European Parliament

Improving EU action to end poverty in developing countries

Cost of non-Europe report

STUDY

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Progress on the United Nations Sustainable Development Goals has been insufficient, not least because of shocks such as the COVID 19 pandemic and recent wars. The cost of this lack of progress is borne by 'least developed countries' – low-income countries with low indicators of socio-economic development, as defined by the UN.

This study reviews the European Union's role in policies that affect poverty in these contexts. It identifies 12 challenges that could be addressed to some extent by further EU action on development policy, climate action, trade and global value chains, and by the EU as an actor in multilateral forums, in line with the policy coherence for development principle.

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Executive summary

Why this study?

In his foreword to the United Nations (UN) 2023 report on the Sustainable Development Goals (SDGs), the UN Secretary General warns that progress on more than 50 % of SDG targets is weak and insufficient, and a further 30 % have stalled – or even gone into reverse,[1] indicating that considerable action is needed to achieve the SDGs.

On top of this deep-seated problem, recent crises such as the COVID-19 pandemic, ongoing wars and rising food prices, have been especially damaging for developing countries. Poverty has risen, and the impact of climate change on poorer countries has been particularly severe, signalling the urgency to step up efforts to achieve the green transformation and move to a sustainable track for the SDGs and Agenda 2030. It is not only about economic growth, but about 'how' growth is realised – and it is particularly about **shared improvements in social standards, living conditions, and environmental protection**.

It is therefore time to review the European Union's role in policies affecting these processes, especially those aiming to reduce poverty in the Global South, and identify where the EU, by playing a greater role, can achieve objectives that would be more difficult or costly for Member States to address on their own. These are especially to be expected in the generation of **public goods**, in the possibility to exploit **economies of scale** in mobilising resources, in **efficiency gains** deriving from a more efficient use of those resources, and in gains from **coordination**. Positive impacts can also be expected from the EU acting with a **single voice** in global arenas. Overall, **the gains that are not realised can be understood as the cost of non-Europe**.

This cost of non-Europe report was prepared upon a request from the European Parliament's Committee on Development (DEVE). It takes the broad European Parliament action on SDGs during the 2019-2024 legislature into account, including resolutions on implementation and delivery,[2] the European Parliament SDG Alliance[3] and European Parliament push for Policy Coherence for Development.[4]

What is the scope?

The study focuses on EU action that affects developing countries, with a focus on the 46 least-developed countries (**LDCs** – see Table 9, Annex I). As 33 out of 46 analysed LDCs are located in Africa, some sections of this report focuses on this continent in particular.

The EU has several levers at hand. This study takes a **broad approach** to these levers and focuses on several dimensions of different policy areas: official development assistance, debt policies, global taxation issues, climate policies, trade and global value chain policies, and multilateral rules. On one hand, poverty is driven by a lack and unfair distribution of resources, and on the other, it is the product of local and global inequalities that depend on how the global economy is shaped and the LDCs' (and other developing countries) position within it. Taking a holistic approach to considering

[1] United Nations, The Sustainable Development Goals Report Special edition, 2023.

[2] European Parliament resolution of 23 June 2022 on the implementation and delivery of the Sustainable Development Goals (SDGs) (2022/2002(INI)) and European Parliament resolution of 23 June 2022 on the implementation and delivery of the Sustainable Development Goals (SDGs) (2022/2002(INI)).

[3] An informal cross-parliamentary group of Members focusing on SDGs.

[4] Resolution of 14 March 2023 on Policy Coherence for Development (2021/2164(INI)).

these aspects is consistent with the Treaty-based EU commitment to **policy coherence for development**[5].

This report therefore considers the extent to which **more efficient EU action** could **raise sufficient and effective resources** and could **set rules to shape the global economy** to provide a more conducive global environment for development and **contribute towards the eradication of poverty**.

The research draws on a range of publicly available data from Eurostat and other sources, research reports, and expertise commissioned from RAND Corporation (see Annex II) and the Turin Centre on Emerging Economies (OEET) (see Annex III).

What are the key findings?

The study identifies **12 challenges**. The European Parliament has called for some of them to be addressed – grouped here in two main policy areas: (1) **Resources for development**; (2) **Trade, global value chains (GVCs) and global markets**.

In the first area, challenges are identified in the amount of official development aid (ODA) that goes to LDCs (the EU has not yet hit its target of 0.7 % of GDP), and more specifically to climate -related development finance. A challenge is also presented by the limitations that persist in coordination between Member States, despite the steps already taken, represented by the Neighbourhood, Development and International Cooperation Instrument-Global Europe (NDICI-Global Europe) and the 'Team Europe' approach. Moreover, several LDCs are in debt distress or at a high risk of it. Especially following COVID-19 and with interest rates rising, LDC's and other developing countries' payments on debt is crowding-out much needed social and climate change-related expenditure.

In the second area, challenges in EU trade and corporate governance tools in global value chains are analysed with respect to their ability to promote inclusive development, well-paid jobs and ultimately poverty reduction: in many cases, EU trade is reinforcing partner countries' patterns of specialisation in commodity exports or in the lower segments of value chains. The current need for 'critical raw materials' risks exacerbating this challenge. The recent food price crisis following the war in Ukraine has unveiled a challenge related to global food markets. These markets are highly concentrated and high profits made by multinational enterprises (MNEs) on foodstuffs go together with increased food insecurity in several countries.

The EU could address these challenges partly through (a non-exhaustive list of) about 20 areas of **EU-level action**, which can be grouped into three main categories:

- action to provide **more and more effective resources** for ODA and climate finance;
- action to reform **trade tools to make them more conducive to reducing poverty**;
- action to **promote a fairer global economy architecture**.

The policy options discussed in this paper may belong to one or more of these groups (see Figure 1).

[5] See Article 208 of the Treaty on the Functioning of the European Union and the new European consensus on development.

Figure 1 – Three categories of possible EU-level action to tackle poverty in LDCs

Source: S. Chahri, EPRS.

Some of these policy options involve the EU alone, while others require the EU to have **a greater and more unified say in global arenas**, and to support the rules-based multilateralism for which the European Parliament has been calling.

These actions can bring important **benefits that would otherwise be lost** – that is **the cost of non-Europe.**

As regards resources for development, EU-level action could help to achieve **economies of scale, reduce inefficiencies and promote coherence** with EU policies, most importantly on the green transformation and social standards. The benefits of EU action stem from better spending, better incentives for the private sector, and correcting for externalities.

EU-level action could pursue a long-term and cooperative approach to economic relations with third countries, rather than a simple exploitation of comparative advantages. For example, it could promote regional integration processes and support **value addition**. Doing so could help to achieve structural transformation, which could improve well-paid job opportunities and reduce poverty.

Moreover, as regards taxation, social and environmental standards in business operations, as well as MNE regulation, the international arena is a context of **strategic complementarities**: in the absence of policy intervention, there are incentives to compete on these issues in the global economy, triggering a **'race to the bottom'**. At the same time, everyone would benefit from an increase in social and environmental standards: the higher the trading partners' standards, the lower the cost

of maintaining these standards 'at home'. Similar reasoning can be applied to taxation. In these cases, there are strong benefits in acting at a supranational level.

The actions of a major global economic actor, such as the EU, impact on other countries and on the capacity to support global public goods; there are potential important benefits in acting consciously of the worldwide impact of EU policy actions. Clearly, most of the challenges related to poverty reduction in developing countries (and the actions needed to address them) have a global component that cannot be achieved by the EU alone. Nevertheless, the EU could both have an impact through its direct action and through a push to a **rules-based multilateralism that is appropriate considering the global scale of the challenges**. Missing this opportunity to act together as the EU represents the cost of non-Europe – which could be perceived as part of a broader 'cost of non-global action' (see Figure 2).

Should the EU miss the opportunity to commit to further action implies a cost for developing countries and also for the EU itself. If nothing is done beyond current initiatives, developing countries face a high risk of sovereign debt crisis, similar to the 1980s crisis, and a slower transition to higher value-added, green and inclusive economies. The EU misses out on having a strong voice and a position as global leader in building relations with third countries, on the economic gains of sustainable industrial policies, and risks undermining its own objectives that extend beyond its borders, such as climate neutrality.

Table 1 summarises the main findings.

Table 1 – Overview of key challenges, the cost of non-Europe and possible EU-level action

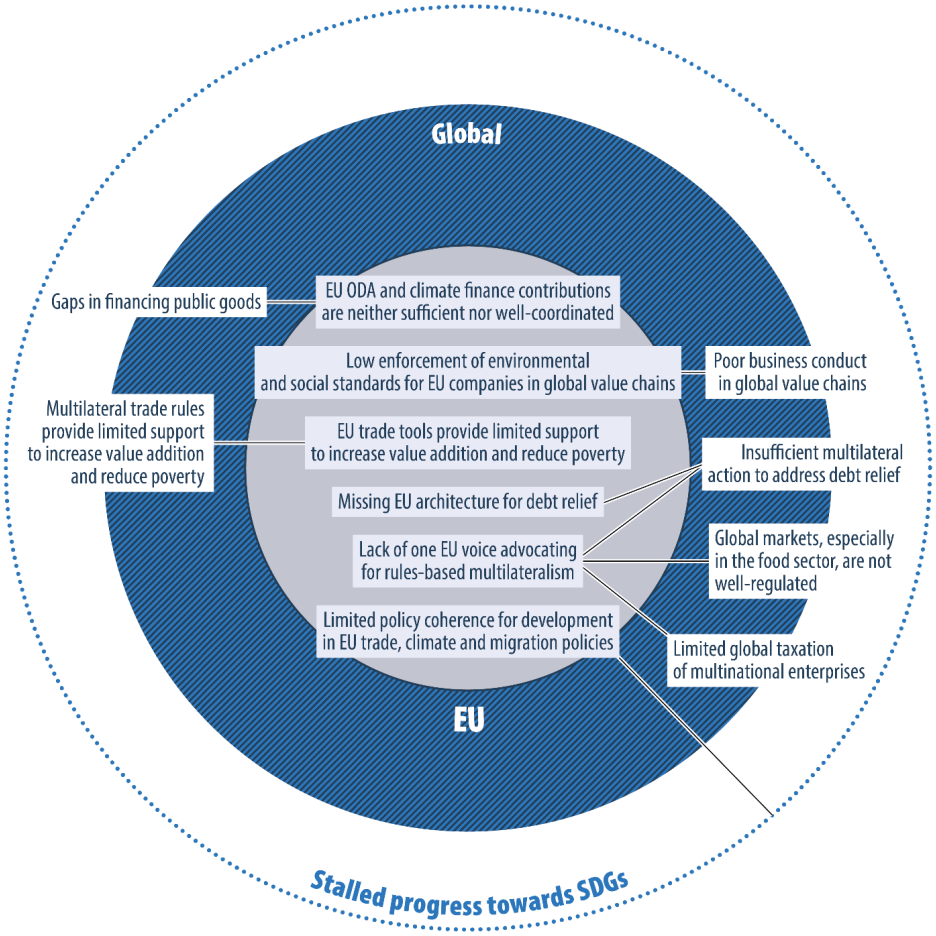
Key challenges	Cost of non-Europe	Possible EU-level action
#1 ODA from the EU and its Member States does not meet the established targets nor is it well-targeted	Higher multi-dimensional poverty. The Human Development Index (HDI) in developing countries could be lower (estimated 4.1 %) by 2050 due to the EU missing its ODA targets by 2050.	Scale-up joint programming Shift Member State ODA spending to the EU level
#2 ODA from EU Member States is fragmented	Continued low fiscal space and insufficient spending on health and education Efficiency loss of about €12.2 billion per year (equivalent to an increase of about 1.4 % on the HDI)	
#3 Many developing countries suffer debt distress	High risk of sovereign debt crisis in developing countries, similar to the 1980s crisis, and a slower transition to green and inclusive economies Lower ODA effectiveness Low fiscal space and financing of public goods	Promote debt-relief measures that are aligned with sustainability commitments Consolidate EU constituency in the International Monetary Fund Transparency requirements for donor governments Establish a fully European public development bank platform
#4 The EU plays a limited role in debt distress	Higher multi-dimensional poverty. Not cancelling the extra debt incurred by developing countries during the COVID-19 pandemic could lead to a lower HDI (estimated 3 %) by 2050.	
#5 Insufficient public climate finance for adaptation and resilience building in developing countries	Sustainable development and poverty reduction in LDCs is challenged by costs of climate-provoked loss and damage Food insecurity in LDCs Climate adaptation gap in LDCs continues to grow	Raise new public resources for climate adaptation and loss and damage including through tools based on the polluter pays principle. Present coordinated joint international financial pledges, e.g. for loss and damage.

Key challenges	Cost of non-Europe	Possible EU-level action
#6 Insufficient and uncoordinated private finance mobilised by for climate adaptation	Constrained, fragmented and less-impactful European private climate finance for development	Better coordination at EU level between MDBs, PDBs and DFIs to unlock private climate investment especially for climate adaptation projects
#7 LDC exports focus on commodities and the low end of GVCs	The current Economic Partnership Agreements are expected to reinforce the existing pattern: missed structural transformation in LDCs Low creation of well-paying jobs Limited integration between export sector and internal demand and lack of fiscal and policy space to support internal demand	Revise trade tools to support structural transformation, internal integration of LDC economies and fiscal and policy space Support technology transfer to and funding of infrastructure in LDCs
#8 Low regional integration among LDCs	Added value in regional value chains is bigger than in GVC: missed structural transformation in LDCs Low creation of well-paid jobs Benefits of free movement of people not tapped	Shape policies to support regional integration in LDCs, especially in the framework of the African continental free trade area (AfCFTA) Migration policies that support intra-African mobility
#9 Trade and climate tools have limited PCD	Risk of unfair distribution of cost of decarbonisation Limited green transition	Make EU Carbon Border Adjustment Mechanism more development coherent Improved green technology transfer to LDCs

Key challenges	Cost of non-Europe	Possible EU-level action
#10 Low enforcement of environmental, social and governance standards in global value chains	Race to the bottom in social and environmental standards Higher risk of human rights violations, environmental damage and lower work conditions	Mandatory due diligence standards for companies in the supply chain Enforceable UN Treaty on business and human rights Enforceable Trade and Sustainable Development chapters in free trade agreements
#11 Gaps in regulation of global food markets.	Increased food insecurity together with high profits in food sector Food dependency and vulnerability to shocks	Revive rules-based multilateralism targeted to SDGs in World Trade Organization and beyond, e.g. to better regulate global food markets
#12 Gaps in global architecture on taxation of MNEs	Loss of fiscal space Unfair distribution of resources between MNEs and LDCs Missed poverty reduction (potential increased HDI of1.7 % by 2050) Missed fairness in functional and geographical income distribution	Revive rules-based multilateralism, e.g. implement Organisation for Economic Co-operation and Development Two Pillar agreement, support UN Framework Convention on International Tax Cooperation

Source: EPRS.

Figure 2 – Shortfalls in EU action are related to shortcomings in global action



Source: S. Chahri, EPRS.

Table of contents

Table of figures

Table of tables

List of abbreviations

ACP	African, Caribbean and Pacific countries
AfCFTA	The African continental free trade area
ASEAN	Association of Southeast Asian Nations
BEPS	Base erosion and profit shifting
CBAM	Carbon border adjustment mechanism
CSDD	Corporate Sustainability Due Diligence
COREPER	EU committee of permanent representatives
DFIs	Development finance institutions
DEVE	European Parliament's committee on development
DRGR	Debt relief for green and inclusive recovery
DSSI	Debt service suspension initiative
EBRD	European Bank for Reconstruction and Development
EIB	European Investment Bank
ECOWAS	The Economic Community of West African States
EEAS	European External Action Service
EFAD	European financial architecture for development
EFSD+	European Fund for Sustainable Development Plus
EPAs	Economic partnership agreements
ESA	Eastern and Southern Africa
ETS	Emissions trading system
EU	European Union
EUTF	EU Emergency Trust Fund
FDI	Foreign direct investment
FTA	Free trade agreement
GDP	Gross domestic product
GNI	Gross national income
GSP	Generalised Scheme of Preferences
GVCs	Global value chains
HDI	Human Development Index
HIPC	Heavily indebted poor countries

IDA	International Development Association
ILO	International Labour Organization
IPR	Intellectual property rights
IMF	International Monetary Fund
IMFC	IMF International Monetary and Financial Committee
ISS	Institute for Security Studies
JEFIC	Joint European Financiers for International Cooperation
LDCs	Least-developed countries
LICs	Low-income countries
LMICs	Low- and middle-income countries
MDBs	Multilateral development banks
MNEs	Multinational enterprises
NDICI-Global Europe	Neighbourhood, Development and International Cooperation Instrument-Global Europe
ODA	Official development aid
OECD	Organisation for Economic Co-operation and Development
OEET	Turin Centre on Emerging Economies
PDBs	Public development banks
R&D	Research and development
RBC	Responsible business conduct
SADC	Southern Africa Development Community
SDGs	Sustainable development goals
SIDS	Small island developing states
SSA	Sub Saharan Africa
TSD	Trade and sustainable development
UN	United Nations
UNEP	United Nations Environmental Programme
UNCTAD	United Nations Conference on Trade and Development
UNFCCC	United Nations Framework Convention on Climate Change
V20	The Vulnerable Twenty group

1. Introduction

1.1. Objective

This forward-looking study investigates the challenges facing policies that address or impact poverty in developing countries, as practiced by the EU and its Member States and assesses the potentially significant added value that a greater EU role could offer. Stated differently, this potential European added value can be understood as avoiding the costs that would be incurred if the EU does not pursue any additional action. A greater EU role in these areas would not require Treaty change. It could include legislative or non-legislative action, budgetary spending, investment and guarantees, assistance, supervision and enforcement action, or could involve citizens and communication activities.[6]

The EU's development policy is one of the pillars of EU external action. It seeks to foster sustainable development and stability in developing countries with the goal of eradicating extreme poverty.[7] **Sustainable development is not equivalent to economic growth and is not simply about raising gross domestic product (GDP).** It rather implies quality growth[8] and the promotion of human capabilities.[9] There could be an important EU added value in mobilising development assistance (and SDG financing), in improving its efficient use via greater coordination, and in other EU action in support of promoting poverty eradication. These actions could be directed to mobilise resources for development globally; to address climate change, which has a major impact on poverty; and to redesign international trade, global value chain governance and investment policies; so that they are conducive to development and serve to eradicate poverty. The EU is also bound by the Treaties to ensure **policy coherence for development as repeatedly underlined by the European Parliament** and to correct for externalities, for example by ensuring respect for the 'polluter pays principle'. The European Parliament has recently renewed its call for Policy Coherence for Development (PCD), calling particularly for 'a "PCD mainstreaming network" gathering members of committees involved in legislation, other committees and delegations for relations with developing countries acting as focal points, in close cooperation with DEVE'.[10]

This report acknowledges that development objectives (and especially poverty eradication in the poorest countries) are a product of action in several policy areas. **Resources available for investment in public goods such as education and health** are a major factor, and global debt, taxation policies and development aid all have an effect. However, **the way the global economy is shaped** also has a crucial impact on poorer countries' position: deepening structural inequalities and concentration patterns in global value chains further weaken poorer countries. **Climate change** is making several countries in the Global South more vulnerable: fair decarbonisation policies as well as resources for adaptation to climate change are needed. The EU has committed to play a major role in all these areas. This report therefore employs a wide scope and aims at adopting a holistic approach to poverty reduction.

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6 Christof Cesnovar, Meenakshi Fernandes, Aleksandra Heflich et al., Mapping the cost of non-Europe report: Theoretical foundations and practical considerations, EPRS, European Parliament, October 2023.

7 Article 208 of the Treaty on the Functioning of the European Union (TFEU) defines the reduction and eradication of poverty as the primary objective of EU development policy.

8 Akbar Noman, Joseph Stiglitz, Ravi Kanbur, The Quality of Growth in Africa, Columbia University Press, August 2020.

9 Amartya Sen, 'Development as Freedom'. Oxford: Oxford University Press, 2019. Research by Nobel Laureate Amartya Sen has helped to change the understanding of development from transformation of the economy to being about expanding peoples' freedoms and capabilities.

10 European Parliament resolution of 14 March 2023 on Policy Coherence for Development (2021/2164(INI)).

1.2. Analytic approach

This cost of non-Europe analysis is underpinned by several fundamental principles, particularly respect for the **principles of subsidiarity and proportionality**. Subsidiarity does not simply mean EU action versus no action. In areas of non-exclusive EU competence (e.g. development policy), it mainly allows the most appropriate level of governance to assume its responsibility to act and for coordination to take place in an efficient way. In areas of exclusive EU competence (e.g. trade policy), the cost of non-Europe can refer to the scope or intensity of EU action. This analysis considers the cost of not pursuing further action at the EU-level (i.e. continuation of the status quo), compared with the alternative, which could be a higher intensity of action at the EU level.

In view of the above, this study primarily analyses the consequences of taking no further EU action on developing countries, with a lesser focus on the impact on the EU (on which we normally focus in cost of non-Europe reports).[11]

The research **identifies notable gaps between ongoing EU action and commitments** in support of development objectives, which most notably include ODA and climate finance targets. Financial figures are often reported in US$ and this currency is retained in this study due to the fluctuating exchange rate between the US dollar and the euro and to ensure the traceability of sources. Factors that limit the efficiency and effectiveness of EU and Member State action in developing countries are also highlighted. The **research presents avenues for further EU action and the cost of not pursuing them**. It considers EU action from a global perspective – as development policy and the SDGs are a global responsibility and commitment. Some avenues for EU action could be pursued alone, while others require multilateral cooperation.

The key measure to assess the gaps, the challenges and the costs of not pursuing further EU action on development policy is **multi-dimensional poverty**. This indicator not only captures income poverty but also the lack of access to, and poor quality of, health and education services, as well as other factors such as food insecurity. The assessment draws on research reports and quantitative and qualitative data and evidence obtained from public sources (e.g. Organisation for Economic Co-operation and Development (OECD) International Development Statistics databases), as well as commissioned quantitative modelling expertise from the RAND Corporation (see Annex II) and qualitative expertise from the Turin Centre on Emerging Economies (OEET) (see Annex III). The quantitative analysis primarily relies on the **Human Development Index (HDI)** developed by the United Nations Development Programme as a measure of multi-dimensional poverty.[12] This dataset covered 48 countries, of which 23 were LDCs between 2000 and 2021. The average HDI value across the dataset of this study stands at 0.55 (spanning a range from 0.3 to 0.78), while among LDCs it hovers around 0.48 (with a range from 0.29 to 0.67).

1.3. Geographic scope

Taking a broad scope, this analysis includes all developing countries (low and middle income), while paying closer attention to the **46 least developed countries (LDCs),** presented in Figure 3 (and listed in Table 9 in Annex I).[13] The broad scope is necessary because more than half of the world's

[11] Christof Cesnovar, Meenakshi Fernandes, Aleksandra Heflich et al., Mapping the cost of non-Europe report: Theoretical foundations and practical considerations, EPRS, European Parliament, October 2023.

[12] As noted in Annex II – RAND (Section 1.3), these measures were not only chosen for their empirical representation of multidimensional poverty but also due to their frequent use in previous studies.

[13] We still analyse 46 LDCs, while as of 13 December 2023, Bhutan graduated from the LDCs group making it a 45-nation group.

poor (62 %) reside in middle income countries.[14] At the same time, more than half of the extremely poor people in the world reside in LDCs.[15] **LDCs are the most vulnerable and fragile[16] countries and face overlapping challenges from climate change, conflict, and low resilience to shocks and their spill-over effects,** such as the COVID-19 pandemic and Russia's invasion of Ukraine. As noted by the World Bank, of the population living in the LDCs:[17]

- 22 % lack access to adequate sanitation;
- 33 % lack access to safe drinking water;
- 65 % lack access to electricity; and
- 37 % do not have access to clean cooking technologies

As LDCs are in greatest need of resources and of a global financial and trade architecture that facilitates structural transformation and progress towards the SDGs, this analysis considers this set of countries as the primary target of further, more ambitious, EU development policy action. As 33 out of 46 analysed LDCs are located in Africa, some sections of this report focus on this continent in particular.

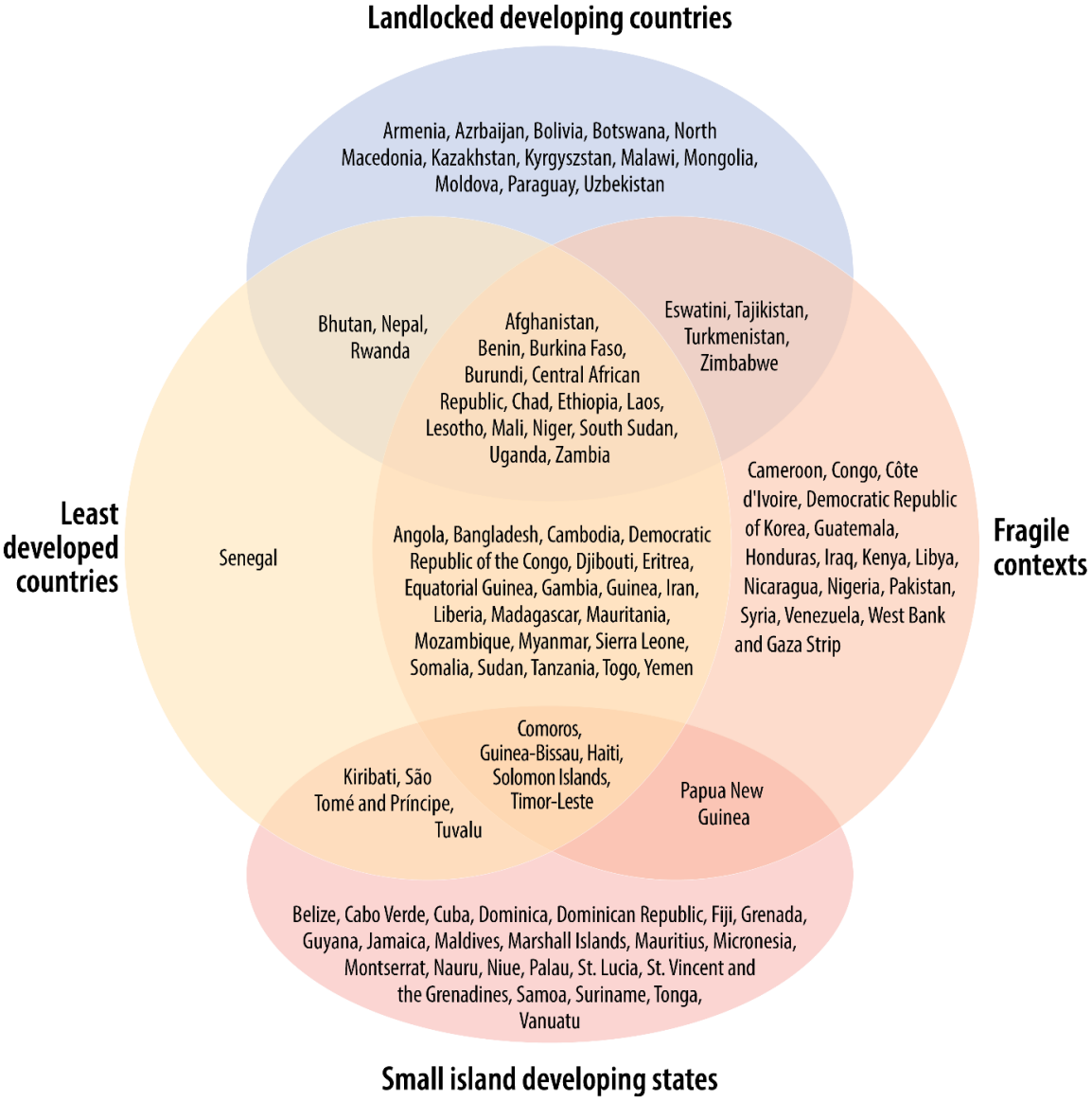
[14] The World Bank in Middle Income Countries, World Bank.

[15] United Nations Conference on Trade and Development (UNCTAD), The least developed countries in the post-COVID world: Learning from 50 years of experience, 2021. This figure was calculated in relation to six transition pathways.

[16] 'The OECD DAC defines fragility as the combination of exposure to risk and insufficient capacity of the state, system and/or communities to manage, absorb or mitigate those risks', OECD.

[17] UNCTAD, Why the least developed countries need urgent action, 6 March 2023.

Figure 3 – An overview of LDCs



Source: OECD; Graphic: S. Chahri, EPRS.

2. Financial resources for development

Developing countries require significant financial resources to recover from the COVID-19 pandemic, to increase resilience to climate change and to get on track to reach the SDGs. Yet, there are significant shortfalls and these pressures are especially felt by the LDCs. The United Nations Conference on Trade and Development (UNCTAD) estimates that US$462 billion of annual investment is needed each year between 2021 and 2030 to meet the growth target (SDG 8.1). It also estimates that US$485 billion in annual investment is needed over the same period to eradicate extreme poverty (SDG 1.1).[18] Climate change has major negative impacts, as the least developed countries are among the most exposed to adverse effects (despite contributing the least to global warming), and have the least resources to adapt and withstand extreme climate events.[19]

To address these investment shortfalls, LDCs need to strengthen their fiscal capacity, promote the mobilisation of domestic resources, scale-up climate financing sources, and improve the efficiency of public expenditure. External financing will continue to play an important role. Research by the Institute for Security Studies (ISS) shows that **aid has the greatest impact on poverty reduction in low-income countries (LICs) in Africa** and is followed by foreign direct investment (FDI).[20] From a global perspective, the EU and its Member States provide the highest level of ODA, one of the main forms of external financing for developing countries.[21] These contributions include bilateral ODA agreed with specific countries, and multilateral aid that is channelled to UN and private organisations.

This study identifies **six main challenges** facing financing for development that could be partly addressed by more EU action – as the European Parliament has called for. The cost of non-Europe is assessed for each challenge, with the assessment summarised in Table 2.

[18] United Nations Conference on Trade and Development (UNCTAD), The least developed countries in the post-COVID world: Learning from 50 years of experience, 2021. This figure was calculated in relation to six transition pathways.

[19] The Intergovernmental Panel on Climate Change, Synthesis Report of the IPCC Sixth Assessment Report (Ar6), 2023. Swiss Re, World economy set to lose up to 18% GDP from climate change if no action taken, 2021. African Development Bank Group, Climate Change and Green Growth Strategic Framework, 2023. African Development Bank Group, Gender, Poverty and Environmental Indicators on African Countries 2022. UNCTAD, The Least Developed Countries Report 2022.

[20] Kouassi Yeboua and Jakkie Cilliers, Financial Flows, 27 February 2024.

[21] The European Council reports that the EU's collective ODA reached €70.2 billion in 2021. It accounts for 43 % of global ODA. Council of the European Union, Annual Report 2022 to the European Council on EU Development Aid Targets – Council conclusions (18 July 2022).

Table 2 – Challenges and opportunities for EU action on financial resources for development

Challenge	Opportunities for EU action	EP resolution	Costs of not taking the EU action (the cost of non-Europe)
#1 ODA commitments not met	Meet ODA commitments	European Parliament resolution of 13 December 2023 on EU development cooperation to enhance access to education and training in developing countries (2023/2067(INI)) European Parliament resolution of 15 June 2023 on the implementation and delivery of the Sustainable Development Goals (2023/2010(INI)) European Parliament resolution of 23 June 2022 on the implementation and delivery of the Sustainable Development Goals (SDGs) (2022/2002(INI))	Lower fiscal space for LDCs due to diversion of public spending Higher risk that LDCs do not meet SDGs Higher poverty and infant mortality. Meeting ODA targets could lead to an increase in HDI of 4.1 % per country by 2050[1]
#2 Fragmentation of ODA	Shift development spending to EU level	European Parliament resolution of 25 November 2020 on improving development effectiveness and the efficiency of aid (2019/2184(INI))	Estimated efficiency losses of about €12.2 billion each year Lack of alignment in education priorities
	Streamline priority setting and programming at EU level		
#3 Many developing countries are	Consolidate EU representation in the IMF	European Parliament resolution of 15 June 2023 on the implementation	

Challenge	Opportunities for EU action	EP resolution	Costs of not taking the EU action (the cost of non-Europe)
suffering debt distress	Transparency requirements for donor governments Establish a fully European public development bank platform Promote debt relief measures that are aligned with sustainability commitments	and delivery of the Sustainable Development Goals (2023/2010(INI)) European Parliament resolution of 23 June 2022 on the implementation and delivery of the Sustainable Development Goals (SDGs) (2022/2002(INI)) European Parliament resolution of 24 November 2022 on the future European Financial Architecture for Development (2021/2252(INI)) European Parliament resolution of 12 April 2016 on the EU role in the framework of international financial, monetary and regulatory institutions and bodies (2015/2060(INI)).	High risk of sovereign debt crisis in developing countries similar to the 1980s crisis and a slower transition to green and inclusive economies Lower effectiveness of ODA Low fiscal space and financing of public goods Higher poverty and infant mortality. Cancelling extra debt incurred in 2020 could lead to an increase in HDI of about 3 % per country by 2050
#4 EU plays a limited role in debt distress			
#5 Insufficient climate finance for adaptation and resilience in developing countries	Raise new public resources for climate adaptation and loss and damage including through tools based on polluter pays principle Present coordinated joint international financial pledges e.g. for loss and damage	European Parliament resolution of 21 November 2023 on the UN Climate Change Conference 2023 in Dubai, United Arab Emirates (COP28) (2023/2636(RSP)) European Parliament resolution of 15 June 2023 on the implementation and delivery of the Sustainable Development Goals (2023/2010(INI)) European Parliament resolution of 23 June 2022 on the	LDC sustainable development and poverty reduction challenged by costs of climate provoked loss and damage Food insecurity in LDCs Climate adaptation gap in LDCs still growing

Challenge	Opportunities for EU action	EP resolution	Costs of not taking the EU action (the cost of non-Europe)
		implementation and delivery of the Sustainable Development Goals (SDGs) (2022/2002(INI)) European Parliament resolution of 25 March 2021 on a new EU-Africa Strategy – a partnership for sustainable and inclusive development (2020/2041(INI)) European Parliament resolution of 10 May 2023 on own resources: a new start for EU finances, a new start for Europe (2022/2172(INI))	
#6 Insufficient and uncoordinated use of private finance for climate adaptation	Better coordination at EU level to unlock private climate investment thanks to MDBs, PDBs and DFIs, especially for adaptation projects	European Parliament resolution of 21 November 2023 on the UN Climate Change Conference 2023 in Dubai, United Arab Emirates (COP28) (2023/2636(RSP)) European Parliament resolution of 23 June 2022 on the implementation and delivery of the Sustainable Development Goals (SDGs) (2022/2002(INI)) European Parliament resolution of 24 November 2022 on the future European Financial Architecture for Development (2021/2252(INI))	Climate adaptation gap in LDCs still growing Lack of coordination in European mobilisation of private climate finance for adaptation in LDCs leads to fragmentation, duplication, reduced impact and ineffective use of resources by European development finance actors

Source: EPRS.

2.1. Official development assistance

2.1.1. What are the challenges?

Challenge #1: Official development assistance from the EU and its Member States fails to meet targets, nor is it well-targeted

The EU and its Member States have fallen short of their commitments to provide ODA. Collective ODA reached 0.49 % of Gross National Income (GNI) in 2020, which fell short of the 0.7 % GNI target. Only four Member States met the 0.7 % GNI target (i.e. Denmark, Germany, Luxembourg and Sweden). The EU's collective ODA to LDCs reached 0.12 % of GNI in 2020, which fell short of the 0.15 % GNI target set for the short-term horizon.[22]

There is evidence to suggest that some ODA does not meet the basic criteria. **Up to 22 % of ODA provided by the EU in 2022 may not count as ODA**.[23] The overstatement includes an estimated €13.9 billion for in-donor refugee costs that have been largely driven by Russia's war in Ukraine, €2.8 billion in imputed student costs,[24] and €1.7 billion due to the use of the grant equivalent methodology for calculating ODA.

Such issues can be compounded by others, such as **elite capture of foreign aid**[25] and the **diversion of EU ODA to manage migration** – rather than address the root causes of migration.[26] The European Court of Auditors has also noted the **lack of a single approach to allocating EU funds across geographical programmes**, which undermines the coherence of the EU's external action.[27]

Challenge #2: ODA from EU Member States is fragmented

There are two forms of aid fragmentation in the EU. The first is the delivery of ODA by multiple Member States to the same recipient countries. This form of aid fragmentation can lead to **high administrative costs and limited economies of scale** in development aid financing.[28] Figure 4 illustrates this type of fragmentation.

In 2022, 27 LDCs had at least 15 donors from EU Member States. The highest number of EU donors was evident in Afghanistan and Yemen (26 and 24 EU Member State donors each). The second is the divergence in policy objectives, even within specific policy fields, which can **undermine the**

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22 Council of the European Union, Annual Report 2022 to the European Council on EU Development Aid Targets – Council conclusions (18 July 2022). Regulation (EU) 2021/947 of the European Parliament and Council (9 June 2021), which establishes the Neighbourhood Development and International Cooperation Instrument – Global Europe, refers to LDCs to reiterate the target of reaching between 0.15 % and 0.20 % of EU GNI as ODA to LDCs (0.15 % in the short term, and 0.20 % in 2030 Agenda timeframe).

23 European Confederation of NGOs working on sustainable development and international cooperation (CONCORD), AidWatch 2023: Bursting the ODA inflation bubble, 2023.

24 This is imputed from the share of education spending allocated to students holding a passport from an ODA eligible country.

25 Jorgen Andersen, Niels Johannesen, Bob Rijkers, Elite Capture of Foreign Aid: Evidence from Offshore Bank Accounts. Policy Research Working Paper; No 9150. World Bank, Washington, DC, 2020. The study finds that about 7.5 % of aid is captured by elites in the recipient country.

26 Oxfam, From Development to Deterrence? Migration spending under the EU Neighbourhood Development and International Cooperation Instrument (NDICI), September 2023. The root causes and drivers of migration could include poverty, inequality and vulnerability.

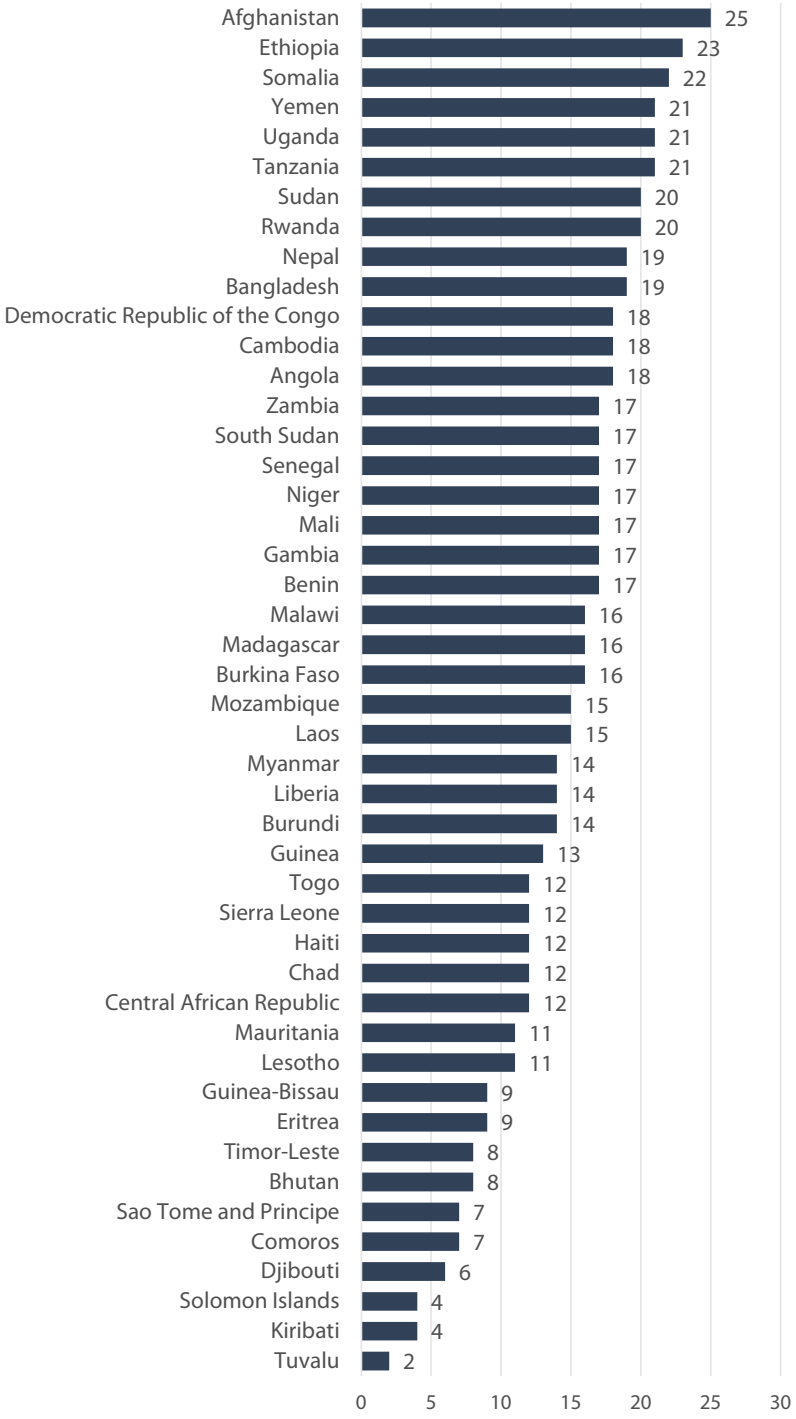
27 European Court of Auditors, Programming the Neighbourhood, Development and International Cooperation Instrument – Global Europe – Comprehensive programmes with deficiencies in the methods for allocating funds and impact monitoring, Special report 14, 2023.

28 Friedrich Heinemann et al., How Europe can deliver - Optimising the division of competences among the EU and its member states, Bertelsmann Stiftung, 2017.

coherence and effectiveness of the EU's development finance.[29] In the case of education finance, significant differences are evident in patterns of ODA spending on basic, secondary and post-secondary education across Member States, suggesting that each country has its own strategy and a lack of an overall EU approach (see Figure 5). Member State action in education finance, however, is not incoherent with the broadly defined SDG4 'Ensure inclusive and equitable quality education and promote lifelong learning opportunities for all'.

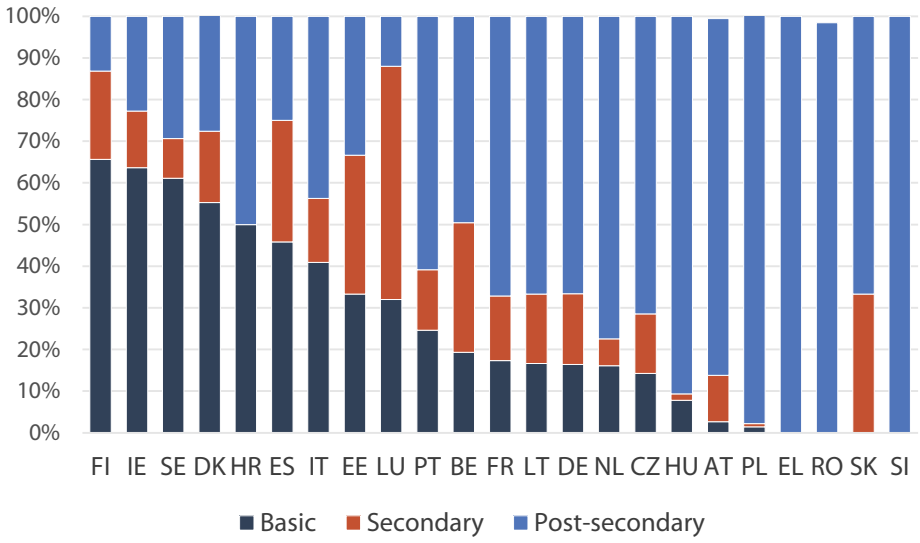
[29] Elena Muñoz Galvez, European Development Aid: How to be more effective without spending more?, Notre Europe, Policy Paper No 58, July 2012.

Figure 4 – Fragmentation in official development assistance to least-developed countries



Source: G. Macsai, EPRS based on OECD Data Explorer for ODA disbursements, 2022, data downloaded on 16 March 2024.

Figure 5 – Differences across Member States in ODA on education sector



Source: UNESCO, Education Finance Watch 2023, Graphic: G. Macsai.

2.1.2. What could the EU do about it?

Scale up coordination and joint programming

While it remains too early to evaluate, the Team Europe approach is a promising one: to help overcome the fragmentation in EU ODA by promoting coordinated action, sharing of information and communication within the EU, partner countries and global fora. The European Parliament considers that this approach could be taken for all development policy, and has called for a **proposal for an act concerning regulatory aspects of EU donor coordination** on development aid.[30] However, a stronger EU role could provide added value in this area. For example, shifting Member State ODA spending to the EU level could lead to greater consolidation and more efficient public spending.[31] As the European Parliament has called for, **the EU could scale up joint programming** to 'go beyond the mere consolidation of bilateral development priorities and actions and form a unified collective European voice'.[32] The European Parliament has also called for the fulfilment of commitments to ODA targets.[33]

[30] This request was made by the European Parliament to the European Commission in 2013, 2017 and 2020. The legal basis could be Articles 209 and 210 TFEU.

[31] Friedrich Heinemann et al., How Europe can deliver - Optimising the division of competences among the EU and its member states, Bertelsmann Stiftung, 2017.

[32] European Parliament resolution of 25 November 2020 on improving development effectiveness and the efficiency of aid (2019/2184(INI)).

[33] European Parliament resolution of 13 December 2023 on EU development cooperation to enhance access to education and training in developing countries (2023/2067(INI)).

2.1.3. Cost of non-Europe

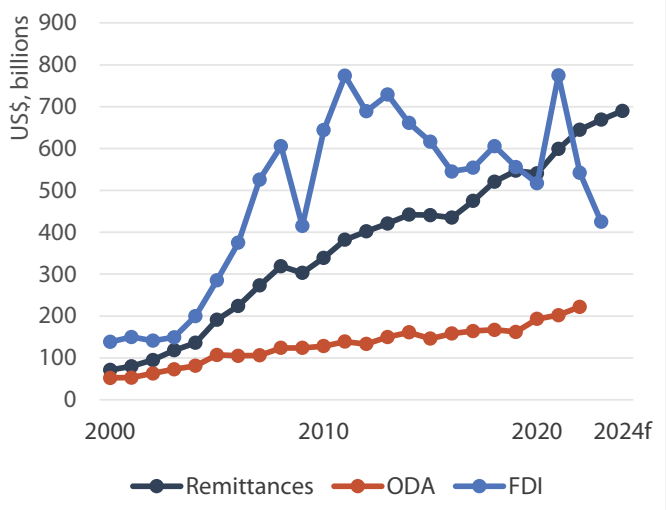
Despite the current challenges and shortcomings, this study finds suggestive evidence that **EU ODA has some impact on lowering multi-dimensional poverty in developing countries.** The evidence draws from a regression analysis, which is inspired by existing development economics research literature and tailored to the specific case of the EU.[34] The analysis focuses on ODA provided by EU Member States in 2000-2021 to 48 developing countries, of which 23 are LDCs.[35] The analysis tests the conceptual framework that EU ODA increases fiscal space in developing countries, which

Box 1 – Cost of non-Europe in development-coherent migration policies

Migrants' remittances are the main financial flow to low- and middle-income countries. This calls for an approach to migration that acknowledges the positive role that migration can play in development processes.

Remittances are the first financial flow to developing countries, bigger than ODA and FDI, as shown in the figure below (although ODA is bigger in the case of LDCs, as OECD data shows). Beyond remittances, other positive impacts of migration on the countries of origin found in the research are: transfer of knowledge and skills, human capital and investment brought by returnees (that are higher if migrants had good living conditions and the possibility to save in the migration country), creation of trade and business networks, incentives to education due to the prospects of migration, support for local public goods, and 'social remittances' (circulation of social norms and ideas). Importantly, researchers underline the relevance of policies in determining the actual impact of migration on the economic growth of migrants' countries of origin.

Financial flows to low- and middle-income countries over time



Source: Global Knowledge Partnership on Migration and Development (KNOMAD) Data downloaded on 24 March 2024

This more positive EU approach would also avoid a lack of political cooperation with third countries, especially in Africa**:** The lack of implementation of the promises of expanding labour migration opportunities has been a major source of frustration among African countries. Moreover, the EU's 'emergency approach' has had, according to scholars, a negative impact on accountability of government in partner countries.

Source: Cecilia Navarra and Meenakshi Fernandes, Legal Migration Policy and Law, European Added Value Assessment, 2021.

[34] The methodology underlying the two-stage model, which is inspired by the existing literature and designed to provide an analytical framework for capturing the complexity of the interactions between economic levers and social outcomes.

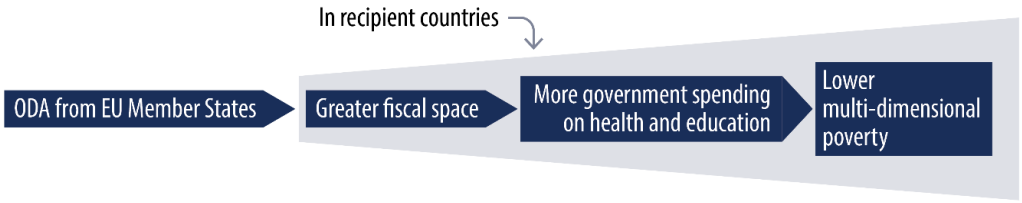
[35] Please see Annex II - RAND, Section 3.1.2. It notes that a 1 % increase in EU ODA is associated with an approximate 0.03 % increase in health and education expenditure, after controlling for other factors, notably country characteristics such as GDP and time trends.

supports increased spending on public goods such as health and education, which then leads to lower multi-dimensional poverty (see Figure 6). The analysis finds that **ODA from EU Member States has a statistically significant and positive impact on government spending on health and education.**[36]

The analysis also finds a positive relationship between government spending on health and education and **the Human Development Index.**[37] The HDI reflects three key dimensions: health (life expectancy at birth), education (mean years of schooling and expected years of schooling), and standard of living (per capita GNI).

The research considers a scenario where EU Member States meet their ODA commitments. It finds that success in this action could lead to a cumulative average increase in HDI in developing countries HDI of about 4.1 % per country by 2050.[38] Such an increase is significant considering trends in HDI over time in developing countries. For example, the HDI in Afghanistan increased from 0.362 to 0.483 between 2002 and 2020, representing an average annual growth rate of 1.8 %.

Figure 6 – Conceptual framework relating ODA to multi-dimensional poverty



Source: S. Chahri, EPRS, based on Annex III – RAND.

Reducing fragmentation of ODA from EU Member States could lead to budgetary savings of about €12.2 billion, under current patterns of ODA spending (see Table 3).[39] This is a significant sum, particularly from the perspective of developing countries. It represents about a third of the shortfall in government spending in the health and education sectors in LDCs.[40]

These estimated efficiency losses could be viewed from a different perspective – the improved effectiveness of EU ODA. Our regression analysis, which estimated the impacts in infant mortality and HDI due to meeting ODA commitments, was based on a gap value of US$40 billion. The potential budgetary savings of €12.2 billion represents about one third of this amount. **An integrated EU policy on ODA could effectively reduce today's gap between current Member State' spending and the EU-wide target by one third.** This narrowing of the gap could be equivalent to an increase in HDI by 2050. The reduction could be equivalent to a rise in HDI of 1.4 % per country by 2050.

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36 Annex II – RAND, Section 3.1.1. No relationship was found between ODA from Member States and military spending in recipient countries. The researchers consider that this may be due to the conditionalities in ODA, or that military spending is less closely linked with fiscal space than health and education spending.

37 Human Development Index, United Nations Development Programme – Human Development Reports website.

38 Annex II – RAND, Section 3.2.2, Scenario 1. The analysis excludes EU ODA.

39 Monika Nogaj, Cost of non-Europe in development policy – Increasing coordination between EU donors, European Parliamentary Research Service, 2013. More details can be found in Annex I.

40 This figure was calculated based on the latest data on government spending in health and education sectors (World Bank database), compared with international benchmarks for public spending (5 % GDP for health and 4 % GDP for education). Di McIntyre, Filip Meheus, Fiscal space for domestic funding of health and other social services, Chatham House Working Group on Financing Paper 5, March 2014; UNESCO, Education Finance Watch 2023.

The existing approach where Member States organise their own development aid leads to the **pursuit of their own national geopolitical interests, rather than EU geopolitical interests, thereby potentially missing an opportunity to build a real EU foreign policy**.[41]

Table 3 – Estimated efficiency loss due to the lack of a fully integrated EU approach to ODA

Source of cost of non-Europe	Scenario 1: Current levels of ODA (€, million)	Scenario 2: EU Member States fulfil ODA commitments (€, million)
Reduced transaction costs	408	489
Reduced volatility	2 447	2 936
Coordinated untying of aid	1 223	1 468
Moving to more general forms of aid	1 699	2 039
Coordination over poverty reduction as sole target	6 423	7 708
Total	12 201	14 641

Source: Chapter 50 in Meenakshi Fernandes, Aleksandra Heflich, Lenka Jančová, et al, Increasing European added value in an age of global challenges: Mapping the cost of non-Europe (2022-2032), EPRS, European Parliament, February 2023, which is based on Monika Nogaj, Cost of non-Europe in development policy - Increasing coordination between EU donors, EPRS, 2013.

[41] Friedrich Heinemann et al., How Europe can deliver - Optimising the division of competences among the EU and its member states, Bertelsmann Stiftung, 2017.

2.2. Debt distress

2.2.1. What are the challenges?

Challenge #3: Many developing countries are suffering debt distress

Recent crises, including the COVID-19 pandemic, have led developing countries to take on more debt. The total debt burden for low- and middle-income countries increased 9 percentage points in 2020, compared with an average annual increase of 1.9 percentage points over the previous decade.[42] In 2018-2020, **11 LDCs spent more on servicing debt than on education and health**.[43] This high level of public debt limits fiscal space for much-needed investment in public goods and the transformation to a more environmentally friendly society.

In November 2023, the IMF reported that **16 LDCs were at a high risk of debt distress**, which means they are at risk of defaulting on their loans.[44] A further six LDCs were already in debt distress at that time.[45] Indebted countries have, on average, 20 different creditors – which can include commercial banks, multilateral development banks and bilateral official creditors.[46] The share of debt from International Development Association (IDA) countries held by multilateral creditors has declined over time, while the share held by private creditors has increased (see Figure 7). About a third of external debt is based on variable interest rates.[47] This, coupled with high interest rates over recent years, has contributed to a high growth in debt payments to foreign creditors.[48] Developing countries with high climate vulnerability are among the most exposed to debt distress.[49]

42 World Bank, World Development Report 2022 – Finance for an equitable recovery.

43 United Nations Conference on Trade and Development (UNCTAD), The least developed countries in the post-COVID world: Learning from 50 years of experience, 2021.

44 IMF, List of LIC DSAs for PRGT-Eligible Countries as of November 30, 2023.

45 Laos PDR, Malawi, São Tomé and Príncipe, Somalia, Sudan and Zambia.

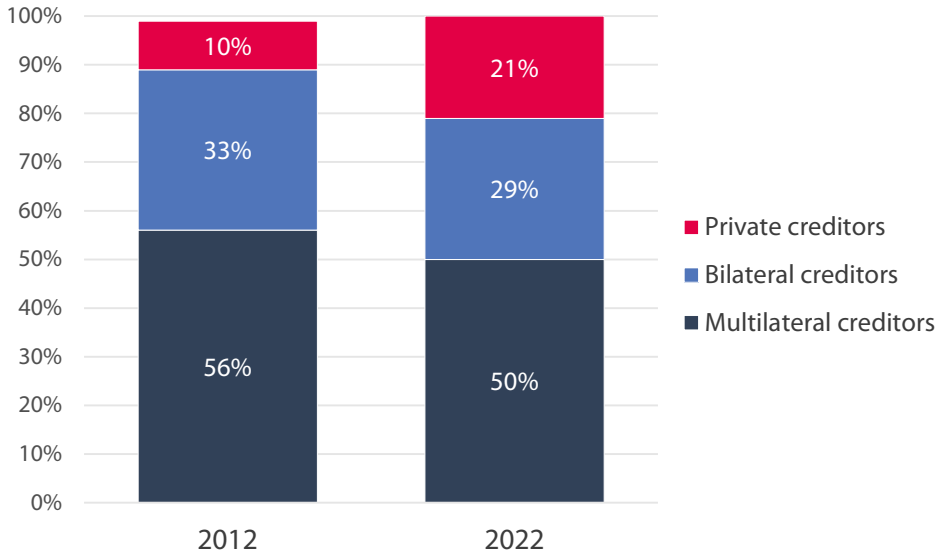
46 World Bank, World Development Report 2022 – Finance for an equitable recovery.

47 World Bank, International Debt Report 2023.

48 Allison Holland, Ceyla Pazarbas, How to ease rising external debt-service pressures in low-income countries, IMFBlog, January 2024.

49 Luma Ramos, Rebecca Ray, Rishikesh Ram Bhandary, et al., Debt relief for a green and inclusive recovery: Guaranteeing sustainable development, Boston University's Global Development Policy Center, April 2023.

Figure 7 – Creditor composition of long-term debt in IDA-eligible countries



Source: G. Macsai, EPRS, based on World Bank International Debt Report 2023.

Today, developing countries are not considered as vulnerable as during the period in the mid-1990s prior to the introduction of the Heavily Indebted Poor Countries (HIPC) debt relief initiative.[50] However, the situation could worsen.[51] To counter indebtedness, recently introduced initiatives include the Debt Service Suspension Initiative (DSSI), launched by the G20 in May 2020. **In total, 48 countries opted into the DSSI to postpone US$12.9 billion in debt-service payments.** In November 2020, the G20 introduced the Common Framework for Debt Treatments, which involves private sector creditors in debt relief and restructuring. As of January 2023, four countries have requested debt relief under the framework.

Challenge #4: The EU's limited role in debt relief policies

Membership in international fora such as the IMF is typically limited to sovereign nations and not open to currency unions such as the EU.[52] However, the European Central Bank has observer status on the IMF Executive Board, while the European Commission has observer status on the IMF International Monetary and Financial Committee (IMFC). While France and Germany each have a chair of their own on the Executive Board, the remaining EU Member States are distributed across six different constituencies, each of which forms its own common position.[53]

The European Commission also has observer status at the Paris Club. This club, founded in 1956, gathers 22 permanent members who are creditors to countries experiencing challenges with their debt payments. Of these 22 members, 11 are EU Member States.[54] As of 2023, 478 agreements with 102 debtor countries had been reached. As an observer, **the European Commission cannot take**

50 Chuku Chuku, Parteek Samal, Joyce Saito et al., Are We Heading for Another Debt Crisis in Low-Income Countries? Debt Vulnerabilities: Today vs the pre-HIPC Era, IMF Working Paper No 2023/079, 2023.

51 Allison Holland, Ceyla Pazarbas, How to ease rising external debt-service pressures in low-income countries, IMFBlog, January 2024.

52 Paul de Ryck, Towards unified representation for the euro area within the IMF, EPRS, July 2019.

53 IMF, Executive Directors and Voting Power, 22 February 2024.

54 Austria, Belgium, Denmark, Finland, France, Germany, Ireland, Italy, Netherlands, Spain and Sweden.

part in negotiations between creditors and debtors, nor sign the agreements stemming from them.[55]

2.2.2. What could the EU do about it?

The European Parliament considers that there is a need for **debt relief measures that are aligned with sustainability commitments**. A possible option could be the proposal from the Debt Relief for Green and Inclusive Recovery (DRGR) project – a collaboration between the Boston University Global Development Policy Centre, Heinrich-Böll-Stiftung and the Centre for Sustainable Finance, SOAS, at the University of London.[56] For the 67 countries eligible for the new Common Framework, the proposal would offer US$143.7 to US$235.8 billion in debt relief and US$37.1 to US$61.9 billion in debt swaps with sustainability-linked bonds. It would also offer credit enhancement to countries that are not in debt distress, but which lack fiscal space.

Enhance transparency and cooperation between public development banks and development finance organisations

The EU's role in debt relief could be strengthened via the European Financial Architecture for Development (EFAD) (see Figure 8). Greater cooperation could be fostered among public development banks, development finance organisations, the European Bank for Reconstruction and Development (EBRD) and the Joint European Financiers for International Cooperation (JEFIC). For example, **a fully European public development bank platform (the JEFIC+) could be established**.[57] The European Parliament also supports the establishment of a development branch within the European Investment Bank (EIB) Group and calls for a strengthened role in the field and greater cooperation with the European External Action Service (EEAS), EU delegations, the EBRD and European development finance institutions (DFIs).[58] Such cooperation could be coupled with **transparency requirements concerning the amount and type of credit provided to developing countries, and the conditions under which it is allocated**.[59] This information is not typically easily available and is a precondition for the restructuring of debt, where the EIB could potentially play an important role.

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55 Annex II – RAND, Section 2.2.1.

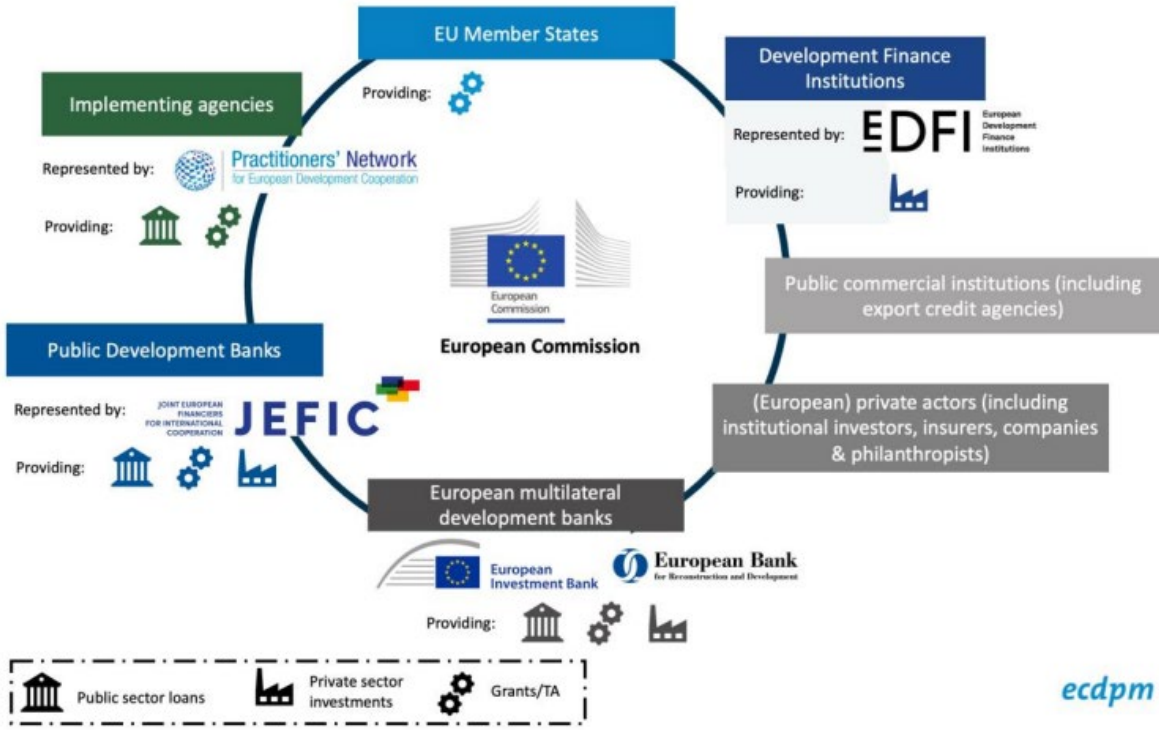
56 Luma Ramos, Rebecca Ray, Rishikesh Ram Bhandary, et al., Debt relief for a green and inclusive recovery: Guaranteeing sustainable development, Boston University's Global Development Policy Center, April 2023.

