must be enforced. The EU should lead the definition and adoption of such a framework.
- Public policy should compel issuers of green bonds to set science-based emission reduction targets, clearly define how green bonds will help them in achieving these targets and report on progress by using transparent and harmonised impact methodologies and metrics. Setting a benchmark for impact reporting to help align the green bond market with the Paris Agreement would build trust and reduce greenwashing risk.
- Raising the bar and scientific demands for impact reporting and external verification will inevitably increase the costs of issuing green bonds. One way to address such incremental costs would be to simplify the requirements for smaller companies, in a way similar to the current practice with environmental system certifications.

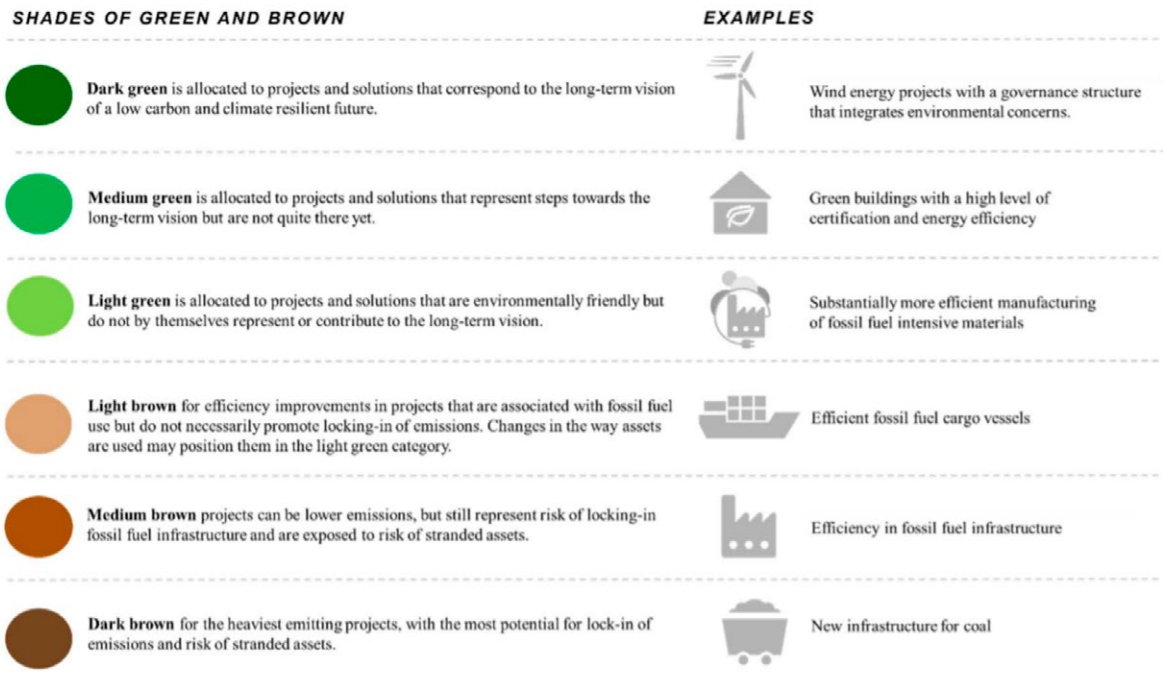
TRANSITIONING FROM BROWN TO GREEN

One problem with the emerging bond labels is that there has not been a clear definition of “green” or Environmental, Social and Governance (ESG) criteria and trade-offs. Standardising terminology and disclosure could help market growth. Mark Carney (former British Central Bank Governor) pointed at the EU Taxonomy and the EU GBS as good starts but noted that they are binary (dark green or brown) and do not account for progress from brown to green — progress that could make a significant contribution to our climate goals. He claims that mainstreaming sustainable investing will require a richer taxonomy — “50 shades of green” (Forsbacka, K., 2021).

CICERO Shades of Green, the second largest provider of Second Party Opinions on green bonds has emphasised that all sectors need to contribute to the transition. Traditional “dirty” sectors such as shipping, aviation, oil and gas have a pivotal role to play in transitioning to a low carbon economy (Forsbacka, K., 2021). CICERO applies a “shades of green and brown” methodology. This science based climate rating method is focused on avoiding the lock in of greenhouse gas emissions over the assets’ lifetime and promoting transparency on resiliency planning and strategy. Green finance projects have environmental strengths, weaknesses and pitfalls and require the issuer to have effective governance procedures to deliver the desired impact.

The shading methodology aims to provide transparency to investors that seek to understand and act upon potential exposure to climate risks and impacts. Investments in all shades of green projects are necessary in order to successfully implement the ambition of the Paris Agreement.

FIGURE 21
Shades of Green Methodology.



Source: CICERO (2020)[62].

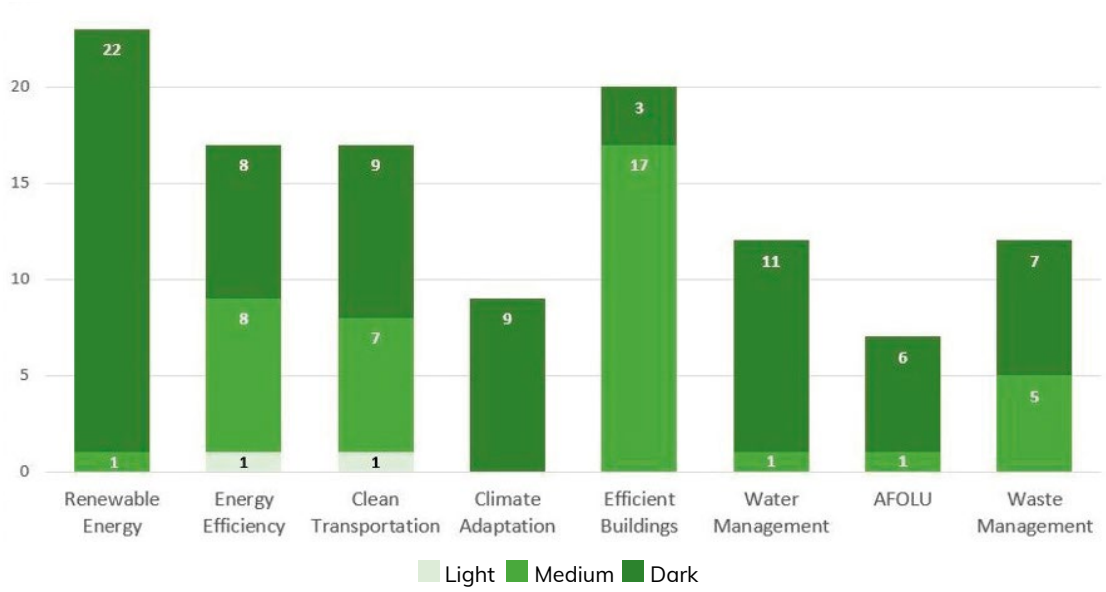
For sustainability finance frameworks, the social benefits are reviewed in addition to the green considerations. The consistency and effectiveness of eligible social asset categories are reviewed against the issuer's overall social targets and the United Nations Sustainable Development Goals (SDGs). SDGs highlighted by the issuer are assessed by clarifying which specific SDG targets are supported by each eligible social asset category. Moreover, the assessment points to relevant SDGs and targets that may not have been identified by the issuer. The assessment covers the issuer's capacity for anticipating and assessing adverse social risks when selecting eligible green and social projects. CICERO also reviews whether the issuer has implemented policies that require project beneficiaries to have systems in place to avoid, reduce or minimize adverse social impacts.

The figure bellow shows the Shades of Green by project type. Renewable energy projects lend themselves more readily for a dark green shading, as these projects generally align well with a low-carbon future. For project types in the transportation, building and waste sectors, more medium green shadings were assigned due to further concern for environmental impacts.

What CICERO's methodology and experience shows is the increasing awareness that in order to effectively carry out the transition to a low carbon and climate resilient society, there is a need to support the transition

62 CICERO (2020). CICERO Shades of Green's new report: Best Practices 2020 — CICERO Shades of Green. CICERO Shades of Green. Available at: https://cicero.green/latestnews/2020/9/7/cicero-shades-of-greens-new-report-best-practices-2020

FIGURE 22
Shades of green by project category



Source: CICERO (2019)

from “brown” to less “brown” industry projects. This transition requires specific financial instruments. The emerging transition bonds aim to fulfil this opportunity and further contribute to the Paris Agreement Alignment Climate and Sustainable Finance.

Emerging Transition Finance

Transition Finance is not about transitioning from 'brown' to 'green': that is Green Finance. Transition Finance is about transitioning from brown to... brown; a lighter shade of brown, of course. Put simply, Transition Finance is for sectors that (1) are not green today; (2) cannot become green tomorrow; yet (3) can and need to get greener (by which we mean "less brown") faster, at a pace likely in line with recognised sustainable development scenarios, or at least within the scope of a disclosed comprehensive strategy roadmap that will get them back in line within an acceptable timeframe (Duteil, 2019[63]).

Recognising the need for transition finance, the European Bank for Reconstruction and Development (EBRD)[64] has implemented a Green Transition Bond/ Green Bond Programme Information Template with a GBP component use-of-proceeds. EBRD recognises that there is an urgent need for projects to go beyond

63 Duteil Hervé, Sustainable finance: It’s all about transition! Part two, Environmental Finance, 13 September 2019 https://www.environmental-finance.com/content/analysis/sustainable-finance-its-all-about-transition-part-two.html

64 The GBP, Green Transition Bond / Green Bond Programme Information Template, Issuer: European Bank for Reconstruction and Development (EBRD), September 2019 https://www.ebrd.com/documents/treasury/framework-for-green-transition-bonds.pdf?blobnocache=true

supporting assets that are considered already to be low carbon, e.g. renewable energy, to finance investments in those sectors of the economy that today are highly dependent on the use of fossil fuels, thereby enabling them to transition to low carbon and resource-efficient operations.

The emergence of transition bonds led to calls for banks to work together with investors and issuers to come up with standards for such bonds as an asset class, a new type of "use of proceeds" instrument, distinct from green bonds (Forsbacka, K., 2021). One such early example of is AXA's early transition bond proposal[65].

According to the AXA proposal, transition bonds are intended for companies which are (i) in GHG intensive industries such as materials, extractives, chemicals and transportation, and (ii) in industries which currently do not (and for the foreseeable future may not) have sufficient green assets to finance but do have financing needs to reduce their greenhouse gas footprint. The AXA proposal included a high level of transparency and follows the same structure as the GBP[66]. The approach was framed around the four core components of (i) use of proceeds, (ii) process for project evaluation and selection, (iii) management of proceeds, and (iv) reporting. Alongside these four components, AXA also wants to establish clear expectations on the issuer's broader environmental strategy and practices. This was an additional component not currently explicit within the GBP. Transition bond issuers should clearly communicate what climate transition means in the context of their current business model and their future strategic direction. AXA suggests that senior management and board directors should make a commitment to align their business with meeting the Paris Agreement goals. The issuer's transition strategies should be intentional, material to business and measurable, and the transition bond must fit into the broader transition strategy, defined by quantified short and long-term environmental objectives (Forsbacka, K., 2021).

In November 2019, Crédit Agricole issued a EUR 100 million transition bond, the first transition bond by a commercial bank, as a private placement subscribed by AXA. The proceeds of the bond are earmarked to a selection of loans made to projects in carbon intensive sectors, which contribute to the transition to a low carbon economy, such as LNG-powered ships, investments in energy efficient industries as well as gas power assets in countries where power generation currently relies on coal (Forsbacka, K., 2021).

Despite the coincidence in time and, sometimes, terminology, we should not confuse the "transition finance" with the concept of "Just Transition". The concept of a Just Transition was written into the Paris Climate Agreement itself. However, it only received real attention at the UN Climate Change Conference in Katowice, Poland, when more than 100 investors representing over $5 trillion of assets signed a statement of commitment to support it, acknowledging that, «There is an increasing recognition that the social dimension of the transition to a resilient and low-carbon economy has been given insufficient attention, notably in terms of the workplace and the wider community.» (HRRC, 2018[67]).

According to the guide commissioned by the Grantham Research Institute on Climate Change and the Environment (Robins, et al. 2018[68]), contributing to the just transition is a way for investors to deliver positive social and environmental impacts:

- Broadening the understanding of systemic risks from climate change, by factoring in

65 AXA Investment managers calls for new transition bonds to help companies go green, Press Release 11 June, 2019 https://www.axa-im.com/content/-/asset_publisher/alpeXKk1gk2N/content/axa-investment-managerscalls-for-new-transition-bonds-to-help-companies-go-green/23818?utm_source=t.co&utm_medium=referral, Avery, Helen, Green Money: Calls for transition bonds gain traction, Euromoney, 11 July 2019, https://www.euromoney.com/article/b1g6t3mnfmrn70/green-finance-calls-for-transition-bonds-gain-traction

66 Takatsuki, Yo, Foll, Julien, Financing brown to green: Guidelines for transition bonds, AXA Investment Managers, 10 June 2019 https://realassets.axa-im.com/content/-/asset_publisher/x7LvZDsY05WX/content/financing-brown-to-green-guidelines-for-transition-bonds/23818

67 HRRC. (2018, December 11). Investors commit to supporting a just transition on climate change. Human Rights Resource Centre. https://www.business-humanrights.org/fr/derni%C3%A8res-actualit%C3%A9s/investors-commit-to-supporting-a-just-transition-on-climate-change/

68 Robins, N., Brunsting, V., Wood, D. (2018). Climate change and the just transition. A guide for investor action. Grantham Research Institute on Climate Change and the Environment. December 2018. Retrieved at: https://www.lse.ac.uk/granthaminstitute/wp-content/uploads/2018/12/Climate-change-and-the-just-transition_Guide-for-investor-action.pdf

issues such as social exclusion and increasing inequality.

- Reinvigorating fiduciary duty by better capturing the interrelated environmental and social drivers of long-term performance and by taking better account of beneficiary interests in sectors and regions affected by the transition.

- Recognising material value drivers in terms of corporate practices in the workplace and the broader social license to operate: business performance will be increasingly conditioned by the just transition.

- Uncovering investment opportunities that combine climate and social goals such as inclusive growth, identified through the lens of the just transition.

- Contributing to societal goals, including existing responsibilities to respect international human rights and labour standards as well as new ways of realising the Sustainable Development Goals.

We will come back, in the next chapter, to the frameworks for a "Just Transition". For the moment, we just want to foster the need for clarity in the classification of the various financial instruments and market bonds. In fact, as there have been no agreed standards or principles for transition bonds, issuers have self-defined the bonds. Some transition bonds have been aligned with the GBP, and others have not. The EU Taxonomy includes certain transition activities, and thus the EU GBS can include transition activities.

Transition Activities, the EU Taxonomy and EU GBS

In order to translate the EU policy commitments, including the Paris Agreement and the UN SDGs and to contribute to the implementation of the EU Green Deal, the Union adopted the TEG proposal for a taxonomy, as a "unified classification system". The EU Taxonomy includes issues from "brown" sectors, and as room for transition activities in the EU GBS (Taxonomy Report 2020).

In particular, the EU Taxonomy considers, in addition to: i) activities that are already low carbon, also ii) activities that contribute to a transition to a net-zero emissions economy in 2050 but are not currently close to a net-zero carbon emissions level, and iii) activities that enable low-carbon performance or enable substantial emission reductions. In establishing thresholds for taxonomy screening criteria, the TEG interpreted climate change mitigation objectives to mean net-zero emissions by 2050 and a 50-55 per cent reduction by 2030, consistent with the commitments under the EU Green Deal.

To establish transition pathways for heavily emitting sectors for which low carbon solutions are not available consistent with these goals, the TEG adopted two principles: i) ensuring no lock-in of assets inconsistent with these goals, and ii) environmental performance well above the sector average. It can be noted that the "no lock-in" requirement is consistent with the requirements under the CICERO medium and light green labels, which can include transition activities (Forsbacka, K., 2021).

The proposed EU GBS chooses the "use of proceeds" method, allowing any company to issue green bonds, regardless of their main activity, as long as they finance eligible green projects (EU GBS 2020). The EU GBS go beyond the current best market practices (e.g. GBP), including additional elements and guidelines to address some barriers to development. The proposed model sets out four components: i) the alignment of the use of proceeds with the EU Taxonomy, ii) the content of a Green Bond Framework to be produced by the issuer, (iii) the required allocation and impact reporting, and iv) the requirements for external verification by an approved verifier. Proceeds from the EU green bonds should finance "green projects" that i) contribute substantially to at least one of the six environmental objectives of the EU Taxonomy Regulation, ii) not significantly harm any of these objectives, iii) comply with minimum safeguards, and iv) comply with technical screening criteria in the EU Taxonomy. (Forsbacka, K., 2021).

One major weakness of the EU GBS, however, is the voluntary approach to enforcement. The standard is not binding, and issuers and companies are free to adopt them at their own discretion. It is true that they have the potential to be a "de facto" requirement for issuers in European Markets, but we recommend going to a "de facto" regulatory approach, after a period of transition and careful deliberation with stakeholders and effective testing.

Another limitation arises from the nature of the option taken by the "use of proceeds" method, which is related to the non-extension of the framework and the benchmarks to an overall sustainability and impact performance. As Herveil Duteil notes, «*...the financial community is opening itself up to a broader set of challenges than just those related to climate change, and that Sustainable Finance is looking at solutions that go beyond the 'green' economy. Indeed, the focus on climate change is expanding to biodiversity challenges (including deforestation, land degradation, desertification, plastic pollution, overfished marine areas or species extinction) and inclusive growth for all inhabitants of our singular planet Earth*» (Duteil, Part One, 2019)[69].

The financial circles are starting to acknowledge the impossibility of reaching a fully decarbonised world by 2050 solely through green processes (wind turbines, solar farms, or electric vehicles). On the one hand, **a transition must be made from a much larger number of sectors that are brown today and will remain brown for a very long time. Resource efficiency, as well as greenhouse gas (GHG) and particulate emission reduction from vast industrial, transportation and agricultural sectors, will continue to be greatly needed as long as we remain unable to displace brown processes and activities at a reasonable cost, without an unsustainable path, and guaranteeing an inclusive development.**

Therefore, as noted by Duteil, we should consider the question "How can we extend some of the benefits traditionally associated with green finance to these 'brown' sectors? Such benefits might take the form of a reduced cost of funding, access to a larger pool of investors, or communication to the financial community of a sustainable strategy that covers the core business strategy. Considering this urgent challenge, the EC Taxonomy and EC GBS falls short. In fact, we cannot label 'green' financial instruments to optimise the efficiency of brown companies and sectors; however, at same time, we cannot afford to ignore the need to build specific rules, methodologies, benchmarks, and transparent reporting, for the brown sectors. «We should not be afraid to call brown 'brown' especially as there is plenty of room for brown in sustainable finance. Sustainable Finance is not just green or social finance, it is also transition finance. » (Duteil, Part One, 2019).

Green and Sustainability-Linked Loans and Bonds

Duteil says that three revolutions are currently taking place in the field that is itself in constant transition: i) labelling the 'use-of-proceeds' green bonds; ii) linking returns with sustainability performance and impacts; iii) linking cost of risk to sustainability performance and impact. We add the need for two extra, larger revolutions: iv) the mainstreaming of "just transition" to both, the green finance ('use-of-proceeds') and the sustainability performance and impacts. This would need both mainstreaming and the full development of specific funds and instruments. Finally, yet importantly, the greatest challenge of all: v) indexing the 'green' economy and the sustainability performance and impacts of companies to the "license to operate", discriminating both, positively and negatively, the degree of inclusiveness and impacts on humanity and the planet.

The first revolution, labelling the 'use-of-proceeds' was already discussed above.

The second revolution and third revolution are, in our view, two faces of the same coin (increased returns as incentive to go sustainable vs cost of risk). This new

69 Duteil Hervé, Sustainable finance: It's all about transition! Part two, Environmental Finance, 106 September 2019. Retrieved at: https://www.environmental-finance.com/content/analysis/sustainable-finance-its-all-about-transition!-part-one.html

generation of instruments is already on the move, but while the 'use-of-proceeds' concept started in the bond space and extended to the loan market, the reverse holds true for 'non-use-of-proceeds' sustainable finance.

The concept was extended to longer-term financing (mostly revolving credit facilities) in the form of SSLs — sustainability-linked loans. SSLs are any types of loan instruments and/or contingent facilities (such as bonding lines, guarantee lines or letters of credit) which incentivise the borrower's achievement of ambitious, predetermined sustainability performance objectives. In SSLs, the interest rate moves up or down in line with the achievement of sustainability performance targets (e.g. ESG score, GHG emissions intensity, water intensity, waste intensity or gender ratios) (Duteil, Part One, 2019). In March 2019, industry associations published the market standards for sustainability linked loan standards, the Sustainability Linked Loan Principles (SLLPs)[70].

