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REPORT FEBRUARY 2023

A NEW FAIR DEAL FOR CLIMATE, TRADE AND DEVELOPMENT

OPPORTUNITIES FOR THE GLOBAL SOUTH

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About E3G

E3G is an independent climate change think tank with a global outlook. We work on the frontier of the climate landscape, tackling the barriers and advancing the solutions to a safe climate. Our goal is to translate climate politics, economics and policies into action.

E3G builds broad-based coalitions to deliver a safe climate, working closely with like-minded partners in government, politics, civil society, science, the media, public interest foundations and elsewhere to leverage change.

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Cover image

Side view of woman in hijab writing on clipboard while standing among rows of solar panels. Two men in helmets standing behind with project plan in hands. Photo by sofiko14 via Adobe Stock.



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ABBREVIATIONS

AGOA	the US African Growth and Opportunity Act
BCA	border carbon adjustment
CBDR	common but differentiated responsibilities
CEPA	Comprehensive Economic Partnership Agreement
COP27	27 th Conference of the Parties of the United Nations Framework Conventions on Climate Change, held in Sharm el-Sheik, Egypt
CTCN	Climate Technology Centre and Network
DFI	Development Finance Institution
EBA	Everything But Arms: an EU initiative under which imports from least developed countries are duty- and quota-free
EBRD	European Bank for Reconstruction and Development
EFTA	European Free Trade Association
EDE	emerging and developing economies
EPP	environmentally preferable product
FDI	foreign direct investment
G7	Group of Seven: the seven largest advanced economies and liberal democracies
G20	Group of Twenty: the world's largest 19 economies and the EU
GATT	General Agreement on Tariffs and Trade
GCF	Green Climate Fund
IDA	International Development Association of the World Bank Group
IEA	International Energy Agency
IFC	International Finance Corporation
IMF	International Monetary Fund
IP	intellectual property
MDB	multilateral development bank
NDC	nationally determined contribution: climate action plan committed to by parties to the Paris Agreement
NTB	nontariff barriers
ODA	official development assistance
RISE	Regulatory Indicators for Sustainable Energy
SDG	Sustainable Development Goals of the United Nations
SDR	Special Drawing Rights
TTC	EU–US Trade and Technology Council
UNFCCC	United Nations Framework Convention on Climate Change
WTO	World Trade Organization



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EXECUTIVE SUMMARY

Countries in the Global South are facing a poly-crisis. Climate change impacts, rising energy costs, food insecurity, and geopolitical insecurity are significant burdens for low-income countries to bear. Add to this the economic challenges of inflation paired with rising interest rates and a strong US dollar, and the still real health challenge of the continuing COVID-19 pandemic.

We have reached the limits of what we can do with existing tools and remedies to address climate, trade and development challenges. We need a major rethink of how we approach North–South relationships. This includes reforming how donors interact with recipients and how to align climate, trade and development.

A New Fair Deal for climate, trade and development could create policy “deals” across multiple policy fields and geographies. It breaks the need to establish one-to-one matches of interests and significantly expands the scope of opportunities. It therefore opens the door to new solutions that provide benefits to countries in the Global South, without leaving anyone worse off.



Figure 1: A New Fair Deal should bring together the fields of climate, trade and development in international politics.



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This report presents research on some of the ways trade and development in the Global South are interlinked with climate. Understanding these issues allows us to identify areas where these policy fields can be usefully linked at the international level, benefiting developing countries but also the global effort to maintain a liveable planet.

Core principles underpinning our approach are that:

1. Trust between the Global South and the Global North needs to be rebuilt.
2. Opportunities for development are essential for functioning communities, both within countries and regions, and at global scale.
3. Rules can be differentiated by the ability to carry, and a simple division into developed and developing countries is insufficient.
4. The focus of tools and measures needs to be on cooperation and positive reinforcements, rather than defensive and reactionary.
5. Convenience and simplicity may not deliver the necessary solutions to today's and tomorrow's problems.

The Global North can only maintain its wealth and prosperity if there is a drastic betterment for the South. Just like ecosystems are interconnected, so are human societies. Given their geopolitical and economic weight and influence, we suggest that the EU and the US lead on this New Fair Deal. Specific steps for them to initially explore are:

- > Offering debt relief for climate action through national and regional development banks such as the European Bank for Reconstruction and Development.
- > Launching regional guarantee platforms (with the intention of linking these to multilateral development banks when these are ready).
- > Offering trade access and privileges for climate action, based on common standards and processes.
- > Working together to reform WTO trade rules.
- > Promoting technology transfer, including through a joint cleantech IP bank.
- > Fostering capacity building, for example through co-developing research and education hubs in Global South countries and developing organisational and institutional capital as part of their development work.



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CHAPTER 1

OUR STARTING POINT

International policy is currently not fulfilling the promises made to the Global South:¹ Despite progress in sustainable development indicators, the 17 UN Sustainable Development Goals (SDGs) remain well out of reach almost a decade since their adoption. The COVID-19 pandemic caused significant setbacks, and current and future impacts of climate change risk aggravating the situation.² The Global North must not let the invasion of Ukraine, and the related energy and economic crises, distract from these long-term development objectives.

This research takes as a starting point that the current rulebook does not deliver. The rules, norms, and standards generally accepted as binding for international relations – including relating to trade, but now also climate – are allowing us to meet neither climate, trade nor development goals.

We therefore need to **rethink, reform and align our global policy priorities**. Approaches to policy must recognise the connections between climate and development needs. In turn, these policy areas connect to trade. From a development point of view, any discussion on trade needs to cover not only trade in goods and services, but also capital flows (that is, foreign direct investments), and consider supply chains and threats to the trade system.

We want to discuss how to:

- > **Rethink** the understanding of the interdependencies between development, trade and climate.
- > **Reform** the role of donor countries – in particular the US and EU/Germany – to meet the needs of the most vulnerable developing countries in a moment of shifting power balances in the Global North.
- > **Align** policy discussions on development, trade and climate, with a focus on including perspectives from the Global South. This is especially important given the current triple crisis of sustainable energy access (as in Pakistan),

¹ The term Global South emerged in the 1960s and serves to group together low- and middle-income countries in Latin America, Africa, Asia and Oceania, mostly former colonies, mostly in the lower latitudes. See Sebastian Haug, September 2021, [What or where is the 'Global South'? A social science perspective](#)

² Bill & Melinda Gates Foundation, 2022, [The Future of Progress – 2022 Goalkeepers report](#)



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food (as in Afghanistan or Congo), and capital scarcity (as in Lebanon or Sri Lanka). The countries named are just some of those affected.

In short: we want to explore what a New Fair Deal for climate, trade and development should look like.

Our research for this report builds on previous work, such as our previous report “The Climate–Trade–Development Nexus: Pathways Towards Transatlantic Cooperation”³, and public conversations. The latter included a discussion with Dr. Clara Brandi, Head of Program at German Institute of Development and Sustainability (IDOS), and Charra Tesfaye Terfassa, Senior Associate at E3G, on September 8, 2022. Additional research consisted of consulting literature, interviews with experts and private conversation on the nexus of climate, trade and development. Our approach led to some answers, but also opened up new questions. We are far from having final conclusions. Still, the current state of research allows us to share these interim findings to foster the debate.

The Global South – more different than alike

Any simplistic division into developed and developing countries does injustice to the many specific circumstances of each country. Low- and middle-income countries face differing climate impacts, have different trade patterns, and have different development needs.