57 Karim Karaki, San Bilal, Strengthening the European financial architecture for development through better coordination, European Centre for Development Policy Management (ECPDM) Discussion Paper No 351, June 2023.

58 European Parliament resolution of 25 November 2020 on improving development effectiveness and the efficiency of aid (2019/2184(INI)); European Parliament resolution of 24 November 2022 on the future European Financial Architecture for Development (2021/2252(INI)).

59 United Nations Conference on Trade and Development (UNCTAD), Principles on promoting responsible sovereign lending and borrowing, January 2012.

Figure 8 – European financial architecture for development



Source: ECDPM.

Promote guarantees to engage the private sector

The private sector in some Member States has pursued innovative financing approaches – in particular, debt-for-nature swaps – that seek to reduce debt burden while providing fiscal space for investment in areas such as climate action.[60] A greater EU role could help to scale-up the use of innovative financing approaches to alleviate debt burden in developing countries. For example, the European Fund for Sustainable Development plus (EFSD+ could **increase the availability of guarantees that could help to attract and engage the private sector**.[61]

Enhance the EU's voice in the international finance arena

A stronger, collective EU voice, amplified by the European Financial Architecture for Development could be possible, for example, by **consolidating EU Member States into one constituency or seat at the IMF**. A single EU constituency could have a greater impact on IMF policies than the current arrangement, and could potentially allow the EU to wield as much power as the United States.[62] The European Commission presented a proposal in support of this action in 1998, before the adoption of the euro,[63] and again in 2015,[64] to unify the representation of the euro area (but not

60 Jim Brands, Stefan Wandrag, Ecuador's Galápagos Islands reap the benefits of innovative financing, ECPDM, May 2023.

61 Karim Karaki, Debt reform for climate action: Demand grows louder, but will Europe respond?, ECPDM, November 2022.

62 Lorenzo Blni Smaghi, A single EU seat in the IMF?, *Journal of Common Market Studies*, 42(2), 229-48, 2004.

63 European Commission, Proposal for a Council Decision on the representation and position taking of the Community at international level in the context of Economic and Monetary Union, COM/98/0637 final.

64 European Commission, Proposal for a Council Decision laying down measures in view of progressively establishing unified representation of the euro area in the International Monetary Fund, COM/2015/0603 final - 2015/0250 (NLE).

the EU) in the IMF. The European Parliament supports this move and considers that it should be subject to democratic scrutiny.[65]

A stronger EU voice in international financial institutions could increase the EU's influence over structural debt reforms in developing countries and help to **eliminate unsustainable lending practices**.[66] The EU could help to restore a multilateral development finance system that is more robust in the face of acute global challenges.

2.2.3. Cost of non-Europe

Debt distress in developing countries heightens the **risk of a debt crisis across LDCs that could repeat the 1980s crisis**.[67] This risk is reinforced by other trends including de-risking from China and the shift towards a more regionalised and services-driven globalisation.[68] An enhanced role for the EU with regards to debt distress in developing countries could help to lower this risk. The World Bank reports that debt relief initiatives in the past, such as the HIPC initiative have shown some success (see Box 2). **Countries that received support from the HIPC initiative spent about five times more on health, education and social services compared to debt service between 2001 and 2015**.[69]

Box 2 – HIPC initiative debt relief for Rwanda

The IMF and the World Bank introduced the HIPC initiative in 1996 to provide debt relief to heavily indebted countries. In total, 38 countries received support. One of these countries was Rwanda, which received full debt relief from the HIPC Initiative in April 2005. Rwanda increased its spending on poverty-reduction measures including on education and health by 50 % as a condition to receive the debt relief. Through the increased spending, Rwanda reformed primary teacher training centres and implemented health plans. Since the debt relief was provided, per-capita income in Rwanda increased by US$465, to US$849 in 2020.

Due to the COVID-19 pandemic and other shocks, Rwanda's external debt has increased and is reaching the pre-HIPC level (76 % GNI in 1996 and 74 % GNI in 2022). According to the IMF it has a moderate risk of debt distress. Of the 38 countries that received support from the HIPC initiative, 17 are in debt distress.

Source: World Bank, International Debt Report 2023. Chapter 5 – Managing Sovereign Debt Case study on Rwanda (box 5.1).

More EU action that supports the provision of debt relief aligned with sustainability commitments could help LDCs move towards a greener and more inclusive economy, while also helping to safeguard the provision of public goods such as health and education – as the European Parliament has called for.[70] The regression analysis prepared for the EPRS provides some evidence on the potential impacts of debt relief on developing countries. It finds suggestive evidence that debt is a particularly important factor in the level of spending in the education sector.[71] It finds that an

65 European Parliament resolution of 12 April 2016 on the EU role in the framework of international financial, monetary and regulatory institutions and bodies (2015/2060(INI)).

66 European Parliament resolution of 24 November 2022 on the future European Financial Architecture for Development (2021/2252(INI)).

67 Federal Deposit Insurance Corporation (FDIC), History of the Eighties: Lessons for the Future, Vol. 1, An Examination of the Banking Crises of the 1980s and Early 1990s, 1997.

68 Council of the European Union General Secretariat, Forward Look 2024 - Managing uncertainty, January 2024.

69 IMF, Debt Relief Under the Heavily Indebted Poor Countries Initiative (HIPC). International Monetary Fund, 2023.

70 European Parliament resolution of 13 December 2023 on EU development cooperation to enhance access to education and training in developing countries (2023/2067(INI)).

71 Annex II – RAND, Section 3.1. The regression analysis finds that a 1 % increase in debt is associated with an over 0.05 % reduction in per capita education expenditure, after controlling for country characteristics such as GDP and time

increase in debt is associated with lower per capita education expenditure. The analysis did not find a statistically significant relationship between debt and spending on health. Another study confirms the relationship between debt and education spending, finding that a 1 % increase in external debt can lead to a 2.9 % reduction in education spending per school-age child.[72]

The analysis presented in Annex II considers a scenario where additional debt incurred in 2020 following the COVID-19 pandemic is written off. In total, the scenario assumes debt relief of more than US$300 billion for 42 countries, which includes 21 LDCs. It finds that this level of **debt relief could lead to an increase in HDI of about 3.0 % per country by 2050, compared with 2020-2021 values**.[73]

More EU action on debt relief could also help illustrate the value added of ODA that fulfils its intended purpose. The RAND results show that **meeting ODA targets and debt relief could be more effective than meeting ODA targets alone.** The interaction between the two was not modelled in the regression analysis, but could provide potential for future research.[74]

2.3. EU climate finance is insufficient to help developing countries tackle climate change

Limiting global warming to 1.5 C degrees by the end of century, as well as increasing resilience to climate change and paying for the loss and damage it causes every year, requires considerable financial resources.[75] There is international consensus that **an urgent scale-up of different climate finance sources – public, private, international and domestic – is necessary,** including in developing countries.[76]

trends. Per capita expenditure is based on the total population, which provides a lower figure than per school-age child spending.

72 Elise Wendlassida Minningou, External debt, fiscal consolidation, and government expenditure on education, Cahier de recherche/Working Paper, July 2023.

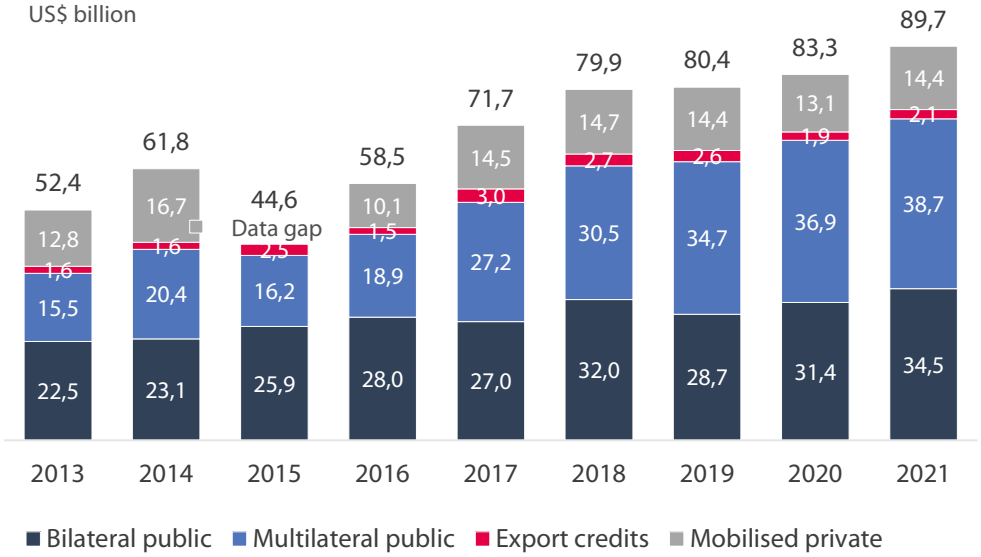
73 Annex II – RAND, Section 3.2.2.

74 Annex II – RAND, Section 3.2.2 presents a combined scenario of meeting ODA targets and debt relief. However, there is no interaction between the two. Meeting both targets would be an additional level of complexity and could be an area for future research.

75 Vera Songwe, Nicholas Stern, Amar Bhattacharya, et al., Finance for climate action: Scaling up investment for climate and development, London: Grantham Research Institute on Climate Change and the Environment, London School of Economics and Political Science, 2022.

76 UNFCCC, COP28, Long-term climate finance. Draft decision -/CP.28. Advance unedited version.

Figure 9 – Climate finance provided and mobilised by developed countries for all developing countries, 2013-2021



Source: OECD, Climate Finance Provided and Mobilised by Developed Countries in 2013-2021: Aggregate Trends and Opportunities for Scaling Up Adaptation and Mobilised Private Finance, Climate Finance and the USD 100 Billion Goal, OECD Publishing, Paris, 2023; Graphic: G. Macsai.

Despite an overall increase in available climate finance in the last decade, **developed countries have not yet fulfilled their 2009 pledge to provide US$100 billion per year to developing countries by 2020**[77] (Figure 9).[78] An OECD report published in November 2023 estimates that in 2021, climate financing provided from developed to developing countries reached US$89.6 billion.[79] As the climate finance data is only available after a delay, the OECD predicts that, the target might have finally been reached in 2022.[80] In the meantime, international climate negotiations for the new post-2025 climate finance goal for developing countries are ongoing and should finish in 2024. The European Parliament supports setting a new, higher goal that should account for developing countries' needs and priorities for additional and adequate climate finance.[81] Moreover, the OECD global overview of climate finance again confirms two persisting **trends to dedicate lower amounts to adaptation** (compared to mitigation) **and a low share of private finance** in climate finance.[82] These issues determine our choice of key challenges related to potential further EU action (see below). Accelerating climate risks require increasing resources for

[77] The Copenhagen Accord from which the pledge originates, is vague on the exact list of countries and the share of climate finance each has to deliver. This paper follows the OECD approach in tracking the US$100 billion commitment, which identifies all EU Member States as developed countries (see Table A.4.).

[78] OECD, Climate Finance Provided and Mobilised by Developed Countries in 2013-2021: Aggregate Trends and Opportunities for Scaling Up Adaptation and Mobilised Private Finance, Climate Finance and the USD 100 Billion Goal, OECD Publishing, Paris, 2023.

[79] Ibid.

[80] Ibid.

[81] European Parliament resolution of 25 November 2020 on improving development effectiveness and the efficiency of aid (2019/2184(INI)).

[82] In 2021, 60 % of climate finances provided and mobilised went towards mitigation (US$53.8 billion), 27 % to adaptation (US$24.6 billion) and 13 % (US$11.2 billion) to both/overlapping; OECD, Climate Finance Provided and Mobilised by Developed Countries in 2013-2021: Aggregate Trends and Opportunities for Scaling Up Adaptation and Mobilised Private Finance, Climate Finance and the USD 100 Billion Goal, OECD Publishing, Paris, 2023.

climate adaptation and mitigation.[83] It is estimated that spending on climate-related development goals (both mitigation and adaptation action) in developing economies (except China) will require US$2.4 trillion annually by 2030 (in both nationally and internationally raised climate finance), which means a four-fold increase is needed.[84] Importantly, over half could be financed by scaling up domestic resource mobilisation in developing countries (see sections 2.2 and 3). But **US$1 trillion per year will still be needed from external climate finance** flows to developing countries.[85] LDCs in particular depend on ODA, their most important external financial flow (second after remittances), whereas private investment and FDI remain insignificant.[86] Climate related finance channelled as ODA, as well as multilateral public finance (channelled e.g. through multilateral development banks (MDBs) and funds) is therefore a key external resource to address current loss and damage due to climate change, as well as to adapt and build climate change resilience for the future.

The United Nations Environmental Programme (UNEP) estimates that merely to close the **adaptation finance gap in developing countries requires US$194-366 billion per year**. The urgent need to at least double the adaptation finance provided by developed countries by 2025 (compared to 2019 levels) was stressed at COP26 (the Glasgow Pact).[87]

Estimating the **financial needs of future loss and damage is uncertain,**[88] but some reports estimate that **US$400 billion per year are needed** in developing countries.[89] Adverse climate change effects are creating additional risks for developing countries, especially as they reinforce existing inequalities and vulnerabilities.[90]

Both LDCs and LICs are especially vulnerable and less resilient to extreme weather events (e.g. drought, flood, extreme heat wave, storm, etc.), as well as slow-onset events provoked by rising global temperatures (e.g. higher sea levels, increased temperatures, ocean acidification, loss of biodiversity, glacial retreat, etc.).[91] [92] The adverse effects of **climate change therefore act as a 'risk multiplier'** that aggravates other existing economic, social, governance, security and environmental problems and worsens existing inequalities.[93] Climate-change effects can escalate

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83 Vera Songwe, Nicholas Stern, Amar Bhattacharya, et al., Finance for climate action: Scaling up investment for climate and development, London: Grantham Research Institute on Climate Change and the Environment, London School of Economics and Political Science, 2022.

84 Nicholas Stern and Amar Bhattacharya, Remarks made by Nicholas Stern and Amar Bhattacharya at the Summit for a New Global Financial Pact in Paris on 22 June 2023.

85 The latter will have to be covered by three groups of actors: 1) MDBs and other DFIs (around US$250 to US$300 billion) that will have to more than triple from current levels, 2) private finance (around US$500 to US$600 billion), a five-fold increase from current levels and 3) bilateral donors that comprises new and innovative sources of finance (around US$150 to US$200 billion); Vera Songwe, Nicholas Stern, Amar Bhattacharya, Finance for climate action: Scaling up investment for climate and development, London: Grantham Research Institute on Climate Change and the Environment, London School of Economics and Political Science, 2022.

86 OECD, External finance to Least Developed Countries (LDCs): A snapshot, 2022, OECD Publishing, Paris.

87 UNFCCC, COP26 Outcomes: Finance for Climate Adaptation.

88 Vera Songwe, Nicholas Stern, Amar Bhattacharya, et al., Finance for climate action: Scaling up investment for climate and development, London: Grantham Research Institute on Climate Change and the Environment, London School of Economics and Political Science, 2022.

89 Heinrich-Böll-Stiftung Washington, DC, The loss and damage finance landscape, 2023.

90 See more in Annex III – OEET.

91 UNFCCC, Synopses series: slow onset events.

92 While sudden-onset climate-related natural disasters get more attention and funding towards planning and preparation, experts say slow-onset climate hazards are being neglected. Devex, Addressing slow-onset climate hazards in Southeast Asia requires social protection, N. Coca, 12 April 2021.

93 EIB, The EIB Climate Adaptation Plan. Supporting the EU Adaptation Strategy to build resilience to climate change. As approved by the European Investment Bank Board of Directors on 13 October 2021.

other drivers, leading to violent conflict.[94] Moreover, countries that are most exposed and vulnerable to climate risks are often the poorest and highly indebted (see section 2.2).[95] In the last half-century, nearly 70 % of worldwide deaths caused by climate-related disasters were in LDCs.[96] Climate change also provokes biodiversity loss, natural environment degradation, leads to forced migration and increases the probability of pandemics. Adverse climate impacts have a higher impact on vulnerable social groups, including women, young people, people with disabilities, and indigenous people.[97] It has been estimated that 80 % of people displaced by climate change are women.[98] The economic losses over two decades (2000-2019) of the 55 most-climate-vulnerable economies – the Vulnerable Twenty group (V20),[99] comprising 68 countries of which 31 are also LDCs – equalled 1 % of GDP lost per year.[100] **In the most-at-risk economies, 51 % of growth was lost due to climate change** (between 2000 and 2019), and yearly GDP losses ranged from 4.6 % in Asia to 3.1 % in Africa (for the 10th percentile of the distribution).[101]

Table 4 – Overview of estimates of climate financing needs in all developing countries

Climate financing needs in developing countries	Estimated gap per year
Climate-related development goals (both mitigation and adaptation action)	US$2.4 trillion [a] (of which US$1 trillion needed in external climate finance)
Adaptation to climate change	US$194-366 billion [b]
Loss and damage	US$400 billion [c]

Source: [a] Vera Songwe, Nicholas Stern, Amar Bhattacharya, et al., Finance for climate action: Scaling up investment for climate and development, London: Grantham Research Institute on Climate Change and the Environment, London School of Economics and Political Science, 2022; [b] United Nations Environment Programme, Adaptation Gap Report 2023: Underfinanced. Underprepared. Inadequate investment and planning on climate adaptation leaves world exposed; [c] Heinrich-Böll-Stiftung Washington, DC, The loss and damage finance landscape, 2023.

94 Kyungmee Kim, Tania Ferré Garcia, Climate Change and Violent Conflict in the Middle East and North Africa, *International Studies Review*, Volume 25, Issue 4, December 2023; Juergen Scheffran, Weisi Guo, Florian Krampe et al., Tipping cascades between conflict and cooperation in climate change, EGUsphere, 2023.

95 V20, V20 Debt Review: An account of debt in the Vulnerable Group of Twenty, September 2022.

96 UNCTAD, 'The Least Developed Countries Report 2022 - The low-carbon transition and its daunting implications for structural transformation', 2022.

97 See more in Annex III – OEET, in particular in section 2.6.8 on 2.6.8. Lack of consideration of the gendered dimension of climate change and poverty.

98 UNDP, Gender and Climate, website.

99 The V20 group comprises of 68 nations, totalling 1.7 billion people and contributing to 5 % to global emissions. See more at https://www.v-20.org/members.

100 V20, Climate Vulnerable Economies Loss Report | 2000-2019, June 2022.

101 Ibid.

2.3.1. What are the challenges?

Challenge #5: Climate finance for adaptation and resilience in developing countries is too low

The EU[102] is the biggest provider of bilateral climate-related development finance (see Figure 10).[103] Between 2012 and 2021, the sum of EU bilateral commitments for climate finance more than doubled.[104] This was the biggest increase among developed countries. Moreover, climate finance has been gaining prominence as a priority in the EIB's activity as well as in the EU Member State public development banks (PDBs) and development finance institutions (DFIs), all key actors in mobilising private climate development finance (see challenge #6).[105]

Although the EU is a global bilateral leader in climate finance and in recent years has prioritised climate spending **particularly for adaptation and loss and damage, the available resources from public donors remain short of what is urgently needed**. Globally, adaptation financing declined by 15 % in 2021 and adaptation planning and implementation appear to be plateauing.[106] These funds are particularly important for LDCs, who are more vulnerable to the adverse impacts of climate change.[107]

The European Parliament has underlined the need to step up adaptation action within the EU and globally to minimise the negative effects of climate change and biodiversity loss.[108] In its resolution of 21 November 2023 on COP28, it called on the EU (as well as all the United Nations Framework Convention on Climate Change (UNFCCC) Parties) to scale up their commitments and present a definitive roadmap for a collective objective of doubling adaptation finance by 2025, based on 2019 levels, with the aim of achieving a balance between mitigation and adaptation finance.[109] The EU Member States have reaffirmed they will follow-up on this objective, but without presenting an EU-wide roadmap as Parliament demanded.[110] The EU ministers also underlined that channelling 'meaningful support' to LDCs and small island developing states (SIDS) is important. Several EU Member States made individual commitments to scale up their climate action towards developing

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102 Meaning the EU Member States and the EU institutions together.

103 Climate finance in this section is understood according to the OECD classification that relies on Rio Markets of ODA. Regarding the EIB, it follows the climate finance classification of the joint reports on multilateral development banks' climate finance and regarding private finance mobilisation, and follows the OECD 2023 report on private finance mobilised by official development finance interventions. The data we present for EU Member States' bilateral climate related finance excludes the UK throughout the dataset (2012-2021) despite the UK being a Member State until 30 January 2020. As the UK is an important provider of finance to tackle climate change, the overall numbers for EU Member States between 2012 and 2019 are underestimated.

104 This section focuses on bilateral flows from public providers based on the OECD, Climate-related development finance datasets, provider perspective. Nevertheless public providers such as the EU Member States and the EU institutions also provide climate finance through international channels. For the data on EIB, this section uses the EIB, 2022 Joint report on multilateral development banks' climate finance and the 2021 Joint Report on Multilateral Development Banks' Climate Finance.

105 Pamella Ahairwe and San Bilal, Mobilising (European) Development Finance for Climate Adaptation and Resilience, ECDPM, CASCADES, September 2023.

106 United Nations Environment Programme, Adaptation Gap Report 2023: Underfinanced. Underprepared. Inadequate investment and planning on climate adaptation leaves world exposed.

107 UNCTAD, Least developed countries report 2023.

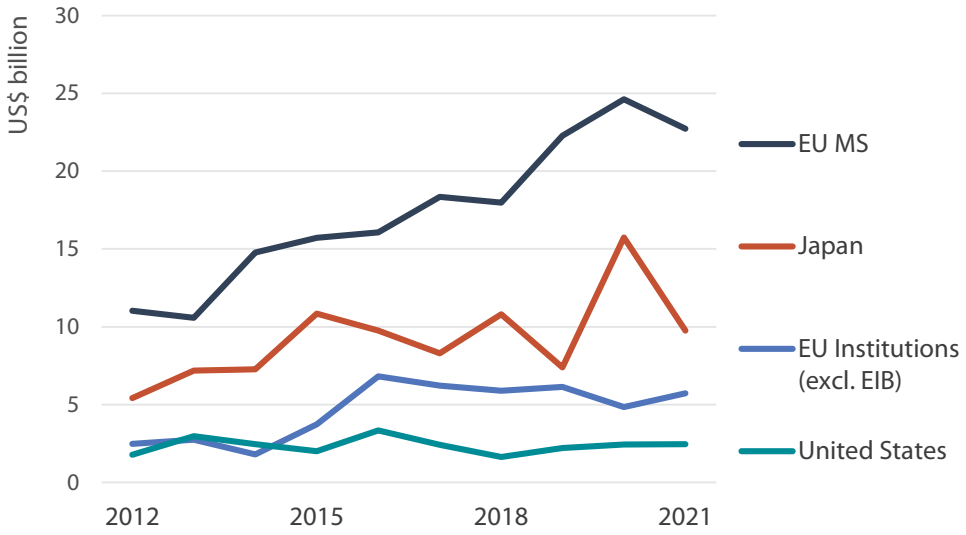
108 European Parliament resolution of 25 November 2020 on improving development effectiveness and the efficiency of aid (2019/2184(INI)).

109 European Parliament resolution of 21 November 2023 on the UN Climate Change Conference 2023 in Dubai, United Arab Emirates (COP28) (2023/2636(RSP)).

110 Council of the EU, Council conclusions on international Climate Finance in view of the UNFCCC 28th Conference of the parties (COP 28) in Dubai on 30 November - 12 December 2023, Council conclusions, 17 October 2023.

countries by 2025, and to report on them with other developed countries.[111] Although **EU Member States** negotiate with a common position in international climate negotiations,[112] they **pledge climate finance contributions separately**. This was also the case for the recent landmark decision to create a Loss and Damage Fund.[113] So far, the fund struggles to raise significant amounts that could correspond to developing countries' needs.[114] This is a typical problem in mobilising funds for global public goods for which negative spillover effects and externalities remain relatively local (e.g. adverse climate effects impacting LDCs more strongly than developed countries), and where supranational coordination is therefore particularly relevant.[115] A greater role for the EU could also support economies of scale in raising sufficient resources.

Figure 10 – Top four providers of bilateral climate-related development finance to developing countries, 2012-2021



Source: Authors based on OECD, Climate-related development finance datasets, provider perspective, as of 28 November 2023 update. Graphic: G. Macsai

In 2021, the **EU collectively committed to provide a total US$28.4 billion in bilateral public climate related development finance**, amounting to nearly 60 % of all global commitments (US$47.8 billion in 2021) – see Figure 10).[116] The EU Member States committed to provide 80 % of EU collective bilateral climate finance (US$22.7 billion), with the EU institutions providing the remaining 20 % (US$5.7 billion).[117] **In 2021, nearly 17 % of EU collective bilateral climate-related development finance was dedicated to LDCs – US$4.8 billion**. This confirms the OECD's finding that most of the climate-related development finance goes outside the fragility context (see also

111 Climate finance delivery plan progress report: advancing the ten collective actions.

112 Council of the EU, COP28: Council sets out EU position for UN climate summit in Dubai, Press release, 16 October 2023.

113 UNFCCC, Pledges to the Loss and Damage Fund, accessed 3 March 2024.

114 *The Guardian*, $700m pledged to loss and damage fund at Cop28 covers less than 0.2% needed, 6 December 2023.

115 IMF, What Are Global Public Goods? Global institutions must coordinate to preserve the goods that benefit us all, Moya Chin, Finance & Development, December 2021.

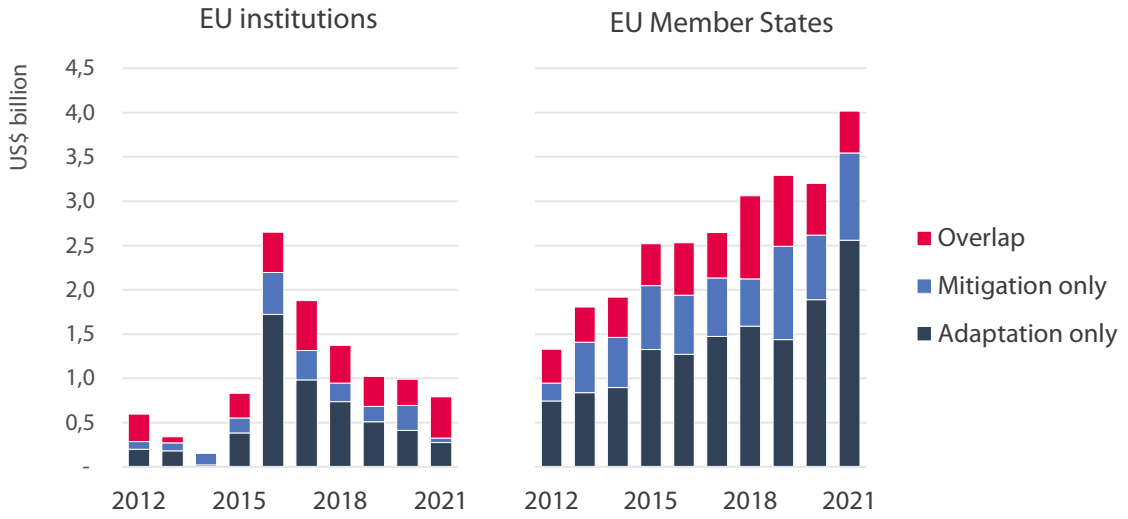
116 This is higher than under the general ODA, as the EU collectively accounted for 43 % of global ODA in 2021. European Commission, Questions and Answers: Preliminary Figures on 2021 Official Development Assistance, 18 July 2022.

117 Excluding the EIB climate finance.

Figure 3).[118] Throughout the decade, the EU collectively prioritised financing dedicated to adaptation to climate change in LDCs compared to funding for mitigation (Figure 11).

While throughout the decade EU **Member States** increased their bilateral commitment to provide adaptation funds to LDCs (see Figure 11), they **allocated an average 30 % of climate adaptation**

Figure 11 – EU institutions (excluding European Investment Bank) and EU Member States' bilateral climate-related development finance to LDCs, by objective



Source: Authors based on OECD, Climate-related development finance datasets, provider perspective, as of 28 November 2023 update; Graphic: G. Macsai.

funding to the LDCs (Annex I – Figure 23). Meanwhile, the **EU institutions'** bilateral climate finance for adaptation provided to LDCs has been fluctuating, then decreasing (see Figure 11), but the **share of climate adaptation funding dedicated to the LDCs averaged 52 %** (Annex I – Figure 23).

Between 2012 and 2020, the EU Member States bilateral climate finance commitments for adaptation alone for all developing countries were lower than for mitigation only (Annex I – Figure 22).[119] However, the trend reversed in 2021, when for the first time, EU Member States committed to provide more to adaptation (US$8.5 billion) than to mitigation (US$6.5 billion), with a substantial amount of overlapping commitments (US$5 billion). The EU Member States' commitments on climate finance for adaptation alone in LDCs continued to increase and reached a decade-high record of US$2.5 billion in 2021, versus US$0.98 billion for mitigation alone (and an overlap of US$0.47 billion). See Figure 11.

In 2021, the EU institutions' bilateral climate commitments to provide funding to all developed countries for adaptation alone (US$0.4 billion) were less than for mitigation alone (US$1.86 billion), and the overlapping commitments (US$3.44 billion) for both objectives were the highest (see Annex I – Figure 22). **EU institutions' commitments to provide funding for adaptation alone in**

[118] OECD, Development finance for climate and environment-related fragility: Cooling the hotspots, Paris, 2023.

[119] According to OECD methodology for accounting for climate-related objectives, for activities marked as **only** a mitigation/adaptation-related objective, the entire underlying commitment is attributed to climate-related development finance with a mitigation/adaptation objective. 'For activities marked with both a mitigation-related and an adaptation-related objective, the entire underlying commitment is attributed to climate-related development finance with a cross-cutting objective' (overlapping), OECD, Aligning Development Co-operation and Climate Action: The Only Way Forward, The Development Dimension, OECD Publishing, Paris.

the LDCs have fluctuated over the last decade and were in decline in recent years (Figure 11). They peaked in 2016 and reached US$0.27 billion in 2021. In 2021, climate finance provided to LDCs for mitigation alone amounted to US$0.05 billion, whereas overlapping activities had the highest share, of US$0.46 billion.

Data from the EIB reinforce this picture: 2023 the bank has invested US$3.9 billion in climate finance in developing countries[120] and had committed US$4.13 billion in 2022 for the same purpose.[121] However, the **EIB's climate financing for developing countries was mainly concentrated on mitigation**. In 2022, the EIB dedicated only 10 % of its total climate finance in LMICs to climate adaptation (US$0.43 billion), compared to 90 % committed to mitigation (US$3.7 billion).[122] This is below the average spending of all MDBs on LMICs' adaptation, which constituted 37 % of total climate finance in 2022. Nevertheless, EIB Global (managing operations outside the EU) will be able to cover up to 100 % of the investment cost of an adaptation project (as opposed to the traditional 50 % limit) in SIDS and LDCs.[123]

As reporting of climate finance data is not harmonised between bilateral and multilateral providers, some comparisons are difficult. Nevertheless, Table 5 attempts to summarise the latest-available key EU public climate finance provider commitments.

Table 5 – Overview of bilateral EU Member State and institutions' climate finance commitments to LDCs, and European Investment Bank climate finance for LMICs, US$ billion

EU public climate finance provider – data for latest available year	Adaptation (only)	Mitigation (only)	Overlap of adaptation and mitigation	Total
EU MS - 2021	2.5	0.98	0.47	4
EU institutions (excluding EIB) – 2021	0.27	0.05	0.46	0.79
EIB – 2022	0.43	3.7	-	4.13

Source: Authors based on OECD, Climate-related development finance datasets, provider perspective, as of 28 November 2023 update and EIB, 2022 Joint report on multilateral development banks' climate finance.

Challenge #6: Insufficient and uncoordinated private finance for climate adaptation

Increased use of private finance for climate adaptation is necessary to close the gap in financing climate action in developing countries (see OEET - Annex III). Many reports indicate that private

120 EIB, EIB climate action explained.

121 EIB, 2022 Joint report on multilateral development banks' climate finance, Table 2.

122 EIB, 2022 Joint report on multilateral development banks' climate finance, Table 3.

123 Pamella Ahairwe and San Bilal, Mobilising (European) Development Finance for Climate Adaptation and Resilience, ECDPM, CASCADES, September 2023.

capital could fill the void (globally, an estimated US$500 trillion in financial assets exist).[124] [125] Meanwhile, despite increasing amounts of global climate finance (especially for mitigation purposes) on one hand, and increasing needs for sustainable investment in the poorest countries on the other, FDI in LDCs fell in 2022.[126] **LDCs have never regained the 2015 three-decade-high level FDI of US$38 billion.**

In 2021, private climate finance constituted only 14 % (of US$14.4 billion) of all climate finance raised by developed countries for developing countries.[127] This amount has remained at similar levels since 2017.[128] Moreover, **private resources committed to climate action are unequally distributed between mitigation and adaptation**. Between 2018 and 2020, of the US$15.5 billion average per year private finance mobilised for climate action, 78 % was dedicated to mitigation alone (US$12.2 billion), 11 % was dedicated to adaptation alone (US$1.8 billion), and 10 % for both mitigation and adaptation (US$1.5 billion).[129] Africa received around US$4 billion per year of these funds, with 64 % dedicated to mitigation and 27 % to adaptation (the rest to both).[130]

The OECD report on private climate finance dedicated to sustainable development giving a detailed overview of these amounts, covers 2018 to 2020.[131] It estimates that among the top bilateral providers of private finance for climate action, the EU Member States[132] together spent US$2.2 billion on average per year.[133] This is the largest amount of private finance for climate action among official providers, if the amounts mobilised by the EU Member States are added together. The total amount provided by EU Member States is two times higher than for the USA, which mobilised US$1.1 billion (the biggest single country that mobilised private finance for climate action).[134] However, the **majority of the private finance mobilised by the EU Member States during this period went to mitigation**.[135]

Among the multilateral banks, the World Bank Group spent the largest amount of private finance for climate action (US$6.8 billion) in 2022, of the multilateral providers to LMICs.[136] Between 2021 and 2022, the EIB more than doubled its private finance mobilisation for climate action (especially

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124 Vera Songwe, Nicholas Stern, Amar Bhattacharya et al., Finance for climate action: Scaling up investment for climate and development, London: Grantham Research Institute on Climate Change and the Environment, London School of Economics and Political Science, 2022; OECD, Scaling Up the Mobilisation of Private Finance for Climate Action in Developing Countries: Challenges and Opportunities for International Providers, 2023; High-Level Expert Group on scaling up sustainable finance in low- and middle-income countries, mandated by the European Commission.

125 World Bank Blogs, New pathways towards mobilizing private capital, Jean Pesme, Niraj Verma, Jing Zhao, 26 October 2023.

126 UNCTAD, World Investment report 2023.

127 OECD, Climate Finance Provided and Mobilised by Developed Countries in 2013-2021: Aggregate Trends and Opportunities for Scaling Up Adaptation and Mobilised Private Finance, Climate Finance and the USD 100 Billion Goal, OECD Publishing, Paris, 2023.

128 Ibid.

129 According to OECD data between 2018-2020.

130 According to OECD data between 2018-2020.

131 According to OECD data between 2018-2020.

132 Available only for the eight top EU Member State providers listed in the OECD report (France, Germany, Sweden, Netherlands, Denmark, Austria, Portugal, Finland).

133 Based on data from Figure 2.4 in: OECD, Private finance mobilised by official development finance interventions, Development Co-operation Directorate, OECD Publishing, Paris, 2023.

134 Based on data from Figure 2.4 in: OECD, Private finance mobilised by official development finance interventions, Development Co-operation Directorate, OECD Publishing, Paris, 2023.

135 Pamella Ahairwe and San Bilal, Mobilising (European) Development Finance for Climate Adaptation and Resilience, ECDPM, CASCADES, September 2023; OECD, Private finance mobilised by official development finance interventions, Development Co-operation Directorate, OECD Publishing, Paris, 2023.

136 EIB, 2022 Joint report on multilateral development banks' climate finance, Table 21.

the indirect component) in LMICs, reaching over US$3.3 billion.[137] However, the EIB's total co-financing activity (including both private and public mobilisation) has remained unbalanced in terms of mitigation/adaptation objectives. In 2022, **three-fourths of total co-financing for climate action in developing countries went to mitigation, and only one-fourth to adaptation**.[138]

This shows that mobilising private financing for adaptation in developing countries, and especially in LDCs, is challenging and complex. This is due to several barriers. One key barrier is that **climate adaptation investment is perceived as high-risk and low-return on investment**, as such investment often generates no revenue, but instead ensures public goods (e.g. ensuring food security, protection from flooding, reducing inequalities, etc.). **Adaptation projects are also often small-scale** and therefore have much more difficulty in attracting private investors such as big mitigation projects, e.g. in decarbonisation of energy systems. **Persisting data gaps** – including on consolidated and asset-level data as well as 'mispricing' based on past disasters –impede climate physical risk assessment, hindering investment decisions.[139] These data gaps may create a vicious circle, because the official sector dominates the climate adaptation field, with **private actors having less experience and knowledge**.[140] Furthermore, the benefits that adaptation investment could bring (e.g. resilience to disasters, reducing social and gender inequalities, improving food security) are often not considered under risk assessments that focus on financial viability. Therefore, despite the potentially high development impact of investment in climate adaptation, its complex and challenging context prevents investment and concentrates that available mainly in middle-income countries.[141]

Other, **institutional, legal, organisational and political barriers** related to the profusion of actors in the European Financial Architecture for Development (EFAD) (including in climate finance) would also need to be overcome.[142] The relevant actors include bilateral development agencies, DFIs, PDBs, MDBs. Funds would need to work more effectively with developing countries, as well as better supporting their own actions.[143] A sub-optimal situation that creates fragmentation, unnecessary and distorting competition, duplication and inefficiencies between the above-mentioned actors has long been identified in EU development finance (see Section 2.1).[144] This situation negatively impacts partner countries as well as the private sector, as it increases administrative red tape, and

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137 Based on the joint reports on multilateral development banks' climate finance for year 2022 (Table 21) and 2021 (Table 21).

138 EIB, 2022 Joint report on multilateral development banks' climate finance, Table 20.

139 Pamella Ahairwe and San Bilal, Mobilising (European) Development Finance for Climate Adaptation and Resilience, ECDPM, CASCADES, September 2023.

140 OECD, Private finance mobilised by official development finance interventions, Development Co-operation Directorate, OECD Publishing, Paris, 2023.

141 Pamella Ahairwe and San Bilal, Mobilising (European) Development Finance for Climate Adaptation and Resilience, ECDPM, CASCADES, September 2023.

142 Pamella Ahairwe and San Bilal, Mobilising (European) Development Finance for Climate Adaptation and Resilience, ECDPM, CASCADES, September 2023; European Think Tanks Group, Enhancing coordination between European donors, development agencies and DFIs/PDBs Insights and recommendations, September 2022; Mikaela Gavas and Aitor Perez, The future of the European Financial Architecture for Development, Policy Department for External Relations Directorate General for External Policies of the Union, May 2022.

143 OECD, Scaling Up the Mobilisation of Private Finance for Climate Action in Developing Countries: Challenges and Opportunities for International Providers, Green Finance and Investment, OECD Publishing, Paris, 2023.

144 Mikaela Gavas and Aitor Perez, The future of the European Financial Architecture for Development, Policy Department for External Relations Directorate General for External Policies of the Union, May 2022; T. Weiser et al., Europe in the world, The future of the European financial architecture for development, An independent report by the High-Level Group of Wise Persons on the European financial architecture for development, October 2019, Council of the European Union; European Commission, Communication 'Towards a more efficient financial architecture for investment outside the European Union', COM(2018) 644 final.

multiplies different financing conditions, entry points and risk approaches.[145] The impact of the status quo is greatest on LICs, where competition between European DFIs is stronger due to the limited number of projects and smaller number of private investment partners.[146] It also leads to a reduction in the 'bankability' of projects.[147] All these challenges become even starker in relation to climate adaptation financing in LDCs, which does not attract actors searching for bankable projects and financial additionality.

The EU and its Member States decided to address EFAD inefficiencies by creating the Team Europe approach and the Global Gateway that implements it, focusing on infrastructure investment in developing countries.[148] **Team Europe remains a decentralised approach that does not fully use the potential of scale**.[149] For example, experts have highlighted that it lacks a single point to support identification, preparation and development of investment projects.[150] Although some progress has already been made,[151] priority projects still lack financing,[152] leaving room for more coordinated EU action.

2.3.2. What the EU could do?

Raise new public resources for climate adaptation and loss and damage at the EU level

The EU is already providing 60 % of global bilateral climate-related development finance. It is also increasing its private finance, estimated to amount to nearly €12 billion in 2022.[153] It is also leading in the development of innovative sustainable finance solutions such as green bonds and the Member States are engaging in new climate finance instruments such as debt for climate swaps (see Section 2.2.2). Nevertheless, more new, innovative and additional resources for climate-related development finance is urgently needed to fulfil the EU's Paris Agreement commitments as well as to increase resilience to negative climate change impacts. The European Parliament has underlined that 'dealing with the climate and biodiversity crises creates a further need to raise more resources and re-evaluate the current incentivising policies in the Union'.[154]

The EU could step up its joint action on climate adaptation development finance as well as on loss and damage in LDCs by **introducing EU-level or international measures that would enable the**

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145 Mikaela Gavas and Aitor Perez, The future of the European Financial Architecture for Development, Policy Department for External Relations Directorate General for External Policies of the Union, May 2022.

146 Mikaela Gavas and Aitor Perez, The future of the European Financial Architecture for Development, Policy Department for External Relations Directorate General for External Policies of the Union, May 2022.

147 Mikaela Gavas and Aitor Perez, The future of the European Financial Architecture for Development, Policy Department for External Relations Directorate General for External Policies of the Union, PE 653.665 - May 2022.

148 Dermot Hodson and David Howarth, From the Wieser report to Team Europe: explaining the battle of the banks in development finance, Journal of European Public Policy, 8 June 2023.

149 Dermot Hodson and David Howarth, From the Wieser report to Team Europe: explaining the battle of the banks in development finance, Journal of European Public Policy, 8 June 2023.

150 Center for Global Development, Bottlenecks in Africa's Infrastructure Financing and How to Overcome Them, December 2023; Center for Global Development, An Accelerator Hub to Foster Investment in Africa.

151 For example under the Team Europe initiative 'Investing in Young Businesses in Africa' (TEI IYBA), a working group was created on developing a pipeline of investment-ready (or 'bankable') projects in Africa involving young businesses and entrepreneurs.

152 Center for Global Development, Bottlenecks in Africa's Infrastructure Financing and How to Overcome Them, December 2023; See e.g. section 7.3 and Box 7.2 in Vera Songwe, Nicholas Stern, Amar Bhattacharya et al., Finance for climate action: Scaling up investment for climate and development, London: Grantham Research Institute on Climate Change and the Environment, London School of Economics and Political Science, 2022.

153 Council of the European Union, Infographic - How is the EU financing the transition to climate neutrality?

154 European Parliament resolution of 10 May 2023 on own resources: a new start for EU finances, a new start for Europe (2022/2172(INI)).

scaling up of necessary public resources. As numerous sources of financing will be necessary, different potential sources of revenue should be considered and made available. Raising the large amounts needed for developing countries' external finance (see Table 4) could be difficult, even impossible in some cases for Member States acting alone.

Revenue for climate adaptation and loss and damage in developing countries could come from existing carbon pricing instruments such as the EU emissions trading system (ETS) and would require an EU decision on repurposing revenue for climate finance, e.g. **extending the scope (to international) aviation and maritime voyages[155] under the EU ETS**.[156] Taxation instruments could provide another source, such as a **tax on aviation and maritime fuel, applied to international voyages** (thus extending the scope of the currently proposed review of the Energy Taxation Directive).[157] [158] Experts indicate that these instruments would anyway be necessary to further financially support decarbonisation of transport to achieve carbon neutrality.

Another initiative could be to dedicate a share of new EU-own resources to climate finance for third countries that are most in need. Creation of new own resources is necessary to match EU political ambitions and commitments, as the European Parliament has called for.[159] **An EU financial transaction tax**, which the European Parliament has advocated,[160] could also be partly dedicated to international climate finance.[161]

Finally, the EU Member States could collaborate more and **present coordinated joint international climate finance pledges**, such as contributions to the Loss and Damage Fund. The current, fragmented approach is neither coherent with the EU's position in international climate negotiations, nor with its ambition to become a global climate and development policy leader.[162]

Considering the EU's global political and economic weight, it could step up its multilateral action to raise funds for climate adaptation and loss and damage in developing countries. Following a call from the United Nations Special Rapporteur on Human Rights and the Environment, the EU could also use its international position to propose **global air travel and maritime shipping levies**.[163] They could deliver substantial revenues for the climate loss and damage in poorest climate-vulnerable countries (alongside resources for decarbonisation of both sectors). For the aviation

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155 Article 3 of Regulation (EU) 2015/757 of the European Parliament and of the Council of 29 April 2015 on the monitoring, reporting and verification of carbon dioxide emissions from maritime transport states that 'voyage' means any movement of a ship that originates from or terminates in a port of call and that serves the purpose of transporting passengers or cargo for commercial purposes. The term also applies to aviation.

156 Climate Action Network Europe, New resources for public climate finance and for the Loss and Damage Fund. Exploring taxes and levies at EU and multilateral level, September 2023; André van Velzen (TAKS), Environmental and economic impacts of EU ETS and CORSIA policy scenarios for European aviation, Report prepared by TAKS for Transport and Environment (T&E) and Carbon Market Watch (CMW) , April 2022.

157 European Commission, Proposal for a Council directive on restructuring the Union framework for the taxation of energy products and electricity (recast), COM(2021) 563 final.

158 Transport & Environment (2023). Aviation's tax gap; Climate Action Network Europe, New resources for pubilc climate finance and for the Loss and Damage Fund. Exploring taxes and levies at EU and multilateral level, September 2023.

159 European Parliament resolution of 10 May 2023 on own resources: a new start for EU finances, a new start for Europe (2022/2172(INI)).

160 European Parliament resolution of 10 May 2023 on own resources: a new start for EU finances, a new start for Europe (2022/2172(INI)).

161 Climate Action Network Europe, New resources for public climate finance and for the Loss and Damage Fund. Exploring taxes and levies at EU and multilateral level, September 2023; European Parliament, Legislative Train Schedule, Financial transaction tax (FTT), as of 20 January 2024.

162 *The Guardian*, $700m pledged to loss and damage fund at Cop28 covers less than 0.2% needed, 6 December 2023.

163 United Nations, Policy brief No. 2, Air Travel and Maritime Shipping Levies: Making Polluters Pay for Climate Loss, Damages and Adaptation, Special Rapporteur on human rights and the environment, 2021.

sector, this could take a form of an air ticket levy and be applied for maritime shipping it would at point of bunker (i.e., the fuelling of a ship). In aviation, the level of the levy could be differentiated per seating class (higher for first and business and lower for economy).[164]

Better EU level coordination to unlock private climate investment

Public actors play an important role in mobilising private climate finance.[165] This is an opportunity for the EU to act to further improve the effectiveness of its EFAD. As the European Parliament has called for, better coordination and collaboration between EFAD actors and international and national partners would be necessary to unlock the full potential of European private development finance.[166] Of these, MDBs, PBDs and DFIs could play a crucial role in de-risking climate-related investments in developing countries and mobilising private investment.[167] Therefore, **EU-level action could ensure that EFAD actors work towards the same objectives and mutually reinforce their action, instead of competing with each other**.[168]

Several EU-level initiatives were launched recently, but considering the complexity of the challenge of scaling up mobilisation of private climate finance in LDCs, further urgent and multi-faceted action would need to be taken to change the status quo.[169] The EU could help to **disseminate expertise among EFAD actors** on mobilisation of private climate investment in markets perceived as risky. It could help to **develop harmonised climate adaptation finance taxonomy and data reporting among EU actors**.[170] The EU could provide added value by **coordinating the preparation of climate investment projects**, especially for adaptation in LDCs, within the EFAD. Finally, the EU could launch a **similar initiative to 'Just Energy Transition Partnerships' for adaptation**. This approach to pooling funding for adaptation projects could allow EFAD actors to showcase that investing in adaptation brings benefits compared to the costs of inaction.

2.3.3. Cost of non-Europe

Without an urgent and substantial increase in climate finance, poor and climate-vulnerable developing countries (like LDCs and SIDS), many of which are simultaneously highly indebted developing countries, will not be able to continue on a sustainable development path.[171] This means

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164 The International Council on Clean Transportation, Taxing aviation for loss and damage caused by climate change, February 2024.

165 OECD, Scaling Up the Mobilisation of Private Finance for Climate Action in Developing Countries. Challenges and Opportunities for International Providers, 2023; Vera Songwe, Nicholas Stern, Amar Bhattacharya et al., Finance for climate action: Scaling up investment for climate and development, London: Grantham Research Institute on Climate Change and the Environment, London School of Economics and Political Science, 2022.

166 European Parliament resolution of 24 November 2022 on the future European Financial Architecture for Development (2021/2252(INI)).

167 OECD, Scaling Up the Mobilisation of Private Finance for Climate Action in Developing Countries. Challenges and Opportunities for International Providers, 2023; Pamella Ahairwe and San Bilal, Mobilising (European) Development Finance for Climate Adaptation and Resilience, ECDPM, CASCADES, September 2023; K. Bayliss et al., The use of development funds for de-risking private investment: how effective is it in delivering development results?, Policy Department for External Relations Directorate General for External Policies of the Union, May 2020.

168 High-Level Expert Group on scaling up sustainable finance in low- and middle-income countries. Mandated by the European Commission. Preliminary findings & recommendations, June 2023.

169 A High-Level Expert Group on scaling up sustainable finance in low- and middle-income countries has been mandated by the European Commission and already proposed several recommendations for EU action. Other progress is reported in the Report from the Commission to the Council. 2022 progress report on the European Financial Architecture for Development, COM(2023)299 final.

170 Pamella Ahairwe and San Bilal, Mobilising (European) Development Finance for Climate Adaptation and Resilience, ECDPM, CASCADES, September 2023.

171 UNEP, 'Adaptation Gap Report 2023: Underfinanced. Underprepared. Inadequate investment and planning on climate adaptation leaves world exposed', 2023.

they will not be able to invest in climate resilience to diminish loss and damage from climate change. In the worst climate scenarios, they might not develop at all, as all their potential growth will be consumed by the adverse effects of climate change (see Annex III).

Table 6 illustrates the **benefits further collective EU-level action could bring** (see Section 2.3.2) **as opposed to EU institutions and Member States continuing to act alone**. Where possible, the exact quantification of the cost of non-Europe not raising climate financing for adaptation and loss and damage in the poorest and most climate-vulnerable countries would depend on the share of revenues raised and transferred for this purpose.

Research shows that investment in key priority areas for climate adaptation, such as agriculture, are much higher than the cost of inaction. **Stronger financing for agricultural adaptation to climate change increases food security and is a more cost-effective approach compared to financing emergency responses**.[172] In Africa, the value of action related to agricultural 'research and extension, water management, infrastructure, land restoration, and climate information services is estimated at US$15 billion per year, less than a tenth of the estimated US$201 billion annual cost of inaction by 2050 (12 % of GDP), which includes paying for disaster relief and recovery after floods and droughts.[173] Investing in parallel in five key climate adaptation areas, i.e., early warning systems, climate-resilient infrastructure, improved dryland agricultural crop production, global mangrove protection, and investment in more resilient water resources, **could provide a 'triple dividend of avoided losses, economic benefits, and social and environmental benefits'**.[174]

Better coordination, use and tracking of the impact of private climate development finance from the EU would benefit recipient countries.[175]

In conclusion, considering the results above and that the EU is both the major climate ODA provider to Africa as well as the biggest foreign investor,[176] the impact of taking no further ambitious EU action on climate finance (but also on FDI and aid in general) could be high in terms of poverty reduction and prospects for sustainable development in Africa.

[172] Food and Agriculture Organisation of the United Nations, Climate finance for agriculture and food security: Implementation of the Nairobi Declaration and outcomes of the UNFCCC COP28.

[173] Global Center on Adaptation, State and trends report 2021.

[174] Global Commission on Adaptation. (2019). Adapt Now: A Global Call for Leadership on Climate Resilience. https://gca.org/reports/adapt-now-a-global-call-for-leadership-on-climate-resilience.

[175] OECD, More effective delivery of climate action in developing countries. DAC perspectives on effective development co-operation, 2023.

[176] World Investment report 2023, UNCTAD

Table 6 – Summary of potential EU action to increase and improve EU climate finance for development

Potential EU action	Potential benefit
Raising resources for climate action by including international aviation voyage under the EU ETS	US$8.6 billion[a] *
Raising resources for climate action by including international maritime voyage under the EU ETS	US$4 billion[a] *
Raising resources for climate action from an aviation and shipping fuel tax for all voyages departing from the EU	US$11.64 billion [a]*
Raising resources for climate action from an EU financial transaction tax	€66.1 billion [a] *
Raising resources for climate action from global air transport and maritime shipping levies	$US132-$US392 billion *
Joint EU pledges on climate finance for development	Stronger collective impact including on raising other international contributions
Improved coordination of private finance mobilisation for climate finance	Reducing competition, fragmentation, duplication, mobilising more private finance

* Total estimated possible revenue – the share that would go to climate finance would need to be decided.

Sources: Authors and [a] Climate Action Network Europe, New resources for public climate finance and for the Loss and Damage Fund. Exploring taxes and levies at EU and multilateral level, September 2023; [b] United Nations, Policy brief No 2 Air Travel and Maritime Shipping Levies: Making Polluters Pay for Climate Loss, Damages and Adaptation, Special Rapporteur on human rights and the environment, 2021.

3. Current international trade, global value chains and global markets do not help to eradicate poverty

While economic growth is increasingly understood to be insufficient to reduce poverty,[177] there is increasing evidence of the influence of 'how' the global economy is shaped on economic and social outcomes for LDCs. This is particularly true for trade and global value chains.[178]

Cost of non-Europe analysis usually applies to areas where competences between the EU and Member States are shared. As an exclusive EU competence, international trade is therefore a special case. The cost of non-Europe in trade policy can therefore be understood as the 'cost' of a lack of scope or intensity in EU action. As discussed in Annex III, the EU represents an important share of trade for many LDCs and there is potential room for more effective trade tools to help reduce poverty.

This section explores **six key challenges**, ways in which the EU could act to address each of them, and the cost of non-Europe. Table 7 summarises the assessment.

[177] During the years of higher economic growth on the African continent, there has been 'a wide disparity between observed growth rates and the scale of poverty reduction across the continent. In most countries, economic growth has not translated into commensurate levels of poverty reduction', ADB, 2016, African Development Report 2015. Growth, Poverty and Inequality Nexus: Overcoming Barriers to Sustainable Development. The African Development Bank, Abidjan, Côte d'Ivoire.

[178] World Bank, World Development Report, 2020.

Table 7 – Challenges and opportunities for EU action on international trade and global value chains

Challenge	Opportunities for EU action	EP resolution	Costs of not taking EU action (the cost of non-Europe)
#7 LDC exports focused on commodities and low end of global value chains	Revise trade tools to support structural transformation, internal integration of LDC economies, and fiscal and policy space Support technology transfer to and funding of infrastructures in LDCs.	European Parliament resolution on the Economic Partnership Agreement between the Cariforum States, of the one part, and the European Community and its Member States, of the other part (2008/2671(RSP) European Parliament resolution of 23 June 2022 on the implementation and delivery of the Sustainable Development Goals (SDGs) (2022/2002(INI))	Current Economic Partnership Agreements expected to reinforce existing pattern: missed opportunity for structural transformation in LDCs Low creation of well-paid jobs Dual economies: limited integration between export sector and internal demand Lack of fiscal and policy space to support internal demand
#8 Low regional integration among LDCs	Shape policies to support regional integration in LDCs, especially in the framework of the African Continental Free Trade Area (AfCFTA) Migration policies that support intra-African mobility	European Parliament resolution on the Economic Partnership Agreement between the Cariforum States, of the one part, and the European Community and its Member States, of the other part (2008/2671(RSP)	Added value in regional value chains is greater than in global value chains: missed opportunity for structural transformation in LDCs: Low creation of well-paid jobs Benefits of free movement of people lost

#9 Limited policy coherence for development in trade and climate tools	Make Carbon Border Adjustment Mechanism more development-coherent	Committee on Development (DEVE) Opinion on the proposal for a regulation establishing a carbon border adjustment mechanism (COM(2021)0564 - C9-0328/2021 - 2021/0214(COD))	LDCs risk bearing disproportionate cost of decarbonisation risk Limited green transition
#10 Low enforcement of environmental, social and governance standards in global value chains	Mandatory due diligence standards for companies in the supply chain Enforceable UN Treaty on business and human rights Enforceable Trade and Sustainable Development chapters in FTAs	European Parliament resolution on corporate due diligence and corporate accountability (2020/2129(INL) European Parliament resolution of 14 February 2017 on the revision of the European Consensus on Development (2016/2094(INI))	Race to the bottom in social and environmental standards Higher risk of human rights violations, environmental damage and lowering work conditions
#11 Gaps in regulation of global food markets.	Revive rule-based multilateralism targeted towards SDGs, e.g. to better regulate global food markets and to implement OECD Two Pillar agreement and possible more ambitious agreements	European Parliament resolution of 6 July 2022 on addressing food security in developing countries (2021/2208(INI)) European Parliament resolution of 26 November 2020 on the EU Trade Policy Review (2020/2761(RSP))	Increased food insecurity together with high profits in food sector Food dependency and vulnerability to shocks
#12 Gaps in global architecture on taxation of MNEs		European Parliament legislative resolution of 19 May 2022 on the proposal for a Council directive on ensuring a global minimum level of taxation for multinational groups in	Missed increased HDI (1.7 %) by 2050 Missed fairness in functional and geographical income distribution Loss of fiscal space

		the Union (COM(2021)0823 – C9-0040/2022 – 2021/0433(CNS)) European Parliament resolution of 15 June 2023 on lessons learnt from the Pandora Papers and other revelations (2022/2080(INI)) European Parliament resolution of 23 June 2022 on the implementation and delivery of the Sustainable Development Goals (SDGs) (2022/2002(INI))	Unfair distribution of resources between MNEs and LDCs

Source: EPRS.

3.1. EU trade tools do not sufficiently support poverty reduction

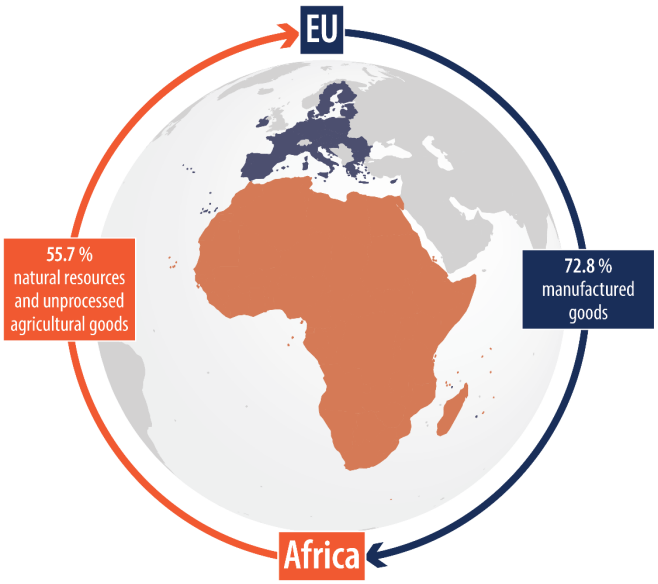
3.1.1. What are the challenges?

Challenge #7: LDC exports are focused on commodities and the low end of global value chains

International trade and global value chains (GVC) can lead to unequal benefits, for example by leaving some countries **'locked' into low value-added positions,**[179] thus limiting the possibilities of structural transformation and generation of well-paying jobs.

African LDCs exports to the rest of the world, including the EU, are particularly focused on **raw commodities**. Figure 12 shows that 55.7 % of EU imports from Africa are natural resources and raw agricultural products; the main category is natural resources (45.5 %). At the same time, Africa mostly imports manufactured goods. This imbalance risks being exacerbated by the increasing EU need for critical raw materials. Several African countries are indeed in discussion on improving creation of local added value, particularly to mineral-related exports,[180] including using legislation to restrict exports of unprocessed minerals.[181]

Figure 12 – Main category of exports between Africa and the EU



Source: Authors' elaboration based on Cecilia Bellora, Cristina Mitaritonna and Andreas Maurer, Ways forward for EU-Africa trade and investment relations, European Parliament, 2022; Graphic: S. Chahri, EPRS.

While GVCs play an important role in economic growth in some countries, benefits have been lower for others.[182] There is evidence that the benefits of GVC integration experienced in Africa are less than those experienced in a number of countries in East Asia. According to a report from the UN Economic Commission for Africa,[183] the lower level of benefits of GVC integration are partly related to timing. In more recent years, a small

179 UNCTAD, Trade and Development Report, 2022.

180 Cristiano Lanzano, Jorgen Levin, Patience Mususa, Green minerals: no blueprint for sustainable growth Roadmap for Africa's shift from raw material exportation to value-added production, The Nordic Africa Institute, forthcoming 2024.

181 Namibia bans export of unprocessed critical minerals, Reuters, June 2023.

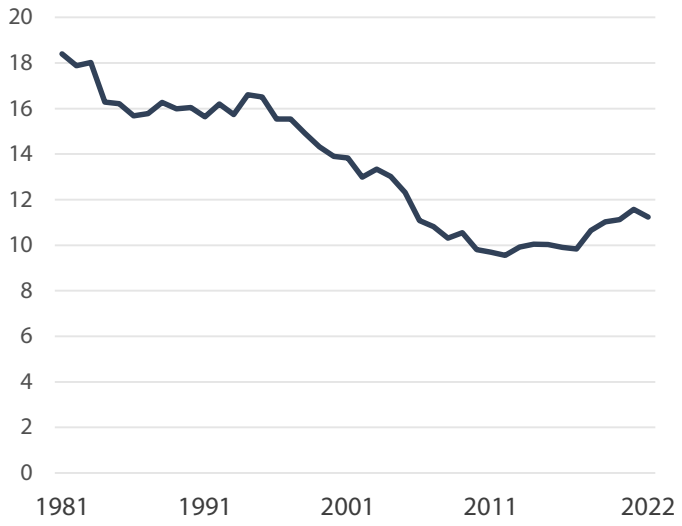
182 World Bank, World Development Report, 2020.