The borrower's sustainability performance is measured using sustainability performance targets (SPTs), which include key performance indicators (KPIs), external ratings and/or equivalent metrics and which measure improvements in the borrower's sustainability profile. The SLLP four core components are: i) relationship to the borrower's overall CSR strategy, ii) target setting — measuring sustainability, iii) reporting, and iv) review.[71]

Sometimes, SSLs are informally addressed as "ESG linked loans", "sustainability improvement loans", "KPI loans" and "SDG linked loans". However, it is recommend that lenders and borrowers consistently refer to these products as SLLs to build a common language and understanding in the market.

The ESG/KPI-linked facilities have the advantage of extra flexibility when compared with green loans. The use of the facilities is not limited to a specific green investment; on the contrary, they can be used for general corporate purposes. Instead of determining specific use of proceeds, sustainability linked loans aim at improving the borrower's sustainability profile. An additional distinction is that sustainability-linked loans have a pricing incentive, which can reduce margins by up to 5 basis points if they meet their benchmarks. The firm's opinions on ESG risk and performance are linked to the interest rate of the loan and allow borrowers to reduce their margins if they improve external ESG ratings or hit specific internal or external KPIs, or use both metrics.

These recent developments finally woke up the credit rating agencies to this reality, and they are gradually showing signs of a more formalised integration of environmental, social and governance (ESG) risk assessment into credit ratings, a move which will ultimately affect security and loan pricing.

A milestone for this new generation of instruments was accomplished in September 2019, when the Dutch-registered finance subsidiary of Enel SpA (Italian electric company) issued the world's first **"general corporate purposes SDG linked bond"** (a Sustainability-linked bond), a single-tranche USD 1.5 billion bond. The issue was four times over-subscribed. In October the same year, Enel issued an additional general corporate purposes SDG-linked EUR 2.5 billion bond that consisted of three tranches. This bond was Europe's first general corporate purpose SDG-linked bond issue, and was almost four times oversubscribed, with the substantial participation of socially responsible investors (Forsbacka, K., 2021).

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70 LMA(Loan Market Association), APLMA (Asia Pacific Loan Market Association) and LSTA (the US Loan Syndication and Trading Association), March 2019. Available at: https://www.icmagroup.org/assets/documents/Regulatory/Green-Bonds/LMASustainabilityLinkedLoanPrinciples-270919.pdf. The current version was updated in May 2020 and can be retrieved at: https://www.lsta.org/content/sustainability-linked-loan-principles-sllp/#

71 A Guidance to the Green Loan Principles and Sustainability Linked Loan Principles jointly issued by the LMA, the LSTA and the APLMA is available at: https://www.lsta.org/content/guidance-on-sustainability-linked-loan-principles-sllp/#

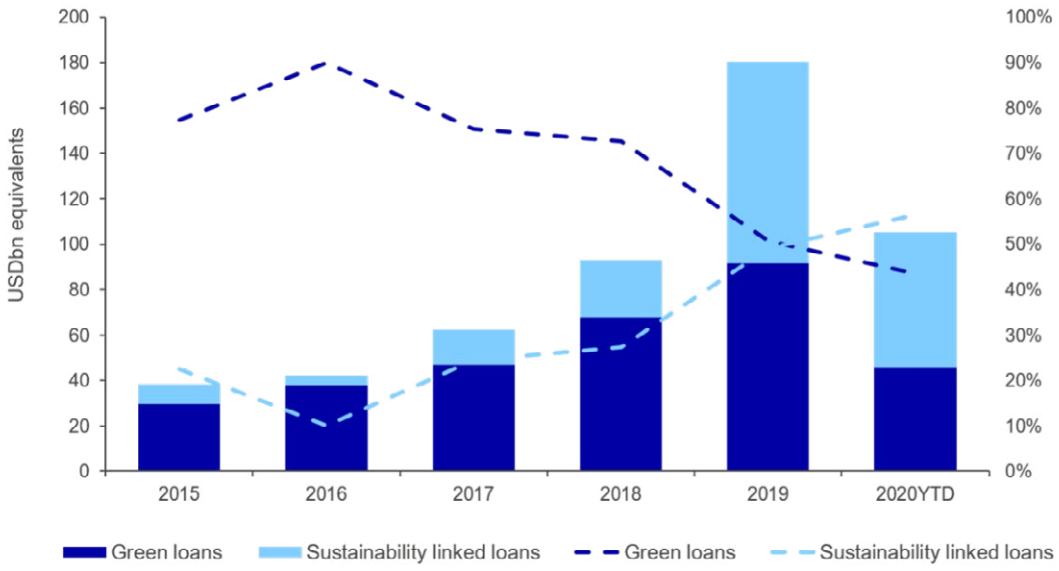
A snapshot of the Green and Sustainable Loan Market

Green loans have been the preferred format in the sustainable loan market, mainly thanks to the early establishment of rules of play in the capital markets, which has provided guidance to the loan market. However, since 2018 and especially following the publication of the SLLPs in 2019, the sustainability-linked loan market has picked up at an impressive pace, surpassing green loan volumes in 2019 (Ramel, E., 2020)[72].

The nature of green loans and bonds means that the formats compete over green assets and projects to be financed by green debt. If an asset or project is financed by a green bond, the same asset or project cannot be financed by a green loan. Because green bonds are public instruments, most entities prefer to use their limited amount of green assets and projects for issuing green bonds, with the communication and branding opportunities they bring. They can then complement the bond with a sustainability-linked loan facility to further push the entity's overall sustainability strategy.

FIGURE 23

Green and sustainability-linked loan supply in absolute numbers and shares, 2015-2020 YTD

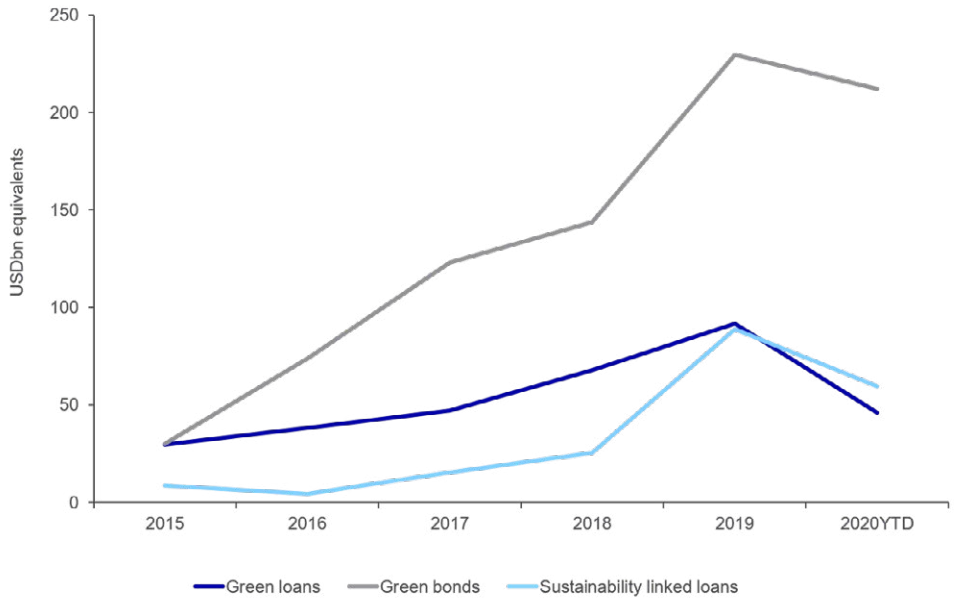


Source: Bloomberg and Nordea

72 The snapshot follows the data collected and presented by Ebba Ramel in the Open Insights by Nordea, on 29 October 2020, available at: https://insights.nordea.com/en/sustainability/sustainable-loan-market/

FIGURE 24

Green loan, green bond and sustainability-linked loan market development 2015-2020



Source: Bloomberg and Nordea

Comparing the top five sectors using the respective sustainable debt formats reveals some interesting findings. Close to 90% of green loans are raised by only five sectors, while that number is around 40% for the top five sectors raising debt through sustainability--linked loans.

TABLE 5

Top five sectors and their respective shares split by sustainable debt format

Sustainability-linked loans		Green loans	
Utilities	14%	Renewable Energy	47%
Transportation & Logistics	9%	Power Generation	23%
Chemicals	7%	Utilities	8%
Industrial Other	6%	Real Estate	6%
Food & Beverage	5%	Financial Services	3%

Source: Bloomberg and Nordea

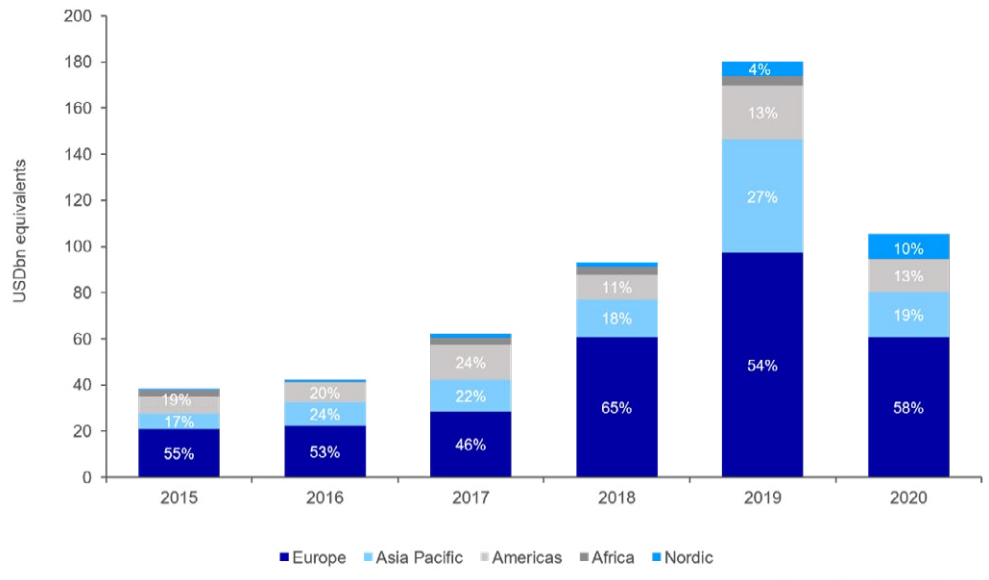
The green loan format is evidently suitable for sectors with assets and projects that are green by nature, such as renewable energy, and sectors with established and broadly accepted methods for defining green, such as real estate.

The sectors raising sustainability-linked loans are more dispersed when it comes to sector type and share size. The format does not require a definition of green assets and projects to be financed, but instead allows all types of entities to commit to sustainability targets that are linked to the terms of the debt. Any entity can improve within sustainability, given its broad meaning and application.

Sustainability-linked loans provide an alternative for borrowers in sectors that lack clear definitions of green, such as the food and beverage industry or companies within sectors that may not have green assets and projects but can decrease their environmental footprint, such as transportation and logistics. The format is also an alternative for entities pushing an overall sustainability strategy by combining raised green debt with a sustainability-linked loan, for example utilities investing in renewable energy solutions (green) and targeting a reduced carbon footprint (sustainability-linked).

FIGURE 25

Regional distribution of sustainability-linked loans and green loans 2015-2020



Source: Bloomberg and Nordea

As explained by Ebba Ramel (Ramel, E., 2020), an interesting insight is that sustainability-linked loans are most popular in the Nordic and European regions, while in the Americas, Asia Pacific and Asia, green loans are the most used. The majority of loans raised by the green lending regions are raised to finance renewable energy and power generation projects, while the European and Nordic sustainable borrowers come from a larger set of sectors, including not only renewable energy and power generation but also chemicals, telecom and pulp and paper, among others. As we mentioned before, **Africa still represents a very small share of global sustainable loans, mainly in the form of green loans.**

Recommendations to improve Transition Finance

- Promote "shaded" approaches in the classification of projects (like CICERO), instead of simplistic black or white methodologies

- Improve efforts in order to contribute to a transparent classification of the various segments of market bonds, from the brown bonds to the transition bonds, green bonds and sustainability--linked bonds, contributing to proper labelling and addressing the risk of greenwashing.

- Progressively transition from the voluntary approach to the enforcement of adapted EU GBS (or similar) rules for issuers in European markets (after a period of transition, testing and careful deliberation with stakeholders).

Altogether, **the sustainable loan market**, with the plethora of financial tools available, **represents some hope for making an impact in terms of decarbonising the global economy**. However, we must maintain a realistic view of the problem. In fact, **even if a company like Enel is unarguably decarbonising, a large part of its electricity will be generated by burning coal and gas, and investment in dirty energy from companies and investors will continue for years. This reality opens the door for the public policy to better regulate the financial markets, enforce the use of scientifically based targets, make heavy use of economic policy instruments to incentivise sustainability, stop subsidising dirty industries and make use of the tax system to promote alignment with the Paris Agreement and the SDGs 2030 Agenda.**

Nevertheless, we believe that a more fundamental transformation is urgent. In the following chapters, we will introduce two key disruptions that need to be carried out in order to further align the financial sector and corporate behaviour with the Paris Agreement and the SDG's Agenda. Concretely, we refer to the incorporation of the "just transition" and the relevance of rethinking the "license to operate" and the business models to change the nature of financial markets and the degree of inclusiveness of private business.

THE "JUST TRANSITION" FOR EARTH AND HUMANITY RESILIENCE

The transition to a zero-carbon world has the potential to bring immense benefits, quite apart from the mitigation of climate change (Stern 2015[73]). As the World Bank has put it, "There is no reason to think that a zero--carbon economy would be any less prosperous in the long run than a high-carbon one (if anything, it is likely to be more prosperous)" (Fay et al. 2015:154) [74]. However, it will also cause profound disruption, dislocation and loss to many, at least in the short term. Because of new climate-related government policies, new technologies, and associated economic changes, a variety of groups will experience numerous kinds of losses. The owners of carbon-intensive business assets — in sectors such as fossil fuel production, electricity production, energy-intensive manufacturing, transportation, agriculture and forestry — will find themselves facing higher production costs and/or greater competition from lower carbon substitutes (Green, F., 2018[75]). For example, one study estimates that a carbon price consistent with the 2°C target could cause US$165 billion of stranded assets in coal-fired power generation alone between 2011 and 2050. Workers in such carbon-intensive sectors — numbering in the millions worldwide — will also be affected. **The variety and scale of potential transitional losses associated with the mitigation of climate change raises urgent policy challenges of both a normative and an empirical kind that are only beginning to be explored by policymakers, civil society groups and researchers** (Green, F., 2018). Furthermore, **the unequal distribution of both costs and benefits of a transition to a low carbon economy creates a scenario in which developing nations will have to cope with increasing pressures while severely lacking the resources**

73 Stern, Nicholas. 2015. Why Are We Waiting? The Logic, Urgency, and Promise of Tackling Climate Change. London: The MIT Press.

74 Fay, Marianne et al. 2015. Decarbonizing Development: Three Steps to a Zero-Carbon Future. Washington, DC.

75 Green, F. (2018), Transition policy for climate change mitigation: who, what, why and how, CCEP Working Paper 1807, July 2018. Crawford School of Public Policy, The Australian National University.

(capital, human and technological) to implement changes to their economy.

Such transitional losses are already happening, despite the relatively weak stringency of climate policies around the globe. Since much more numerous, more stringent and longer-term climate policies are needed to have a good chance of achieving global climate change objectives, the aggregate demand for transitional assistance will be even higher in a world that does mitigate climate change effectively. Governments will therefore increasingly need to develop systematic, principled policy approaches to address transitional losses — they will need transition policy. In effect, good transition policy might be a necessary condition for sufficiently deep climate change mitigation. We can at least be sure of this: **transition policy and sufficiently deep climate change mitigation are inextricably intertwined. Due to the normative and political issues raised by the issue of potential losers from the low-carbon transition, civil society groups** — from the international labour union movement and major multinational environmental NGOs to ad hoc local groups — **are increasingly mobilising to provide policy advice and on-the ground assistance for the purpose of transition. Much of this activity is being organised around the theme of a Just Transition** (Green, F.,2018).

The just transition is not only required under the climate change and low carbon transition. There are, at least, two other major economic transformations underway: circular economy and digitalisation of the economy. These rapid transformations will create winners and losers, demanding difficult trade-offs and requiring an ethical approach to compensate the losers and positively discriminate in favour of the poor people, communities and countries.

At the international level, the structural transition to a circular economy will influence and reshape trade relations, value chains and flows of primary raw materials between countries. Most importantly, import and export demand for primary materials, secondary materials and waste may decrease in certain economies. Low- and middle-income countries that are heavily dependent on extractive industries stand to lose out in the medium to long term. **The impacts arising from lost exports in countries that are particularly reliant on resource exports for their economy and tax revenue are likely to be significant.** This may also **have a negative effect on the ability of low- and middle-income countries to attain the SDGs. A just transition is therefore critical in ensuring that the circular economy does not create new disadvantages for countries in the future trade system**. International support for inclusive initiatives and the diversity of circular approaches that are emerging in developing and fast-industrialising economies provide an opportunity to advance just transitions on a global scale (Schroeder, 2020[76]).

At the subnational level, in regions relying on extractive industries, the risk of lost jobs will also demand social welfare policies, retraining and new job creation.

Economic digitalisation and the disruptive new technologies offer the prospect to improve productivity and the quality of work. For example, blockchain technology is being used to ensure traceability, transparency and ethical global supply chains through data monitoring. **If combined with good management practices, digital tools have the potential to enhance the quality of life of workers in all sectors**. However, **there is also increasing evidence that some innovative and disruptive business models are assigning little priority to workers' rights or social protections. Policymakers and all stakeholders need to ensure that digitalisation leads to overall better living conditions and more equality in societies. An inclusive technological diffusion is required for a just transition.**

Just Transition: The making and globalisation of a contested concept

Unlike the concepts of "green economy", "green growth" or "sustainable development", "Just Transition" (JT), at least when it emerged, was geographically and socially "grounded". Its origins were the frontline effort to defend and improve the workers and their local communities'

76 Schroeder, P. (2020). Promoting a Just Transition to an Inclusive Circular Economy. Royal Institute of International Affairs.

health and livelihoods, while simultaneously preserving the natural environment (JTRC, 2018[77]).

Just Transition: Incubation of a concept in the US Trade Unions movement

The idea behind what was eventually called Just Transition was born in the United States, in the 1970s. Most observers agree that it was a creation of Tony Mazzocchi, a trade unionist from the Oil, Chemical and Atomic Workers' Union (OCAW), and the product of his determined efforts to reconcile environmental and social concerns. As early as 1973, Mazzocchi successfully enlisted support from environmentalists to help OCAW wage what he presented as "the first environmental strike" over health and safety issues at Shell refineries across four US states (Mazzocchi 1993[78]).

Mazzocchi and his collaborators were convinced that addressing environmental and health problems did not necessarily mean destroying communities. Rather, they believed that it was possible and necessary to promote, through the mobilisation and collaboration of workers and communities, public policies that simultaneously address environmental challenges and secure decent jobs and livelihoods for affected workers.

By the early 1990s this network of unionists and activists had developed an explicit programme of action that was called "Superfund for Workers" (Mazzocchi 1993). The Superfund was brought forward in response to the rising jobs versus environment discourse, which was fuelled by the neoconservative policies and often took the shape of union and employer-sponsored studies pointing to significant job losses associated with increased environmental regulations. In 1995, Les Leopold and Brian Kohler introduced the term Just Transition during a presentation to the International Joint Commission on Great Lakes Water Quality (Hampton 2015[79]). Kohler (1996)[80] subsequently emphasized that "the real choice is not jobs or environment. It is both or neither".

In 1997 the Just Transition Alliance (JTA) was launched for the purpose of connecting the trade union movement with community-focused environmental justice groups. These groups had been sprouting up throughout the 1980s and 1990s, mobilised around the designation of Superfund sites. The launch of the JTA marks an important milestone towards the development of a comprehensive, holistic and multistakeholder strategy.