Despite these limitations, for the purposes of this report we use “Global South” as a shorthand for low- and middle-income countries, no matter their size and geographic location. The Global North, by contrast, comprises the high-income countries. In this report we aim to show the need for a different approach to relationships between these groups of countries in the broadest sense. The practical application of that approach must recognise and accommodate the diversity of contexts and needs, for example by differentiating rules and policies.

³ Gruenig M, Scull D, January 2022, **The Climate–Trade–Development Nexus – Pathways Towards Transatlantic Cooperation**, Konrad-Adenauer-Stiftung and E3G.



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Capital flows are not serving the Global South

While developing countries need investment to support development and climate goals, trade is still extracting capital from their economies

Today, more wealth flows from Global South to Global North than the other way. This is despite the dire need for the South to catch up in terms of health, education, and other public goods – such as food security, energy access and climate security.

Since 1960, the Global North has gained approximately \$62 trillion through trade exchanges with developing countries. The most recent data suggests that these outflows still represent \$2.2 trillion annually.⁴ The imbalance is the result of developing countries exporting unfinished and raw materials with less value added and importing more manufactured and high value-added goods. Inequalities in trade rules and costs also play a part.

This capital outflow is even more perturbing if we compare it to the stated investment needs in emerging and developing economies (EDEs). According to the International Monetary Fund (IMF), these amount to at least \$1 trillion annually for the energy sector alone, and altogether \$3–6 trillion annually until 2050.⁵

Alongside the development needs stand the quickly accumulating effects of climate change, leading to additional funding needs for adaptation and mitigation. While the fact that we are breaking the planetary boundaries threatens the whole of humanity, the most vulnerable countries are being hit hardest and fastest and have the least capacity to adapt to current and future climate impacts such as droughts, flooding, heat waves, rising sea levels, vector borne diseases, and so on.⁶ \$140–300 billion are currently needed annually for climate change adaptation, though this number could rise sharply to between \$520 billion and \$1.75 trillion by 2050 if mitigation investments continue to

⁴ Hickel J, Sullivan D, Zoomkawala H, 2021, Plunder in the Post-Colonial Era: Quantifying Drain from the Global South Through Unequal Exchange, 1960–2018, *New Political Economy*, 26:6, 1030–1047, DOI: [10.1080/13563467.2021.1899153](https://doi.org/10.1080/13563467.2021.1899153)

⁵ IMF, October 2022, [Global Financial Stability Report: Navigating the High-Inflation Environment](#)

⁶ IPCC, 2022: Climate Change 2022: Impacts, Adaptation, and Vulnerability. Contribution of Working Group II to the Sixth Assessment Report of the Intergovernmental Panel on Climate Change [H.-O. Pörtner, D.C. Roberts, M. Tignor, E.S. Poloczanska, K. Mintenbeck, A. Alegría, M. Craig, S. Langsdorf, S. Löschke, V. Möller, A. Okem, B. Rama (eds.)]. Cambridge University Press. Cambridge University Press, Cambridge, UK and New York, NY, USA, 3056 pp., DOI: [10.1017/9781009325844](https://doi.org/10.1017/9781009325844).



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stall.⁷ According to Blackrock, 2020 investment in climate change mitigation in the Global South (excluding China) came to \$150 billion, about a sixth of the necessary funding.⁸

Clean energy is a mitigation need that exemplifies the unequal abilities of Global South countries to fight climate change. The gap in per-capita investment in clean energy between North and South (without China⁹) is increasing. Annual global investment in clean energy amounts to \$750 billion, only a fraction of the total need. But just \$150 billion of that investment is made in the Global South, excluding China. (Investment in China was estimated to be around \$300 billion in 2022.¹⁰)

Capital inflows to the Global South exist, but are insufficient and unevenly spread

EDEs do not have the domestic capital stocks to drive the necessary investments from within. They rely on capital inflows to achieve the required transition.

Foreign direct investment (FDI) is the most relevant means of directing capital flows to the Global South, though it is not the only one. Total FDI is picking up as the global economy exits the COVID-19 slow-down and reached a total of \$1.5 trillion in 2021, of which 53% (\$837 billion) flowed to the Global South.¹¹ By comparison, remittances were worth \$589 billion,¹² followed by portfolio investments¹³ at just above \$300 billion and official development assistance (ODA) at \$178.9 billion.¹⁴ Given the restrained economic outlook for 2022 and 2023, however, FDI numbers are expected to fall again.¹⁵

⁷ IMF Blog, October 2022, [How to Scale Up Private Climate Finance in Emerging Economies](#)

⁸ BlackRock Investment Institute, October 2021, [How to finance the net-zero transition in emerging markets](#)

⁹ China is a middle-income country and self-declared developing country. However, the sheer size and dominance of the Chinese clean energy investment and its very special status as a leading economy, and a global leader in cleantech exports, suggest excluding China in most overview statistics of the Global South.

¹⁰ IMF, July 2022, [Mobilizing Private Climate Financing in Emerging Market and Developing Economies – Staff Climate Note 2022/007](#)

¹¹ UNCTAD, 2022, [World Investment Report 2022](#)

¹² World Bank Blogs, November 2021, [Global Remittance Flows in 2021: A Year of Recovery and Surprises](#)

¹³ According to the IMF, “Portfolio investment is defined as cross-border transactions and positions involving equity or debt securities, other than those included in direct investment or reserve assets”. IMF Statistics Department, January 2015, [Portfolio Investment \(L6\) – Course on external sector statistics](#), <https://www.imf.org/external/region/tlm/rr/pdf/Jan11.pdf> (last accessed 18 January 2023)

¹⁴ OECD website, [Official Development Assistance \(ODA\)](#), <https://www.oecd.org/dac/financing-sustainable-development/development-finance-standards/official-development-assistance.htm> (last accessed 18 January 2023)

¹⁵ UNCTAD, 2022, [World Investment Report 2022](#)



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FDI is not evenly split among Global South countries. Most FDI in 2021, \$619 billion, went to Asia, with China the biggest recipient at \$181 billion. The whole of Africa received a total of just \$83 billion, of which almost half is linked to one single transaction to South Africa, further illustrating the small role of FDI in Africa in general. This imbalance of FDI within the Global South shows that we are not looking at one homogeneous bloc, but rather clusters and segments of countries.

The renewed momentum in 2022 for a reform of the multilateral development banks (MDBs), such as the World Bank, is an encouraging sign that shareholders recognise the need to step up and confront the multiple crises.¹⁶ Most recently, Barbadian Prime Minister Mia Mottley presented the Bridgetown Initiative, which proposes an overhaul of the global financial system, at the 27th Conference of the Parties (COP27) in Egypt and gained significant support.¹⁷

Taking stock of current financial flows coming from the MDBs: In 2022, the World Bank planned disbursements of \$67 billion.¹⁸ The IMF supplies economies in peril with \$1 trillion lending capacity and currently about \$100 billion in outstanding credit.¹⁹

Public funding through concessional loans and grants is an important part of the solution, but it can by no means bridge the low-carbon infrastructure investment gap for EDEs on its own, which is estimated at \$15–20 trillion by 2040.²⁰ The private sector needs to step up and deliver on climate-aligned trade and investment for development, both with a view to the 2030 SDGs and beyond.

In short, the gap between what the Global South needs and its current resources is vast. Meanwhile, climate change is further eroding these countries' ability to cope and adding further burdens.