183 Economic Commission for Africa, Transformative Industrial Policy for Africa, Addis Ababa: ECA, 2016.

number of companies, mostly based outside Africa, have taken the lead within GVCs, and benefit from a higher level of the profits than in previous decades (see Section 3.3).[184]

Even in the cases where participation is not confined to commodity and raw material, **the value added in GVCs is concentrated in the pre- and post-production phase** branding, research and development (R&D), design, etc.), **while usually extraction and parts of production are outsourced to LDCs**, (lower value-added activities).[185] The structure of value chains may leave suppliers in LDCs little bargaining power vis-à-vis buyers in the Global North, resulting in suppliers finding themselves locked into certain activities within value chains.[186] Moreover, greater value addition is concentrated in knowledge-based activities that remain largely in the companies' home-countries; relatively little R&D is relocated to developing countries.

Figure 13 – Sub-Saharan Africa manufacturing, value added (% of GDP)



Source: authors' elaboration based on World Bank national accounts data, and OECD National Accounts data files.; Graphic: G. Macsai.

The lack of value addition in the export-led sector is closely related to the **limited structural transformation** in LDCs (especially on the African continent),[187] i.e. the shift of employment and value creation from on economic sector to another, moving from low-productivity to high-productivity, which has the potential to generate better jobs and ultimately to reduce poverty (as

[184] An interesting example occurred in the coffee industry: producing countries appropriated half of the total income of the final retail price of processed coffee until the mid-1980s. When the farm-gate prices of coffee decreased sharply in the early 1990s, retail prices of processed coffee remained the same, driven by the increased market power of the largest coffee trans-national corporations, who controlled marketing and distribution links. This shrank producers' incomes in developing countries, Economic Commission for Africa, Economic Report on Africa 2013: Making the Most of Africa's Commodities, Addis Ababa: ECA.

[185] See OEET, Annex III.

[186] See OEET, Annex III.

[187] Carol Newman, John Page, John Rand et al., Made in Africa. Learning to Compete in Industry, Brookings Institution Press, 2016.

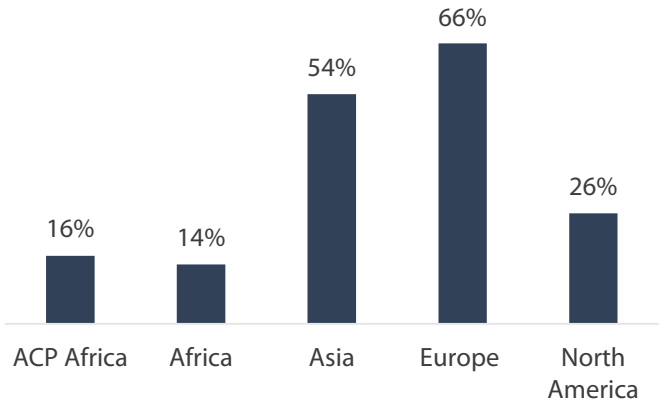
the case of Vietnam shows).[188] For example, in agrifood value chains, downstream segments help create non-farm jobs, which can generate higher output per worker than farming.[189]

African economies have limited 'backward integration' in GVCs: while they largely participate in the global value chain by exporting natural resources and agricultural commodities, subsequently transformed in other countries, foreign value added embodied in African exports accounts for around only 2 % of GDP, which is lower than other LDCs.

Challenge #8: Low regional integration among LDCs

Recent evidence shows **reduced LDC participation in regional value chains**, particularly in Africa; most African trade is with non-African partners.[190]

Figure 14 – Share of intra-regional trade by economic region



Source: Cecilia Bellora, Cristina Mitaritonna and Andreas Maurer, Ways forward for EU-Africa trade and investment relations, European Parliament, 2022; Graphic: G. Macsai.

Despite the important increase in terms of exports observed during 2007 to 2019 (+38 %), the share of intra-African trade has stagnated since 2007 (at 15 % of value). Regional value chains account for only 2.7 % of Africa's participation in GVCs, a significantly smaller share compared to Latin America and developing Asian countries.[191]

The weak complementarity between African national specialisations, linked in particular to the weight of primary natural resources in their exports, constitutes a first obstacle to regional trade. In turn, low regional integration is an obstacle to value addition: it is more likely that regional trade focuses on processed goods, while raw agricultural products and natural resources are mostly exported outside the African continent (see Section 3.1.3).

Limited regional integration moreover limits the possibility to develop economies of scale, which are particularly important in a growingly digitalised economy, where the possibility to manage a critical mass of data is crucial. Indeed, the digitalisation of the economy has increased the

[188] Brian McCaig, Nina Pavcnik, *Moving out of agriculture: structural change in Vietnam* (No. w19616), National Bureau of Economic Research, 2013.

[189] Cecilia Bellora, Cristina Mitaritonna and Andreas Maurer, Ways forward for EU-Africa trade and investment relations, European Parliament, 2022.

[190] Bruce Byiers, Philomena Apiko, Poorva Karkare, The AfCFTA and industrialisation: From policy to practice, ECDPM, 2021.

[191] Cecilia Bellora, Cristina Mitaritonna and Andreas Maurer, Ways forward for EU-Africa trade and investment relations, European Parliament, 2022.

phenomenon of market concentration mentioned under Challenge 7, due to the gatekeeping role played by data owners.

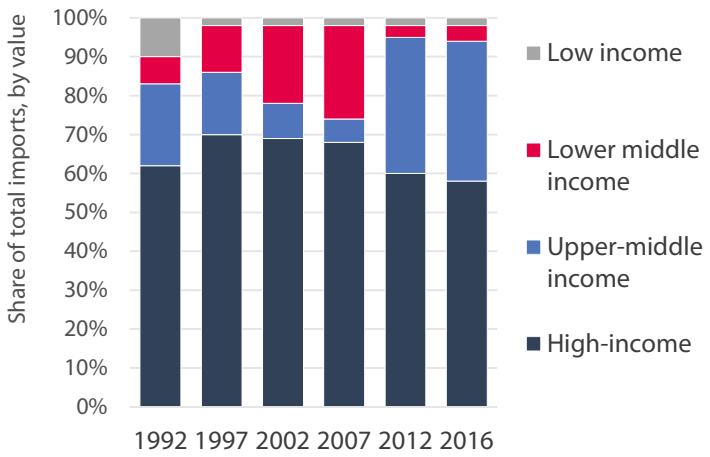
Challenge #9: Limited development coherence in trade and climate policy tools

The EU's internal climate policies supporting the transformation to a more sustainable society also have a considerable impact on third countries, particularly the least developed. Nevertheless, experts warn of the risks of climate and development policies working in isolation: producing trade-offs rather than mutual benefits.[192] Through careful design, mutual benefits can emerge.

The EU Carbon Border Adjustment Mechanism (**CBAM**) has the potential to substantially reduce carbon leakage. At the same time, it risks putting greater cost burden on poorer countries who are only marginally responsible for emissions. This cost burden is due to the costs of decarbonisation in addition to other costs due to the increased costs of their exports and the costs of certification and monitoring. While this is not necessarily the case for all developing countries, it may be true, for example, for aluminium-exporting countries such as Mozambique, Cameroon, Guinea and Sierra Leone, as well as steel-exporting LDCs such as Zimbabwe and Zambia.[193] While LDCs would benefit from creating added value higher up the value chain, many remain dependent on mineral and fuel exports, as discussed in Section 3.1.1.

While the CBAM could provide incentives to decarbonise their economies, it is most likely that additional measures would be needed for LDCs to make the switch, which is costly, lengthy and

Figure 15 – Share of low-carbon technology imports, by income group



Source: Miria Pigato, Simon Black, Damien Dussaux, et al., 'Technology Transfer and Innovation for Low-Carbon Development', International Development in Focus, Washington DC, World Bank, 2020; Graphic: G. Macsai.

demands a full set of measures.[194] Most 'green' technology has to be imported, and, despite technology transfer being an integral part of international commitments – the Paris Agreement and

[192] Susi Dennison and Mats Engström, Decarbonisation nations: How EU climate diplomacy can save the world, European Council on Foreign Relations Policy Brief 4, May 2023.

[193] See OEET, Annex III.

[194] UNCTAD, A European Union Carbon Border Adjustment Mechanism: Implications for developing countries, 14 July 2021 and Olamide Oguntoye, Kitty Mant, Alfonso Medinilla et al., The EU's carbon border tax can accelerate a low-carbon revolution if done right, ECDPM, 2023.

the UN's Agenda 2030 – there is a **gap in low-carbon technology transfer** from high-income to poor countries.[195]

While low-carbon technology (LCT) imports have increased in recent decades in low-income and low-middle income countries, it appears that this is mostly driven by the latter group (see Figure 15).

3.1.2. What could the EU do about it?

Combine trade and industrial policy to support the structural transformation and internal integration of LDC economies

As well as coming under World Trade Organization rules, the framework for EU trade relations with about 60 developing countries, including LICs and LDCs, is set by the Generalised Scheme of Preferences that includes a more favourable GSP+ scheme available on certain conditions and the Everything But Arms agreement specifically for LDCs. In addition, the status quo of EU trade with African, Caribbean and Pacific (ACP) countries, where the overall relationship is defined under the Cotonou Agreement (now under the Samoa Agreement), is framed by the **Economic Partnership Agreements**. These are bilateral (or mostly regional) agreements, currently in different stages of negotiation and ratification. They involve several African countries, including LDCs: Southern Africa Development Community (SADC),[196] Eastern and Southern Africa (ESA),[197] Côte d'Ivoire, Ghana and Cameroon. Recently, for example, the EU and Kenya concluded negotiations on an EPA on 19 June 2023.

Ex-ante impact assessments on these **EPAs** indicate they are **expected to reinforce existing comparative advantages and trade patterns**: an increase in African agricultural and textile exports and an increase in industrial goods import from the EU.[198] This risks producing the effect of moving investment and employment away from potentially more productive (and better-paid) sectors.[199] A lack of consideration of policy coherence for development in decarbonisation policies and the consequent need for 'critical raw materials' risks exacerbating the issue.

Research on EU EPAs with African countries moreover shows that EU exporters are expected to be the main beneficiaries of the agreements,[200] while the room to improve African exporters' position simply via trade liberalisation alone is small. Generalised Scheme of Preferences and Everything But Arms agreements grant comparatively low tariffs for LDC exports to the EU, but this does not appear to be enough to trigger export-led development. In all Sub-Saharan African countries in the sample shown in Figure 16, the relative weight of the EU in overall exports has decreased.

The first potential avenue for action to counteract this trend could be to **support upgrading to export-oriented production in LDCs and encourage the concentration of value creation at**

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195 See OEET, Annex III and Miria Pigato, Simon Black, Damien Dussaux, et al., 'Technology Transfer and Innovation for Low-Carbon Development', International Development in Focus, Washington, DC, World Bank, 2020.

196 Botswana, Eswatini, Lesotho, Namibia, Mozambique and South Africa.

197 Comoros, Madagascar, Mauritius, Seychelles and Zimbabwe.

198 Cecilia Bellora, Cristina Mitaritonna and Andreas Maurer, Ways forward for EU-Africa trade and investment relations, European Parliament, 2022. The authors find that only 3 % of the 5 113 goods classified at the HS6 level represent more than 90 % of expected new exports. Frederik Stender, Axel Berger, Clara Brandi, Jakob Schwab The Trade Effects of the Economic Partnership Agreements between the European Union and the African, Caribbean and Pacific Group of States: Early Empirical Insights from Panel Data, DIE Discussion paper, 2020. The authors find that EPAs with SADC and ESA countries led to greater manufacturing exports from the EU to partner countries.

199 This risk has been underlined in the EU-Mercosur agreement in Jeronim Capaldo and Özlem Ömer , Trading Away Industrialization? Context and Prospects of the EU-Mercosur Agreement, GDPC Boston University, 2021.

200 Cecilia Bellora, Cristina Mitaritonna and Andreas Maurer, Ways forward for EU-Africa trade and investment relations, European Parliament, 2022.

earlier stages throughout global value chains.[201] For example, this could take place by combining extraction with the early stages of processing in the same region Research has found that exports of processed agricultural goods from developing countries has a notable positive impact on their value addition capacity.[202]

This can be achieved by a mix of strategies, including:

- when reducing tariffs, prioritise products with a higher proportion of their value added in the LDCs,[203]
- introduction of dynamic objectives in trade agreements (e.g. setting increased value-added targets in imports to the EU from partner countries), and
- complementing trade measures with technology transfer and infrastructure creation, that could build on the Global Gateway Investment Package.[204]

Another possible action to favour the integration of the export sector and the local economy, is to **discourage the concentration of foreign firms involved in global value chains in special economic zones**. Foreign firms operating under different legal standing further aggravates the detachment between local firms and those that operate in global markets.[205]

The EU could also conclude bilateral and multilateral trade agreements that support open trade and multilateralism, together with guaranteed **fiscal and policy space** to support development processes in poorer countries. According to UNCTAD,[206] certain FTA (Free Trade Agreement) rules 'constrain the use of industrial and environmental support policies needed to enhance the structural transformation of developing countries and to reduce their energy and material throughput'. The EU could support the application of special and differential treatment and common but differentiated responsibility principles in FTAs with developing countries, going beyond GSP, to take into consideration further aspects. First, the more immediate import effects of liberalisation, as opposed to export effects, should be considered,[207] as well as that in some countries, tariff revenues constitute an important source of public budget.[208] Second, devising trade rules and agreements could take more account of the need for policy space,[209] for example in fields such as Intellectual Property Rights (IPR) protection (especially for medicines and other health-related products),[210] the

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201 See OEET, Annex III. An increase in the geographical consolidation of global value chains would also have the effect of reducing the hurdles that strict industrial standards place on the internal integration of GVCs. Since there is a reduced need to accommodate inputs from varied locations, this helps to address the potentially overbearing features of trade agreements.

202 Jan Grumiller, Werner G. Raza, Cornelia Staritz, Hannes Grohs, Christoph Arndt , Perspectives for export-oriented industrial policy strategies for selected African countries: Case studies Côte d'Ivoire, Ghana and Tunisia, Research Report, No 10/2018, Austrian Foundation for Development Research (ÖFSE), Vienna, 2018.

203 This is partly achieved under the Everything But Arms agreement, where Rules of Origin require two-stage processing in the partner country.

204 European Commission, EU-Africa: Global Gateway Investment Package, Global Gateway.

205 See OEET, Annex III and Susanne A. Frick and Andrés Rodríguez-Pose, 'Special Economic Zones and Sourcing Linkages with the Local Economy: Reality or Pipedream?', The European Journal of Development Research, 34(2), 2021, p.p. 655–676.

206 UNCTAD, Trade and Development Report, 2022, p. VIII.

207 Scholars suggest to avoid premature opening of sensitive sectors, see Jan Grumiller, Werner G. Raza, Cornelia Staritz, Hannes Grohs, Christoph Arndt ,'ibid.

208 Cecilia Bellora, Cristina Mitaritonna and Andreas Maurer, Ways forward for EU-Africa trade and investment relations, European Parliament, 2022.

209 See OEET, Annex III and Dani Rodrik, 'What Do Trade Agreements Really Do?', Journal of Economic Perspectives, 32(2), 2018.

210 They extend the period during which companies (almost always located in richer countries), can extract monopoly rents, thus risking further aggravating the technological lag in developing countries. See e.g. the repudiation of patents on anti-AIDS drugs by Brazil in the early 2000s (OEET, Annex III).

reduction of capital controls that are incorporated in trade agreements, and investor-state dispute settlement mechanisms, which allow foreign investors to sue the government for the enactment of policy changes that they consider to be detrimental to their profits.[211]

Shape policies to support LDCs' regional integration

The EU is a unique position to support (including by example) the gains from regional economic and political integration, a possibility which is currently underutilised.

The EU is already shaping its main EPAs with African countries as **regional agreements**, but country-level agreements often proceed faster than regional ones, thus increasing the fragmentation.[212] Analysts[213] recommend that the EU and their partners revise these agreements in light of their limitations (see Section 2.2.1), and of the need to facilitate continent-wide African integration, for example with 'rules of origin cumulation'.[214]

The EU **support for existing regional integration** attempts is also important, for example the Zambia and The Democratic Republic of Congo agreement to invest in the electric vehicle value chain.[215] Notably, several analysts point to the importance of encouraging the implementation of the **African Continental Free Trade Area** (AfCFTA),[216] and particularly its capacity to increase the African continent's production capacity. As UNCTAD argues,[217] 'trade integration should not be confined to trade liberalisation but be part of a broader development strategy promoting regional specialisation, economies of scale and mutual economic interdependence'. Continental integration should therefore also support investment in and diversification of the production base of each member country. The EU debate around AfCFTA has until now been greatly focused on the possibility of a continent-to-continent FTA. Nevertheless, given the difficulties encountered on the AfCFTA, including on the African side, and the limitations of a liberalisation-only approach, analysts recommend that the EU commit to trade rules encouraging African exports, even in the absence of a continent-to-continent FTA[218] (for example, cumulation of rules of origin, trade facilitation and market access for those African countries emerging from LDC status).

Migration policies that encourage intra-African mobility

A key recommendation from analysts on the AfCFTA, is to **support the free-movement protocol** that is expected to accompany the free trade area. The benefits of free trade would be greatly limited by an absence of free movement.[219] However, ratification of the protocol has stalled.

If the current restrictive focus on border securitisation is maintained in EU migration policy, this risks hindering free-movement integration within Africa. **EU migration management tools should not restrict mobility within Africa.** The EU Trust Fund evaluation[220] underlines that in some cases EU

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211 In this respect, a potentially relevant policy action is the EU proposal for a multilateral investment court.

212 Cecilia Bellora, Cristina Mitaritonna and Andreas Maurer, Ways forward for EU-Africa trade and investment relations, European Parliament, 2022.

213 Sean Woolfrey, What does the AfCFTA mean for an EU-Africa trade agreement?, ECDPM 2021.

214 Meant to allow LDCs to combine originating materials without losing their originating status.

215 United Nations. Economic Commission for Africa, Zambia and DRC Sign cooperation agreement to manufacture electric batteries, Addis Ababa, April 2022.

216 Bruce Byiers, Philomena Apiko and Poorva Karkare, The AfCFTA and industrialisation: from policy to practice, ECDPM, 2021.

217 UNCTAD; Trade and Development Report, 2022.

218 Sean Woolfrey, ibid, 2021.

219 Amanda Bisong, Labour mobility as a key element of the AfCFTA: What role for the AU's free movement protocol?, ECDPM, 2022.

220 Altai, op. cit.

migration management priorities risk hindering local development processes based on mobility (there are studies reporting this phenomenon for example in the Agadez area in Niger, see 3.13.). It therefore recommends adopting policies that encourage intra-Africa mobility.

Migration policy has also proved a bottleneck in EU-African Union relationships since the EU and its Member States focus is on migrant returns, while African countries and the AU prioritise free movement within Africa.[221]

A more development-coherent EU Carbon Border Adjustment Mechanism

The EU is developing unilateral arrangements to reduce CO_2 emissions, such as its Carbon Border Adjustment Mechanism (CBAM), which is expected to decarbonise the economy and limit carbon leakage. As discussed above, the CBAM risks putting further cost burden on LDCs, who are responsible for a much smaller share of emissions. To address this issue without undermining the aim to contribute to reducing emissions and levelling the playing field, several possible policy options have been discussed:[222] Together with the possibility of a delay in its implementation for LDCs (or selected exemptions), either based on volume threshold or on environmental criteria,[223] other measures could help reduce the expected export and welfare gap between developed and developing countries:[224]

- **use CBAM revenues to help LDCs transition to a greener economy**. According to the European Commission, the EU CBAM could generate about €1.5 billion per year as of 2028,[225] which represents about a tenth of developed countries' commitment on adaptation funds, or of the African Development Bank's estimate of the funding gap for infrastructure in Africa. While meaningful, this represents a small share of the assistance required.
- Accompany the CBAM with **green technology transfer** to LDCs for the energy and production transition, such as low carbon technologies mentioned in Figure 15.

These options are not mutually exclusive and their added value could even increase if considered together.

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221 Amanda Bisong, Migration Partnership Framework and the Externalization of European Union's (EU) Migration Policy in West Africa: The Case of Mali and Niger, *Regional Integration and Migration Governance in the Global South* ,pp. 217-237, Springer, Cham, 2020

222 See OEET, Annex III, Samuel Pleeck, Fatima Denton, Ian Mitchell, An EU Tax on African Carbon – Assessing the Impact and Ways Forward, Center for Global Development, 2022; Olamide Oguntoye et al, The EU's carbon border tax can accelerate a low-carbon revolution if done right, ECDPM, 2023.

223 Sunayana Sasmal, Dongzhe Zhang, Emily Lydgate and L. Alan Winters, Exempting Least Developed Countries from carbon border adjustments: A legal and economic analysis, CITP Briefing Paper 5, 2023.

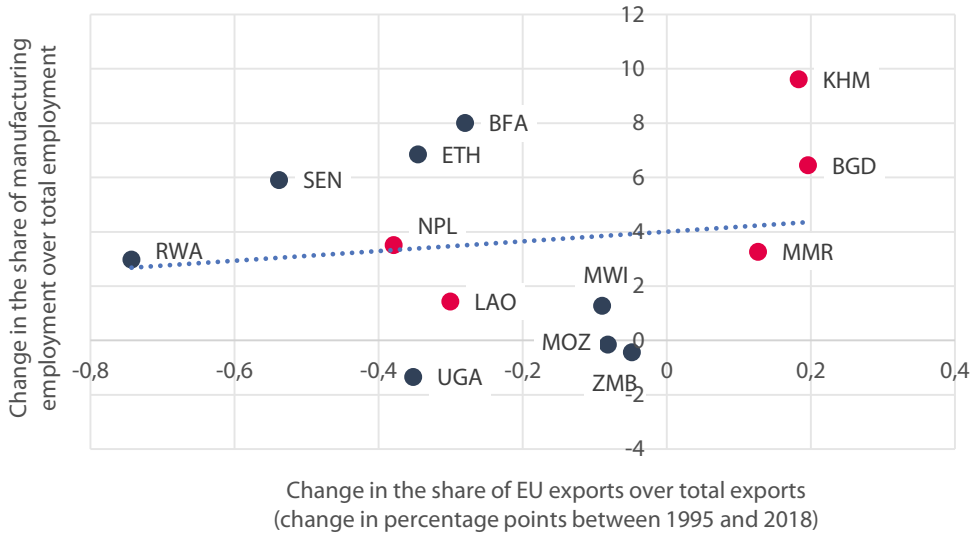
224 UNCTAD, ibid, 2021.

225 European Commission, Questions and Answers: An adjusted package for the next generation of own resources, press release, June 2023.

3.1.3. Cost of non-Europe

Firstly, the **lack of action to aid LDCs' structural transformation limits the creation of well-paid jobs**. Without action, sectors with higher productivity would not develop, or would be isolated from

Figure 16 – Relationship between change in manufacturing value added and change in share of exports to the EU



Source: authors' elaboration based on BACI and ETD Change in the share of manufacturing employment over total employment and change in the share of EU exports over total exports (change in pp between 1995 and 2018), in selected LDCs, due to data availability; Graphic: G. Macsai.

the local economy, without generating the employment levels that could otherwise be expected.[226] One of the main benefits of structural transformation is the generation of better-paid jobs, resulting from the movement of workers from less- to more-productive sectors. The persistence of a pattern of an export-oriented sector focused on primary products and low value addition limits the creation of well-paid jobs.[227]

As a consequence of the focus on raw materials, exporting to the EU does not seem to have increased manufacturing employment in African LDCs (manufacturing employment is considered a proxy for well-paid jobs, being a higher productivity sector). Figure 16 and especially Table 11 in Annex I illustrates that the share of EU exports is negatively correlated with manufacturing employment in African countries.

In some cases, manufacturing employment has fallen over time, together with a reduction in the share of exports to the EU (Mozambique, Uganda, Zambia). In other cases (Ethiopia, for example, in the top left side of the Figure 16), industrial employment increases, but without the EU market playing a significant role. Indeed, recent research has shown that manufacturing employment in several developing countries is increasing again (after decades of decline, as shown in Figure 13),[228] but this is unrelated to trade: in Sub-Saharan Africa, this new increase is due to unregistered firms that expand employment to meet local demand for basic manufactures.

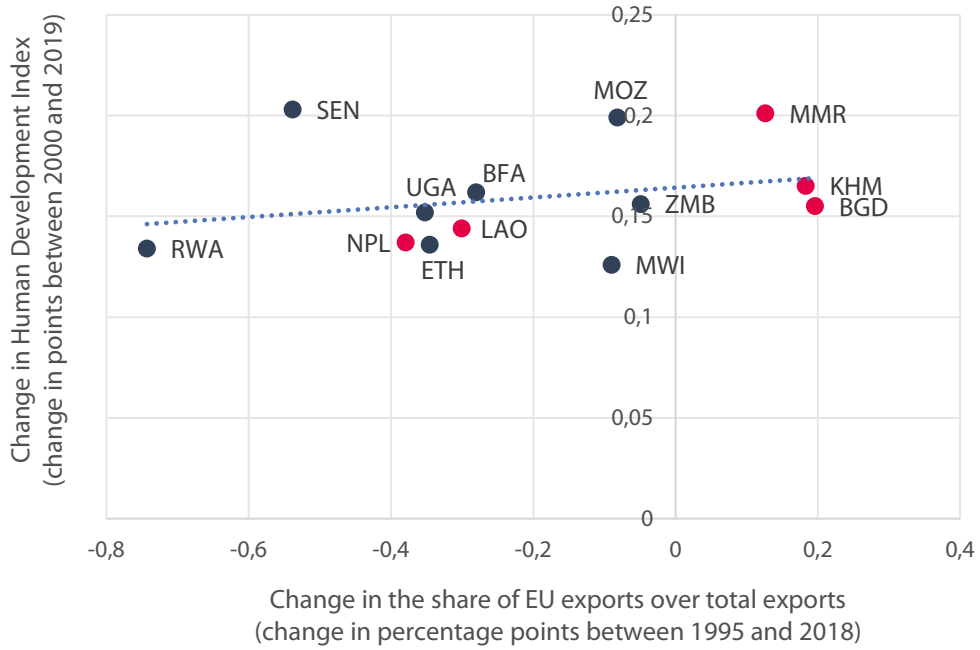
[226] Annex III - OEET.

[227] Thomas Farole, 'Do global value chains create jobs?', IZA World of Labor, 2016.

[228] Hagen Kruse, Emmanuel Mensah, Kunal Sen and Gaaitzen de Vries, A manufacturing (re) naissance? Industrialization in the developing world, *IMF Economic Review*, Vol. *71*(2), pp. 439-473, 2022.

The picture is different in Asian LDCs, and the EU share of exports is positively correlated with employment in manufacturing (Table 11 in Annex I and Figure 16). This could confirm the observation that GVC participation (and therefore increased export value added) encourages structural transformation only when it occurs in a larger context of manufacturing and higher productivity sectors' expansion.[229]

Figure 17 – Relationship between change in share of exports to the EU and change in HDI



Source: authors' elaboration based on BACI and HDI index on a subset of LDCs (due to data availability); Graphic: G. Macsai.

Nevertheless, there is a risk of **limited translation into poverty reduction.** Structural transformation historically played an important role in eradicating poverty[230] and the share of manufacturing employment is usually associated with lower poverty levels[231] (Figure 25 in Annex I).[232] The correlation between the EU share in exports and poverty is weak, although it points in the right direction (Figure 17). Even in the group of Asian LDCs, the correlation with poverty reduction is weaker than with manufacturing employment. In Figure 26 in the Annex, where the Multi-Dimensional Poverty Index is used (instead of HDI), it even seems mildly positive: countries that had an increased trade with the EU over the last decades tend also to have higher rates of multidimensional poverty.[233] This may confirm that, in some cases, the expected positive effects of manufacturing exports on poverty reduction are limited by several factors including international

[229] Elissa Braunstein, Piergiuseppe Fortunato, Richard Kozul-Wright, Trade and Investment in the Era of Hyperglobalization. *The Palgrave Handbook of Development Economics: Critical Reflections on Globalisation and Development*, pp. 727-762, 2019.

[230] Brian McCaig, Nina Pavcnik, Moving out of agriculture: structural change in Vietnam (No. w19616). National Bureau of Economic Research, 2013.

[231] Measured by the Human Development Index.

[232] Poverty measured by the Multidimensional Poverty Index.

[233] It is important to note that this analysis is not able to identify causal relationships, but only correlation between the two variables.

trade-induced standardisation and related labour saving techniques, this does not occur.[234] This limited translation into poverty reduction could also highlight that some manufacturing exporting countries still face pressure to **compete over prices**, which reduces the gains of structural transformation.[235] This underlines the importance of improving working conditions and social standards (see Section 3.2), and to address market power concentration in global value chains (see Section 3.3).

Countries where exports are focused on raw materials also face the risk of an isolated sector generating **few positive spillovers in the local economy**. In some cases, this has a small employment-generating potential and most employment remains in sectors with low productivity and low wages. Research also shows that a strong specialisation in raw commodity exports is often associated with below-potential investment in education and health, and with increased inequalities.[236] At the same time, there is no strict determinism in this association. Resource-rich countries show different possible outcomes: some African countries have been relatively successful in using their profits from extractive activities to invest in public services, such as health and education.[237]

The **missed opportunity to encourage regional value chains contributes to limiting value addition in LDCs.** Research shows that regional value chains, especially in Africa, incorporate greater value added than global value chains. As shown in Figure 18, African countries are more likely to export manufactured goods and processed food to other African countries, compared to their global exports, where primary products represent 45.6 % of total exports. The missed opportunity to encourage regional integration therefore limits value addition in African economies.

As several policy makers in African countries have envisaged, regional value chains can also support economies of scale and 'regional innovation hubs', for example there is a debate on developing an African regional automotive value chain, drawing inspiration from the ASEAN (Association of Southeast Asian Nations) 'hub and spokes' approach.[238]

[234] See OEET, Annex IIII and Dani Rodrik, 'New Technologies, Global Value Chains, and Developing Economies', National Bureau of Economic Research, 2018a.

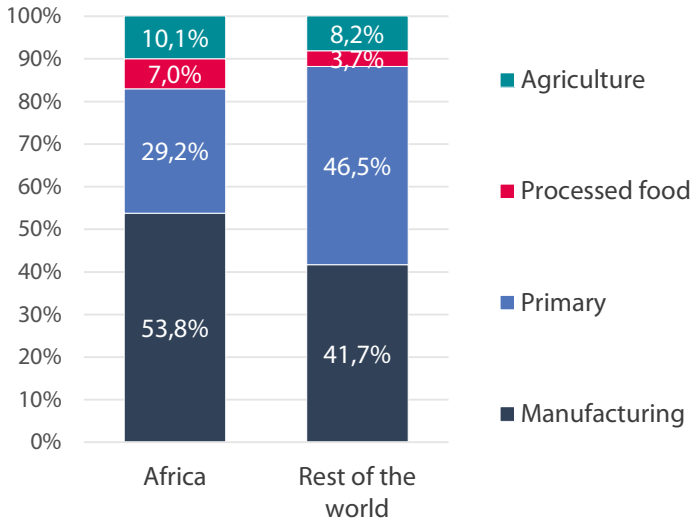
[235] Elissa Braunstein, Piergiuseppe Fortunato, Richard Kozul-Wright, Trade and Investment in the Era of Hyperglobalization, *The Palgrave Handbook of Development Economics: Critical Reflections on Globalisation and Development*, pp. 727-762, 2019.

[236] See OEET, Annex IIII and Dani Rodrik, 'New Technologies, Global Value Chains, and Developing Economies', *National Bureau of Economic Research*, 2018; and Antonio Savoia and Kunal Sen, The Political Economy Of The Resource Curse: A Development Perspective, WIDER Working Paper 2020/123 Helsinki: UNU-WIDER, 2020.

[237] Cristiano Lanzano, Jorgen Levin, Patience Mususa, ibid, 2024, report some 'success stories', such as Botswana.

[238] See OEET, Annex IIII.

Figure 18 – Composition of intra-Africa and international African exports, 2019



Source: Cecilia Bellora, Cristina Mitaritonna and Andreas Maurer, Ways forward for EU-Africa trade and investment relations, European Parliament, 2022; Graphic: G. Macsai.

Political cooperation with partner countries could moreover benefit from a stronger regional dialogue.

The willingness EU institutions have expressed to establish a horizontal relationship with partners in the Global South risk being frustrated by a lack of coordination with regional organisations' priorities in LDCs.

For example, evaluations highlight that migration management cooperation between the EU and Africa risks countering the need for coordinated policies within Africa and its political institutions (African Union and regional organisations). As the European Commission's evaluation of the EU Emergency Trust Fund for stability and addressing root causes of irregular migration and displaced persons in Africa (EUTF), some countries have benefited more than others from the EUTF and this may contribute to 'creating or worsening regional/continental imbalances that could in turn worsen the mobility and migration situation in Africa'.[239]

The cost of this lack of coordination in supporting intra-African mobility had negative impacts in regions whose economies were particularly linked to labour mobility and local trade. Excessively strict border management can increase borderland communities' vulnerabilities, as in the case of the partnership with Niger: the strengthening of border and movement controls had a negative impact on several areas of the local economy, such as transport and trans-border activities, with specific impacts on the Agadez area. This risks hindering the mobility of people within the ECOWAS (the Economic Community of West African States), who previously enjoyed free movement – risking damage to regional integration and bring economic costs.[240]

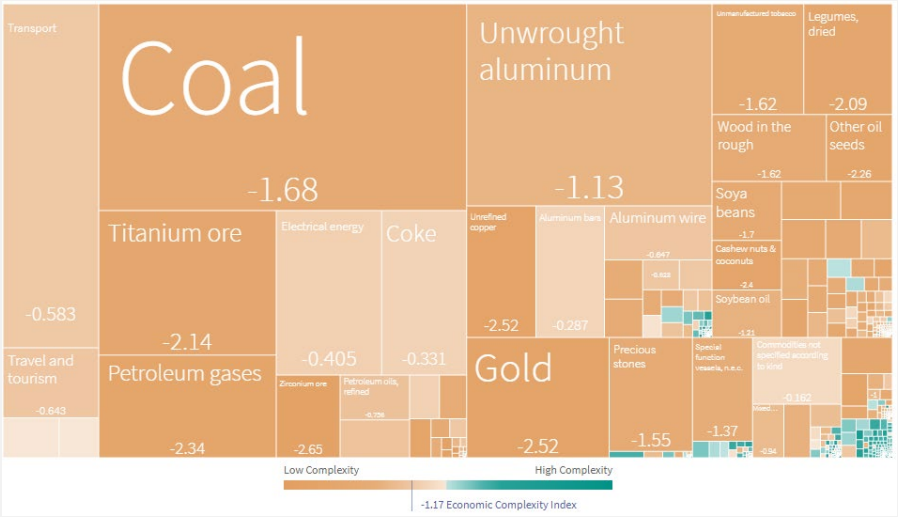
Moreover, in the absence of coordinated multilateral and bilateral action, the **cost of the green transition could increase and be unfairly distributed**. Researchers estimate that the lack of

[239] Altai Consulting for the European Commission, Learning Lessons from the EUTF - Phase 2 - Paving the way for future programming on migration, mobility and forced displacement, February 2021 and Meenakshi Fernandes, Cecilia Navarra, ibid, 2021, p. 216.

[240] Marta Latek, La mise en œuvre du nouveau cadre de partenariat avec les pays tiers: Le cas du Niger, EPRS, 2019 and Meenakshi Fernandes, Cecilia Navarra, Legal Migration Policy and Law, European Added Value Assessment, 2021.

Box 3 – Mozambique in global value chains and the graphite sector

Mozambique's main exports consist of fossil fuels, metals and minerals. Fossil fuels accounted for about 32 % of Mozambique's exports in 2021, while mineral products accounted for around 29 % of Mozambique's exports in 2021. Mozambique's specialisation in commodity exports is illustrated by the export complexity index below (brown represents low complexity products, while green/blue represents higher complexity products).



Source: Growth Lab, The Atlas of Economic Complexity

The picture does not change substantially looking at Mozambican exports to the EU, which are dominated by unwrought aluminium (47 %) and are likely to see a sharp increase in graphite.

There is indeed a risk of Mozambique experiencing limited structural transformation. The share of employment in the manufacturing sector fell in the last decade (Figure 24 in Annex I), despite it being a sector with increasing productivity. While the mining sector is growing in terms of contribution to GDP, this does not translate into a comparable increase in employment (less than 1 % in 2018).

In 2022, Mozambique was the world's second biggest producer of graphite. More than 50 % of Mozambique's graphite production is destined for export to the EU. According to the European Commission, the EU's graphite supply currently sourced from Mozambique is 13 %. As of 2023, there are three active large-scale graphite mining concessions in the Cabo Delgado province (Northern Mozambique). This has not translated into a pattern of structural transformation in the region (Annex III). Currently, Cabo Delgado's employment structure has not changed with the mining extraction activity; while mining sector employment increased from 0.1 % to 1.5 % between 2014 and 2019, it then declined to 1.3 %. Manufacturing employment declined from 3.7 % to 1.3 % (Annex III).

complementary action in cooperation with LDCs on the CBAM could lead to losses. Analysis shows that the CBAM could provoke a gap between developed and developing countries in terms of its impact on exports and welfare.[241] Despite the fact that LDCs are not among the main exporters to the EU, the impact of a price increase for their main exports could be important for exporter countries' GDP.[242]

241 UNCTAD, ibd, 2021

242 The most extreme case is Mozambique, for its extraction and export of aluminium, where a study estimates (although with several caveats in the assumptions) that a possible impact is a reduction of 1.6 % in GDP if demand follows a price change., Samuel Pleeck, Fatima Denton, Ian Mitchell, Iibid., 2022.

3.2. Low enforcement of environmental, social and governance standards in corporate actions in global value chains

3.2.1. What are the challenges?

Challenge #10: Lack of mandatory responsible business conduct standards in global value chains

As shown by the discussion on the proposed corporate sustainability due diligence directive[243] and the European Parliament's demands,[244] there is the awareness that the internationalisation of production, unless properly governed, risks generating **incentives to lower social and environmental standards**.[245] As pointed out by Reddy,[246] the global economic arena can be seen as a context of strategic complementarities, where the rule-systems that encourage players to act in an undesirable way can create incentives for other players to act similarly undesirably. Liberalising trade without setting labour and environmental standards provides incentives to compete over these standards. At the same time, these **standards are 'strategic complements'**: the higher they are in the trading partners, the lower is the cost of maintaining these standards 'at home'**.** The European Commission highlights this danger in its 2021 Trade Policy Review, identifying 'a serious decent work deficit ... in global supply chains in many parts of the world. [...] Depriving workers of their fundamental rights puts downward pressure on social conditions globally and fuels people's disenchantment with globalisation and open trade.'[247]

From 1994 to 2011, the labour share of global GDP[248] declined, both in the Global North and in the Global South. In 2020, the Word Bank identified several contributing factors: of the around 2.5 percentage point decline, GVCs contributed for around 0.5 percentage points; therefore while they are not the main contributor, they have significant effect on the phenomenon.[249] A 2016 International Labour Organization (ILO) survey[250] investigates how GVC practices influence working conditions and wages: unwritten contracts with buyers, unclear clauses and attribution of responsibilities and duties, insufficient lead time for offers, and greatly unbalanced market power, influence supplier dependency on buyers. The ILO finds that 54 % of the surveyed suppliers are at 'dependency risk' because they sell more than 35 % of their production to the same buyer, and this percentage rises to 75 % in the textile and garment sector.

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243 Proposal for a directive of the European Parliament and of the Council on corporate sustainability due diligence and amending Directive (EU) 2019/1937 COM/2022/71 final.

244 European Parliament resolution of 10 March 2021 with recommendations to the Commission on corporate due diligence and corporate accountability (2020/2129(INL)).

245 Cecilia Navarra, Corporate due diligence and corporate accountability, European Added Value Assessment, EPRS, European Parliament, 2020 and Aleksandra Heflich, An EU legal framework to halt and reverse EU-driven global deforestation: European added value assessment, EPRS, European Parliament, 2020.

246 Sanjay Reddy., International Trade as a Means to Diverse Ends: Development, Workers, the Environment, and Global Public Goods. Oliver De Schutter, Trade in the service of sustainable development: Linking trade to labour rights and environmental standards, *Bloomsbury Publishing*, 2017.

247 Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions Trade Policy Review – An Open, Sustainable and Assertive Trade Policy, COM/2021/66 final.

248 The labour share of national income is the part of income that goes to salaries, therefore a measure of the extent to which income goes to the less-advantaged layers of society.

249 The World Bank, World Development Report, 2020 cited in Cecilia Navarra, Corporate due diligence and corporate accountability, European Added Value Assessment, EPRS, 2020.

250 ILO, Purchasing practices and working conditions in global supply chains: Global Survey results, INWORK Issue Brief No 10, 2017.

Forced labour is an extreme case of violation of labour rights: in 2022, the ILO updated its report on forced labour, highlighting an increasing problem with respect to the previous 2017 report: in 2021, it estimates that 27.6 million people are in forced labour.[251] About 17 million are exploited in the private economy (excluding sexual exploitation).[252] Of the 17 million, 6.5 million people are in low-middle income countries and 2.3 million in low-income countries. In low-income countries, the incidence of forced labour in the total population is higher than in other income groups.

A number of soft-law instruments and guidelines exist – notably the United Nations Guiding Principles on Business and Human Rights,[253] and the OECD Guidelines on Responsible Business Conduct.[254] The lack of a mandatory system of enforcement of responsible business conduct or a guarantee of social environmental and governance standards worldwide[255] limits the upward convergence of business practices, and this is one reason behind the recent initiatives at the European Union level on sustainability due diligence. While some Member States have already begun, the EU is indeed moving towards the establishment of due diligence obligations for companies in the supply chain.

3.2.2. What could the EU do about it?

Mandatory and enforceable tools could uphold social and environmental standards in supply chains

Research shows the need to switch from voluntary responsible business conduct standards to mandatory procedures.[256] The EU is working on a proposed directive for **mandatory sustainability due diligence for companies along the entire value chain**, including in third countries.[257] This would establish a corporate due diligence duty to identify, bring to an end, prevent, mitigate and account for negative human rights and environmental impacts in a company's own operations, their subsidiaries and their value chains. A provisional agreement was reached in December 2023, and after being blocked at the EU Committee of Permanent Representatives (COREPER) level in February 2024,[258] it was finally adopted in an amended form in March 2024. The European Parliament supports this proposal, despite some differences with respect to its own proposal, adopted in 2021.[259] The Parliament's proposal had a wider scope, both in terms of companies to which the duty would apply (not merely large companies). Further criticisms regarding the current proposal are that it defines few obligations on climate-related responsibilities, it excludes the financial sector, and it only covers partner companies in third countries that have 'established relationships' with the main EU company.

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251 ILO, Global Estimates of Modern Slavery. Forced Labour and Forced Marriage, Geneva. 2022.

252 Commercial sexual exploitation involves about 6 million people and State-imposed forced labour about 4 million.

253 United Nations Human Rights, Guiding Principles on Business and Human Rights: Implementing the United Nations 'Protect, Respect and Remedy' Framework, 2011.

254 OECD, OECD Due Diligence Guidance for Responsible Business Conduct, 2018.

255 Cecilia Navarra, Corporate due diligence and corporate accountability, European Added Value Assessment, 2020 and Aleksandra Heflich, An EU legal framework to halt and reverse EU-driven global deforestation: European added value assessment, 2020, see also Annex IIII - OEET.

256 Cecilia Navarra, ibid, 2021.

257 Proposal for a Directive Of The European Parliament And Of The Council on Corporate Sustainability Due Diligence and amending Directive (EU) 2019/1937, COM/2022/71 final.

258 International Federation for Human Rights, EU member states' failure to endorse Corporate Sustainability Due Diligence Directive, February 2024.

259 European Parliament resolution of 10 March 2021 with recommendations to the Commission on corporate due diligence and corporate accountability (2020/2129(INL)).

Another action that the EU could endorse is the international **Binding Treaty on Business and Human Rights promoted by the United Nations**.[260] In the context of the 2017 Review of Development Policy, the European Parliament already asked the EU to support the adoption of a legally binding international instrument to hold companies accountable for their human rights violations.[261]

As regards trade and sustainable development (TSD), since the 2011 EU-South Korea Agreement, all 'new generation' FTAs include indeed a **TSD chapter**.[262] A possible action for the EU would be to improve their **enforceability**: these FTAs have a dedicated dispute settlement mechanism, which involves recommendations from a panel of experts, but there is no formal requirement to follow up on these recommendations,[263] and there is no possibility of economic sanction on a party that does not comply. Academic observers[264] have criticised this element, arguing that TSD-related disputes should be settled in the same way as any other dispute in an FTA.

The EU's bilateral agreements have an 'essential elements' human rights clause and the generalised system of preferences (GSP) also imposes human rights conditionality in cases of massive violation.[265] Nevertheless, research shows that human rights dialogues with trade partners produce non-binding conclusions and that stronger monitoring mechanisms and clearer enforcement mechanisms are limited to date.[266]

3.2.3. Cost of non-Europe

The cost of not taking EU action in this area falls both on EU companies and on social and environmental conditions in partner countries. The cost borne by EU companies is that of an uneven playing field; there is moreover evidence that companies that follow higher standards, instead of short-term cost-cutting strategies, have better performance indicators, thanks for example to increased quality and innovation.[267] The overall cost is due to the persisting incentive to embark on a **'race to the bottom' on social, governance and environmental standards**, that has negative impacts on social standards and environmental protection worldwide.

Value chain governance can have substantial impacts on social outcomes on the ground. Empirical analysis finds that interventions on the buyer side, which manage to address the practices that are harmful to working conditions in local suppliers, have a significant impact on working conditions, health and safety, respect for decent work standards, and wage indicators.[268]

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260 United Nations Human Rights, BHR Treaty Process. OHCHR and business and human rights.

261 European Parliament resolution of 14 February 2017 on the revision of the European Consensus on Development (2016/2094(INI))

262 Parties agree to implement or ratify fundamental ILO conventions and multilateral environmental agreements such as the Paris Agreement on climate change, and usually agree on a number of commitments to promote sustainable development. Jana Titievskaia, Sustainability provisions in EU free trade agreements Review of the European Commission action plan, EPRS, 2021.

263 Titievskaia J, ibid, 2021.

264 Marco Bronckers, and Giovanni Gruni, Retooling the sustainability standards in EU Free Trade Agreements. Journal of International Economic Law, 24(1), pp. 25-51, 2021.

265 Ionel Zamfir, Human rights in EU trade agreements: The human rights clause and its application, EPRS, 2019 and Ionel Zamfir , Human rights in EU trade policy: Unilateral measures applied by the EU, EPRS, 2018.

266 Isabelle Ioannides, The effects of human rights related clauses in the EU-Mexico Global Agreement and the EU-Chile Association Agreement, EPRS, 2017; Isabelle Ioannides, The Trade Pillar in the EU-Central America Association Agreement: European Implementation Assessment, EPRS, 2018; Pascal Lamy, Genevieve Pons, Isabelle Garzon and Lea Kauffman, Sustainable development in EU trade agreements, Jacques Delors Institute, 2021.

267 Cecilia Navarra, ibid, 2021.

268 See the description of the joint ILO and IFC/WB Better Work Program and the 2013 Accord on Fire and Building Safety in Bangladesh in Navarra, ibid, 2021.

For example, the 2013 Accord on Fire and Building Safety in Bangladesh,[269] established in the aftermath of the 2013 Rana Plaza disaster, is **enforceable** and makes international brands directly responsible for the safety of supplier-company employees. Research[270] carried out among 1 500 Bangladeshi garment factory workers finds that the impact of participation in the accord has been substantial for many working condition indicators, e.g., workers in factories affiliated with the accord or the alliance are less afraid of losing their job and more likely to receive a written letter of appointment upon recruitment. Health and workplace safety indicators improve in these factories.

Table 8 provides a limited simulation to give an indication of the potential impact of all EU companies and all foreign companies applying mandatory social standards in LDCs on indicators representing respect for fundamental labour rights (using data from the World Justice Project's Rule of Law Index). Meeting such standards could have an impact on fundamental rights protection, which in turn is expected to have a direct impact on poverty reduction, and a positive impact on economic growth.[271] The potential impacts are extrapolated from two cases (the 'Better Work Program' in Vietnam and the Accord on Fire and Building Safety in Bangladesh), and are applied to LDCs based on their openness to trade and on the relevance of the EU as a trade partner. The potential impact of a multilateral measure is also simulated, such as the UN Treaty, assuming that the changes apply to all companies, not just those from the EU, therefore implying a greater impact.[272]

Table 8 – Scenario simulation on potential impacts of mandatory responsible business conduct measures

	Scenario 1	Scenario 2	Scenario 3
EU Corporate sustainability due diligence (proportional to trade with EU)	0.488	0.498	0.564
UN Treaty (including all trade)	0.507	0.544	0.791
Baseline	0.4821		

Source: authors' elaboration on a subsample of LDCs on Factor 4.8.

269 2018 Accord on Fire and Building Safety In Bangladesh.

270 Naila Kabeer. et al, 2020, ibid.

271 Cecilia Navarra., ibid, 2021.

272 Details of calculations and limitations presented in Annex I.

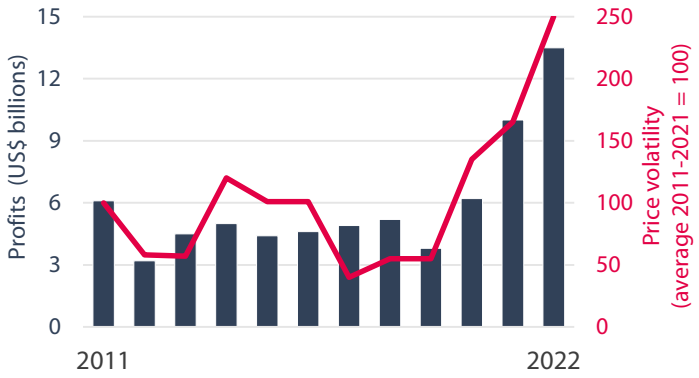
3.3. Gaps in global market regulation

3.3.1. What are the challenges?

Challenge #11: Gaps in regulation of global food markets.

Despite being major producers, LDCs often experience **dependency on food and energy imports**. Agriculture is a crucial sector for most LDC economies. It is simultaneously challenged by and could provide resilience tools to combat, food insecurity and climate change. While structural transformation implies workers moving out of agriculture, it can also facilitate increased productivity in agriculture. Countries that show both economic growth and poverty reduction in recent years share the common feature of having had a sustained period of **agricultural growth with smallholder participation**.[273] To the contrary, an element common to the group of countries having experienced low poverty reduction records, despite economic growth, is a stagnation in agricultural productivity. Increased agrarian production can be both a cause and consequence of food security. Both 'ends' need policy support, since market incentives are likely to be insufficient.[274]

Figure 19 – Main food companies' profits



Source: UNCTAD, Trade and Development Report, 2023; Graphics: G. Macsai.

At the same time, global markets do not properly respond to the food security needs of LDC populations. UNCTAD finds that the majority of LDCs are also net importers of basic commodities.[275] In consequence, commodity price shocks and volatility can have an impact on fiscal space and on poverty, via the price of food and energy. For example, food prices have seen an important increase in recent years. **The global food market is highly concentrated: four major companies hold 70 % of the global food market share**,[276] and their profits are rising sharply. Known as 'ABCD' companies,(Archer, Daniels, Midland, Bunge, Cargill and Louis Dreyfus), the increase in their profits is mainly due to their financial activities, using food as an asset on global financial markets – an area that lacks regulation.[277]

[273] Channing Arndt, Andy McKay and Finn Tarp, Growth and Poverty in Sub-Saharan Africa, Oxford University Press, 2016.

[274] African Union Agenda 2063. Adopted in June 2014, the first ten-year implementation plan (2015-2025) covers seven priority areas aligned with the SDGs, defined in the 2014 Malabo Declaration on 'Accelerated Agricultural Growth and Transformation for Shared Prosperity and Improved Livelihoods'. One of the goals is to end hunger by 2025, focusing on the triple targets of increased production, reduced losses and waste and improved nutrition.

[275] UNCTAD, Least Developed Countries Report, 2023.

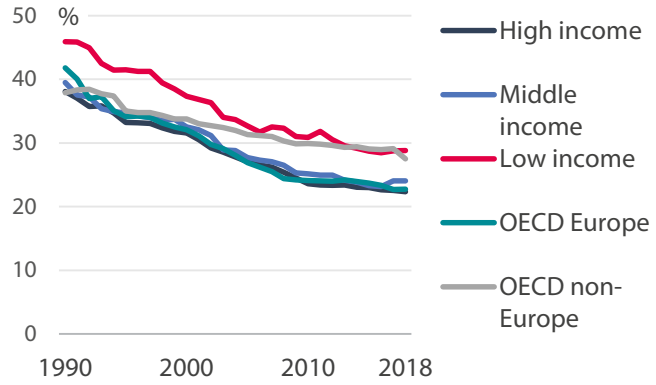
[276] UNCTAD, Trade and Development Report, 2023.

[277] UNCTAD, ibid, 2023.

Challenge #12: Gaps in global architecture on taxation of multinational enterprises

In recent years, awareness of tax evasion, tax avoidance and profit shifting has risen.[278] There is a well-documented risk of a 'race to the bottom' in taxation, due to competition between countries, as shown in Figure 20. It is estimated that the overall global cost of tax avoidance reaches US$500 to US$600 billion per year; the loss specifically for developing countries is estimated to reach about US$200 billion each year. For countries such as Chad, Zambia or Pakistan, the cost amounts from 5 % to 8 % of GDP per year, which is higher than the cost for several countries in the global North.[279] Profit-shifting, other forms of **tax avoidance and evasion and illicit financial flows** therefore **undermine domestic mobilisation of resources** for development and climate action.

Figure 20 – Average corporate income tax rates by country income group



Source: EPRS, Slowing down or changing track? Understanding the dynamics of 'Slowbalisation', 2020 on OECD data; Graphic: G. Macsai.

To respond to this challenge, the **OECD** promoted the **'Inclusive Framework initiative'**, a multilateral agreement, progressively entering into force, comprising two pillars.[280] Pillar 1 envisages profits from multinational enterprises (MNEs) no longer being linked to their physical presence for taxation jurisdiction, but instead depending on the countries where their profits are generated (for those MNEs with revenues higher than €20 billion and profit margins superior to 10 %). Under the second pillar, a new minimum corporate tax of 15 % will be applied to companies whose global revenue is higher than €750 million.

Several **criticisms** have been raised by countries in the Global South, such as the high threshold for Pillar 1 to apply, the exclusion from the same pillar of the financial and extractive sectors, and the low taxation rate under Pillar 2. This agreement still has to be fully implemented and the EU could contribute to removing some of the shortcomings. At the same time, the UN General Assembly adopted a resolution to establish a **United Nations Framework Convention on International Tax Cooperation**,[281] in November 2023, aiming at addressing these shortcomings.

[278] Annex II - RAND.

[279] Annex II - RAND.

[280] Annex II -RAND.

[281] United Nations Secretary-General, Note to Correspondents – on a United Nations Framework Convention on International Tax Cooperation, November 2023.

3.3.2. What could the EU do about it?

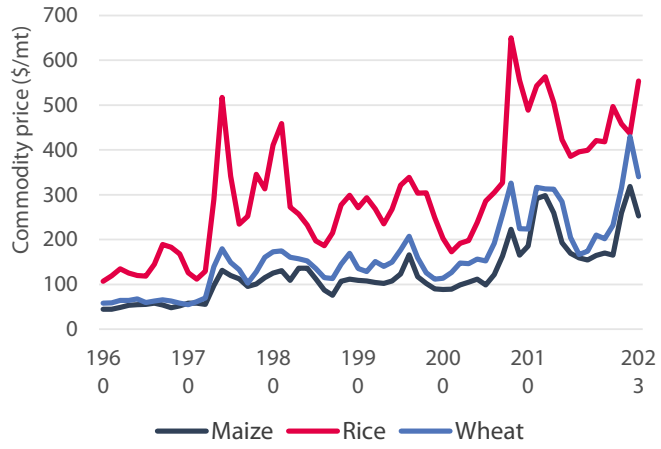
Revive rule-based multilateralism targeted towards SDGs

As advocated by the European Parliament,[282] the EU could play a role in **reviving a multilateral approach to shaping trade and investment globally, in a way that is targeted to meet the SDG and Paris Agreement objectives**.

This requires a complex set of policies, including multilateral actions where the EU could contribute. The EU could play a major role in restoring a multilateral approach to addressing global challenges, due to its historical 'progressive transfer of competences from national to supra-national level',[283] and its Treaty commitment to upholding the principles of multilateralism.

In this context, the EU could contribute to **revised regulation of global food markets**, especially when it comes to MNE financial activities with a direct impact on food prices. Multinationals' rising profits pose problems in terms of inequality and efficient allocation of global savings, which do not translate into productive investment. Regarding food and energy, moreover, these increasing profits correspond to increased prices, which constrain people's livelihood (particularly the poor, who consume a higher share of their disposable income on these goods). UNCTAD[284] has formulated proposals to regulate food markets, including to facilitate transparency and competition at market level, recognising aspects of food traders' activities as financial institutions, and extending the relevant regulations to them, as well as extending monitoring and regulation to the level of corporate subsidiaries in the sector to address the problem of unearned profits, enhance transparency and curb the risks of illicit financial flows.

Figure 21 – Price of selected crops



Source: UNCTAD, Trade and Development Report, 2023; Graphic: G. Macsai.

As regards taxation, the EU, as well as implementing and monitoring the impacts of the OECD framework, could more broadly review its legislation of relevance to illicit financial flows and asset recovery. It could also **support introduction of a revised and more ambitious global taxation agreement**. Further action to address Base Erosion and Profit Shifting (BEPS) could for example increase the coverage of the current measures. For example, thresholds could be revised to cover MNEs that are currently excluded, and to the scope could be widened to encompass more sectors. The EU could moreover support the proposed **UN Framework Convention on Taxation**, as the European Parliament demanded in its resolution calling for support for 'the setting up of a UN framework convention on tax, with the aim of strengthening international cooperation and

[282] European Parliament resolution of 26 November 2020 on the EU Trade Policy Review (2020/2761(RSP)).

[283] David O'Sullivan, The European Union and the multilateral system Lessons from past experience and future challenges, EPRS, 2021.

[284] UNCTAD, ibid, 2023.

governance on tax and trade-related illicit financial flows; highlights the need to introduce transparent and inclusive decision-making where all countries can negotiate as equals'.[285]

3.3.3. Cost of non-Europe

A lack of action to address market failures in global food markets is expected to result in continued **vulnerability to price volatility**, and especially rising prices. The lack of regulation of global food markets has already resulted in historically high prices, as UNCTAD have highlighted – even before Russia's war on Ukraine. This has contributed to an **increased number of people living in food insecurity**, doubling from 2020 to 2023.

Stronger action in regulating MNE activity could have considerable benefits in **translating profit into investment, which is currently weak**, due to the high prospective gains for corporations from financial activities, and due to the highly concentrated markets.[286]

According to estimates,[287] full application of the current agreement could lead to greater resources for developing countries, equal to around 0.02 % of GDP, due to implementation of Pillar 1 of the OECD 'Inclusive Framework initiative', and to an additional €750 million due to Pillar 2. This could translate into an **increase in HDI of around 1.7 %** and to a reduction in infant mortality of 23 % by 2050, if the public budget thus saved is channelled to the health and education sectors. A simple, **more ambitious threshold** to include MNEs under Pillar 1 (companies above US$10 million revenue rather than US$20 million)[288] would **increase the amount of relocated profit by one third**.[289]

The cost of the lack of a multilateral approach to food security and fiscal space **cannot be completely ascribed to an absence of EU action**, but the EU's influence and its ambitious proposals within the UN, WTO and other multilateral organisations is nevertheless key to making real progress.

[285] European Parliament resolution of 15 June 2023 on lessons learnt from the Pandora Papers and other revelations (2022/2080(INI)).

[286] Elissa Braunstein, Piergiuseppe Fortunato, Richard Kozul-Wright, Trade and Investment in the Era of Hyperglobalization, *The Palgrave Handbook of Development Economics: Critical Reflections on Globalisation and Development*, 2019, pp. 727-762.

[287] Annex II – RAND and Oxfam, The effect of the OECD's Pillar 1 proposal on developing countries, 2022.

[288] The seven-years covered by the agreement.

[289] Oxfam, The effect of the OECD's Pillar 1 proposal on developing countries, 2022.

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ANNEX I – EPRS

This annex presents more information about the calculations presented in the study.

Further information – Section 1

Table 9 – List of least-developed countries (LDCs)

Afghanistan	The Democratic Republic of Congo	Malawi	Somalia
Angola	Eritrea	Mali	South Sudan
Bangladesh	Ethiopia	Mauritania	Sudan
Benin	Gambia	Mozambique	Tanzania
Bhutan	Guinea	Myanmar	Timor-Leste
Burkina Faso	Guinea-Bissau	Nepal	Togo
Burundi	Haiti	Niger	Tuvalu
Cambodia	Kiribati	Rwanda	Uganda
Central African Republic	Lao PDR	São Tomé and Príncipe	Yemen
Chad	Lesotho	Senegal	Zambia
Comoros	Liberia	Sierra Leone	
Djibouti	Madagascar	Solomon Islands	

Source: The United Nations, Office of the High Representative for the Least Developed Countries, Landlocked Developing Countries and Small Island Developing States, as of 1 December 2023.

Table 10 – List of small island developing states (SIDS)

Antigua and Barbuda	Fiji	Mauritius	Saint Vincent and the Grenadines
Bahamas	Grenada	Nauru	Seychelles
Barbados	Guinea-Bissau*	Niue	Solomon Islands*
Belize	Guyana	Palau	Suriname
Cabo Verde	Haiti*	Papua New Guinea	Timor-Leste*
Comoros*	Jamaica	Samoa	Tonga
Cook Islands	Kiribati*	São Tomé and Príncipe*	Trinidad and Tobago
Cuba	Maldives	Singapore	Tuvalu*
Dominica	Marshall Islands	Saint Kitts and Nevis	Vanuatu
Dominican Republic	Micronesia (Federated States of)	Saint Lucia	

* Also an LDC.

Source: The United Nations, Office of the High Representative for the Least Developed Countries, Landlocked Developing Countries and Small Island Developing States.

Quantification of efficiency loss for missing coordination of EU aid (Table 3)

The findings presented in Table 3 updates an analysis carried out in two previous studies[290] focusing on several aspects of development aid where coordination may be crucial for effectiveness. These aspects include both measures that directly reduce donor costs and measures that increase the impact in the recipient countries.

The first cost-saving effect of greater coordination is the reduction of transaction costs at the donor level, both through a decrease in the number of partner countries (thus increasing the size of interventions in each country) and through a shift from project-level spending to programme-level spending. Such shifts could lower administrative costs. Moreover, aid volatility may be an important constraint for recipient countries: its cost is measured as the reduction in aid that a recipient country would be willing to accept, provided that it is completely predictable.[291] Increased predictability is much harder to organise in a decentralised fashion, since all the donor countries have their own political and budgetary processes. Another source of effectiveness is the 'untying' of aid,[292] which is one of the aims of the OECD Development Assistance Committee. This action could be achieved through greater coordination. Bigsten et al (2011) then find that increasing the share of more general modalities of aid, and especially general budget support over total aid has a positive effect on recipient countries' economic growth.[293] The last cost-saving effect is the measurement of the potential benefit of an 'optimal' allocation of aid across countries, i.e. the allocation that maximises poverty reduction, thus eliminating the 'aid orphans' and the 'aid darling' cases. This can be seen as the impact of greater coherence around the focus on poverty reduction, in line with the European Parliament's request to better target poverty.