Besides the JTA, the 1990s saw other efforts to build broader links between labour and environmentalists, especially in a context marked by the signing of the North American Free Trade Agreement (1994) and the World Trade Organization Ministerial Conference in Seattle (1999). Notable examples include the "Blue/Green Working Group", set up by American Federation of Labor and Congress of Industrial Organizations (AFL-CIO) President John Sweeney in 1997, which brought together the AFL-CIO and large environmental nongovernmental organizations (NGOs). The Working Group produced one of the first comprehensive programmes fusing the promise of the new, green economy and a Just Transition under market-based rules(Barrett and Hoerner 2002[81]). In the longer run, participants in the Working Group founded the BlueGreen Alliance in 2006[82]. Although Just Transition went into decline in the United States, by the early 2000s it had spread to other national contexts and to the international policy space (JTRC, 2018).

77 Just Transition Research Collaborative (JTRC, 2018). Mapping Just Transition(s) to a Low-Carbon World. Rosa-Luxemburg-Stiftung, University of London Institute in Paris and United Nations Research Institute for Social Development, Geneva (2018) http://www.unrisd.org/jtrc-report2018

78 Mazzocchi, Tony. 1993. "An Answer to the JobsEnvironment Conflict?" Green Left Weekly 114, 8 September. https://www.greenleft.org.au/content/answer-jobs-environment-conflict

79 Hampton, Paul. 2015. Workers and Trade Unions for Climate Solidarity: Tackling Climate Change in a Neoliberal World. New York: Routledge.

80 Kohler, Brian. 1996. "Sustainable Development: A Labor View – The Real Choice is not Jobs or Environment: It is Both or Neither." Presentation at the Persistent Organic Pollutants Conference, Chicago, 5 December. http://www.sdearthtimes.com/et0597/et0597s4.html.

81 Barrett, James P., and J. Andrew Hoerner. 2002. Clean Energy and Jobs: A Comprehensive Approach to Climate Change and Energy Policy. Washington, D.C.: Economic Policy Institute. https://www.epi.org/files/page/-/old/studies/cleanenergyandjobs.pdf.

82 The BlueGreen Alliance is an ongoing alliance between labor unions and environmental organisations with the mission to promote Good Jobs, a Clean Environment and Fair Trade. More information available at: https://www.bluegreenalliance.org/

2000–2010: Global Diffusion of Just Transition

Largely through the efforts of national unions and union federations, the Just Transition was increasingly referred to at the international level as well — especially in relation to the United Nations climate negotiations and discussions on sustainable development.

In the late 1990s and early 2000s, the International Confederation of Free Trade Unions (ICFTU) and Trade Union Advisory Council to the Organization for Economic Co-operation and Development included Just Transition language in their OSH and environmental activities. The ICFTU's position at the climate conference (COP3) in Kyoto (1997), for example, included the declaration that "workers will demand an equitable distribution of costs through 'just transition' policies that include measures for equitable recovery of the economic and social costs of climate change programmes" (ICFTU 1997:1)[83] (JTRC, 2018).

The lobby from the International trade union space for the inclusion of Just Transition in UN processes and agreements had an important moment in the 2006 merger of the ICFTU and the World Confederation of Labour that gave birth to the International Trade Union Confederation (ITUC). From the outset, the ITUC placed environmental concerns at the heart of its agenda.

A key promoter of Just Transition was the Spain-based Sustainlabour Foundation, a green think tank closely linked to the research and educational arm of *Commissiones Obreras* (CCOO) and active at the international level. Sustainlabour organised training sessions for union members, published thematic reports, case studies, and policy recommendations, and played a pivotal role in getting workers' voices heard in national and international policy spaces (United Nations Environment Programme (UNEP), International Labour Organization (ILO), United Nations Framework Convention on Climate Change (UNFCCC), United Nations Commission on Sustainable Development). Sustainlabour was also instrumental in organising the first Trade Union Assembly on Labour and the Environment in January 2006, which produced a landmark resolution (UNEP 2007, Annex 1)[84]. A second assembly was organised in 2012, on the occasion of the Rio+20 Conference (JTRC, 2018).

Given its growing importance, the United Nations climate process became a privileged venue for the ITUC to push its Just Transition agenda. Consequently, and within the international climate community, Just Transition was increasingly framed and recognised as the trade union movement's contribution to the international climate debate.

By shedding light on the social implications of climate change, Just Transition filled an important gap in the international climate debate. The priority for many climate justice activists involved in and around the UNFCCC had been getting developed countries to recognise their historical responsibilities for climate change and to act upon them — both through more ambitious national mitigation efforts and through higher levels of financial and technological assistance to developing countries, which are much more vulnerable to climate change.

When climate justice groups referred to the uneven social impacts of climate change, they tended to focus on geographical differences (Fisher and Galli 2015). Limited attention was paid to the differentiated social implications of both climate change and climate policies on the world of work in both the Global North and South (JTRC, 2018). This can be an asset for today's struggle of making corporate business accountable for their responsibility towards a sustainable and just transition, both in Europe and partner developing countries.

However, the other side of the coin of this period of global diffusion, where trade unions — especially at the international level — were the main promoters of Just

83 ICFTU (International Confederation of Free Trade Unions). 1997. Climate Change and Jobs: Towards a Strategy for Sustainable Employment. Trade Union Statement to the Kyoto Conference (1-10 December 1997). Brussels: ICFTU. https://sustainabledevelopment.un.org/index.php?page=view&type=255&nr=23693 Guy Ryder, then General Secretary of the ICFTU, later also included Just Transition in his statement at the 2002 World Summit on Sustainable Development in Johannesburg:

84 UNEP (United Nations Environment Programme) (2007). 2007. Labour and the Environment: A Natural Synergy. Nairobi: UNEP. https://wedocs.unep.org/bitstream/handle/20.500.11822/7448/-Labour%20and%20the%20Environment_%20A%20Natural%20Synergy-2007739.pdf?sequence=3&isAllowed=y

Transition, was the disconnectedness with the original promoters and causes of the Just Transition movement. Through their active involvement in the international climate debate, their framing of the Just Transition progressively shifted away from its initial community and occupational safety and health focus to one centred on trade union responses to climate change. This focus on climate policy disconnected the original promoters of Just Transition from the new global Just Transition community forming around the ITUC and other global union federations (JTRC, 2018).

After 2010: Globalisation and Proliferation of Just Transition

Just Transition language has entered into the mainstream of climate change debates, where it is used by UN organisations, governments, NGOs, indigenous groups, feminist groups, businesses and philanthropists, among others. The growing popularity of the JT concept inevitably led to a proliferation of different, and sometimes contradictory, framings.

It is also important to note that, while the Just Transition has gained traction in the international policy space and the Global North, apart from a few notable exceptions — including South Africa — it is rarely referred to in the Global South.

The global diffusion of Just Transition, particularly in the context of the international climate negotiations, has led to the adoption of Just Transition language by the most prominent environmental NGOs and networks. Many are now referring to Just Transition in their campaigns and publications. In parallel, Just Transition has also made a significant comeback in the United States. At the grassroots level, community-based labour and environmental justice organisations and networks are actively campaigning for a Just Transition that does not limit itself to labour issues but also addresses cultural, gender and racial injustices as well. These groups are supported by a small number of more progressive philanthropic foundations and philanthropic networks such as the Chorus Foundation, Edge Funders Alliance, Building Equity and Alignment for Impact, among others (JTRC, 2018).

Other noteworthy and innovative philanthropic initiatives include the Just Transition Fund, launched in April 2015 with support from the Rockefeller Family Fund and Chorus Foundation, whose mission is to support Appalachian coal-dependent communities to transition to a strong, resilient and diversified economy. More mainstream climate funders such as Bloomberg Philanthropies and the European Climate Foundation have also incorporated Just Transition wording into their work — the Beyond Coal campaigns in the United States and Europe, for example — as have foundations involved in the recently established F20 Platform[85] (JTRC, 2018).

At least some of the partners of the F20 Platform endorsed a *Global Call for an Equitable Wind Down of Fossil Fuels*. A growing network of civil society, indigenous, youth, government, academic, business and other leaders from the Global South and North is joining together to call for a Fossil Fuel Non-Proliferation Treaty to wind down oil, gas and coal in keeping with 1.5°C and fast track a fair energy and economic transition. The main rationale for this proposal is the lack of a global mechanism to limit fossil fuel expansion. The Paris Agreement does not even mention oil, gas and coal. The full extent of plans to produce these dangerous fuels is unknown, as there is no publicly available source of information identifying the actual, planned, and potential fossil fuel production or related emissions. This lack of transparency makes it difficult to determine how to use the last of the world's carbon budget in a just way and the extent to which proceeding with business as usual will overshoot it. This campaign is built on three main pillars of action: i) Non-proliferation — preventing the proliferation of coal, oil and gas by ending all new exploration and production; ii) Global Disarmament, or phasing-out existing stockpiles and the production of fossil fuels in line with the 1.5°C global climate goal; and iii) Just Transition: Fast-tracking real solutions and a just transition for every worker, community and country.

In regard to Just Transition, the campaign states:

85 For more information see: https://www.foundations-20.org/fossiltreaty-allison-robertshaw/.

«The scale of the challenge demands urgent collective action. A peaceful and just transition calls for a clear path and a proactive plan to enable economic diversification, implement renewable energy and other reliable, cost-effective low-carbon solutions, and to support every worker, community and country. We can either intentionally develop new ways to meet our needs or lose the window of opportunity to ensure a safe climate, healthy economy and sustainable future.»[86]

The campaign, however, lacks concrete mechanisms to address the Just Transition. There is only one reference to a hypothetical "Global Transition Fund" in a supporting research paper (Newell & Simms, 2020[87]). Eventually, the Fund would be constituted from the reallocation of current fossil fuel subsidies and, potentially, the revenues from a global carbon tax. The fund would mainly be channelled towards countries needing additional finance to meet energy and other needs in lower carbon ways (Newell & Simms, 2020).

Even if the Global Call for a non-proliferation of fossil fuels deserves attention and action, their concept of Just Transition and the proposal for the Transition Fund do not address critical needs, namely: i) the subnational and local community transitions; ii) the increased pressure on poor households without energy access and depending on fossil fuel or carbon (biomass) fuels; iii) the trade-offs and policy instruments to address the environmental and health problems being caused by the extractive industries and the rush to the new gold (the rare earth metals necessary to produce renewable energy, especially electric vehicles).

Despite the growing popularity of the concept of Just Transition, the most influential concepts remained firmly rooted in and associated with the union movement, most notably at the international level, co-opted in the meantime by the International Labour Organization (ILO).

The ILO's guidelines for a just transition towards environmentally sustainable economies and societies for all (2015) have, since its publication, "become the anchor of just transition policies" and the organisation "has been paving the way to make just transition an established element of the sustainable development agenda" (Galgóczi, 2018[88]). They are "the result of a tripartite multilateral negotiation between unions, employers' organisations and governments" (Smith, 2017), based on the shared responsibility principle, "unlike the capital/labour nexus that is based on conflicting interests, environmental and labour priorities are based on shared interest" (Galgóczi, 2018). In just transition narratives it is important to stress that, alongside ensuring environmental sustainability, societies must be inclusive, provide opportunities for decent work for all, reduce inequalities, and effectively eliminate poverty (Franssen & Holemans, 2020[89]).

Within this, there are a number of key elements. First, "strategies and policies for a just transition should be context-sensitive. A country-specific approach fully recognising the peculiar conditions in each country would be needed, while one size fits all initiatives would be counterproductive (ILO, 2015: 6[90])". Second, "a further element of complexity to be considered is that, while the challenges of the transition have territorial specificities, decisions taken at one geographical level may have repercussions at other geographical levels. In other words, while addressing specific territorial or sector-related challenges, to be 'just', the transition towards a low-carbon society should also take into account the broader global framework and the connections between 'multi-scalar realities' (McCauley and Heffron 2018: 2[91]), (Sabato & Fronteddu, 2020: 10[92]), (Franssen & Holemans, 2020).

86 The Campaign proposal is available at: https://fossilfueltreaty.org/home.

87 Newell, P., & Simms, A. (2020). Towards a fossil fuel non-proliferation treaty. Climate Policy, 20:8, 1043-1054, DOI:10.1080/14693062.2019.1636759

88 Galgóczi, B. (2018). Just transition towards environmentally sustainable economies and societies for all – ILO ACTRAV Policy Brief. Geneva: International Labour Organization https://www.ilo.org/actrav/pubs/WCMS_647648/lang--en/index.htm

89 Franssen, M.-M., Holemans, D. (2020) Climate, Jobs and Justice For a green and socially just transition GEF Project Just Transition – Working paper, Green European Foundation. December 2020. Retrieved at: https://gef.eu/wp-content/uploads/2021/01/GEF_just-transition-paper-EN-Final.pdf

90 International Labour Organisation (2015). Guidelines for a just transition towards environmentally sustainable economies and societies for all. Geneva: ILO. https://www.ilo.org/wcmsp5/groups/public/---ed_emp/---emp_ent/documents/publication/wcms_432859.pdf

91 McCauley, D., & Heffron, R. (2018). Just transition: Integrating climate, energy and environmental justice. Energy Policy, 119, 1-7.

92 Sabato, S. & Fronteddu, B. (2020). A socially just transition through the European Green Deal?. Brussels: ETUI. https:// www.etui.org/sites/default/files/2020-09/A%20socially%20just%20transition%20through%20the%20European%20Green%20Deal-2020-web.pdf

TABLE 6

The framework of the 2015 ILO Guidelines on just transition

Greening of economies requires a coherent country-specific mix of macroeconomic, industrial, sectoral, and labour policies. The aim is to generate decent jobs along the entire supply chain with employment opportunities on a wide scale.

As the challenge cuts across several domains, sustainable development needs to be addressed across all policy fields in a coherent manner. For such a policy framework, institutional arrangements are needed to ensure the participation of all the relevant stakeholders at all levels.

Governments should:

1. Provide a coherent and stable policy framework for sustainable enterprise development and decent work for all.
2. Promote and engage in social dialogue, at all stages from policy design to implementation and evaluation and at all levels, from the national level to the enterprise, in line with international labour standards.

Social partners should:

1. Raise awareness and provide guidance among their members for the just transition framework.
2. Play an active role in the formulation, implementation and monitoring of national sustainable development policies.
3. Encourage their members to participate in social dialogue at all levels.
4. Promote the inclusion of environmental provisions through collective agreements at all levels.

Source: Galgóczi (2018). Adapted from: (Franssen & Holemans, 2020)

The Labour movement succeeded in their lobbying efforts to include some Just Transition language in the 2015 Paris Agreement on Climate Change. The inclusion of the concept in the Paris Agreement Preamble further legitimised the concept and encouraged a wider range of stakeholders to use it. This was complemented by the concept's compatibility with the agreement's voluntary and bottom-up theory of change and the wider narrative on the combined economic, social and environmental benefits of climate action, especially in the energy field (JTRC, 2018).

The launch, in 2016, of the ITUC-affiliated Just Transition Centre (JTC) signals the beginning of a new phase in its Just Transition-related efforts (in line with the Paris Agreement Voluntary narrative), reflecting a renewed commitment to collaborative industrial relations. The centre is distinct in that it closely collaborates with two global green business groupings — the B Team and We Mean Business — that are actively involved in the international climate arena. This collaboration between business interests and the JTC resulted in the publication of a Just Transition Business Guide (JTC & B Team 2018)[93].

93 JTC (Just Transition Centre) and The B Team (2018). Just Transition: A Business Guide. https://www.ituc-csi.org/IMG/pdf/just_transition_-_a_business_guide.pdf.

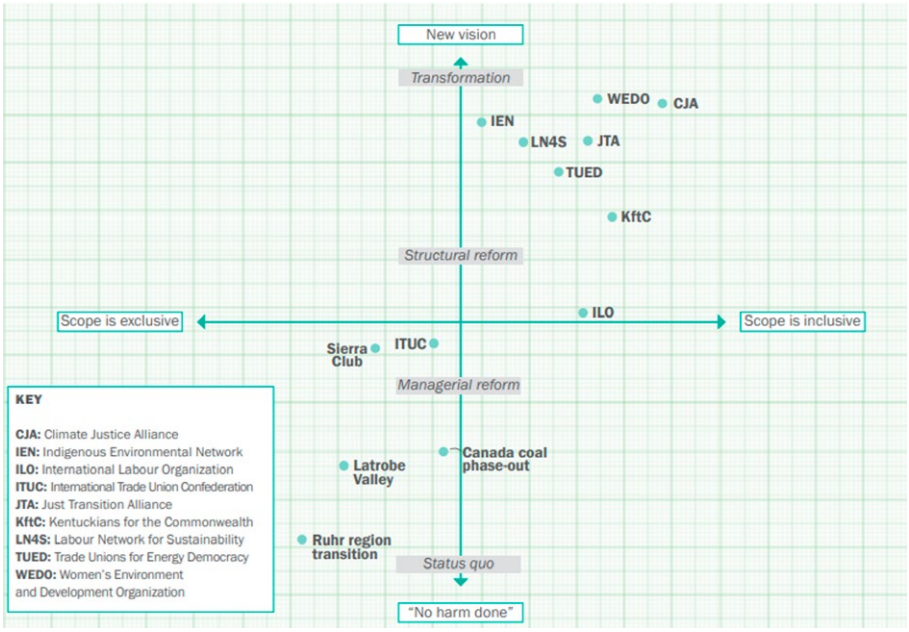
Framing Just Transition(s)

Different understandings of Just Transition also reflect actors' broader political and ideological beliefs (Goddard and Farrelly 2018[94]; Barca 2015a[95]), which in turn translate into demands that range "from a simple claim for jobs creation in the green economy, to a radical critique of capitalism and refusal of market solutions" (Barca 2015b:392[96]). Most authors situate Just Transition framings within this range. By delving into different stakeholders' approaches to Just Transition, we can further distinguish framings that are "group-" or "constituency-focused" (i.e., that place a particular group at the heart of the transition towards a low-carbon world) and others that are "sector-specific" (i.e., approaches that associate Just Transition with a specific economic sector rather than the economy as a whole) (JTRC, 2018).

Drawing on existing stakeholder and academic classifications (and in particular borrowing from Fraser [1995, 2005], Hopwood et al. [2005], as well as Stevis and Felli [2015]), the JTC Report identified four ideal-typical approaches to Just Transition. These are not distinct categories, but rather form part of a continuum ranging from those approaches that preserve the existing political economy to those that envision significantly different futures: i) status quo; ii) managerial reform; iii) structural reform; iv) transformative (JTRC, 2018).

Each of these approaches to Just Transition can be further differentiated depending on the more or less inclusive scope of the transition (Figure above). Assuming that all people eventually benefit from Just Transition initiatives (the purpose of which is to drive the necessary change towards a low carbon future), scope considers which actors or constituencies are to be directly supported in

FIGURE 26
Mapping Approaches to Just Transition



Source: Morena, E., et al., (2018)

94 Goddard, George, and Megan Farelly (2018). "Just Transition Management: Balancing Just Outcomes with Just Processes in Australian Renewable Energy Transitions." Applied Energy, 225:110–123.

95 Barca, S., (2015a). "Labour and Climate Change: Towards an Emancipatory Ecological Class Consciousness." In Refocusing Resistance to Climate Justice: COPing in, COPing out and Beyond Paris, EJOLT Report 23, edited by Leah Temper and Tamra Gilbertson, 74–78. http://www.ejolt.org/wordpress/wp-content/uploads/2015/09/EJOLT-6.74-78.pdf

96 Barca, S., (2015b). "Greening the Job: Trade Unions, Climate Change and the Political Ecology of Labour." In International Handbook of Political Ecology, edited by Raymond L. Bryant, 387–400. London: Edward Elgar

the form of some kind of resource allocation, and ranges from exclusive (benefiting a specific group) to inclusive (benefiting society as a whole).

Status Quo Approaches to Just Transition

With rising awareness and recognition of the human origins of global environmental change — and most notably climate change — a growing number of corporations and free market advocates are voicing concerns about the risks of inaction and stressing the huge business opportunities associated with a green economy. Their calls to action do not involve changing the rules of global capitalism, but rather a greening of capitalism through voluntary, bottom up, corporate and market--driven changes. States or governments are expected to provide an enabling environment for action through incentives to businesses and consumers and aspirational objectives such as the 1.5°C temperature goal laid out in the Paris Agreement.

Some of the most ardent supporters of this corporate driven transition to a low-carbon world also refer to the Just Transition concept. In particular, they recognise the need to compensate and/or provide new job opportunities to workers who will lose out because of the shift to a low-carbon economy (JTRC, 2018).

Managerial Reform Approaches to Just Transition

A managerial reform approach to Just Transition is one in which greater equity and justice is sought within the existing economic system and without challenging existing hegemony. Certain rules and standards are modified, and new ones can be created on access to employment, occupational safety and health, but the economic model and balance of power do not change.