We start to question that simply more of the same approaches will not be able to deliver on this massive global challenge.

¹⁶ Federal Ministry for Economic Cooperation and Development, October 2022, "**World Bank needs to restructure to address global challenges of the future**", says Development Minister Schulze

¹⁷ E3G, November 2022, **The Bridgetown Initiative, a climate and development plan for COP27**

¹⁸ The World Bank, 2022, **Annual Report 2022 – Fiscal year data**

¹⁹ IMF, October 2022, **Weekly Report on Key Financial Statistics**

²⁰ IMF, July 2022, **Mobilizing Private Climate Financing in Emerging Market and Developing Economies – Staff Climate Note 2022/007**



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Holistic policy is the key to fairness for the Global South

Our hypothesis is that only a New Fair Deal can deliver in a holistic manner: restructure the relationship between North and South, between anthroposphere and ecosphere, between today and tomorrow.

A New Fair Deal can bring climate, trade and development together synergistically, with negotiations and packages built across the three dimensions. For example, a country that feels it can carry more trade responsibility than it currently does but would benefit from debt restructuring or specific climate finance could engage in such a deal. Conversely, a country seeking additional trade access could offer additional climate action, in either mitigation or adaptation. Splitting the policy areas from each other foregoes a whole bookshelf of Pareto improvement “deals”, that is, where nobody loses and at least one party is better off. At least in theory, such deals should be able to overcome the barriers of consensus decision making.

Linking climate, trade and development would imply linking, for example UNFCCC negotiations, WTO reform discussions and MDB reform. This does not require merging or reopening these separate frameworks; it would suffice to coordinate packages across these three planes.

The result would be far from simple or clean. Instead of removing developing country protections, it would be adding many case-specific rules, resulting in a highly complex web of conditionalities and balances.

However, the more issues are included in the pool, the more opportunities for a deal emerge. One way to illustrate this is to compare the current diplomatic field to an economy without money, where barter is the default approach to organising the exchange of goods and services. The introduction of money allows the exchange of goods and services across geography and time without the need to find a one-to-one match. A similar fluid approach is required in international policy diplomacy if we want to make progress.

This might be the best path forward for entrenched multilateral frameworks to respond to today’s and – even more importantly – tomorrow’s challenges.



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Key theses

1. We are in a decisive decade, where the need for renewed global cooperation overlaps with the risk of a global recession. A new approach to global cooperation is needed to create renewed trust and to deepen the dialogue on principles.²¹
2. We need to prevent a new era of poverty, which is both an individual and a country-level challenge. Sustainable development needs to focus on the opportunity for development, including market access, technology transfer and promoting the trade in green goods and services.
3. The principle of common but differentiated responsibilities applied in the climate space can be the basis for a reconsideration of special and differential treatment in trade. Not everybody can and should apply the same price on carbon or apply the same set of climate policies.
4. It is important to prevent a protectionist spiral and to focus on global cooperation and positive measures. In this light, the introduction of border carbon adjustments (BCAs)²² needs to support development in the Global South, balancing the climate, development and trade objectives. Sectoral deals such as on steel and aluminium provide another opportunity to reshape the trade regime within a narrow timeframe.
5. Linking more policy fields – such as climate, trade and development – opens up a vast space of opportunities for deals, bridging between multiple parties and topics. This would indeed complicate negotiations and add inconvenience. But the challenges ahead require inconvenient approaches to craft effective and lasting solutions, not only to today's problems and questions but also for tomorrow's.

We will explore our ideas in more detail in the following chapter.

²¹ Mark Mallow-Brown and Dr. Leslie Vijnamuri identify lack of trust as a barrier to mobilizing capital and recommend co-creation of development initiatives and accountability as ways to reset relationships in: Chatham House, December 2022, **Building global prosperity – Proposals for sustainable growth**

²² Such as the EU's Carbon Border Adjustment Mechanism, EU CBAM.



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CHAPTER 2

A NEW FAIR DEAL FOR CLIMATE, TRADE AND DEVELOPMENT

Policy tools and instruments for a New Fair Deal for climate, trade and development

If the existing tools and instruments cannot simply be scaled up to fulfil the need for development and climate action, then new or evolved tools and instruments need to be explored. The following list is neither complete, nor does it claim to prioritise. Rather, it focuses on suggestions found in literature and recommended by experts in the climate, trade and development nexus:

1. **Debt relief for climate:** reducing the debt burden in exchange for climate action via a range of tools.
2. **Regional guarantee platforms:** reducing the risk premium on FDI.
3. **Trade access and privileges for climate:** offering market access and trade privileges in return for additional climate action.
4. **Reform of trade rules:** fostering the trade in cleantech and discourage the trade in carbon-intensive products and services.
5. **Technology transfer:** sharing intellectual property rights and technology access to cleantech in exchange for specific commitments.
6. **Capacity building:** providing training and developing educational and research infrastructure in exchange for specific climate commitments.

We will explore each of these tools and instruments in more detail.

Debt relief for climate

World Bank president David Malpass encouraged the G20 finance ministers in July 2022 to work towards debt relief since countries in the Global South were facing record debt with some moving dangerously close to defaulting.²³ His assessment did not improve and at the annual meetings of the International

²³ Brookings, July 2022, [World Bank President David Malpass on the state of the global economy](#)



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Monetary Fund (IMF) and the World Bank Group in October 2022, he warned of the increasing risk of a global slow-down. He emphasised that the debt service from International Development Association (IDA)²⁴ countries amounted to \$44 billion in 2022, more than they will receive from the World Bank and IMF together, reducing the fiscal space for these countries.²⁵

The current maelstrom of rising global interest rates paired with a strong US dollar makes debt relief a pressing matter. A large group of EDEs are facing an increased debt burden, reducing their ability to invest in climate-ready infrastructure, in health, education and social development, or in strengthening their economic ecosystem. While restoring the fiscal space is not an end in itself, and we also need to look at other tools to enable development, in the current context it becomes an imperative. It is a crucial building block to develop economic resilience and empower governments to invest in their country's future.

Fiscal space can be increased through growing revenue or adding additional credit. The latter, however, will have to be paid back and creates future financial liabilities. Another alternative is to reduce existing debt, which, again, can take various forms.

Broadly, four types of debt-for-climate approaches are being discussed:

1. So-called swaps where current debt is replaced by a commitment to fund specific climate action, either in a two-party or in a tripartite constellation. This might include a funder or aggregator, a creditor or a class of creditors and the debt-owing country.
2. Climate-conditional (concessional) loans.
3. Climate-conditional grants.
4. Climate-linked comprehensive debt restructuring.

²⁴ IDA serves the world's poorest countries with low to zero interest credits and grants.

²⁵ The World Bank, October 2022, **Remarks by WBG President David Malpass to the Development Committee – 2022 Annual Meetings**



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Debt-for-climate swaps are increasingly considered and discussed in the global climate and development communities.^{26,27,28} The starting point here is the simple finding that climate risk and financial risk appear to be correlated.

Debt relief of this type could be conditional on climate ambition levels, in the form of either commitments or nationally determined contributions (NDCs). Alternatively – which would be a higher threshold – it could be based on relative or absolute emissions reductions. A further option is to consider climate change adaptation action, that is, measures to increase resilience against climate impacts. The co-benefits are, among others, that countries with less vulnerability will be more likely to pay their remaining outstanding debt.

