Financing the sustainable development of the Mediterranean: What role for Green and climate finance?
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1. Green Finance: concept and situation

Green Finance is usually defined as the set of financial mechanisms, tools and programmes to shift from a carbon-intensive economy to a decarbonized (green) economy. It aims to reduce environmental pollution and greenhouse gas emissions of the economy, minimising waste and improving efficiency in the use of natural resources. Green finance includes, but is not limited to, the financing of public and private green investments in environmental goods and services and prevention, minimisation and compensation of damages to the environment and to the climate, the financing of public policies (including operational costs) that encourage the implementation of environmental and environmental-damage mitigation or adaptation projects and initiatives and components of the financial system that deal specifically with green investments (Fosse et al. 2017).

Global climate finance flows reached USD 632 billion in 2019/2020, a 10% increase compared to the previous period (CPI, 2021). Nonetheless, to meet climate objectives by 2030, annual climate finance must increase by 588% to USD 4.35 trillion (CPI, 2021). Therefore, investments need to rapidly increase, as failing to do so will have long term lasting effects on the economy that can be up to 6 times higher than previously expected (Kikstra et al., 2021). It is therefore clear that there is a need to rapidly increase the amount of money invested in low-carbon technologies if we want to avoid the more severe effects of climate change at global and mediterranean level, as one of the most vulnerable regions of the world (MedECC, 2021).
FINANCING THE DEVELOPMENT OF THE MEDITERRANEAN: WHAT FUTURE FOR GREEN AND CLIMATE FINANCE?

I. Green Finance: concept and situation

At European level, but also in other major countries (Russia, China, USA), the so-called Taxonomy aims to identify clearly what is (and what is not) green finance, to better flag and monitor the impact of public and private financial flows. Once approved and implemented, this taxonomy should have a major impact in accelerating the development of green and climate finance in the Mediterranean countries.

**Note:** Due to the difficulties for finding disaggregated data on the region, this factsheet only takes into account international green investments related to climate mitigation and adaptation in the Mediterranean countries.
Climate finance commitments to the Southern Eastern Mediterranean (SEMed) region amounted to USD 6.95 billion in 2018, around USD 1.1 billion less than in 2017. Bilateral donations represented around 41% of the total amount, mainly from Germany, France and the EU institutions. Multilateral Development Banks stand for 58% of all donations. Finally, Multilateral climate funds (GEF, FAO) provided the smallest share of overall climate finance to the SEMed region, with USD 69 million USD (1%).

International climate finance commitments to the Southern and Eastern Mediterranean (SEMed) region accounted for 11% of global financial flow in 2019, amounting to 9.12 billion.

Particularly, multilateral climate funds in the MENA region have been mostly focused on large projects aimed at mitigation effects while overlooking the huge adaptation needs of the region. Morocco was the main beneficiary of climate funds between 2003 and 2017, receiving 57% of the funds in the region, followed by Egypt with 27% (Climate Funds Update, 2018). The Climate Technology Fund is the main multilateral climate fund followed by the Green Climate Fund.

Regarding bilateral aid, since the 70s most EU funds have been going to the Mediterranean region through bilateral agreements and other instruments like the European Neighbourhood Policy. Between 2013 and 2020, the EU provided a financial envelope of €15.4 billion (European Union External Action, 2021). Investments in climate related issues are still low and mostly focused on energy and infrastructure but the EU has just renewed the partnership with the Southern Neighbourhood (SWD(2021) 23 final), with a new Economic and Investment Agenda for the Mediterranean in the post-covid scenario focusing on:

- Human Development, good governance and the rule of law
- Strengthen resilience, build prosperity and seizing the digital transition
- Migration and Mobility
- Green transition: climate resilience, energy, environment

On green transition, the aim is to work on the compliance of the NDC approved under the Paris Agreement, energy transition, resource efficiency and biodiversity conservation and sustainable food systems, mainly financing through green bonds and bilateral agreements with the different MENA countries.