Advocates of this approach to Just Transition recognise that the existing fossil fuel regime generates rising inequalities within fossil-dependent communities, and that existing labour standards are ill adapted when it comes to securing workers' health and wellbeing. In localities that have not produced fossil fuel products, the issue is not the legacy of the fossil fuel sector, but the lack of energy access and affordability. Under managerial reform, these groups are granted energy access but do not control it.

The ITUC, for example, pursues managerial reform that is rooted in public policies and investments. Workers and their unions are placed at the centre of their approach and the Just Transition process—as being both beneficiaries of support as well as drivers of the shift towards a low-carbon world. The ITUC's efforts are centred on labour-related and workplace related issues, but do not involve a more general questioning of the economic model. Particular emphasis is placed on social dialogue and tripartite negotiations between governments, unions and employers as the process through which rights and benefits can be secured.

A number of national unions, as well as large environmental organisations and private sector initiatives, share this approach to Just Transition. For example, the Sierra Club, which plays an important role in the BlueGreen Alliance and Beyond Coal campaign, has developed a similar understanding of Just Transition. For progressive and environmentally minded businesses and business networks, enterprise-wide planning, as well as social dialogue between unions and employers, is presented as a key means to "reduce emissions and increase resource productivity in a way that retains and improves employment, maximises positive effects for workers and local communities, and allows the company to grasp the commercial opportunities of the low-carbon transition" (JTC & The B Team 2018:2). This worker and workplace centred approach is also reflected in the ILO's Just Transition Guidelines (2015) that call for skills development, OSH measures, the protection of rights in the workplace, social protection and social dialogue (JTRC, 2018).

Structural Reform Approaches to Just Transition

A structural reform approach to Just Transition implies both distributive justice and procedural justice.

The procedural justice entails an inclusive and equitable decision making process guiding the transition, and collective ownership and management of the new, decarbonised energy system by the different stakeholders rather than by a single interest (see for example McCauley et al. 2013[97]).

In order to implement such an approach to Just Transition, an institutional change and structural evolution of the system is required. Solutions are not solely produced via market forces or traditional forms of science or technology, but emerge from modified governance structures, democratic participation and decision-making, and ownership (Healy and Barry 2017[98]). Structural reform means that the distribution of benefits or compensation is not simply granted by the powers that be, but rather, it is the result of the agency of workers, communities and other affected groups. This type of transition highlights the fossil fuel energy system's embeddedness in society and the structural inequalities and injustices that it produces (Healy and Barry 2017). The transition not only compensates the unjustly affected but reforms the institutions themselves.

This kind of reform might be found at the local level in a small, worker-owned energy cooperative, or a citizen-owned, non-profit energy cooperative. However, it also entails the implementation of new forms of governance that span political boundaries and a reassessment of not only the inequitable institutions and structures that govern energy production, but also those that have historically governed global supply chains. The Trade Unions for Energy Democracy initiative, for example, advocates for "Just Transition politics that somehow addresses the concerns of the here-and-now (worker-focused transitions) in ways that also keep the need for a transition of the entire economy in the forefront (socioeconomic transformation)" (Sweeney and Treat 2018:2[99]). However, it calls for a shift away from a social dialogue approach used by the ITUC and mainstream unions towards a social power approach guided by the belief that current power relations must be challenged and changed, and that this can only be achieved through public/social ownership and democratic control over key sectors (and in particular energy) (Sweeney and Treat 2018; JTRC, 2018).

Transformative Approaches to Just Transition

A transformative approach to Just Transition implies an overhaul of the existing economic and political system that is seen as responsible for environmental and social crises ((Hopwood et al. 2005[100]; Healy and Barry 2017). In addition to changing the rules and modes of governance, proponents of this approach also promote alternative development pathways that undermine the dominant economic system built on continuous growth and imply profoundly different human-environment relations. Several proponents advocate for a series of short-term measures in support of workers and their communities (job retraining, decent pensions with health care, job-creating community economic development), but they also insist on the need to adopt a more systems-critical approach.

While workers and work-related issues are an important part of this approach, a transformative Just Transition also involves the dismantling of interlinked systems of oppression — such as racism, patriarchy and classism — that are deeply rooted in contemporary societies.

A growing number of Just Transition framings have been broadened to include specific, often marginalised, social groups such as women, indigenous peoples, people of colour and lesbian, gay, bisexual, transgender, queer and intersex persons (see Table below) (JTRC, 2018).

97 McCauley, Darren, Raphael J. Heffron, Hannes Stephan, and Kirsten Jenkins. 2013. "Advancing Energy Justice: The Triumvirate of Tenets and Systems Thinking." International Energy Law Review, 32(3):107–116

98 Healy, N., & Barry, J. (2017). Politicizing energy justice and energy system transitions: Fossil fuel divestment and a "just transition". Energy policy, 108, 451-459.

99 Sweeney, S., & Treat, J., (2018). Trade Unions and Just Transition. The Search for a Transformative Politics. TUED Working Paper No. 11. New York: Trade Unions for Energy Democracy, Rosa Luxemburg Stiftung – New York Office and Murphy Institute. Available at: http://unionsforenergydemocracy.org/wp-content/uploads/2018/04/TUED-Working-Paper-11.pdf

100 Hopwood, B., Mellor, M., & O'Brien, G. (2005). Sustainable development: mapping different approaches. Sustainable development, 13(1), 38-52.

TABLE 7
Examples of Transformative Framings

Constituency	Just Transition Framing
Indigenous Environmental Network (IEN)	Democratic, decentralised and diversified approaches and an "indigenous-based green economy, native energy justice and democracy" as well as "community-based planning" and "meaningful work and localised community-building jobs" (IEN Just Transition Principles).[101]
Just Transition Alliance (JTA)	Inclusion and empowerment of "frontline workers and fence line communities most affected by pollution, ecological damage and economic restructuring",[102] with a particular focus on working-class people of colour.
Women's Environment and Development Organization (WEDO)	"When we refer to a just transition away from fossil fuels, we must challenge new industries to also transition away from prevailing power structures and a sexually disaggregated labour force". This implies factoring in "intersectional realities, particularly with regards to the intersections of gender, race and class disparities" (Majandra. R.A., 2016[103]). This can be achieved through gender quotas for the renewable energy sector, building capacities of female workers, childcare services, ensuring an income in case of hardship.

Adapted from: (JTRC, 2018).

Transformation is, for sure, **necessary for just transition for all**. However, **the process required to attain it is context specific and dependent upon the societal baseline,** or status quo, **from which change emerges. Common to the different interpretations of transformation is the notion of aiming for positive and progressive change that overcomes systems and structures that reproduce and exacerbate environmental problems and social injustice** (UNRISD 2016). But there is a less coherent vision of the pathways that can be followed to get there.

101 http://www.ienearth.org/justtransition/

102 http://jtalliance.org/what-is-just-transition/

103 Majandra. R.A., (2016). Gender Equality & JustTransition. Discussion Paper. Bonn: WEDO. https://wedo.org/wp-content/uploads/2016/08/gj-transition.pdf

Just Transition and Pro-Poor Approach to Planetary Stewardship

Despite the concrete global appeals to promote Sustainable Development Goals and implement a just transition to a zero carbon emissions economy, **we do not consider the current volunteer approaches as a sufficient condition to succeed and manage all trade-offs between the environment, social welfare and economy. On the contrary, following Kashwan at al. (2020)[104] we recommend the establishment of a powerful state and non-state actors governance, across all scales of governance, abiding by a principled and oriented pro-poor planetary justice transition** and the following three tenets:

I. That the poor and marginalised majority shall not be made worse off;
II. That the lot of the poor must improve;
III. That the poor be recognised as legitimate participants (whether directly or via representation) in decisions about planetary stewardship.

These three tenets have both a distributive/substantive and a representational/procedural component and are an extra layer of legitimacy to pursue local and global planetary stewardship efforts. Five concrete and convergent steps must be taken to fulfil this type of a pro-poor transition agenda:

- **First, promoting robust international institutional frameworks that explicitly focus on supporting the interests of the poor** in the design and implementation of climate mitigation strategies and plans. For example, institutional arrangements that lead to large-scale unemployment would have to be accompanied by compensatory mechanisms, such as the provision of basic income for the poorest (Kashwan at al. 2020).

- **Second, pro-poor policies are also crucial for securing the integrity of local socio-ecological systems.** Here, innovations developed by indigenous people and peasants often offer some of the best tools in today's climate--changed world. Examples are systems of controlled fire interventions, ethics of landscape conservation, and agroecological systems of food production (Perfecto and Vandermeer, 2010[105]) (Kashwan at al. 2020).

- **Third, promoting broad social coalitions, including the middle classes in order to change the overconsumption basis of the economic systems and promote a pro-poor planetary justice.** For instance, behavioural change across four major categories — food, agriculture and land management, transportation, and energy and materials — could contribute to as much as 19% to 38% in emission reductions, compared to a reference case of projected cumulative emissions from 2020-2050 (Williamson et al., 2018). Such fundamental transformation in patterns and practices of consumption must be promoted by structural reforms in the economy so that the burden does not fall disproportionately on the poor (Kashwan at al. 2020).

- **Fourth, investing in key sectors that are central to securing the basic dignities for the world's poor and marginalised majorities:** food, water, energy, and infrastructure. The characteristics of global food production illustrate the challenges of radical transformations in these sectors: a select few multinational corporations control nearly all the global food business and consume 75% of the energy requirements of the entire food sector, but they feed a much smaller proportion of the world's population (GRAIN & IATP, 2018[106]) (Kashwan at al. 2020).

104 Kashwan, P., Biermann, F., Gupta, A., & Okereke, C. (2020). Planetary justice: Prioritizing the poor in earth system governance. Earth System Governance, 6, 100075.

105 Perfecto, I., & Vandermeer, J. (2010). The agroecological matrix as alternative to the land-sparing/agriculture intensification model. Proceedings of the National Academy of Sciences, 107(13), 5786-5791.

106 GRAIN & IATP. (2018). Emissions impossible—How big meat and dairy are heating up the planet

- **Fifth, ensure, by legal and institutional means, that international support is not funnelled into serving the interests of global corporations or the political and economic elites in the Global South.** Making governments and corporations accountable, fostering mechanisms of transparency, access to information, participation in decision making processes and fighting against corruption are conditions necessary for success.

In order to implement such a pro-poor approach to just transition, one of the major challenges remains the participation and voice of the poor in the democratic processes of deliberation and decision-making. A special recommendation to the UN and International Organizations, the European Union, national governments, private sector actors and civil society organizations is the need to truly reform the poor's representativeness in deliberative and decision-making processes across the international, regional, national and local scales. In order to do so, we must promote a more inclusive democratic behavior on the procedural, distributional and discursive representation (Sénit & Bierman[107]):

- **Procedural representation.** How do governance institutions conduct representation, consultation processes, decision-making processes and compensation/reparation instruments?

- **Distributional representation.** Promoting greater inclusiveness and diversity of worldviews, cultures, religions, social and economic status and gender in local, national and global institutions.

- **Discursive representation.** How the diversity of worldviews is present in the official discourse of the multilateral and international organisations, national delegations and the major groups of civil society organisations. At the global level, it is necessary to reinforce the representativeness of the Global South, especially the Least Developing Countries, at both the government and civil society level. At the national level, gender equity and the participation of minorities, indigenous people and the most vulnerable people is also decisive.

Just Transition Policy Instruments

The implementation of transformational and pro-poor just transition needs concrete policy instruments to address the unavoidable trade-offs of a complex interconnected network of actions needed to reconcile the pro-poor approach, the earth stewardship, and build the strategic broader alliances (including developed and developing countries' middle classes, inclusive and sustainable corporate business) to support the overall transition.

Before trying to classify the policy instruments, it is necessary to define the Just Transition, not in terms of objectives and ambitions, but in terms of its basic functions, independently of the theoretical and ideological framework guiding their implementation. In simple terms, ***we can define "Just Transition" as a public policy concerning the procedural and substantive entitlements of a defined class of agents who have been or are expected to be made worse-off because of a structural change in the economy.***

The two dimensions of transition policy — substantive and procedural — can further be defined, in relation to climate change, as:

- a) the nature, scope and magnitude of transitional assistance (if any) to be provided to a class or classes of agents made worse-off as a result of a climate change mitigation-related structural change in the economy (substantive dimension); and

- b) the nature, scope and magnitude of consultation or other participatory procedure to be engaged in by the relevant government with affected agents in respect of the content of proposed climate policies (if applicable) and/or the substantive component of transition policy

107 Sénit, C. A., & Biermann, F. In Whose Name Are You Speaking? The Representation of the Poor in Global Civil Society.

(procedural dimension) (Green, F., 2018[108]). As we saw before, this procedural dimension of a deliberative democracy must also guarantee a diversity and discursive representation.

The available policy instruments can be organized as a function of both, the policy options and the agents affected by/affecting the transition (Green, F., 2018). From the above definition, numerous policy design elements (Schneider & Ingram 1997[109]) are identifiable: the class(es) of agents to be targeted by the transition policy; (ii) the scope of transitional assistance to be provided or the procedure to be engaged in (which relates to what it means to be made "worse off" as a result of a relevant structural change); and (iii) the nature and magnitude of assistance to be provided or the procedure to be engaged in (which relates to the policy's objectives, instruments and rationale) (Green, F., 2018).

The implementation of a public policy is shaped by a set of policy objectives and policy instruments. The objectives and scope of transitional assistance depend on the correct identification of the target agents, but they also depend on the supporting theory of change and ideology. Together these elements will determine the ambition and extent of the assistance, but their implementation is, in general terms, served by different combinations of four classes of policy instruments: Compensation, Exemption, Structural adjustment assistance and Holistic adaptive support. According to Fergus Green we can define these categories as follows:

I. **Compensation:** this category covers instruments involving monetary payment to an agent to mitigate financial losses incurred by the agent. This could include, for example: public funded early retirement, redundancy or special unemployment payments to workers; compensation payments to firms for lost business asset values; compensation to households for increased costs of living or reduced value of household investments (e.g. energy inefficient homes, vehicles or appliances); basic income schemes, and compensation to local authorities for lost tax revenue Green, F., 2018).

II. **Exemption:** legal exemptions from climate change laws include various mechanisms built into the design of the climate change law that temporarily or permanently, partially or fully, exempt a class of agents from the application of the new law, thus de facto maintaining the pre-reform legal position of that class of agents. Possible options include "grandfathering" of the agent's interests, "postponed implementation" of the policy/law, or "graduated implementation" of the policy/law insofar as it applies to those agents (Trebilcock 2014[110]).

III. **Structural adjustment assistance:** This category involves monetary payments or in-kind assistance to facilitate agents' adjustment to the new market conditions that exist because of the structural change. For example, this could include wage subsidies, subsidised education/training, and relocation assistance for workers; subsidies to firms to purchase energy-efficient or low carbon technology; subsidies to households to purchase energy-efficient or low-carbon household assets; or investment in local-level public goods (infrastructure, innovation, skills) to facilitate economic activity in new (less-carbon-intensive) industries (Green, F., 2018).

IV. **Holistic adaptive support:** this category includes financial or in-kind support to assist the agent to mitigate or adapt to the full range of recognised losses, not merely financial losses but the loss of a wider set of resources or functionings that has been diminished, including non-financial external resources, intrinsically valued goods, and mental and physical functionings. There is a wide range of possible assistive

108 Green, F. (2018), Transition policy for climate change mitigation: who, what, why and how, CCEP Working Paper 1807, July 2018. Crawford School of Public Policy, The Australian National University.

109 Schneider, A. L., & Ingram, H. M. (1997). Policy design for democracy. University Press of Kansas.

110 Trebilcock, M. J. 2014. Dealing with Losers: The Political Economy of Policy Transitions. Oxford: Oxford University Press.

instruments here, which may include things like: comprehensive transition planning; counselling and other social services to workers and their families; investments that support worker-reemployment in industries of a similar social standing, in a similar industry and/or in the same community; and investments in community social, cultural and environmental goods (i.e. not merely economic goods) (Green, F., 2018).

Recommendations for ethical criteria to choose Policy Transitions

As we saw previously, policymaking is a process that requires a procedural interactivity with a diverse range of stakeholders, particularly the poorest and most affected by the climate change, digitalisation and circular economy policies. As such, instead of identifying the "first-best" ideal solutions a priori, the procedural representativeness and inclusive decision-making approach highlights the negotiated "second or third-best" options that stakeholders can agree on, in order to guarantee a broad alliance to the transition path. In order to navigate this participatory and inclusive decision-making process, three selection criteria are well placed as guidance for policymakers, in a principled just transition: i) "fairness", ii) "transformative political potential", and iii) "expected effectiveness".

I. **Fairness** is ethical or normative political justification for transition policy

As discussed before, there is no consensus or consistency within the normative debate over structural or transformational transitions. However, there are several basic questions, aiming at an ethical minimum that can be transversal to any serious attempt to guide a just transition: What is the expected effect of a transition policy choice on the distribution of well-being? How is well-being defined for this purpose? Under what conditions and for what reasons are individual persons justified in receiving transitional assistance? Given that transitions also create benefits and winners, how should the risks (positive and negative) of legal change and other kinds of structural change be allocated across society? What kinds of behaviour should transition policy reward and encourage? What, if anything, normatively justifies giving transitional assistance to corporations or to collectives such as "communities"? When are agents' expectation of structural (including legal) continuity legitimate, and how should this affect their entitlement to transitional assistance? Answers to these questions will vary. However, it is suggested that transition policy should be guided by the following principles (Green, F., 2018):

- We should understand the impacts of structural transitions on individual human well-being in terms of a version of the capability approach, according to which well-being is understood as people's real opportunities to achieve valued functionings (functionings are "beings and doings") (see Nussbaum 2000[111]; Robeyns 2016[112]; Sen 1999[113]) and real opportunities are understood in terms of people's internal resources (e.g. natural abilities, aptitudes, skills), *external resources* (e.g. money, property, support networks) and *structural conditions* (e.g. material structures, laws, formal power relations, and cultural and social norms) (Green 2017[114]; Wolff and De-Shalit 2007[115]).
- Transition policy should respect agents' expectations of structural continuity only where these expectations are reasonable. Reasonableness should be interpreted in

111 Nussbaum, M. C. (2001). Women and human development: The capabilities approach (Vol. 3). Cambridge University Press.

112 Robeyns, I., (2016). "The Capability Approach." In The Stanford Encyclopedia of Philosophy, ed. Edward N. Zalta. The Metaphysics Research Lab, Center for the Study of Language and Information (CSLI), Stanford University.

113 Sen, A., (1999). Development as Freedom. Oxford: Oxford University Press.

114 Green, F., (2017). "What Should Change and What Should Stay the Same? Using Capabilities to Compare the Impacts on Well-Being of Climate Change and Measures to Mitigate and Adapt to It." In ECPR General Conference, Panel on the Ethics of Climate Change Adaptation, Oslo.

115 Wolff, J., & De-Shalit, A. (2007). Disadvantage. Oxford university press on demand.

light of (i) agents' relevant social roles (e.g. corporation, investor, worker, citizen) and the social practices and standards of excellence with which they are associated in the relevant context, and (ii) systematic differences in individuals' capabilities that are relevant to their performance of standards associated with those roles, including the capability to self-insure against risks associated with structural changes (e.g. through diversification, hedging and third-party-provided insurance). These considerations imply, for example, that corporations (and other group agents) should be treated very differently from natural persons; that shareholders should be treated differently from workers and households; and that high--capability householders, workers and shareholders should be treated differently from those already more disadvantaged. Indeed, persons who are the most vulnerable to the impacts of transition should receive special attention in transition policy (Green, F.2018).

- Special attention in transition policy should also be paid to potential "shocks", where shocks are understood as transitions that cause sudden and severe losses in well-being.

- Transition policy responses, where justifiably provided, should be appropriate to the kind of loss incurred.

- Transition policy responses should take into account the distribution of costs necessary to finance such responses. Transitional assistance will often involve allocating resources from a government's consolidated revenue fund to particular agents or groups, and these resources have an opportunity cost. For transitional assistance to be normatively justified "all things considered", this wider distributive trade-off has to be included in the normative analysis.

- In some cases, it may be more efficient or otherwise normatively preferable to target transition policy responses at the community or other group level (e.g. as with investment in regionally specific public goods). In such cases, particular attention should be paid to the value of structural conditions (e.g. material infrastructure, institutional arrangements) to the flourishing of individual community members (Green, F.2018).