Though debt-for-climate swaps are still a niche product, African countries are expressing interest.²⁹ However, some observers are more cautious.³⁰ It remains unclear whether these swaps can provide enough fiscal space to meaningfully reduce the climate investment gap, or whether there might be more efficient or effective debt-for-climate instruments for the task.

Debt-for-climate can be applied not only to the amount owed, but also translate into lower interest rates, and higher borrowing ratios, or other aspects of debt. The idea could also be applied to the recycling of Special Drawing Rights (SDRs),³¹ i.e., offering preferential access or lower interest rates on loans in exchange for climate action.

Not every tool can be applied in any situation and, thus, the growth potential for each kind of climate-debt tool depends on getting the right parties at the table. Given that these tools are still in early adoption, there are no off-the-rack solutions, meaning scaling-up takes time. Therefore, while these approaches are necessary, they are not sufficient to solve the climate–development crisis.

²⁶ IMF, August 2022, **Debt-for-Climate Swaps: Analysis, Design, and Implementation – IMF Working Paper 2022/162**

²⁷ Climate Policy Initiative, May 2021, **Debt for Climate Swaps – Blueprint**

²⁸ While there are many proponents, there are voices in both the climate and the development communities pointing to possible risks in the approach such as: positioning climate action as the only pathway towards more fiscal space at the cost of other SDGs, or the risk of establishing climate action as a neo-colonial policy, imposed by outside structures.

²⁹ Climate Home News, September 2022, **African nations eye debt-for-climate swaps as IMF takes an interest**

³⁰ Climate Home News, January 2021, **Debt-for-climate swaps – are they really a good idea, and what are the challenges?**

³¹ International Monetary Fund website, **Special Drawing Rights**, <https://www.imf.org/en/Topics/special-drawing-right> (last accessed 18 January 2023)



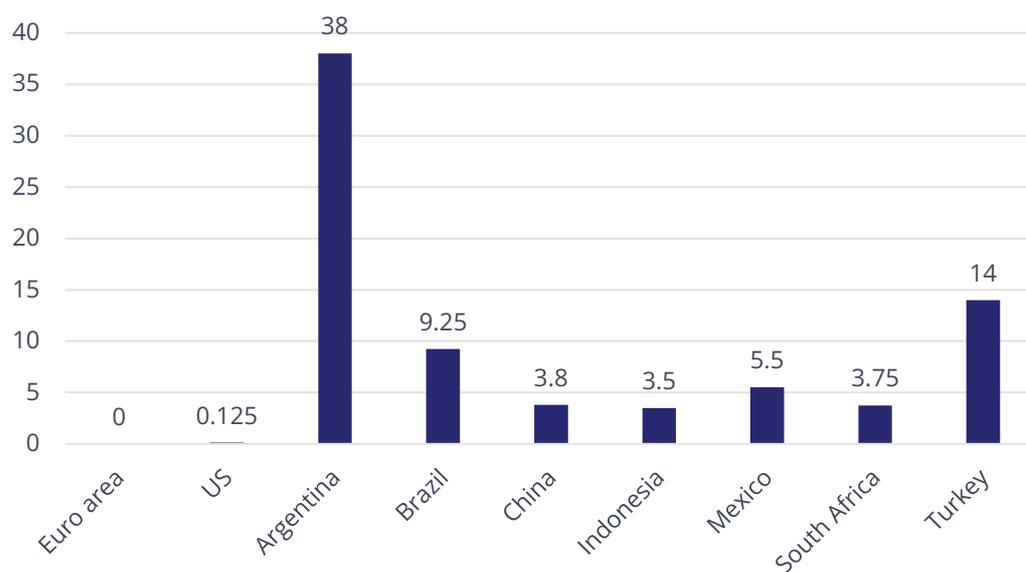
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Regional guarantee platforms

If we consider investment in emerging and developing economies, the cost of capital is a significant barrier to capital availability. The premium for credit is substantial in the Global South, as exemplified by a comparison of average central bank rates for a pool of developed and developing countries over time (Figure 2).³²

The International Energy Agency (IEA) provides a dashboard of weighted average cost of capital for exemplary 100 MW solar PV and 250 MW gas fired power stations in five emerging economies: Brazil, India, Indonesia, Mexico, and South Africa. The cost of capital averaged between 9% and 14.5% in 2019–2021, with the highs reaching to 18.1% and the lower boundary around 5.5%. These energy projects are not operating under full merchant risk. Rather, they consist of feed-in tariff projects, purchasing power agreements and contracts for difference. Otherwise, the rates would be even higher.³³

Central bank policy rates for selected countries (2021)



Source: Bank for International Settlement, October 2022, Central bank policy rates



Figure 2: Central bank rates tend to be significantly higher in developing countries than in high-income countries such as the US and euro area.

³² United Nations Inter-agency Task Force on Financing for Development, April 2022, **Financing for Sustainable Development Report 2022**

³³ IEA, September 2022 (last updated), **Cost of Capital Observatory**, data explorer, <https://www.iea.org/data-and-statistics/data-tools/cost-of-capital-observatory>



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Factors driving high risk for clean energy projects in EDEs



Source: Adapted with stylistic changes only from IEA, last updated 23 September 2022, Cost of Capital Observatory, all rights reserved.

Figure 3: Factors driving high risk in addition to technology risk, increasing the weighted average cost of capital for cleantech in emerging and developing economies.

Figure 3 shows the main drivers for the added cost of capital as identified by the IEA, with regulatory risk being the most relevant, followed by political risk, off-taker risk (such as in a power purchasing agreement), currency and land acquisition risks, transmission risk, inflation and finally a lack of project pipeline.

Research shows that reducing the weighted average cost of capital through radical changes to capital flows results in faster and lower-cost decarbonisation pathways.³⁴

One important tool to lower the cost of capital is to de-risk the investment via investment guarantees. Today, individual cleantech projects can find investment guarantees at the same rate as other investments. The risk premium, however, is higher for cleantech investments due to the novelty of the technology. Therefore, from an investor perspective, additional incentives are required to lower the financial risk. Reducing the investment risk for cleantech would level the playing field and render the investment at least as attractive as other choices, considering the otherwise positive assessment of cleantech

³⁴ Ameli N et al., 2021, **Higher cost of finance exacerbates a climate investment trap in developing economies**, *Nature Communications*, 12, 4046



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opportunities. A special rate for green investment guarantees can offer this lever.