Finally, at the climate COP21 in Paris, developed countries agreed to provide and mobilise USD 100 billion of climate finance per year for climate action in developing countries by 2020. However the OECD expects this amount to be reached by 2023 at the earliest (OECD, 2021).
3. The challenges for the Mediterranean

Today, the main challenge regarding green finance in the Mediterranean region is upscaling the level of funds available to meet the urgent financing needs of the green transition in a region that is particularly impacted by climate change and environmental degradation. This is a worldwide issue, especially regarding climate finance, with developed countries notably failing to deliver on their pledges made at the COP15. Although the green financial market is constantly growing, records of funds mobilised being broken each year, this growth is uneven in the Mediterranean and falls considerably short of what is needed to tackle the climate emergency and the environmental degradation because of a number of challenges and barriers that are on one hand global, and on the other specific to the region.

In particular, the flows of green finance in the region are essentially driven by the public sector, with Multilateral Development Banks (MDB) and national development banks and agencies. Greater efforts to mobilise private finance are needed, especially in the Southern and Eastern Mediterranean (SEMed) countries where financial instruments to mobilise private investments are lacking (for instance, only Egypt issued green bonds up to date). Although the situation tends to improve, this could reflect a weak commitment - compared to other regions of the world - by the public and private sectors in countries where political stability and business environment have been challenged over the last decades. The COVID-19 crisis has also put a heavy strain on government budgets, especially in the SEMed countries, diverting resources to emergency economic measures and social protection systems - although the recovery is often perceived as an opportunity to operate a transition of economic models.

EU Mediterranean countries can be considered as leaders and pioneers of green finance, with an important developing market, while countries of the SEMed countries are performing relatively well in attracting international climate finance compared to their population and GDP (UfM, 2020), the flows are far from being sufficient to meet the needs that a shift towards a green economy imply and the objectives of the Paris Agreement. It is also important to acknowledge the disparities between countries of the SEMed, with Turkey and Morocco as important recipients, Egypt and Jordan to a lesser extent, while the rest of countries witness difficulties in accessing green finance (Migley et al., 2016).

Disparities are also important when it comes to the type of recipients and projects benefiting from green finance, whether in the North or the South of the Mediterranean. Green finance in the Mediterranean tends to be directed towards large-scale infrastructure projects, mainly in the energy and transport sectors, thus essentially focusing on the mitigation pillar. Yet, to operate the necessary transition towards a green economy, public and private finance should be made available to SMEs, which are the backbone of Mediterranean economies and engines of innovation. They are also connected to the realities at the local level and they could prove to be instrumental to scale up adaptation actions, beyond the energy sector and large-scale projects. However, lending to SMEs in general, and to green SMEs in particular, is often perceived as risky by the banking sector, especially in the
SEMed countries (Sorrosal and Gasparini, 2018). There is also a misalignment between the offer of (green) financial services and the needs of small businesses that lack the technical knowledge to be able to apply to green financial products. In order to tackle the challenge of access to green finance, all actors of the financial systems must engage in an effort to make green finance more inclusive, affordable, available, innovative, and flexible while developing instruments to de-risk investments in the green sector (guarantees, public equity).

Moreover, a set of technical barriers, which are not specific to the Mediterranean region, hamper the emergence of a strong green financial market in the region: the lack of a common definition or taxonomy of what can be considered a “green” investment, and the lack of regulation and standardisation. Agreeing on a common taxonomy is indeed a crucial issue to fight the greenwashing phenomenon, which is, according to the European Commission, a common practice (EC, 2021).

In addition to these barriers, the lack of data and transparency make it difficult to track green finance, which is crucial to ensure the credibility of the green financial market to incentivise investors while helping design adequate policies to further develop green finance in the region (Fosse et al., 2019).

4. Prospects and disruptions up to horizon 2050

Current trends at the global level indicate a growing interest in sustainable finance that is likely to sustain the growth of this market in the upcoming years. Environmental, Social and Governance (ESG) criteria are gaining substantial ground among the finance community, both private and public.

This upward trend is notably driven by political commitments to increase climate finance flows towards developing countries and recently committed to add €4 billion for the period 2021-2027 (Abnett, 2021). Multilateral Development Banks are also announcing regularly stepping up their climate finance support to meet the Paris Agreements’ targets (EIB, 2019).