The EPRS calculations leading to these results are summarised in Table 3, with the total potential yearly benefits reaching between €12.2 billion and €14.6 billion. We consider the first three impacts to be relatively independent from each other, and thus can be added together to achieve an aggregate impact, being closely related to EU coordination. The extent to which the last two impacts can be added to the others depends on their independence and can only partially be tapped via greater coordination, thus are discounted by 50 %. As underlined by Bigsten (2013), the last estimate is an upper bound of potential benefits that could be obtained by reallocation of aid. GDP figures are 2032 projections of the current baseline.

To take account of the potential impact of the Neighbourhood, Development and International Cooperation Instrument/Global Europe that entered into force in 2021, some discount factors are used, based on a qualitative assessment of the relevance of the NDCI on each of the sources of Cost of non-Europe. It is assumed that NDCI may address transaction costs reduction by 70 % (it does a substantial coordination effort without replacing national aid systems), reduction of aid volatility

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290 Arne Bigsten A., Jean-Philippe Platteau, & Sven Tengstam, The Aid Effectiveness Agenda: The benefits of going ahead Final Report, 2011, updated in Annex to Monika Nogaj, The Cost of Non-Europe in Development Policy: Increasing coordination between EU donors, EPRS, September 2013.

291 It can be interpreted as expenses that could be avoided by donors if they provided more predictable aid flows.

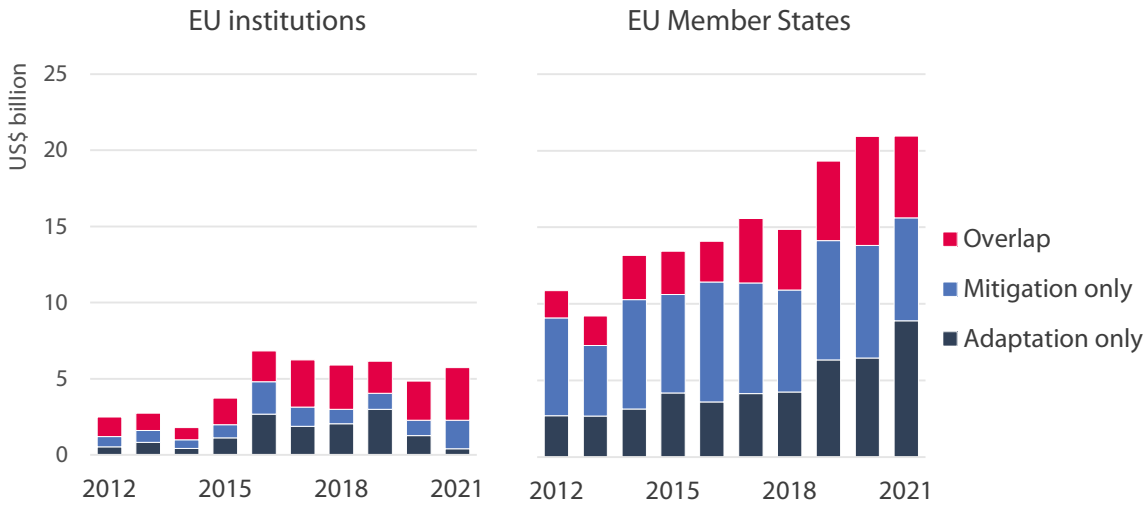
292 OECD defines aid as untied when proceeds from loans and grants are fully and freely available to finance procurement from all OECD countries and substantially all developing countries, OECD (2010), DAC statistical reporting directive, DAC, Paris. This is considered able to reduce project costs by 15-30 % on the recipient side. In 2014, about 80 % of EU aid was untied (Eric Pichon, Understanding 'development effectiveness': An overview of concepts, actors and tools, EPRS, 2017).

293 Bigsten et al. (2011) found that general budget support has a positive effect on recipient's economic growth. They then simulated the effect of an 11 % increase in the share of EU aid that comes in the form of general budget support. In 2020, the EU overall budget support programmes amounted to about €3 billion; See European Commission, Directorate General for International Cooperation And Development and Directorate General For Neighbourhood And Enlargement Negotiations, 2021; *Budget support: trends and results 2021*, Publications Office of the European Union, Luxembourg.

and untying aid by 20 % (it refers to aid untying concerning EFSD+; moreover, untying of aid is progressing: according to the OECD[294], from 1999-2001 to 2008, the proportion of untied bilateral aid rose progressively from 46 % to 82 %.. Coordination on poverty reduction is assumed to be affected by 10 % (the estimate is an upper bound). The current allocation[295] sees Türkiye, Egypt, Ukraine, India and Syria as the top five recipient countries.

Further information – Section 2.3

Figure 22 – EU institutions (excluding European Investment Bank) and EU Member State bilateral climate-related development finance, by objective, US$ billion

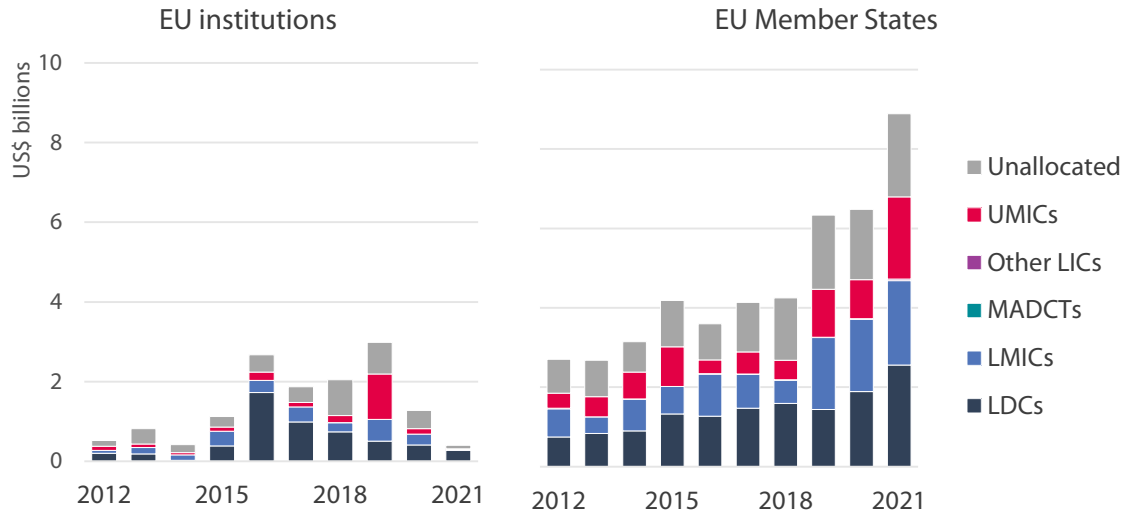


Source: Authors based on OECD, Climate-related development finance datasets, provider perspective; Graphic: G. Macsai.

294 OECD, Untying of Aid: is it working?

295 EU Aid Explorer, accessed 5th April 2024.

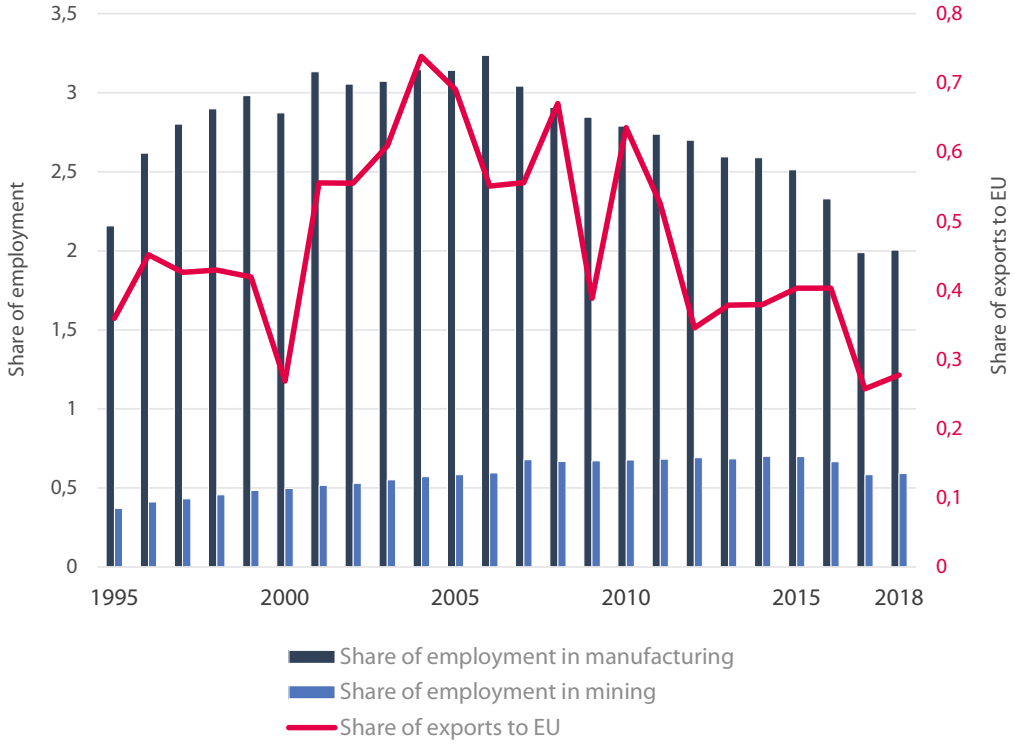
Figure 23 – EU institutions (excluding European Investment Bank) and EU Member State bilateral climate-related development finance for adaptation only (without overlap) per recipient income group, US$ billion



Source: Authors based on OECD-DAC, Climate-related development finance datasets, provider perspective, as of 28 November 2023 update; Graphic: G. Macsai.

Further information – Section 3

Figure 24 – Share of manufacturing and mining in employment in Mozambique (bars) and share of EU in exports (lines)



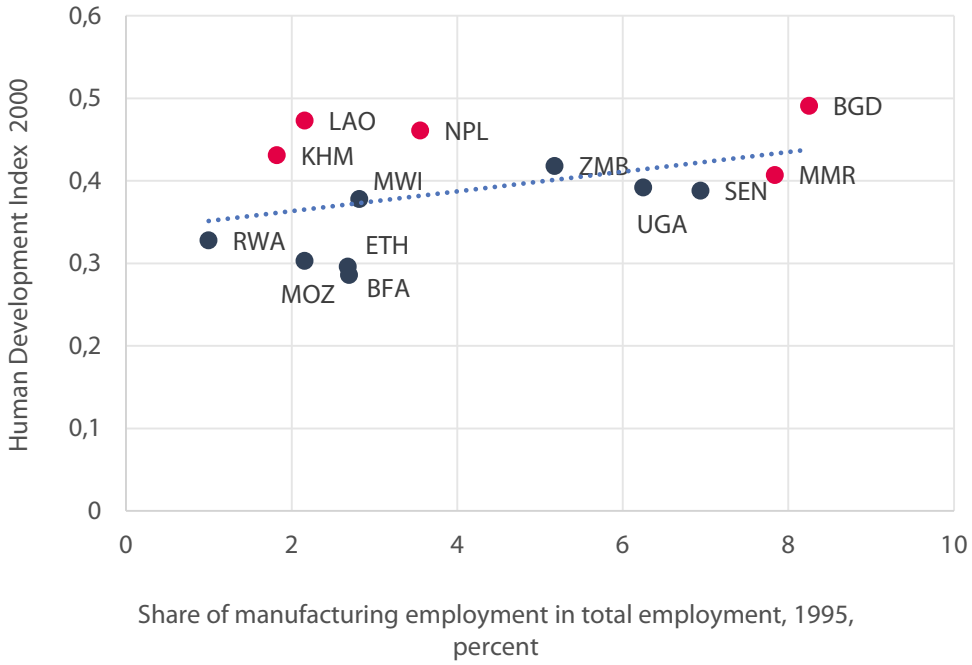
Source: Authors' elaboration based on BACI and ETD; Graphic: G. Macsai.

Table 11 – Correlates of the share of manufacturing in selected LDC economies

	(1)	(2)	(3)	(4)
Value added pc (log)	-0.316	0.144		
	(0.527)	(0.529)		
Value added pc squared (log)	0.0235	0.0237		
	(0.0694)	(0.0678)		
Population (log)	-56.03***	-48.35***	-63.30***	-57.35***
	(13.60)	(13.44)	(12.66)	(12.53)
Population squared (log)	1.740***	1.461***	1.994***	1.777***
	(0.407)	(0.404)	(0.376)	(0.374)
Exports as a share of GDP			4,814***	4,535***
			(1,020)	(1,004)
EU exports as a share of total exports	0.239	-2.244**	-1.077	-3.354***
	(0.945)	(1.125)	(0.987)	(1.165)
Total exports (log)	1.032***	1.093***		
	(0.229)	(0.224)		
EU exports as a share of total exports* Asia		7.142***		6.625***
		(1.850)		(1.884)
GDP pc (log)			-3.812	-6.977*
			(4.175)	(4.194)
GDP pc squared (log)			0.318	0.607*
			(0.324)	(0.328)
Constant	439.0***	388.9***	515.2***	485.3***
	(112.7)	(110.9)	(110.8)	(109.0)
Country fixed effects	Yes	Yes	Yes	Yes
Observations	312	312	312	312
R-squared	0.449	0.475	0.453	0.475
Number of country	13	13	13	13

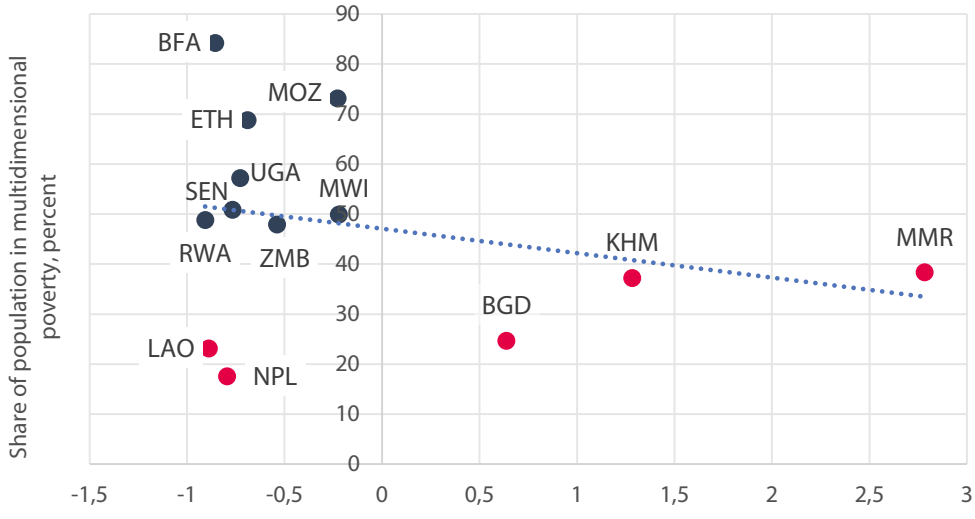
Standard errors in parentheses, *** p<0.01, ** p<0.05, * p<0.1
Source: authors' elaboration based on BACI and ETD on a subset of LDCs (due to data availability).

Figure 25 – Relationship between share of manufacturing on total employment (in 1995) and Human Development Index (in 2000)



Source: Authors' elaboration based on BACI, and HDI UNDP data on a subset of LDCs (due to data availability); Graphic: G. Macsai.

Figure 26 – Relationship between change in share of exports to the EU and multidimensional poverty



Source: authors' elaboration based on ETD and Global MPI on a subset of LDCs (due to data availability). Share of population in multidimensional poverty and relative change in the share of exports to EU (1995-2018); Graphic: G. Macsai.

Quantification of impact of due diligence legislation.

The analysis aims to give a rough indication of the potential impact of mandatory responsible business conduct measures in the value chain. As outcome variable, the Index of Respect of Fundamental Labour Rights of the World Justice Project (WJP) is used. Baseline values are the average value of this index between 2000 and 2018.

To approximate the potential effect on countries where production is located, were all EU companies (with a business relation with subcontractors or suppliers in that country) to move to conducting supply chain due diligence, we extrapolate indicative measures of effectiveness of these supply-chain responsibility initiatives from the cases above and we construct three scenarios, assuming:

1. being in a 'responsible value chain' improves respect for fundamental labour standards by 8 %;[296]
2. being in a 'responsible value chain' improves respect for fundamental labour standards by 20 %;[297]
3. being in a 'responsible value chain' improves respect for fundamental labour standards by 100 % – representing an 'ideal scenario', or the full cost of the status quo.

These define three possible impact coefficients. In order to measure the potential impact of mandatory rules of due diligence of EU companies, the coefficients are weighted on the basis of the product of:[298]

- the country's trade openness = trade/GDP, to measure to what extent foreign companies may be relevant for that specific country, or whether the domestic economy is more relevant, which indicates the possible size of the impact of changes in foreign companies' behaviour;
- the share of trade with the EU over the country's total trade (to measure the EU's position as a relevant commercial partner, which indicates the possible size of the impact of changes in EU companies' behaviour.

In order to measure the potential impact of mandatory measures set at the UN level, we only apply the first coefficient, thus applying the potential change to all companies and not only to EU ones.

We then apply these changes to the World Justice Project (WJP) Index of Respect of Fundamental Labour Rights, which measures the effective enforcement of fundamental labour rights, including freedom of association and the right to collective bargaining, the absence of discrimination with respect to employment, and freedom from forced and child labour. The index is based on perception surveys, and ranges between 0 and 1.[299]

The changes in the WJP index are calculated as:

$$new\ WJP = Initial\ WJP + Initial\ WJP * (impact\ coefficient * weight)$$

[296] This is extrapolated from Holloweg (2012) analysing the impact of Better Work Program in Vietnam and finds an impact of being in a responsible value chain for longer than the median of 4.3 %, and an impact of the public disclosure of non-compliance of 3.7 %; the coefficient used here is the sum of the two.

[297] This is extrapolated by Kabeet et. al (2020), analysing the impact of the Accord in Bangladesh on perception of changes in terms of safety and health in the workplace and finds an impact between 17.6 % and 22 %.

[298] Both UNCTAD data.

[299] Factor 4.8.

Several caveats have to be taken into consideration: first, impacts that are calculated on specific cases and specific variables are then applied to more aggregate indicators; second, impacts are derived from specific cases which are not necessarily generalizable; third, the weight is only based on trade and excludes e.g. FDIs, and therefore does not fully capture the extent of GVCs.

Results for the subsample of LDCs for which data are available (The initial average index is 0.48 – level of the Philippines):

- In the first scenario it would increase to 0.49 (level of Bangladesh) if applied at the EU level and to 0.51 (level of Uzbekistan) if applied at the UN level;
- In the second scenario it would increase to 0.51 if applied at the EU level and to 0.54 (level of Tunisia) if applied at the UN level;
- In the third scenario it would increase to 0.65 (level of Brazil) if applied at the EU level and to 0.79 (just below the level of Austria) if applied at the UN level.

Table 12 – Scenario simulation of potential impacts of mandatory responsible business conduct measures

	Baseline values			EU CSDD 1	EU CSDD 2	EU CSDD 3	UN Treaty 1	UN Treaty 2	UN Treaty 3
	WJP Index[1]	Trade % GDP[2]	share EU trade/ total trade[3]						
AFGHANISTAN	0.2989	0.8304	0.0304	0.2995	0.3004	0.3064	0.3187	0.3485	0.5470
BANGLADESH	0.4956	0.3778	0.5621	0.5040	0.5167	0.6009	0.5106	0.5331	0.6829
BURKINA FASO	0.5895	0.4632	0.0681	0.5910	0.5932	0.6081	0.6114	0.6441	0.8626
CAMBODIA	0.4987	1.2484	0.3514	0.5162	0.5424	0.7175	0.5485	0.6232	1.1213
LIBERIA	0.4504	1.4888	0.4653	0.4754	0.5128	0.7624	0.5040	0.5845	1.1209
MADAGASCAR	0.6327	0.6273	0.4001	0.6454	0.6645	0.7915	0.6644	0.7121	1.0296
MALAWI	0.4546	0.6046	0.3651	0.4626	0.4746	0.5549	0.4766	0.5095	0.7294
MYANMAR	0.4056	0.1526	0.1128	0.4061	0.4070	0.4125	0.4105	0.4179	0.4675
NEPAL	0.5496	0.4816	0.1225	0.5522	0.5561	0.5820	0.5708	0.6026	0.8143
SENEGAL	0.6304	0.6093	0.1516	0.6351	0.6420	0.6886	0.6611	0.7072	1.0145
SIERRA LEONE	0.5285	0.5818	0.3721	0.5377	0.5514	0.6429	0.5531	0.5900	0.8360
TANZANIA	0.4516	0.4025	0.1079	0.4531	0.4555	0.4712	0.4661	0.4879	0.6333
UGANDA	0.4183	0.4445	0.1918	0.4211	0.4254	0.4540	0.4332	0.4555	0.6042
ZAMBIA	0.3963	0.6899	0.0446	0.3972	0.3987	0.4085	0.4181	0.4509	0.6697
ZIMBABWE	0.4307	0.7023	0.0984	0.4331	0.4367	0.4605	0.4549	0.4912	0.7332

[1] World Justice Project (WJP) Index of Respect of Fundamental Labour Rights; Average 2000-2018.

[2] average 2000-2018.

[3] average 2015-2019.

Annex II

EU action to address poverty in developing countries in an age of global challenges – A cost of non-Europe report

Poverty is a global challenge that particularly affects developing countries. Following years of decline in the share of extreme poverty in developing countries, millions of people are projected to remain impoverished out to 2050. The aim of this report is to identify gaps and challenges pertaining to current EU action supporting poverty reduction in developing countries and to identify potential further action at the EU level to address them.

The analysis conducted comprised quantitative econometric analysis combined with qualitative review of literature and stakeholder interviews. Nine potential areas for further EU action have been identified in relation to the gaps and challenges highlighted in the report. The cost of no further EU action (cost of non-Europe) has been explored in quantitative terms for three of these areas.

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Executive summary

Poverty is a global challenge, affecting individuals and nations worldwide, including European Union (EU) Member States (MS). The EU, since the 1960s, has advanced its efforts to contribute to poverty alleviation in developing countries. In the 1970s, the EU shifted its emphasis to basic needs, the Millennium Development Goals (MDGs) in 2005, and in 2015 to the Sustainable Development Goals (SDGs), in alignment with objectives developed by the United Nations (UN). Although extreme poverty has decreased over recent decades, UN projections estimate that 575 million individuals worldwide will remain impoverished in 2030. To contribute to efforts to reduce poverty, the EU has taken various development-related initiatives. In the face of crises that require emergency support, the EU, through DG ECHO has also provided humanitarian aid. Crises such as the 2008 financial crash, the COVID-19 pandemic, and more recently the 2022 Russian invasion of Ukraine have exacerbated poverty. Against this backdrop and to address the effects of the COVID-19 pandemic on fragile populations, the EU initiated 'Team Europe' and the 2022 Global Gateway Initiative, focusing on sectors such as digital innovation. The urgency for intensified EU action to fight poverty remains high.

The report examines the 'Cost of non-Europe' in the fight against poverty in developing countries amid global challenges. It aims to determine the benefits of more profound EU coordination and integration. The study focuses on identifying benefits from EU action to alleviate poverty in developing countries, pinpointing gaps in EU efforts, and suggesting solutions. Specifically, the report focuses on two areas: mobilisation of financing for development, and the promotion of public goods.

In line with the UN SDGs, the study considers poverty as multi-dimensional, and therefore includes factors such as health and education in addition to economic considerations. The study applied several research methods, including literature reviews, key stakeholder interviews, and econometric modelling, to identify gaps and barriers in the current state of play and to assess the potential impact of further EU action on poverty alleviation efforts in developing countries. Specifically, the empirical analysis sought to decipher the effects of the EU's development financing and public goods promotion through social policies on poverty. To emphasise the multifaceted nature of poverty, indices such as the Human Development Index (HDI) were used. To quantify the outcomes of potential further EU action in developing countries, the research considered three policy scenarios in relation to ODA targets, global digital services taxation, and debt relief strategies.

EU action to support poverty reduction in developing countries: current state of play and identifying gaps and challenges

Current state of play: The EU has historically championed poverty reduction measures, aligning with the UN's 2030 Agenda for Sustainable Development. According to estimates, US$485 billion per year by 2030 would be required to eradicate poverty worldwide. Developing countries have limited financial means to fulfil this objective on their own. The COVID-19 pandemic exacerbated poverty disparities. Since 1992, the EU has adhered to policy coherence for development (PCD) principles, which aim at consistent consideration of the impact of EU policies on developing countries. Key EU post-pandemic initiatives include 'Team Europe' and the Global Gateway. The EU and its Member States remain a top aid donor to developing countries committed to a poverty reduction approach, including through partnerships with other organisations and institutions, both at the EU and global levels.

Gaps and challenges in relation to official development assistance (ODA): both EU institutions and EU MS have used ODA as a source of funding for developing countries. An ODA target relative to Gross National Income (GNI) has been established (0.7 %) to 2030, supplemented by a specific ODA target to least-developed countries (LDCs – 0.15 to 0.20 %). It is anticipated that neither targets will be reached by 2030 as EU MS spend overall about 0.5 % of their GNI as ODA, with just four EU

states meeting this target. Additional challenges in relation to ODA pertain to aid fragmentation that could lead to overlaps and inefficiencies, conditionality of development aid including for EU budget support or monitoring and transparency of development programmes.

Gaps and challenges in relation to debt distress policies: Recent crises, especially COVID-19, have amplified public debt, with many developing nations now facing high debt levels, making them vulnerable to global financial shocks and higher interest rates than developed countries. Since the mid-1990s, the International Monetary Fund (IMF) and World Bank launched debt initiatives like the Heavily Indebted Poor Countries (HIPC) Initiative and Multilateral Debt Relief. From the EU's stance, debt relief for developing countries mainly falls under individual EU MS. During the COVID-19 pandemic, the European Commission proposed linking debt relief to SDGs, but progress is minimal so far. The EIB's role in coordinating EU MS debt relief is also limited.

Gaps and challenges in relation to global taxation and fiscal space improvement efforts: the Organisation for Economic Cooperation and Development (OECD) and G20 unveiled the Inclusive Framework in 2021, suggesting two key tax reforms. One aims to tax multinational enterprises (MNEs) by profit location, and the other sets a minimum 15 % corporate tax for major companies. These reforms face opposition, particularly from developing nations. The research also pointed out challenges in expanding developing countries' fiscal space, which indicates governmental financial capacity to develop and implement policies relate in part to their debt servicing capacities. The choice of instrument to support fiscal space capacity depends on the structure of their economy and on tax revenue sources such as income taxes and VAT.

Gaps and challenges in relation to the promotion of public goods: Promoting public goods such as health and education in developing countries is essential for growth and poverty reduction. Challenges include free-riding and local financial issues. Low-Income Countries (LICs) are becoming more dependent on external health funding, with external aid rising from 16 % to 29 % from 2000 to 2019, and government contributions decreasing. Health aid often neglects broader issues, while education funding varies considerably across LICs. Human capital development is slow, with benefits emerging over generations. Current EU action such as the NDICI – Global Europe instrument and the EU-Africa package focus on vaccines and literacy, but funding appears inadequate.

Potential options for further EU action to reduce poverty in developing countries

Utilising econometric modelling, this study offers a preliminary assessment of the potential effect of taking no further EU action, quantifying changes in poverty metrics across three policy scenarios until 2050. A two-stage modelling framework is employed to investigate the indirect relationships among three key variables – ODA, the debt-to-GDP ratio, and the government revenues-to-GDP ratio – of multidimensional poverty, through health and education expenditure channels. This approach facilitates an examination of the intricate aspects of developmental policies and government-led collective actions in this context. The analysis is underpinned by data from 2000 to 2021 across 48 countries, including 23 LDCs. Infant mortality rate (per 1 000 live births) and HDI are selected as primary outcome indicators. These metrics are chosen not only for their empirical representation of multidimensional poverty but also due to their frequent usage in prior studies. The methodology employs a 'what-if' approach, examining how variations in independent variables under different scenarios might alter outcomes, rather than attempting to forecast future values. Furthermore, the study explores three policy scenarios up to 2050, assessing potential shifts in poverty metrics under varying conditions. This provides insights into the complex interplay between aid, government expenditure, and poverty outcomes.

Policy scenario 1 – EU MS reach ODA target (0.7 % of GNI) and (0.2 % towards the LDCs)

The first policy scenario delves into the associated change in poverty derived from all EU MS achieving their ODA targets of 0.7 % of GNI. The key consideration of this policy scenario is allocating

0.2 % of aid to LDCs, based on their initial endowments. This 0.2 % figure acknowledges that LDCs, despite their urgent need for aid, often receive less per capita than other developing nations, including lower middle-income countries. This aid discrepancy is evident both globally and within the EU, spanning both bilateral and multilateral aid channels.

The findings indicate that achieving the set target is associated with significant reductions in infant mortality by 2050, estimated at nearly 40 % lower than the 2020-2021 figures. Given the current rates, this is equivalent to preventing over 13 infant deaths per 1 000 live births on average per country by 2050. Globally, with LDCs accounting for over a billion people in 2023, this translates into approximately 496 000 infant lives saved across LDCs by 2050. On the HDI front, there is a modest increase of around 4 % compared to 2020-2021 values by 2050.

Policy scenario 2 – Global taxation mechanism to generate revenue for developing countries

In the study's second policy scenario, the focus shifts to the financial impacts of global tax reforms, specifically the two-pillar approach. This approach, expected to generate significant annual profits for reallocation, particularly benefits developing countries. The study incorporates these changes by allocating an additional 0.02 % of GDP to developing countries' revenues, reflecting the impact of Pillar 1 of the Organisation for Economic Co-operation and Development (OECD) Two Pillar agreement impact. Additionally, it assumes that half of the US$150 billion generated by Pillar 2 is distributed among these countries.

Findings suggest that with the heightened fiscal capacity from increased government revenues, there can be enhancements in expenditures for crucial sectors like health and social welfare. This improvement correlates with a more than 23 % decrease in infant mortality rates by 2050. In LDCs, this reduction is associated with about 292 000 infant lives saved, based on a population estimate of one billion. The corresponding change in HDI, however, is very modest, with an anticipated increase of only 1.7 % by 2050.

Policy scenario 3 – COVID-19 debt relief to address 2020 debt hike

In this scenario, the analysis posits debt relief for developing countries impacted by the COVID-19 pandemic in 2020, concentrating on the rise in debt from 2019 to 2020. It envisions the cancellation of all additional debt accumulated in 2020, which totals upwards of US$300 billion across 42 countries. This includes 21 LDCs.

The findings suggest that by 2050, the debt relief initiative for the economic hike of 2019-2020 is associated with a 17.7 % reduction in infant mortality rate, compared to 2020-2021. In LDCs, with an assumed one billion population, this could save around 225 000 infant lives. Moreover, a slight increase of around 3 % in HDI compared to 2020-2021 values is observed.

Combined scenario and SDG 3

The primary objective of these policy interventions is to alleviate multidimensional poverty, thus aligning their projected outcomes with the global standards set by the SDGs could provide a clearer understanding of their potential role. Specifically, this includes SDG 3, established to ensure healthy lives and promote well-being for all ages. Target 3.2 within this goal is focused on ending preventable deaths of newborns and children under five years, with an aim of reducing neonatal mortality to at least 12 per 1 000 live births by 2030.

Consequently, this study also explores a scenario where all three policy interventions are implemented concurrently, assessing whether such a combined approach could be in harmony with the objectives of SDG 3. The findings indicate that this combined approach is associated with a 24 % reduction in infant mortality by 2030, equating to approximately 8 fewer infant deaths per 1 000 live births. Consequently, this could reduce the average mortality rate from the 2021 figure of 32 to 24 in low and lower-middle-income countries covered in this study. However, it is important to note that

even with this combined approach, the SDG 3 target of reducing neonatal mortality to 12 per 1 000 live births remains unmet.

Caveats and limitations

The study focuses on two main areas that could affect EU action in developing countries, and due to limitations with regards to data availability and stakeholder engagement, the study may not provide a comprehensive overview of the policies affecting poverty reduction in developing countries or challenges encountered. Moreover, this study's quantitative approach is designed to examine changes associated with different policy scenarios, analysing correlations, not causality. It does not seek to forecast future values, rather uses a 'what-if' approach for potential changes up to 2050, assessing shifts in key variables like ODA from EU MS on public expenditures, and subsequent alterations in outcome variables. Scenarios are based on extended real GDP and GNI values, recent averages, and the *ceteris paribus* principle, keeping other factors constant. Also, the study does not explore the potential multiplier effect of policy interventions. Its focus is on the indirect relationship between development initiatives and poverty metrics, specifically through health and education expenditures, while keeping other variables constant.

Abbreviations

AAAA	Addis Ababa Action Agenda
ACP	African, Caribbean and Pacific
APF	African Peace Facility
AU	African Union
CBHE	Capacity-Building for Higher Education
CCRT	Catastrophe Containment and Relief Trust
CEMAC	Economic and Monetary Community of Central Africa
CSOs	Civil society organisations
DAC	Development Assistance Committee
DFIs	Development Finance Institutions
DRM	Domestic Revenue Mobilisation
DSSI	Debt Service Suspension Initiative
EBRD	European Bank for Reconstruction and Development
ECB	European Central Bank
ECHO	European Civilian Protection and Humanitarian Aid Operations
EDF	European Development Fund
EDFI	European Development Finance Institutions
EEAS	External Action Service
EFAD	European Financial Architecture for Development
EFSD+	European Fund for Sustainable Development Plus
EIB	European Investment Bank
EPA	European Partnership Agreement
EU	European Union
FDI	Foreign Direct Investment
GAVI	the Vaccine Alliance
GDP	Gross Domestic Product
GFATM	Global fund to Fight AIDS, Tuberculosis and Malaria
GNI	Gross National Income
GPE	Global Partnership for Education
GPEDC	Global Partnership for Effective Development Cooperation
HDI	Human Development Index

HIPC	Heavily Indebted Poor Countries
ICO	International Coffee Organization
IMF	International Monetary Fund
INPTA	International Partnerships
LDCs	Least Developed Countries
LICs	Low-Income Countries
LMICs	Lower-middle-Income Countries
MDGs	Millennium Development Goals
MFF	Multiannual Financial Framework
MNEs	Multinational Enterprises
MPI	Multidimensional Poverty Index
MS	Member States
n.d.	no date
NDICI	Neighbourhood, Development and International Cooperation Instrument
NGOs	Non-governmental organisations
ODA	Official Development Assistance
OECD	Organisation for Economic Cooperation and Development
OPHI	Oxford Poverty and Human Development Initiative
PCD	Policy Coherence for Development
PGII	Partnership for Global Infrastructure and Investment
PRGT	Poverty Reduction and Growth Trust
RECs	Regional Economic Communities
SADC	Southern African Development Community
SDGs	Sustainable Development Goals
SDRs	Special Drawing Rights
TEIs	Team Europe Initiatives
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme
UNICEF	United Nations International Children's Emergency Fund

Table of Contents

Table of figures

Table of tables

1. Introduction

1.1. Background

Understanding poverty in developing countries

Poverty and its multifaceted effects inflict serious harms to individuals and societies around the world, affecting their quality of life and economic performance. The consequences of poverty are long-lasting and can identified across decades and generations. Poverty affects all countries in the world, and although its effects are most pronounced in developing countries, available indicators show the impacts of the phenomenon in the European Union (EU) Member States (MS) as well.

The risks of and harms caused by poverty worldwide are well recognised by the EU. In order to address poverty in developing countries, the EU typically employs broad frameworks and funding mechanisms to implement its development cooperation efforts. The EU has been involved in actions related to poverty alleviation in developing countries for several decades. However, the EU's specific focus and strategies in this area have evolved over time.

Development cooperation with Least Developed Countries (LDCs) and Low-Income Countries (LICs) dates back to the 1960s. At that time, the emphasis was largely on providing financial assistance to former European colonies through development aid programs. The year 1960 also marks the creation of the Development Assistance Committee (DAC; Development Assistance Group at its creation) within the Organisation for Economic Cooperation and Development (OECD). The United Nations (UN) General Assembly designates the 1960s as the United Nations Development Decade and set two specific objectives, including that of achieving by 1970 a rate of growth in the developing countries of 5 % per annum. The idea of using donor-funded programs to meet people's basic needs in health, education, water and sanitation appeared around a decade later, with the Lomé Convention (first signed in 1975) which is a trade and aid agreement between the EEC and African, Caribbean, and Pacific (ACP) countries (European Community, 1977).

As of 1990, despite significant efforts through various global initiatives and national programs the disparity between developed and developing nations continued to grow. The World Bank and the International Monetary Fund (IMF) played pivotal roles by providing financial assistance and advocating for economic reforms to stimulate growth in developing regions. For instance, debt relief programs such as the Highly Indebted Poor Countries (HIPC) Initiative launched in 1996, aimed to alleviate the financial burden on struggling nations (IMF, 2023a). The launch of the Millennium Development Goals (MDGs) in 2000, replaced later on by the Sustainable Development Goals (SDGs), marked a milestone in the fight against poverty in developing countries, setting targets for poverty reduction, education, and healthcare.[1]

While 1.8 billion individuals lived below the US$2.15 per day extreme poverty line in 2000 (2017 Purchasing Power Parity prices), this number reportedly decreased to 689 million in 2018 (World Bank, 2022). In 2015, around 60 % of the world's extreme poor lived in five large developing countries, namely Bangladesh, China, the Democratic Republic of the Congo, India, and Nigeria (World Bank Group and World Trade Organization, 2015). As a result of the COVID-19 pandemic, the pace of extreme poverty reduction has slowed down and in some LICs the poverty rate has increased. Nowcasting tools estimate that in 2022 the number of people living in extreme to be around 670 million (8.4 % of the global population). The UN further estimates that out to 2030, about 7 % of the world population, 575 million individuals, will live in extreme poverty, specifically in areas affected by conflicts and in sub-Saharan Africa (UNGA Economic and Social Council, 2023).

[1] For more information on the Millenium Development Goals, see: https://www.un.org/millenniumgoals/

EU approach towards poverty reduction in developing countries

The 'European Consensus on Development' in 2005 laid out a unified approach to development cooperation and poverty reduction, emphasizing ownership, partnership, and a focus on achieving the Millennium Development Goals (MDGs) developed by the UN. The 2011 'Agenda for Change' refocused development aid on the poorest and most vulnerable countries and sectors.

The EU also played a significant role in shaping the post-2015 development agenda, which followed the adoption of the Sustainable Development Goals (SDGs). The 2030 United Nations Agenda for Sustainable Development, the UN's roadmap towards sustainable development and poverty eradication adopted in 2015, encompasses 17 SDGs, of which the first one is to 'end poverty in all its forms everywhere' – including extreme poverty eradication by 2030 (UN, 2015).

EU actions related to poverty in developing countries have been ongoing and have adapted to changing global circumstances and priorities. Specific initiatives, strategies, and regulations have been developed and adjusted over the last decades to address the challenges of poverty and sustainable development in developing countries.

In addition to development aid, the EU also provides humanitarian aid according to the principles outlined in the 2007 European Consensus on Humanitarian Aid. EU humanitarian aid supports populations affected by both natural and human-induced disasters and is delivered in partnership with international organisations, UN agencies as well as civil society organisations (CSOs) in areas such as water and sanitation, food, healthcare or education (DG ECHO, n.d.a & n.d.b). EU humanitarian aid is coordinated by the European Commission-Directorate General for European Civil Protection and Humanitarian Aid Operations (DG ECHO) and falls outside the realm of the Neighbourhood, Development and International Cooperation Instrument (NDICI) – Global Europe (Bilquin, 2022).

Recent global crises in the last 25 years such as the 2008 financial crisis, the COVID-19 pandemic, the 2022 Russian invasion of Ukraine, in addition to climate change-related risks, have had demonstrable impacts on the level of poverty worldwide, and especially in LICs and LDCs. The COVID-19 pandemic has severely disrupted developing countries' economies in response to which the EU has created the 'Team Europe'[2] initiatives in order to address the challenges of the pandemic and ensure a co-ordinated and comprehensive response. For instance, one of the Team Europe initiatives aimed at boosting local manufacturing capacities in Africa and strengthening pharmaceutical systems (DG INTPA, 2023a).

The latest developments in EU action against poverty in developing countries have taken place under the Global Gateway Initiative, launched in 2022. The initiative aims at increasing trade with international partners and invest in digital innovation, green energy, transport, healthcare (security of supply chains and manufacturing capacities) and education (support quality education, continuous learning including through digital education and increased cooperation). The Global Gateway also draws on the new financial tools in the EU Multiannual Financial Framework (MFF) 2021-2027, notably, the NDICI – Global Europe.

In the aftermath of the recent global crises, there is a need for international EU action to pursue the efforts and actions implemented in support of promoting poverty reduction and eradication.

[2] Team Europe refers to the pooling of resources between European development actors such as the European Union, the EU Member States including their respective public development banks and implementing agencies, the EIB and the EBRD. See: https://international-partnerships.ec.europa.eu/policies/team-europe-initiatives_en#:~:text=Team%20Europe%20consists%20of%20the,Reconstruction%20and%20Development%20(EBRD).

1.2. Scope and objectives of the study

The overarching objective of this study is to identify potential benefits of EU action in addressing poverty reduction in developing countries (i.e. LDCs, LICs and to some extent LMICs). In particular, this study seeks to identify gaps and shortcomings in relations to EU action towards poverty reduction and eradication and to develop options to address these gaps through further action at the EU level.

In line with this, two main areas of global policies and dynamics where obstacles to poverty eradication are considered in the context of the report:

- **Mobilisation of financing for development**, including mechanisms such as Official Development Assistance (ODA), debt distress policies, global taxation and fiscal space improvements for developing Countries); and
- **Promotion of public goods** through social policies in education and health.

1.3. Research approach

1.3.1. Multidimensional approach to poverty

For the purpose of this study, poverty is understood as a multidimensional concept that includes income poverty but also the lack of access to, and poor quality of, health and education services as well as other factors such as food insecurity. This characterisation of poverty account for key dimensions of human development and reflects the idea that poverty is an endemic phenomenon that takes multiple shapes and forms across all facets of society. Indeed, there is now a broad consensus in international development policy that poverty is multidimensional, as reflected in the first SDGs to 'end poverty in all its forms, everywhere' (UN, 2015).

1.3.2. Research approach

The research approach developed in the context of this study comprises the activities presented in the table below and their accompanying methodology.

Table 1.1 – Overview of research tasks and research activities

Research activity	Research methodology
Mapping current EU actions supporting poverty reduction in developing countries	Document and literature review, Interview with eight key stakeholders
Identifying gaps and barriers and identification of possible areas for further action	
Quantitative assessment of policy scenarios of EU action in support of poverty reduction in developing countries	Identification and review of relevant data sets Build bespoke data set for analysis Econometric modelling
Synthesis, reporting and dissemination	Analysis of findings from previous research activities to produce report

Source: RAND Europe.

Document and literature review

The study team conducted a review of existing literature and documentation pertaining to EU actions to address poverty in developing countries to understand the existing policy and research landscape relevant for this study. Targeted searches and snowballing techniques helped identify additional sources by using references in previously reviewed publications to identify new sources.

This activity helped the study team map existing instruments and mechanisms to generate a baseline understanding of EU action towards developing countries in the areas of development financing and the promotion of public goods through social policies in health and education. The review of literature also contributed to the identification of gaps and barriers related to current EU action to reduce poverty in developing countries. A complete list of references reviewed as part of the document and literature review is available in the dedicated 'References' section at the end of the document.

Stakeholder interviews

The study team supplemented the information found in the literature with a selection of semi-structured interviews with:

- Academics, researchers and CSOs, including from developing countries, with relevant expertise relating to EU action in developing countries and poverty reduction;
- Representatives from EU institutions involved in the implementation of the EU's development policy in developing countries;
- International organisations and institutions involved in actions supporting poverty reduction in developing countries.

In particular, the interviews aimed to complement and validate results emerging from literature review activities relating to the gaps and challenges pertaining to EU action towards poverty reduction in developing countries in the areas of development financing and the promotion of public goods and social policies. The study team conducted eight interviews between August and November 2023.

Quantitative analysis to identify the potential poverty alleviating effects of further EU action in the areas of development financing and the promotion of public goods through social policies

The existing empirical evidence suggests that the relationship between ODA, government debts and revenues with multidimensional poverty is neither direct nor immediate (Gomanee et al., 2003, Yontcheva and Masud, 2005; Gomanee et al., 2005; Winkleman and Adams, 2017; Li et al., 2020). As monetary flows do not directly represent an intervention in itself, it is therefore key to assess the funded intervention contributing to the intended reduction in poverty indicators. In other words, it is important to ensure that the funds are being used effectively in initiatives that demonstrate poverty reduction properties.

This study primarily aims to capture the relationship between development initiatives, specifically ODA, government revenue, and debt, and poverty, via the channels of health and education expenditure. To capture this indirect and potentially delayed relationship, an empirical two-stage regression model was developed. In the first stage, the relationship between ODA, debt to GDP, and government revenue to GDP on public expenditure is explored. This first stage of the modelling process aims to provide an understanding of their role in shaping government-led initiatives. These initiatives, particularly those focused on public health and education, are paramount in assessing the dedication of governments to combat poverty. For instance, research has highlighted a concerning trend in relation to debt: it tends to curtail social-sector public expenditure, particularly impacting education (UNU-WIDER, 2012). This reduction in expenditure does not just limit sectoral growth; it has broader implications. As highlighted in existing empirical research diminished government spending can precipitate an economic slowdown, further intensifying poverty (Ahuja and Pandit, 2020). To gain a more comprehensive understanding of governmental priorities, another major area of expenditure, military spending, was included as part of government expenditures, which often commands a significant portion of budgets in developing nations. Evidence suggests that while military spending might contribute positively to economic growth and social expenditure (Keynes, 1963; Lin et al., 2015), it could also crowd out social expenditure and

therefore impede growth (Elish et al., 2023). After establishing these foundational aspects of expenditure, the analysis then transitions to explore the poverty outcomes and ramifications of these spending decisions in the second stage of the modelling.

In terms of poverty measures, there is an increasing consensus that poverty measures should reflect the multidimensional nature of poverty, and hence go beyond monetary poverty alone. In line with this, multidimensional poverty measures have emerged to complement the income measures. These measures either take the form of scalar indices, or proxy variables that reflect key dimensions of human development. A popular index is Human Development Index (HDI), developed by the United Nations Development Programme (UNDP), which captures three key dimensions: health (life expectancy at birth), education (mean years of schooling and expected years of schooling), and standard of living (Gross National Income (GNI) per capita).

Another index is the Multidimensional Poverty Index (MPI), developed by the Oxford Poverty and Human Development Initiative (OPHI). The MPI provides a detailed view of poverty, capturing multiple deprivations at the household level across three dimensions: health, education, and living standards. The MPI however, has a more restricted data availability compared to the HDI.

There are also indicators which measure outcomes that are closely associated with poverty but also hint at broader issues, such as infant mortality rates which are commonly used in academic and policy studies, including those by the World Bank and IMF (Yontcheva and Masud, 2005; Winkleman and Adams, 2017; World Bank, 2019; Lee et al., 2019). This indicator, therefore, provides rich insights into poverty, health access, and health quality. Furthermore, aligning with the fourth Millennium Development Goal (MDG), which aimed at reducing the mortality rate of children under five, child health not only reflects a nation's healthcare efficacy but also serves as a vital measure of its overall economic and social progress.

For the purpose of this analysis, infant mortality rates (out of 1,000 new births) and the HDI are selected as primary outcome indicators. These metrics not only provide an empirical measure of multidimensional poverty and have been applied in existing empirical research (Yontcheva and Masud, 2005; Winkleman and Adams, 2017; Lee et al., 2019), but also offer a lens to view the efficacy of state spending on the health, education and military sectors. Alternative poverty metrics are expected to yield similar results, but data limitations, particularly smaller sample sizes, could lead to the exclusion of useful information. For instance, the commonly used US$2.15 a day Poverty Headcount Ratio, which is not collected annually for most countries, significantly reduces the sample size. For the expenditure measures applied in the analysis, per capita values are selected to adjust for differences in population across countries.

To provide a raw assessment of the potential effects of no further action at the EU level, the modelling framework was used to quantify the relationship between the key development variables of ODA, debt to GDP, and revenue to GDP, with poverty metrics in three potential policy scenarios. The first envisions all EU MS achieving their ODA targets (of 0.7 % total and 0.2 % for LDCs), while the second contemplates the fiscal repercussions of a global taxation mechanism. The third scenario outlines a strategy for debt relief, targeting the increased debt accumulated in 2020 due to the COVID-19 crisis. Understanding the changes in poverty associated with these scenarios offers a strategic vantage point, enabling comparative analysis, and understanding some of the potential implications in the target countries by 2050.

1.4. Key limitations

There are a number of caveats and limitations that need to be taken into consideration in this study

- The scope, in terms of the areas of global policies and dynamics considered was narrowly defined to focus on specific key areas. For example, some areas that may have

been relevant in analysing obstacles to poverty eradication, such as climate change, energy and international trade were not considered in the context of this report.

- The research team faced some limitations in terms of data availability and coverage. This is due mainly to the fact that multidimensional poverty is still a relatively recent concept, and availability and the quality of data relevant for the empirical modelling framework for LDCs and LICs are not as good and comprehensively available as for developed countries.
- The study team conducted a limited number of interviews, including with stakeholders from developing countries that have been recipients of EU and EU MS development aid. It may not provide a comprehensive overview of the challenges and barriers encountered by all stakeholder groups involved in development financing and the promotion of social policies in health and education developing countries.
- The quantitative approach is structured to investigate changes linked to different policy scenarios, through exploring correlation rather than causality. This method utilises the estimated magnitude and statistical significance of coefficients to elucidate the correlation between shifts in key variables and alterations in poverty measures, encompassing two stages. This approach is not developed for the purpose of forecasting future values.
- The study was conducted within a limited timeframe, which determined the extent of the analysis and the number of stakeholders consulted.

1.5. Structure of the report

In addition to this introductory chapter, the report is structured as follows:

- Chapter 2 first provides and overview of current EU action in relation to development financing and the promotion of public goods through health and education policies in developing countries. It then presents an overview of the gaps and challenges identified in relation to EU action in developing countries in those two areas.
- Chapter 3 presents quantitative estimates of the Cost of Non-Europe in the area of poverty reduction in developing countries
- Chapter 4 summarises the study findings and conclusions.

2. EU action in supporting poverty reduction in developing countries: Identifying gaps and challenges

2.1. Current state of play

It is necessary to first map actions that have already been implemented by the EU to alleviate poverty in developing countries before being able to identify gaps and challenges related to these mechanisms. This chapter does not seek to provide a comprehensive overview of the development landscape detailing all actors involved in poverty reduction in developing countries. Rather, this section provides an overview of selected instruments and programs implemented over the last two decades by various organisations and institutions including but not limited to the EU; the OECD or UN agencies such as UNDP. Given the multidimensional nature of poverty, it should also be noted that efforts to reduce poverty are multifaceted and involve a wide range of stakeholders, including but not limited to EU institutions.

Aligning EU action with UN Sustainable Development Goals

The 2030 United Nations Agenda for Sustainable Development, the United Nations' roadmap towards sustainable development and poverty eradication adopted in 2015, is based on 17 SDGs, of which the first one is to 'end poverty in all its forms everywhere' – including extreme poverty eradication by 2030 (UN, 2015). Indeed, the average annual investment required to end extreme poverty in LDCs has been estimated at US$485 billion (UNCTAD, 2021). LDCs hence do not have the means to progress towards this objective by themselves, and the international community has a crucial role to play in aiding these countries as they work to secure the necessary resources for their sustainable development needs.[3]

Moreover, recent global crises affecting the world in the past few years have had significant impacts on the level of poverty worldwide, and especially in LICs and LDCs. For example, the COVID-19 pandemic has severely disrupted developing countries' economies and halted their economic growth; whilst developed countries having spent about 27 % of their GDP to support their populations during the pandemic, the poorest countries have only spent 2 % of their GDP in support measures. In addition, the rise of interest rates in the EU and in the USA has yielded debt crises as well as increased pressures on public budgets (Lechevallier, 2023). Between 2010 and 2021, the UN estimates that the public debt of developing countries has increased from 35 to 60 % of GDP and that the share of developing countries public debt to foreign creditors has risen by 10 percentage point over the same period from 19 to 29 % of GDP. As a consequence, shocks impacting developing countries' national currencies such as devaluations disrupt their ability to service debt payments in foreign currencies (UN, 2023a).

The risks of and harms caused by poverty worldwide are recognised by the European Union. Since the Treaty of Maastricht in 1992, EU action in LDCs and LICs is based on the principle of Policy Coherence for Development (PCD), which seeks to ensure that no EU policies have negative effects on developing countries and hence to maximise the effectiveness of development cooperation to the benefit of partner countries (European Commission, 2019).

As early as 2000, and with the objective of strengthening the relationship between the EU and African, Caribbean, and Pacific countries to eventually eradicate extreme poverty, the Cotonou Agreement was adopted (European Commission, 2000). Concluded for a period of 20 years, it was

[3] The UNCTAD has also estimated the amount of money that would be needed to reach other Sustainable Development Goals, in order to ensure structural transformation in developing countries. For instance, it has been estimated that the average annual investment to meet the growth target is US$462 billion annually (SDG 8.1), and that US$1,051 billion would be needed annually to double the manufacturing share of GDP (SDG 9.2) (UNCTAD, 2021).

replaced in November 2023 by the Samoa agreement which now serves as the overarching framework for the relations between the EU and these countries for the next 20 years (Council of the European Union, 2023). The agreement aims to further support cooperation mechanisms between the EU and the 79 ACP countries (47 African, 16 Caribbean and 15 Pacific countries, and the Republic of Maldives) and covers subjects such as sustainable development and growth, human rights and peace and security (Council of the European Union, 2023).

In 2017, the EU and EU MS adopted the new European Consensus on Development, which outlines the shared principles and framework for EU institutions and Member States with regards to the establishment of a common development policy (European Commission, 2018). It aims at a more coordinated and effective EU action in development to support partner countries to implement the SDGs, by incorporating development concerns in non-aid policies in order to minimise contradictions, and if possible, create synergies between policies. It includes themes such as youth, gender equality, mobility and migration, sustainable energy and climate change, investment and trade, good governance, democracy, the rule of law and human rights, innovative engagement with more advanced developing countries, and mobilising domestic resources (European Commission, 2017b). It should also be noted that collectively the EU and EU MS are the first provider of development aid at the global level (about 43 %) (Council of the European Union, 2022).

EU action following the breakout of the COVID-19 pandemic

Following the outbreak of the COVID-19 pandemic a new initiative called 'Team Europe' was created in cooperation with the Member States to tackle the challenges of the pandemic and ensure a co-ordinated and comprehensive response (European Council, Council of the European Union. 2023). As a result, 'Team Europe' has become an essential pillar of the financial tool Global Europe and has yielded several Team Europe Initiatives (TEI), of which the main goal remains to remove existing barriers to development.[4] As of 2022, more than half of the TEIs (52 %) have been implemented in developing countries in sub-Saharan Africa (for example, Madagascar, Mali, Cameroon, Togo). 53 TEIs are established in LDCs and 42 in LICs across the world (Jones & Sergejeff, 2022). For instance, one of the Team Europe initiatives aimed at boosting local manufacturing capacities in Africa and strengthening pharmaceutical systems to facilitate access to quality, safe, effective and affordable health products as outlined in the UN's SDG target 3.8 (European Union, n.d.).

The overall objective of this TEI is to facilitate access to quality, safe, effective and affordable health products as outlined in the UN's Sustainable Development Goal target 3.8. Supporting access to essential health products and technologies is an opportunity to target several development objectives and geo-political priorities shared by both the EU and the African Union.

Overall, in order to help partner countries that face the impact of COVID-19 on human development, the EU has contributed to global initiatives on health and education, including the Global Fund to Fight AIDS, Tuberculosis and Malaria (GFATM), the Vaccine Alliance (GAVI), and the Global Partnership for Education (GPE) (European Commission, 2021).

On 1 December 2021, the European Union unveiled the Global Gateway, which focuses on supporting infrastructure development. This aims at mobilising up to €300 billion in public and private funds between 2021-2027 to finance EU infrastructure projects in developing countries, notably in the digital, climate and energy, transport, health, education and research sectors. It is based on a 'Team Europe' approach, which consists of the EU, its Member States and their financial and development institutions and includes the conception of TEIs.[5] The Global Gateway Initiative, officially launched in 2022, was set up to narrow the international gap in infrastructure investment

[4] For a list of Team Europe Initiatives and Joint Programming, see the Team Europe Initiative and Joint Programming Tracker: https://europa.eu/capacity4dev/tei-jp-tracker/dashboard

[5] Team Europe, European Commission website.

and specifically seeks to support digital innovation, green energy, transport, healthcare and education. The goal is to improve the way countries work together and do business in these important sectors. It draws on the new financial tools in the EU MFF 2021-2027, notably, the NDICI – Global Europe (European Commission, 2021b).

The NDICI – Global Europe is the new funding mechanism for development cooperation. It replaces or brings together other funding arrangements in a single instrument, including the European Development Fund (EDF), the European Fund for Sustainable Development (EFSD), the Emergency Trust Fund for Africa, and the Bêkou EU Trust Fund; to facilitate consistency in the EU's external action (Pouwels, 2021).

In terms of development aid, the EU and its MS remain among the world's leading aid donors. The EU has seen its commitment reaffirmed through Recital 22 of the Global Europe Regulation, which sets out that it is intended to contribute to making 0.2 % of the EU's GNI available as ODA to LDCs by 2030, out of a total of 0.7 % GNI as ODA (Pichon 2020; Bilquin, 2022).

In parallel, the European Commission adopted in 2022 a new EU Global Health Strategy, which positions global health as an essential pillar of EU external policy. The overarching goal of the Strategy is to improve global health security and ensuring better health for all and is structured around three interrelated priorities: deliver better health and well-being of people across the life course; strengthen health systems and advance universal health coverage; and prevent and combat health threats, including pandemics, applying a One Health approach (European Commission, 2022a). As part of the EU Global Health Strategy, on 15 December 2022, the Commission launched a flagship initiative to enhance sexual and reproductive health and rights (SRHR) in Africa (European Commission, 2022d). In addition, the EU has also been actively acting through independent actions. For instance, during the COVID-19 pandemic, the EU and its Member States remained a major donor of vaccines worldwide: the EU had exported around half its vaccine production and supported setting up vaccine manufacturing capacities in Africa (European Commission, 2021c). Another example is that the EU committed US$734.3 million (3.4 % of its bilateral allocable aid) to address the immediate or underlying determinants of malnutrition in developing countries across a variety of sectors, such as maternal health, water, sanitation and hygiene, or agriculture (OECD, 2023a).

Moreover, the EU has signed several agreements with the ACP states aiming at fostering human development and addressing poverty in LDCs and LICs in the areas of financing for development and promotion of public goods through health and education policies initiated by the EU. These include[6]:

- **Agreement between the European Community and the Pacific States** – Regulation (EU) 2016/1076: This agreement aims at establishing a free trade area between the parties, as well as enabling the considered countries to benefit from improved market access provided by the EU through Economic Partnership Agreement (EPA) negotiations. The Pacific States (15) as defined in the agreement include 6 countries that are categorised as either LDC or LMIC.
- **ACP countries – economic partnership agreements and export arrangements**: Replacement of Regulation (EC) 1528/2007 on arrangements for products originating in ACP countries outlined in agreements that establish or contribute to the formation of EPAs.

[6] This list is based on the 'Development' webpage from the European Parliament. For further information, see: https://eur-lex.europa.eu/summary/chapter/development.html?root_default=SUM_1_CODED%3D11&locale=en . Some of the agreements were not included because not considered as part of the scope of this study, such as the Political dialogue and cooperation agreement for Cuba or the Trade, Development and Cooperation Agreement (TDCA) with South Africa.

- **Agreement with Bangladesh on partnership and development**: The agreement emphasises the need for social and economic development in Bangladesh, through a strengthening of relations with the EU.
- **Interim Economic Partnership Agreement between the EU and the Central Africa Party**: Creation of basis for an EPA between the EU and the Economic and Monetary Community of Central Africa (CEMAC), which is made of 6 states including one LMIC and four LDCs.
- **The International Coffee Agreement 2007**: Agreement between the EU and the other members of the International Coffee Organization (ICO) to promote the sustainable development of the coffee industry worldwide. As of today, out of the 42 exporting members, 15 are LMICs and 16 are LDCs.
- **Cotonou Agreement and Samoa Agreement**: The Cotonou Agreement is the backbone of the partnership between the EU, its MS and ACP countries, and targets the eradication of poverty. Building on the UN's 2030 Agenda for Sustainable Development, a new agreement called the Samoa agreement was adopted in November 2023. It aims to strengthen the capacity of the EU and the ACP countries to address global challenges together and focuses on six priorities areas: democracy and human rights; sustainable economic growth and development; climate change; human and social development; peace and security.
- **Peace Facility for Africa**: This is a financing scheme for the African Peace Facility (APF), which is the primary source of funding from the EU to the African Union (AU) and Africa's regional economic communities (RECs) in the area of peace and security.
- **Economic Partnership Agreement between the EU and the CARIFORUM states**: The Caribbean Forum (CARIFORUM) is made of 15 Caribbean countries, including one LMIC and one LDC. The agreement sets up an EPA between the EU and the CARIFORUM states.
- **Economic Partnership Agreement between the EU and the Southern African Development Community countries**: The Southern African Development Community (SADC) includes one LMIC and two LDCs, and guarantees them (and some others) duty-free and quota-free access to the EU market.
- **EU-Côte d'Ivoire Economic Partnership Agreement**: The Agreement sets a basis for an EPA between the EU and Côte d'Ivoire.

While the EU has implemented a variety of regulations, instruments, and initiatives to address poverty and promote public goods and social policies in developing countries, directives are typically legislative acts that primarily concern EU MS and their internal policies rather than external actions in developing countries. However, the EU can adopt directives that have an indirect impact on its external policies, including development cooperation. The next paragraphs present relevant directives and legislative acts that can influence the EU's approach to poverty reduction and social policies for public goods promotion in developing countries, some of which have been amended since their adoption. This is for instance the case of:

- **Directive (EU) 2017/1371** on the fight against fraud to the Union's financial interests by means of criminal law: This directive addresses fraud, including cases that may involve funds allocated to development projects or initiatives in developing countries. Ensuring proper use of funds indirectly contributes to poverty reduction efforts (European Commission, 2017a).
- **Directive 2013/34/EU** on annual financial statements, consolidated financial statements, and related reports of certain types of undertakings: While primarily concerned with financial reporting for companies within the EU, it indirectly encourages transparency and responsible business practices, which can extend to operations in developing countries (European Commission, 2013).