Development Finance Institutions (DFIs) cannot offer the volume of investment guarantees necessary for a climate-aligned development in the Global South. Guarantees are a relatively small subset of multilateral development banks' (MDBs) climate finance, estimated at about \$3.3 billion in 2020, compared to \$38 billion total MDB climate finance to developing countries.³⁵

Private re-insurance providers with their significant capital reserves could provide the leverage to scale up the guarantee portfolio to the level required to finance the global clean transition. DFIs can play an important role in getting re-insurers on board by offering first-loss capital. Another condition for ensuring participation of re-insurers is to reach sufficient scale. Individual projects cannot reach the necessary volume required to meet re-insurance standards. It is therefore necessary to aggregate individual projects not only within a country but at the regional level and offer the re-insurer the portfolio as subject. The portfolio approach also contributes to risk-diversification. While regional pooling in a regional de-risking platform may lead to risk clustering, a large enough scale of regions can balance this out. A regional pool is preferable firstly because it can be managed by regional development banks, and secondly because it can provide the benefit of regional expertise in the portfolio oversight.³⁶

An early example of a regional guarantee platform is the AfDB's Africa Co-Guarantee Platform, though this does not have any specific climate or sustainability focus.³⁷

A private sector example of applying some of the concepts is Amundi Planet Emerging Green One where the International Finance Corporation (IFC) and other DFIs joined as anchor investors to de-risk the other tranches by taking on first-loss risk. The fund has sufficient scale (initially \$1.42 billion, growing to \$2 billion) to be attractive to institutional investors.³⁸

³⁵ IMF, July 2022, **Mobilizing Private Climate Financing in Emerging Market and Developing Economies – Staff Climate Note 2022/007**

³⁶ E3G, 2021, **Closing the trillion dollar gap to keep 1.5 degrees within reach**

³⁷ African Development Bank Group website, **Africa Co-Guarantee Platform**, <https://www.afdb.org/en/topics-and-sectors/initiatives-partnerships/africa-co-guarantee-platform> (last accessed 18 January 2023)

³⁸ OECD, 2021, **Scaling up green, social, sustainability and sustainability-linked bond issuances in developing countries**



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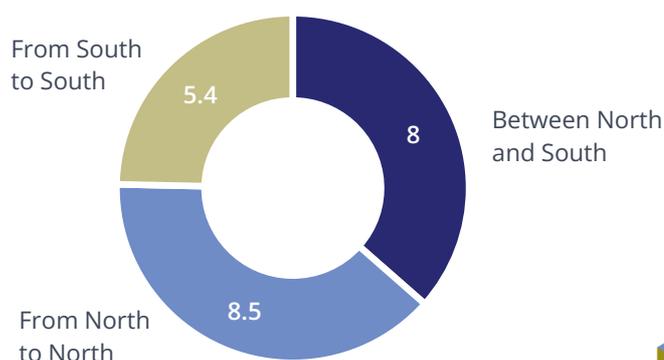
The specific design of regional de-risking platforms will need to be adapted to the individual situation and may have more or less of a role for public or private entities. In any case, these platforms can only unlock a massive growth of cleantech projects, if a pipeline exists and can be implemented. This requires for example capacity and a skilled workforce.

Trade access and privileges for climate

Trade links emerging and developing economies with developed economies. Trade flows have suffered during the pandemic but are now reaching new highs. This is partly driven by price inflation, and partly by the global recovery. Global trade in goods and services reached \$7.7 trillion in the first quarter of 2022, an increase of \$1 trillion year-on-year and an overall record number. While annual trade in goods and services dropped to \$22.5 trillion in 2020 from \$25 trillion in the previous year, it then rebounded to \$28 trillion in 2021.³⁹

While still smaller than North–North trade, trade among Global South countries has reached a total volume of \$5.4 trillion (Figure 4).⁴⁰ This includes a wide range of countries. South–South trade is most prominent in East and South Asia and least in Latin America. Intra-regional trade is very pronounced in China and the rest of East Asia, but low in South Asia, Africa and Latin America, reflecting a lack of regional economic integration.⁴¹

Global trade flows (2021, in trillion US\$)



Source: UNCTAD, 2023, Handbook of Statistics 2022.



Figure 4: Trade among Global South countries has been growing but is still smaller than trade between countries in the South and those in the North.

³⁹ UNCTAD, July 2022, **Global trade hits record \$7.7 trillion in first quarter of 2022**

⁴⁰ UNCTAD, 2023, **Handbook of Statistics 2022 – Trade structure by partner**

⁴¹ UNCTAD, March 2022, **Key statistics and trends in international trade 2021**



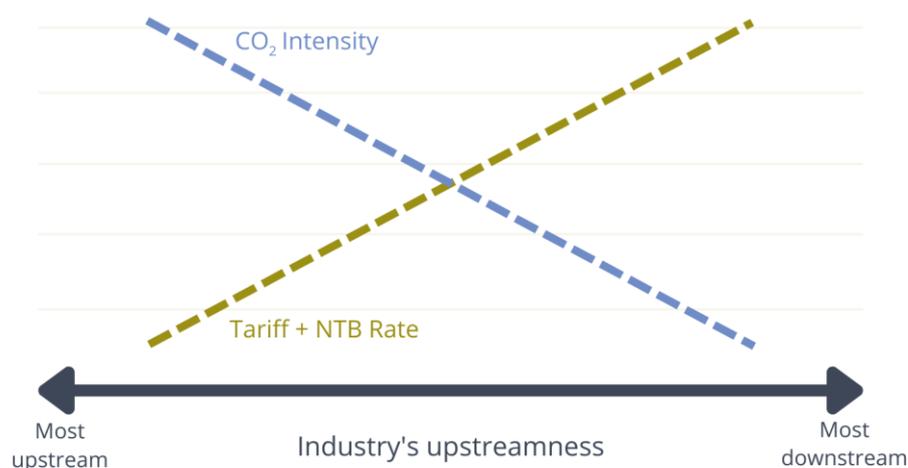
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This implies that we need to not only think about climate-aligning trade between the North and the South, but also increasingly within the Global South, making it even more relevant to work towards global trade rules being climate-aligned.

Currently, we see that high-emissions goods (or bads) are proportionally less subject to customs tariffs and nontariff barriers compared to green and clean goods. This is due to strategic inclinations to reduce the additional costs on energy imports, but also the fact that more refined or processed goods tend to be subject to higher import duties (Figure 5), making fossil fuel imports in principle less taxed than, for example, solar panels.⁴² Shapiro estimates the implicit subsidy in global trade to be around \$85–120 per tonne of CO₂.

Overall, tariffs on environmentally preferable products (EPPs)⁴³ amounted to 7.3% in 2018, significantly higher than the global tariff average.⁴⁴

CO₂ intensity and trade barriers across global trade (qualitative)



Source: Adapted from Shapiro, J, 2020, The Environmental Bias of Trade Policy, *The Quarterly Journal of Economics*, 136:2, 831–886, DOI: [10.1093.aje.qjaa042](https://doi.org/10.1093.aje.qjaa042)



Figure 5: Across global trade, high-emissions goods tend to be subject to lower tariffs and barriers than low-emissions goods. NTB = nontariff barriers.

⁴² Shapiro J, 2020, The Environmental Bias of Trade Policy, *The Quarterly Journal of Economics*, 136:2, 831–886, DOI: [10.1093.aje.qjaa042](https://doi.org/10.1093.aje.qjaa042)

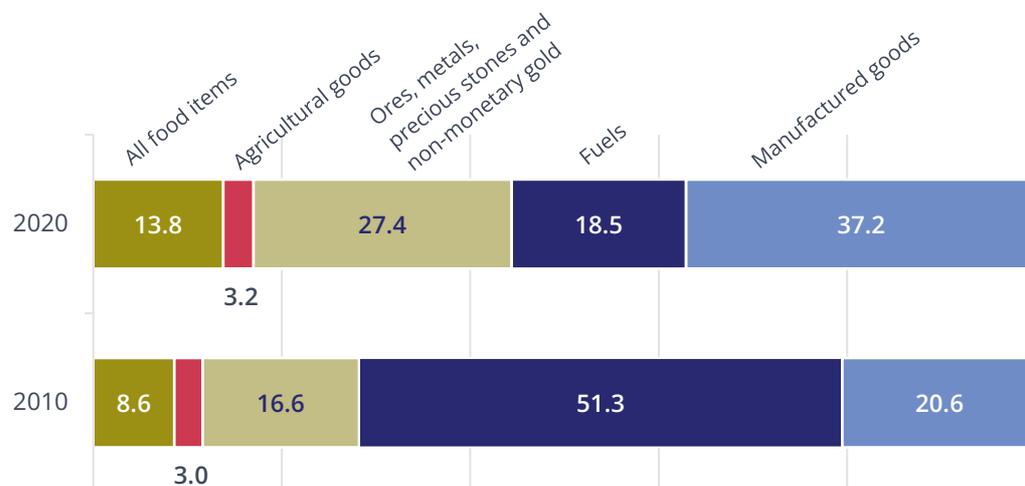
⁴³ Defined by the World Bank as “durable products, reusable products, energy-efficient products, low-pollution products, products (including those used in services) that contain the maximum level of post-consumer waste and/or recyclable content, and products that in any other way have a minimal harmful impact on the environment.” The World Bank, **Environmentally Responsible Procurement**