II. Political transformational potential

As we said before, in order to succeed in the implementation of ambitious climate mitigation policies, the concrete plans must help to create new and broad alliances capable of supporting ambitious policies. Again, the interpretation and application of this criterion will be highly context sensitive. Nonetheless, it is suggested that **assistance to three of the potential target groups of transition policy warrant particularly close consideration in respect of this criterion: workers, households, and communities. It appears possible that well-designed transition policy benefiting these groups could facilitate the cultivation of a coalition of support for decarbonisation policy that is economically and politically sustainable over the long term of a transition. By contrast, providing assistance to corporations appears likely to achieve only narrow, short-term climate policy wins that entrench the power of energy- and emissions-intensive businesses while setting a precedent that could lead to extremely expensive transition payments over the long run if climate change is to be addressed at sufficient scale** (Menezes, Quiggin, 2009[116]; Green, F., 2018).

III. Expected Effectiveness

The third suggested selection criterion for transition policy is "expected effectiveness", which simply means the likelihood that the chosen transition policy, once enacted, will achieve its stated goals.

The effectiveness of different transition policies will vary from context to context, but we can state some

116 Menezes, F., Quiggin, J., & Wagner, L. (2009). "Grandfathering and Greenhouse: The Role of Compensation and Adjustment Assistance in the Introduction of a Carbon Emissions Trading Scheme for Australia." Economic Papers: A journal of applied economics and policy 28(2): 82–92.

general theoretical expectations. **Backward looking policies (compensation and exemption) will tend to be administratively simple to implement, requiring less in the way of institutional capacity. Yet the narrowness of the objectives of such programmes threatens to undermine their fairness and political transformation potential. Forward-looking policies (structural adjustment assistance and holistic adaptive support) have more ambitious objectives and greater potential to be fair and transformative, although they are more complex to implement and require greater institutional capacity to succeed.**

Governments typically require not merely the financial resources and hierarchical authority to "push" new policies and technologies, but also the capacity to steer long-term, participatory, cooperative processes that empower diverse local actors to recombine their existing knowledge, skills and competences in new ways. These may include the capacity to experiment with new governance processes, to broker dialogue among the various actors, to build or reconfigure networks, to disseminate information, and to facilitate shifts in cultural norms and worldviews (Campbell & Coenen 2017, 5–12).

Of course, much of the above analysis assumes that policymakers in the relevant government are at least motivated themselves to pursue both a low-carbon transition and (fair and politically transformative) transition policy. Yet, the relationship between government and vested interests can be a major barrier to effective transition policy (Green, F., 2018).

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Investors and Just Transition: Providing some Guidance

For this chapter on guidance to investors on climate change and just transition, we will follow closely the guide published in 2018 by the Grantham Research Institute on Climate Change and the Environment (Robins, N., Brunsting, V., & Wood, D., 2018)[117].

The critical need for the transition to be both fast and fair is recognised in the Paris Agreement. The evidence shows that the shift to a resilient, low carbon economy will boost prosperity and be a net driver of job creation. There will be transitional challenges, however, for workers, communities and countries as this shift takes place. To address this, investor strategies to tackle the growing threat of climate change need to incorporate the full range of environmental, social and governance (ESG) dimensions of responsible investment. As fiduciaries, investors can make an important contribution to achieving a just transition, as stewards of assets, allocators of capital, and as influential voices in public policy.

117 Robins, N., Brunsting, V., & Wood, D. (2018). Climate Change and the Just Transition: A guide for investor action. *Centre for Climate Change Economics and Policy, Grantham Research Institute on Climate Change and the Environment, and Initiative on Responsible Investment* Retrieved at: https://sustainabledevelopment.un.org/content/documents/22101ijtguidanceforinvestors23november1118_541095.pdf

FIGURE 27

Reasons for investor action on the just transition

Source: Robins, N., Brunsting, V., & Wood, D., (2018), p.4.

Five motivations for investor action

The case for investor action rests on five strategic motivations. These are aligned with core duties and interests and also show that contributing to the just transition is a way for investors to deliver positive social and environmental impacts.

I. **Broadening the understanding of systemic risks** from climate change, by factoring in issues such as social exclusion and increasing inequality.

II. **Reinvigorating fiduciary duty** by better capturing the interrelated environmental and social drivers of long-term performance and by taking better account of beneficiary interests in sectors and regions affected by the transition.

III. **Recognising material value drivers** in terms of corporate practices in the workplace and the broader social license to operate; business performance will be increasingly conditioned by the just transition.

IV. **Uncovering investment opportunities** that combine climate and social goals such as inclusive growth, identified through the lens of the just transition.

V. **Contributing to societal goals**, including existing responsibilities to respect international human rights and labour standards as well as new ways of realising the Sustainable Development Goals.

FIGURE 28

The just transition: five action areas for investors

Source: Robins, N., Brunsting, V., & Wood, D., (2018), p.5.

Five areas for investor action

Based on these motivations, there are five areas for action through which investors can make the just transition part of their core operating practices

I. **Investment strategy:** Assessing exposure to the social dimension (including employment impacts) of the transition, pursuing dialogue with workers and other key stakeholders, and integrating just transition factors into investment beliefs and policies.

II. **Corporate engagement:** Including just transition factors in investor expectations, requesting disclosure, benchmarking performance, and pressing for improvement. The guide provides an initial set of questions for corporate engagement.

III. **Capital allocation**: Incorporating the social dimension into strategies for climate investment across all asset classes, including listed equities, bonds, private equity and real assets.

IV. **Policy advocacy and partnerships:** Making the just transition a part of policy dialogue at subnational, national and international levels as well as taking part in place-based partnerships.

V. **Learning and review:** Understanding emerging lessons and disclosing results so that the efficiency and effectiveness of investor action on the just transition continue to improve.

Where can investors start?

Key next steps include:

- **Incorporate** the just transition into policy on responsible investment and climate change.
- **Integrate** the just transition into the procurement of investment services across all asset classes.
- **Engage** with companies to include the just transition within climate strategies, covering critical workplace issues, as well as supply chain management and community relations.
- **Participate** in place-based initiatives to channel capital into community renewal and regional diversification through investments with positive social and environmental impacts.
- **Promote** disclosure by companies, asset owners and asset managers using the framework of the Task Force on Climate-related Financial Disclosures (TCFD) and extending this to include the social dimension.

ENVIRONMENTAL, SOCIAL AND CORPORATE GOVERNANCE AND HUMAN RIGHTS DUE DILIGENCE

Sustainability Corporate Governance and the EU – An evolving Legislative Framework

The Policy Context for an EU Sustainability Corporate Governance (EU SCG)

The political guidelines of the EU Commission foresee a strong focus for the EU to deliver on the UN Sustainable Development Goals, and the EU submitted its strategy for climate neutrality by 2050 to the United Nations Framework Convention on Climate Change in March 2020. On April 21st, 2021, the Council's and the European Parliament's negotiators reached a provisional political agreement setting into law the objective of a climate-neutral EU by 2050, and a collective, net greenhouse gas emissions reduction target (emissions after deduction of removals) of at least 55% by 2030 compared to 1990 (Council of the European Union, 2021[118]). The Communication on the European Green Deal (European Commission, 2019[119]) sets out that "*sustainability should be further embedded into the corporate governance framework, as many companies still focus too much on short-term financial performance compared to their long-term development and sustainability aspects.*" Sustainability encompasses encouraging businesses to frame decisions in terms of environmental (including climate, biodiversity), social, and human impact for the long-term, rather than on short-term gains. The sustainable corporate governance initiative was listed among the deliverables announced in the Action Plan on a Circular Economy, the Biodiversity and Farm to Fork strategies and would be part of the renewed Strategy on Financing Sustainable Growth. The Communication "Europe's

118 Council of the European Union. (2021, May 5). *European climate law: Council and Parliament reach provisional agreement*. European Council. https://www.consilium.europa.eu/en/press/press-releases/2021/05/05/european-climate-law-council-and-parliament-reach-provisional-agreement/

119 European Commission. (2019, December 11). *Communication on The European Green Deal*. European Commission - European Commission. https://ec.europa.eu/info/publications/communication-european-green-deal_en

moment: Repair and Prepare for the Next Generation" also announces this initiative with the objective to "ensure environmental and social interests are fully embedded into business strategies", in the context of competitive sustainability contributing to the Covid-19 recovery and to the long-term development of companies. The initiative is complementary to the review of the Non-Financial Reporting Directive which requires certain large public-interest companies to disclose sustainability-related matters.

Problems to Tackle with the EU SCG Initiative

A new study (Smit, L., et al.2020[120]) shows that many companies, in particular those listed on regulated markets, face pressure to focus on generating financial return in a short timeframe and redistribute a large part of the income generated to shareholders, which may be to the detriment of the long-term development of the company, as well as of sustainability. **Short-term focus on corporate directors' remuneration incentivises improving share price performance, and corporate income distribution patterns show a strong trend towards declining investment. Between 1992 and 2018 the ratio of total shareholder pay-outs — i.e. dividend payments and share buybacks — to corporate net income, increased from 20% to 60% in listed European companies. Simultaneously, business investment — in terms of the ratio of capital expenditure and research and development spending to net income — has declined by 45% and 38% respectively.** Over the last two decades, these indicators seem to have stabilised around high levels of pay-outs and low investment intensity.

This **trend appears to be stable across the EU**. Thus, **it may hamper investment crucial for the sustainability transition, into productive facilities, innovation, upgrading and employee retraining, upskilling and reskilling. It may also contribute to income inequality as short-termism creates pressure to depress non-executive wages and employees often do not benefit from shareholder pay-outs. It may have an impact on the resilience of companies, including in the Covid 19 crisis.** On the other hand, a meta study (Friede, Bush & Bassen, 2015[121]) of 2000 studies shows that companies performing well on sustainability factors outperform their peers and are more competitive. New research about the Covid-19 crisis (Ding, et al. 2021[122]) also shows that companies with better social and environmental performance are more resilient in the crisis.

However, pressure to focus on short-term financial performance reduces companies' ability to integrate sustainability considerations adequately into business strategies and decisions. This has two aspects: on the one hand, companies do not properly identify and address climate change and other environmental, social and human rights (including workers' rights, child labour etc.) risks and impacts in their operations and supply chains. Many EU companies are sourcing supplies from entities based in countries with lesser social, human rights or environmental standards and the identification and mitigation of related risks and impacts is weak. On the other hand, companies fail to integrate potential new opportunities either for investment or for building resilience. While several large companies are frontrunners, most corporate strategies are rarely elaborated with proper measurement or aligned with science-based targets such as, for example, the goals of the Paris Agreement on climate change. In addition, frontrunner businesses face issues of a level playing field, which could hamper their leading efforts in the long run.

The drivers of these problems are both market and regulatory failures. **Though (national) company laws in essence require corporate boards to act in the interest of the company as a whole, the company interest and directors' duties are interpreted narrowly favouring maximisation of short-term financial value. Shareholder pressure also plays a role as does the directors' remuneration linked to financial performance.**

120 Smit, L., Bright, C., McCorquodale, R., Bauer, M., Deringer, H., Baeza-Breinbauer, D., ... & Heasman, L. (2020). Study on due diligence requirements through the supply chain: FINAL REPORT [Country Reports were authored by Lia Heasman (Denmark, Finland and Sweden)]. Available at: https://op.europa.eu/en/publication-detail/-/publication/8ba0a8fd-4c83-11ea-b8b7-01aa75ed71a1/language-en

121 Friede, G., Busch, T., & Bassen, A. (2015). ESG and financial performance: aggregated evidence from more than 2000 empirical studies. Journal of Sustainable Finance & Investment, 5(4), 210-233.

122 Ding, W., Levine, R., Lin, C., & Xie, W. (2021). Corporate immunity to the COVID-19 pandemic. Journal of Financial Economics.

This market failure has been facilitated by shortcomings in corporate legislation and governance codes as they foster directors' accountability towards shareholders and do not sufficiently cover the interest of other stakeholders, including those affected by the company and the local and global environment. Furthermore, the legal framework lags behind the development of global value chains and corporate structures when it comes to the responsibility of a limited liability company for identifying and preventing harm in its group-wide operations and production channels. Relevant national law standards and requirements for companies differ among EU Member States.

These market failures enable companies, including EU Companies, to avoid liability for their harmful impacts on local communities, either by hiding behind the 'corporate veil' (when they act through subsidiaries and companies they control) or by exploiting weak and poorly enforced domestic regulation in developing countries, or by abusing the international investors' protection system. In other cases, the development of global supply chains has unintended harmful effects, such as when independent local suppliers enter into a race to the bottom to secure their share of the market. Such was tragically the case when the Rana Plaza factory collapse in Bangladesh in 2013 killed over 1 000 people. Negative impacts of this kind, ranging from environmental disasters and land grabbing to serious violations of labour and human rights, are often in the news (European Parliamentary, Research Service, 2021[123]).

Sustainability Corporate Governance towards a Stringent Legislative Binding Approach

The preferred approach to encouraging multinational companies to step up to this role has until now been based on voluntary action. It was expected that multinational companies would voluntarily conduct due diligence in order to avoid reputational damage and improve their standing with workers and customers. Several international frameworks have been established as guidance, to encourage multinational companies to prevent negative human rights impacts, and when they occur to mitigate and remedy them. In 2011, the United Nations Human Rights Council unanimously endorsed the Guiding Principles on Business and Human Rights (UNGPs) establishing the first global framework outlining the duties and responsibilities of governments and business enterprises, to prevent, address and remedy the impacts of globalised business activity on human rights. The UNGPs are based on three pillars that outline how states and businesses should implement them:

- Pillar I: The state duty to protect human rights
- Pillar II: The corporate responsibility to respect human rights
- Pillar III: Access to remedy for victims of business-related abuses.

Of the 31 guiding principles outlined, principles 17 to 21 refer to the human rights due diligence to be conducted by companies. Academics and civil society organisations have criticised the UNGPs on account of their voluntary nature,[124] showing that most companies do not voluntarily undertake human rights due diligence. Recognising the fact that the voluntary approach promoted by the UNGPs is insufficient, international negotiations in the UN framework on the drafting of an international binding treaty on business and human rights have started. At the current stage of negotiations, the draft treaty puts mandatory due diligence at the heart of its approach. It requires 'State Parties [to] adopt measures necessary to ensure that all persons conducting business activities, including those of transnational character, undertake human rights due diligence'. (European Parliamentary, Research Service, 2021)

The OECD Guidelines for Multinational Enterprises (2011 update[125]) and the International Labour Office's ILO Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy (2017

123 European Parliamentary Research Service. (2021). Towards a mandatory EU system of due diligence for supply chains - Think Tank. Retrieved April 21, 2021, from https://www.europarl.europa.eu/thinktank/en/document.html?reference=EPRS_BRI(2020)659299

124 See European Parliament, DG External Policies, Implementation of the UN Guiding Principles on Business and Human Rights, External Study, 2017.

125 Available at: http://mneguidelines.oecd.org/guidelines/

update[126]) also set voluntary standards for companies regarding due diligence. The OECD Guidelines, which are backed by 44 governments, mainly from developed countries, is the only instrument to outline business responsibility for all relevant thematic areas, including human rights and labour rights, as well as information disclosure, the environment, bribery, consumer interests, science and technology, competition, and taxation. They were initially drafted in 1976 and have been revised several times. The last update introduced a new human rights chapter in line with the UN Guiding Principles on Business and Human Rights and a new approach to due diligence and responsible supply chain management.

In a resolution of 17 April 2020 on EU coordinated action to combat the Covid-19 pandemic and its consequences, the European Parliament[127] expressed its conviction "that corporate human rights and environmental due diligence are necessary conditions in order to prevent and mitigate future crises and ensure sustainable value chains".

Existing EU legislation and other initiatives: Lessons learnt

The EU has adopted binding legislation and voluntary initiatives to address human rights and environmental violations in the sectors traditionally worst affected, such as the extractive industries, timber, garment and leather industries. The EU has also been actively involved in international initiatives, such as the Kimberley process[128], to stop the trade in 'blood diamonds' (diamonds extracted by armed groups and traded to finance deadly conflicts), as well as in OECD efforts to design guidance for various sectors (European Parliamentary, Research Service, 2021).

Conflict minerals regulation

Certain valuable metals and metal ores have driven conflict in their areas of extraction and even beyond, particularly in Central Africa, enabling rebel groups to finance military operations. They are thus considered potentially responsible for severe human rights violations, affecting miners and, more broadly, local communities. These products end up in electronic products, such as mobile phones or car components, used in the EU on a daily basis. To stop these abuses, in May 2017, after a complex legislative process in which Parliament proposed important changes to the initial text drafted by the Commission, establishing a compulsory certification scheme (rather than voluntary self-certification), the European Union adopted Regulation (EU) 2017/821[129]. The Regulation lays down supply chain due diligence obligations for Union importers of tin, tantalum and tungsten, their ores, and gold originating from conflict-affected and high-risk areas. EU importers of tin, tantalum, tungsten and gold must check that the minerals or metals they buy do not contribute to conflict, forced labour or other illicit activities. The regulation requires importers to follow the five-step framework established by the OECD:

- establish strong company management systems;
- identify and assess risk in the supply chain;
- design and implement a strategy to respond to identified risks;
- carry out an independent third-party audit of supply chain due diligence;
- report yearly on supply chain due diligence.

The EU regulation entered into force in January 2021. While its impact cannot yet be assessed, similar US legislation (Dodd-Franck Act Section 1502) has engendered substantial controversy regarding unintended negative effects (Bloem, 2019[130]). The negative effects

126 Available at: https://www.ilo.org/wcmsp5/groups/public/---ed_emp/---emp_ent/---multi/documents/publication/wcms_094386.pdf

127 See at: https://www.europarl.europa.eu/doceo/document/TA-9-2020-0054_EN.pdf

128 See more information at: https://ec.europa.eu/fpi/what-we-do/kimberley-process-fight-against-conflict-diamonds_pt

129 Available at: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32017R0821

130 Bloem, J. R. (2019, November 25). The Unintended Consequences of Regulating 'Conflict Minerals' in Africa's Great Lakes Region: Guest Post by Jeffrey R. Bloem. World Bank Blogs. https://blogs.worldbank.org/impactevaluations/unintended-consequences-regulating-conflict-minerals-africas-great-lakes-region

of the application of the US legislation highlighted by some researchers include "the loss and displacement of the mineral trade from communities, said to support between 8-10 million people" causing poverty and infant mortality to increase, as well as the "creation of monopolies in the form of mining cooperatives ... under the control of local strongmen, but also [of] international actors", driving wages down. However, the extent of such harmful effects is disputed by other researchers (Koch & Kingbergen, 2018[131]) who point to the positive impact. Further concerns refer to the possible relocation of extraction activities to other countries, with a potentially severe socio-economic effect on local communities (European Parliamentary, Research Service, 2021).

Timber Regulation

Regulation (EU) No 995/2010 of the European Parliament and of the Council of 20 October 2010[132] laying down the obligations of operators who place timber and timber products on the EU market entered into force in March 2013. It takes measures to stop the trade in illegally harvested timber and timber products. The regulation applies to both imported and domestically produced timber and timber products. It requires EU traders who place timber products on the EU market for the first time to exercise 'due diligence'. Under the regulation, due diligence refers to a system of measures and procedures to minimise the risk of placing illegally harvested timber and timber products derived from such timber on the internal market. The due diligence system includes three elements inherent to risk management: access to information about the origin of wood, risk assessment, and mitigation of the risk identified. Enterprises selling or buying timber already on the EU market have to keep records that trace the origin of the wood. Timber or timber products carrying certain certifications (valid FLEGT license[133] or CITES permit[134]) are automatically considered to comply with the requirements of the regulation (European Parliamentary, Research Service, 2021).

EU Non-financial Reporting Directive (NFRD)

Directive 2014/95/EU[135] requires large companies from 2018 onwards to publish information on the policies they implement in relation to environmental protection, social responsibility and the treatment of employees, respect for human rights, anti-corruption and bribery, and diversity on company boards, including on due diligence procedures throughout the supply chain with a view to addressing existing and potential negative effects. The NFRD does not impose a legal obligation on EU companies to undertake human rights due diligence; however, if they do, they are required to provide information on it. It also requires them to give the reasons why they do not undertake it if that is the case. The Commission has indicated the first quarter of 2021 as the target date for the review of the Non-financial Reporting Directive in 2020. Between February and June 2020, the Commission held a public consultation in this respect. According to civil society organisations, there are serious shortcomings[136] with the implementation of this directive: more specifically, companies fail to report properly on their human rights risks, impacts and due diligence, while the national competent authorities are not fulfilling their supervisory and enforcement role adequately. These findings reveal that the voluntary due diligence[137] approach is insufficient (European Parliamentary, Research Service, 2021).