- **Directive (EU) 2015/849** on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing: It aims to combat money laundering and the financing of terrorism by preventing the financial market from being misused for these purposes (European Union, 2021).
- **COM/2022/245** on asset recovery and confiscation: The objective of this proposal for directive is to strengthen the EU's asset recovery and confiscation rules and reinforcing the powers of asset recovery offices (European Parliament, 2023a).
- **Directive 2004/35/CE** on environmental liability with regard to the prevention and remedying of environmental damage for environmental damage: This directive establishes a framework of environmental liability based on the 'polluter-pays' principle, to prevent and remedy environmental damage (European Parliament, 2017).
- **Directive (EU) 2022/2464** on corporate sustainability reporting: This strengthens the rules concerning the social and environmental information that companies have to report to include a broader set of companies that are required to report on sustainability (European Parliament, 2022).
- **COM/2022/71** on corporate sustainability due diligence: This proposal for a directive sets obligations for companies regarding actual and potential human rights and environmental adverse impacts (European Parliament, 2023b).
- **Regulation (EU) 2023/1115** on the making available on the Union market and the export from the Union of certain commodities and products associated with deforestation and forest degradation and repealing: It ensures that any entity that places commodities on the EU market, or exports from it, must be able to prove that the products do not originate from recently deforested land or have contributed to forest degradation (European Parliament, 2023c).

In addition to these legislative acts and agreements initiated and led by the EU, other actions have been conducted at the global scale by global organisations and international groups to address poverty in developing countries. For most of them, the EU and its MS are stakeholders to these initiatives but are not the sole actor and contributor. Article 21 of the Treaty on European Union states the role of the EU in the multilateral system of the UN, and the Communication COM(2001)231 sets some key points to strengthen the partnership between the EU and UN in the field of development and humanitarian affairs, of which a main objective is the implementation of the SDGs (previously MDGs) (European Union, 2001; European Union, 2016). Examples of global partnerships implemented include the Global Partnership for Effective Development Cooperation (GPEDC)[7], the Partnership for Global Infrastructure and Investment (PGII)[8], the Global Partnership for Universal Social Protection to Achieve the Sustainable Development Goals (USP2030)[9], and the Global Partnership for Education (GPE)[10]. During the COVID-19 pandemic, the COVAX[11] facility was

[7] The GPEDC brings together governments, bilateral and multilateral organizations, civil society, the private sector and representatives from parliaments and trade unions among others, who are committed to strengthening the effectiveness of their partnerships for development.

[8] The PGDII is a partnership initiated by the G7 to advance public and private investments in sustainable, inclusive, resilient and quality infrastructure. As stated by the President of the European Commission, the Global Gateway Strategy is the European part of this initiative.

[9] The objective of this partnership is to develop universal social protection systems, in line with the SDG 1.3: 'Implement nationally appropriate social protection systems and measures for all, including floors, and by 2030 achieve substantial coverage of the poor and the vulnerable.'

[10] The GPE is both the largest global fund dedicated to transforming education in lower-income countries, and a multi-stakeholder partnership, in line with the SDG 4. GPE convenes partners around policy dialogue to determine how to best support each country collectively, based on agreed national priorities.

[11] COVAX is the vaccines pillar of the Access to COVID-19 Tools (ACT) Accelerator, a global collaboration to accelerate the development, production, and equitable access to COVID-19 tests, treatments, and vaccines.

implemented, and as part of the team Europe contribution, the Member States contributed with €3.1 billion, the European Commission with over €1.4 billion, and the EIB with a total of around €7 billion (European Commission, 2021d).

The EU also contributes funds to World Bank trust funds and IMF facilities including for countries facing debt distress. For instance, the EU through its institutions has also contributed €183 million to the IMF's Catastrophe Containment and Relief Trust (CCRT), which provides debt relief for the 29 LICs with a GNI per capita lower than US$1,175 that are considered to be particularly vulnerable to global health issues or to natural disasters (European Commission, 2020a).[12] It is also important to note that several other initiatives and instruments exist at the international level for countries in financing needs, such as Special Drawing Rights Allocations (SDRs)[13] from the IMF, or the Global Tax Program[14] from the World Bank.

Furthermore, EU MS institutions have also started and implemented their own instruments and initiatives independently, such as for instance the European Development Finance Institutions (DFIs) and the Association of European Development Finance Institutions (EDFI).[15]

[12] This figure is for EU institutions only, and hence excludes Member States acting separately.

[13] Created in 1969 as a supplementary international reserve asset, SDRs can be exchanged for currencies among the IMF member countries, and serve as the unit of account of the IMF and other international organisations. In total, there have been four general SDR allocations; the most recent ones during the COVID-19 pandemic and in 2009 during the Global Financial Crisis.

[14] The Global Tax Program (GTP) aims at strengthening tax institutions and mobilizing revenues in a fair and efficient manner through advisory and technical assistance. It is one of the main mechanisms to deliver the Domestic Revenue Mobilization (DRM) approach, which supports countries' efforts in raising more and better revenues to achieve the SDGs.

[15] DFIs are MS institutions investing in projects financed by the private sector in order to promote job creation and sustainable economic growth, and to contribute to the SDGs, alongside aid agencies and development banks. The EDFI is a group of DFIs which aims at fostering its members' cooperation with EU institutions and other DFIs, improve their efficiency and effectiveness, develop and support joint policies, and secure financing opportunities. See: https://www.edfi.eu/

2.2. Assessing EU action supporting poverty reduction in developing countries

Summary Box – Overview of key gaps and challenges in EU action

The level of EU ODA remains below the 2030 targets, both in relation to the 0.7 % of GNI as ODA target and to the 0.15 %-0.20 % of GNI as ODA to be directed specifically towards LDCs. As of 2022, only four EU MS reach the 0.7 % target, namely Luxembourg, Sweden, Germany and Denmark.

The external activities of the EIB as the EU's development financing institutions remains limited despite ongoing activities to further increase its activities in Sub-Saharan Africa.

The development and implementation of Team Europe Initiative gathers numerous actors at the EU and EU MS level and requires further coordination mechanisms.

The implementation of the NDICI – Global Europe instrument as replacement of previous financing schemes has led to the perception of increased competition among smaller development actors in developing countries to access EU development funding mechanisms and reduced transparency in the attribution of EU funded projects.

The flexibility of EU development aid remains limited as on-the-ground conditions change in developing countries and conditions attached to the delivery of development aid continue to increase (e.g. security considerations).

Debt relief policies remain a competence of EU MS and the EU has a very limited role in the development of coordinated positions.

The implementation of a new global taxation framework is likely to reduce the funds developing countries can leverage compared to developed countries.

Fiscal space improvement in developing countries is dependent on numerous factors, including the mechanisms through which the EU and its MS fund development programmes and initiatives.

Following the breakout of the COVID-19 pandemic, education appears to be less of a priority compared to the health sector for the promotion of public goods through social policies.

Development aid in the health sector focuses primarily on the delivery of basic services in replacement of governments to the detriment of wider preparedness and anticipatory tools and structures.

2.2.1. Financing for development

This section presents a high-level overview of gaps and challenges identified by the study team through data collection and data analysis activities in relation to development financing, namely ODA, global taxation, debt distress policies and fiscal space improvements. It should be noted that some challenges relating to development financing may be addressed by EU institutions while others are likely to require the involvement of EU Member States or other actors.

Gaps and challenges related to ODA

ODA is one of the primary tools of development financing leveraged by the EU and managed by the European Commission and European Investment Bank (EIB) (OECD, 2023). The EU institutions and Member States are the world's leading provider of ODA. The NDICI – Global Europe is the main instrument through which the EU delivers ODA (Bilquin, 2022; RAND Europe interview, August 2023; OECD, 2023). The next paragraphs present a consolidated overview of the challenges and gaps identified in relation to EU ODA to developing countries, including in relation to EU MS ODA.

Level of ODA/development aid

Calls to increase the level of financing to support poverty reduction have been repeatedly made, including in the 2015 Addis Ababa Action Agenda (AAAA)[16] (Beegle & Christiaensen, 2019).

Under the 2017 European consensus on development, aligned with the 2030 UN Agenda for sustainable development, the EU reaffirmed that social inclusion and human development should account for 20 % of EU ODA with a specific focus on LDCs. As established both for EU institutions and EU MS: out to 203, ODA should account for 0.7 % of GNI (Pichon 2020; Bilquin, 2022; OECD, 2023). As of 2019, this target was not met despite renewed calls to fulfil these commitments and EU ODA reached 0.50 % of GNI (Latek, 2019). According to OECD data, EU institutions ODA in 2021 was divided between grants (69.5 %) and loans or equity investments (30.5 %) and was delivered primarily through bilateral ODA.[17] EU institutions ODA to multilateral organisations was divided between project-type (77.6 %) and programming (22.4 %) earmarked funding (OECD, 2023). Despite the breakout of the COVID-19 crisis, the level of EU collective ODA[18] as percentage of GNI remained around 0.50 % (Council of the European Union, 2022; DG INTPA, 2022; European Commission, 2022c). In 2021, EU institutions ODA focused geographically on Africa (37.1 %), Europe (25.9 %) and Asia (10.5 %) (OECD, 2023).

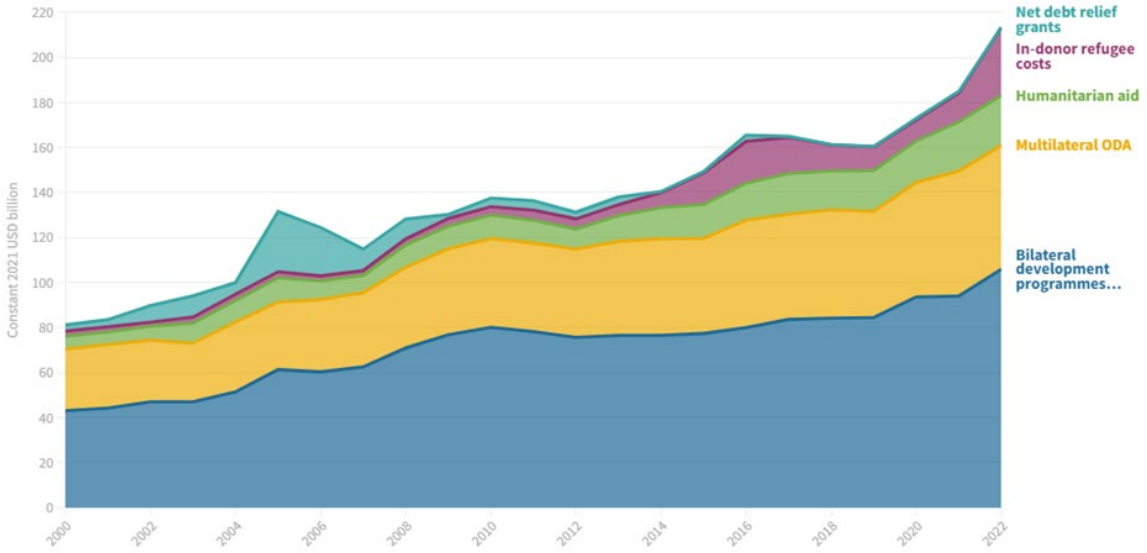
According to the OECD, preliminary data suggests that total ODA for DAC members rose from US$185.9 billion in 2021 to US$204 billion in 2022. At the global level this represents an increased from 0.33 % to 0.36 % of GNI for DAC members between 2021 and 2022 (OECD, 2023b). This increase appears to be mainly driven by in-donor refugee costs, which have risen from US$12.8 billion to US$30.1 billion between 2021 and 2022, and bilateral development programmes, from US$94 billion in 2021 to US$106 billion, as shown in the Figure 2.1 below (OECD, 2023b). As of 2021, only four EU MS met the target of 0.7 % of GNI to ODA target: Luxembourg, Sweden, Germany and Denmark as presented in Figure 2.2 (Council of the European Union, 2022). Preliminary data from the OECD from 2022 appear to confirm that these four EU MS reached their target (OECD, 2023b).

[16] The Addis Ababa Action Agenda is a framework developed to support sustainable development financing to align with the UN 2030 Agenda for Sustainable Development, see: https://www.un.org/esa/ffd/publications/aaaa-outcome.html

[17] Loans can comprise sovereign loans, multilateral loans or loans to the private sector, see OECD: https://www.oecd-ilibrary.org/sites/c0ad1f0d-en/index.html?itemId=/content/component/c0ad1f0d-en#endnotecffc027d7724

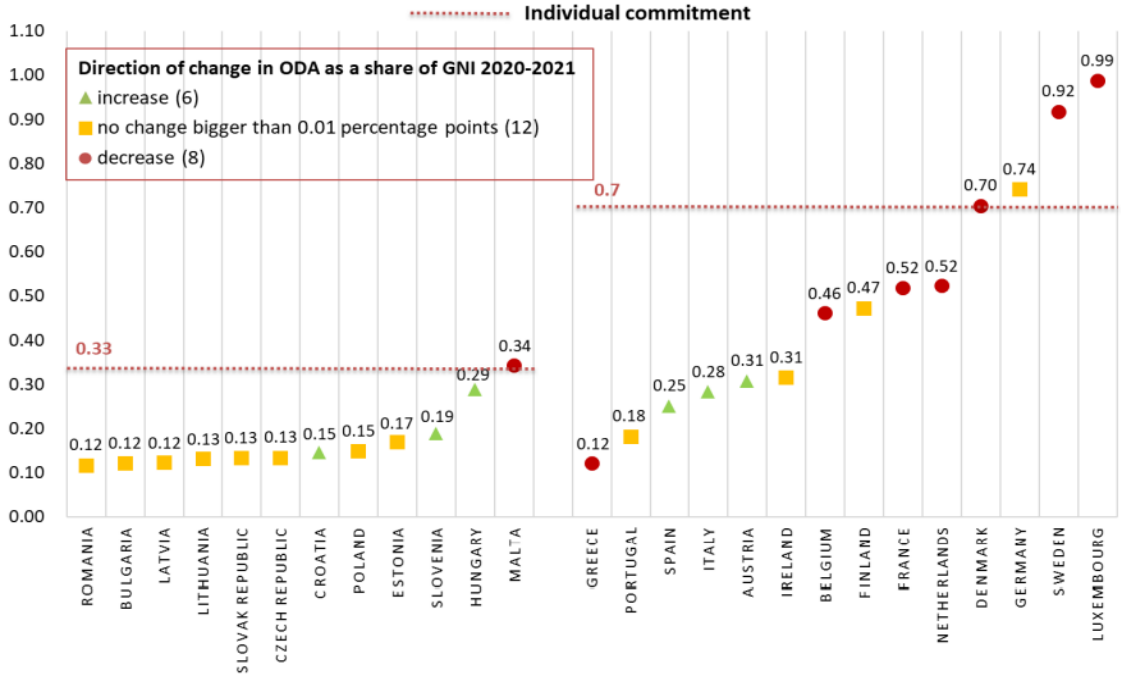
[18] EU collective ODA comprises ODA from EU institutions and EU MS.

Figure 2.1 – Components of ODA (DAC countries), 2000-2022 (US$ billions, constant prices)



Source: https://public.flourish.studio/story/1882344/

Figure 2.2 – Gap between 2021 ODA/GNI levels and agreed individual targets of the EU MS and direction of change from 2020 to 2021.



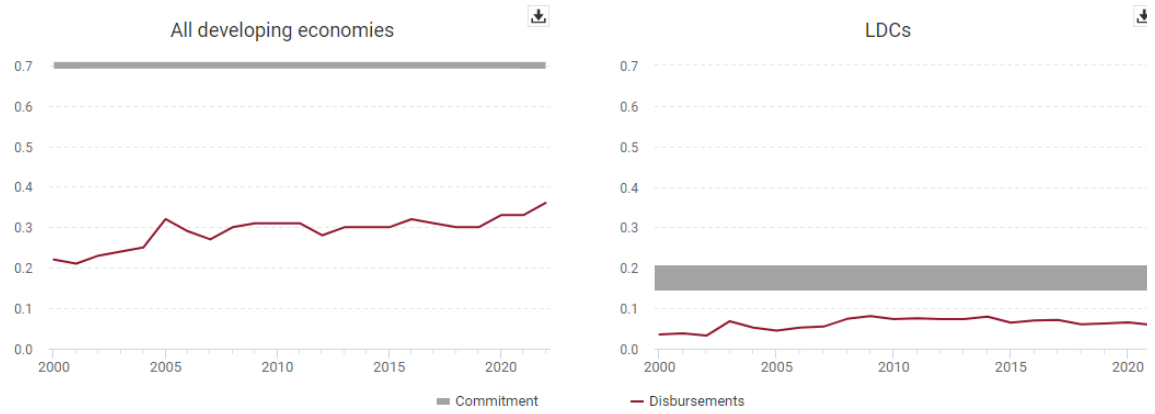
Source: Council of the European Union, 2022.

In addition to this overall target of 0.7 % of GNI, a specific target has also been developed in relation to LDCs and similarly applies both to EU institutions and EU MS ODA. By 2030, between 0.15 and 0.20 % of ODA should specifically target LDCs. Between 2014 and 2017, the proportion of EU collective ODA towards LDCs accounted for 0.11 % of GNI (Pichon 2020; Bilquin, 2022). Between

2018 and 2020, there has been a slight increase in EU collective ODA to LDCs to 0.12 %, but remains below the target (Council of the European Union, 2022). The Council of the European Union voiced concerns with regards to the ODA targets including to LDCs. The Council of the European Union has urged EU MS to take concrete measures to meet ODA targets and the EU could also support these efforts (Council of the European Union, 2022; OECD, 2022e). In 2021, EU institutions ODA to LDCs accounted for US$ 4.4 billion compared to US$6.3 billion to LMICs and US$6.9 billion to upper middle-income countries (OECD, 2023).

According to the OECD, in 2019 the level of ODA to LDCs from DAC countries accounted for 0.09% of their combined GNI (OECD, 2022d). At the global level, the United Nations Conference on Trade and Development (UNCTAD) assessed that the level of ODA to LDCs increased from 0.063 % in 2019 to 0.065 % in 2020, this increase resulting mostly from the breakout of the COVID-19 pandemic (UNCTAD, 2021). As presented in Figure 2.3, at the global level, ODA flows towards LDCs appear to have slightly decreased in 2021 to 0.059 % of GNI (UNCTAD, n.d.).

Figure 2.3 – Comparison between ODA flows to developing countries and ODA flows to LDCs.



Source: UNCTAD, 2023.

In addition to bilateral ODA that EU institutions and EU MS can leverage to support development activities according to thematic or geographic preferences in developing countries directly, there are also multilateral ODA flows channelled through multilateral organisations (for example, UN agencies) (OECD, 2023b; van Schaik & Maes, 2016; Bodenstein et al., 2017). While bilateral ODA can be perceived as simpler and quicker to action given the reduced administrative burden and alignment with priorities and interests, the amount of ODA available is likely to be smaller, increasing the number of programmes on the same topic or geographic areas and could lead to duplication of efforts. Donor neutrality could be reduced and perceived to be politically motivated. On the other hand, multilateral EU ODA is likely to generate economies of scale and increase donor neutrality despite more complex processes and lengthier administrative procedures (van Schaik & Maes, 2016; OECD, 2022e).

It should also be noted that there could be differences between EU MS in their contribution to the increase of EU ODA envelope. Some EU MS, with long lasting experience and expertise in the implementation of development programmes could prioritise bilateral ODA towards developing countries, for example due to specific expertise in an area or long-lasting relations with specific countries (RAND Europe interview, August 2023; Bodenstein et al., 2017). On the other hand, EU MS that have limited capacity in that area (e.g. Cyprus, Estonia) are less likely to implement bilateral instruments and more likely to rely on multilateral settings (RAND Europe interview, August 2023).

In addition to the overall EU ODA targets, some concerns have also emerged specifically in relation to the Global Gateway strategy launched in 2021 with the objective to invest in physical infrastructure as a means to support sustainable development across various sectors (i.e. Digital transition, Climate and energy, Transport, Health and Education and Research) (European Commission, 2021a; Szczepański, 2023). In addition, the Global Gateway relies on six principles that aim to support the implementation of quality projects for developing countries. These include democratic values and high standards; good governance and transparency; equal partnerships; green and clean development; security-focused infrastructure and catalysing private sector investment (Szczepański, 2023).

Concerns have been made relating to the funds used for the Global Gateway strategy and the repackaging of existing funds (Szczepański, 2023; RAND Europe interview, August 2023). The figures put forward under the Global Gateway strategy are likely to remain insufficient to address the so-called investment gap identified (Szczepański, 2023; RAND Europe interview, August 2023). The specific focus of the Global Gateway on physical infrastructure could also be detrimental to other sectors (RAND Europe interview, August 2023). Additional concerns have been made with regards to the inclusion of private sector investments that are likely to be misaligned with the Global Gateway principles (e.g., democratic values and good governance) (Szczepański, 2023).

EU development financing is also bounded by the role and geographical scope of the EIB. This institution was created to support European added value and regional coherence, therefore focused to a lesser extent on external activities (Gavas & Pérez, 2022). Since the 1960s, its external operations have increased, widening its geographical scope. However, compared to other development financing actors the EIB operations only amounted to €9.3 billion in 2020, €5 billion of which went to Africa (Gavas & Pérez, 2022). The EIB has little capacity to increase the amount of its operations and establish thematic and geographical targets and its presence in developing countries remains limited, but it seeks to continue to develop its presence in Africa through increased on the ground representation and further cooperation including with the African Development Bank (Gavas & Pérez, 2022; European Investment Bank, 2021).

Governance fragmentation

In addition to gaps and challenges relating to the overall level of development aid, the study team identified gaps pertaining to the fragmented nature of ODA governance to developing countries. EU institutions play a crucial role in ODA development financing. The Directorate-General for International Partnerships (DG INTPA) as well as the Directorate-General European Neighbourhood and Enlargement (DG NEAR) are involved in development programmes design and implementation on the ground. The External Action Service (EEAS) plays a role in the allocation of ODA to developing countries (Bodenstein et al., 2017). In terms of financial institutions involved, the EIB is the main EU actor that supports EU action in developing countries though the majority of its activities remain within the EU (Gavas & Perez, 2022).

Following recent developments including the development of the Team Europe approach and Team Europe Initiatives (TEIs), a multitude of actors both at EU and EU MS level are involved in development programming in the partner countries, including the European Bank for Reconstruction and Development (EBRD), of which the European Commission is a minority shareholder, but the biggest donor. EU MS, through their DFIs (e.g., development banks and agencies) are also taking part in TEIs (Gavas & Perez, 2022; DG INTPA, n.d.). The level of coordination between various stakeholder groups at EU and EU MS levels within joint programmes and more recently TEIs has been an inherent and long-lasting challenge to the EU's external action towards developing countries. In addition to the EU development policy, each EU MS is also able to develop its own development policy based the shared competence principle. However, these policies at EU and EU MS level should seek to complement rather than compete with each other in this space to

increase their visibility (RAND Europe interviews, August and September 2023, Bodenstein et al., 2017, Claras, 2019; Karaki & Bilal, 2023).

Over the last decades further efforts to encourage cooperation and coordination between actors involved in development programmes (e.g., for example in their communications activities) have been encouraged both between and within EU MS an at EU level. For example, in the increased involvement of private sector actors that sometimes are new to this sector can increase the complexity of existing cooperation mechanisms (RAND Europe interview, September 2023). This fragmentation could lead to duplication of efforts between various actors within the EU and EU MS. It should also be noted that not all EU MS have the same capacity and experience in the development sector. For example, France, Germany the Netherlands, Spain or Italy can rely on their national development agencies and well-established networks in developing countries while others may not have the same structures (Gavas & Pérez, 2022; RAND Europe interviews, September 2023).

There are also challenges associated to the governance structure of the development aid instruments. The creation of a Global Gateway Board was proposed under the Global Gateway for the delivery of Team Europe Initiatives and doubles to the existing Strategic Board of the EFSD+, the Global Gateway's main financial tool. (Gavas, 2022). The EFSD+ Strategic Board sits representatives from the European Commission, the High Representative, EU MS, the EIB and the European Parliament as an observer (Gavas & Pérez, 2022).

In addition, the development of numerous development objectives and priorities accompanying the launch of the NDICI - Global Europe instrument are likely to foster competition between developing countries to gain access to EU development funding mechanisms (Sabourin et al., 2023; RAND Europe interview, August 2023). Access to information relating to EU development funding initiatives and processes remains difficult and lacks clarity. Smaller development organisations are also less likely to be able to access EU development funding because they lack the capacity to manage large funds and may not be familiar with the specific administrative processes (Sabourin et al., 2023; Gavas, 2022; RAND Europe interview, September 2023). Wider information sharing mechanisms that could also help developing countries have a complete picture regarding to development initiatives and actions that are conducted on their soil have yet to be established (RAND Europe interview, August 2023; Sabourin et al., 2023).

The implementation of the NDICI – Global Europe and Global Gateway initiative aimed at increasing coordination between various actors involved in development aid financing. The combination of several instruments into the single NDICI – Global Europe and its integration to the EU budget aimed at establishing joint priorities at EU level (RAND Europe interviews, August-September 2023; Chahri, 2021). The breakout of unforeseen events and crises such as the breakout of the COVID-19 pandemic or the 2022 Russian invasion of Ukraine have also contributed to the fragmentation of EU development aid. Indeed, the COVID-19 pandemic led to increasing emphasis on health while the war in Ukraine has prompted security and specifically food security considerations in relation to developing countries (RAND Europe interview, August 2023). According to the OECD, the highest volume of ODA delivered to Ukraine was funded by EU institutions (US$10.6 billion) (OECD, 2023).

Other challenges, for example, increased migratory pressure including from LICs and LDCs can lead to changes in ODA allocation. In 2015, the European Union Trust Fund for Africa was set up to address the root causes of migration in 26 countries across the continent (Fine et al., 2019; European Union, 2023). The literature suggests that ODA is often oriented towards countries of origin or transit countries. More attention is also paid to the overall ODA figures rather than assessing whether development aid is used to implement programmes targeting the root causes of migration (Clemens & Postel, 2018; Fine et al., 2019). The literature also suggests that emigration is more likely to occur from LICs and LMICs than LDCs, given the amount of resources required (Clemens & Postel, 2018; Fine et al., 2019). Recent changes to the Development Assistance Committee (DAC) within the OECD implemented in late 2022 now enable to various activities related to migration to sit within

the ODA umbrella. These activities encompass, in-country refugee costs and returnees' reintegration initiatives as well as activities supporting border management efforts or countering irregular migration flows including human smuggling and trafficking across borders (Fox, 2023; Weisner & Pope, 2023). In this context and in alignment with OECD guidelines, the increased migratory pressure on Europe led to agreements between the EU and Niger, Turkey or Tunisia for example to provide technical assistance in countries such as Libya to train border guards (Fine et al., 2019; Fox, 2023; Weisner & Pope, 2023). Under the NIDICI – Global Europe instrument, which aims to support development efforts in partner countries in North and sub-Saharan African and the Asia Pacific region, initiatives pertaining to migration are targeted to account for about 10 % of overall spending. In 2021, these initiatives accounted for 14 % of NDICI – Global Europe spending (about €1.5 billion) (European Commission, 2023b).

To mitigate the fragmentation of European development aid, committees gathering all stakeholders involved have been put in place among European stakeholders and the implementation of the various Team Europe initiatives under the Global Gateway are likely to foster coordination between stakeholder groups, including among developing financing institutions who may not have much in-country presence (RAND Europe interviews, August 2023). Additional efforts could also be made either at EU level within the TEIs or among EU MS to further streamline and potentially limit the number of development aid financing instruments and mechanisms (RAND Europe interviews, August 2023). The multiplication of such mechanisms and instruments is likely to limit the ability of developing countries' stakeholder groups (i.e., local and governmental authorities, as well as the private sector and private branches of development banks) to identify priorities to support poverty reduction and implement programmes accordingly in a coordinated and strategic manner (RAND Europe interviews, August 2023; Danglade & Toulmin, 2023; Karaki & Bilal, 2023).

The role of supranational structures in regions where the EU is? already conducting development action (e.g., the African Union, the Association of Southeast Asian Nations, the East African Community or the Economic Community of West African States) could be strengthened to increase developing countries' visibility to EU development funding mechanisms. The EU-Africa: Global Gateway Investment Package seeks to include regional structures to support investment opportunities and development projects (European Union, 2022). These supranational structures could represent developing countries as a counterpart to the EU in discussions about ODA and development aid more widely. In the context of the Global Gateway, which focuses on the development of physical infrastructures, regional organisations could support the development of projects in more than one developing country (e.g., railway infrastructure) (RAND Europe interview, August 2023).

Inherent challenges pertaining to the cyclical character of development funding mechanisms are likely to continue. For example, by increased fund disbursement at the end of a financial year of cycle to match funding plans (RAND Europe interviews, August and September 2023). It should nevertheless be noted that the NDICI – Global Europe instrument enables unused funds to be carried over to the following financial year (Concord, 2022).

Operationalisation

The difficulty in translating development aid objectives into concrete action characterises the challenges and gaps pertaining to the operationalisation of development aid. Programmes are often established along multiannual plans. On the one hand these plan secure funds for a period of time that usually spans across several years, on the other hand they can limit the reallocation of development funding to different activities or to address a new global crisis or shock as it arises (e.g., the 2008 financial crisis, the COVID-19 pandemic or the war in Ukraine). While the NDICI – Global Europe includes a so-called cushion to address these types of events, most of the €9.53 billion to be spent between 2021 and 2027 has already been used to support COVID-19 vaccination efforts, respond to the 2022 Russian invasion of Ukraine or to address the migration crisis (Bilquin, 2022;

RAND Europe interview; August 2023). Once this reserve fund is used and if simultaneous crises were to emerge within the same financial cycle, development aid resources may not be available to the EU (RAND Europe interview, August 2023). It should also be noted that within the European Financial Architecture for Development (EFAD), priorities and objectives within institutions are likely to vary and the risk of misalignment between competing priorities remains (Kakari & Bilal, 2023; RAND Europe interviews, September 2023).

Challenges also exist in relation to the establishment of joint programming between the EU and EU MS in the context of the TEIs that gather a myriad of actors. The level of experience between groups of stakeholders is likely to vary across institutions. This specific challenge could disappear over time as more TEIs are implemented despite initial efforts needed to develop coordination capacities between stakeholders involved (Karaki & Bilal, 2023; Bilquin, 2022).

In addition, some challenges were identified in relation to the perceived administrative burden and bureaucracy associated with EU development programmes. A limited number of stakeholders within Developing countries have the human capital and financial capacity to apply for European development funding and undertake the administrative procedures required under European funded programmes (RAND Europe interview, August 2023). There is a risk of misalignment between the financial capacity of local actors and the potential impact of a development project within a local community (e.g., water and sanitation, and health initiatives are likely to have a great impact on poverty at the local level) (RAND Europe interview, August 2023). Further to the identification of objectives and targets, there is also a need to identify those relevant implementing partners that will support development activities (RAND Europe interview, August 2023).

Given its role in the implementation of Team Europe joint programming and initiatives, the EBRD can also be mentioned. The geographical scope of EBRD action has been limited despite a 2012 decision to expand the scope of the EBRD to the Southern and Eastern Mediterranean in the aftermath of the Arab Spring (Official Journal of the European Union, 2012). A new decision taken in May 2023 has confirmed that the geographical scope of the EBRD will further expand to include Iraq and the countries of Benin, Cote d'Ivoire, Ghana, Kenya, Nigeria and Senegal. Investments in these countries will only start from 2025 (Zgheib, 2023).

Reporting/transparency

Some challenges have also been identified in relation to the transparency, public scrutiny and reporting of the EU development financing instruments (Bilquin, 2022). For example, documents and wider access to information in relation to EFAD are not publicly available, which not only limits transparency but also reduces accountability and scrutiny of development financing (Gavas & Pérez, 2022). To support communications and information sharing efforts, workshops like the one organised in January 2023 in Cameroon on the Global Gateway initiative could be further developed and promoted (Sabourin et al., 2023)

The NDICI – Global Europe instrument faces similar challenges in relation to the lack of transparency over the financial instruments used, the division of labour between stakeholder groups or the development of joint ownership of these interventions between EU and partners countries (Gavas & Pérez, 2022).

Within partner and developing countries, the limited transparency of the NDICI – Global Europe has also led to the perception that the level of competition has increased between partner countries to be awarded EU funded projects and aid allocation is awarded on a 'first come, first served basis' (Sabourain et al., 2023). This is also strengthened by the increased flexibility of the NDICI – Global Europe instrument which no longer guarantees each partner country with a certain level of funding as it was the case under the EDF (Sabourin et al., 2023).

Unbalanced approaches between the implementation of development programmes and the implementation of extensive reporting rules are also likely to present a challenge. Extensive reporting and evaluation activities conducted under EU-funded development programmes and the administrative burden they represent could hamper the execution of development projects to reduce poverty in developing countries (RAND Europe interview, August 2023).

Gaps and challenges relating to the transparency of development aid also highlight the reputational risk for the EU. Suspicion towards EU funded development projects and programmes can enhance distrust in the EU as a donor and disbelief in its ability to support poverty reduction (Gavas & Pérez, 2022).

Conditionality

The activities conducted by the study team suggest that the financing of development is increasingly linked to conditions relating to security, human rights or rule of law considerations established by donors for both for LDCs and LICs (Pichon, 2020). Conditionalities to EU budget support to developing countries is clearly stated and comprises four conditions: 'national or sectoral public policy, a stable macroeconomic framework, credible public financial management and transparency of the budget' (Berkowitz et al., 2017). These conditions aim to foster 'local ownership' in recipient countries by tailoring the conditions to the local context and development strategies. However, it should be notes that examples of EU budget support in Ghana, Tunisia or Uganda have focused on fostering economic development and liberalisation to the detriment of human development and poverty reduction in these countries (Langan, 2015; Stichelmans, 2016).

Though development policies are not bound to legal obligations posed by the PCD, under which EU policies should 'ensure that no EU policies have negative effects on developing countries'. Concerns have emerged with regards to the prioritisation of security considerations over poverty reduction in shaping development aid in developing countries (Pichon, 2020; Latek, 2015).

For example, a partnership was implemented in Niger in 2019 to support border control efforts and disrupt migration routes across the Sahel region (Latek, 2019b). This specific initiative was in opposition with EU support to African regional integration efforts (Pichon, 2020). Unforeseen events are also likely to change the conditions in which EU and European development aid can be delivered to developing countries (RAND Europe interview, August 2023). For example, the recent military coup in Niger has prompted various EU MS to halt their development aid programmes and the EU to stop its budgetary aid to the country (Le Monde, 2023; Hutton, 2023; RAND Europe interview, August 2023).

Other countries in the Sahel have been faced with similar coups and regime change. There are strict conditions under which EU ODA can be delivered and if these are not met then development aid can be reduced or suspended. These conditions can pertain to the occurrence of human rights violations, changes away from democratic governance or the rule of law, or corruption (RAND Europe interview, August 2023; DG NEAR, 2023; Berkowitz et al. 2017). This can result from the decreased security conditions for development actors on the ground, access to certain areas and localities, availability of local partner country stakeholders, etc. (RAND Europe interview, August 2023). It should be noted that while development aid is likely to be halted, humanitarian aid is likely to continue – but it is a distinct instrument that operates under different rules at the EU level (RAND Europe interview, August 2023; Chahri, 2021; Bilquin, 2022).

The delivery of development programmes remains dependent on favourable on-the-ground conditions. Changing conditions to the local environment may disrupt the implementation of development programmes. In such cases, there is limited flexibility to leverage existing alternative channels or create new ones, for example, towards local non-governmental organisations (NGOs) or CSOs. These conditions may not be as severe as the situations mentioned in the previous paragraph

(e.g. coups or regime change) and could be occurring within a specific locality (RAND Europe interview, August 2023).

Case study: ODA and regime change in LDCs and LICs – the example of Mali

As explained in the above analysis, EU ODA has been extensively used as an instrument to alleviate poverty in developing countries. However, the impact of EU aid on poverty is dependent on a range of factors, and the political regime of the recipient country is no exception (OECD, 2022c). This is of significant importance in a world with a global trend towards more autocratic governance (OECD, 2022).

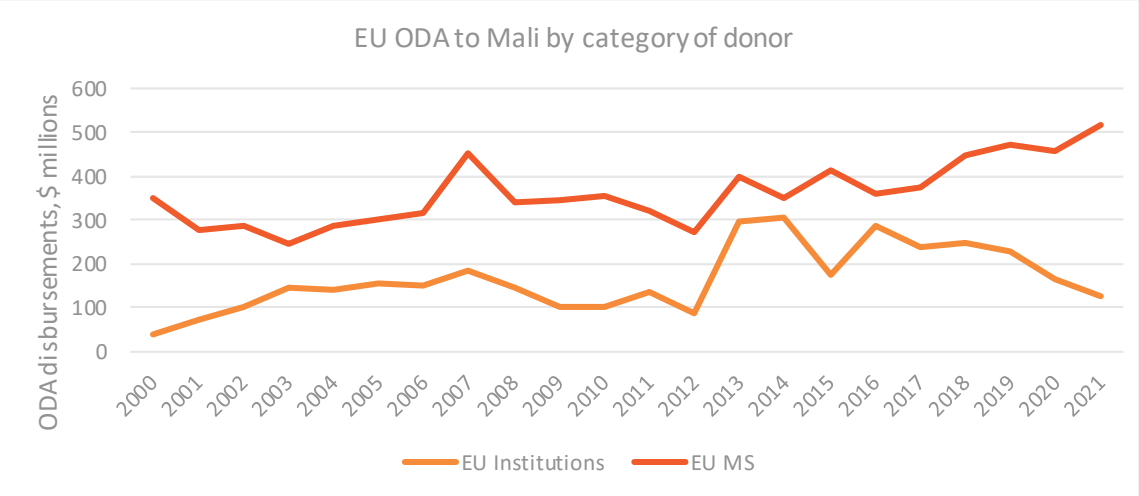
In the last couple of years, the number of coups has risen to a historically high point, and especially in Africa. Since 2020, West and Central Africa has had to face 8 coups against democratic systems.[19]

Changes in political regime can impact directly the dynamics of ODA, especially in terms of dimensions and speed of ODA responses. Indeed, donor countries and institutions can decide to suspend development aid for an indefinite amount of time. This case study illustrates this with the situation in Mali following the coup in 2012.

Historically, Mali has been one of the countries receiving the largest amount of ODA from EU donors, in order to support the country towards its democratic transition. Indeed, the country was among the poorest countries in the world, both in terms of income and in terms of human development indicators, and consistently received aid.

Figure 2.4 shows the level of aid received by Mali from EU institutions and EU MS from 2000 to 2021. Over this period, the main EU Member State donors were France, Germany, the Netherlands, Sweden and Denmark (with total ODA amounts over 500 million euros).

Figure 2.4 – Level of ODA from EU institutions to Mali



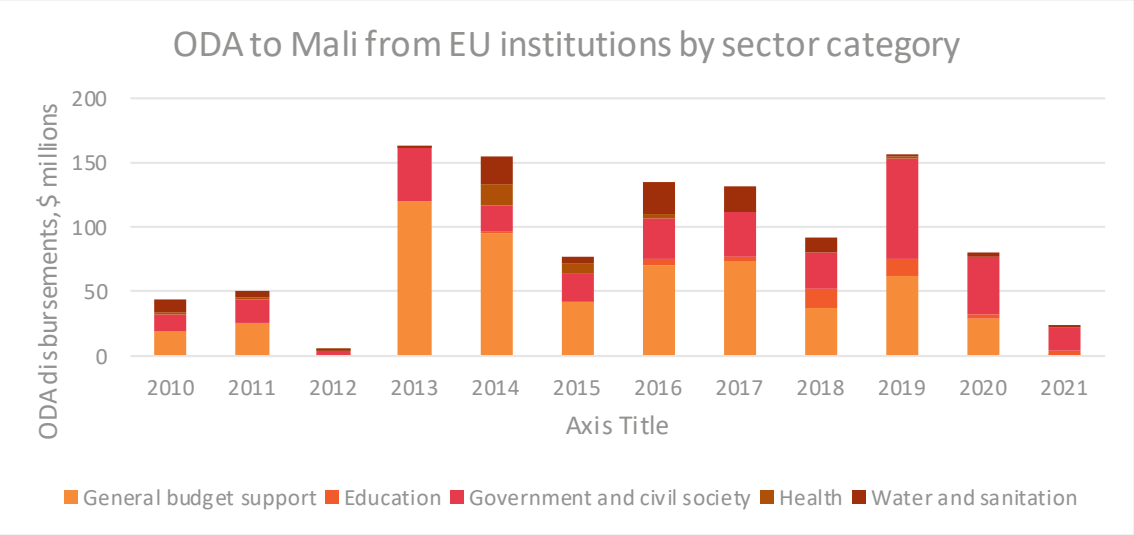
Source: EU AidExplorer, based on OECD Data: ODA Official Development Assistance: Disbursements. Authors' computations. The amount is in US$ millions, constant 2021 prices.

In 2012, the Malian former President Amadou Toumani Touré was deposed by a coup. In reaction, the EU suspended development aid between March 2012 and February 2013 (European Commission, 2012). The World Bank and the African Development Bank had also suspended development aid. It is important to note that humanitarian and food aid, both included in the ODA total, were maintained during the coup.

[19] At the time of the project, these include: Gabon in 2023, Niger in 2023, Burkina Faso in 2022 (x2), Sudan in 2021, Guinea in 2021, Mali in 2021, Mali in 2020. Attempted coups are not included in this number.

As shown in Figure 2.5, the cut in ODA support to Mali was mainly through general budget support and government and civil society ODA, i.e. less aid was directed towards the public sector and a larger share of aid was channelled through multilateral organisations and NGOs (Zuercher et al., 2022). Interestingly, ODA towards health and education started to increase in the years following the coup.

Figure 2.5 – ODA to Mali from EU institutions by sector category



Source: EU AidExplorer, based on OECD Data: ODA Official Development Assistance: Disbursements. Authors' computations. The amount is in US$ millions, constant 2021 prices.

Following the coup, and hence the suspension of foreign budgetary aid, the Malian economy has been negatively impacted, mainly through the national budget and real GDP. Indeed, because foreign aid and grants represented around 17 % of the country's national budget before the coup, the country has had difficulties meeting its budgetary obligations in 2012 (Diallo, 2012). According to the rectified 2012 Finance Act, both overall expenditures and government resources fell by around 30 %. The GDP growth rate in 2012 reached his second lowest level since the beginning of the century with -0.8 %. [20]

Consequently, the poverty rate as measured by the poverty headcount ratio at national poverty lines increased significantly from 41.1 % in 2009 to 47.1 % in 2013 (WB estimates). According to the IMF, this could be explained by poor agricultural production (food insecurity), trade disruption, and the low level of public investments (IMF, 2022). Moreover, the availability and quality of basic social services were impacted, and most education establishments as well as health centres have closed (IMF, 2022).

As such, the suspension of aid and external support to the public services budget has been harmful to the Malian economy in the institutional and security crises that the country was facing in 2012.

However, in the few years following the coup, the Malian economy has seen an upturn in economic activity and renewed support from the international community, which, combined with internal efforts in terms of budget, have allowed the country to preserve the fragile results it had seen before the 2012 crisis.[21] Nonetheless, the country now remains on a sharp downward trajectory, especially with the other coup that happened in 2020, weakening further the country's economy. Overall, the level of security and democracy are lower than before the breakdown of the democratic order in 2012 (Zuercher et al., 2012).

[20] The lowest level was in 2020, after the coup, with -1.2 %. Computed using IMF data https://www.imf.org/external/datamapper/NGDP_RPCH@WEO/MLI?zoom=MLI&highlight=MLI

[21] The Government's Emergency Priority Action plan (2013-2014) highlights the aims and ways to achieve the country's objectives after the crisis: https://www.imf.org/external/pubs/ft/scr/2013/cr13111.pdf

As for any regime changes in developing countries, it is hard to distinguish the effect of aid suspension on poverty outcomes from the ones of the coup in itself, and causal relationships are complex to establish.

Gaps and challenges related to debt distress policies

The recent shocks and crises that have emerged over the last years, specifically the COVID-19 pandemic, have led to an increase in the level of public debt in developing countries. However, it should be noted that this trend is not new and the level of debt of LICs and LMICs has been on the rise for over 10 years (World Bank, 2022c). As of 2022, 30 % of the public debt was owed by developing countries according to the UN Global Crisis Response Group (UN, 2023). An increased number of developing countries also face high levels of public debt, above 60 % of GDP (UN, 2023). The external public debt of developing countries has also increased from 19 % in 2010 to 29 % in 2021 (UN, 2023). This trend has continued in 2022 (Eickhoff & Thiele, 2023). These countries are therefore dependent on global financial conditions and potential shocks and are also subject to higher interest rates than developed countries, sometimes up to 10 or 11 % (UN, 2023a; RAND Europe interview, September 2023). Since the mid-1990s, various initiatives have been launched by the IMF and the World Bank regarding developing countries debt including the Heavily Indebted Poor Countries (HIPC) or the Multilateral Debt Relief initiatives (IMF, 2023a). The case study below presents an overview of the impact of global crises on the level of debt in developing countries.

Case study: global crises and debt levels in LDCs and LICs

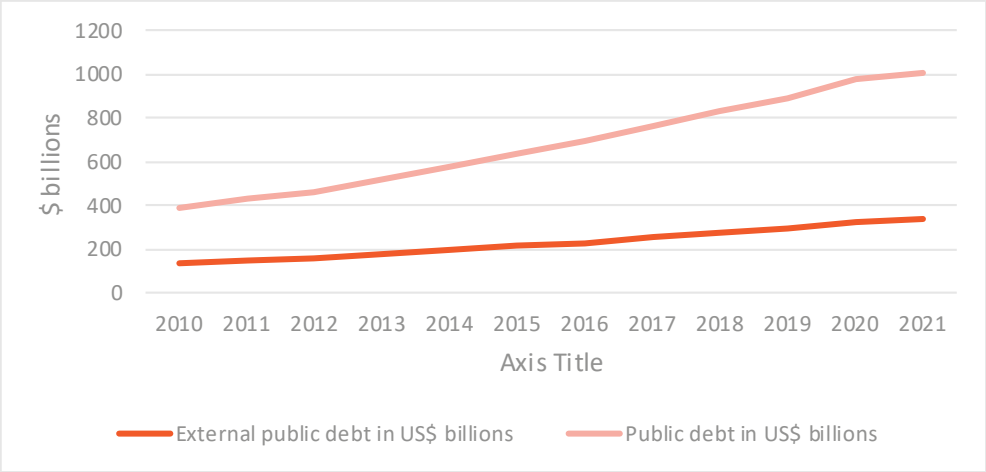
Recent global crises have been adding to the strain on public finances worldwide, and especially for developing countries. Indeed, around 60 % of LICs are in debt distress or at high risk of debt distress, yielding to debt crises all over the world (UN, 2022).

During the last 50 years, developing economies have experienced several waves of debt accumulation. These include the one following the series of financial crises in the early 1980s, the one from the beginning of the century following the financial and capital market liberalisation, as well as the one due to the financial crises in 2007-2009. Since 2010, debt has been reaching record highs, with developing countries facing an average annual increase in debt of almost 7 percentage points of GDP (Kose et al., 2020). LICs, more specifically, saw their debt level rising from 47 % of GDP in 2010 to 65 % of GDP in 2019 (Kose et al., 2020).

More recently, global shocks such as the COVID-19 pandemic, rising interest rates, high food and energy prices and currency depreciation have further increased external debt distress and financial constraints for LDCs and LICs.

Figure 2.6 below shows the evolution of both public debt and external public debt in LDCs since 2010.

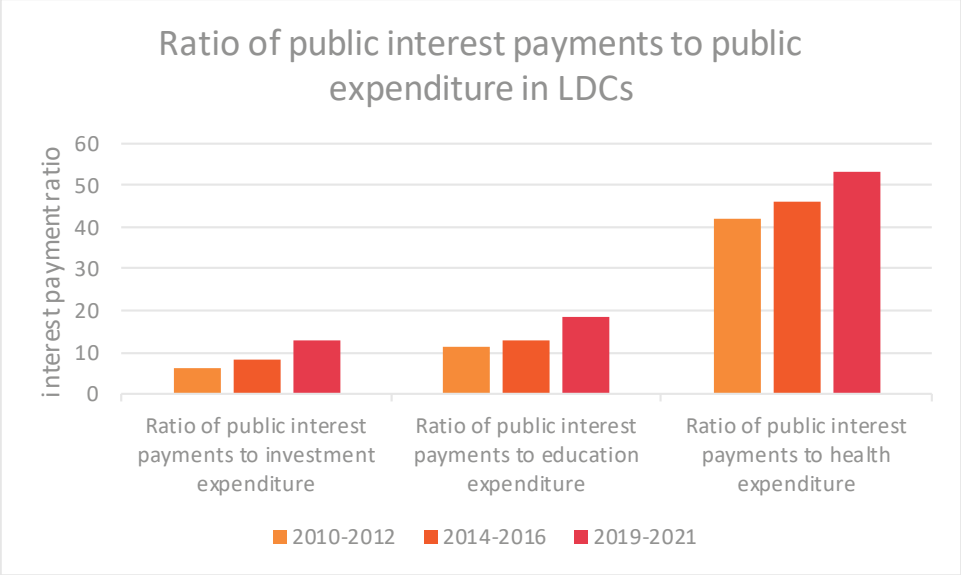
Figure 2.6 – Public debt in LDCs, in US$ billions

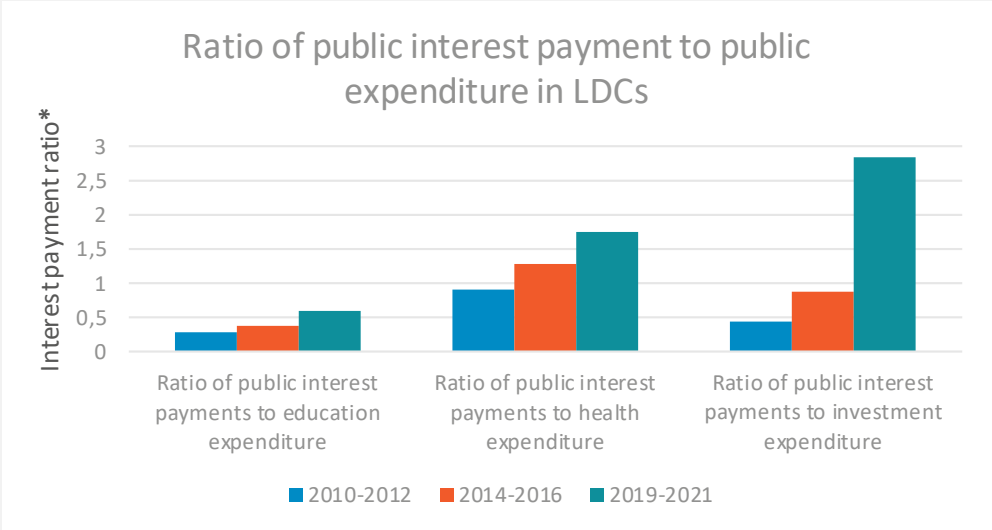


Source: World of Debt data (World Bank).

With public debts being on the rise for LDCs and LICs and reaching unseen levels due to current global crises, these countries have to face a choice between servicing their debt or serving their people. Indeed, most LDCs spend more on interest payments than on essential public expenditures. More precisely, developing countries in Latin America and the Caribbean devote more money to interest payments than to investment; developing countries in Asia and Oceania spend more money on interest payments compared to health expenditure; and countries in Africa spend more on interest payments than on either education or health (UN, 2023a).

Figure 2.7 – Ratio of public interest payment to public expenditure in LDCs





Source: World of Debt data (World Bank).

Note: The source data was already aggregated in the time periods 2010-2012, 2014-2016, and 2019-2021, using thee-year averages. *The indicators measure the relative proportion of a country's general government's resources that are dedicated to net interest payments to those allocated to investment, education and public health respectively. A value greater than 1 shows that a country spends more on interest payments than on the considered public service.

Since the beginning of the century, several mechanisms have been implemented to provide the poorest countries debt service relief, including the HIPC Initiative, which aims is to cancel debts only for those states that are already heavily indebted and are unable to pay these liabilities on their own. The full process of the HIPC Initiative is done around the decision point and the completion point. The decision point refers to the situation where a country is assessed to be eligible for debt relief and can then immediately obtain interim debt relief. The completion point, on the other hand, allows a country to receive the full debt committed at the decision point based on a few pre-defined criteria.[22] To date, a total of 36 countries has past the post-

[22] To be eligible to the HIPC Initiative, countries should also have the ability to grow out of poverty after a waiver. Other initiatives include, for instance, the CCRT, and the DSSI. Further information on the decision and completion points

completion-point; two are between decision and completion point, there's one pre-decision point country (IMF, 2023a).

Recent estimates put total (committed) HIPC and related Multilateral Debt Relief Initiative debt relief for the 36 post-completion point countries at almost US$125 billion in nominal terms (IMF and World Bank 2019)

Overall, debt-relief policies and initiatives have proven to be efficient in supporting LDCs and LICs. Indeed, post-completion-point countries have been shown to have a faster growth rate than other LICs (Cheng et al. (2019) and Marchesi and Masi (2021)). Essers and Cassimon (2021) showed that most post-completion-point countries have not faced an immediate re-accumulation of large external debts in the following years, and more generally overall external debt ratios remain low in these countries even if some exceptions exist. However, results in terms of revenue mobilization and export performance are more mitigated (World Bank IEG, 2006).

Despite the fact that countries at post-completion point have made modest progress towards reaching the SDGs, the data on the results and impact of the HIPC Initiative are still limited (World Bank IEG, 2006). Moreover, it is important to emphasize that the current global crises have a significant impact on LDCs and LICs, and if current trends persist, debt vulnerabilities in LICs could reach levels comparable to the pre-HIPC era over the medium to long-term (Chuku and others, 2023).

Against this backdrop, it should be noted that debt relief instruments towards developing countries remain within the realm of EU MS (RAND Europe interview, August 2023). Only a limited number of EU MS own the majority of debt from developing countries, namely France, Germany, Italy, Portugal and Spain (Gavas & Pleeck, 2020). However, during the COVID-19 pandemic, the European Commission President called for a so-called Global Recovery Initiative that would link debt relief efforts with SDGs but little concrete action was taken (Pleeck & Gavas, 2020; RAND Europe interview, August 2023). In the context of the COVID-19 pandemic, the EU contributed to the IMF's CCRT that was aimed to support debt relief in 29 LICs (European Commission, 2020a). The European Commission is also an observer to the Paris Club. This club, founded in 1956, gathers 22 permanent members[23] who are creditors to countries that are experiencing challenges with their debt payments. As of 2023, 478 agreements with 102 debtor countries have been reached. As an observer[24], the European Commission can attend the negotiations between creditors and debtors but cannot either take part in the negotiations or sign the agreements stemming from them (Paris Club, n.d.).

Some concerns have also risen with regards to debt relief policies that could produce negative effects in developing countries such as enhancing corruption or further increase the level of debt in these countries. This negative effect or moral hazard can in some cases enable countries to take out new loans without having to provide guarantees on the use of these funds and in turn have no impact on poverty reduction. Paris Club members could help develop new standards to be applied to debt relief policies for developing countries and limit the risk of moral hazard (Bouchet, 2021).

The role of the EIB as a coordinator in support of EU MS debt relief efforts towards developing countries remains limited. Debt distress policies are determined by EU MS with little oversight from EU institutions often conducted bilaterally with developing countries. These policies can also result

can be found here: https://www.imf.org/en/About/Factsheets/Sheets/2023/Debt-relief-under-the-heavily-indebted-poor-countries-initiative-HIPC . For the Completion and Decision Point documents (including countries and dates), see: https://www.worldbank.org/en/topic/debt/brief/hipc

[23] 11 of the 22 permanent members of the Paris Club are also EU MS: Austria, Belgium, Denmark, Finland, France, Germany, Ireland, Italy, The Netherlands, Spain and Sweden. See: https://clubdeparis.org/en/communications/page/permanent-members

[24] Other international organisations that are observers to the Paris Club include: the IMF, the World Bank, the OECD, UNCTAD, The African Bank of development, the Asian Bank of development, the EBRD and the Inter-American Bank for development. See: https://clubdeparis.org/en/communications/page/observers

from historical ties or specific interests between EU MS and developing countries, which can explain the coordination at EU level of debt distress related issues (RAND Europe interview, August 2023).

EU MS positions with regards to debt relief policies in the multilateral development financing institutions such as the IMF and the World Bank are also likely to vary. Attempts to develop EU-wide positions in those international settings therefore remains limited. It should also be noted that there is a lack of preparatory work conducted ahead of these meetings to develop a common EU position. Each EU MS promotes their national policies and concerns on these topics. As a supranational institution, the EU is only represented through its MS in these international financing institutions. (RAND Europe interview, August 2023).

Aside from direct loans to support financing of developing countries, other mechanisms could be explored by the EU such as technical assistance or ODA grants. However additional challenges pertaining to the human and/or financial resources needed to implement these mechanisms are likely to prove challenging (RAND Europe interview, August 2023).

Another potential avenue for the EU's increased involvement is via Special Drawing Rights (SDRs) Allocations. SDRs are reserve assets that aim at increasing countries' liquidity and can function as an alternative funding mechanism to contracting debt. Since 1973, their value is based on five currencies (US dollar, Euro, Chinese Renminbi, Japanese Yen and British Pound Sterling). Following the COVID-19) and updated by the IMF on a daily basis. SDRs were first issued in 1969 by the IMF to increase the diversity of reserve assets available to member countries and their liquidity. A limited number of actors namely the IMF and its 190 member countries can get allocated SDRs, depending on their respective IMF capital share. As of 2023, four SDR allocations have been conducted and calculations based on members respective share of IMF quota while other so-called 'prescribed holders' do not have access to SDR allocation but can trade them while individual or private actors cannot hold SDRs (IMF, 2021a; IMF, 2023b). Following the COVID-19 related rounds of SDR allocation, some countries committed to redirect SDRs to developing countries in need. In this context the EU complemented EU MS contribution to SDRs (US$13 billion) (Hallak, 2022). Specifically, in late 2022 the EU contributed €100 million to the IMF's Poverty Reduction and Growth Trust (PRGT) that aims at providing zero interest rates loans to LICs affected by the COVID-19 pandemic (European Union, 2022; IMF, n.d. & 2021). The European Central Bank (ECB) is one of the 15 holders of SDRs.[25] At the EU level, debates have emerged surrounding the issue of SDR rechannelling from EU MS national central banks to finance developing countries through multilateral development banks and whether such mechanisms could violate the so-called 'monetary financing prohibition established in the Treaty on the Functioning of the European Union (TFEU). 'Monetary financing [can be understood as] a central bank lending directly to its government or buying its debt on the primary market' (Paduano, 2023) (RAND Europe interview, August 2023; Paduano, 2023; ECB, 2021). Though the literature suggests that there is general support to the further reallocation of SDRs, this instrument remains an IMF-managed mechanism (Hallak, 2022).

Gaps and challenges related to global taxation

Over the last decades concerns have risen in relation to tax evasion, with companies shifting profits to locations with lower taxation rates. These base erosion and profit shifting practices (BEPS) have also led some countries such as the US to cut their corporate tax rates in a context of global tax competition and so-called 'race to the bottom' (Wier & Zucmnan, 2022; McCarthy, 2022; Parada,

[25] Holders of SDRs include: European Central Bank, Bank of Central African States, Central Bank of West African States, and Eastern Caribbean Central Bank, Bank for International Settlements, Latin American Reserve Fund, and Arab Monetary Fund, African Development Bank, African Development Fund, Asian Development Bank, International Bank for Reconstruction and Development and the International Development Association, Islamic Development Bank, Nordic Investment Bank, and International Fund for Agricultural Development. See: https://www.imf.org/en/About/FAQ/special-drawing-right

2023). It is estimated that the overall global cost of tax avoidance reaches between US$500 to US$600 billion per year, specifically the loss for developing countries is estimated to reach about US$200 billion each year (Shaxson, 2019; Cobham & Jansky, 2018). The OECD rather estimates that BEPS accounts for US$100 to US$240 billion loss per year globally (OECD, n.d.). For countries such as Chad, Zambia or Pakistan the cost amounts from 5 % to 8 % of GDP per year. In comparison, the cost for EU MS such as France or Germany only represents about 0.6 % to 1 % of GDP (McCarthy, 2022).

In front of such challenges and in the context of the COVID-19 pandemic that led to increased levels of poverty and economic turmoil, the OECD and G20 concluded a new tax deal, the Inclusive Framework, in October 2021. This reform of the global tax system relies on two pillars. Under the first pillar, profits from Multinational Enterprises (MNEs) are no longer linked to their physical presence to be subjected to taxation, but rather depend on countries where their profits generate from. Specifically, pillar one focuses on those MNEs with revenues higher than €20 billion and profit margins superior to 10 % before taxation and will not apply to companies in the financial and extractive sectors (McCarthy, 2023, Agymang et al., 2021). Under the second pillar, a new minimum corporate tax of 15 % will be applied to companies whose revenue is higher than €750 million (McCarthy, 2022; OECD, 2021b; Mason, 2021; Christians et al., 2023;). As a result of the implementation of the two-pillar approach it is expected that under pillar one US$125 billion of MNE profits could be subjected to the new taxation rule and that the pillar two new minimum tax rate could generate about US$150 billion in additional tax revenue globally (McCarthy, 2022; OECD, 2021; Bunn & Bray, 2023). Analysis suggests that the additional revenue under pillar one would amount 0.02 % of the collective GDP of 52 developing countries (Oxfam, 2021). Each country is required to translate the agreement into their domestic legislation to enforce it. As of November 2023, the EU, Japan, Mauritius, South Korea and the UK have integrated pillar two into law. The Inclusive Framework faces deadlock in the US Congress (Bunn & Bray, 2023; Agymang et al., 2021; EY, 2023)

Various criticisms of the new taxation deal have risen, including from developing countries (GATJ, 2021; Oxfam, 2021, McCarthy, 2022). Kenya, Nigeria, Pakistan and Sri Lanka have not yet signed the deal and less than half of African countries have joined the Inclusive Framework (MacCarthy, 2022). The lack of enthusiasm for the deal partly stems from the lack of information and transparency on its economic and financial implications, including an impact assessment for each country or wider public scrutiny on the process (McCarthy, 2022). In addition, there are several areas uncertainty for developing countries with regards to this deal. First, the 15 % minimum global taxation rate established by the new deal is lower than the corporate income tax rate of developing countries. For example, in African countries, the average income tax rate is at 27.5 %. There is a perception that the new global tax rate will lead to losses for developing countries, not too different from previous tax evasion practices towards tax havens (McCarthy, 2022). As a result, developing countries have been pushing for alternative initiatives to the OECD framework through the UN. A resolution was adopted by the UN General Assembly in December 2022 and followed by a report from the UN Secretary General proposing a blueprint to increase the organisation's role in the area of global taxation in a more inclusive and effective manner for developing countries (UNGA, 2023). This proposition seeks to establish: 'i) a multilateral convention on tax, ii) a framework convention on international tax cooperation; or iii) a framework for international tax cooperation (UNGA, 2023). Developed countries, including within the EU and the UK have opposed this parallel initiative to OECD efforts with regards to global taxation rules (Agyemang, 2023). It should also be noted that the proposed changed could also lead to decrease in tax revenue from MNE activities in developing countries. Specifically, the application of pillar one could affect the level of tax revenue in the US as most MNEs subject to this pillar are US-based technology companies (Bunn & Bray, 2023).