⁴⁴ Brenton P, Chemutai V, 2021, **The Trade and Climate Change Nexus: The Urgency and Opportunities for Developing Countries**. Washington, DC: World Bank



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Export structure by product group in least developed countries in 2010 and 2020 (percentage)



Source: Brenton P, Chemutai V, 2021, *The Trade and Climate Change Nexus: The Urgency and Opportunities for Developing Countries*. Washington, DC: World Bank.



Figure 6: While emerging economies are increasingly trading manufactured goods, fuels and metal ores still make up a significant proportion of their trade flows.⁴⁵

Reducing the tariff burden on environmental goods and services benefits both importers and exporters, reducing the overall cost of the transition to a net zero emissions society. This implies that reducing these tariffs unilaterally is economically advantageous.⁴⁶

Aside from the barriers to trade in environmental goods specifically, the tariff structures limit the extent to which EDEs can diversify their exports in general. Emerging economies currently primarily focus on exports of fuels and metal ores, though the share of manufactured goods is increasing over time (Figure 6).

Even in the preferential trade framework, agricultural and manufactured goods are subject to higher tariffs compared to natural resources.⁴⁷ In general, agricultural products are taxed higher than manufacturing and natural resources.

⁴⁵ Brenton P, Chemutai V, 2021, **The Trade and Climate Change Nexus: The Urgency and Opportunities for Developing Countries**. Washington, DC: World Bank

⁴⁶ Centre for European Reform, January 2022, **The EU should remove tariffs on environmental goods**

⁴⁷ UNCTAD, March 2022, **Key statistics and trends in trade policy 2021**



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For example:

- > South Asian and East Asian countries apply markedly higher tariff rates to agricultural goods compared to Latin America or developed countries.
- > Tariffs on manufactured goods are about 8% in both South Asia and Africa.
- > Globally, tariffs are close to 8% on vegetable products and even higher for beverages, while they are close to zero for fuels and metal ores.
- > Key export goods for developing countries such as textiles and apparel are taxed at a relatively high 6%.

This prevailing tariff structure penalises certain goods and favours others, impeding both development and decarbonisation while providing little to no benefits, except for a privileged few in the Global North.

Adding to the penalising tariff structure, the nontariff export barriers that EDEs often face limit the potential positive contribution of trade to development.

About 30% of product lines and 70% of world trade is subject to nontariff barriers to trade. Figure 7 (next page) illustrates the impact of various measures. Agricultural products are most affected by nontariff measures, as most of agricultural trade is subject to sanitary and phytosanitary⁴⁸ measures and/or technical barriers to trade.⁴⁹ Taking into account the significance of agricultural trade for developing economies, this results in lower trade activity and lost development potential.

Countries in the Global North could offer those in the South trade privileges within the scope of WTO rules to reward them for climate action. These trade benefits could range from entering a free trade agreement at the highest ambition level, to removing nontariff barriers to trade at the lower end of the effort spectrum.

One recent example is the Comprehensive Economic Partnership Agreement (CEPA) between the European Free Trade Association (EFTA) and Indonesia, specifying that sustainable palm oil will receive preferential tariff treatment.⁵⁰

⁴⁸ regarding the health of plants.

⁴⁹ UNCTAD, 2021, **Key statistics and trends in trade policy 2021**

⁵⁰ Deere Birkbeck C, 2021, **Greening international trade: Pathways forward**, Global Governance Centre and the Forum on Trade, Environment & the SDGs (TESS): Geneva



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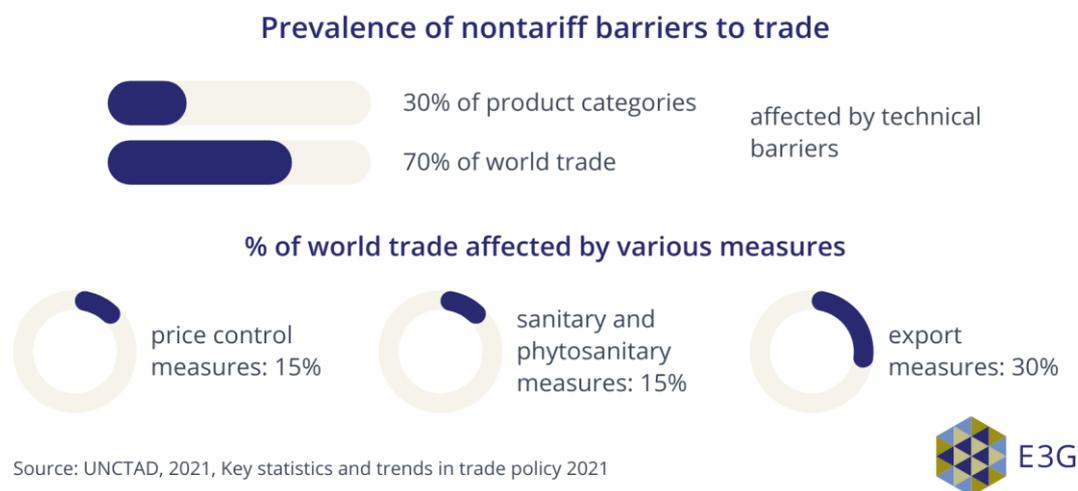


Figure 7: Nontariff barriers affect a significant proportion of world trade.

Looking at driving trade in environmental goods in Africa in particular, the EU and US can update two existing unilateral trade tools: the EU's Everything But Arms (EBA) and the US African Growth and Opportunity Act (AGOA) preference programmes, which allow duty-free and quota-free access for certain products from specific countries. Reforming these programmes is both an opportunity and a necessity. For example, 83% of exports from Africa to the US under AGOA in 2017 were petroleum products. Among non-oil exports, apparel is a prominent category.⁵¹ Fostering trade in sustainable products seems to be a promising pathway.

There is a certain sense of urgency as the AGOA authorisation expires in September 2025. Without renewal, several low-income countries might lose out on development opportunities.⁵² A renewal of AGOA could serve to align the programme with climate objectives. Similarly, the EU's EBA could be climate- and SDG-aligned to increase the overall benefits deriving from the system.

These discussions should also link back to current proposals for carbon border adjustments and carbon-intensity standards for imported goods, such as steel and aluminium. Respectively, such trade incentives could also be worked the other way, where importing countries in the Global North could directly support industrial decarbonisation efforts in exporting countries in the Global South in

⁵¹ Coulibaly S, Woubet K, Zeufack AG, eds, 2022, **Africa in the New Trade Environment: Market Access in Troubled Times**, Washington, DC: World Bank

⁵² Congressional Research Service, January 2022, **African Growth and Opportunity Act (AGOA)**



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response to further climate-aligned cooperation, which links to the following area of access to technology.