The room for development is significant and progresses will rely on the capacity to engage the private sector. A number of elements allow us to be optimistic in this regard. The development of green finance, in the private sector, will be steered on the demand side by new generations that are increasingly considering sustainability and eco-friendly criteria when investing. This interest is to be progressively met by financial institutions as suggests the
increase in products available. They now should be aligned with the expectations of the demand. The future growth of the green financial market could also be based on the promises of higher performance offered by green products (Covo, 2021), although requiring a shift from short-term to long-term approaches by investors. The increasing use of guarantees is also expected to de-risk private capital and overcome financial and non-financial barriers. Finally, the issues of definitions, regulations, and standardisation, which are key to jump to the next level, are currently on the political agenda, especially in the European Union, and positive developments in the years to come are likely to give green finance greater visibility and credibility (notably avoiding the widespread practice of greenwashing), thus unlocking larger financial flows to the green economy.

Bestides, the emergence of new financial methods, like cryptocurrencies, could increase the financial resources available for the ecological transition.

The Mediterranean is no stranger to these developments. However, we can identify specific trends and disruptive factors that will determine the future of green finance for the sustainable development of the region, the first of which is the clear geographical imbalances between both shores of the Mare Nostrum.

Indeed, as previously said, EU Mediterranean countries are leaders in terms of green finance development and this trend is likely to be strengthened in the coming years. The greening of the European economy has become a priority of the Union for the next three decades. The EU will allocate substantial funds and financial instruments to this endeavour. The implementation of the European Green Deal provides for the mobilisation of at least €1 trillion over the next decade, with 30% of the EU's multiannual budget (2021-2028) dedicated to green investments. In the context of the EU recovery plan (NextGenerationEU), EU countries will allocate 37% of the funds they will receive (of which 30% will be financed through the issuance of green bonds by the European Commission) to move towards a decarbonised economy.

Boosting private financial flows towards green investments is also a priority of the EU which has been working on definitions, standards, and regulatory measures (European green bonds standard, EU taxonomy, climate reporting guidelines, IPSF) to enhance transparency, effectiveness, and credibility of the market. This work is expected to benefit the whole Mediterranean region, especially as public key players such as European MDBs and member states' ODA will follow these rules when operating in the region.

In this context, green financial flows from the EU towards SEMed countries are expected to increase in the coming years, the latter benefiting from the positive spillovers generated by the EU Green Deal and its implementation in the framework of the EU external action. The Neighbourhood, Development and International Cooperation Instrument (NDICI), also known as Global Europe, will be the financial arm of this external policy, allocating 30% of the €79.46 billion fund to climate and biodiversity programmes (7.5% by 2024; 10% by 2026). In addition, additional financial resources (more than half a trillion euros over the 2021-2027 period according to the European Commission) are to be raised from the public and private sector through the European Fund for Sustainable Development (EFSD+)
including the External Action Guarantee, technical assistance, and grants provided through blending for a total of €53.45 billion for 2021-2027 (+12% compared to the previous period) (EC, 2020). In addition, the New Agenda for the Mediterranean states the ambition to engage with the IFIs and the private sector to develop the financial systems and adequate regulatory systems in Southern Neighbourhood countries that will support green finance. This will be key given the relative underdevelopment of the financial infrastructures in SEMed countries (Ayadi et al., 2019).

In that respect, Southern Mediterranean countries are also experiencing encouraging trends in developing their own green finance market, although much remains to be done. Positive signs are notably seen with, for instance, Egypt being the first SEMed country to successfully issue sovereign green bonds in 2020 and 2021, and the Union of Arab Banks (UAB) making the case for the implementation of a regulatory framework for green banking according to the best international standards (AFED, 2018). The green market is emerging at a fast pace in the MENA region with social and sustainability debt growing lately at an exponential pace (although largely driven by Gulf public and private actors) surpassing 2020’s sales in the first semester of 2021 (Khan, 2021). It should be noted that the region’s Islamic banks have yet to involve themselves in sustainable finance (only one issuance has been made by the Islamic Development Bank so far). This is likely to happen shortly, following global trends, with important positive consequences for the market.

Several voices consider that the creation of a common bank for the Mediterranean region (Euro-Mediterranean Development Bank) could decrease the current north-south and south-south imbalances on the distribution of the green finance, reduce the fragmentation and duplication of work between the EIB, EBRD and national development agencies for an optimised impact, as well as facilitate financing procedures of small and medium sized enterprises’ development projects in southern Mediterranean countries (Huber, 2010). This was notably the case of the Euro-Mediterranean Parliamentary Assembly that recommended in 2010 the transformation of the Facility for Euro-Mediterranean Investment Partnership (FEMIP) of the EIB into a Euro-Mediterranean Development Bank.