A second area of concern relates to reallocation of residual profits from places where MNEs are based to places where they make profits. Under pillar one, only 25 % of profits made above the 10 % percent margin (i.e. residual profit), would be subject to reallocation (McCarthy, 2023; Bunn & Bray,

2023). Critics from developing countries have argued that at least 30 to 35 % of residual profit should be subjected to reallocation to lead to support the revenue of developing countries and that reallocation of 20 % of residual profits could lead to a loss in revenue of US$230 million in LDCs (McCarthy, 2022; Oxfam, 2021). Third, the thresholds established by the OECD to determine which companies would be subjected to the new taxation rules appears less favourable to developing countries. Specifically, the US$20 billion profit threshold reduced the number of MNEs subjected to the pillar one rules compared to the €750 million established under pillar two. Analysis suggests reducing the threshold would lead to a significant increase in the number of MNEs subjected to pillar one rules. In volume, the amount of profit subjected to taxation rules is likely to be less significant below US$5 billion. The exclusion of the financial and extraction sectors also limits the scope of pillar one (Devereux & Simmler, 2021). Fourth, tax disputes resolution mechanism included in the new deal are mandatory. These processes are known to be lengthy and resource intensive, which could have further negative impact on developing countries with limited resources. Fifth, countries joining the new taxation deal have to renounce existing or future taxes on digital services. Such tax mechanisms are a source of revenue for developing countries and there are no guarantees that under pillar one the reallocation would generate equivalent revenue. In Kenya for example, under the current tax on digital services applies to 89 MNEs while under pillar one only 11 MNEs would be subjected to profit reallocation, leading to potential losses in revenue (McCarthy, 2022).

Gaps and challenges relating to fiscal space improvement

Various challenges hamper the development of fiscal spaces in developing countries, including in relation to global taxation and tax avoidance issues. While there is no commonly agreed definition, fiscal space relates to 'the financing of policies conducive to the development of a country […] both in its narrow sense, as a redefinition of the fiscal rules to which sensible fiscal policy has always been subject, or in broader term as a full-blown set of policy actions for development' (Aguzzoni, 2011; Roy et al., 2009). Despite the absence of common definition of fiscal space, there appears to be consensus on the types of policy actions that can be conducted or pillars of fiscal space, namely ODA, domestic revenue mobilisation, the level or debt and government expenditure (Aguzzoni, 2011; Roy et al., 2009). Governments' budgetary resources encompass tax revenues as well as other revenue sources such as revenues from their natural resources, grants or loans from donors (Beegle & Christiaensen, 2019). Fiscal space can therefore be linked in part to a country's capacity to repay its debt, which encompasses 'financing needs that are related to budget positions, access to liquid markets, resilience to valuation changes, and contingent liabilities.' (Ayhan Kose et al. 2022). The fiscal space policies pursued across developing countries to support development and contribute to poverty reduction are therefore likely to vary (Roy et al., 2009, Aguzzoni, 2011).

The literature suggests that ODA could be a preferred means to increase fiscal space in LDCs in the shorter term as its only source of financing. In contrast, domestic resource mobilising could be a sustainable source of fiscal space in developing countries. The role of the informal economy, the existence of effective governance mechanisms and the wider social contract are important factors that can disrupt the development of effective taxation systems (Aguzzoni, 2011). Tax revenues can stem from direct sources including income taxes on individuals or companies or indirect sources such as VAT, custom duties or excise taxes (Beegle & Christiaensen, 2019). According to the OECD, tax revenues in developing countries in the immediate period prior to the COVID-19 pandemic (2015-2019) were increasing very slowly (less than 1 %). It should also be noted that the decrease in tax revenue in developing countries during the COVID-19 pandemic was higher than in the aftermath of the 2008 financial crisis (OECD, 2022a). The sudden reduction of economic activities combined with reduced consumption, increase of the informal economy and decrease in tax revenue and reduction in domestic resource mobilisation (OECD, 2022a).

Given the different experiences of developing countries, it can be difficult for donors such as the EU to identify the types of policies that can most contribute to fiscal space and differentiate between those developing countries that do not have the capacity to raise taxes and mobilise domestic

resources to repay loans and are therefore more likely to rely on ODA grants to reduce poverty and those developing countries that are able to leverage their fiscal space and have some capacity to repay loans (RAND Europe interview, August 2023; Beegle & Christiaensen, 2019). The EU also provides budget support to partner countries in the form of direct grants and is often targeted at developing countries that have limited budgetary capacities (RAND Europe interview, August 2023; DG INTPA, n.d.; Pichon, 2020). EU budget support to developing countries aims at strengthening domestic resource mobilisation in developing countries and help them reduce their dependence on external financing (Stichelmans, 2016). Budgetary support from the EU is subjected to various conditions as presented in the first sub-section of this chapter. This mechanism aligns with the 'Collect More Spend Better' framework launched in 2015 by the EU in the aftermath of the AAAA to support domestic resource mobilisation as well as government spending (DG INTPA, 2023).

Additional challenges also relate to the national development banks in developing countries that lack the proper structures and are not certified to access EU funds directly. Examples of developing countries with such national development banks include South Africa, Rwanda, Ethiopia, Uganda, Senegal, but some of them are primarily focused on commercial activities. In such cases they are often dependent on intermediaries which can be EU MS development agencies (e.g., AfD, KfW) (RAND Europe interview, August 2023; Sustainable Development Goals Center for Africa, 2021). Increases in the number of these structures across developing countries could potentially reduce the role played by intermediaries in granting access to EU development financing (RAND Europe interview, August 2023).

2.2.2. Promotion of public goods through social policies

This section presents a high-level overview of the gaps identified in relation to the promotion of public goods and indirect support to human development through EU action in Developing countries. In the context of this study two specific social policies are investigated, health and education. Health and education policies in developing countries contribute to human capital development, which in turn plays a role in poverty development (Beegle & Christiaensen, 2019). According to the OECD, the share of bilateral ODA from DAC countries dedicated to the promotion of public goods has almost doubled in recent years, increasing from about 37 % for the period between 2007 and 2011 to 60 % for the period between 2017 to 2021 (Elgar et al., 2023). Globally, the share ODA allocated to health has increased since the breakout of the COVID-19 pandemic from 16.5 % in 2019 to 23.3 % in 2021 while the total of ODA for education decreased from 10.9 % to 9.7 % (UNESCO, 2023a). In 2021, EU institutions bilateral ODA to health and education respectively amounted to US$2.9 billion and US$1.3 billion (OECD, 2023).

Challenges relating to the reporting of multilateral ODA currently limits similar analysis to be conducted (Elgar et al., 2023). This trend nevertheless showcases the multiplicity and simultaneity of global challenges. Such events and shocks have also had effects on the allocation of ODA to other sectors such as education. Between 2019 and 2020, while the overall amount of development aid for education has increased, direct aid to education has decreased[26] (The World Bank & UNESCO, 2022). In 2020, the share of total ODA to the education sector represented less than 10 % while the share towards the health sector increased to nearly 20 %. (The World Bank & UNESCO, 2022). Based on recent trends, the lack of investment in the education sector in LICs, including through ODA, will prevent them from reaching the objectives of SDG 4 that specifically focuses on education out to 2030 in relation to pre-primary, primary and secondary education (Global Monitoring Education Report Team, 2023). It should also be noted that since 2018, the share of LDCs government expenditure spent on education is lower than on their debt obligations (UNCTAD, 2023).

[26] The overall development aid figure for education comprises both direct aid to education programmes and budget support (20 %). See: https://thedocs.worldbank.org/en/doc/e52f55322528903b27f1b7e61238e416-0200022022/related/EFW-2022-Jul1.pdf

A recurring gap identified in relation to promotion of public goods is the lack of collective and coordinated action hampered by the free-riding tendencies of certain actors[27] and the limited incentives or sanctions that are developed in response (Bodenstein et al., 2017; Birdsall & Diofasi, 2015). In addition, the provision of public goods in developing countries is dependent on the local fiscal space (see Section 2.2.1). The inability to raise taxes, the prevalence of the informal economy are additional exemplar challenges pertaining to the provision of public goods such as health and education (RAND Europe interview, September 2023).

Data from the WHO shows that in LICs, spending in the health sector primarily stems from external aid and out-of-pocket expenses paid directly by households to healthcare providers[28] rather than from governmental funding sources (WHO, 2021a: OECD, 2020).[29] Between 2000 and 2019, the share of external aid in the health sector increased from 16 to 29 % Over the same period, 25 % to 30 % of aid for health was directed towards LICs and LMICs (OECD, 2020). In addition, the share of government transfers decreased from 28 to 21 % (Adeyi, 2023). It should be noted that following the breakout of the COVID-19 pandemic, developing countries governments temporarily increased their budget spending towards the health sector before reducing health spending level, in some cases at lower levels than before the pandemic (Murthi, 2023; Kurowski et al., 2023). The literature suggests that development aid for health has had limited effects on the health of developing countries populations (Negeri, 2023). Furthermore, debt relief mechanisms such as the HIPC Initiative have not been successful in reducing developing countries' dependence on development aid in the health sector (Adeyi, 2023). Additional challenges limit developing countries' government's ability to mobilise resources to finance their health sector including their inability to collect domestic revenue, low tax to GDP ratios, instances of corruption, inefficiencies in funds allocated to the health sector as well as overall management issues in relation to public funding (Adeyi, 2023; Negeri, 2023). There is a lack of incentives to use development aid to support government financing of basic health services in developing countries, which contributes to their continued dependence on development aid (Adeyi, 2023).

In addition, development aid relating the health sector in developing countries focuses on the delivery of health services to local populations such as the delivery of vaccines for children, maternal care and treatment for infectious diseases like malaria that governments are not able to provide at sufficient scale. These programmes have contributed to reduce level of epidemics such as malaria, HIV or tuberculosis (Murthi, 2023). The delivery of basic health services has become the priority and other areas such as preparedness against potential pandemics, disease control and prevention, institutions dedicated to public health, regulation of pharmaceutical industries or centres for disease control are often less of a priority (Adeyi, 2023; Murthi, 2023). According to the WHO, LICs and LMICs are severely affected by non-communicable diseases. Developing countries account for

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[27] Public goods are characterised by their non-excludable and non-rival characters, all actors can benefit from public goods without impacting other actors' experience. Free-riding actors are those that do not contribute to the provision of public goods but can benefit from them. For example, vaccine immunisation can benefit populations even if some individuals do not get vaccinated. See: Chin, 2021: https://www.imf.org/en/Publications/fandd/issues/2021/12/Global-Public-Goods-Chin-basics

[28] 'Out of pocket expenditure is any direct outlay by households, including gratuities and in-kind payments, to health practitioners and suppliers of pharmaceuticals, therapeutic appliances, and other goods and services whose primary intent is to contribute to the restoration or enhancement of the health status of individuals or population groups. It is a part of private health expenditure.' See: https://databank.worldbank.org/metadataglossary/africa-development-indicators/series/SH.XPD.OOPC.TO.ZS#:~:text=Out%20of%20pocket%20expenditure%20is,of%20the%20health%20status%20of

[29] The WHO considers the World Bank country classification by income which distinguishes between High income, Upper-middle income, Lower-middle income and low income. The group of least developed countries is determined by the UN Committee for Development Policy (CDP) every three years and considers three criteria: income, the human assets index and the economic and environmental vulnerability index. See: https://unctad.org/press-material/what-are-least-developed-countries-9

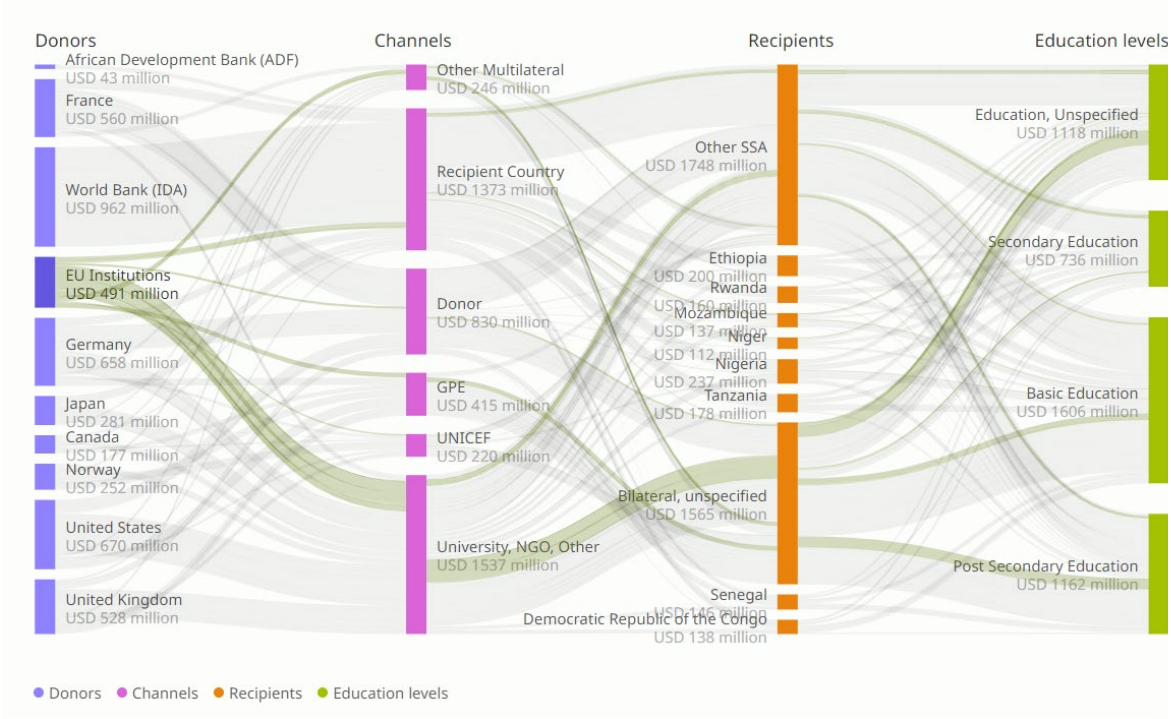
77 % of deaths from non-communicable diseases worldwide (WHO, 2023). Donors often condition health development financing to specific products and/or services to developing countries while the potential benefits from strengthening health systems at large would help developing countries reduce their dependence on foreign aid (Adeyi, 2023; Murthi, 2023).

Over the last 20 years, education funding in LICs continues to be split between government funding (about 50 %), households (about 35 %) and external aid (about 15 %) (The World Bank & UNESCO, 2022). It should be noted that the share of education spending shouldered by households in LICs varies greatly between countries. For example, households in Liberia fund over 73 % of education spending compared to about 40 % in Sudan or 10 % in Mozambique or Burundi (The World Bank & UNESCO, 2022). Household spending in education can relate the cost of uniforms, school supplies, transport or tuition fees (UNESCO, 2021). It should also be noted that data availability in relation to government spending in education remains patchy and uneven (The World Bank & UNESCO, 2022).

Overarching challenges pertaining to human capital relate to the slow pace at which change is taking place. It not only takes time to implement health (e.g., vaccines and immunisation programmes) and education programmes (e.g., literacy or universal primary education programmes) but the effects of the measures or policies put in place are only likely to visible after a generation (Beegle & Christiaensen, 2019).

Another noticeable challenge pertaining to education, is the lack of funding to fulfil the SDG objective by 2030. According to UNESCO, even if various successive assumptions are met, the financing gap for education would be reduced only by about 30 %. The successive assumptions include: (i) the 0,7 % ODA target is met; (ii) 12 % of the total amount of ODA is dedicated to education; (iii) 90 % of that share is spent on basic and secondary education; and (iv) aid to education is exclusively targeted towards LICs and LMICs (UNESCO, 2023b; RAND Europe interview, 2023b). It should also be noted that 10 % of EU institutions ODA is aimed at basic education. In sub-Saharan Africa where most LDCs are located, EU institutions ODA is focused more on post-secondary education than basic education as shown in Figure 2.8 below (RAND Europe interview – October 2023; UNESCO, 2023a).

Figure 2.8 – ODA to education in sub-Saharan Africa



Source: UNESCO, 2023a

Human development topics, including health and education have been integrated in EU instruments seeking to reduce poverty in developing countries such as the NDICI – Global Europe and Global Gateway initiatives. In the context of the EU-Africa: Global Investment Package, projects related to health issues pertain to vaccines (e.g., production, infrastructure, human resources, skills). An illustration is presented in the case study below. In the education sector, investments aim to support children's literacy as well as teachers' competence and capacities (European Commission, 2022a).

As part of the NDICI – Global Europe, €4.4 billion is planned to be spent on global health programmes from the local to global levels (Leclerc, 2023). There is a recognition however that the level of EU development financing towards these issues remains insufficient despite increases in the years prior to the breakout of the COVID-19 pandemic. According to the NDICI – Global Europe 20 % of EU ODA should be spent on human development (Claros, 2019; Chahri, 2021). In recent years, developing countries have increasing reliance on development aid to their health sector while their own expenditures in this sector have decreased (Adeyi, 2023).

Case study: Capacity building in the health sector - TEI on manufacturing and access to vaccines, medicines and health technologies in Africa

African nations need to enhance the effectiveness of their public sectors in order to attain the objectives of addressing multidimensional poverty, expediting economic expansion and delivering improved services to their populations. Achieving this enhanced performance will necessitate countries to combine reforms with sustained capacity building (World Bank, 2005).

Investments in capacity building in the sectors of infrastructure, health and education are crucial for LDCs, in order to maintain a health and nutritional status that ensure both the wellbeing and productivity of individuals as well as functional literacy and numeracy of the general population.

International bodies and organisations, such as the World Bank or the EU institutions, among others, have supported a significant number of capacity building interventions in LDCs, especially in Africa.

The discourse on capacity development has always been closely associated with development cooperation, and capacity building investments were often tightened through ODA flows. More recently, private finance has gained significant importance with ODA and domestic resource mobilisation as a tool to develop and increase capacity building in LDCs, creating new opportunities to mobilise resources.

In terms of health, the past decade has seen a shift towards communicable diseases with first the Ebola outbreak in 2015, which highlighted a lack of capacity to respond to a severe, prolonged, and widely spread public health crisis. Exceeding €1 billion in total, the EU has made a significant financial contribution to combat the epidemic, around half of which was funded by the European Commission both for immediate emergency measures and long-term support (European Commission, 2014).

The COVID-19 pandemic, even though less virulent in Africa than in Western Europe or North America, has amplified further the importance of capacity building in LDCs, especially in terms of vaccines development, production and distribution. During the pandemic, Team Europe has been one of the biggest contributors to the COVAX initiative to support developing countries.

Furthermore, in an effort of strengthening further African partners in the development of health infrastructure and resources, a Team Europe Initiative was launched in 2021 on manufacturing and access to vaccines, medicines and health technologies in Africa. The aim is to target development goals and geo-political priorities through supporting access to essential health products and technologies, with an initial budget of €1 billion from the EU budget and European development finance institutions (European Commission, n.d.a).

This Team Europe Initiative is taking place at both the country and continental levels. For instance, one of the first projects supported by the EU through this initiative is the MADIBA (Manufacturing in Africa for Disease Immunization and Building Autonomy) project led by Institut Pasteur in Senegal. The country's situation during the COVID-19 pandemic was the image of vaccine inequality in Africa, with more than 92 % of the continent's population not vaccinated by the end of 2021 (Borgen Project, n.d). In Senegal, around 40 % of the population was estimated to be living in poverty, and 75 % of families suffering from chronic poverty (World Food Programme, n.d.). The MADIBA project aims at constructing a vaccine manufacturing facility in Senegal, which could in the long run, provide the local population with vaccines against endemic diseases such as the yellow fever, but also childhood diseases like polio or rubella (Borgen Project, n.d.).

As such, it targets poverty reduction through an improvement of public health in the region and hence a reduction in maternal and child mortality rates. As acknowledged by the UNDP, a lack of vaccine equity is associated with the widening of the poverty gap (World Bank, 2023). In addition, this is also an opportunity for creating jobs, lowering unemployment rates and potentially impacting economic growth. Indeed, the Institut Pasteur de Dakar intends to develop a specific curriculum tailored to train young vaccine scientists from the country, aiming to achieve a 40 % representation of female trainees (Okwatch, 2023). As mentioned by the EIB Vice-President Ambroise Fayolle, 'This project is also a concrete example of the European Union's joint approach in Africa through Team Europe' (European Investment Bank, 2022).

Another significant implementation as part of this TEI at the continental level is the establishment of the African Medicines Agency (AMA), among others. AMA will be the second continental health agency after the Africa Centres for Disease Control and Prevention (Africa CDC). The AMA treaty came into effect in 2021,

and as of today, it has been signed and ratified by 37 and 26 member states of the African Union, respectively (Health Policy Watch, n.d).

Overall, recent global health crises have emphasised a lack of necessary infrastructure and resources to respond to an outbreak, as well as the global need for capacity building in terms of disease surveillance, vaccination and strengthening of health systems in order to address poverty in LDCs in the long term.

Case study: Capacity building in the education sector – Erasmus+ Capacity Building in Morocco

Another highly relevant sector for capacity-building in developing countries, including LMICs, is education. It is, just as health, a widely recognised component of multidimensional poverty through educational attainment and enrolment.

In most African countries, primary education is not yet universal and widespread, and adult illiteracy is common; and hence capacity building is needed in terms of infrastructure, trainings and securing skilled workers. One of the main EU actions to support education is through the Erasmus+ programme, which is the EU programme for education, training, youth and sport and offers opportunities for both individuals and organisations.

While the programme is mainly known for learning mobility opportunities, it also offers cooperation opportunities between organisations and institutions, and support for policy reform. While designed and implemented mainly for EU countries, some third countries can take part in specific actions of the programme, subject to conditions – this is the case of most LDCs and LICs.

More specifically, such projects include capacity-building projects in the fields of higher education, youth, and vocational education and training (VET). For instance, the Capacity Building in the field of Higher Education (CBHE) action of the Erasmus+ programme funds cooperation projects aimed at developing higher education institutions and educations systems in the partner countries. These projects are based on multilateral partnerships and are the results of calls for proposals. Between 2015 and 2020, more than 900 projects were implemented, with Asia and the South Mediterranean region being the main receivers with 27 % and 22 % of the budget, respectively (European Commission, 2022b).

Morocco has long been involved in the Erasmus+ programme, both through the international credit mobility, accounting for 17 % of the total South Mediterranean budget, and the CBHE program (European Commission, 2020b). Regarding the latter, Morocco ranks 3rd in terms of participation in CBHE projects in the South Mediterranean region between 2015 and 2019, after Jordan and Egypt (Ibid.). These projects are expected to have an impact both in the short and long run on the higher education system, institutions as well as individuals; and, consequently on socio-economic factors such as employment, innovation, internationalisation, ultimately yielding economic growth and human development (Daadaoui and Ghanimi, 2023).

For instance, in 2015, and in parallel with Tunisia, Algeria and Jordan, the country participated in the RISE project, 'Modernising human Resource management In South Mediterranean Higher Education', providing local population structured training programmes and conferences to improve people management. On the same year, Morocco joined the MIMIr programme, Modernisation of Institutional Management of Innovation and Research in South Neighbouring Countries, simultaneously with Jordan. The project contributed to the mapping of innovation and research structures and strategies in the countries, further helping and supporting the exchange of information among stakeholders (European Commission, 2020c). Another example if the OpenMed project, 'A bottom-up approach for opening up education in South-Mediterranean countries', which resulted in the establishment of 'Innovation Centres for Open Education', the delivery of specific training courses and the development of a networks aiming at supporting the co-creation of knowledge from a regional perspective (Ibid).

Overall, the Erasmus+ projects have contributed to advancements in the area in the country, both at the system and institutions level through the initiation of new reflections, the setting up of mechanisms, and the inspiration of laws or reforms (Daadaoui and Ghanimi, 2023). Indeed, as highlighted in a report presenting the views of partners on the structural impact of the Erasmus+ CBHE programs, the MIMIr

project led to the creation of innovation centres and a doctoral school, the SATELIT30 project has allowed the creation of university centres for technology transfer, and the INCITE project has contributed to includes the role of university in the country's governance (Bunescu et al., 2021).

Other challenges can pertain to the changing priorities of donors to focus less on public goods or to change health or education priorities from vaccination to non-communicable diseases. (RAND Europe interview, September 2023). At the EU level, there have been concerns with the redirection of development aid to fund programmes to address migration flows in EU MS (Chahri, 2021; Beegle & Christiaensen, 2019; RAND Europe interview, August 2023)

In 2022, the European Commission launched its second Global Health Strategy, which aims at placing health at the centre of the EU's external action through three pillars: better health throughout life, the strengthening of health systems and universal health coverage (Leclerc, 2023). However, the literature suggests that concerns have emerged. For example, the implementation of this strategy requires increase coordination between various actors (including non-state and local actors such as NGOs and CSOs) as well as the mobilisation of a variety of sectors (e.g., energy, nutrition and food security, trade, climate change). Coordination at the EU level on health remains insufficient and lack coherence (Leclerc, 2023; Pichon 2020).

2.2.3. Potential impact of identified gaps and challenges in developing countries

The specific impact of the abovementioned gaps on developing countries and poverty reduction are difficult to assess with precision. This is due in part to the recent nature of various EU actions and mechanisms that have been developed and launched. For example, the new global taxation framework is yet to come fully into force and the number of signatories among developing countries remains limited, namely only half of the countries on the African continent are parties to the new framework and others have so far declined to sign (MacCarthy, 2022; OECD, 2021).

In addition, the NDICI – Global Europe, the Global Gateway and the TEIs have only been put in place in the last couple years. The ongoing mid-term evaluation of the NDICI-Global Europe will seek to assess 'the instrument's efficiency, relevance, coherence and potential areas of improvement for future external instruments after 2027'. The evaluation will feed into the instrument's mid-term review that is conducted in parallel and expected to be published in early 2024 (Jones, 2023). Evaluations of development programmes stemming from these have yet to be published, including to establish comparisons with previous instruments. For example, there is a perception that the disappearance of the EDF has led to increased difficulties for developing countries seeking to apply for EU development funding. In addition, if developing countries no longer have the capacity to access EU development programmes, the impact on levels of poverty at the local or national level could be severe (RAND Europe interview, August 2023).

These changes could also reduce the trust developing countries have in the EU as a leading development actor (Gavas & Pérez, 2022). The size, complexity and administrative burden of EU development aid could also limit the ability of smaller actors within developing countries to take part in programmes or TEIs. As a result, this could lead to the implementation of larger development programmes that have limited impact on poverty reduction compared to smaller and more targeted ones (RAND Europe interview, August 2023).

[30] Solutions Académiques pour le Territoire Euro-méditerranéen Leader d'Innovations et Transferts technologiques d'excellence.

Increased conditions attached to the delivery of EU development aid and stemming from the PCD could also disrupt poverty reduction in developing countries that are already subject to sudden regime change (Pichon, 2020: Latek, 2019).

It should also be mentioned that the gaps and challenges explored in this section are likely to impact infant mortality rates in developing countries, contributing to maintain low HDI scores. This is further explored in the next chapter.

3. Quantification of the links between ODA, taxation, debt relief mechanisms and poverty alleviation and related policy scenarios

3.1. The links between government initiatives and poverty outcomes

The relationship between aid conditionality and the effectiveness of ODA in poverty reduction is documented in multiple studies, such as those by Collier and Dollar (2001, 2002, 2004) and Mosley et al. (2004). These studies suggest that the effectiveness of aid is contingent on the presence of specific factors, often referred to as 'pro-poor' policies. Within the same context, 'Pro-poor public social spending' (SDG indicator 1.b.1) refers to public spending that targets key social issues, most notably health and education expenditure (UNICEF, 2023). Inspired by this body of research, and further informed by studies that underscore the significance of public expenditure in elucidating the indirect association of ODA with poverty (e.g., Gomanee et al., 2003; Yontcheva and Masud, 2005; Gomanee et al., 2005), this study utilises a two-stage analytical approach. This approach examines the association of government expenditures with poverty alleviation, particularly through education and health channels, which are central to this study. Consequently, the study delves into the complex interplay between ODA and government expenditure in essential sectors vital for poverty reduction.

The two-stage modelling framework is designed to probe the indirect relationship of three key variables (i.e., ODA, the debt to GDP ratio and the government revenues to GDP ratio) with multidimensional poverty. This framework enables an examination of the complex dimensions underpinning developmental policies and government-led collective actions in this context.

It is important to recognise that development finance initiatives don't always translate into poverty alleviation initiatives in recipient countries. For instance, there are cases where ODA has been utilised for purposes like accommodating migrants in the donor countries, as noted by Oxfam (2023), or instances of funds being misdirected, as highlighted by Andersen et al. (2022).

The present study draws on a range of data sources, inclusive of the OECD, World Bank, UNDP, the International Monetary Fund (IMF), and UNU-WIDER. The dataset for this study combined information about ODA flows, government revenues, debt situations, and other variables. The basis for the construction on this dataset was metadata on 'ODA disbursements to countries and regions' from the Organisation for Economic Cooperation and Development (OECD).[31] ODA is one of the main tools that developed countries and institutions use to support developing countries, and the EU is one of the biggest contributors of ODA. The OECD data collected encompasses details on the nature of the parties involved, including both recipients and donor countries (including both EU27 and other donors), whether they are countries or institutions, as well as the type of aid[32], between 1960 and 2021. This metadata presents the geographical distribution of bilateral and multilateral disbursements of official development assistance flows to developing countries and territories on the DAC list of ODA Recipients and multilateral organisations that are ODA-eligible. The extracted data encompasses 82 low-income countries (LICs) and lower middle-income countries (LMICs) with positive net ODA, including 46 LDCs. However, due to data constraints, the cleaned dataset which

[31] See Table DAC2a at https://stats.oecd.org/Index.aspx?DataSetCode=Table2A

[32] ODA can take the form of either grants (countries are provided with financial resources out of interest and no provision for repayments), or loans (countries have to repay with interest). For further explanation, see: https://www.oecd.org/dac/financing-sustainable-development/development-finance-standards/What-is-ODA.pdfbn

was effectively utilised for the analyses covers 48 countries in total, out of which 23 are LDCs, spanning the years 2000-2021. The dataset on public expenditure is specifically limited at the lower end, with data only available from the year 2000 onwards. The analysis incorporates both LDCs and other net-positive ODA recipients (some LMICs) to ensure a sufficiently large number of observations. Country classifications are controlled in the regression analyses to account for the differences between LDCs and other LMICs.

The following paragraphs detail the two-stages methodology, presents the derived results and introduces three policy scenarios and their corresponding estimates.

3.1.1. First Stage: Financial and development initiatives and public expenditure

The initial focus gravitates towards assessing the implications of key development initiatives, namely development aid, debt relief initiatives, and the government revenue flow. These initiatives all contribute to enhancing fiscal space, as defined by Heller (2005) as the room in a government's budget that allows it to provide resources for a desired purpose without jeopardising the sustainability of its financial position or the stability of the economy. These are represented in the analysis by ODA, the debt to GDP ratio and the government revenues to GDP ratio. This approach aligns with the literature on the conditionality of aid, suggesting that aid initiatives are more effective in alleviating poverty when aligned with government policies and objectives focused on poverty reduction. For instance, ODA allocated for hosting immigrants in donor countries (Pope and Weisner, 2023), as opposed to direct development initiatives in recipient countries, might not align with the fundamental assumptions of ODA effectiveness. The goal of the first stage of the analysis is to understand the relationship between the three key development factors with state-driven initiatives, with a focus on public health and education.

To understand the relationship between development initiatives and governments' policy towards health and education, this study utilises spending on health and education as indicative metrics. This enables gaining insight into government commitment and resource allocation towards these vital sectors. Additionally, the present study looks into military expenditure, enriching the analysis by spotlighting the spending priorities of numerous developing nations and elucidating the delicate equilibrium of governmental choices.

The regression analysis in the initial stage facilitates predictions for three specific sectoral expenditures: health, social, and military. These predicted values are then utilised in the second stage of the analysis, which concentrates on exploring the relationship between these expenditure variables with poverty measures. This method enables an examination and understanding of the indirect association that development initiatives have with poverty metrics.

3.1.2. Second stage: Relationship with multidimensional poverty

Following the first stage, attention is then shifted to the societal repercussions stemming from government expenditures. The aim is to explore the relationship between variations in health, education and military expenditure (as predicted in the first stage) and two outcome metrics: infant mortality rates (out of 1000 births) and the HDI.

Infant mortality rates, deeply intertwined with poverty in developing nations, offer insights into population health and well-being. The relationship between child mortality and ODA is likely not a direct relationship, as money itself is not an intervention; it is what the money is used to do that is contributing to reductions in child mortality. Therefore, many of the same arguments found in previous studies apply; aid is a useful tool if it is used by the right hands. Good governance and adequate infrastructure are still requirements for aid to be effective.

Moreover, HDI, with its multidimensional facets, emerges as an instrumental tool in gauging the intricate nexus between development and poverty. By assessing life expectancy, education and economic prosperity, HDI pinpoints areas considered most relevant for development interventions.

Technical aspects and methodology

The methodology underlying the two-stage model, which is inspired by existing literature (Gomanee et al., 2003; Yontcheva and Masud, 2005; Gomanee et al., 2005) and designed to provide an analytical framework for capturing the complexity of the interactions between economic levers and social outcomes. The approach leverages statistical techniques and econometric models to draw meaningful conclusions and insights from the data. By employing this two-stage model, the present study seeks to offer a practical approach to understand the indirect relationship between development initiatives and multidimensional poverty. This will enable policymakers and stakeholders to devise more effective and targeted interventions for sustainable development.

Considering the persistent nature of government expenditure, where prior values strongly influence current ones, the model controls for the expenditure in the previous year. For robustness of analysis, especially amidst diverse data scales, all variables undergo log-transformation. Furthermore, all independent variables are used in their previous year's values (or as called lagged), enabling the discernment of delayed effects and mitigating endogeneity concerns – a situation where there is a risk that two variables may influence each other simultaneously. Errors are clustered at the recipient country level to account for potential correlations within groups of observations that share a common characteristic – namely, the recipient country.

Application

In the first stage, three equations targeting health, education, and military expenditure are estimated. Three main specifications are estimated for Equations 1-3, namely (i) dependent variables and all independent variables with no controls, (ii) similar to (i) but with an addition of controls for country classification (LDCs or other LMICs), and (iii) similar to (ii) but with addition of country and year fixed effects. This sets the stage for estimating the outcome variables for implementation in the second-stage. The first regression equation is described as the following:

$$HE_{it} = \alpha + \beta_0 HE_{it-1} + \beta_1 BOE_{it-1} + \beta_2 BOE_{it-2} + \beta_3 MOE_{it-1} + \beta_4 MOE_{it-2} + \beta_5 ONE_{it-1} + \beta_6 ONE_{it-2} + \beta_7 DTG_{it-1} + \beta_8 GR_{it-1} + \beta_9 Z_{it-1} + \gamma_i + \delta_t + \epsilon_{it}$$ ***(Equation 1)***

BOE is bilateral ODA per capita from EU Member States in real terms, *MOE* is ODA per capita from the EU institutions (labelled as bi/multi EU ODA) in real terms. *ONE* is ODA from non-European states or organisations. The regression analyses exclude ODA to multilateral organisations. This exclusion is due to the regression model's focus on controlling for characteristics specific to recipient entities, which aren't applicable in the case of multilateral organisations. Moreover, *DTG* is the debt to GDP ratio, *GR* is government revenue, *Z* represents other controls such as country classification dummies (LDCs or other LMICs) to differentiate between LDCs and other LMICs. These dummies allow us to control for distinct attributes and development challenges that are unique to LDCs in contrast to their LMIC counterparts. Diagnostic tests affirmed the model's robustness and fit, demonstrating that the current number and quality of observations sufficiently support the model without the need for extra control variables. Moreover, γ_i, δ_t are controls for country and time fixed effects. Adding country fixed effects controls for all unobserved, time-invariant characteristics of each country that could affect the outcome variable. This means any constant differences between countries, such as geography or culture, are accounted for, allowing for a clearer analysis of the effects of variables that do change over time. Time fixed effects control for global shocks or trends that affect all countries in the same period, such as the financial crisis of 2008 or the COVID crisis of

2020. By including these fixed effects, the analysis can isolate the impact of the independent variables from these common temporal effects. Together, country and time fixed effects help to ensure that the variation being analysed is due to the factors of interest rather than omitted variables that vary across countries or over time.

Government revenue availability plays a pivotal role in determining health expenditure. When this revenue dwindles due to challenges like economic downturns or other fiscal strains, the budget for health spending typically contracts. In such circumstances, governments may be compelled to seek alternative funding sources or adopt strategies that boost efficiency to guarantee adequate health outlays. Such investments are vital for upholding public health standards and managing health emergencies effectively.

Additionally, health expenditure is anticipated to be positively correlated with ODA amounts. As ODA is predominantly channelled towards addressing health and social challenges, it stands to reason that governments would allocate these funds accordingly. However, it is important to note that the impact of ODA on government spending might not be immediate. To delve deeper into the influence of ODA from the EU, this study differentiates between bilateral and bi/multi flows originating from the EU.

Table 3.1 – Estimates of equation 1 (health expenditure per capita)

Health Expenditure per capita	Specification (i)	Specification (ii)	Specification(iii)
Health expenditure pc (t-1)	0.956***	0.943***	0.793***
	(78.85)	(61.32)	(20.78)
Bilateral EU ODA pc (t-1)	-0.0182*	-0.0200*	-0.00158
	(-1.83)	(-1.99)	(-0.13)
Bilateral EU ODA pc (t-2)	0.0310***	0.0306***	0.0276***
	(2.99)	(3.04)	(3.55)
Bi/Multi EU ODA pc (t-1)	-0.00753	-0.00569	0.00728
	(-0.54)	(-0.42)	(0.54)
Bi/Multi EU ODA pc (t-2)	0.0140	0.0158	0.0283**
	(1.03)	(1.16)	(2.14)
ODA non-EU pc (t-1)	0.00635	0.00744	0.00837
	(0.96)	(1.13)	(0.64)
ODA non-EU pc (t-2)	-0.0239***	-0.0231***	-0.00948
	(-3.19)	(-3.14)	(-1.54)
Government revenue (%GDP) (t-1)	0.0568***	0.0584***	0.117**
	(3.12)	(2.90)	(2.42)
Debt to GDP (%) (t-1)	0.000691	-0.00388	-0.00465
	(0.07)	(-0.35)	(-0.22)
_cons	0.0834	0.125*	0.289
	(1.38)	(1.96)	(1.64)
Country classification	No	Yes	Yes
Country and Year FEs	No	No	Yes

Health Expenditure per capita	Specification (i)	Specification (ii)	Specification(iii)
R-squared	0.974	0.974	0.982
N	616	616	616

Source: RAND Europe.

Note: All variables are log transformed (natural logarithm). t statistics in parentheses. ***,' **and *denote significance at 1 per cent, 5 per cent and 10 per cent respectively, based on t-ratios using standard errors clustered at the country level to reduce the bias in standard errors

The findings from Equation 1 are detailed in Table 3.1 above. Specification (iii) emerges as the model of choice, with superior diagnostic scores indicating a more favourable balance between model fit and complexity. The results in this specification suggests that EU's ODA is associated with lower infant mortality rates, but with a lag of two years. While the estimates from the first stage are not intended for immediate interpretation, preliminary results suggest that a 1 % increase in ODA from EU countries is associated with almost 0.03 % rise in health expenditure within recipient nations (same for ODA from EU organisations). Other primary variables align with the expectations, with government revenue exerting a potent positive influence. Moreover, the estimations demonstrate good explanatory and predictive powers.

The second equation looks into expenditure on education. Table 3.2 below reports the parameter estimates from estimating Equation 2. The leading model, specification (iii), exhibits good explanatory and predictive capabilities. ODA from the EU seems to exert a similarly positive impact on education as it does on health, with a marginally greater coefficient of slightly over 0.03 % for each 1 % increase in ODA. It appears that debt is especially an important factor affecting the decision to spend on education, where 1 % increase in debt is associated with more than 0.05 % reduction in per capita education expenditure.

$$EE_{it} = \alpha + \beta_0 EE_{it-1} + \beta_1 BOE_{it-1} + \beta_2 BOE_{it-2} + \beta_3 MOE_{it-1} + \beta_4 MOE_{it-2} + \beta_5 ONE_{it-1} + \beta_6 ONE_{it-2} + \beta_7 DTG_{it-1} + \beta_8 GR_{it-1} + \beta_9 Z_{it-1} + \gamma_i + \delta_t + \epsilon_{it}$$ ***Equation 2)***

Education, particularly in developing countries, is predominantly financed by public resources. An increase in a nation's external debt can influence its fiscal policies, often leading to fiscal consolidation. This policy is primarily aimed at curbing the fiscal deficit and reducing debt accumulation. Fiscal consolidation can be achieved through various methods, such as inflation targeting, financial repression, debt default, or restructuring. However, empirical data from multiple countries indicates that expenditure reduction is more effective than tax-based consolidations (Miningou, 2023a), therefore its more commonly exercised.

The vulnerability of educational spending to changes in debt levels is notably high. For instance, a 1 % increase in the debt-to-reserve ratio can increase the likelihood of a decline in total government expenditure relative to revenue by 0.25 percentage points. More alarmingly, a mere 1 % surge in external debt can result in a 2.9 % decrease in education spending per school-age child (Miningou, 2023b). It is important to note that the observed 0.05 % reduction in education expenditure, resulting from a 1 % increase in debt as identified in this study, pertains to per capita spending (total population), rather than per school-age child spending. A more pronounced relationship between debt and child spending can be logically assumed. This sensitivity makes educational funding a potential target when governments seek to adjust fiscal imbalances, especially in the wake of heightened debt levels brought about by unforeseen challenges like the pandemic.

Countries with significant developmental hurdles, such as those in Sub-Saharan Africa and other LICs, are particularly susceptible to these fiscal pressures. The rising debt levels put them at an

elevated risk of fiscal consolidation, which can further jeopardise their educational investments. In understanding these economic realities, it is imperative for policymakers to craft strategies that ensure consistent investment in human capital. In this context, carefully designed debt relief initiatives could serve as a pivotal mechanism to mitigate these fiscal challenges. Specifically, such measures can provide a pathway to reduce debt distress, thereby freeing up resources that can be reinvested into vital areas like education, offsetting the negative impacts of stringent fiscal consolidation.

Table 3.2 – Estimates of equation 2 (education per capita)

Education Expenditure per capita	Specification (i)	Specification (ii)	Specification(iii)
Education expenditure pc (t-1)	0.978***	0.966***	0.813***
	(115.05)	(77.27)	(22.60)
Bilateral EU ODA pc (t-1)	-0.0474**	-0.0486**	-0.0292
	(-2.64)	(-2.62)	(-1.53)
Bilateral EU ODA pc (t-2)	0.0525***	0.0506***	0.0316*
	(2.84)	(2.73)	(1.70)
Bi/Multi EU ODA pc (t-1)	0.00678	0.00902	0.0326*
	(0.43)	(0.54)	(1.74)
Bi/Multi EU ODA pc (t-2)	-0.00373	-0.00175	0.0155
	(-0.22)	(-0.11)	(1.18)
ODA non-EU pc (t-1)	0.0157	0.0179*	0.00334
	(1.51)	(1.72)	(0.28)
ODA non-EU pc (t-2)	-0.0236**	-0.0219**	-0.0143
	(-2.55)	(-2.35)	(-1.05)
Government revenue (%GDP) (t-1)	0.00459	0.0100	0.0136
	(0.26)	(0.55)	(0.21)
Debt to GDP (%) (t-1)	-0.0137	-0.0176	-0.0527***
	(-0.95)	(-1.18)	(-2.74)
_cons	0.174**	0.183**	0.437**
	(2.60)	(2.63)	(2.42)
Country classification	No	Yes	Yes
Country and Year FEs	No	No	Yes
R-squared	0.973	0.973	0.981
N	565	565	565

Source: RAND Europe.

Note: All variables are log transformed (natural logarithm). t statistics in parentheses. ***, ** and * denote significance at 1 percent, 5 percent and 10 percent respectively, based on t-ratios using standard errors clustered at the country level to reduce the bias in standard errors.

While the focus of this study in on public goods expenditure, particularly health and education, and the impact of development initiatives to affects them, this study also includes military expenditure in the analysis. This is on the grounds that military spending is argued to have a complex relationship

with poverty measures: it might boost economic growth following the Keynesian perspective, where all government spending components lead to growth (Keynes, 1963; Lin et al., 2015). However, it can also divert resources away from poverty alleviation programs and development initiatives. Evidence suggests that the effect's direction may be linked to the context and the country's level of development (Brauer, 1996; Gomez-Trueba Santamaria, 2021). For example, the crowding out effect has been explored and confirmed in a study on Egypt, where Elish et al. (2023) finds that military spending negatively affect economic growth. The third equation of the first stage is then presented as:

$$ME_{it} = \alpha + \beta_0 ME_{it-1} + \beta_1 BOE_{it-1} + \beta_2 BOE_{it-2} + \beta_3 MOE_{it-1} + \beta_4 MOE_{it-2} + \beta_5 ONE_{it-1} + \beta_6 ONE_{it-2} + \beta_7 DTG_{it-1} + \beta_8 GR_{it-1} + \beta_9 Z_{it-1} + \gamma_i + \delta_t + \epsilon_{it}$$ ***(Equation 3)***

Table 3.3 – Estimates of equation 3 (military expenditure per capita)

Military Expenditure per capita	Specification (i)	Specification (ii)	Specification(iii)
Military expenditure pc (t-1)	0.974***	0.973***	0.906***
	(46.12)	(41.98)	(13.52)
Bilateral EU ODA pc (t-1)	-0.0258	-0.0259	-0.0191
	(-1.39)	(-1.40)	(-1.01)
Bilateral EU ODA pc (t-2)	0.0314*	0.0313*	0.0206
	(1.93)	(1.90)	(1.17)
Bi/MultiEU ODA pc (t-1)	-0.00454	-0.00445	0.00697
	(-0.31)	(-0.30)	(0.47)
Bi/Multi EU ODA pc (t-2)	0.00239	0.00260	0.0147
	(0.14)	(0.15)	(0.78)
ODA non-EU pc (t-1)	0.00170	0.00179	0.00699
	(0.18)	(0.18)	(0.58)
ODA non-EU pc (t-2)	-0.0217	-0.0217	-0.0113
	(-1.18)	(-1.17)	(-0.56)
Government revenue (%GDP) (t-1)	0.0140	0.0137	0.0126
	(0.34)	(0.35)	(0.18)
Debt to GDP (%) (t-1)	0.00203	0.00182	0.0410
	(0.13)	(0.11)	(1.12)
_cons	0.122*	0.123*	-0.0739
	(1.82)	(1.83)	(-0.59)
Country classification	No	Yes	Yes
Country and Year FEs	No	No	Yes
R-squared	0.955	0.955	0.964
N	869	869	869

Source: RAND Europe.

Note: All variables are log transformed (natural logarithm). t statistics in parentheses. ***, ** and * denote significance at 1 percent, 5 percent and 10 percent respectively, based on t-ratios using standard errors clustered at the country level to reduce the bias in standard errors.

Based on the results presented in the table for Equation 3 (Table 3.3), it appears that military expenditure is not associated with ODA from the EU, debt-to-GDP ratio, or government revenue. This lack of correlation might stem from the defence and security-focused nature of military expenditure, which could operate independent of fiscal space. Moreover, aid is often directed towards specific public good targets, generally with conditionality attached to it.

In the second stage, as previously detailed, the objective is to assess the relationship between health, education, and military sector expenditures with multi-dimensional poverty indicators. In the initial stage, these expenditure variables were analysed as dependent or outcome variables within regression Equations 1-3. Now, for the current stage, the predicted values of these expenditures – obtained from the first stage – have been transitioned to serve as independent variables. These predictors are then employed on the right-hand side of Equations 4-5 for further analysis. This study is specifically looking to gauge their relationship with key poverty metrics, such as Infant Mortality and the HDI. As the expenditure predictions are based on one- and two-year lagged values, there is no requirement in the second-stage equations to control for data beyond the previous year's figures. The analysis commences with the estimates for infant mortality.

$$IM_{it} = \alpha + \varphi_1 \widehat{HE}_{it-1} + \varphi_2 \widehat{EE}_{it-1} + \varphi_3 \widehat{ME}_{it-1} + \varphi_4 Z_{it-1} + \gamma_i + \delta_t + \varepsilon_{it} \qquad \textbf{(Equation 4)}$$

Where, IM_{it} denotes the infant mortality rate (out of 1,000 new births), while $\widehat{HE}_{it-1}$, $\widehat{EE}_{it-1}$, and $\widehat{ME}_{it-1}$ represent the predicted expenditures for health, education, and military sectors from the previous year, respectively. Furthermore, Z represents other controls such as country classification dummies (LDCs or other LMICs), real GDP growth, and urban population share. Lastly, γ_i and δ_t capture the country and time fixed effects respectively. The estimated results in Table 3.4 match well with expectations. Both health and education spending play a role in reducing infant mortality rates. However, military spending does not show a significant effect, suggesting no effect on infant mortality rates. Specification (iii), which is the full fixed effects model with controls, is the optimal strategy which exhibits high explanatory and predictive power.

Table 3.4 – Estimates of equation 4

Infant mortality (per 1000 births)	Specification (i)	Specification (ii)	Specification(iii)
Health expenditure pc (t-1)	-0.492***	-0.456***	-0.0856***
	(-9.46)	(-9.84)	(-2.73)
Education expenditure pc (t-1)	-0.0384	0.0705	-0.0479**
	(-0.80)	(1.35)	(-2.13)
Military expenditure pc (t-1)	0.0269	0.0110	-0.0311
	(0.71)	(0.33)	(-1.42)
_cons	5.721***	5.365***	2.961***
	(61.76)	(51.96)	(6.12)
Other controls[33]	No	Yes	Yes
Country and Year FEs	No	No	Yes
R-squared	0.476	0.529	0.991
N	444	4444	444

Source: RAND Europe.

Note: All variables are log transformed (natural logarithm). t statistics in parentheses. ***, ** and * denote significance at 1 percent, 5 percent and 10 percent respectively, based on t-ratios using standard errors clustered at the country level to reduce the bias in standard errors.

The last step for setting up the foundations for the scenario analysis is exploring the relationship between health, education, and military expenditures and an alternative measure of multi-dimensional poverty, HDI. Equation 5 depicts this regression:

$$HDI_{it} = \alpha + \varphi_1 \widehat{HE}_{it-1} + \varphi_2 \widehat{EE}_{it-1} + \varphi_3 \widehat{ME}_{it-1} + \beta_9 Z_{it-1} + \gamma_i + \delta_t + \varepsilon_{it} \qquad \textbf{(Equation 5)}$$

The insights derived from Equation 5 and presented in Table 3.5, favours the full fixed effects model with controls. The results indicate that government spending on health and education sectors are positively associated with the HDI. A higher HDI score signifies improved general wellbeing and reduced multi-dimensional poverty. The findings align well with our expectations. The findings do not substantiate the proposed trade-off (Elish et al., 2023) nor align with Keynesian theory (Keynes, 1963; Lin et al., 2015) concerning the link between military expenditure and poverty alleviation. Instead, they align more closely with research indicating a nuanced relationship between military spending and the HDI, a relationship that differs based on individual country contexts and stages of development (Brauer, 1996; Gomez-Trueba Santamaria, 2021).

[33] In specification (ii), the controls used are dummy variables for LDCs and non-LDC LMICs. For specification (iii), these dummies are included alongside controls for real GDP growth and the share of the urban population.

Table 3.5 –Estimates of equation 5

HDI	Specification (i)	Specification (ii)	Specification(iii)
Health expenditure pc (t-1)	0.0264***	0.0216***	0.00687*
	(4.95)	(4.69)	(1.96)
Education expenditure pc (t-1)	0.0242***	0.00974**	0.00678***
	(5.21)	(2.18)	(3.20)
Military expenditure pc (t-1)	0.00973***	0.0118***	0.00383
	(3.04)	(4.66)	(1.53)
_cons	0.214***	0.261***	0.289***
	(19.44)	(23.92)	(20.88)
Other controls[34]	No	Yes	Yes
Country and Year FEs	No	No	Yes
R-squared	0.578	0.655	0.990
N	444	444	444

Source: RAND Europe.

Note: All variables are log transformed (natural logarithm). t statistics in parentheses. ***, ** and * denote significance at 1 percent, 5 percent and 10 percent respectively, based on t-ratios using standard errors clustered at the country level to reduce the bias in standard errors.

After working through Equations 1 to 5, the next sections present an overview of the base scenario as well as cases where a change alters the baseline. These sections present an overview of the approach adopted for each of the three policy scenarios explored in relation to EU action in developing countries in support of poverty reduction.

3.2. Policy scenario development to assess the potential effects of no further EU action on poverty outcomes

3.2.1. Baseline scenario

The methodology of the present study aims at understanding the correlation of changes in independent variables with poverty measures under different policy scenarios, using a 'what-if' approach, rather than predicting absolute future values. To achieve this, the study uses the magnitude and statistical significance of coefficients from Equations 1-5, as presented in Tables 3.1-3.5. In Stage 1, these coefficients are applied to estimate how shifts in a key independent variable (e.g., ODA from EU MS) might influence public expenditure (like health expenditure). Stage 2 evaluates the changes in outcome variables (like infant mortality rates) resulting from the change introduced in a given scenario. The study creates scenarios modelled around the real GDP and GNI values, which are extended into the future (2022-2050) based on their historical growth rates from 2011 to 2021. The policy scenarios are outlined in Table 3.6 and further explored in detail in the following section.

[34] In specification (ii), the controls used are dummy variables for LDCs and non-LDC LMICs. For specification (iii), these dummies are included alongside controls for real GDP growth and the share of the urban population.

Table 3.6: – Overview the three policy scenarios explored

Scenario 1	EU MS reach ODA target (0.7 % of GNI) and (0.2 % towards LDCs)
Scenario 2	Global taxation mechanism to generate revenue for developing countries
Scenario 3	COVID-19 debt relief to address 2020 debt hike

Source: RAND Europe.

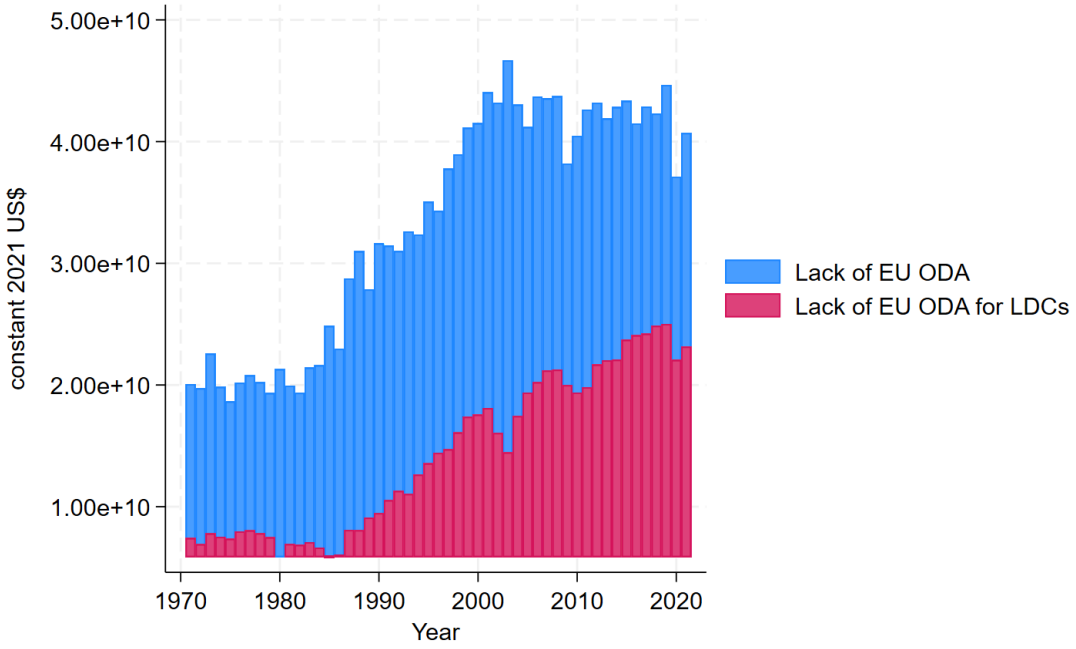
3.2.2. Policy scenarios

Scenario 1 – EU MS reach ODA target (0.7 % of GNI) and (0.2 % towards LDCs)

Set up

In this policy scenario, a situation is envisioned where all EU donor countries successfully meet their required aid targets. This approach initiates with an exhaustive review of the historical ODA transactions from EU MS. Using this data historic ODA rates over GNI were computed for the observed data by donor country per year, enabling the discrepancy from the 0.7 % target to be gauged, thereby deriving the differential. The gap from targets is calculated in a way that 0.2 % of GNI from donor countries is ring-fenced for LDCs, and the remaining 0.5 % is distributed across other LMICs. The gap value in 2021 was about US$40 Billion (constant 2021 prices) in total (0.7 % target), of which about US$23 Billion (constant 2021 prices) was lacked for LDCs (based on the 0.2 % target). See Figure 3.1 for historic values of the annual gaps.

Figure 3.1 – Sum of ODA gap to meet targets (0.7 % total and 0.2 % towards LDCs) in constant US$



Source: RAND Europe.

The cornerstone of this policy scenario is the allocation of 0.2 % of the aid to be distributed across LDCs. This allocation rate is calculated based on the sum of ODA received by each recipient country as a rate of total ODA paid by each donor country in each given year. It should be noted that although EU ODA flows to multilateral organisations are not incorporated in the regression analysis, they are considered in the calculation of gaps here, as they represent contributions from EU donors

towards the targets. The rationale behind the 0.2 % earmark stems from the recognition that LDCs, despite being in dire need of ODA and other financial supports, typically receive less aid per capita compared to other developing nations such as lower middle-income countries. This disparity holds true both globally and within the EU, encompassing both bilateral and multilateral aid flows.

But there are also discrepancies across EU MS on the level of commitment. Sweden's dedication to international development especially to LDCs is relatively high. In 2022, it provided US$5.4 billion in ODA, with significant portions directed towards LDCs like Afghanistan and Mozambique, receiving US$137.07 million and US$119.17 million respectively. Furthermore, Sweden's aid gravitates towards crucial sectors such as health, education, and humanitarian assistance, specifically focusing on the world's poorest and most vulnerable countries. According to the OECD strategic allocation not only epitomises Sweden's international solidarity but also significantly contributes to creating fiscal space in LDCs, addressing multidimensional poverty, and inching closer to global sustainable development goals (OECD, 2023). It is worth noting however that in December 2023 the Swedish government announced upcoming changes to country's development policy, establishing conditions under which Swedish aid to developing countries would be put in place with the aim to reduce bilateral aid to a maximum of 30 developing countries (Swedish government office, 2023).

In this scenario, the gap between the actual ODA sent (as share of GNI) and the targets (0.2 % for LDCs and 0.7 % overall) was calculated for each donor over the period of 2011-2021 and its annual average was calculated (extended timeframe covering annual averages for all EU MS covering 1970-2021 is presented in Figure 3.1). Simultaneously, the distribution of ODA transactions between donors and recipients was examined, and the average share of ODA each recipient received from the total ODA of each donor, based on 2011-2021, was calculated to set the donor-recipient allocation matrix. Importantly, both the gap rate and the allocation matrix calculations were performed separately for LDCs and other LMICs to accommodate the distinct targets for these groups. Assuming these rates remain constant over time, they were then multiplied by each other and applied to the extrapolated GNI figures for 2022-2050, thereby enabling the estimation of the gap in US$ for each recipient country for this period. The assumption underlying the calculation is that both the 0.7% and 0.2% ODA goals are consistently met each year from 2021 through to 2050. The approach allows estimating the cumulative changes in outcome metrics (infant mortality rate and HDI) for the period 2022-2050 using the estimated coefficients from Equations 1-5. The cumulative change could then be compared with 2020-2021 poverty values for infant mortality and HDI to understand their relative size.

Through this policy scenario, the aim is to understand the relationship between EU aid and poverty measures, after considering the 0.7 % target and ensuring that the agreed share of 0.2 % reaches the nations where it is most needed, thus amplifying its efficacy in promoting sustainable development.

Findings

While accounting for merely 11% of the global population, LDCs bear a staggering 40 % of the child mortality rate, a burden far outweighing any other demographic stratum (Winkleman and Adams, 2017). Over the past 30 years, a notable decline in child mortality rates has been witnessed worldwide (World Bank, 2019). ODA could be a contributing factor to this encouraging trend (Winkleman and Adams, 2017). In 2021, the data suggests an infant mortality rate of around 41 per 1000 births in LDCs, down from 55 in 2010 and 80 in 2000. Yet, an escalation in ODA to meet specified targets (0.2 % for LDCs and 0.7 % overall) holds promise for initiating a positive boost. This increase is associated with a reduction in the annual infant mortality rate by around 11 % by 2030, compared to 2020-21 values and keeping everything else constant (see Figure 3.2 and Table 3.7), which is the target year for achieving the SDGs, and nearly up to 40 % by 2050. Considering an average infant mortality rate of approximately 32 per 1,000 new births across the LDCs and LMICs in

this study (in 2021), it is estimated that about 13 infant mortalities per 1,000 live births could be prevented in each country by 2050.

Illustratively, in an average LDC with a population of 20 million and presuming 31 successful new births per 1000 people (based on 2021 figures for LDCs on average; WHO, 2021b), this reduction (13 per 1000) translates to a minimum of 9,920 infant lives saved by 2050 (given an infant mortality rate of 41 per 1000 for LDCs). At a global scale, LDCs account for more than a billion population in 2023. Assuming the same population by 2050, this means 496,000 infant lives saved across just LDCs. This scenario sheds light on the potential of EU action, through augmented ODA, to enhance healthcare access, significantly curb infant mortality rates, and thereby pave the way for a healthier, more resilient generation in LDCs.

Over the last two decades, considerable strides have been made in reducing child mortality, yet the urgency for further progress persists. Channelling ODA to developing countries emerges as a potent policy instrument to advance public health objectives, underscoring the potential of well-directed aid in fostering sustainable health improvements.

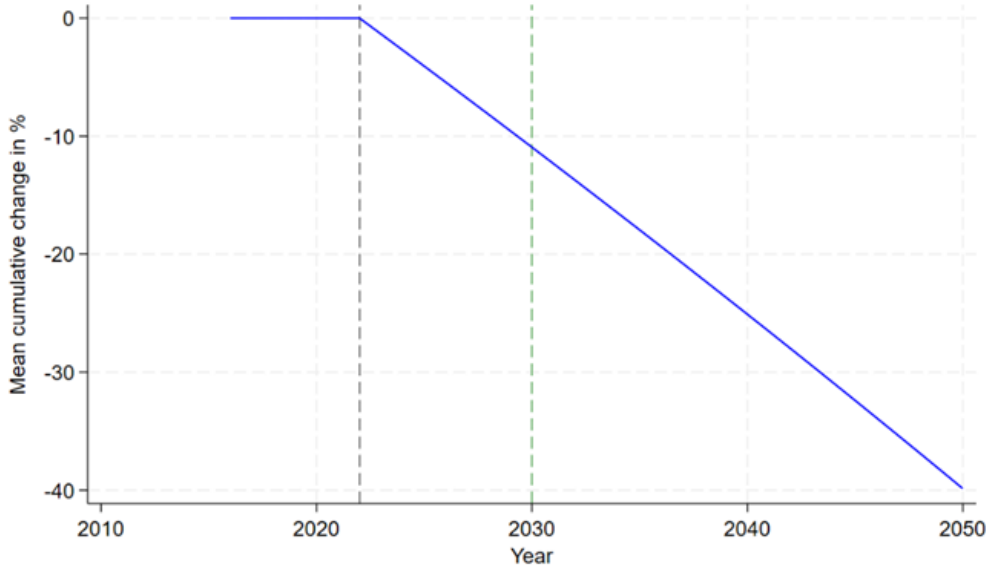
On the matter of HDI, it is important to acknowledge that this metric embodies a composite index, ranging between 0-1, and exhibiting a sticky nature that does not change instantly through time. The average HDI value across the dataset of this study stands at 0.55 (spanning a range from 0.3 to 0.78), while among LDCs it hovers around 0.48 (with a range from 0.29 to 0.67). Typically, the annual modifications are modest, averaging about 1 %. Hence, a cumulative average increase of around 4.1 % per country by 2050, assuming all other factors remain constant, is a positive change but not as significant as one could expect. It is also important to note the smaller coefficient magnitudes between expenditure and HDI (Table 3.5), and the broader nature of this composite metric.