EU voluntary approaches with third countries

The EU has also promoted voluntary approaches with a focus on specific sectors, namely the garment, textile and

131 Koch, D. J., & Kinsbergen, S. (2018). Exaggerating unintended effects? Competing narratives on the impact of conflict minerals regulation. Resources Policy, 57, 255-263.

132 Available at: https://ec.europa.eu/environment/forests/timber_regulation.htm

133 See https://www.flegtlicence.org/ for more information.

134 See the Practical Guide to CITES. NEPCon - Preferred by Nature. Retrieved April 21, 2021, from https://preferredbynature.org/library/articles/thematic-article-no3-practical-guide-cites

135 Directive available at: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32014L0095

136 See European Coalition for Corporate Justice (ECCJ) report, available at: http://corporatejustice.org/wp-content/uploads/2021/04/2020_eccj_nfrd_update_1.pdf

137 A 2019 study by the European Alliance for Corporate Transparency showed that while 90% of the European companies surveyed expressed a commitment to respect human rights, only 36% described their human rights due diligence system (but not always according to the UNGP reporting standard). The same study found that 90% of companies had no description of the risks their operations posed to human rights; 48% had a 'vague' description; while only 26% had a clear statement of salient issues. Study available at: http://www.allianceforcorporatetransparency.org/

leather industry,[138] with the main objective of fostering improvements in the medium to long term in environmental impacts and working conditions in producing countries. The approach adopted by the Commission, as outlined in the staff working document (SWD) 'Sustainable garment value chains through EU development action', involves extensive development cooperation with the countries concerned as well as the provision of development aid to various projects in the area. According to the SWD, there is "a large number of EU financed projects and programmes in direct support of more sustainable garment, textiles, and related supply chains across partner countries such as Bangladesh, Cambodia, India, Lesotho, Madagascar, Myanmar, Pakistan and Vietnam". For example, the ongoing (2019-2020) Trade for Decent Work Project[139] jointly established and managed by the EU and the International Labour Organization (ILO) aims at improving application of ILO fundamental conventions and working conditions in EU trading partner countries. The project has started with Bangladesh, Myanmar and Vietnam. Although the primary focus is not on improving due diligence by EU-based multinational enterprises, it does contribute to this through its awareness raising on labour and human rights, and efforts to strengthen responsible value chains and improve and supply chain transparency and traceability (European Parliamentary, Research Service, 2021).

Due diligence legislation at national level

There are several examples of mandatory due diligence legislation in EU and non-EU countries, but they focus on specific sectors (extractive industries — US 2010 Dodd-Frank Act Section 1502)[140] or on particular human rights violations, such as child labour (Dutch law[141]) or forced labour (United Kingdom 2015 modern slavery law[142]). The only national legislation to adopt a cross-sectoral approach is the French 2017 law[143] on the duty of vigilance, which requires all large French companies (with over 5 000 employees in France and over 10 000 in the world) to undertake due diligence with regard to the companies they control, and all their contractors and suppliers. The French law requires companies to develop a vigilance plan in consultation with trade unions. Companies that do not fulfil their due diligence obligations are liable to sanctions and payment of damages. The plans should contain a mapping of risks, regular risk assessment procedures, mitigation and prevention actions, an alert mechanism and a monitoring mechanism. An assessment from February 2020 by the French government of the application of the law[144] found that whereas some companies have made real progress, others do not yet apply the law effectively. Companies can be held civilly liable if they do not comply with the law, but the fines initially provided for in the draft law have been invalidated for reasons of unconstitutionality. In numerous other EU Member States, there are various civil society initiatives as well as legislative proposals calling for mandatory due diligence[145] (European Parliamentary, Research Service, 2021).

The need for a binding approach

While for minerals and timber the EU enforces strict due diligence obligations at cross-sectoral level, alongside the obligations of disclosure provided for in the NFRD, the EU has until now followed the voluntary approach proposed by the international frameworks, mainly the UNGPs, with respect to human rights due diligence. This approach is considered largely insufficient.

Academic research demonstrates that commonly used due diligence tools are not very effective at

138 Commission staff working document, Sustainable garment value chains through EU development action, April 2017. Available at: https://ec.europa.eu/transparency/regdoc/rep/10102/2017/EN/SWD-2017-147-F1-EN-MAIN-PART-1.PDF

139 See Trade for Decent Work Project. (2019, May 8). https://www.ilo.org/global/standards/WCMS_697996/lang--en/index.htm

140 More info available at: https://www.sec.gov/opa/Article/2012-2012-163htm---related-materials.html

141 See: https://www.business-humanrights.org/en/latest-news/the-netherlands-takes-a-historic-step-by-adopting-child-labour-due-diligence-law/

142 Available at: https://www.legislation.gov.uk/ukpga/2015/30/contents/enacted

143 Available at: https://www.legifrance.gouv.fr/jorf/id/JORFTEXT000034290626?r=4HCCHXskwf

144 Evaluation de la mise en oeuvre de la loi n° 2017-399 du 27 mars 2017 relative au devoir de vigilance des sociétés mères et des entreprises donneuses d'ordre. Retrieved from https://www.economie.gouv.fr/cge/devoir-vigilances-entreprises

145 National & regional movements for mandatory human rights & environmental due diligence in Europe. Business and Human Rights Resource Centre. Retrieved from https://www.business-humanrights.org/en/latest-news/national-regional-movements-for-mandatory-human-rights-environmental-due-diligence-in-europe/

improving respect for rights. Earlier work by(Locke 2013[146]); (Barrientos & Smith 2006[147]); and (Lindholm, H. 2016)[148], among others, is being followed up by a second generation of rigorous analysis of larger data sets, much of it affiliated with Sarosh Kuruvilla and the Cornell ILR School New Conversations Project[149].

Civil society organisations have presented similar findings. In December 2019, over 100 NGOs demanded human rights and environmental due diligence legislation. These organisations and networks from all over Europe and other regions stressed their demands for binding rules on corporate respect for human rights and the environment on the occasion of the Finnish Presidency "Conference on Business and Human Rights: towards a common agenda for action". Representatives of the EU institutions, Member States, civil society and companies discussed how the European Union can effectively implement business respect for human rights.

The civil society statement[150] makes it clear that **current EU policy and legislation fails to adequately address the pressing challenges linked to human rights and environmental impacts of corporate global operations. The absence of cross-sectoral rules in the EU requiring companies to identify and address those impacts prevents companies from being held legally accountable when they neglect their responsibilities**. Moreover, **it makes it impossible for victims of corporate malpractice to seek remedy in courts.**

The **reliance on a voluntary approach** to promote business respect for human rights and the environment **has proven insufficient and does not prevent violations of human rights and environmental damages.**

The new European Commission should thus take swift action and present a legislative proposal that establishes a mandatory human rights and environmental due diligence framework for business and that provides access to remedy for victims of corporate abuse (European Coalition for Corporate Justice, 2019[151]).

Taking into account the multiple findings described above, and the fragmentation of international guidance that the EU follows, it is expected that the EU cross-sectoral legislation on mandatory due diligence should establish a single standard of care even if allowing for a sector-sensitive approach. Currently, there is a lack of conceptual and legal clarity on due diligence processes, with companies applying varying and even divergent approaches. The voluntary approach does not guarantee a level playing field and can create competitive disadvantages for companies that do undertake due diligence. According to the study ordered by the European Commission, business interviewees indicated a level playing field and legal certainty as the most important considerations of a mandatory due diligence approach. Another potential benefit is that it could address the lack of access to remedies for parties harmed by EU companies by establishing civil or even penal liability in the event that they do not comply (European Parliamentary, Research Service, 2021).

European Parliament position

On March 10, 2021, the European Parliament adopted by a large majority, 504 in favour, 79 against and 112 abstentions, the Parliament's Legal Affairs Committee (JURI) legislative own-initiative report by MEP Lara Wolters on corporate due diligence and corporate accountability with recommendations for the European Commission on necessary next steps to be taken.

With this report[152], the European Parliament has shown its strong support for the ongoing legislative initiative on sustainable corporate governance launched in 2020

146 Locke, R. M. (2013). The promise and limits of private power: Promoting labor standards in a global economy. Cambridge University Press.

147 Barrientos, S., & Smith, S. (2006). Ethical Trading Initiative impact assessment report. Ethical Trading Initiative.

148 Lindholm, H. (2016). Trying to secure decent working conditions: Do corporate social responsibility audits improve risk management in global garment supply chains? (Doctoral dissertation, KTH Royal Institute of Technology).

149 See more info about this research project at: https://www.ilr.cornell.edu/new-conversations-project/research

150 See the statement at: http://corporatejustice.org/wp-content/uploads/2021/04/final_cso_eu_due_diligence_statement_2.12.19.pdf

151 European Coalition for Corporate Justice. (2019, December 2). Over 100 NGOs demand human rights and environmental due diligence legislation. ECCJ. https://corporatejustice.org/news/over-100-ngos-demand-human-rights-and-environmental-due-diligence-legislation/

152 The report is available at: https://www.europarl.europa.eu/doceo/document/TA-9-2021-0073_EN.html

by the European Commission. This proposal, which is expected to be tabled in June 2021, aims to require businesses to conduct due diligence in order to prevent and address human rights and environmental risks and impacts within their own operations and value chains, as well as to provide access to judicial remedy when harm occurs.

The report sends a strong signal to the European Commission on what key elements the European Parliament expects in the upcoming legislation. It calls for the introduction of a mandatory corporate due diligence obligation to prevent and address adverse impacts on human rights, the environment (including on climate change), and good governance in businesses' operations and value chains.

It states that businesses should ensure that their purchasing policies do not cause or contribute to potential or adverse impacts. The report highlights the role of value chain mapping and disclosure in order for companies to better identify their business relationships; and it recommends disclosure requirements regarding the companies' due diligence strategy.

The report also provides for competent authorities undertaking investigations of their own initiative, or as the result of complaints, and issuing fines and other administrative sanctions.

It also calls on Member States to ensure that they have a civil liability regime in place to ensure companies are held liable and which provides remediation for harm to people and the planet.

Mandatory Human Rights Due Diligence in the EU: The Promise and the Risk

As noted by Olivier de Schutter and Sharan Burrow[153] (De Schutter & Burrow, 2020[154]), as the debate shifts from the principle of adopting mandatory due diligence legislation at the EU level to the precise content of such legislation, it is important to ensure that corporate actors remain encouraged to permanently improve their track record in complying with human rights and environmental standards. This is the warning from a study commissioned by ITUC on how mandatory due diligence should be established: **Due diligence should not degrade into a boxticking exercise, shielding companies from any form of liability provided they follow the standard list of "do's" and "do not's"**. This is why **HRDD and potential civil liability for violations occurring in the supply chain should be treated as two separate**, albeit complementary, duties. The former is **a duty to prevent the risk of human or environmental rights violations occurring within the supply chain or the corporate group. It is forward-looking and essentially imposes on companies that they seek information from their business partners or affiliates and that they act based on such information to minimise the negative human rights or environmental impacts of their activities**. The latter is **backward looking: it is a duty to accept liability where such preventative measures have failed, but where it can be shown that, should the company have done more, it could have prevented the harm from occurring**.

Even if HRDD **duties** (as may be prescribed under the future EU framework) are fully complied with, this should not result in a guarantee of legal immunity from civil liability claims, where it appears that the preventative measures have failed to stop the harm from occurring: once the victim has proven that the harm was inflicted and that it is in connection with the company's activities, it should be for the company to rebut the presumption that it could have done more to prevent such harm from materialising. Unless we keep the two separate, HRDD, the imposition of which has been fought for by so many actors for so many years, will become a formalistic exercise, leading companies to adopt a minimalistic approach simply to shield themselves from the risk of liability — in effect, buying legal immunity by ticking the boxes. We need the opposite: **we need to incentivise corporate actors to permanently improve and adopt a "hands-on" and proactive approach to ensure human and**

153 Olivier De Schutter, UN Special Rapporteur on extreme poverty and human rights & Sharan Burrow, International Trade Union Confederation.

154 De Shutter, O., & Burrow, S., (2020). Mandatory Human Rights Due Diligence in the EU: The Promise and the Risk. Business & Human Rights Resource Center, Towards EU Mandatory Due Diligence Legislation Perspectives from Business, Public Sector, Academia and Civil Society. November 2020, pp.41-43. Available at: https://media.business-humanrights.org/media/documents/BHRRC_EUPresidency_mHREDD_Compendium_11-2020.pdf

environmental rights are fully complied with in the supply chain or the corporate group. HRDD is essential to ensure that the EU contributes to a form of economic globalisation that contributes to human development. It should not become a substitute for ensuring a right to remedy for victims of corporate negligence (De Schutter & Burrow, 2020).

Civil Society Contributions and Recommendations

Civil society organisations welcomed the recent EU Parliament report. However, as stated by the ECCJ[155], the Commission should build on this report in the upcoming legislation and build a legislation to mandatorily apply to all businesses, along with a stronger and standardised due diligence obligation covering the entire value chain. The due diligence definition should build on the internationally recognised instruments, namely the UN Guiding Principles & Business & Human Rights and OECD Guidelines.

The definition given to human rights, environment and good governance must be clarified to cover the widest range of impacts across the entire value chain and match the objectives enshrined in the EU Treaties with respect to those matters.

While the report recognises the need for engagement with a wide range of stakeholders in order to establish and implement a company's due diligence strategy, the upcoming legislation should ensure that consultation is meaningful and effective.

Furthermore, enforcement mechanisms (through both public/administrative and private/civil enforcement mechanisms) in the case of non-compliance with the due diligence obligations or for harm caused must provide an effective deterrent. In this regard, we expect the Commission to consider criminal liability or equivalent instruments.

Finally, as outlined in the report, access to justice and remedy for affected individuals and communities when harm has occurred is essential for the success of the upcoming legislation. For the latter, we call on the Commission to establish a civil liability regime with notably strong provisions to facilitate access to justice for victims of corporate abuses at home and abroad. These must include liability for the failure to prevent harm throughout the value chain; a fairer distribution of the burden of proof for all evidentiary elements; and reasonable time limitations for transnational claims.

155 See : European Coalition for Corporate Justice. (2021, March 11). Strong signal from European Parliament, but the Commission will have to go further. ECCJ. https://corporatejustice.org/news/strong-signal-from-european-parliament-but-the-commission-will-have-to-go-further/

Key Policy Recommendations to the EU

Both European civil society organisations[156] and NGOs from southern countries, especially those representing indigenous people[157], have put forward concrete recommendations, addressed to the EC, in order to reinforce a truly mandatory HRDD as a basis for a binding Corporate Sustainability Governance, while enhancing other legal instruments to guarantee civil and criminal liabilities. We summarise and support the main recommendations, as follows:

1. **Business enterprises must have an obligation to respect human rights and the environment in their own operations, in their global value chains and within their business relationships.**

This obligation to respect human rights and the environment must relate to the business enterprises, including financial institutions, domestic and international operations, products and services. Business enterprises must integrate this obligation across all their business practices and decisions, for instance, their purchasing practices or product design. It must include the duty to duly exercise leverage to ensure that all internationally recognised human rights, including labour rights, and environmental standards are respected in their global value chains and business relationships. When there is not sufficient leverage, business enterprises need to increase their leverage.

2. **Business enterprises must have an obligation to identify, cease, prevent, mitigate, monitor and account for potential and actual human rights and environmental adverse impacts through an ongoing due diligence process, in accordance with existing international due diligence standards.**

Due diligence is a continuous, preventative, risk-based process through which all business enterprises must effectively identify and assess; cease, prevent and mitigate; track and monitor; and communicate and account for specific risks and actual and potential adverse impacts in their operations and along their global value chains and business relationships.

3. **Business enterprises must provide for or cooperate in the remediation of adverse impacts in their global value chains and within their operations and business relationships.**

Due diligence must enable and support the provision of remedy. The obligation to respect human rights and the environment requires active engagement in remediation of adverse impacts where business enterprises, including financial institutions, cause or contribute to harm by way of actions or omissions. Remediation must be provided, as appropriate, by the business entity on its own or in cooperation with other actors, in accordance with the above-mentioned international standards. In cases of adverse impacts that a business enterprise has not caused or contributed to, but which are directly linked to its operations, products or services, the business enterprise must also exercise or increase its leverage over those responsible to help ensure that remediation is provided. Remedy may include, but is not limited to, financial or non-financial compensation, reinstatement, apologies, restitution, rehabilitation, contribution to investigation as well as the prevention of additional harm through, for example, guarantees of non-repetition. Business enterprises should ensure that remedy is effective and ensure there is mutual agreement with the rightsholders on the parameters of the remedy and how it is provided. Both the process of defining remedy and the remedy itself should take into account and seek to redress imbalances in power, resources and information between the rightsholders and the business enterprise. This includes taking into account the specific barriers rightsholders may face because of their gender, and/or because they face heightened risks of vulnerability and/or marginalisation.

4. **Business enterprises must be liable for human rights and environmental adverse impacts in their global value chains and within their operations and business relationships.**

Business enterprises must be liable for harm they, or a company they control or have the ability to control, have, by acts or omissions, caused or contributed to. Equally, grounds for liability must be established on the basis of failure to carry out due diligence. Stricter liability must be imputed in certain situations and for certain conducts. Where two or more business enterprises are liable for the same harm, they shall be liable jointly and severally. Rules on disclosure

156 European Coalition for Corporate Justice ECCJ. (2020, September 1). Principal elements of an EU due diligence legislation - European Coalition for Corporate Justice. https://corporatejustice.org/eccj-publications/16828-principal-elements-of-an-eu-due-diligence-legislation

157 Open letter to EU Commission dated from April 6th, 2021 and subscribed by organisations representing indigenous peoples, forest communities & human rights defenders. The organisations recommend essential elements for effective EU legal measures on corporate governance, due diligence & forest risk commodities. Retrieved at: https://media.business-humanrights.org/media/documents/d6ecf4599b77f085b829176743ab45434b2879a5.pdf

of evidence and statute of limitations must ensure adequate, timely and effective access to judicial remedy. In particular, where a claimant has presented reasonably available facts and evidence sufficient to support their action, the business enterprise must bear the burden of clarifying the nature of its relationship with the entities involved in the harm and proving whether it took all reasonable measures to prevent the harm from occurring.

5. **Member States must ensure robust enforcement of all the above obligations and ensure the right to an effective remedy.**

Member States must put in place effective measures to ensure compliance with the above-mentioned obligations as well as access to remedy, including judicial remedy, for victims. Victims of human rights abuses must be afforded the right to an effective remedy under international, EU and national law. Competent administrative and judicial authorities must have the mandate to, as appropriate, provide a central registry for annual reporting, investigate potential infringements, enforce compliance, provide access to remedy and penalise or sanction infringements through an array of instruments. Administrative authorities should be able to act on their own initiative, and both administrative and judicial authorities should be able to act on a complaint by third parties, including members of the public and, as such, civil society organisations and trade unions, through safe and accessible channels which prevent and respond to the threat of reprisals.

6. **The above provisions must apply irrespective of the law otherwise applicable to the resolution of the conflict, as described in Article 16 of Regulation (EC) No 864/2007 (Rome II).**

Unless the claimant(s) choose(s) otherwise, where international private law requires the application of the law of the State where the harm occurred, the provisions of this new legislation must be considered as overriding mandatory in line with Rome II.

7. **This legislation must be cross-sectoral, covering all business enterprises, including financial institutions.**

This new legislation must apply to business enterprises, both public and private, including financial institutions, of all sizes and across all sectors, domiciled or based in, operating, or offering a product or service, within the EU. It must recognise that both small and large business enterprises are part of the same value chain, and the focus must be on identifying and mitigating the risks in the entire value chain. Although cross-sectoral in scope, it should allow for additional measures or specifications for specific sectors, products or activities, especially when they pose high human rights and environmental risk. Such additions must not limit the obligations established in this general legislation.

8. **The EU Legislative Framework must establish an independent compliant and grievance system.**

The complaint and grievance system must be easily accessible to affected communities, including indigenous people, in terms of language, cost and distance, and provide effective remedy for harms experienced.