The negative impact of the COVID-19 crisis should also be acknowledged. The pandemic has undermined efforts to increase physical space in SEMed countries, making some of them more dependent than ever on external sources of financing for their recovery, in a difficult context of perceived higher investment risk and rising capital costs (Hourcade et al., 2021). Debt cancellation and debt-for-development swaps (already used in Egypt, Morocco, and Jordan) would help alleviate the debt burden that undermines SEMed countries to finance the green transition.

The successful deployment of green finance in the region will also rely on efforts to address the poor business environments that currently hinders the capacity of SEMed countries to attract FDI s. Risks of political and economic instability that have marked the recent decades in some Mediterranean countries will be key factors in that regard. Here the digitalisation of the banking system can play an important role, specially taking into account that SEMed countries receive large amounts of diasporas and
that a large part of the jobs are informal, therefore, out of the regulated financial system. Thus, this decentralisation of the economy can be an opportunity for the development of green projects at a local level.

There is no doubt that the impact of the green finance available in the region will remain a core issue for the years to come. It is likely that, without proper mechanisms to enhance SMEs access to green finance in the region and upgrading the capacity (from public and private sector) to manage and monitor large investments, the risks of financing “White Elephants” (large projects not benefiting communities) will remain important. Finally, the dependency on fossil incomes in the rentier states of the region (Algeria, Libya) implies that the sustainable finance deployed towards and in these countries should have a strong social component to ensure fair and just transitions.

In light of the social and political risks that the green transition entails for rentier states, one must also consider the financial risks that are tied to stranded assets such as fossil fuels. Indeed, banks from the EU and SEMed countries are still largely exposed to fossil assets. With the Paris Agreement, fossil fuels are to be progressively phased out, leading to the depreciation of fossil assets, becoming what are called “stranded assets.” This context can be an opportunity for banks to shift their business model towards green assets. For that, they must be incentivised by regulations. If banks fail to get rid of their fossil assets on time, they will be exposed to important depreciations with the potential to lead to a financial crisis, which could in turn impact the capacity of the financial system to finance the green transition in Europe and the Mediterranean (Giraud & Nicol, 2021).
5. Different scenarios for the future of Green and Climate Finance

**ALL GREEN:** All development finance has green (and social) conditionalities and is well aligned with the 2030 Agenda and the Paris Agreement. Green finance, led by the public sector but with a strong and increasing involvement of the private sector, has a transformative effect which responds to the needs for achieving a green transition in the region. This scenario would be based on the following developments:

### POLITICAL FACTORS

- In face of the climate emergency and its growing socioeconomic impacts in the Mediterranean, the EU and its member states continuously step up their **financial commitments** for sustainable development and climate action, delivering on and going beyond their pledges to provide sustainable finance to SEMed countries and beyond through a variety of EU, international and national funds.

- SEMed countries, including rentier states, implement their own Green Deal, based on a **genuine economic diversification** with long-term approaches allowing for a green transition that spurs the demand and offer of sustainable finance. Reforms are a window of opportunity to improve the business environment.

- There is a strong political leadership to involve the financial sector, fostering Euro-Mediterranean cooperation to develop a **common strategy** and share experiences and know-how.

- The Mediterranean as a coalition has **gained weight** on international climate negotiations and is able to mobilise resources that benefit the whole region.

### REGULATORY FACTORS

- Green and climate finance are clearly defined by **sound common standards** applicable and accepted across the region, helping to accurately fight greenwashing, which becomes a marginalised practice.

- **Reporting and measurement** of funded activities are standardised and commonly shared across the Mediterranean for the benefit of all stakeholders.
## MARKET FACTORS

- The **multiplication and wide use of funds and innovative instruments** (green bonds, guarantees, blended finance, public-equity co-investments, etc.) ensure that green and climate finance is becoming increasingly **flexible and attractive**, allowing to crowd in the **private sector**, while alleviating constraints to access to sustainable finance and adapting to green MSMEs.