Reform of trade rules

There are ample possibilities for reforming the WTO trade regime, which dates to 1994 and consists currently of 164 members. There is no explicit inclusion of climate concerns in the WTO agreement, despite it coming into existence following the 1992 Rio Earth Summit, which led to the United Nations Framework Convention on Climate Change (UNFCCC). The underlying General Agreement on Tariffs and Trade (GATT) evades climate considerations altogether and has only limited protections for people and planet. It foresees in Article XX (b), exceptions “necessary to protect human, animal or plant life or health”. The emphasis here is on “necessary,” setting a high bar for justification. This implies a hierarchy of objectives, where freedom of trade is given higher priority than protections for humans, animals and plant life on earth. A trade measure can only be justified if it is necessary to protect these three categories, not merely because it would benefit them.

Aligning trade and climate regulatory frameworks can sometimes be hindered by WTO principles. WTO principles of non-discrimination between countries (the Most Favoured Nation principle) may contradict UNFCCC principles such as common but differentiated responsibilities (CBDR).⁵³ Non-discrimination between “like”⁵⁴ products under WTO rules can make it difficult to distinguish between environmentally harmful or beneficial products. This is because trade rules cannot differentiate between products that are identical in terms of physical attributes but may have been produced with less carbon intensive methods – for instance, green steel compared to conventional steel.

The principle of CBDR also results in a differentiated treatment of developing and developed nations within the UNFCCC. In comparison, WTO rules have a softer principle of Special and Differential Treatment, which allows developing countries more time to implement agreements, access to preferential tariff schemes, and technical support.⁵⁵

⁵³ Opinio Juris, September 2022, **The “Common but Differentiated Responsibilities” – WTO Conundrum**

⁵⁴ Likeness being defined on a case-by-case basis at the WTO.

⁵⁵ World Trade Organization website, **Special and differential treatment provisions**, https://www.wto.org/english/tratop_e/devel_e/dev_special_differential_provisions_e.htm (last accessed 18 January 2023)



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Developed countries blame certain developing countries of abusing the self-declaration as developing nation to gain trade advantages under the special and differential treatment provisions. James Bacchus is among the voices arguing for a more granular differentiation of the “developing” status. Such voices argue that the more developed developing countries currently benefit from excessive protections, whereas the least developed countries are under-protected. Their proposal also calls for a clearer definition of what special rights are covered under this provision.⁵⁶ From a theoretical and legal perspective, this makes sense.

It remains unresolved how countries should be convinced to voluntarily give up rights and benefits unless they can get something in return. There is no specific voting process established at the WTO; the default decision-making mechanism is unanimity, another element that it has in common with the UNFCCC. And unlike the climate framework agreement, WTO trade rules are enforceable and foresee punitive action and procedures. From a developing country’s perspective, breaking up the established protective regime would offer only risks, but no reward – unless one would introduce rewards, such as technology transfer.

Technology transfer

Developing countries state a need for technology transfer or technology support to be able to add more value to their resources. Increasing the amount of value added by developing countries to global supply chains would help diversify exports away from raw materials and reduce the wealth funnelled away from the Global South. More added value translates into economic development, opportunities for social development, and building up capital (financial, human and social). This capital can then become the basis for increasing climate resilience and driving a post-carbon economy. In Africa, “45 of its 54 economies still rely on raw materials for over 60 percent of their exports”, according to W. Gyude Moore, Senior Policy Fellow at the Center for Global Development.⁵⁷

The UNFCCC aims to address this need via the Technology Executive Committee and the Climate Technology Centre and Network (CTCN) since 2010, but progress has been slow. This may also be the result of inadequate tools, structures and means at the hands of the CTCN, which so far focuses mostly on technical

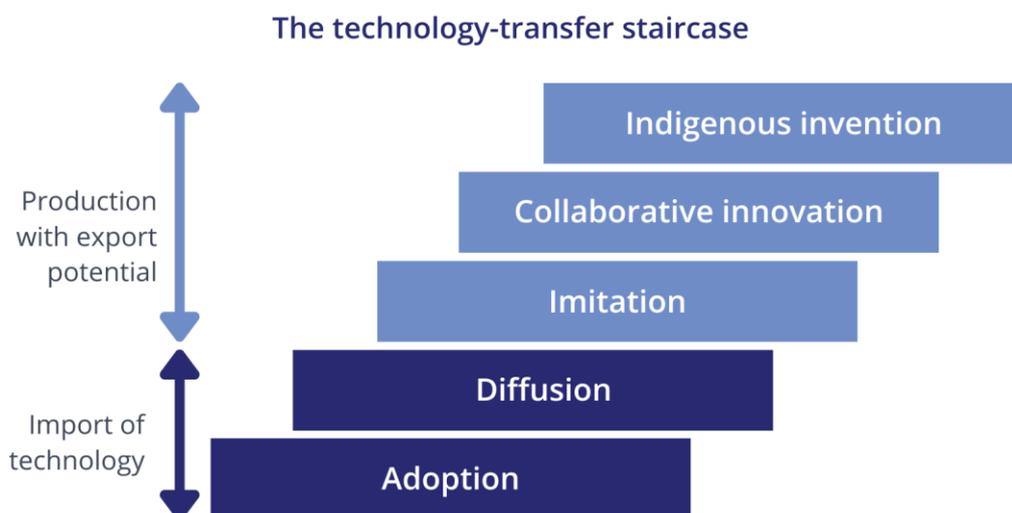
⁵⁶ Cato Institute, April 2020, **The Development Dimension: What to Do about Differential Treatment in Trade**

⁵⁷ Center for Global Development, August 2022, **The New US Africa Strategy Recognizes the Continent’s Promise but Faces a Looming Credibility Gap**



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assistance and never had the political consensus to go further. To go beyond the status quo, developing countries have suggested that green patents be purchased via the Green Climate Fund (GCF) or directly made available, but these initiatives have not succeeded.⁵⁸



Source: Adapted with stylistic changes only from Pigato, MA, Black SJ, Dussaux D, Mao Z, McKenna M, Rafaty R, Touboul S, 2020, Technology Transfer and Innovation for Low-Carbon Development, Washington, DC: World Bank. Creative Commons Attribution CC BY 3.0 IGO

Figure 8: This figure shows the different stages of technology transfer, from importing a foreign technology to domestic production with the potential for further innovation.⁵⁹

Technology transfer is a process with different levels of transfer quality, ranging from adoption to indigenous invention, as described in the technology-transfer staircase (Figure 8).