9. **The legislation must contain robust safeguards and requirements for solid corporate actions to improve safety and protection for human rights defenders and whistle-blowers who lodge complaints against a specific company or investor.**

10. **Provide complementary non-regulatory measures and Policy Coherence.**

The EU must explore how technical and financial support to producer countries can best catalyse the recognition, protection of human rights through policy, legal and judicial reform as well as direct funding of communal and indigenous people land tenure security, forest protection, and monitoring initiatives. Additionally, the EU must ensure that other European investments and external actions in developing countries (e.g. in relation to agriculture, transportation, infrastructure, climate change and conservation) do not have negative impacts on rightsholders and territories. Progress in these areas will also contribute towards the EU's goals to address the global environmental, biodiversity and climate change crises.

INCLUSIVENESS AND EMERGING INNOVATIVE BUSINESS MODELS

A current critic to the contemporary "age of sustainable development" (Sachs, 2015[158]) argues that sustainable development does not have a transformative character as it fails to address the contradictions of the current economic system (Matikainen, 2019[159]). Sustainable development fails to go beyond GDP but instead includes economic growth as a goal (SDG 8) (Menton et al., 2020[160]). SDG 8 has been found to violate the sustainability objectives of the SDGs (Hickel, 2019[161]). This further supports the positioning of the influence of the economic system with respect to sustainable development in the model presented (Trollman & Colwill, 2021[162]).

In order to go beyond GDP or beyond short-term objectives we do need innovative business models. The urgency to engage business is, however, indisputable. In fact, traditional efforts to address the root causes of social and economic marginalisation have scarcely disrupted patterns of persistent poverty and inequality (Ranieri and Ramos, 2013[163]; Schoneveld and Zoomers, 2015[164]), with market, government and civil society

158 Sachs, J. D. (2015). The age of sustainable development. Columbia University Press.

159 Matikainen, O. A. (2019). Sustaining the One-dimensional: an Ideology Critique of Agenda 2030 and the SDGs.

160 Menton, M., Larrea, C., Latorre, S., Martinez-Alier, J., Peck, M., Temper, L., & Walter, M. (2020). Environmental justice and the SDGs: from synergies to gaps and contradictions. Sustainability Science, 15(6), 1621-1636.

161 Hickel, J. (2019). The contradiction of the sustainable development goals: Growth versus ecology on a finite planet. Sustainable Development, 27(5), 873-884.

162 Trollman, H., & Colwill, J. (2021). The imperative of embedding sustainability in business: A model for transformational sustainable development. Sustainable Development.

163 Ranieri, R., & Almeida Ramos, R. (2013). Inclusive growth: Building up a concept (No. 104). Working Paper.

164 Schoneveld, G., & Zoomers, A. (2015). Natural resource privatisation in Sub-Saharan Africa and the challenges for inclusive green growth. International Development Planning Review, 37(1), 95-119.

failures in many developing countries remaining unresolved (Mendoza and Thelen, 2008[165]). Recognising the limits of what public intervention can achieve in the post-liberalisation era, many governments and development agencies are beginning to challenge the private sector to contribute more proactively towards solutions to these failures (Schoneveld, G. C., 2020[166]). This is clearly manifested in the Post-2015 Development Agenda from which the Sustainable Development Goals (SDG) emerged, and the Paris Agreement and Zero-carbon Transition Agenda. In these Agendas, businesses, governments and civil society organisations are considered equally responsible for a sustainable path forward (Scheyvens et al., 2016[167]; Schoneveld, G. C., 2020).

Nevertheless, we must acknowledge that **placing businesses at the heart of sustainable development agendas poses risks. Without fundamentally changing the corporate bottom line, leveraging the "transformative" potential of the private sector may only serve to further entrench the neoliberal mechanisms that have contributed to societal inequalities in the first place** (Scheyvens et al., 2016). Since many corporate sustainability initiatives are often developed on the side-lines and respond to symptoms of underdevelopment rather than its root causes, the structures that perpetuate poverty and inequality are unlikely to be radically disrupted (Utting, 2005[168]; Scheyvens et al., 2016). For businesses to own their role as development agents and invest in providing durable solutions to the poor, sustainability objectives need to be at the core of how a business does business. In other words, sustainability objectives should permeate all critical elements of its business model (Schaltegger et al., 2016[169]), (Schoneveld, G. C., 2020).

To be able to evaluate the strategic drivers and actual performance of business models in that which concerns the embeddedness of the inclusiveness and sustainability in their core business is then decisive. Policy decision makers, governments, the EU and multilateral agencies as well as investors need to be able to assess whether a concrete company deserves a "license as development agent" or if, on the contrary, it must be removed from the economic system. The exclusion from the economic system has already happened before. A good example is the historical exclusion from several markets of the building companies that persisted their activity based on the use of asbestos, against the scientific evidence of human health risks.

The Genesis of the Inclusive Business Concept

With its roots in the development policy of the early 2000s, **inclusiveness** began to be used to qualify the **pro-poor growth** agenda that emerged from rising concerns over the distributional effects of global economic growth dynamics (Kakwani and Pernia, 2000[170]).

Despite ideological differences around the intended distributional outcomes of growth and disagreements on metrics, one commonly shared perspective is that **inclusive growth** is distinguishable from pro-poor growth by emphasising both the ***process*** and the **outcome** of growth (Ranieri and Ramos, 2013; Schoneveld and Zoomers, 2015).

Where pro-poor growth is focused primarily on reducing poverty and inequality, inclusive growth also explicitly emphasises productive participation in growth through non-discriminatory and disadvantage-reducing access to opportunity (Klasen, 2010[171]; Ranieri and Ramos, 2013).

The **inclusive development** concept emerged largely as a countervailing narrative to the more income-focused inclusive growth discourse (Schoneveld, G. C., 2020). **Inspired by principles of social and environmental**

165 Mendoza, R. U., & Thelen, N. (2008). Innovations to make markets more inclusive for the poor. Development policy review, 26(4), 427-458.

166 Schoneveld, G. C. (2020). Sustainable business models for inclusive growth: Towards a conceptual foundation of inclusive business. Journal of Cleaner Production, 124062.

167 Scheyvens, R., Banks, G., & Hughes, E. (2016). The private sector and the SDGs: The need to move beyond 'business as usual'. Sustainable Development, 24(6), 371-382.

168 Utting, P. (2005). Corporate responsibility and the movement of business. Development in practice, 15(3-4), 375-388.

169 Schaltegger, S., Hansen, E. G., & Lüdeke-Freund, F. (2016). Business models for sustainability: Origins, present research, and future avenues.

170 Kakwani, N., & Pernia, E. M. (2000). What is pro-poor growth?. Asian development review, 18(1), 1-16.

171 Klasen, S. (2010). Measuring and monitoring inclusive growth: Multiple definitions, open questions, and some constructive proposals.

justice, the emerging inclusive development discourse is premised on the supposition that in order to effectively balance trade-offs between economic growth and (multi-dimensional) well-being and/or the environment, economic growth will need to be de-emphasized (Gupta et al., 2015). While similarly adopting a dual process-outcome perspective of inclusiveness — albeit focused more on participation in decision making and governance processes than on the economy — a more encompassing definition of inclusiveness was proposed, which not only incorporates principles of social inclusiveness, but also ecological and relational inclusiveness (Gupta and Vegelin, 2016[172]), (Schoneveld, G. C., 2020).

While the business community rapidly adopted an approach where economic and development objectives can be complementary — the commercial opportunities can be exploited from actively engaging and/or serving the "bottom of the pyramid" (BoP), a concept inspired by Prahalad and Hart (2002[173]) — the development community aligned itself more closely with inclusive growth and the SDGs. This inspired the germination of the Inclusive Business (IB) concept as one of the possible solutions to specially market failures that frustrate meaningful engagement of low-income groups in the economy.

A consensual and operationalisable definition of IB is yet to emerge, however. Nevertheless, a review of commonly employed definitions does reveal two differentiating and generally agreed on principles. Firstly, more recent IB definitions from G20 (2015[174]), IFC (2018[175]) and ADB (2020[176]) emphasise how activities/operations contributing to inclusivity should be part of the core business and be commercially viable. Secondly, most definitions highlight — in line with inclusive growth — how an IB integrates into the supply and/or demand-side of the value chain people and/or communities that are poor, have low income, are at the BoP and/or disadvantaged. Although this differs from Prahalad and Hart's (2002) more consumer-oriented perspective, some definitions suggest that a business can still be deemed inclusive if it only serves poor consumers (Schoneveld, G. C., 2020).

These principles leave a wide latitude for interpretation. Where inclusive development, and to a lesser extent inclusive growth discourse, is typically framed around delivering improved income, well-being and societal equality, many development organisations are clearly avoiding IB definitions with operationalisable outcome targets that could facilitate independent monitoring of IBs and enhance corporate accountability to intended beneficiaries. Furthermore, and somehow surprisingly, most mainstreaming definitions systematically ignore issues pertinent to the environment, for example, environmental inclusiveness, supply chain sustainability, climate resilience and sustainable value creation (Schoneveld, G. C., 2020).

The business model of an inclusive business

In order to develop a more comprehensive definition of Inclusive Business Models (IBM), we should answer three critical questions: i) inclusiveness towards what; ii) inclusiveness of whom; and iii) inclusiveness in what? Accepting that inclusivity both denotes an outcome and a process, the first question pertains to the IBM 'ends' objective and the latter two to the inclusiveness 'means' objective (Schoneveld, G. C., 2020).

Inclusiveness towards what?

In practice, few businesses engaging low-income groups can reasonably be expected to enhance all types of inclusiveness. Instead, they typically aim to provide a utility-enhancing solution that responds to a specific business opportunity associated with a specific neglected

172 Gupta, J., & Vegelin, C. (2016). Sustainable development goals and inclusive development. International environmental agreements: Politics, law and economics, 16(3), 433-448.

173 Prahalad and Hart, 2002. The fortune at the bottom of the pyramid. Strat. Bus., 26 (2002), pp. 1-14

174 G20 Development Working Group. (2015). G20 Inclusive Business Framework. United Nations Development Programme Istanbul International Center for Private Sector in Development (UNDP IICPSD).

175 Kelly, S., Vergara, N., & Bammann, H. (2015). Inclusive business models. Rome: Food and Agriculture Organization of the United Nations. Available at: https://www.ifc.org/wps/wcm/connect/Topics_Ext_Content/IFC_External_Corporate_Site/Inclusive+Business

176 Asian Development Bank [ADB]. (2018). *Inclusive Business in the Asia–Pacific Economic Cooperation.* Available at: https://www.adb.org/publications/inclusive-business-apec

problem affecting a specific stakeholder group (generally a market failure).

While this aspect of the business model can be regarded as inclusive by providing solutions to neglected problems that generate utility for marginalised groups, at what point does the value the business intends to create for its stakeholders constitute inclusiveness and at what point does it not? This raises an important, but very subjective and normative, question about the required depth and breadth of intended inclusivity outcomes (Schoneveld, G. C., 2020).

If we were to conceptualise the IBM as a type of SBM, that implies that natural, social, and economic capital be minimally maintained beyond organisational boundaries (Schaltegger et al., 2016.). This suggests that an IBM should anticipate and articulate how it intends to respond to unintended outcomes including introducing, where appropriate, safeguards. This is especially true for direct negative externalities and perverse outcomes associated with business model implementation, some of which the business can anticipate ex ante and account for in its (initial) business model design. More difficult to anticipate are the indirect negative externalities that may emerge from business model implementation. For example, households using their additional income to build their asset base may choose to invest in land, thereby exacerbating local land conflicts and pressure on fragile ecosystems. These reflections raise an important question about the limits of entrepreneurial responsibility (Schoneveld, G. C., 2020).

One possible way to differentiate between those unintended consequences for which a business is and is not accountable is by applying the theory of change concept of the "accountability ceiling" (Taplin et al., 2013[177]). While typically applied to development programming, in articulating how value is created and inputs are transformed into outputs and outcomes, business models are often similarly informed by something akin to a theory of change. Within a theory of change, the accountability ceiling is typically placed at the juncture between an organisation's sphere of control and influence and the sphere of interest. Only outcomes arising from within an organisation's sphere of control and influence are those it needs to realistically monitor and take credit for (Tsui et al., 2014[178]). Direct externalities and perverse outcomes therefore tend to lie within the sphere of control and influence, while indirect externalities are within the sphere of interest (Schoneveld, G. C., 2020).

In order to ensure efficacy and legitimacy, an IBM should demonstrate how the business intends to monitor and manage unintended consequences arising along the path to value creation.

Inclusiveness of whom?

Low-income, poor, vulnerable and marginalised groups

Usually, the definitions and metrics to measure poverty are relative to a territory or country. Both local and global metrics do not provide sufficient comparability between different social and economic environments. The same difficulty exists in classifying the most vulnerable and marginalised people. Different ethnic, cultural, religious, environmental settings determine different degrees of vulnerabilities, which are difficult to crystalise in a business model.

While different organisations and legal systems define such groups differently, groups with such a status tend to include youth, women, elderly, disabled, racial, ethnic and religious minorities, migrants, unemployed, prisoners, single parents, homeless, farmers and the poor (Chapman and Carbonetti, 2011[179]). Since this list is ever-expanding, "the concept of 'vulnerability' ceases to be useful because if everyone is vulnerable, then no one is" (Wrigley and Dawson, 2016, p 204). Even though these concepts are still important (e.g. by not homogenising the "poor" and reducing poverty merely to monetary indicators), they tend to be too subjectively

177 Taplin, D., Clark, H., Collins, E., & Colby, D. (2013). Technical papers: a series of papers to support development of theories of change based on practice in the field. ActKnowledge and the Rockefeller Foundation: New York, USA.

178 Tsui, J., Hearn, S., & Young, J. (2014). Monitoring and evaluation of policy influence and advocacy. London: ODI Working paper, 395. Available at: https://cdn.odi.org/media/documents/8928.pdf

179 Chapman, A. R., & Carbonetti, B. (2011). Human rights protections for vulnerable and disadvantaged groups: The contributions of the UN Committee on Economic, Social and Cultural Rights. Hum. Rts. Q., 33, 682.

defined to enable consistent IBM targeting (Schoneveld, G. C., 2020).

The utility of the living income concept

A recent concept, which partly accounts for both the depth of experienced deprivation and vulnerability and marginalisation, is living income. This is defined as "the net annual income required for a household in a particular place to afford a decent standard of living for all members of that household" (Living Income Community of Practice, 2020[180]). Elements of a decent standard of living are closely aligned with the SDGs, including inter alia water, food, education, healthcare and unexpected events. With emphasis on decency and living comfort, a living income sets the bar significantly higher than most of the traditional poverty measures, which often merely account for subsistence and survival needs. By explicitly considering all members of the household, it also accounts for household-level marginalisation and by accounting for unexpected events and vulnerability risks (Schoneveld, G. C., 2020).

Inclusiveness in what?

Most definitions emphasise that an IB 'integrates' their target groups into the value chain. While inclusive growth discourse in contrast tends to emphasise productive employment, participation or engagement, the fundamental principles of both concepts are similar; namely, that income-constrained groups actively participate in and contribute to economic development, rather than merely being beneficiaries (Klasen, 2010). Productive engagement typically implies performing activities that contribute to producing a good or service (Morrow-Howell and Wang, 2013[181]). Similarly, integration into (global) value chains suggests the active involvement of income-constrained groups in activities performed to bring a specific product from its conception to its end use (Gereffi and Lee, 2012[182]). This includes design, production, marketing, distribution and support to the final consumer. Based on these interpretations, **IBMs can be regarded as business models that create value for income-constrained groups by enabling these to perform activities that contribute towards the production of goods or services along one or multiple nodes in a value chain** (Schoneveld, G. C., 2020).

Definition of Inclusive Business Models

George Schoneveld (2020, p.8), based on the analysis of previous questions, provides the following definition of IBM: *"A type of sustainable business model that seeks to productively engage income-constrained groups in the value chain by providing solutions to neglected problems"*. With respect to the three business model building blocks, this implies that:

I. **An IBM's value proposition captures what value is created for what types of income-constrained groups through what types of solution offerings, as well as how a competitive advantage is derived from doing so.**

II. **An IBM's value creation and delivery system captures how a business intends to create value.** Using a theory of change, an IBM articulates the mechanisms through which value will be created and monitored and the types of partnerships and value network needed to do so effectively. This theory of change explicitly accounts for anticipatable unintended consequences arising along the path to value creation. It furthermore details how primary beneficiaries will be targeted and non-discrimination will be ensured.

III. **An IBM's value capture system details how the business intends to capture economic value for itself from creating value for its stakeholders. Additionally, it articulates how the economic value captured will be invested in deepening and/or broadening value creation.**

180 Living Income Community of Practice, 2020. Living Income Community of Practice - The concept Available at: https://www.living-income.com/the-concept

181 Morrow-Howell, N., & Wang, Y. (2013). Productive engagement of older adults: elements of a cross-cultural research agenda. Ageing International, 38(2), 159-170.

182 Gereffi, G., & Lee, J. (2012). Why the world suddenly cares about global supply chains. Journal of supply chain management, 48(3), 24-32.

An inclusive business is more than its business model

As noted by George Schoneveld (2020), most definitions emphasise that social entrepreneurs and enterprises differentiate themselves from conventional counterparts through the primacy of the social mission over other organisational objectives (Defourny and Nyssens, 2017[183]). Consequently, the concept is principally bounded by the agents' intent. One notable exception is Martin and Osberg (2007[184]), who view social entrepreneurship as an "ex post term, because entrepreneurial activities require a passage of time before their true impact is evident" (p. 30). Defourny and Nyssens (2017) also insinuate that characterising an enterprise as social *ex ante* can be problematic. Whether an enterprise complies with the differentiating quality of a social enterprise (e.g. the primacy of the social mission) cannot be established without critically interrogating its practices first (Defourny and Nyssens, 2017), especially in for-profit enterprises without profit distribution restrictions and/or participatory governance structures (Schoneveld, 2020).

Furthermore, an inclusiveness determination based purely on a firm's business model does a disservice to the development discourse from which IB(M) emanated. Notwithstanding the disparate ideologies between inclusive development and inclusive growth, both view inclusivity as a process and an outcome. Merely **adopting a business model that aims to integrate income-constrained groups into a company's supply chain does not necessarily translate into positive outcomes. Inclusion may result in adverse incorporation when individual agency is constrained and new dependency structures emerge,** thereby not only depriving income-constrained groups from material gain, but **potentially exacerbating poverty, vulnerability and indebtedness** (McCarthy, 2010[185]; Oya, 2012[186]). Based on this, there are compelling reasons to consider both processes and outcomes in an IB definition (Schoneveld, 2020).

Based on this, Schoneveld (2020, p. 10) provides the following **definition of an Inclusive Business:**

"Any type of self-sustaining business entity with an IBM that creates net value for income-constrained groups". In order to become a genuine IB a business has to ensure:

I. Its value creating activities and partnerships are fully captured and informed by its IBM.

II. The net value that is created for income-constrained groups is not offset against the value destroyed along the path to value creation.

III. The value that is captured by the business enables it to sustain operations without charitable contributions.

IV. The majority of economic surplus is reinvested into broadening and/or deepening value creation.

In our opinion, this definition still lacks a definition of the value creation. In order to comply with the current development agenda (SDG's and Climate transition), the value creation must respect a triple outcome of value: social value, economic value and environmental value. The trade-offs and unintended externalities must:

V. **Be carefully managed to guarantee a "do-no harm" approach and provide safeguards;**

VI. **Avoid displacement of externalities (e.g. to other communities); and**

VII. **Be accountable and provide remedy when unintended consequences under their control still arise.**

In this sense, we provide the following definition: an Inclusive Business is ***«Any type of self-sustaining business entity with an IBM that creates net sustainable***

183 Defourny, J., & Nyssens, M. (2017). Fundamentals for an international typology of social enterprise models. VOLUNTAS: International Journal of Voluntary and Nonprofit Organizations, 28(6), 2469-2497.

184 Martin, R. L., & Osberg, S. (2007). Social entrepreneurship: The case for definition. Available at: http://www.ngobiz.org/picture/File/Social%20Enterpeuneur-The%20Case%20of%20Definition.pdf

185 McCarthy, J. F. (2010). Processes of inclusion and adverse incorporation: oil palm and agrarian change in Sumatra, Indonesia. *The Journal of peasant studies*, 37(4), 821-850.

186 Oya, C. (2012). Contract farming in sub-Saharan Africa: A survey of approaches, debates and issues. Journal of Agrarian Change, 12(1), 1-33.

value for income-constrained groups, adequately manages the externalities, is accountable and provides remedy when unintended consequences under their control still arises.» (Own Definition).