- An increase in **grants and concessional loans** to capital ratios by less conservative MDBs allow SEMed countries to successfully kick-off their green transition without further exacerbating their debt burden.

- **Externalities (positive and negative)** are being taken into account when analysing the profitability of new investments, which further **discourages fossil fuel investments** while it **fosters** the development of renewables and other **environmental-friendly projects**.

## SECTORS

- **Large, bankable and transformative projects** in the energy, building and transport sectors are funded across the Mediterranean reinforcing the mitigation pillar of the green transition.

- In parallel, green finance reaches **small projects** carried by MSMEs, including social enterprises, benefiting local communities and a **greater array of sectors** including agriculture, water, restoration of biodiversity and ecosystems, and a circular economy. Green finance has a stronger impact on human development.

- Green finance is directed towards projects entailing a strong social component providing for reemployment assistance schemes and creating decent and sustainable jobs, contributing to a **fair and just transition**.

- Both mitigation and adaptation projects are put in place which considerably improve the livelihoods of SEMed population.

## OTHER FACTORS

- SEMed countries' financial needs are well understood and quantified based on transparent and available data, helping regional cooperation to **calibrate financial targets** through a regional strategy.
5. Different scenarios for the future of Green and Climate Finance

**2. SHADES OF GREEN:** the green financing paradigm shift becomes a reality in the region, although at a slow pace and with regional disparities (North-South and South-South). However, structural challenges remain to be overcome to untap the full development potential of the sustainable finance market.

### POLITICAL FACTORS

- The EU is progressively meeting the financing needs of its Southern partners although with delay with respect to the Paris Agreement’s targets. Green finance is a **well-established pillar of development cooperation** in the region.

- SEMed countries implement **economic reforms** to develop their green economy sectors, although at a slow pace. The energy sector (renewables and hydrogen) is the only exception witnessing an accelerated development that attracts important flows of green funds from the EU.

- Despite existing initiatives to cooperate at the regional level on designing a common strategy on sustainable finance, its **implementation remains uneven and fragmented**.

- The **Mediterranean as a coalition** struggles to go in block at international climate negotiations to mobilise resources that benefit the whole region due to regional disparities in development.

### REGULATORY FACTORS

- **EU definitions and standards** are adapted by some Mediterranean countries and rejected by others on political grounds.

- **Progress on reporting and measurements** allows for better understanding of the dynamics of the market and to devise better policies.

- Limited progress regarding business environment reforms does not fully lead EU private investors to pour their money into the SEMed green market.

- **Green financial centres** are created in the region to **build the capacity of financial institutions** in Mediterranean countries.
### MARKET FACTORS

- Green investments prove **profitable in the long-term** and draw increasing interest from a new generation of investors with **greater environmental awareness**.

- The multiplication and wide use of funds and innovative instruments is **increasingly aligned** with the demand of sustainable finance, although they tend to remain hardly accessible to small projects.

- **Negative Externalities** are partially being taken into account when analysing the profitability of new investments which **discourages fossil fuel investments**. Further work should be done on taking into account positive externalities to foster the development of **environmental-friendly projects**.

### SECTORS

- Green finance remains mainly channelled by MDBs and ODA which are **pioneering new sectors** and progressively deploy at the local level with incipient adaptation projects being developed.

- Efforts to engage the private sector yield good results at the international and European level. However, due to structural challenges regarding financial infrastructures and business environments, there are experience **disparities among countries** in the Mediterranean region.

- Green finance continues to focus on **large-scale infrastructure projects** which do not significantly impact production and consumption patterns and human development, although specialised actors of the sustainable finance market focusing on **impact finance** emerge.
5. Different scenarios for the future of Green and Climate Finance

**3 (BROWN) FINANCE as USUAL:** no major transformation of the sustainable finance market largely driven by the public sector, and which performs below the targets and needs in the Mediterranean region. The market remains at a superficial stage of development in SEMed countries.