For instance, the HDI in Afghanistan has shown a marked improvement over the last two decades, albeit from a lower base. Between 2002 and 2020, the country's HDI increased from 0.362 to 0.483, representing an average annual growth rate of 1.8 %. Specifically, in 2019, Afghanistan's HDI was 0.49, a significant increase from 0.27 in 1990. Despite these improvements, Afghanistan's progress is fragile, with poverty, inequality, and political instability posing substantial threats. The HDI growth, notable as it is, also reflects the challenges faced by countries in the lower human development spectrum in making substantial headway. For Afghanistan, a 4.1 % increase in HDI by 2050 is small progress. The factors contributing to this HDI growth include efforts in improving education and healthcare systems, though much remains to be done to ensure sustainable development.

Delving deeper into the implications, an ascent in HDI is synonymous with advancements in the fundamental dimensions of human development - health, education, and standard of living. A higher HDI is indicative of longer life expectancy, higher levels of education and income, which collectively contribute to better living conditions. The positive shift in HDI, as proposed in scenario 1, although small, transcends mere statistical movement; it encapsulates potential real-world improvements in the quality of life and long-term development prospects for individuals residing in LDCs.

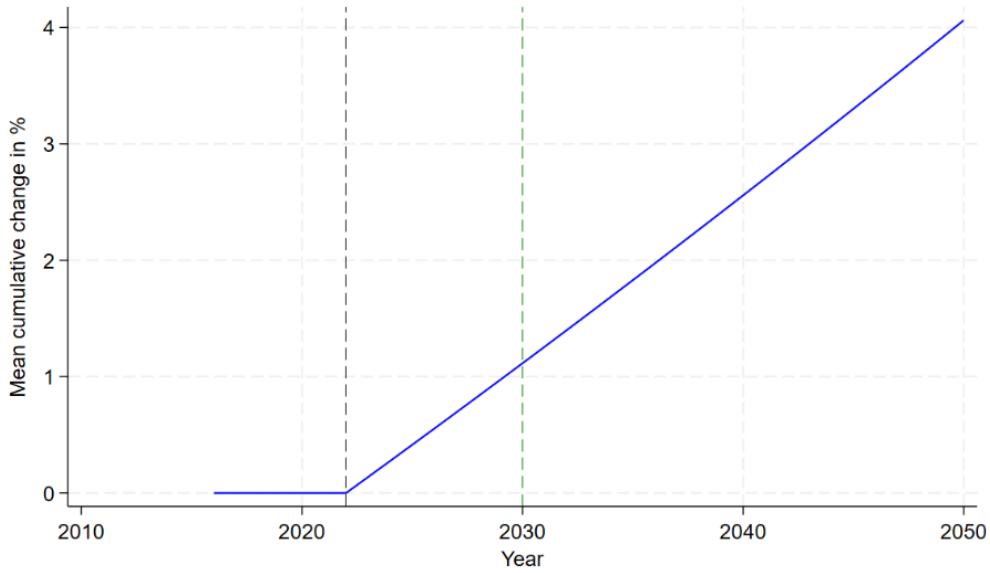
Moreover, a tangible increase in HDI could pave the way for a self-reinforcing cycle of development. Enhanced health and education outcomes, coupled with improved economic standards, can foster an environment conducive for further investments in human capital and infrastructure. Over time, these improvements could catalyse a virtuous cycle of development, propelling the nations on a path of sustainable growth and reduced poverty.

Figure 3.2 – Cumulative change in infant mortality rates under scenario 1



Source: RAND Europe.

Figure 3.3 – Cumulative change in HDI for scenario 1



Source: RAND Europe.

Table 3.7 – Cumulative change of infant mortality and HDI under scenario 1

Scenario 1	Cumulative change compared to 2020-21 values	
	Infant mortality rate (out of 1,000 new births)	HDI
2030	-10.9 %	+1.1 %
2035	-17.9 %	+1.8 %
2040	-25.1 %	+2.6 %
2045	-32.4 %	+3.3 %
2050	-39.9 %	+4.1 %

Source: RAND Europe.

Scenario 2 – Global taxation mechanism

Set up

In the second policy scenario, the present study delves into the potential financial ramifications of the global tax reforms. As previously discussed in the 'Gaps and challenges related to global taxation' section (2.2.1), the implementation of the two-pillar approach to global taxation is anticipated to yield US$125 billion in profits annually for reallocation to market jurisdictions under Pillar 1. It is expected that developing countries will see greater revenue gains relative to their existing revenues compared to more advanced economies. According to Oxfam (2021), the additional revenue from Pillar 1 could represent 0.02 % of the collective GDP of developing countries. Furthermore, Pillar 2 aims to establish a minimum tax rate of 15 % for companies with revenues exceeding EUR 750 million, potentially generating approximately US$150 billion in additional global tax revenues each year (OECD, 2021a). These reforms are poised to bear fruit especially for developing countries. It is worth mentioning that OECD suggest that their work has already channelled at least US$43 billion in tax revenue to developing countries that would have otherwise gone uncollected and the implementation of the Two Pillar Solution should only accelerate progress (USUN, 2023).

In this scenario, an additional 0.02 % of GDP is allocated to the revenue share of all developing countries in the study to reflect the increased revenue generation under Pillar 1, as indicated by Oxfam (2021). This reflects a positive change in the revenue to GDP share of each country from 2022 to 2050. Additionally, the present study assumes that half of the US$150 billion generated by Pillar 2 is distributed among developing countries, proportionate to their existing revenue size. This additional revenue is then divided by the extrapolated GDP figures for 2022-2050, allowing for an estimation of the incremental revenue as a percentage of GDP for each developing country. Utilising Equations 1-3, the health, education, and military expenditure were estimated after applying the change in revenue to GDP. The new values of public expenditure were then applied in Equations 4-5 to estimate cumulative differences. The relative magnitude of changes was also estimated as comparison to 2020-2021 values. This exercise sketches a picture of the change in poverty landscape post-reform, keeping everything else constant.

Findings

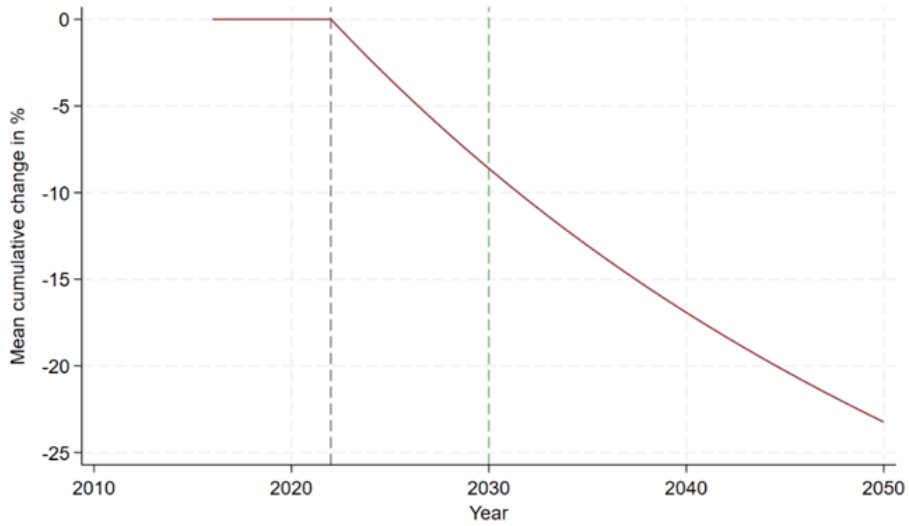
With enhanced fiscal capacity stemming from increased government revenue, a window of opportunity opens for governments to bolster their expenditures, particularly in crucial sectors like health and social welfare. These sectors are instrumental in poverty alleviation, as demonstrated in Figures 3.4-3.5 and Table 3.8. The distribution of new revenue is associated with a decrease in infant mortality rates – a key indicator of a country's health status and developmental progress. The estimate rate is expected to be just over 23 % by 2050. Following the same logic as the previous scenario, this translates to around 292,000 infant lives saved by 2050 solely in LDCs, based on an assumed total population of 1 billion.

Furthermore, the associated change in HDI is relatively modest, amounting to only a 1.7 % increase by 2050 compared to 2020-21. Potentially due to the same reasons explained in the previous case.

Within a wider context, this initiative suggests the ability of financial commitments to drive positive change, no matter how modest, particularly in areas struggling with poverty and insufficient healthcare. Yusri (2022) finds a positive impact for government spending, particularly the Special Autonomy Fund, in Aceh, Indonesia, showing its significant role in reducing poverty and enhancing both sanitation access and secondary education enrolment. Another study on Pakistan, (Kousar et al., 2023), underscores the importance of objective-based expansionary fiscal policies for enhancing health and educational outcomes, essential for human capital development. The study advocates for increased government spending in creating health facilities and educational opportunities, recognising their significant impact on human capital growth. It also highlights the role of social protection programs in alleviating financial barriers, further contributing to the development of human capital in Pakistan.

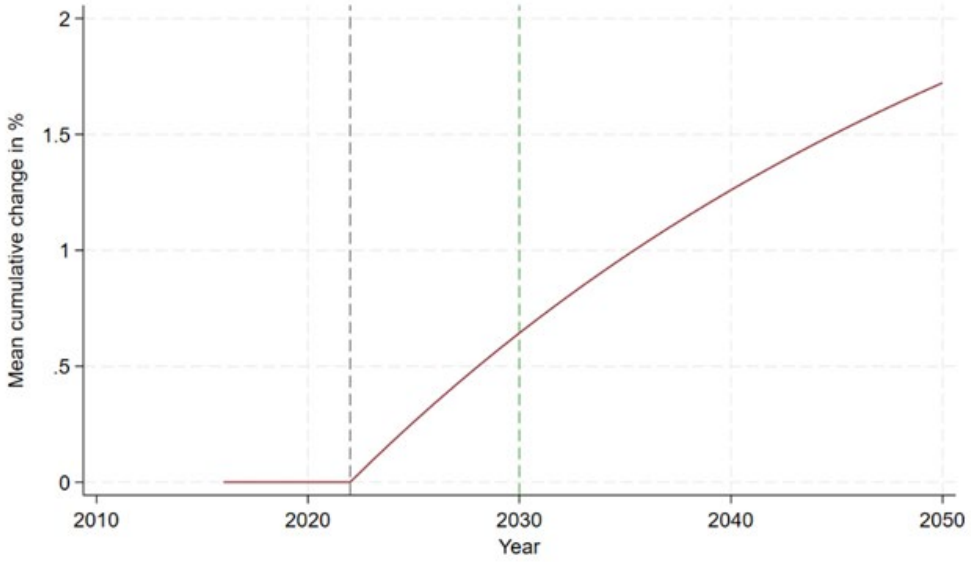
These studies indicate the transformative potential of enhanced fiscal capacity in bolstering social outcomes, particularly in reducing infant mortality rates – a critical yardstick for gauging a country's developmental trajectory. Like in the broader scenario depicted earlier, the Indonesian and Pakistan cases underscore the impact that financial allocation to health and education can have on poverty alleviation, ultimately contributing to improved human development. Through strategic financial investments, be it from domestic resources or foreign aid, countries can make significant strides in improving healthcare outcomes, thereby advancing along the path of sustainable development.

Figure 3.4 – Cumulative change in infant mortality rates under scenario 2



Source: RAND Europe.

Figure 3.5 – Cumulative change in HDI (and 95 % confidence intervals) under scenario 2



Source: RAND Europe.

Table 3.8 – Cumulative change of infant mortality and HDI for scenario 2

Scenario 2	Cumulative change compared to 2020-21 values	
	Infant mortality rate (out of 1,000 new births)	HDI
2030	-8.6 %	+0.6 %
2035	-13.1 %	+1 %
2040	-16.9 %	+1.3 %
2045	-20.3 %	+1.5 %
2050	-23.2 %	+1.7 %

Source: RAND Europe.

Scenario 3 – COVID-19 debt relief to address 2020 debt hike

Set up

Many countries entered the pandemic with elevated debt levels. According to IMF Global Debt Database (Mbaye et al., 2018), global debt reached US$197 trillion in 2019, up by US$ 9 trillion from the previous year. This substantial debt created challenges for countries that faced a debt surge in 2020, as economic activity collapsed, and governments acted swiftly to provide support during the pandemic. Although the first cost of COVID-19 has been to human life and health, measures taken to address the crisis have pushed global public debt up to record levels. In some countries above 100 % of GDP, according to the IMF (Mbaye et al., 2018).

The Debt Service Suspension Initiative (DSSI) was introduced by G20 to support poorest countries during the pandemic by temporarily pausing their debt payments. This enabled these nations to redirect their resources towards efforts to combat the pandemic. Through this initiative, over US$10.3 billion in aid was distributed to 40 countries. However, the DSSI did not offer a permanent solution; it merely postponed debt payments which continued to accrue interest. Furthermore, it lacked a robust mechanism to address ongoing crises. In response to these limitations, the G20,

along with the Paris Club, developed the Common Framework for Debt Treatments (CFDT) beyond the DSSI. This framework aims to provide a more structured and coordinated approach for debt treatment, addressing the long-term sustainability of debt for the most vulnerable countries. It emphasises the need for private creditors' participation and ensures a more comprehensive treatment of debt beyond mere suspension, thereby offering a more viable pathway for countries grappling with debt challenges in the wake of the pandemic (IMF, 2021b). However, despite the international community's appeals for broader debt relief, only a handful of countries leveraged the DSSI for debt restructuring (Cassimon et al., 2023). Moreover, this framework did not deliver any debt relief since the recent Zambia deal collapse in November 2023 (Bradlow, 2023).

In parallel to global efforts, the European Union recognised the significant impact of the escalating debt crisis, especially its potential to exacerbate poverty and global instability. The EU urged its member states and the international community, including multi-national organisations and developed countries, to actively engage in initiatives focused on alleviating the debt burden of low- and middle-income countries. This approach was part of a broader EU strategy to mitigate the economic and social ramifications of the COVID-19 pandemic on vulnerable nations, emphasising the need for rapid and effective solutions to prevent further financial crises and poverty escalation (European Union, 2020). The urgency of the situation is further highlighted by a report from the United Nations International Children's Emergency Fund (UNICEF, 2021), which indicates that approximately one in every eight countries spends more on debt repayment than on social services. Alarmingly, in 2019, 25 mainly impoverished countries allocated a larger portion of their budgets to debt services than to education, health, and social protection combined. This stark reality underscores the pressing need for substantial debt relief to safeguard vital services during the persistent health crisis (UN, 2021).

Debt has severely restricted public investments in basic social and health services in many developing nations, particularly in LICs, leading to weakened health systems and poorer population health. These financial constraints have further hampered underfunded health ministries. For instance, before the pandemic in 2020, 46 countries were spending more resources as a share of GDP on public debt service than on their healthcare systems. LICs, on average, spent 7.8 % of GDP on public debt service and only 1.8 % on public health services (APHA, 2022).

The lack of government health financing is a substantial barrier to achieving Universal Health Coverage, especially in populations with deeper levels of poverty where individuals cannot afford or have limited access to private health services (Federspiel et al. ,2022).

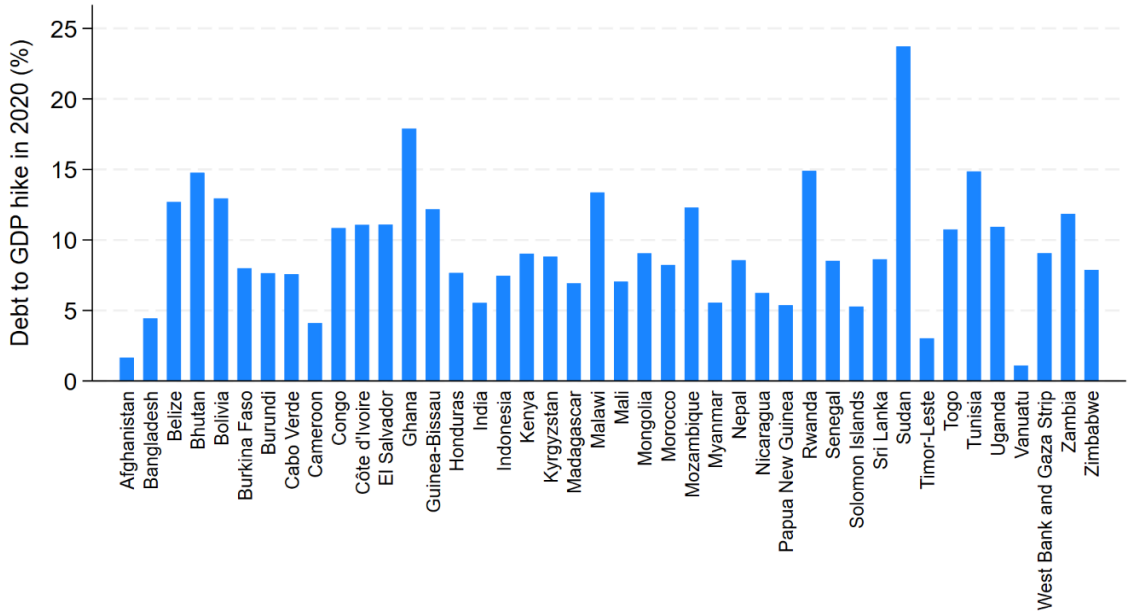
However, the potential moral hazard effect of debt relief policies can also be recognised. Debt relief or debt cancellation policies towards developing countries can further increase corruption and debt levels due to the misuse of funds with little to no effect on poverty levels (Bouchet, 2021).

As the debt crisis persists, with its complex challenges and the critical need for relief measures, the European Union, in collaboration with its member states, is proactively seeking diverse and effective strategies to alleviate the financial burdens facing developing countries. This initiative, underscored by recent public hearings held by the Committee on Development in conjunction with the Delegation to the African, Caribbean, and Pacific (ACP-EU) Joint Parliamentary Assembly, aims to explore and implement viable solutions for debt relief and reduction. These efforts reflect the importance of the issues and its relevance to the EU's agenda (European Parliament, 2023).

In this scenario, a situation is assumed where debt relief is granted to developing nations grappling with the health and economic repercussions of COVID-19 in 2020, which burdened many LICs even more than others (Shiva and Molana, 2021). The amount of debt only covers the hike in debts from 2019 to 2020. The calculated debt amount is divided by the GDP to determine its ratio to GDP (see Figure 3.6). This scenario entails writing off all additional debt accrued in 2020 by developing countries, translating to a combined debt relief of more than US$300 billion for 42 countries where

2019-2020 debt data was available, of which 21 are LDCs. The debt amounts were then taken off the debt burden of all concerned countries for period 2022-2050, as ratio of GDP which was previously extended to cover 2022-2050. Then, Equations 1-3 are used to estimate changes in public expenditure. Subsequently, Equations 4-5 are employed to assess the change in poverty levels associated with the reduction in the debt to GDP ratio through 2050. The outcomes of this analysis are depicted in Figures 3.7-3.8 and detailed in Table 3.9, illustrating the magnitude of change on poverty levels estimated using debt reduction.

Figure 3.6 – Debt hike from 2019 to 2020 as percentage of GDP



Source: RAND Europe.

Findings

The manner in which the freed-up fiscal space is utilised is highly contextual. Countries with stronger institutions and governance structures, particularly those with a focus on social and health outcomes, may respond differently compared to nations with weak institutions and high levels of corruption (e.g. Sengupta et al., 2023). In developing countries, where institutional frameworks might not be as robust, the effective utilisation of fiscal space becomes even more critical. The ability to allocate resources efficiently towards health and social sectors can significantly impact the overall well-being of the society, especially in times of crises.

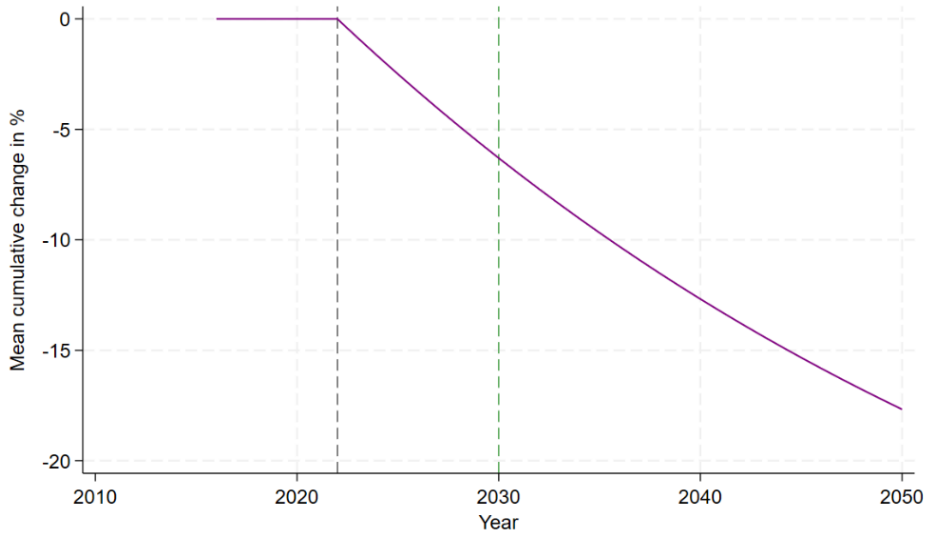
By 2050, as a consequence of a debt relief initiative covering the significant economic hike experienced over the year 2019-2020, it is estimated that there will be a reduction of 17.7 % in infant mortalities compared to 2020-21 values. This translates into almost 6 infant mortalities per 1,000 live births across all developing countries. Also, same as the previous scenarios, taking 41 infant mortality rates across LDCs (in 2021) and an assumed population of one billion, this translates into almost 225,000 infant lives saved by 2050. Additionally, the HDI is anticipated to exhibit a slight improvement, increasing by around 3 %, compared to the 2020-21 values. Although very subtle, this positive change in the HDI can bring positive outcomes when consistently occurred and combined with other measures.

The alleviation of debt through relief initiatives has the potential to significantly impact the education sector in developing countries. One notable initiative, the HIPC Initiative, has

demonstrated that countries receiving debt relief could allocate about five times more towards health, education, and other social services compared to debt service (IMF, 2023). This shift in financial allocation took place between 2001 and 2015, hinting at the beneficial outcomes of debt relief on education expenditure. Such financial reprioritisation could potentially lead to enhanced educational infrastructure, better-paid educators, and thus improved literacy rates and educational outcomes.

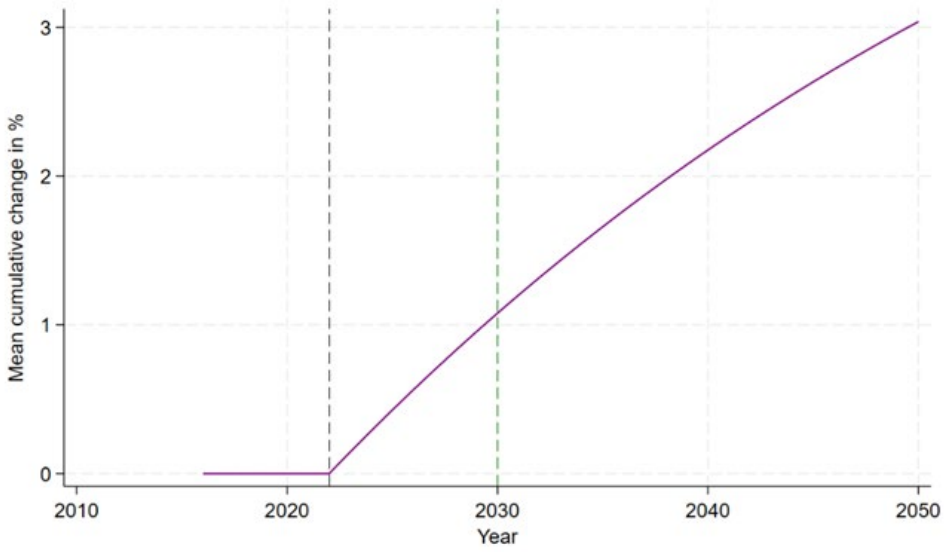
Moreover, the diversion of resources away from social provisions like education to service debt has been a critical issue, as highlighted by UNICEF in multiple reports (UNICEF, 2000a; UNICEF, 2000b). Debt repayment pressures lead to reduced investment in essential social services, adversely impacting the poor, especially women and children. This cycle perpetuates poverty and hinders educational attainment, emphasising the need for debt relief to break this cycle and to foster better educational and literacy outcomes. By alleviating the financial burden through debt relief, developing countries can redirect their resources towards improving educational infrastructure and literacy programs, thereby creating a foundation for long-term sustainable development and poverty reduction.

Figure 3.7 – Projected change in infant mortality rates under scenario 3



Source: RAND Europe.

Figure 3.8 – Cumulative change in HDI under scenario 3



Source: RAND Europe.

Table 3.9 – Cumulative change of infant mortality and HDI under scenario 3

Scenario 3	Cumulative change compared to 2020-21 values	
	Infant mortality rate (out of 1,000 new births)	HDI
2030	-6.3 %	+1.1 %
2035	-9.7 %	+1.7 %
2040	-12.7 %	+2.2 %
2045	-15.3 %	+2.6 %
2050	-17.7 %	+3 %

Source: RAND Europe.

Cross scenario comparison

This section provides cross-scenario analysis and also look at the joint effect of all three scenarios together, since policy intervention are often considered together and not separately. It is important to note that while the first policy scenario falls directly under the EU's authority, the other two scenarios necessitate global collaboration and coordination. Particularly for the third scenario, the debt relief case, the EU is accountable only for its share of the debt and cannot unilaterally implement this policy in isolation.

The three policy scenarios under consideration are the achievement of the ODA targets by EU MS, the introduction of a global taxation mechanism and distribution of parts of the generated revenue to developing countries, and the provision of debt relief in response to the 2020 debt surge due to the COVID-19 pandemic.

Given the overarching goal of these policy interventions is to alleviate multidimensional poverty, it is pertinent to align their projected outcomes with the global benchmarks set by the SDGs. Specifically, SDG 3, which has been established to ensure healthy lives and promote well-being across all age brackets. Within this goal, Target 3.2 is dedicated to ending preventable deaths of newborns and children under 5 years of age, aiming for a reduction in neonatal mortality to at least

12 per 1,000 live births and under-5 mortality to at least 25 per 1,000 live births by 2030. This target is especially relevant for the LDCs, where the current average infant mortality rate is around 45 per 1,000 live births, with variations ranging from 16 to 75.

The achievement of the ODA target by EU MS holds significant promise. This scenario yields more favourable results, as ODA from the EU demonstrates a significant correlation with both health and education expenditures. If realised, estimates indicate that by 2050, infant mortality could be almost 40 % less than 2020-21 values. However, even if fully implemented, this initiative is unlikely to meet the targets of SDG 3 by 2030. It is estimated to be associated with a reduction of almost 4 infant mortalities per 1,000 live births by 2030 in developing countries (with an average infant mortality rate of 32 in 2021), lowering the average to 28. Yet, SDG 3 aims for a decrease to 12 infant mortalities per 1,000 live births by 2030. On the HDI front, a projected increase by around 4 % – compared to HDI values in 2020-21 – is expected by 2050.

The second scenario, the global taxation mechanism, represents an innovative approach to fund developmental projects. Preliminary estimates associated with this mechanism suggest about 23 % decrease in infant mortality rates by 2050. Regarding HDI, a small rise of about 1.7 % of HDI by 2050 is estimated.

It is worth noting that similar initiatives currently exists but not at a global scale, such as those focused on digital services such as the Digital Service Taxes that exists in various countries like France and the UK (e.g. CRS, 2021). India implemented an equalisation levy, also referred to as the "Google Tax," on online advertising revenues earned by non-resident companies in the country (EY, 2020). While these taxes are primarily aimed at ensuring fair taxation, they showcase the potential for generating additional revenue that could be redirected towards developmental projects.

The debt relief scenario for COVID-19 induced debt resonates with the debt relief initiatives like the HIPC Initiative, which significantly alleviated debt burdens allowing countries to invest more in social services. A pertinent example is the case of Tanzania, which after receiving debt relief under the HIPC initiative, increased its expenditure on education and health, thereby making strides in improving literacy rates and reducing infant mortality (IMF, 2001).

The last scenario indicates the importance of resource reallocation from debt repayment towards sectors like health and education. Implementing such a strategy could lead to an estimated decrease of up to 18 % in infant mortality by 2050. In terms of HDI, projections suggest an increase of up to 3 % by 2050, which is very small but more than the previous scenario (Figures 3.9-3.10).

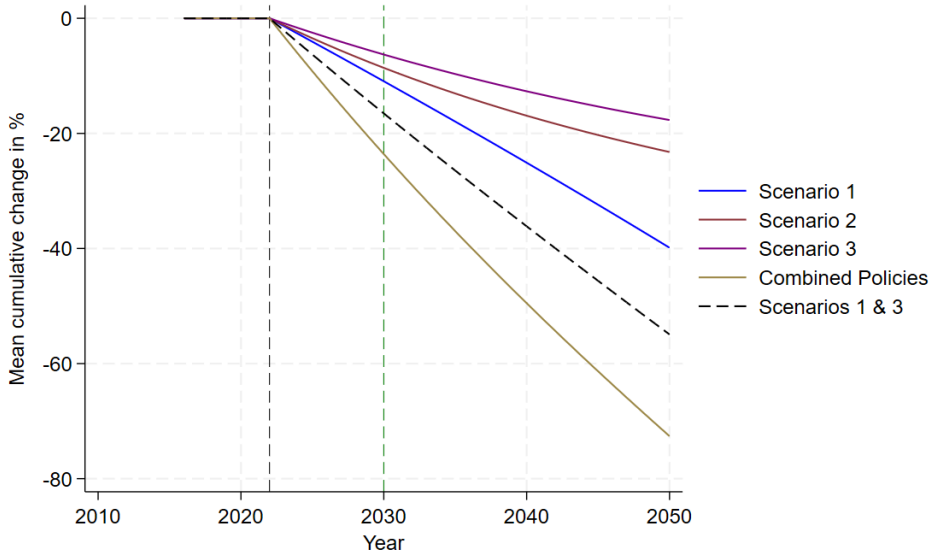
Combining all scenarios might be viewed as a single, overarching scenario. Implementing them together is estimated to be associated with a 72 % decrease in infant mortality and an 8.5 % increase in HDI by 2050, compared to 2021 baseline values (refer to Table 3.10). This combined scenario is set independently, so the reported estimates are not simply the sum of the three individual scenarios due to the logarithmic function involved (Table 3.10). The estimated rates for this scenario suggest a lower infant mortality rate of around 23.6 % by 2030, translating to almost 8 fewer infant mortalities per 1,000 live births and bringing the average down to 24. However, this is still not enough to achieve the SDG 3 goals.

It is also important to mention that while the HDI does not have a specific target within the SDGs, even small increases can matter. However, it should be reminded that an increase in one component of the HDI can potentially balance out a decline in another, leading to an overall net increase in HDI. The correlation between policy interventions and HDI improvement can be illustrated through the example of Sri Lanka. Despite being a lower-middle-income country, Sri Lanka has an HDI comparable to middle-income countries, largely due to its significant investments in health and education over several decades (World Bank, 2021).

Overall, the scenarios discussed underscore the positive role of development initiatives on multidimensional poverty alleviation. Pursuing these and similar development initiatives is especially crucial for developing economies that have been battered by a succession of recent crises. The present study highlights a pathway that connects development initiatives to poverty measures via public expenditure. This aligns with earlier research on the government's role in aid effectiveness (Collier and Dollar, 2001, 2002, 2004) and the impact of public spending on poverty reduction (Gomanee et al., 2003; Yontcheva and Masud, 2005; Gomanee et al., 2005). Emphasising 'pro-poor' policies is crucial in this regard. Within this framework, 'Pro-poor public social spending' (as defined by SDG indicator 1.b.1) specifically refers to public spending directed towards major social concerns, particularly in health and education sectors (UNICEF, 2023).

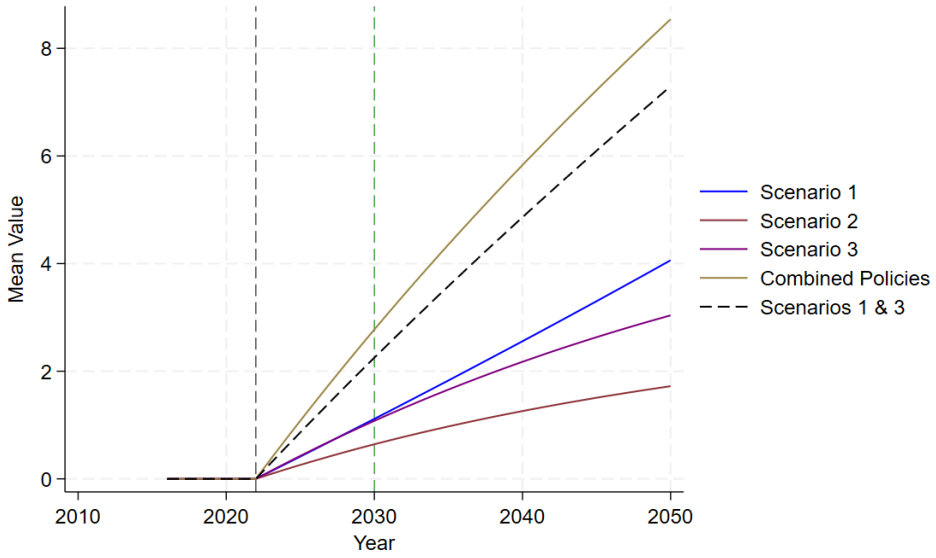
Lastly, the present study acknowledges the potential for policy interventions to create a multiplier effect. For instance, healthcare investments might lead to a healthier population, which in turn could enhance economic productivity (Remes et al., 2020). This may result in more available resources for further investment in healthcare and education, contributing to progress towards SDG 3 and the improvement of global HDI, thus fostering sustainable development. However, such interplay was not examined in the present study. Its focus was on the indirect relationship of development initiatives with poverty metrics through health and education expenditure channels, assuming other variables constant, and comparing against 2020-21 values.

Figure 3.9 – Predicted cumulative change of infant mortality under all policy scenarios



Source: RAND Europe.

Figure 3.10 – Cumulative change of HDI under all policy scenarios



Source: RAND Europe.

Table 3.10 – Cumulative change of infant mortality and HDI under all policy scenarios (compared to 2020-2021 values)

	S1	S2	S3	combined	S1&S3	S1	S2	S3	combined	S1&S3
	Infant mortality rate					HDI				
2030	-10.9 %	-8.6 %	-6.3 %	-23.6 %	-16.5 %	+1.1 %	+0.6 %	+1.1 %	+2.8 %	+2.2 %
2035	-17.9 %	-13.1 %	-9.7 %	-37.0 %	-26.5 %	+1.8 %	+1.0 %	+1.7 %	+4.4 %	+3.6 %
2040	-25.1 %	-16.9 %	-12.7 %	-49.5 %	-36.1 %	+2.6 %	+1.3 %	+2.2 %	+5.8 %	+4.9 %
2045	-32.4 %	-20.3 %	-15.3 %	-61.3 %	-45.6 %	+3.3 %	+1.5 %	+2.6 %	+7.2 %	+6.1 %
2050	-39.9 %	-23.2 %	-17.7 %	-72.6 %	-54.9 %	+4.1 %	+1.7 %	+3.0 %	+8.5 %	+7.2 %

Source: RAND Europe.

3.3. Further potential for EU action to address the identified gaps

In addition to the policy scenarios presented in the previous section, the study team has identified the following potential EU action that could lead to benefits both for the EU and towards poverty reduction in developing countries:

Expand on the role of the EIB in EU development financing.

The activities of the EIB remain primarily focused in support of EU coherence and European added value and to a lesser extent on external operations. (Gavas & Pérez, 2022). Over the last decades, the

EIB has continued to widen its geographical scope and has increased its activities, specifically in sub-Saharan African (Gavas & Pérez, 2022; European Investment Bank, 2021). Through this partnership the EIB could further increase its capacity to operate in developing countries, including by developing thematic and geographical targets to continue to increase its physical presence in developing countries, perhaps beyond sub-Saharan Africa (Gavas & Pérez, 2022; European Investment Bank, 2021).

The EIB proposes to set up a dedicated EU partner for all its activities conducted outside of the EU, supporting the Team Europe approach. This would enable it to clearly distinguish between EIB activities within and outside of the EU and further support cooperation mechanisms with regional structures such as the African Development Bank, with whom the EIB signed Joint Partnership Action Plan in 2021 (European Investment Bank, 2021)

Enable effective information-sharing mechanisms

As highlighted in Chapter 2, there appears to be numerous challenges pertaining to developing countries' lack of access to information relating to EU development funding initiatives and programmes. Even when available, such information often lacks clarity. The implementation of wider information sharing mechanism could also help developing countries at their national level. They could have a complete picture of development landscape and be able to identify all development initiatives and actions that are conducted on their soil (RAND Europe interview, August 2023; Sabourin et al., 2023).

Align EU and partner countries' priorities

Increased alignment between EU and developing countries' priorities could also increase the local ownership of development programmes in partner countries as well as to foster greater transparency in processes and programmes' implementation (Pichon, 2020).

Account for changing conditions on the ground

Changing conditions in developing countries are likely to disrupt EU development financing flows towards these counties and limit efforts to address poverty. Additional clauses could be considered to allow local NGOs and CSOs to continue to deliver development programmes through other channels, in cases where EU development aid can no longer be delivered as security and political challenges arise. (RAND Europe interview, August 2023).

Increase the EIB's coordination role to support EU position on debt relief policies

Debt relief remains a competence of EU MS and there is uncertainty as to whether EU MS would be willing to develop common EU positions on this topic due to historical ties or specific interests in some developing countries. (RAND Europe interview, August 2023). The EU could also seek to harmonise EU MS positions with regards to debt relief policies in the multilateral development financing institutions (i.e. IMF and the World Bank). The EU could take the lead on coordinating preparatory work ahead of meetings to foster the development of a common EU positions, which in turn would increase the EU's visibility (RAND Europe interview, August 2023).

Account for developing countries' when considering development financing mechanisms

Further consideration regarding developing countries' financial structures and capacity should be taken into account when considering development financing. Specifically, developing countries who lack the capacity to repay loans may receive aid in the form of grant while developing countries with such repayment capacities could be provided with loans. Various factors are likely to play a role in determining whether specific countries possess such repayment capacities (RAND Europe interview, August 2023; Adeyi, 2023; The World Bank & UNESCO).

4. Report summary and conclusions

This study aimed at identifying and analysing the potential impacts of EU action affecting developing countries. Specifically, the study sought to assess the state of play of EU action to help reduce poverty in developing countries and identify gaps in current policies and investigate potential future action at EU level in this area.

The focus of the study was on areas pertaining to mobilisation of financing for development, (i.e., ODA, debt distress policies, global taxation and fiscal space improvements) and the promotion of public goods (i.e. education and health policies). A combination of quantitative (i.e. compilation of bespoke data set and econometric modelling) and qualitative (document and literature review with six stakeholder interviews) methods was used.

4.1. What are the gaps and challenges pertaining to current EU action regarding developing countries?

While development policy is a shared competence between the EU and EU MS, the EU has taken steps in recent years to act further on development financing and to encourage the availability of public goods. Based on the literature review and key interviews conducted by the study team, several gaps have been identified in relation to the two areas of interest in the context of the present study.

In the area of funding for development the following gaps and challenges have been highlighted:

- The level of EU ODA remains below the 2030 targets. Only four EU MS meet the 0.7 % of GNI ODA target (i.e. Luxembourg, Sweden, Germany and Denmark). In addition, a specific target was established for ODA oriented specifically towards LDCs, i.e. 0.15 %-0.20 % of GNI. Though limited data is available at the level of EU MS, it appears this target remains unmet and there are serious concerns whether these trends will change by 2030 and beyond.
- The external activities of the EIB as the EU's development financing institution remains limited. It should nevertheless be noted that activities and efforts are ongoing to further increase the activities of the EIB in Sub-Saharan Africa, including its physical presence through the creation of regional offices.
- The development and implementation of the 'Team Europe' initiative gathers numerous actors at the EU and EU MS levels. The level of coordination between these actors remains insufficient. As a consequence, the absence of effective coordination also raises concerns with regards to potential duplication of efforts between EU and EU MS actors in developing countries.
- The emergence of simultaneous global challenges (i.e., the COVID-19 pandemic, the Russian invasion of Ukraine, increased migration flows from developing countries including from Sub-Saharan Africa) have led to increased fragmentation of EU development aid. The NDICI – Global Europe Instrument launched in recent years had included considerations that unforeseen global challenges could emerge and disrupt development aid needs in developing countries – but only to a limited extent.
- The implementation of the NDICI – Global Europe Instrument has led to the perception of increased competition to access EU development funding mechanisms and reduced transparency in the attribution of EU-funded projects.
- The flexibility of EU development aid remains limited as on-the-ground conditions change in developing countries and conditions attached to the delivery of development aid continue to increase (e.g. security considerations).

- Debt relief policies remain an exclusive competence of EU MS, and the EU has a very limited role in the development of coordinated positions. Efforts to develop a common EU position on this issue that could be shared at IMF or World Bank meetings remain limited.
- The implementation of a new global taxation framework is likely to reduce the funds developing countries can leverage compared to developed countries. Only a limited number of developing countries are signatories to the new framework, due to concerns about the financial resources it would generate compared to existing mechanisms.
- Fiscal space improvement in developing countries remains dependent on numerous factors. Developing countries' lack of capacity to mobilise resources is likely to impact the funding mechanisms they can leverage in support of poverty reduction and development activities from the EU and its MS.

In addition to the gaps identified in relation to development financing, the study team also sought to understand the gaps and challenges pertaining to the promotion of public goods through social policies in the health and education sectors. These include:

- The difference in levels of funding between the health sector which has increased in light of the COVID-19 pandemic and the education sector, which has been considered less of a priority in recent years.
- The burden shared by households to fund education in developing countries varies greatly (from less than 15 % to over 70 %). Across developing countries, the cost of education for households relates to schools fees and supplies, uniforms or transport.
- Development aid for health in developing countries has been focused on supporting the delivery of basic services that government structures are unable to carry. As a consequence, support for preparedness efforts, the development of public health governance structures, or health and medicine supply chains, remains insufficient.

4.2. Future scenarios for EU action

The relationship between aid conditionality and ODA effectiveness in poverty reduction is evidenced in studies by Collier and Dollar (2001, 2002, 2004) and Mosley et al. (2004). These suggest that aid effectiveness hinges on 'pro-poor' policies. 'Pro-poor public social spending' (SDG indicator 1.b.1) targets critical social issues, particularly in health and education (UNICEF, 2023). Based on this and studies highlighting public expenditure's role in ODA's indirect impact on poverty (e.g., Gomanee et al., 2003; Yontcheva and Masud, 2005; Gomanee et al., 2005), the study uses a two-stage analytical approach. This method investigates the indirect relationship of three variables (ODA, the debt-to-GDP ratio, and the government revenues-to-GDP ratio) with multidimensional poverty. Initially, the model examines the association of these variables with public spending, particularly in health and education. Military spending, significant in many developing countries' budgets, is also considered. The second stage assesses the relationship between these spending choices using infant mortality rates (out of 1 000 new births) and HDI as primary outcome indicators, with expenditures adjusted per capita for population differences.

To provide a raw assessment of the potential effects of taking no further action at EU level, the modelling framework quantifies changes in poverty metrics for three policy scenarios to 2050. The methodology examines how variations in independent variables under different scenarios, using a 'what-if' approach, might alter outcomes, rather than forecasting future values. Utilising coefficients' magnitude and statistical significance, Stage 1 allows an estimation of shifts in key variables (e.g., ODA from EU MS) on public expenditures like health. Stage 2 then assesses the subsequent changes in outcome variables, such as infant mortality rates, due to alterations in each scenario. Scenarios rely on extended real GDP and GNI values from 2022 to 2050, extending historical growth rates from 2011 to 2021.

Policy scenario option 1

The first policy scenario delves into the associated change in poverty derived from all EU MS achieving their ODA targets of 0.7 % of GNI. The key consideration of this policy scenario is allocating 0.2 % of aid to LDCs, based on their initial endowments. This 0.2 % figure acknowledges that LDCs, despite their urgent need for aid, often receive less per capita than other developing nations, including lower middle-income countries. This aid discrepancy is evident both globally and within the EU, spanning both bilateral and multilateral aid channels.

The findings indicate that achieving the set target is associated with significant reductions in infant mortality by 2050, estimated at nearly 40 % lower than the 2020-2021 figures. In an average LDC with a population of 20 million and an estimated 31 successful new births per 1 000 people (based on 2021 WHO figures for LDCs), this reduction translates to saving at least 9 920 infant lives by 2050 (given an infant mortality rate of 41 per 1 000 in 2021 across LDCs). Globally, with LDCs accounting for over a billion people in 2023, this could result in approximately 496 000 infant lives saved across LDCs by 2050. Such outcomes highlight the significant potential of EU action and increased ODA in improving healthcare access and reducing infant mortality rates in LDCs.

However, this initiative might still fall short of achieving the SDG 3 targets by 2030. The estimated reduction in developing countries is about 4 infant mortalities per 1 000 live births by 2030, from an average rate of 32 in 2021 (for all developing countries) to 28, while SDG 3 aims for a decrease to 12 per 1 000. On the HDI front, there is a modest increase of around 4 % compared to 2020-2021 values by 2050.

Policy scenario option 2

In the study's second policy scenario, the focus shifts to the financial impacts of global tax reforms, specifically the two-pillar approach. This approach, expected to generate significant annual profits for reallocation, particularly benefits developing countries. The study incorporates these changes by allocating an additional 0.02 % of GDP to developing countries' revenues, reflecting Pillar 1's impact (Oxfam, 2021). Additionally, it assumes that half of the US$150 billion generated by Pillar 2 is distributed among these countries.

Findings suggest that with the heightened fiscal capacity from increased government revenues, there can be enhancements in expenditures for crucial sectors like health and social welfare. This improvement correlates with a more than 23 % decrease in infant mortality rates by 2050. In LDCs, this reduction could result in about 292 000 infant lives saved, based on a population estimate of one billion. The corresponding change in HDI, however, is very modest, with an anticipated increase of only 1.7 % by 2050.

Policy scenario option 3

The final scenario evaluates the implications of providing debt relief in response to the debt surge caused by the 2020 COVID-19 pandemic. This is an important scenario, since debt has curtailed investment in crucial services in developing nations, especially in LICs, leading to compromised health systems and poorer community health. Financial challenges have exacerbated the strains on already under-resourced health sectors. Alarmingly, in 2019, 25 mainly impoverished countries allocated a larger portion of their budgets to debt services than to education, health, and social protection combined (UN, 2021). This stark reality underscores the pressing need for substantial debt relief to safeguard vital services during the persistent health crisis.

In this scenario, the study assumes debt relief for developing countries affected by the COVID-19 pandemic in 2020, focusing on the increased debt from 2019 to 2020. The scenario involves cancelling all extra debt incurred in 2020, amounting to over US$300 billion across 42 countries, including 21 LDCs.

The findings suggest that by 2050, the debt relief initiative for the economic hike of 2019-2020 is associated with a 17.7 % reduction in infant mortality rate, compared to 2020-2021. In LDCs, with an assumed one billion population, this could save nearly 225 000 infant lives. Moreover, a slight increase of around 3 % in HDI compared to 2020-2021 values is observed, signifying a subtle yet positive shift that could yield beneficial outcomes when combined with other measures.

Combined scenarios

This study also examines a case where all three scenarios are simultaneously implemented, to assess whether such a combined approach could align with SDG 3 goals. The estimated cumulative reduction in infant mortality by 2030 is nearly 24 %, which means about 8 fewer infant deaths per 1 000 live births, reducing the average to 24 from the 2021 average of 32 in LMICs. However, this combined scenario still falls short of meeting the SDG 3 target of 12 mortalities.

EU role

It is crucial to recognise that while the EU can directly control the first policy scenario, the other two require global cooperation. The second scenario, involving global tax reforms, demands multilateral agreements and coordination due to its complexity and the potential imbalance in revenue redistribution. In the third scenario, concerning debt relief, the EU's responsibility is limited to its share of the debt owed, making it impossible for the EU to implement this policy alone.

Limitations

The present study's quantitative approach is designed to examine changes associated with different policy scenarios, analysing correlations, not causality. It does not seek to forecast future values, rather uses a 'what-if' approach for potential changes up to 2050, assessing shifts in key variables like ODA from EU MS on public expenditures, and subsequent alterations in outcome variables. Scenarios are based on extended real GDP and GNI values, recent averages, and the *ceteris paribus* principle, keeping other factors constant.

Also, the study does not explore the potential multiplier effect of policy interventions. Its focus is on the indirect relationship between development initiatives and poverty metrics, specifically through health and education expenditures, while keeping other variables constant.

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Annex III

Cost of non-Europe in EU action to eradicate poverty in developing countries: Impact of policies in areas of trade, global value chains and climate action

Research paper

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Executive summary

This paper explores the need for effective EU tools in the climate and trade domains for approaching poverty eradication and development goals in developing countries, focusing on least developed countries (LDCs). It highlights the importance of European added value in climate action and global value chains (GVCs) in the light of the overarching aim to alleviate poverty. In the light of the multiple challenges of LDCs, that face the recovering from the COVID-19 pandemic, the escalating climate emergency, and the serious vulnerability to external shocks due to wars, the achievement of the Sustainable Development Goals is increasing in urgency.

The first focus of this paper provides an in-depth analysis of the impact of global value chain participation on LDCs, with a focus on EU policies and the case study of Mozambique's graphite sector. The participation of LDCs in international trade and in global value chains can serve as an expedient route to development and poverty eradication. It may allow countries to leapfrog into technologically advanced areas of manufacturing without the need to domestically develop the whole value chain. Furthermore, production for global value chains is not dependent on domestic demand, which is often slow to catch up. Nonetheless, there are several drawbacks. Trade with LDCs is characterised by an asymmetrical relationship between leader firms and subordinate firms in GVCs, which often results in developing countries getting 'stuck' in a suboptimal place in the value chain. The leader firms, typically located in developed countries, capture most of the added value, leaving LDCs at a disadvantage. This imbalance is further exacerbated by strict product standards and by the need for standardisation, which often forces firms in developing countries to adopt capital goods developed in the Global North that are labour-saving in nature. Consequently, these countries find themselves caught in a low-income trap, unable to fully leverage their participation in GVCs to foster growth in the rest of the economy. As a leading trade partner to many LDCs, the EU can play an important role in ensuring that their participation in GVCs has beneficial impacts.

Economic development in LDCs faces difficulties due to the unpredictable nature of commodity exports. LDCs struggle with upgrading their economy beyond resource extraction due to unfavourable terms of trade, limited differentiation of exports, and inflexible industrial structures. Additionally, relying on commodity exports can cause inequality and instability in the economy, negatively affecting social development, included access to education and healthcare services. The case study on the graphite sector in Mozambique highlights the importance of implementing better environmental protection standards to minimise ecological harm. The study concludes that although engaging in GVCs can accelerate economic growth and alleviate poverty, there are different obstacles that must be addressed. These issues include transformation of the economy's structure, risks of environmental and human rights violation, dependence on exporting low value-added products, and risks linked to the shortening of GVCs.

The proposed policy options recommend fostering internal integration within and among LDCs to increase the internal spillovers resulting from international trade. They also suggest encouraging the concentration of value added in fewer stages throughout GVCs and discouraging foreign firms from operating in special economic zones and tax havens. The EU is urged to tighten its due diligence standards and to foster regional integration among LDCs. The paper further discusses the EU's Global Gateway strategy and the Aid for Trade framework, which aim to facilitate international trade with developing countries and promote sustainable economic development. However, it notes that these approaches have shortcomings, particularly in stimulating the upgrading of the industrial structure of the LDCs that it trades with.

The second focus of this paper provides an analysis of European climate action and its effects on LDCs under consideration of their specificities. LDCs are especially affected by climate inequalities between countries. However, climate change drives social inequalities within each country at an increasing pace, and this holds particularly for marginalised groups. Moreover, most of the LDCs are

particularly exposed to the effects of climate change and are marked with a high climate vulnerability.

Climate change and poverty are entangled and further raise the concern whether both global challenges can be tackled simultaneously, especially in LDCs. Furthermore, climate change effects would erase the poverty eradication efforts of recent decades in the absence of mitigation, adaptation, and socio-economic measures. Some scholars demonstrate that some countries in the Global South are poorer today than they would have been in the absence of climate change. Across all geographical regions, it is clear that climate change is hindering poverty alleviation. Responses to climate change are constrained by worsening living conditions, and by threatening food security due to undernutrition, malnutrition, and low opportunities for income generation. The access to basic ecosystems services, such as rainwater, is in danger, creating favourable conditions for the spread of diseases. Gender inequalities are also enhanced by climate impacts.

LDCs are facing structural challenges that increase their vulnerability to climate change ex ante. LDCs, notably in Africa, are primarily agricultural economies with nearly 55 % of the population engaged in agriculture, and an estimated 50 % of their farmers are considered vulnerable because of infrequent market, land and education access. Exposed to the imperative to decarbonise industries, the call for low-carbon technology transfer is eminent – despite only having marginal effects on the whole economy in its current structure. Nevertheless, a lack of access to energy and internet, high costs of implementation, insecurities and low transparency about the real figures of technology transfer, pose a challenge. Faced with the specific structural challenges from their exposure to the green techno-economic paradigm established by developed countries, LDCs struggle to catch-up, regarding capacity, financing and technical know-how. The EU Carbon Border Adjustment Mechanism provides a vivid example of these contradictory patterns in LDCs.

The analysis highlights the need for transparency in EU private sector finance mobilisation in order to channel these private resources towards the achievement of targeted climate goals, and the necessity of addressing the asymmetry in adaptation and mitigation finance. Despite being a large provider of climate financing to developing countries, the EU still faces a financing gap for climate adaptation through multilateral channels. A partial solution would be the imperative to design climate finance schemes that are highly accessible for LDCs to increase their capacity to react to the effects of climate change they are exposed to. This would be achievable through the issuing of more grants and concessional loans, acknowledging the high debt of LDCs, and through focusing on sustainable offers in adaptation funding, such as building climate-resilient infrastructure, implementing early warning systems, promoting sustainable agriculture, and increasing the transparency and accessibility of international climate funds, among other things. Additionally, the pivotal role of considering gendered aspects in the nexus of climate action and poverty eradication is considered.

In conclusion, the paper emphasises the need for a balanced approach that considers both the economic benefits of GVCs and the challenges they pose to LDCs. It calls for more inclusive and sustainable policies that can help these countries leverage their participation in GVCs for broader economic growth and sustainable development, having the overarching objective of poverty eradication. In the case of reacting to the trade-offs caused by EU climate action affecting LDCs, the study calls for support for a green and resilient transformation, to boost climate finance, and to prioritise gender-sensitive mechanisms and vulnerable populations in climate adaptation planning. These include the promotion of technology transfer, support for the implementation of integrated energy approaches, and the construction of solid partnerships. The EU's added value derives from acting as a coordination platform for policies and partnerships for GVCs and climate action.

Table of contents

Table of figures

List of tables

1. Introduction

Even if income-based poverty reduction in the Global South was slowing before the Covid-19 shock, the pandemic reversed the trend by increasing income-based poverty globally, along with rising numbers of multi-dimensional vulnerabilities and inequalities.[1] The complex challenge of recovering from the Covid-19 pandemic and addressing the serious climate emergency has been at the core of ongoing global efforts to foster an inclusive and green recovery.[2] The Global Human Development Index has declined, two years in a row, from 2020 to 2022, cancelling the gains of the preceding five years.[3] Other global crises enhanced exposures to external shocks, such as the consequences of the Russian war of aggression on Ukraine[4] and its impacts on food and energy prices, in a context where the financialisaton of commodity markets is already increasing the vulnerability of Least Developed Countries (LDCs).[5] This makes it urgent to analyse and to increase the effectiveness of the pursuit of the development policy objectives, as well as associated European Union (EU) actions and tools that impact development initiatives and development outcomes in partner countries. This is particularly urgent in the domains of trade, global value chains, investments, and climate action.

This paper seeks to explore through literature review, interviews and two case studies the main challenges related to the impact of EU trade and climate policies on poverty reduction in LDCs. It formulates then some policy proposals that would enhance the potential for poverty eradication of EU policies in trade and climate domains in LDCs.

Chapter 1 introduces the main aspects of EU climate action, EU trade policies and EU initiatives on poverty eradication in LDCs and their synergies. Chapter 2 will then present a selection of risks and challenges in relation to climate policies, trade policies and poverty reduction in LDCs. Chapter 3 will provide suggestions on what the EU could consider and improve while still promoting poverty reduction and sustainable economic development in LDCs. Finally, in the conclusions we will focus on some general considerations.

1.1. Multidimensional poverty in least developed countries

Since 1971, the United Nations recognised Least Developed Countries (LDCs) as a category of States that are strongly disadvantaged in their development process, for historical, structural, and also geographical reasons. With respect to other countries, LDCs face particularly the risk of serious poverty and of long persistence in a situation of underdevelopment. Over 75 per cent of the LDCs' population still live in income-based poverty. These countries are also vulnerable to external economic shocks, natural disasters, human-made conflicts, and communicable diseases. Currently, the 46 LDCs comprise approximately 1.1 billion people, which correspond to 14% of the world

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1 Sumner, A., Hoy, C. & Ortiz-Juarez, E., 'Estimates of the impact of COVID-19 on global poverty', *WIDER Working Paper 2020/43,* UNU-WIDER, 2020; Valensisi, G., 'COVID-19 and Global Poverty: Are LDCs Being Left Behind?' , *The European Journal of Development Research* 32, 2020, p.p. 1535–1557; Belaid, F. & Tiba, S., 'Repercussions the Covid-19 Pandemic on the SDGs Achievement: Is it a New Era for the Development?', *The European Journal of Development Research* 35, 2023, p.p. 138–147; UNDP, 'Human Development Report', 2021-2022; UNSTATS, 'SDG Report 2023'.

2 UNCTAD, 'The Least Developed Countries Report 2022 - The low-carbon transition and its daunting implications for structural transformation', 2022.

3 UNDP, 'Human Development Report', 2021-2022.

4 Hellegers, P., 'Food security vulnerability due to trade dependencies on Russia and Ukraine', *Food Security*, 14(6); p.p. 1503-1510, 2022.

5 UNCTAD, 'Development prospects in a fractured world : Global disorder and regional responses', Trade and Development Report, 2022.

population.[6] However, at the same time, LDCs account for only 2 % of the world GDP and 1 % of the world trade.[7] Around 244 million people in LDCs were undernourished in 2020, 466 million had no access to electricity, 665 million lacked access to clean drinking water, and 874 million had no access to safe fuels and cooking tools.[8] Thirty out of the 46 countries recognized as part of the LDC group are in Africa, four in the Arab States, eleven in Asia and the Pacific, and one in the Caribbean region. Eight are Small Island Developing States (SIDS).[9]

With regard to trade, LDCs have a very small participation in trade and global value chains. In fact, according to the World Trade Organization[10], in 2021 the share of total world trade of goods and services attributed to LDCs was around 1.15 %, while in 2022 the share of EU trade attributed to LDCs was of 1.8 %.[11] Moreover, their participation in global trade is dominated by the export of commodities, with primary products accounting for around 53 % of the value of exports and to a lesser extent clothing, mostly in southeast Asia, accounting for around 27 % of the value of exports. Least developed countries also have deficiencies in their health and education outcomes, and face challenges with economic and environmental vulnerability.

The implementation of inclusive and successful policy solutions in LDCs is particularly challenging since they face multiple obstacles to development bottlenecks simultaneously, with high levels of poverty interacting with limited access to water, sanitation, and education, with forced migration and, in some cases, with state fragility.[12] [13] [14]

1.2. Global value chains and trade in non-finished goods

The concept of global value chains (GVCs) was initially conceived by Gereffi and Korzeniewicz[15] to refer to the change in the structure of multinational enterprises that started taking shape in the 1980s. This shift was partly a response to the new development strategy of the developing world after the crisis brought about by the collapse of the Bretton Woods system.[16] They consist of a dispersion of the production and value along processes throughout different countries.[17] The concept of GVCs is distinguished from the concept of traditional trade, where all the production activity takes part in a single country and all the consumption activity takes part in another. Throughout this paper we will follow a wide definition of the global value chain that also encompasses all exports of non-finished goods, notably commodities, even if there are no permanent formal contractual relations between buyer and seller. The reason for the adoption of

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6 UNCTAD, 'The Least Developed Countries Report 2022 - The low-carbon transition and its daunting implications for structural transformation', Report, 2022.

7 UNCTAD, 'Trade and Environment Review 2021', Report, 2021.

8 UNCTAD, 'The Least Developed Countries Report 2022 - The low-carbon transition and its daunting implications for structural transformation', Report, 2022.

9 UNDP, 'State of Climate Ambition', Report, 2022.

10 WTO, 'Trends in LDC trade', Website.

11 European Commission, Directorate General for Trade, 'European Union, Trade in goods with LDC', website.

12 Hallegatte, S. & Rozenberg, J., 'Climate change through a poverty lens', *Nature Climate Change*, 7(4), 2017.

13 Feldmeyer, D., Birkmann, J., McMillan, J.M. et al., 'Global vulnerability hotspots: differences and agreement between international indicator-based assessments', *Climatic Change*, 169 (12), 2021.

14 Birkmann, J., Jamshed, A., McMillan, J.M., Feldmeyer, D., Totin, E., Solecki, W., Ibrahim, Z.Z., Roberts, D., Kerr, R.B., Poertner, H.-O., Pelling, M., Djalante, R., Garschagen, M., Leal Filho, W., Guha-Sapir, D. & Alegría, A., 'Understanding human vulnerability to climate change: A global perspective on index validation for adaptation planning', *Science of The Total Environment*, 803, 2022.

15 Gereffi, G., & Korzeniewicz, M. (Eds.), '*Commodity chains and global capitalism*', Praeger, 1994.

16 Frieden, J. A., 'Global Capitalism: Its Fall and Rise in the Twentieth Century', W. W. Norton & Company, 2007.

17 OECD, 'Global value chains', website.

this wide definition is that it better fits LDCs, without losing most of the central characteristics of global value chains in their more restricted sense.