Given that technology transfer constitutes a global issue, multilateral fora seem best positioned to effectively allocate cleantech intellectual property (IP) rights and technology access on a concessional basis. The GCF could cover the costs for technology transfer to low-income countries.⁶⁰ Given the limited resources of the GCF, this does not seem like a near-term option. The US and the EU could

⁵⁸ Engineering and Technology, 2021, **The role of technology transfer in raising climate ambition**

⁵⁹ Pigato, MA, Black SJ, Dussaux D, Mao Z, McKenna M, Rafaty R, Touboul S, 2020, Technology Transfer and Innovation for Low-Carbon Development, Washington, DC: World Bank. DOI: [10.1596/978-1-4648-1500-3](https://doi.org/10.1596/978-1-4648-1500-3), based on: Cirera, X, Maloney W, 2017, **The Innovation Paradox: Developing-Country Capabilities and the Unrealized Promise of Technological Catch-Up**, Washington, DC: World Bank

⁶⁰ Pigato, MA, Black SJ, Dussaux D, Mao Z, McKenna M, Rafaty R, Touboul S, 2020, Technology Transfer and Innovation for Low-Carbon Development, Washington, DC: World Bank. DOI [10.1596/978-1-4648-1500-3](https://doi.org/10.1596/978-1-4648-1500-3)



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initiate their own green IP bank to facilitate the transfer of IP rights for cleantech. Even this option is limited by the need for private sector cooperation, except in those limited cases where the government holds the IP rights. Here, public research institutes could make their patents available at a reduced cost. More broadly, governments could request companies receiving research funding to open the resulting IP to users in the Global South via the vehicle of a green IP bank. This is just one way that development aid should adapt.

A green, concessional patent technology bank could also succeed if driven or initiated by a group of Global South countries, pooling resources, and intellectual property, as an example of South–South cooperation.⁶¹

Access to cleantech patented technology is just one aspect to consider. In many instances, lack of capital, rather than access to intellectual property, is the main barrier to deploying cleantech in the Global South. This is where technology transfer links back to the question of encouraging foreign direct investment. To achieve technology diffusion in the developing economy, it is important that cleantech projects be co-developed and built with an open IP framework. Encouraging joint-ventures to manufacture and produce cleantech in Global South countries could achieve tangible results. In this context, the conditions for the joint-venture are crucial to ensure that a fair share of development benefits flows to the host country. The Global North can encourage such fair joint-ventures by providing favourable conditions for guarantees for cleantech investments, which leads to our next tool.

Capacity building

Technology and capital cannot yield lasting development without the necessary human capacity in the Global South. Education and training for both blue-collar and white-collar jobs in cleantech will be essential.⁶² Ultimately, this should focus on developing educational infrastructure in the Global South, at both the high and low end of the skill spectrum. The goal should be co-development, and even own development of cleantech in the Global South. Therefore, programmes must not be isolated, but rather built into an education–innovation ecosystem, enabling research, discovery, and development.

⁶¹ UNCTAD, September 2022, **South-South Cooperation for Climate Adaptation and Sustainable Development**

⁶² Pigato, MA, Black SJ, Dussaux D, Mao Z, McKenna M, Rafaty R, Touboul S, 2020, Technology Transfer and Innovation for Low-Carbon Development, Washington, DC: World Bank. DOI: [10.1596/978-1-4648-1500-3](https://doi.org/10.1596/978-1-4648-1500-3)



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An important way of transferring knowledge and building capacity is for the Global North to host international students from developing countries. Programmes to promote educational mobility should be designed with this goal in mind and provide skills and capacities that can be applied in the home country.

However, such programmes carry the risk of brain drain, which can depress economic development in the Global South.⁶³ Building an education infrastructure within those countries themselves therefore constitutes an added benefit, especially since the cost of education per student is significantly lower in developing countries compared to the Global North, considering real estate and salary costs.

Building out training and education facilities for cleantech and green innovation in the Global South is as yet an under-explored avenue.⁶⁴ Still, creating new educational institutions is by far not the only option. Skills and capacity building can take many forms, including programmes in existing national universities or within companies.

Capacity building does not end with building capacity in people, but goes far beyond that:⁶⁵

- > Organisational capital: the capacity of companies to absorb and deploy cleantech.
- > Institutional capital: the capacity of government institutions to support and facilitate cleantech.
- > Physical capital: the quality of infrastructure.
- > Financial capital: on the expansion of foreign direct investments, supported by, i.e., investment guarantees.

⁶³ Pigato, MA, Black SJ, Dussaux D, Mao Z, McKenna M, Rafaty R, Touboul S, 2020, Technology Transfer and Innovation for Low-Carbon Development, Washington, DC: World Bank. DOI: [10.1596/978-1-4648-1500-3](https://doi.org/10.1596/978-1-4648-1500-3)

⁶⁴ Examples include: German University of Technology in Maskat / Oman (GUtech), in cooperation with RWTH Aachen; the Vietnamese–German University (VGU), in cooperation with the German State of Hessian and the German Ministry for Education; and the German–Mongolian University for Raw Materials and Technology, a cooperation of the German academic exchange service and the development agency. See: DAAD, **Binationale Hochschulen, Fakultäten und Institute**

⁶⁵ Pigato, MA, Black SJ, Dussaux D, Mao Z, McKenna M, Rafaty R, Touboul S, 2020, Technology Transfer and Innovation for Low-Carbon Development, Washington, DC: World Bank. DOI: [10.1596/978-1-4648-1500-3](https://doi.org/10.1596/978-1-4648-1500-3)



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There is no simple blueprint to follow, but the above list shows how only an organic cleantech ecosystem can yield successful technology transfer. Within the large group of countries in the Global South, starting conditions vary widely, both in terms of financial attractiveness as measured in the BloombergNEF Climate Scope Score⁶⁶ and policy quality as expressed in the Regulatory Indicators for Sustainable Energy (RISE) score of the World Bank.⁶⁷ Consequently, measures to foster technology transfer need to be tailored to countries' respective specific needs and conditions.

Only in concert can these tools yield a New Fair Deal

Next steps for getting the EU and the US on board: venues, moments, and opportunities

The European Union – and its key member states – and the United States have a unique opportunity to shape the agenda and influence the discussion when they are in a forum with others, and to take action and initiative in venues that they own exclusively, such as the EU–US Trade and Technology Council (TTC). Specific steps for the EU and US to take bilaterally either in the TTC or in other contexts include:

- > Offering debt relief for climate through their national and regional development banks such as the European Bank for Reconstruction and Development (EBRD).
- > Launching regional guarantee platforms (with the intention of linking these to the MDBs when these are ready).
- > Offering trade access and privileges for climate action, based on common standards and processes.
- > Working together to reform WTO trade rules.
- > Promoting technology transfer, including through a joint cleantech IP bank.
- > Fostering capacity building, including through co-developing research and education hubs in Global South countries, but also by developing organisational and institutional capital as part of their development work.

⁶⁶ BloombergNEF, **Climatescope** website, <https://global-climatescope.org/> (last accessed 18 January 2023)

⁶⁷ The World Bank, 2017, **Regulatory indicators for sustainable energy : a global scorecard for policy makers**



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Currently, leaders on both sides of the Atlantic are not fully invested in such a reset of North–South relations, partly because the narrative of what this new future might look like is not yet fully developed. In times of crisis, leaders tend to turn inwards and gather around tried and tested ideas, rather than attempting something new.

The Global North can only maintain its wealth and prosperity if there is a drastic betterment for the South. Just like ecosystems are interconnected, so are human societies. While a focus on domestic priorities may seem rational in the short term, it may lead to disaster in the long term. This is what inspired the United States after WWII to be proactive in the world, to rebuild Europe. By doing so, they also created a multitude of customers and markets. Transposing this line of thinking to today’s challenges, the EU and US could – applying our recommended tools – drastically grow the markets for cleantech around the world, meaning that even a smaller market share would correspond to an absolute economic gain.

Despite being on a finite planet, there is so far no shortage of capital, labour or technology that keeps us from achieving an outcome that is – in a Pareto-improving sense – better for all.