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<tr>
<th><strong>POLITICAL FACTORS</strong></th>
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<tr>
<td>• Despite significant commitments, the level of green finance provided by the EU and its member states remains <strong>below the needs</strong> of developing countries in the Mediterranean region.</td>
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<tr>
<td>• The green transition is a serious threat to rentier states which delay reforms. Only limited reforms are implemented at the margins of the rentier system while the EU relaxes conditionality clauses for fear of a general collapse.</td>
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<td>• Tensions at the regional level hinder efforts to cooperate effectively. The Mediterranean as a coalition at international climate negotiations to mobilise resources that benefit the whole region fails to be formed</td>
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<tr>
<th><strong>REGULATORY FACTORS</strong></th>
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<tr>
<td>• Despite efforts to set common standards, these are <strong>not commonly recognised</strong> across the region.</td>
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<td>• Political pressures outweigh science-based approaches to adopt taxonomies, which in result <strong>fuel greenwashing practises and brown industries</strong> (gas especially) delaying the green transition.</td>
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<td>• Reporting and measurement are insufficient to provide sound and comparable data for guiding investment flows. Needs in SEMed countries are not well understood enough.</td>
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<td>• Poor business environments and political instability in some SEMed countries draw away the interest of potential private investors.</td>
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<td>• Green investments are still perceived as “risky” and the investors’ focus on <strong>short-term returns</strong> prevent the market from drawing further interest from the private sector.</td>
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<tr>
<td>• The multiplication and wide use of funds and innovative instruments is <strong>not aligned with the demand</strong>.</td>
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<tr>
<td>• Externalities are not taken into account when analysing the profitability of investments.</td>
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SECTORS

- Green finance remains channelled by MDBs and ODA and, despite increasing funds allocated to green instruments, fails to achieve a transformative impact.

- Green finance continues to focus on large-scale infrastructure projects, concentrated in the energy, building and transport sectors, which do not significantly impact production and consumption patterns and human development.

- The focus is still predominantly on financing mitigation actions.

- Because of the lack of capacity to access and manage green financing, small and community-based projects remain underserved.

POLITICAL FACTORS

- Despite significant commitments, the level of green finance provided by the EU and its member states shifts towards tackling short term necessities, namely humanitarian aid towards SEMed countries in conflict or in any other disruptive event in the region.

- The green transition is a serious threat to rentier states which delay reforms and position fossil fuels as a need in this period of crisis.

- Tensions at the regional level hinder efforts to cooperate effectively. The Mediterranean as a coalition at international climate negotiations to mobilise resources that benefit the whole region fails to be formed.

CRISIS AND CONFLICTS: This scenario contemplates a negative disruption under which climate objectives are not prioritised due to several plausible disruptions (pandemics, armed conflicts) mainly within the southern and eastern Mediterranean countries.
### Crisis and Conflicts

#### Regulatory Factors

- Setting common green standards in the region is refused by countries in conflict. Northern Mediterranean countries adopt the EU taxonomy but fail to influence the rest of the region.

- Political pressures outweigh science-based approaches to adopt taxonomies, which results in **fuel greenwashing practices and brown industries** (gas especially).

- **Reporting and measurement are insufficient** to provide sound and comparable data for guiding investment flows. Needs in SEMed countries are not well understood due to the lack of data and the conflict environment that the region suffers from.

- **Poor business environments and political instability** in some SEMed countries draw away the interest of potential private investors.

#### Market Factors

- Green investments are perceived as "non-priority" and the investors' focus on **short-term returns** prevent the market from drawing further interest from the private sector.

- Funds are mostly used to tackle short-term priorities but omit the climate crisis.

- **Externalities** are not taken into account when analysing the profitability of investments.

#### Sectors

- Green finance is minimal and remains channelled by **MDBs and ODA** and fails to achieve a transformative impact as only focus on **large-scale infrastructure projects**, concentrated in the energy, building and transport sectors, which do not significantly impact production and consumption patterns and human development.

- The focus is financing **mitigation actions**.

- There is little to no green finance available for **small and community-based projects**.
5. Different scenarios for the future of Green and Climate Finance

### GREEN FINANCE SCENARIOS TOWARDS 2050

- **Involvement of financial actors**
  - Full commitment of public and private actors

- **Level of green policies**
  - Agenda 2030 and Paris alignment

- **No policy ambition**

- **Shades of green scenario**
  - Business as usual scenario

- **All green scenario**
  - No involvement of financial sector

- **Crisis scenario**
Main bibliographic references / Sources of information


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