

Climate Inaction Will Destroy Europe's Public Budgets

Article by **Jaya Sood, Sebastian Mang**

April 7, 2026

Europe's fiscal debate remains fixated on debt and deficits. Yet climate change represents a growing and still largely unpriced threat to public finances. Without early investment in mitigation and adaptation, families and businesses will face repeated shocks, higher prices, a weaker economy and a state forced into consistent emergency spending.

In late January, torrential rainfall triggered a massive landslide near Niscemi, Sicily, opening a 4-kilometre chasm beneath homes and forcing entire neighbourhoods to evacuate. Weeks later, storms swept across Spain and Portugal, forcing thousands to be driven from their homes and causing millions of euros of damage to crops. These are not isolated incidents. The 2021 floods in Germany and Belgium killed nearly 200 people and caused an estimated 46 billion euros in damage. Wildfires have repeatedly torn through Greece, Italy, France, and Spain, destroying homes and livelihoods. Indeed, NASA's satellites recorded extreme weather events last year at twice the intensity of the 2003–2020 average. Climate impacts are increasingly shaping our lives and economies.

Yet the direction of European economic policy is running directly against this reality. Since 2024, the EU's new fiscal rules have significantly constrained public investment capacity across member states, including for climate-related spending. At the same time, the Commission has moved to roll back core elements of the European Green Deal, weakening corporate sustainability reporting requirements, removing climate transition plan obligations for most companies, and diluting the 2035 internal combustion engine phase-out date, under the banner of competitiveness and simplification.

What is being set aside in economic policy making, in the rush to appear business-friendly, is any serious accounting of what climate inaction will actually cost. New modelling by the New Economics Foundation (NEF) incorporates physical climate damages, mitigation and adaptation costs, and the effect of climate risk on sovereign borrowing costs. It finds that average EU public debt could be around 58 percentage points of GDP higher than official climate agnostic projections by 2050, and around 197 percentage points higher by 2070, under a business-as-usual scenario in which global warming reaches approximately 2.5°C.

Climate change alters debt dynamics through at least three channels. First, it reduces potential economic output. Climate change lowers labour productivity, damages infrastructure and disrupts energy production, agriculture and tourism. These are not one-off shocks but cumulative drags on growth. In 2024 alone, heat exposure across the EU resulted in the loss of 90 million potential working hours, which amounts to 111 per cent more than the 1990–1999 average. Under current policies, OECD projections suggest GDP losses of around 12 per cent across the Mediterranean region by 2070, with Continental and Atlantic Europe close behind at around 10 per cent, and Nordic-Baltic countries seeing losses of just below 9 per cent.

Second, it increases public spending. Governments finance emergency relief, rebuild infrastructure, and support households and firms after disasters. As insurance gaps widen, with less than 20 per cent of climate-related losses in Europe privately insured between 1980 and 2024, the state increasingly

becomes the payer of last resort. After the 2021 flood disaster, the German government established a 30-billion-euro reconstruction fund to cover what was not insured and to support local councils and infrastructure reconstruction.

Third, climate exposure and weak transition policies raise sovereign risk premiums, increasing borrowing costs themselves. Research by the ECB finds that climate risks are already being priced into sovereign bond markets. Countries with high carbon emissions face higher borrowing costs, and when extreme weather strikes, highly indebted governments see their yields rise. The implication is clear, as climate risks intensify, states that have not credibly mitigated and adapted to climate change will find it progressively more expensive to borrow.

The climate risk estimates may in fact be conservative. Most climate risk projections assume that climate damages rise gradually as temperatures increase and rely on historical data. But climate systems are not linear. Crossing tipping points, such as large-scale ice-sheet destabilisation or disruption of the Atlantic Meridional Overturning Circulation (AMOC), could trigger abrupt and potentially irreversible shifts. From an economic perspective, that means damages would not simply accumulate, they could accelerate, compound, and cascade across sectors and regions.

In contrast, scenarios in which governments frontload investment in clean energy, resilient infrastructure, and adaptation show substantially better long-run debt outcomes. The same NEF analysis finds that increased climate action today produces debt trajectories roughly 20 percentage points more favourable than business-as-usual by 2050, and 58 percentage points more favourable by 2070. If greater globally coordinated climate action were achieved, average EU debt falls below current official baseline projections by 2070. In effect, early public investment strengthens fiscal sustainability.

This is because early investment improves debt outcomes through three reinforcing mechanisms. First, it reduces emissions. Less warming means less damage, and less damage means lower debt. Second, climate investment generates economic activity well above its cost. Research by the IMF finds that each euro of green public spending produces between 1.10 and 1.50 euros of output, as jobs are created, innovation accelerates, and productivity improves. Third, investment in adaptation to climate change reduces the fiscal cost of future climate shocks, so that when extreme weather strikes, the damage is contained. A framework that undervalues these dynamics is not prudent but instead is structurally biased against the investments most likely to improve economic outcomes. It is fiscally irresponsible.

Overcoming this requires a decisive expansion of public investment in clean energy, resilient infrastructure, and adaptation, financed through more progressive taxation, excluding green investment from fiscal rules and through common European borrowing that enables all member states to invest at scale. The case for doing so extends beyond climate risk alone. The conflict in Iran and the resulting energy price spike, Europe's second major fossil fuel shock in less than five years, is a reminder that dependence on fossil fuels carries its own severe economic and fiscal costs. Investment in clean energy and efficiency is therefore also an investment in strategic resilience. Europe has already shown in the field of defence that it can both mobilise joint borrowing and create fiscal space by exempting strategic expenditure from fiscal constraints.

The choice, ultimately, is not between spending and saving. It is between investing now in resilience and transition, or spending far more later on lost economic potential, damage, recovery, and debt service. Every year of delay narrows the options and raises the bill.

A German version of this article was published in Surplus – Das Wirtschaftsmagazin on 2 April 2026.



Jaya Sood has been working on the economic policy team at the New Economics Foundation (NEF) since January 2025. Her work focuses on the implementation and financing of the energy transition. She has over six years of experience in economic policy.



Sebastian Mang is EU Programme Lead at the New Economics Foundation, working on European economic policy.

Published April 7, 2026

Article in English

Published in the *Green European Journal*

Downloaded from <https://www.greeneuropeanjournal.eu/climate-inaction-will-destroy-europes-public-budgets/>

The Green European Journal offers analysis on current affairs, political ecology and the struggle for an alternative Europe. In print and online, the journal works to create an inclusive, multilingual and independent media space.

Sign up to the newsletter to receive our monthly Editor's Picks.