An Enabling Environment and Partnerships with community-engaged social actors are Fundamental to African Inclusive Business

Inclusive businesses provide low-income people with access to opportunities for income, basic goods and services, and choice. In addition, inclusive businesses are often associated with "green" business practices that conserve resources and protect the environment. Several prominent examples in sub-Saharan Africa demonstrate not only that this paradigm shift is possible, but that it can be both profitable and beneficial for a wide range of stakeholders. M-Pesa's mobile money services, for instance, reach 15 million people in Kenya alone, and similar mobile money services have provided millions of Africans around the continent, including those in rural areas, with access to financial services. Equity Bank provides 8 million customers in Kenya, Uganda, Tanzania, Rwanda and South Sudan with banking and credit services. South African brewer SAB Miller sources ingredients from around 50 000 smallholders in Zambia, Zimbabwe, South Sudan, Uganda, Mozambique and Tanzania (UNDP IBReport[187]).

Local entrepreneurs are creating significant positive change. Nancy Abeiderrahmane created Mauritania's dairy industry essentially from scratch. Today, Tiviski Dairy sources camel milk from more than 1 000 herders. In Kenya, David Kuria founded Ecotact as a social enterprise providing sanitation services. Ecotact's Ikotoilets today serve nearly 50 000 slum dwellers. South Africa's Eduloan, founded by Johan Wasserfal and Jan Kitshoff, aims to "unlock potential" among its client base, and has, over time, provided study loans to more than 600 000 tertiary-level students. Dozens of other examples of such inclusive businesses have been documented by the UNDP's Growing Inclusive Markets Initiative and are available on its online database (UNDP IBReport).

Inclusive businesses can directly contribute to achieving the SDGs. Many inclusive businesses provide goods and services to low-income people as customers and clients. Improved access to education, health care, clean water and energy, as well as communication and financial services improves customers' well-being and productivity. Other inclusive businesses create jobs and income by working with low-income people as producers, suppliers, employees and entrepreneurs. The table below provides examples of how inclusive businesses can contribute to achieving the SDGs. Enabling and pro-actively supporting disadvantaged women and young entrepreneurs to run successful profitable ventures is a key thread of inclusive business. These examples illustrate the wealth of innovation that enables inclusive businesses to create value where other firms' "business as usual" approach has been less successful.

187 UNDP. (n.d.). Realizing Africa's Wealth - Building Inclusive Businesses for Shared Prosperity. UNDP in Africa. Retrieved May 8, 2021, from https://www.africa.undp.org/content/rba/en/home/about-us/AFIM/ibreport.html

TABLE 8

Examples for how inclusive businesses contribute to the SDGs

	IMAI Farming Cooperative (South Africa). Engaging Woman Farmers, contributes to reduce food waste and creates income opportunities by producing and marketing vegetable "atchar" pickles made from surplus horticultural production. Case Study: https://seed.uno/articles/case-studies/case-study-imai-farming-cooperative
	Tunza is a health franchise network that improves the quality of health care services across Kenya. Its 316 clinics and maternity homes and 300 community outreach workers handle some 5 000 visits each day. For detailed information see Tunza Report: https://globalhealthsciences.ucsf.edu/sites/globalhealthsciences.ucsf.edu/files/pub/tunza-report.pdf
	Omega Schools in Ghana provide primary and secondary education to over 20 000 students in 38 schools across the country. For an affordable price of about US$113 per year, children receive a hot meal per day, two uniforms, a school bag and workbooks in addition to classroom teaching. Learning outcomes are significantly better than in schools in similar contexts. To know more see Omega Schools Website: https://omega-schools.com/about
	Mobisol has installed more than 16 900 solar home systems in Tanzania and Rwanda since 2010 at an average rate of 3 000 per month. Systems are made affordable through a mobile-based pay-as-you-go system. Families benefit from clean air and an improved quality of lighting while an estimated 8 300 tons of CO2 have been averted. Further details available at: https://engie-energyaccess.com/about
	Tiviski is a dairy company in Mauritania. It collects camel, cow and goat milk from hundreds of pastoralists around Nouakchott. The company creates a reliable source of income for these herders, and supports them through veterinary services and advice. More information available at: https://www.tiviski.com/index1.php?lang=eng
	M-PESA is Safaricom's mobile money service in Kenya. Mobile users can, for a small fee, receive, transfer, and cash out money throughout the country. Even in slums and rural villages, where people have previously depended entirely on cash, users can now safely and easily save, pay bills, and send and receive remittances. Twenty million users are registered for the service in Kenya. M-PESA has spread to other countries, and has led the way for more mobile money services around the globe. Further information available at: https://www.safaricom.co.ke/personal/m-pesa/m-pesa-home

Adapted from: UNDP Inclusive Business in Africa[188] and Norese, et al. 2021[189].

188 UNDP (n.d). Inclusive Business in Africa. UNDP in Africa. Retrieved May 8, 2021, from https://www.africa.undp.org/content/rba/en/home/about-us/AFIM/inclusive-business-in-africa0.html

189 Norese, M. F., Corazza, L., Bruschi, F., & Cisi, M. (2021). A multiple criteria approach to map ecological-inclusive business models for sustainable development. International Journal of Sustainable Development & World Ecology, 28(1), 75-91.

Enabling Environment and Supportive Ecosystem

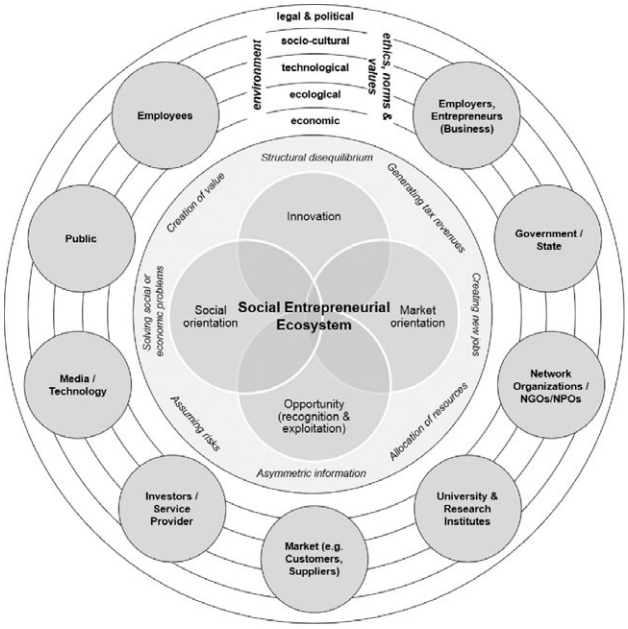
Nevertheless, to overcome the challenging market conditions characteristic of low-income communities, inclusive businesses need a supportive environment. An inclusive business ecosystem refers to a network of interconnected, interdependent actors whose actions make it possible for inclusive businesses to succeed and generate impact at increasingly large scales. According to the UNDP, an Inclusive Business Enabling Ecosystem needs four primary supporting functions:

- **Information** provides businesses with the awareness, knowledge, technology and know-how required to operate in low-income markets;
- **Incentives** provide businesses with the impetus to engage with low-income communities by rewarding positive externalities and reducing the cost of doing business;
- **Investment** provides the financial backing that enables businesses to venture into challenging low-income markets;
- **Implementation** support provides the logistics, transaction, marketing and communication, and micro-business support services that allow inclusive businesses to function in a variety of dynamic environments (UNDP IBReport).

A more comprehensive vision of an inclusive business ecosystem, from concepts, barriers, enables and supporting strategies can be found in the figure bellow.

However, in order to develop such enabling ecosystems, it is crucial that governments, local African entrepreneurs, African and international investors and international donors be able to operate inside a "development license to operate" framework, distinguishing and building a capacity to assess the role of social and environmental impacts by inclusive business. Otherwise, the risk of "social washing" will add up to the current risk of "greenwashing" in the implementation of the Sustainable Development agenda.

FIGURE 29
Vision of an inclusive business ecosystem



Source: (Wirtz et al., 2015[190])

190 Wirtz, M., Volkmann, C., University of Wuppertal; Germany. (2015, August 7). Social entrepreneurial ecosystems as a means for creating sustainable urban development. University of Western Sydney. https://isscbookofblogs.pressbooks.com/chapter/social-entrepreneurial-ecosystems-as-a--means-for-creating-sustainable-urban-development/

Cooperation and Partnerships as a core Business Strategy for Inclusive Business: A case Study from 15 African Businesses

In a multidimensional analysis study (Norese, et al. 2021), 15 inclusive business organisations from African countries, including Mozambique, South Africa, Kenya and Ghana, were studied. One of the most consistent findings was the value of partnerships. All the companies make extensive use of collaboration and partnerships with third parties, which are of fundamental importance to achieve scalability and to expand to other markets, but also to acquire and transfer knowledge, as well as to produce positive social and environmental value for the low-income stakeholders. The networks analysed include various kinds of relationships concerning:

- **Economic aspects,** between the organisation and the business partners;
- **Knowledge and technical expertise,** between the organisation and universities, agencies, research centres or foundations (technical support, quality tests, assessment of the natural resources or climate vulnerability);
- **Social concerns,** between some partners and the low-income stakeholders that the organisation has engaged as customers (in training processes that involve women, farmers or young people, often as sales agents; engagement of the customers in projects and co-creation of innovative actions that generate their autonomy or stimulate cooperation and local network creation; actions that facilitate the trust of the local communities, improve communication and ensure transparency);
- **Environmental concerns,** between the organisation, its customers and some partners (training on climate risks and adaptation measures, services and technological support, or the promotion and/or management of community projects) (Norese, et al. 2021).

Promoting the engagement of local communities and partnering with local social agents trusted by the most vulnerable groups is crucial for entrepreneurs build long lasting inclusive business and sustainable impact.

Policy Recommendations to Support Inclusive Business for Sustainable Development

Defining Inclusive Business is a fundamental requirement if the international development community is seriously committed to engaging private business as "development agents". In this sense, an extension of the concept of license to operate and the social license to operate can be framed as a ***"Business License to operate as a Development Agent"*** [191]. Such a tool could provide a set of criteria to guide decision makers engaging private business in the climate transition, the implementation of SDGs and the respective flow of financial architecture and other policy tools (e.g. fiscal policies).

In concrete terms, we recommend that the EU and its member states champion the following steps[192]:

The EU and its Members States should champion the design and implementation of a baseline assessment instrument to determine if a business model and activities are compliant with fundamental ESG principles and performance good practices, including inclusiveness.

- The instrument, that we labelled as a "Business License to operate as Development Agent", should be considered an extra layer to the current Social and Actuarial Licenses to Operate, and a prerequisite to access European public finance and/or contracts for international activities, and other policy instruments aligned with the Agenda 2030, the Paris Agreement and the European Green Deal.
- Include southern partner countries and local, regional and global civil society organisations and networks as partners in monitoring the

191 This concept is being proposed by the authors of this report.

192 Some of the policy recommendations are taken from CONCORD, the EU Confederation of NGO's. See: CONCORD, 2020. REBUILDING BETTER with sustainable and inclusive business models Working document - July 2020. Available at: https://concordeurope.org/resource/rebuilding-better-with-sustainable-and-inclusive-business-models/ However, we follow a more binding approach, proposing the "Business License to Operate as Development Agent" as a concrete tool to help decision makers in the use of concrete policy instruments aiming to engage private business in development.

Business Compliance with License to Operate as Development Agent.

Monitor support to and impact of sustainable and inclusive businesses.[193]

- The monitoring tools of external action instruments of the EU and its Member States should include quantitative and qualitative indicators on support to sustainable and inclusive business models, as well as gather evidence of how the projects funded contribute to the achievement of the 2030 Agenda and the Paris Agreement. The positive development impact for local communities should be prioritised over the financial leverage or the return on investments.

- Disseminate good practices on how these actors contribute to sustainable development and how diversifying enterprise models helps to increase economic stability while serving important environmental and social goals.

- Include local, regional and global civil society organisations and networks as partners in monitoring the implementation of EU and Member States' external action instruments and policies.

Map sustainable and inclusive businesses, assess the context they operate in and help to create an enabling environment for them in partner countries[194]**:**

- Foster an enabling environment for sustainable and inclusive businesses in partner countries, by raising their concerns or including them, where relevant, in policy dialogues with partner governments, and by promoting the role that people centred businesses play in achieving the SDGs.

- Dedicate funding for technical assistance and capacity-building to support governments in partner countries to develop adequate legal and regulatory frameworks that allow sustainable and inclusive enterprises to flourish.

Provide access to finance for sustainable and inclusive businesses[195]**:**

- EU and Member States' external investment tools such as the EU External Investment Plan, which aim to support private sector actors in partner countries, should primarily focus on supporting sustainable and inclusive businesses that are aligned with and deliver on sustainable development objectives and the Paris Agreement.
- EU external financing instruments such as the Neighbourhood, Development and International Cooperation Instrument (NDICI), national development budgets, development cooperation programmes and Aid for Trade strategies, should promote and engage with sustainable and inclusive business actors in the design, implementation, monitoring and evaluation of programmes, addressing their specificities.

Help boost sustainable and inclusive businesses:

- Systematically add a section or pillar on social and inclusive business in all EU-Africa and other similar EU-sponsored business summits.

- Take the needs and interests of small-scale sustainable and inclusive businesses into account when negotiating trade agreements and be sure to avoid putting them in situations of unfair competition.

- Shape tender processes to favour sustainable and inclusive businesses through public procurement practices and legislation, in the EU and partner countries, for example by applying weighted criteria in tender documents or by showing flexibility when it comes to quantities and lead times, as various contracting authorities in the EU already do.

- Make sure investment treaties and investors' protection mechanisms do not prevent partner countries from favouring sustainable and inclusive businesses.

- Facilitate cross-border cooperation between different sustainable and inclusive businesses to allow them to expand their business and further increase their resilience.

193 Ibidem.
194 Ibidem.
195 Ibidem.

RECOMMENDATIONS

Reducing the risks of debt impacting on the implementation of a green transition in Africa

- Recognise that the simultaneous impact of the pandemic and the climate emergencies is an extraordinary occurrence, and as such there is a need for extraordinary measures to prevent a continental wide meltdown of the African countries' national debts.
- Recognise that most African countries will not be able to implement the NDC that they proposed within the Paris Agreement without substantial aid from developed nations, especially the European Union.
- The EU countries must comply with their committed funding level in climate finance agreements and channel the additional funds for grants, and not loans that will further lock developing nations in a cycle of debt related poverty.
- Multilateral and bilateral funding for developing countries must increasingly focus on adaptation rather than on mitigation (which is more easily financed with market instruments).
- The EU should, at the next COP, push for parties to agree on a fixed set of rules and accounting standards under the UN Framework Convention on Climate Change (UNFCCC). These rules should reflect the real value to the developing nations of the funds provided (grants cannot be counted in the same way as loans).
- The EU countries need to remember that the commitment in the Paris Agreement was for additional funding, not for rebranding of ODA.

Stronger green bonds in Africa

- Invest in knowledge and build capacity of all stakeholders through training, dialogue, cooperation, research, and investment in data and knowledge sharing.
- Multilateral agencies should facilitate the capacity building process by providing both technical and financial support.
- Involve local stakeholders in the design and rollout of national guidelines, regulations and rules.
- No single, universally accepted framework can satisfy every context in Africa.
- Guidelines should be as simple and robust as possible.
- EU must consider working with African stakeholders towards the adaptation of the current EU Taxonomy and EU GBS to Africa.
- Conduct research and trials on fiscal incentives to assess whether they stimulate interest and demand for green bonds in Africa.
- Adapt and apply the "shades of green" criteria to the evaluation of the projects in the pipeline for financing.
- The EU should lead international efforts to address the unsustainability of the African national debts, supporting the abatement of unfair debt, in order to create room for fresh green investments and promote a just transition.

Improve the transparency and the additionality of green bonds

- The EU must lead in the definition and adoption of a policy framework for accurate measurement and reporting of GHGs in projects financed with green bonds.
- The EU Green Bond Standards (EU GBS) is an excellent starting point for the promotion of transparency and disclosure of information on projects.
- Public policy needs to compel issuers of green bonds to define and implement a common set of science-based impact indicators (including determination methodologies, GHG emission reduction targets).

Improve transition finance

- Promote "shaded" approaches in the classification of projects, instead of traditional black or white methodologies
- Implement a progressive participatory transition from the voluntary approach to the enforcement for the EU GBS (or similar) rules for issuers in European markets.

Towards a Just Transition

- Promote a Pro-Poor Approach to Planetary Stewardship, including:
    - Implementing international institutional frameworks that explicitly focus on supporting the interests of the poor
    - Recognise that pro-poor policies are also crucial for ensuring the integrity of local socio-ecological systems
    - Facilitate broad social coalitions in order to change the overconsumption basis of the economic systems, to a more inclusive planetary justice approach
    - Channel investment (public and private) to key sectors that are central to securing the basic dignities for the world's poor and marginalised majorities (food, water, energy, and infrastructure)
    - Implement an effective international support and ensure that international support and investment is not funnelled into serving the interests of global corporations and elites in both the Global North and South.
- The European Union and the United Nations must take the steps necessary to ensure the representation of poor and marginalised majorities at all levels of local, national and supranational entities.

Implementing ethical criteria to choose policy transitions

- T-Policymakers should select between policy options to implement based on "fairness", "transformative political potential", and "expected effectiveness".
- Transition policy most take into account the specificities of the agents (cultural characteristics, individual and institutional capacities, expectations, etc.). There are no "one size fits all" ready solutions.
- Transition policy responses must be appropriate to the kind of loss incurred and must take into account the distribution of costs necessary to finance its implementation.
- Corporation focused assistance will help achieve short term climate policy targets, but it will deepen disparities in societies, so long-term sustainability will require a focus on people.
- Investors must incorporate "Just transition" principles as soon as possible in their policy on responsible investment and climate change.

Real Sustainability Corporate Governance

- Value chain mapping and traceability are the absolute foundations of any solution that moves us towards implementing a functioning accountability system for corporations, so the EU should promote further research and pilot initiatives in these areas.

- Competent authorities must be capable of undertaking investigations of their own initiative, or as the result of complaints, and be able to issue sanctions.
- Corporations must assume their obligation to respect human rights and the environment in their entire global value chains and within all their business relationships. This should imply a legal obligation to identify, cease, prevent, mitigate, monitor and account for potential and actual human rights and environmental adverse impacts, in all their value chain.
- Corporations must provide for or at least cooperate in the remediation of negative impacts in their global value chains, within their operations and business relationships.
- To prevent the implementation of HRDD duties from becoming an exercise of box ticking, no guarantee of legal immunity from civil liability claims should come from failing to fully comply with the rules in cases where it appears that the preventative measures failed to stop the harm from occurring.
- The legislation implemented to ensure effective due diligence by the corporations must be cross-sectoral, covering all business enterprises, including financial institutions.
- The EU Legislative Framework must establish an independent compliance and grievance system. Member States should ensure that the civil liability regime in place is capable of holding companies liable and implement remediation for harm done to people and the planet.
- The EU must lead by example, apply similar rules of conduct, analyse their own policies and ensure Policy Coherence in all of its approaches and interventions.

Support more inclusive business models

- The current definition of Inclusive Business Model needs to be modified, because it is not focused solely on the social and economic value side of things, creating a scenario where a business can be formally classified as inclusive, while simultaneously reducing several environmental aspects that are at the core of both the SDG and the climate transition.
- Mechanisms to evaluate the actual performance of business models in regard to the embeddedness of the inclusiveness and sustainability in their core business must be developed and implemented. This information must be made public so that policy decision makers and investors can assess if concrete companies deserve a "license to operate" or not.
- The EU and its Members States need to champion the design and implementation of a baseline assessment instrument to determine if a business model and activities are compliant with fundamental ESG principles and performance good practices, including inclusiveness. This evaluation would be used to implement a threshold value that would be a pre-requisite to access European public finance and/or contracts for international activities
- In the meantime, the EU could shape tender processes to favour sustainable and inclusive businesses (for instance, by applying weighted criteria in tender documents or by allowing more flexibility in regard to quantities and lead times etc.).
- The monitoring of the implementation of EU and Member States' external action instruments and policies systems must include active representation of local, regional and global civil society organisations and networks.
- Funding should be directed towards technical assistance and capacity-building to support governments in partner countries in the development of legal and regulatory frameworks that foster sustainable and inclusive enterprises.
- EU and Member States' external investment tools should primarily focus on supporting sustainable and inclusive businesses that contribute to the fulfilment of the SDGs and Paris Agreement.
- Ensure that current and future investment treaties and investors' protection mechanisms are flexible enough to allow partner countries to favour sustainable and inclusive businesses.

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