The relationship between the lead firm and the firms associated with them can take various forms, with the lead firm exerting various levels of control.[18] The level of control can range from purely market-based to purely hierarchical through an increasing degree of explicit coordination.[19] GVCs are facilitated by the existence of regional trade agreements that set up the necessary regulatory conditions for them to be able to function.[20]

The establishment of GVCs became possible due to a sharp decrease in the costs of transport information and communication[21] that have led to a significant decrease in trade costs. The political view towards trade liberalisation also shifted significantly in favour of freer trade. This is evidenced by the collapse of the import substitution strategy in the early 1980s in different countries of the Global South, the end of the cold war, the accession of China into the World Trade Organization and the expansion of the EU into the former "Eastern bloc". The reasons for a company to unfold its production into GVCs can vary. They can be based on facilitated access to inputs as to reduce transport costs[22], they could be based on cheaper labour in the host country[23], or they can be due to a desire of securing distant sources of raw materials. [24]

The dispersion naturally has consequences on the industrial structure and employment of the countries involved in the GVCs. GVCs by transplanting parts of the production process to developing countries can present an opportunity for these countries to leapfrog in the development process. This was the route followed by the so-called Asian Tigers (Hong-Kong Singapore, South Korea, and Taiwan).[25] Some authors consider GVCs to have a positive impact on the host countries while others consider them to have a mixed or negative effect. We will briefly go over the main arguments.

The most immediate way in which GVCs can help a country develop its economy and directly decrease poverty is through the creation of well-paid jobs for the relatively higher skilled workers[26], even if this may happen at the cost of increasing internal wage inequality. The creation of better paid jobs could then have a spill over effect on the rest of the economy. The jobs created have the further advantage of being dependent on external demand that, under some circumstances, may be on average less volatile when compared to domestic demand[27]. Furthermore, as the external demand for consumer goods does not depend on internal income, a country can export goods in high quantities without having to pass through the slow process of accumulating internal demand.

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18 Gereffi, G., & Fernandez-Stark, K., 'Global Value Chain Analysis: A Primer', Duke Center on Globalization, Governance & Competitiveness, 2016.

19 Gereffi, G., 'Global value chains and international development policy: Bringing firms, networks and policy-engaged scholarship back in', *Journal of International Business Policy*, 2(3), 2019, p.p. 195–210.

20 Baldwin, R., 'Global supply chains: Why they emerged, why they matter, and where they are going', *CEPR Discussion Papers,* Article 9103, 2012.

21 Amador, J., & Cabral, S., 'Global Value Chains: A Survey of Drivers and Measures', *Journal of Economic Surveys*, 30(2), 2016, p.p. 278–301.

22 Buelens, C., & Tirpák, M., 'Reading the Footprints: How Foreign Investors Shape Countries' Participation in Global Value Chains', *Comparative Economic Studies*, 59(4), 2017, p.p. 561–584.

23 Humphrey, J., & Schmitz, H., 'Governance in Global Value Chains.', *IDS Bulletin*, 32(3), 2001, p.p.19–29.

24 Gereffi, G., Lim, H.-C., & Lee, J., 'Trade policies, firm strategies, and adaptive reconfigurations of global value chains.', *Journal of International Business Policy*, 4(4), 2021, p.p. 506–522.

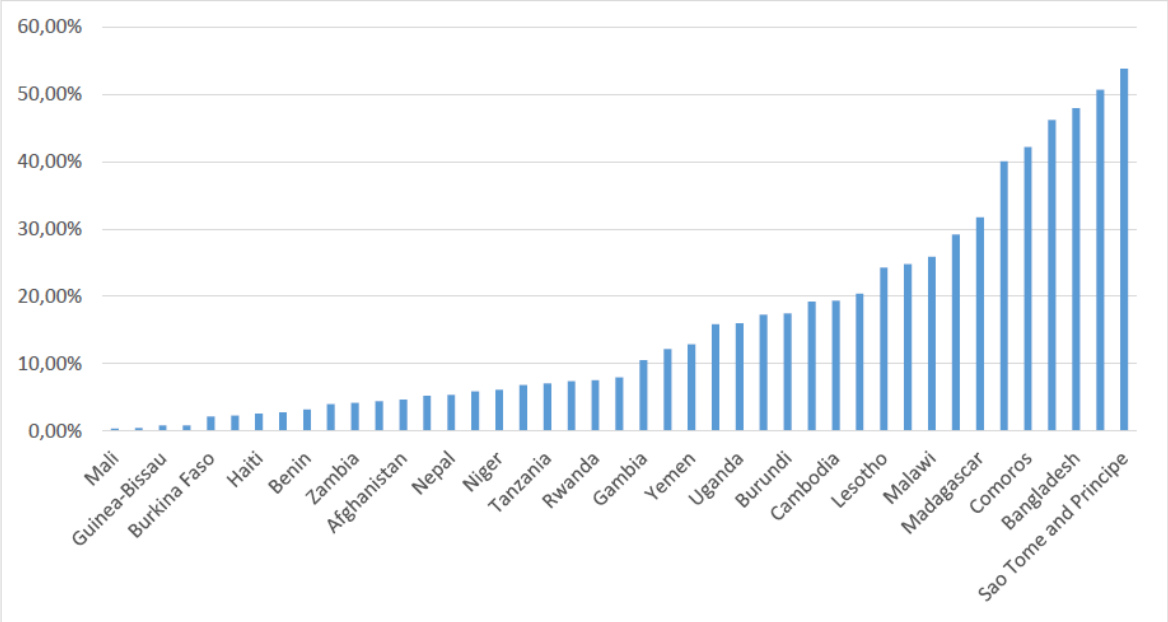
25 Hauge, J., 'Industrial policy in the era of global value chains: Towards a developmentalist framework drawing on the industrialisation experiences of South Korea and Taiwan.', *The World Economy*, 43(8), 2020, p.p. 2070–2092.

26 Shepherd, B., 'Global Value Chains and Developing Country Employment: A Literature Review', *OECD Trade Policy Papers*, 156, 2013.

27 Dine, M. N., 'Impact of Global Value Chains' Participation on Employment in Turkey and Spillovers Effects.', *Journal of Economic Integration*, 34(2), 2019, p.p. 308–326.

More importantly, global value chains can allow developing countries to upgrade their industrial structure. This can either mean a spillover of knowledge and technology to the rest of the economy or the improvement of the position of the developing country inside a GVC. Under these circumstances the leader firm has often an incentive to improve the capabilities of its suppliers.[28] Furthermore, the constant stream of product innovations and process innovations, usually developed by the leader firm, force the subordinate firms to keep improving their technology, frequently with the aid of the leader firm[29]. The presence of advanced manufacturing techniques inserted in the context of a GVC can lead to the formation of an array of knowledge externalities as workers who are employed in the GVC gain experience in the particularities and operation of

Figure 1 – Share of LDC merchandise exports to the EU in 2021



Source : CEPII, BACI dataset.

sophisticated industrial endeavours.[30] Aggregation externalities may also arise, as the concentration of productive enterprises and the movement of people from the countryside into cities create the demand conditions necessary for the establishment of productive and productivity enhancing economic activities.[31][32]

The EU is strongly involved in global value chains. In 2022 intermediate goods represented 61 % of the total imports from extra EU sources. The EU is an important export market for LDCs. As can be seen in Figure 1, it is the destination of more than 20 % of merchandise exports from 12 LDCs and it is the destination of at least 10 % of the merchandise exports of more than half of all LDCs. Furthermore, the EU has a prominent role in trade with the African continent. In 2020, 31 % of Africa's imports originated in the EU, and 33 % of Africa's exports were destined to the EU, making

[28] Humphrey, J., 'Upgrading in Global Value Chains', *SSRN Scholarly Paper* 908214, 2004.

[29] Ravenhill, J., 'Global value chains and development.', *Review of International Political Economy*, 21(1), 2014, p.p. 264–274.

[30] Marshall, A., '*Principles of Economics*', Palgrave Macmillan, 8th ed., 1920.

[31] Jacobs, J., '*The Economy of Cities*.', Random House, 1969.

[32] Krätke, S., '*The Creative Capital of Cities: Interactive Knowledge Creation and the Urbanization Economies of Innovation*', John Wiley & Sons, 2011.

the EU Africa's largest trading partner[33]. The way in which the EU structures its trade policy can have important repercussions in the African continent, where many LDCs are located.

1.3. The urgency of climate action in LDCs

LDCs are already experiencing higher temperatures than in the past, with a median temperature that is 1.3 °C higher than in the reference time span 1951-1980.[34] Human-generated climate change is increasing the frequency of extreme weather events, which moreover occur with higher probability in tropical regions where LDCs are mainly concentrated. Climate change is also causing gradual environmental degradation, which affects more strongly poor rural communities and those with limited access to productive land, food supplies and water.[35] Additionally, the growth in human population and economies, especially concentrated in areas with climatic harm, means that the risks of multidimensional damages from climate change for LDCs will continue to increase. Within the time span 1970-2019, disasters from weather, climate and water extreme events represented 50 % of all recorded disasters, and 74 % of related monetary losses. The World Meteorological Organization showed an almost eightfold increase in average daily economic losses between 1970-79 and 2010-19.[36] This figure is particularly higher for the most vulnerable LDCs, since they are especially exposed to global warming and to the rise of natural hazards. It has been estimated that, in order to cover these damages, Sub-Saharan African countries would have to take on an additional USD 996 billion in debt over the next 10 years, which represents a 50 % increase on current debt levels as a percentage of GDP. [37]

More ambitious action is needed, especially in and by high-income countries that contributed most to the historic emissions of greenhouse gases (GHG), such as the EU and its Member States (see 1.3.1 and 2.6.1). Actions aimed at reducing inequality, addressing poverty and promoting proactive adaptation to climate related shocks would reduce the size of exposed and vulnerable population, especially if co-benefits with climate mitigation policies are also in place.[38] To support such effective climate action in LDCs, an understanding of their exposure to the effects of climate change is essential, by means of climate inequality, climate vulnerability and the intersection of climate and poverty action.

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33 Eurostat, 'Africa-EU - international trade in goods statistics', website.

34 UNCTAD, 'The Least Developed Countries Report 2022 - The low-carbon transition and its daunting implications for structural transformation', Report, 2022.

35 Birkmann, J., E. Liwenga, R. Pandey, E. Boyd, R. Djalante, F. Gemenne, W. Leal Filho, P.F. Pinho, L. Stringer, and D. Wrathall, 'Poverty, Livelihoods and Sustainable Development', *Climate Change 2022: Impacts, Adaptation and Vulnerability*, Contribution of Working Group II to the Sixth Assessment Report of the Intergovernmental Panel on Climate Change, 2022. Further: IPCC WG II AR 6, Poverty, Livelihoods and Sustainable Development, 2022.

36 OECD, 'Climate Action Monitor', 2022.

37 Woolfenden, T. & Khushal, S., 'The Debt and Climate Crisis', Climate Network International, 2022.

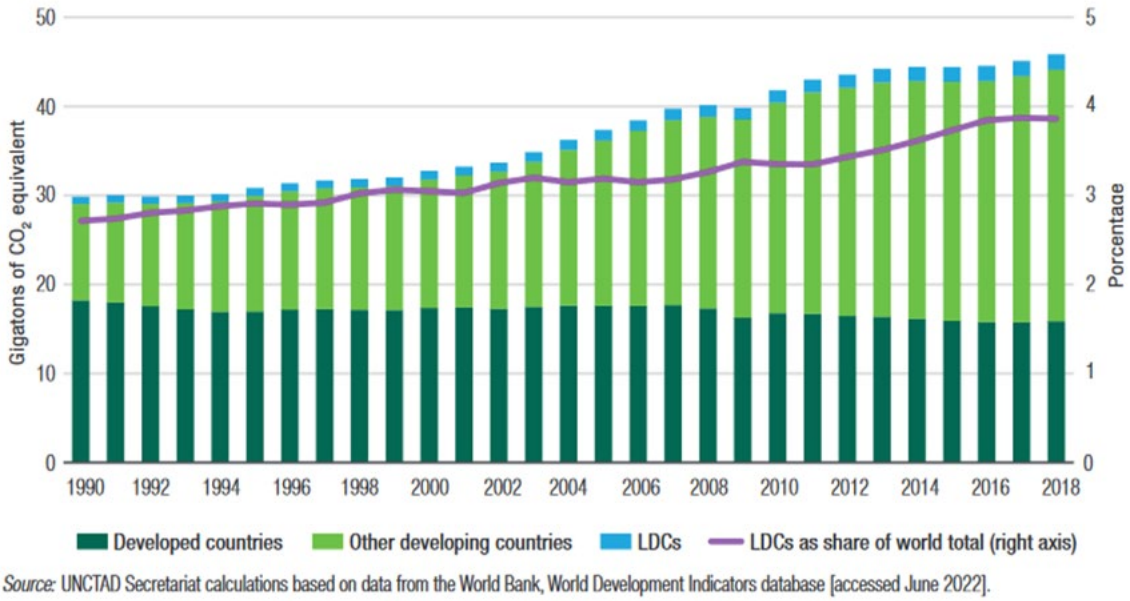
38 Byers, E., Gidden, M., Leclère, D., Balkovic, J., Burek, P., Ebi, K., Greve, P., Grey, D., Havlik, P., Hillers, A., Johnson, N., Kahil, T., Krey, V., Langan, S., Nakicenovic, N., Novak, R., Obersteiner, M., Pachauri, S., Palazzo, A. & Parkinson, S., 'Global exposure and vulnerability to multi-sector development and climate change hotspots', *Environmental Research Letters*, 13(5), 2018.

1.3.1. Carbon inequality

In 2019, LDCs were estimated to have accounted for about 1.1 % of total world CO_2 emissions from fossil-fuel combustion and industrial processes, going along with the historical trend of LDCs contributing the least to global emissions (Fig. 2).

Although bearing the least historical responsibility for climate change, LDCs are hit the hardest by it. According to UNCTAD, over the last 50 years, 69 % of worldwide deaths caused by climate-related disasters occurred in LDCs.[39] This is also due to lacking information and infrastructure: as of 2023,

Figure 2 – Total GHG emissions, by country group, 1990-2018



Source: UNCTAD, The Least Developed Countries Report 2022.

only 17 % of LDCs had access to disaster risk information, 46 % had a multi-hazard early warning system, and 61 % reported to have national disaster risk reduction strategies.[40] Carbon inequality between countries is slowly decreasing, whereas the bigger concern now is the growing inequality within countries, especially in LDCs: individuals and income-based groups of individuals contribute differently to carbon emissions, and are not equally equipped to tackle the effects of climate change.[41]

Gendered aspects of climate change

Especially exposed to the threats of climate change are women, indigenous communities, ethnic and racial minorities, particularly in LDCs.[42] Very complex systematic ties make women vulnerable to poverty: years of potential economic productivity overlap with traditional care responsibilities,

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39 UNCTAD, 'The Least Developed Countries Report 2022 - The low-carbon transition and its daunting implications for structural transformation', 2022.

40 UNDRR, 'Disaster Risk Reduction in LDCs', Website.

41 World Inequality Lab, 'Carbon Inequality Report 2023', 2022.

42 Ibarrarán, M.E., Ruth, M., Ahmad, S. & London, M., 'Climate change and natural disasters: macroeconomic performance and distributional impacts', *Environment, Development and Sustainability*, 11(3), 2007, p.p. 549–569.

which leave women globally vulnerable to poverty due to time constraints.[43] Education and paid employment is a huge factor in the fight against poverty, while women in LDCs are included with higher difficulties in these opportunities. According to recent forecasts, 62.8 % of the world's extreme poor women and girls are living in Sub-Saharan Africa and 20.9 % in Central and Southern Asia, where LDCs are mainly located.[44] Concerning gender, climate hazards have different impacts on men or women, depending on their roles in their community and on their economic situation.[45] Women are especially affected by climate change because their dwellings tend to be located in areas more exposed to flooding, landslides, or drought. They tend to live from agriculture, fishing and other activities based on natural resources that are in turn vulnerable to climatic changes, and they lack income diversification sources that would improve resilience to shocks.[46] Gender and other marginalizing dimensions further intersect with economic, ethnic and other social factors, which can influence the adaptive capacity of people. This can also affect the information status of marginalized groups reacting to catastrophes in case of emergency.

1.3.2. Climate change vulnerability

LDCs are highly vulnerable to climate change due mainly to four factors: their geographic exposure (Fig. 3), economic structure, labour market composition, and low adaptive capacity. The latter is in turn related to their physical and social infrastructure, financial resources, and political institutions.[47] This creates a double challenge for LDCs regarding structural transformation and climate change in the meantime. In 2022 UNCTAD classified 36 of the 46 LDCs as commodity dependent. Observing the 1990-2020 period, researchers observed that LDCs had very low levels of natural resource extraction and the lowest footprints worldwide, but they were still net providers of most ecological resources to the world market.[48] Yet, the dependency of the economies on natural resources enhances further climate change vulnerability and poverty. This is highly visible in the agricultural sector in LDCs that is highly exposed to droughts and floods caused by climate change and thus threatens livelihoods of the poorest.[49] Volatile and unreliable climatic trends coupled with a low production and export diversification (further explored in section 2.1) increases LDC's vulnerability to external shocks, trade imbalances, and the increasing accumulation of external debt.[50]

Regional distribution of vulnerability and climate-related displacement

Figure 3 maps the regional distribution of climate change vulnerabilities, especially concentrated on the African continent, which hosts 30 of the 46 LDCs, and other hotspots in South Asia, clustered along the equator. Globally, rural areas are most heavily hit by climate change, yet new global mega-trends, such as urbanisation, underscore the need to assess both rural and urban communities and

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43 Munoz Boudet, A.M, Buitrago, P., de la Briere, B.L., Newhouse, D., Rubiano Matulevich, E., Scott, K. & Suarez-Becerra, P., 'Gender Differences in Poverty and Household Composition through the Life-Cycle – A global Perspective', World Bank Group, Poverty and Equity Global Practice & Gender Global Theme, 2018.

44 UN Women, 'Poverty deepens for women and girls, according to latest projections', Research Highlight, 2022.

45 Patt, A., Dazé, A., & Suarez, P., 'Gender and Climate Change Vulnerability: What's the Problem, What's the Solution?' in Ruth M. & Ibarran M. (eds) *Distributional Impacts of Climate Change and Disasters: Concepts and Cases*, Edward Elgar Publishing, 2009.

46 European Parliament, Legislative Observatory, 'Motion for a European Parliament Resolution on the impacts of climate change on vulnerable people in developing countries', (2020/2042(INI)), 2020.

47 ILO, 'Present and Future Work LDCs', 2022; Biagini, B., Bierbaum, R., Stults, M., Dobardzic, S. & McNeeley, S.M, 'A typology of adaptation actions: A global look at climate adaptation actions financed through the Global Environment Facility', *Global Environmental Change* 25, 2014, p.p. 97-108; ILO, 'Present and future of work in the Least Developed Countries', Report, 2022.

48 UNCTAD, 'The Least Developed Countries Report 2022', Report, 2022.

49 Callahan, C. W. & Mankin, J. S., 'Globally unequal effect of extreme heat on economic growth', *Science Advances*, 8 (43), 2022; Casillas, C.E. & Kammen, D.M., 'Quantifying the social equity of carbon mitigation strategies', *Climate Policy* 12, 2012, p.p. 690–703.

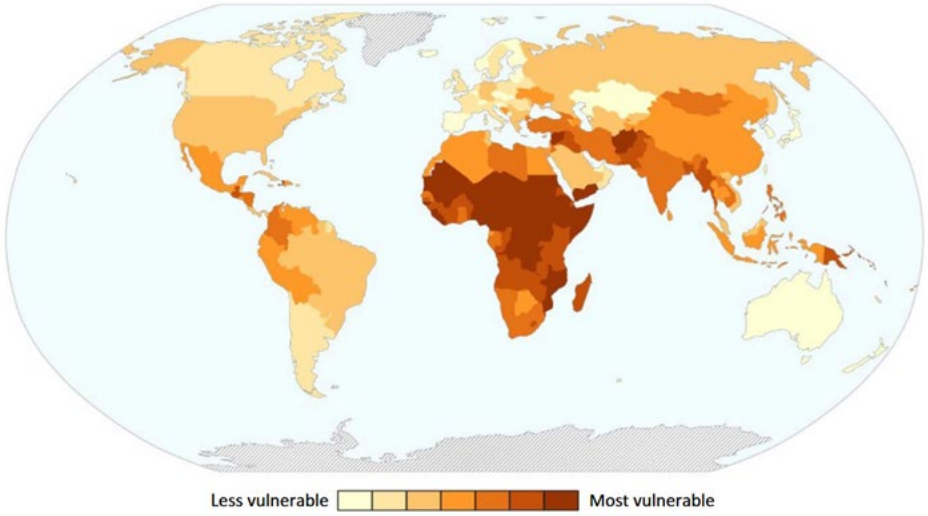
50 ILO, 'Present and future of work in the Least Developed Countries', Report, 2022.

their vulnerability. This is particularly important for informal settlements due to high numbers of migration which are often located in hazard-exposed regions of mega-cities.[51]

Worldwide, more than 32.6 million people were displaced due to disasters in 2022, making up 53 % of overall internal displacement. 7.4 million were displaced in Sub-Saharan Africa, while 2.1 million were recorded due to the longest and most severe drought in the region.[52] 80 % of people displaced by climate change are women.[53] Climate internal or international migration can have a double effect: after sudden or slow environmental disasters that lead to internal and cross-border displacement of people, massive migration may in turn affect environmental conditions in both areas of origin and destination and along the transit routes in between. This holds particularly when large concentrations of people are forced to find refuge in already ecologically fragile areas.[54]

1.3.3. Climate change and poverty

Figure 3 – Regional distribution of vulnerabilities to climate change



Source: Birkmann et al., Regional clusters of vulnerability, 2021.

Climate change and (extreme) poverty are strongly entangled and raise the concern on whether both global challenges can be tackled simultaneously, especially in LDCs. According to the World Bank, unmitigated climate change could lead up to 130 million people into poverty over the next 10 years and could cause migration within the own country for more than 200 million people by 2050.[55] Natural and climate features, such as low rainfall, annual floods and poor soil quality, accelerated by climate change, are seen as important poverty drivers, among others.[56] Many

[51] Rana, I.A., Asim, M., Aslam, A.B. and Jamshed, A., 'Disaster management cycle and its application for flood risk reduction in urban areas of Pakistan', *Urban Climate* 38, 2021.

[52] Internal Displacement Monitoring Center, 'Global Report on internal displacement 2023', Report, 2023.

[53] UNDP, Gender and Climate, Website.

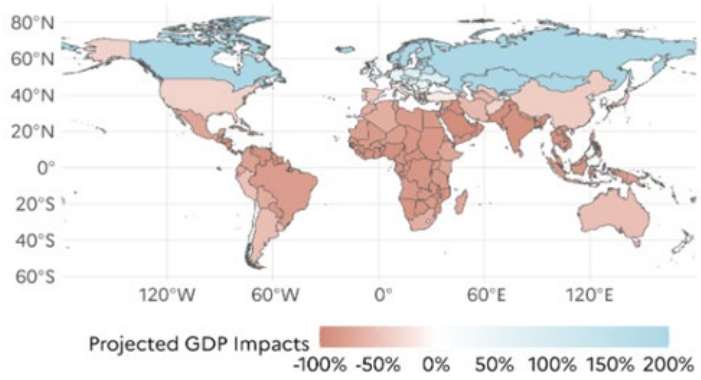
[54] EU Parliamentary Assembly, Assembly debate on 30 January 2009, on environmentally induced migration and displacement: a 21st-century challenge'.

[55] The World Bank, 'When poverty meets climate change: A critical challenge that demands cross-cutting solutions', 2021.

[56] Latek, M., 'EU Support for fighting Global Poverty', EPRS, EU Briefing Note, 2019; Hallegatte, S. et al., 'Shock Waves – Managing the Impacts of Climate Change on Poverty', World Bank Group, 2016.

countries in the Global South are significantly poorer today than they would have been in the absence of climate change.

Figure 4 – Change in GDP per capita by 2100 attributable to climate change (SSP5)



Source: WID, Climate Inequality Report 2023.

This trend is set to continue and results in strong GDP per capita losses for many low- and middle-income countries by the end of the century (Fig. 4).[57] The estimated impacts in Fig. 4 derive from Burke et al. (2015), who identify a baseline inverse U-shaped relation between economic output and temperature for 166 countries within the time range 1960-2010. An annual mean temperature around 13◦C is estimated to maximize income, therefore for countries having mean temperatures below this threshold, climate change may bring some positive consequences for GDP growth due to enhanced productivity, while countries presenting higher average temperatures would face significant GDP losses. As most countries below the threshold are low- and middle-income countries, global warming is likely to increase existing global income inequalities. In Fig. 4 Burke et al. (2015) considered the shared socio-economic pathway SSP5 for 2100 that foresees high baseline growth and unmitigated climate change, and they estimated a GDP loss between 25% and 80% in many low- and middle-income countries under this most fossil-fuelled development scenario.[58]

Across all geographical regions there is evidence that climate change is hindering poverty alleviation and thereby constraining responses to it.[59] Climate change worsens living conditions, by threatening food and nutrition security due to undernutrition and reduced opportunities for income generation, by unsettling access to basic ecosystems services such as rainwater, and by creating favourable conditions for the spread of diseases.

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57 World Inequality Database, Climate Inequality Report 2023, 2023.

58 Burke, M., Hsiang, S. M., & Miguel, E. (2015). 'Global non-linear effect of temperature on economic production'. *Nature*, 527(7577), 235-239. The SSPs are "shared socio-economic pathways", that is to say modelled reference scenarios showing plausible alternative trends in the evolution of the economies and ecosystems over a timescale of 100 years. They are modelled by the Intergovernmental Panel on Climate Change (IPCC) in the Sixth Assessment Report of 2021. In SSP5, climate policies are absent, most of the high energy demand is met with carbon-based fuels, and economic development is relatively rapid.

59 Denton, F., T.J. Wilbanks, A.C. Abeysinghe, I. Burton, Q. Gao, M.C. Lemos, T. Masui, K.L. O'Brien, & K. Warner; 'Climate-resilient pathways: adaptation, mitigation, and sustainable development'. In: Climate Change 2014: Impacts, Adaptation, and Vulnerability, *Part A: Global and Sectoral Aspects. Contribution of Working Group II to the Fifth Assessment Report of the Intergovernmental Panel on Climate Change*, 2014, p.p. 1101-1131.

Gender inequalities may also be enhanced, for example those related to access and control to productive inputs, to the reinforcement of socio-cultural norms[60] and to the creation of persistent poverty traps.[61] However, on the other hand, there is little evidence that poverty alleviation conflicts with the fight against climate change.[62] Looking at the trade-off between short-term poverty alleviation policies versus climate action in LDCs, it is interesting to note, that, despite an increasing understanding that inequality and multidimensional poverty are clear determinants of systemic vulnerability to climate change, only few countries explicitly declare to reduce poverty and income inequality also as an adaptation measure to climate change.[63] Moreover, evidence suggests that higher power inequality may lead to higher levels of pollution acceptance due to short-term policies.[64]

1.4. Current EU policy

1.4.1. Current EU policy: Aspects of trade and GVCs

Starting December 2021, the EU is rolling out the Global Gateway, its strategy for sustainable investments in infrastructure worldwide in order to achieve progress on a range of interlinked Sustainable Development Goals (SDGs). The strategy aims to finance projects worldwide in order to narrow the global investment gap in the key areas of climate and energy, transport, digital sector, health, and education and research.[65] The Global Gateway strategy further aims to involve the private sector in its development aid schemes. The EU-Africa global investment package aims to fulfil several development goals: i) accelerating the green transition; ii) accelerating the digital transition; iii) accelerating sustainable growth and decent job creation; iv) strengthening health systems; and v) investing in education and training. It is relevant to highlight three of the package's ambitions for 2030 with regard to sustainable growth. The first is to strengthen continental and regional economic integration and accelerate Africa's industrial development. The second is to enable African countries to integrate their raw materials and resources into sustainable global value chains. The third is to accelerate Africa's transition to an innovation-led, scientific, knowledge-based economy.[66] These policies illustrate the objective of encouraging growth through the upgrading of the position of African countries in global value chains.

The "Aid for Trade" framework runs alongside the EU's Global Gateway strategy. Aid for trade's underlying premise is that stable and sustainable economic development can stem from the integration of developing countries into the global trading system. Empirical studies by Helble et al.[67] show that aid directed towards the facilitation of trade has a significant impact on the increase of exports while regular aid has a significant impact on the increase of imports. The idea of aid for trade was initially launched by the World Trade Organization in 2005 and began to be implemented in 2007, the same year in which the EU adopted its aid for trade strategy.[68] To this regard the EU has

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60 Singh, C., M. Tebboth, D. Spear, P. Ansah, & A. Mensah, 'Exploring methodological approaches to assess climate change vulnerability and adaptation: reflections from using life history approaches', *Regional Environmental Change*, 19(8), 2019, p.p. 2667–2682.

61 IPCC WG II AR 6, 'Poverty, Livelihoods and Sustainable Development', 2022.

62 Bruckner, B. Hubacek, K., Shan, Y., Zhong, H., & Feng, K., 'Impacts of poverty alleviation on national and global carbon emissions', *Nature Sustainability*, 5(4), 2022, p.p. 311-320.

63 IPCC WG II AR 6, 'Poverty, Livelihoods and Sustainable Development', 2022.

64 Malerba, D., 'The Trade-off Between Poverty Reduction and Carbon Emissions, and the Role of Economic Growth and Inequality: An Empirical Cross-Country Analysis Using a Novel Indicator', *Social Indicator Research*, 150, 2020, p.p. 587–615.

65 European Commission, 'International Partnerships', website.

66 European Commission, 'EU-Africa: Global Gateway Investment Package', website.

67 Helble, M., Mann, C. L., & Wilson, J. S., 'Aid-for-trade facilitation', *Review of World Economics*, 148(2), 2012. p.p. 357–376.

68 WTO, 'Aid for Trade', website.

striven both to facilitate international trade with its aid packages and established an array of trade agreements, on a varying degree of preferentiality of terms with developing countries.

The trade relations that the EU establishes with developing countries can come under the umbrella of the 'Generalised Scheme of Preferences'. The 'Generalised Scheme of Preferences' is a unilateral mechanism that applies to all countries classified below "upper-middle-income" by the World Bank and do not have a preferential access to the EU market. It includes a partial or total reduction of duties on two thirds of tariff lines. Furthermore, the "Generalised Scheme of Preferences +" lowers the tariffs mentioned above even further to 0 % on the condition that the partner country implements a series of international conventions on human rights, labour rights, environmental protection and climate change, and good governance.[69] The "Generalised Scheme of Preferences" also includes the "Everything but Arms" scheme, under which all exports from LDCs into the EU are exempt from tariff barriers except for exports of weapons. The concept behind the 'Generalised Scheme of Preferences' is to allow developing countries preferential access to the EU's market while at the same time allowing them to keep trade protections on certain sensitive tariff lines. Some authors consider that the inclusion of developing countries in international trade is able to foster development in a more sustained manner when compared to traditional aid.[70][71]

With a similar goal the EU also establishes Economic Partnership Agreements. These agreements have as their focus countries of the African Caribbean and Pacific group and involve a deep level of economic integration. Not only is market access facilitated through the reduction of tariffs, but also through the cooperation between the EU and the partner countries. By default, Economic Partnership Agreements are meant to be balanced in favour of the developing countries involved. Hence, the EU completely removes its import duties on goods coming from the developing country, while the developing country has to open its markets only partially and with a fairly long grace period of 15 to 25 years, depending on the tariff line involved.[72]

For these reasons, when compared to the "Generalised Scheme of Preferences", the Economic Partnership Agreements are considerably more flexible and are able to incorporate the regional particularities of the partner countries. Unlike what happens with the "Generalised Scheme of Preferences" the contents of an economic partnership agreement can change considerably from country to country. The effectiveness of these type of approaches to development was explored by Ruta[73], who found that "deeper" trade agreements - trade agreements that have a greater number of legally enforceable provisions - are more likely to increase the participation of developing countries in global value chains. The reverse is also verifiable, meaning that a reduction in depth tends to decrease participation in GVCs. This could be explained in a "cost of doing business" framework. Deeper trade agreements reduce the uncertainty and therefore the implicit costs of participating in a GVC. Furthermore, international norms governing aspects such as product standards can further increase the ease into which developing countries join GVCs, by reducing the so-called "non-tariff" barriers.[74] This can be potentialised when these agreements are taken at the regional level (multilateral) and not merely at the country level (bilateral). When considering the EU's

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69 EU Parliament and Council, 'Regulation (EU) No 978/2012 of the European Parliament and of the Council of 25 October 2012 applying a scheme of generalised tariff preferences and repealing Council Regulation (EC) No 732/2008', 2012.

70 Hughes, H., 'Trade or Aid? Which Benefits Developing Countries More?'; *Economic Papers-Economic Society of Australia*, 22(3). 2003. p.p. 1-19.

71 Teignier, M., 'The role of trade in structural transformation', *Journal of Development Economics*, 130, 2018, p.p. 45–65.

72 European Commission, 'Report from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions on the implementation and enforcement of EU trade agreements', Publications Office, 2022.

73 Ruta, M., 'Preferential Trade Agreements and Global Value Chains: Theory, Evidence, and Open Questions', *SSRN* Scholarly Paper 3035623, 2017.

74 Kinzius, L., Sandkamp, A., & Yalcin, E., 'Trade protection and the role of non-tariff barriers', *Review of World Economics*, 155(4), 2019, p.p. 603–643.

Economic Partnership Agreements, it is important to note the role played by the rules of origin. Rules of origin are the rules that determine which is the country of origin of a certain good with regard to the European customs duties. These rules determine for example what is the maximum amount of foreign value added a certain product can have in order to still be considered as originating from a partner country.[75]

1.4.2. European action on climate: Goals, pledges and commitments

The EU, along with its Member States, is a signatory to the United Nations Framework Convention on Climate Change (UNFCCC) and plays a key role in aiming to reach agreements on global targets. The EU was an influential player in the creation of the Paris Agreement of 2015, the first universal, legally binding climate agreement and it continues to encourage an enhancement of global targets.[76] According to the European Council, in the framework of the commitment made in the 2015 Paris Agreement towards the developed countries' collective goal of mobilising USD 100 billion per year to international climate finance, the EU and its Member States are the largest provider of public climate finance in the world.[77] Since the Paris Agreement, external EU climate policy has included supporting partner countries with the formulation and implementation of their Nationally Determined Contributions.[78] Moreover, the Agenda 2030 commits the EU to the 17 Sustainable Development Goals.[79]

Climate change policies, like other EU policy issues, are expected to align with the principle of Policy Coherence for Development (PCD). PCD enshrines the task of taking into account development objectives in all policies that are likely to have an impact in developing countries, and this has been recently reiterated and underlined by the European Parliament.[80] PCD is an important requirement to avoid potential negative impacts of EU policies on poor and vulnerable people in developing countries, to take advantage of the opportunities for achieving synergies among different policies, and to pursuit of the horizontal development objective of addressing poverty.

According to the European Council, in 2022 the EU and its 27 Member States contributed a total of EUR 28.5 billion from public sources in climate finance (demonstrating a substantial increase in funding with respect to the EUR 23.04 billion of 2021), and they mobilised an additional amount of EUR 11.9 billion of private finance to assist developing countries to mitigate their GHG emissions and to adapt to the climate change related disruptions.[81]

The European Consensus on Development calls for climate change consideration across all sectors of development cooperation. Moreover, it commits to addressing the root causes of migration,

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75 European Commission, 'Taxation and Customs Union', website.

76 Oberthür, S., & Groen, L., 'Explaining goal achievement in international negotiations: the EU and the Paris Agreement on climate change', *Journal of European Public Policy*, 25(5), 2018, p.p. 708-727.

77 Council of the EU, 'Financing the climate transition', Website.

78 Allwood, G., 'Gender and EU External Climate Policy' in Gunnhildur Magnusdottir and Annica Kronsell (eds) *Gender, Intersectionality and Climate Institutions in Industrialised States*, New York: Routledge, 2021.

79 SDG Knowledge Hub, 'UN LDC5 Conference Generates Commitments for World's Poorest Countries', IISD, 2023.

80 European Parliament, Resolution of 26 May 2021 on Policy Coherence for Development, (2021/2164(INI)).

81 Council of the EU, 'Council approves 2022 climate finance figure, Press Release', 2023, website. Climate disbursement from public budgets encompasses €4.0 billion from the EU budget and the European Development Fund and €5.7 billion from the European Investment Bank. The total public figure is calculated by the European Council through a new methodology, which is based on commitments for bilateral and disbursements of multilateral finance made in 2022. Private finance figure regards the private financial contributions mobilised through public interventions (guarantees, syndicated loans, direct investment in companies, credit lines, and others). It does not include the amount of public finance deployed for the mobilisation of this private financial support.

including climate change.[82] As stated in the EU report under the UNFCCC of 2022, the main specific instruments targeted at the poorest and most vulnerable countries, next to other policies and measures, are the Neighbourhood, Development and International Cooperation Instrument [NDICI] Regulations for the period 2021-27, with a total budget of EUR 79.5 billion.[83] 30 % of the NDICI is earmarked to step up efforts on climate change, as a principal or a subsidiary objective. The NDICI programming is issued in regional envelopes, with a high concentration in Sub-Saharan Africa (at least EUR 29.18 billion, around 48 % of the total budget earmarked in 2021).[84] The European Fund for Sustainable Development Plus (EFSD+) and its External Action Guarantee will provide EUR 53.45 billion within the NDICI framework until 2027. It will entail guarantees, "blended" grants (a composition of EU grants with bank loans), technical assistance and other support tools for developing countries.[85] At the COP27 in 2022, the EU and the African Union established a new Team Europe Initiative on Climate Change Adaptation and Resilience in Africa as part of the EU-Africa Global Gateway Investment Package. The initiative would mobilize over 1 billion EUR for adaptation measures, including 60 million EUR for loss and damage from the overall EU contribution. Additionally, with the adoption of the Doha Programme for Action in LDCs[86] and its ten-year action plan established in March 2023 the EU announced Cooperation agreements for more than EUR 130 million in sustainable investments in Africa.[87]

This non-exhaustive list of commitments already underpins the European recognition of urgency in supporting developing countries in climate action and the need for financing. The sections of 2.6 will analyse shortcomings and gaps in these attempts to improve the quality and effectiveness of climate finance for LDCs.

Agenda 2063 – African Union's strategy and its climate partnership with EU

The Agenda 2063 is shaping the African Union's (AU) vision for an "integrated, prosperous and peaceful Africa". African-led initiatives include the African Adaptation Initiative which aims to support climate information services; strengthen policies and institutions; enhance on-the-ground action; increase access to and mobilizing climate finance and investment. They include also the African Risk Capacity Program. This Program supports African governments to improve their skills to plan, prepare for and respond to extreme weather events and natural disasters, mainly through an insurance-based approach. The AU-EU Partnership was further elaborated on the corresponding Summit in early 2022, discussing a Joint Vision for 2030. This foresees at least EUR 150 billion to support the EU 2030 Agenda and the AU 2063 Agenda, including a dedicated Global Gateway investment package for boosting public and private investment, supported by Team Europe Initiatives (TEI) under consideration of local needs. Moreover, the Green Transition Priority of AU-EU Cooperation and related partnerships supports the joint efforts on tackling climate change. Nevertheless, this is not at the core of this cooperation, since a strong focus is paid to peace, security, migration and mobility. Additionally, consideration of vulnerability, gender or other inequalities could improve.

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82 Council of the EU, 'The new European consensus on Development' of 7 June 2017', Joint Statement by the Council and the Representatives of the Governments of the Member States meeting within the Council, the European Parliament and the European Commission, 2017.

83 EU Report under the UNFCCC, Eighth National Communication and Fifth Biennial Report, 2022.

84 European Commission, NDICI – Global Europe, Fact Sheet, 2021.

85 Jones, A. & Bilal, S., 'Tailored, multidimensional and coherent: Towards a renewed EU partnership with least developed countries', ECPDM, 2022.

86 United Nations Conference on the Least Developed Countries, fifth Conference, 'Draft Doha Programme of Action for Least Developed Countries', 2022.

87 SDG Knowledge Hub, 'UN LDC5 Conference Generates Commitments for World's Poorest Countries', IISD, 2023.

2. Impact of EU external trade and climate policies in LDCs: Challenges and gaps

2.1. Industrial structure of LDCs

2.1.1. Barriers to structural change

One of the main concerns about the negative effects of GVCs on development regards the ways in which countries can become "stuck" in a suboptimal place in the value chain due to the asymmetrical relationship between the leader firm and its subordinate firms. The first way in which this asymmetrical relationship shows itself is in the capture of the value added by the leader firm. Indeed branding, design, and R&D, that are frequently controlled by the leader firm, take the higher share of the added value when compared to manufacturing and extraction.[88] This allows developed countries, where the leader firms are usually located, to appropriate the greatest share of the value added. Moreover, the balance of power is strongly slanted towards the leader firms, since they are in a position that allows to choose and arbitrate between suppliers.[89] By being incorporated into a GVC, firms find themselves bound by strict product standards. In order to meet these standards, firms have to structure their factor combination in particular forms that persist over time, since modifications are usually expensive and time consuming. This feature not only does compound the power imbalance, since a firm that is specialised in producing intermediate goods exclusively for a single buyer will face considerable hurdles in finding a new buyer[90], but it also stops firms from adopting a factor combination that suits better the local factor availability.[91] Indeed, the strict need for standardisation forces firms into using capital goods developed in the Global North that are intensely labour saving in nature. Therefore, developing countries that have deeply integrated their economy with global value chains find themselves stuck in a "middle income trap". They are able to absorb the immediate advantages resulting from the participation in GVCs, but they face difficulties in leveraging them to foster growth in the rest of the economy. [92]

The creation of a significant number of good high-paying jobs is another challenge faced by countries that participate in global value chains. Even if results differ according to the sectors and the geographical areas, many empirical studies have shown that the participation in GVCs does not necessarily imply a significant increase in high paying jobs.[93] While it is true that foreign firms and their suppliers, on average, pay their workers higher salaries when compared to domestic firms, in many situations the absolute number of jobs that they create is disappointing.[94] This ties into the misadjusted factor mix that was referred above. Due to their dependence on foreign developed capital goods, firms that are involved in global value chains often exist inside an enclave of high productivity and relatively low employment. In many cases it is possible to discern the formation of a "two-tiered" economy. One of the "tiers" presents very high productivity, but an employment level that does not respond to an increased demand. The other "tier" has a very low productivity, but an

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88 Banga, R., 'Linking into Global Value Chains Is Not Sufficient: Do You Export Domestic Value Added Contents?', *Journal of Economic Integration*, 29(2), 2014, p.p. 267–297.

89 Anner, M., 'Power relations in global supply chains and the unequal distribution of costs during crises: Abandoning garment suppliers and workers during the COVID-19 pandemic', *International Labour Review*, 161(1), 2022, p.p. 59–82.

90 Kano, L., Tsang, E. W. K., & Yeung, H. W., 'Global value chains: A review of the multi-disciplinary literature', *Journal of International Business Studies*, 51(4), 2020, p.p. 577–622.

91 Rodrik, D., 'Industrial Policy for the Twenty-First Century', *SSRN Scholarly Paper* 617544, 2004.

92 Rodrik, D. 'New Technologies, Global Value Chains, and Developing Economies', *National Bureau of Economic Research*, 2018a.

93 Farole, T., 'Do global value chains create jobs?', *IZA World of Labor*. 2016.

94 Pahl, S., & Timmer, M. P., 'Do Global Value Chains Enhance Economic Upgrading? A Long View.', *The Journal of Development Studies*, 56(9), 2020, p.p.1683–1705.

employment level that reacts strongly to shifts in demand. Nevertheless, this situation hinders a sustained process of elimination of material poverty.

The EU's approach shows two main shortcomings when faced with the problem of stimulating the upgrading of the industrial structure of the LDCs it trades with. The first is that, by offering protection to certain sensitive sectors, the mechanisms that would foster a structural change of the economy in the partner country are weakened.[95] Tendentially the industries protected in an Economic Partnership Agreement are not those that would require support for a substantial increase in the internal value added. Some scholars argue that if a country aims at achieving socio-economic development, and not only economic growth, it will need structural transformation and not just perpetuating existent comparative advantages. This holds particularly when a country is specialising in an unfavourable area of the policy space.[96] For example, the Republic of Korea did not achieve its improvements by keeping its industrial structure focused on the sectors that dominated it prior to the development process. [97] In a more recent example, scholars realized that a considerable part of the economic growth that was verifiable in Vietnam since 1990 is attributable to structural change in its economy.[98]

The technological foundation of manufacturing today is different from the one that existed when the so-called Asian Tigers lifted themselves out of poverty through their participation in global value chains. Furthermore, in the late 1970s, when manufacturing jobs started to move to developing countries, they were not only plentiful, but also competing with comparably well-paid jobs in the economies of the Global North. Nowadays, as manufacturing jobs worldwide are executed by people who earn ever lower wages, the competition between them will further reduce the margin for the creation of high paying jobs.

The second of the shortcomings has to do with the particularities of the EU's tariff structure. Due to the Most-Favoured Nation Clause sponsored by the World Trade Organisation, which foresees that a country cannot discriminate between their trading partners, and that when a concession is offered to one trading partner it has to be offered to all others partners, many industrial goods already have zero or very low tariff duties. In a context where tariffs on high value-added goods are already low, if trade protection is decreased, then low value exports would become comparatively more attractive. Under these circumstances the incentive that an Economic Partnership Agreement could provide to structural change ends up being reversed. The tariff reduction would be felt first and foremost in the primary sector (agriculture, fishing, forestry, and mining) and therefore this same sector would become comparatively more attractive to investment and expansion when compared with industrial goods. Under these conditions an increasing volume of trade would be steered to products with unfavourable terms of trade, such as primary goods. [99]

2.1.2. Export of primary goods

The integration into GVCs can also place some LDCs that are rich in natural resources in a situation where their foreign trade is mostly based on the export of primary commodities. An economic model based on this trend leaves LDCs at the mercy of volatile commodity prices due to fluctuations

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95 Diao, X., Dyck, J. H., Skully, D. W., Somwaru, A., & Lee, C., 'Structural Change and Agricultural Protection: Costs of Korean Agricultural Policy, 1975 and 1990', *United States Department of Agriculture, Agricultural Economic Report*, 809, 2002.

96 Hausmann, R., & Klinger, B., 'Structural Transformation and Patterns of Comparative Advantage in the Product Space', *SSRN Scholarly Paper* 939646, 2006.

97 Shafer, M., 'The political economy of sectors and sectoral change: Korea then and now.', In Maxfield S. and Schneider B. R. *Business and the State in Developing Countries*. Cornell University Press, 1997, pp. 88–121.

98 McCaig, B., & Pavcnik, N, 'Moving out of Agriculture: Structural Change in Vietnam', *National Bureau of Economic Research*, Working Paper 19616, 2013.

99 Horn, H., & Mavroidis, P. C., 'Economic and legal aspects of the Most-Favored-Nation clause', *European Journal of Political Economy*, 17(2), 2001, p.p. 233–279.

in the global demand. In fact, commodity prices are the most sensitive to shocks in global demand. This volatility has a nefarious effect over real exchange rates and consequently over macroeconomic stability.[100] Additionally, developing countries that specialise in commodity exports, particularly LDCs, have a high probability of merely exporting unprocessed, or barely processed commodities. This can be attributed to low transportation costs, and to problems associated with the unavailability of inputs that might make it more affordable to continue the processing further downstream in the value chain.[101]

Developing countries are faced with several hurdles when they attempt to upgrade their economy downstream from resource extraction. The terms of trade are not favourable to commodity exporters due to the low level of differentiability that commodities possess.[102] This means that the same commodity extracted from different places tends to be practically interchangeable for its buyers, while the same phenomenon is less pronounced in industrial goods where considerations of brand reputation, design, proprietary technology, and associated services can lock in buyers on a specific supplier even if prices change. The export of commodities also tends to ossify a country's industrial structure. Since commodity export dependence is associated to higher inequality and macroeconomic instability, it is also negatively correlated with social development indicators such as access to education and to health services.[103] The low performance of social development indicators, besides reinforcing multi-dimensional poverty, also compromises the economy's potential for structural change.[104] Moreover, the dependence on commodity export has a tendentiously nefarious influence over the economic governance of developing countries. High levels of short-term revenues can lead policymakers to disregard sensible long-term economic policy in favour of projects that are myopic in nature.[105, 106] Moreover, as the process typically starts from one commodity and subsequently slowly moves downstream from it, developing countries are left very vulnerable to demand shocks given the low level of export diversity.[107] Lastly, scholars observed that in many circumstances the availability of easily marketable natural resources that are easy to access supports the funding of armed conflicts, potentially fuelling political instability.[108]

Extraction based economies have an extremely high impact on environmental degradation. Mining activities can produce and spread toxic chemicals as part of their tailings. These chemicals can then infiltrate the water supply and the food chain working their way up to human consumption.[109,110] Moreover, strip mining also destroys vast swathes of forests and wildlife habitats making the

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100 Bodart, V., Candelon, B., & Carpantier, J.-F., 'Real exchanges rates, commodity prices and structural factors in developing countries', *Journal of International Money and Finance*, 51, 2015, p.p. 264–284.

101 Zhu, S., & Fu, X., 'Drivers of Export Upgrading', *World Development*, 51, 2013, p.p. 221–233.

102 Aguiar de Medeiros, C., & Trebat, N, 'Inequality and Income Distribution in Global Value Chains', *Journal of Economic Issues*, 51(2), 2017, p.p. 401–408.

103 Carmignani, F., & Avom, D., 'The social development effects of primary commodity export dependence', *Ecological Economics*, 70(2), 2010, p.p. 317–330.

104 Porzio, T., Rossi, F., & Santangelo, G., 'The Human Side of Structural Transformation', *American Economic Review*, 112(8), 2022, p.p. 2774–2814.

105 Ross, M. L., 'The Political Economy of the Resource Curse', *World Politics*, 51(2), 1999, p.p. 297–322.

106 Venables, A. J., 'Using Natural Resources for Development: Why Has It Proven So Difficult?', *Journal of Economic Perspectives,* 30(1), 2016, p.p. 161–184.

107 Auty, R. M., 'How Natural Resources Affect Economic Development', *Development Policy Review*, 18(4), 2000. p.p. 347–364.

108 Collier, P., & Hoeffler, A., 'Greed and Grievance in Civil War', *Oxford Economic Papers*, 56(4), 2004, p.p. 563–595.

109 Dudka, S., Adriano, D.C., 'Environmental Impacts of Metal Ore Mining and Processing: A Review', *Journal of Environmental Quality*, 26, 1997, p.p. 590–602.

110 Haque, N., Hughes, A., Lim, S., & Vernon, C., 'Rare Earth Elements: Overview of Mining, Mineralogy, Uses, Sustainability and Environmental Impact', *Resources*, 3(4), Article 4, 2014.

interested region more vulnerable to the effects of climate change such as droughts and floods.[111] Extensive agriculture is the leading cause for deforestation, with acutely damaging results for rainforests. The overuse of nitrate-based fertilisers pollutes freshwater reservoirs, making it unfit for human consumption. Lastly, the reliance on extensive monoculture is catastrophic for biodiversity[112] as well as being very susceptible to disruptions caused by plant diseases or adverse weather phenomena exacerbated by climate change.[113] As these disruptions become more common due to climate change, so too do the costs associated with pursuing said development strategies.

Current EU policy faces a major challenge with regards to the commodity export dependence phenomenon on the countries with which it trades. The EU is torn between its own need for strategically important raw materials and its commitments to become the first climate neutral continent and to other sustainability achievements. The conflict in the Ukraine and the increasing tensions with China have thrust the guaranteeing of a stable supply of critical raw materials. The EU has developed the concept of "open strategic autonomy" that aims to guarantee a steady supply of critical raw materials.[114] In many aspects this policy can clash with the goal of supporting the development of LDCs as it may force European policymakers to decide between advantages domestically and abroad. Under these circumstances trade with the EU can compromise a developing country's path to environmental sustainability. For example, the import of raw materials to build the batteries needed for clean transport in Europe can mean strip mining[115] in the country that exports it. This is a phenomenon labelled "green extractivism", in which unequal exchange relations in the context of the green transition end up having one sided benefits[116]. Countries such as Mozambique, by specializing themselves in the supply of raw materials to industrialized nations, feed the external green transition and industrialization as it undermines their own[117], as it will be explained in section 3.4.

On the one hand, structural economic transformation and development can contribute to reduce climate vulnerabilities (Sections 1.3, 2.6). On the other hand, however, at the same time, if not deliberately planned and designed to be inclusive of environmental sustainability, structural economic transformation could even reinforce vulnerability, for example through situations of "green extractivism". Joint political efforts are needed in order to link economic transformation and employment with the resilience capacity of communities and countries as a whole.[118]

2.1.3. EU's external approach on sustainability and technology

The importance of technology in solving societal challenges is an ongoing imperative in European policy making since the industrial revolution and therefore it represents also a crucial part of the

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111 Dontala, S. P., Reddy, T. B., & Vadde, R., 'Environmental Aspects and Impacts its Mitigation Measures of Corporate Coal Mining', *Procedia Earth and Planetary Science*, 11, 2015, p.p.2–7.

112 Grant, S. M., 'The Importance of Biodiversity in Crop Sustainability: A Look at Monoculture', *Journal of Hunger & Environmental Nutrition*, 1(2), 2007, p.p. 101–109.

113 Altieri, M. A., Nicholls, C. I., Henao, A., & Lana, M. A., 'Agroecology and the design of climate change-resilient farming systems', *Agronomy for Sustainable Development*, 35(3), 2015, p.p. 869–890.

114 Directorate General For External Policies of the Union, 'Global value chains: potential synergies between external trade policy and internal economic initiatives to address the strategic dependencies of the EU', 2023.

115 "Strip mining" is a method of obtaining substances such as coal from the ground that involves removing the top layer of soil instead of digging deep holes underground (Cambridge Dictionary).

116 Bruna, N., 'A climate-smart world and the rise of Green Extractivism', *The Journal of Peasant Studies,* 49(6), 2022. p.p. 839-864.

117 Bruna, N., 'Green extractivism and financialisation in Mozambique: the case of Gilé National Reserve', *Review of African Political Economy,* 49(171), 2022, p.p. 138-160.

118 Jones, A. and Bilal, S., 'Tailored, multidimensional and coherent: Towards a renewed EU partnership with least developed countries', ECPDM, 2022.

narrative about solutions to climate-related challenges. The so called "green techno-economic paradigm" favours the inclusion of sustainability objectives in the general economic growth goal through the application of technological means.[119] This vision is clearly included in the latest EU initiatives, like, among others, the Global Gateway initiative. By applying this approach externally, more specifically in LDCs, historical pathways of carbon-fuelled growth could be avoided – but other risks and challenges could emerge.

Technology transfer is an integral part of international commitments, like the Paris Agreement and its Poznan Strategic Technology Program, the UN's Agenda 2030, the Addis Ababa Action Agenda on financing for development, and UNFCCC (Art. 4.9). Yet, there is a gap in low-carbon technologies transfer from high-income to poor countries.[120] For countries that have an existing technological infrastructure, the transition to a green economy may be smoother. Conversely, LDCs are lacking the necessary infrastructure and technological ecosystems and are depending on timely-delayed technological disruptions in the form of consumer goods, like for example smartphones or e-commerce.[121] This further decreases the capability to respond to climate change and maintain and expand market access in an era of increasing environmental regulation in LDCs (for example the Carbon Border Adjustment Mechanism, see 2.6.6). Lacking access to energy and to the internet further challenges the sustainable implementation and added value of technology transfer.[122] High costs of green technology are an additional challenge for the African continent, where many LDCs are located. However, competition between producers, especially the EU and China, could lead to price decreases and could place African countries in a position for proactively negotiating skills, knowledge, and technology transfer as well as the management of jobs around these new technologies.[123] An in-depth analysis is challenged by the lack of transparency regarding actual low carbon transfers to LDCs by the EU. Moreover, there is no data on participation to funding by the private sector, despite the Global Gateway aims to mobilize private resources to achieve the EUR 300 billion target of investment.[124]

Moreover, even if we assume that all countries will reduce emissions linearly to net zero by 2050, emissions in LDCs would still only be 6 % of global emissions in 2030, assuming they do not change the CO_2 intensity of their income (Fig. 5).[125] Applying the "green techno-economic paradigm" on LDCs, including its costs, would pose further inequalities and challenges on the poorest parts of the world population. A very prominent example of this trend is the introduction of the EU Carbon Border Adjustment Mechanism (CBAM, see section 2.6.6), which might create high costs on the EU-exporting sectors in LDCs. To avoid increasing poverty in LDCs, EU action needs to account for the structural economic situation in LDCs and support its transformation. LDCs, and especially those located in the Sub-Saharan Africa, are mainly relying on their primary sector, with an average of 55 % of the population employed in agriculture.[126] Agriculture dependency is clearly one of the key

[119] UNCTAD, in the 'Technology and Innovation Report' 2023, states that "a techno-economic paradigm can be defined as a set of 'common-sense guidelines for technological and investment decisions as pervasive new technologies mature'. A sustainable new techno-economic paradigm involves switching to greener technologies and modes of production" (p. 5).

[120] Pigato, M., Black, S. J., Dussaux, D., Mao, Z., McKenna, M., Rafaty, R. & Touboul, S. 'Technology Transfer and Innovation for Low-Carbon Development', International Development in Focus, Washington, DC, World Bank, 2020.

[121] UNCTAD, 'Technology and Innovation Report 2023', Chapter I: Green Windows for Opportunity', 2023.

[122] SDG Action, 'Boosting Technology Transfer to support the SDGs in LDCs', Article, 2023.

[123] Usman, Z., Abimbola, O. & Ituen, I., 'What does the European Green Deal mean for Africa', Carnegie Endowment for International Peace, 2021.

[124] EU Report under the UNFCCC, 'Eighth National Communication and Fifth Biennial Report', 2022.

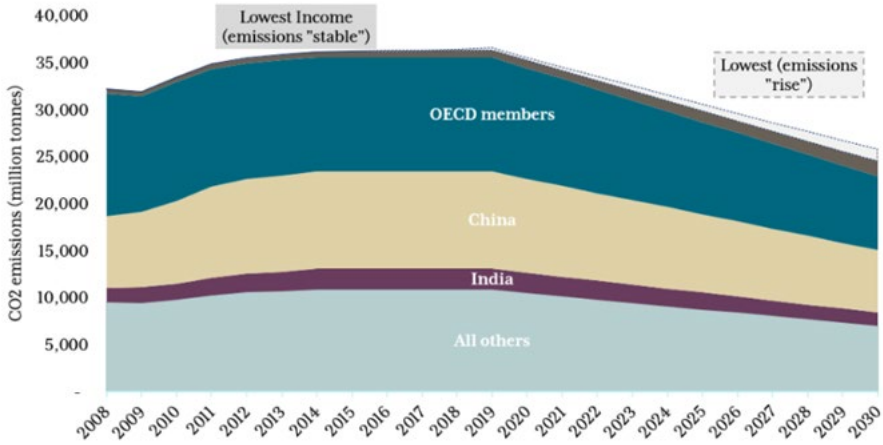
[125] Center for Global Development, 'Projecting Global Emissions for Lower-Income Countries', 2020.

[126] The World Bank, World Development Indicators, dataset, 2023.

drivers for climate change's impact on poverty, which is not covered by such a green techno-economic approach currently sponsored by the EU.[127]

2.2. Corporate due diligence

Figure 5 – Projected global emissions assuming all other countries than LDCs reach net zero by 2050



Source: Center for Global Development, Projecting Global Emissions for Lower-Income Countries, 2020.

The decision by firms to offshore part of their production is often determined by the relatively more relaxed labour and environmental regulations of the host country.[128] In many cases the lower costs that attract firms are a direct product of these relaxed standards. This sets the problem of corporate due diligence with regards to environmental sustainability and human rights.

The asymmetric power relation between the leader firms and their subsidiaries and suppliers implies a redistribution of wealth in favour of the leader firms. Not only is this redistribution unfair but it is also harmful to the development process, as a substantial amount of income that could be used for local capital accumulation is syphoned away to the leader firms in the form of profits. According to a study by the European Commission[129] only 37 % of the companies interviewed that are operating in more than one country follow proper environmental and human rights due diligence procedures. The share is reduced further to 16 % when the same standards are considered throughout their supply chains.[130] This illustrates that many firms do not have the information on how their subsidiaries and suppliers operate and therefore can be unwillingly contributing to the deterioration of environmental and human rights. The auditing of the supply chains is especially important as most women in developing countries who work in the context of GVCs tend to work

[127] Hallegatte, S. & Rozenberg J., 'Climate change through a poverty lens', *Nature Climate Change,* 7(4), 2017.

[128] Stern, R. M., 'Labor Standards and Trade Agreements', Research Seminar in International Economics, University of Michigan, *Working Papers* 496, 2003.

[129] Directorate-General for Internal Market, Industry, Entrepreneurship and SMEs, 'Study on the critical raw materials for the EU 2023: Final report'; Publications Office of the European Union. 2023.

[130] Spinaci, S., 'Corporate sustainability due diligence. How to integrate human rights and environmental concerns in value chains', BRIEFING: EU Legislation in Progress, EPRS, European Parliament, 2023.

in suppliers and not in the foreign firms themselves.[131] Therefore guaranteeing the existence of labour rights in these firms also contributes to the reduction of gender inequality through the convergence of employment conditions.

The problems with corporate due diligence are heightened in the LDCs. Since LDCs tend to have weaker institutions, the damage that firms can cause to their environment is sizable. This damage can be from pollution, from low health and safety standards, or from merely poorly paid work. Furthermore, as most of their economy is based on the primary sector, notably subsistence agriculture, there is a lower likelihood of the formation of strong organised labour unions to create internal pressure for the improvement of corporate due diligence standards. This also creates a strong political pressure on the host countries not to improve their ecological or labour standards under the risk of foreign firms pulling out.[132] Hurdles to the improvement of labour and ecological standards are a considerable barrier to the eradication of poverty.

Until now, the EU's policy has been one of obliging firms above a given size level to disclose what they consider to be the risks and opportunities related to a series of social and environmental issues. The disclosure must follow the EU's European Sustainability Reporting Standards [133] and it covers areas such as environmental matters; social matters and treatment of employees; respect for human rights; anti-corruption and bribery; and diversity on company boards.[134] With the entering into force of the Corporate Sustainability Reporting Directive in early 2023 the number of firms that need to report the risks and opportunities according to the European Sustainability Reporting Standards has been expanded from 17,000 to about 50,000.[135] As the law at the European level deals mostly with reporting, more prescriptive legislation has been left in the hands of Member States or at the initiative of the firms themselves.[136] The concentration of these efforts at the European level is beneficial as it levels the playing field between all European firms, and at the same time it discourages firms to avoid following sustainable environmental and human rights practices. The current efforts that the EU is undertaking to tackle this issue, and how they could be improved are further explored in section 3.2.

2.3. Reshoring of global value chains

The increased attention that policy makers attribute to guaranteeing the supply of critical raw materials has also been accompanied by an increasingly inward-looking economic policy.[137] This change in political will may explain part of the continued stagnation and even reduction in the value added through global value chains in the most recent years. In 2008, right before the great financial crisis, the participation in global value chains, measured by the share of indirect trading in total gross exports in the world, reached 46.1 %, starting from 35.2 % in 1995. After the great financial crisis, it

131 Gantner, O., 'Gender and Trade: Assessing the Impact of Trade Agreements on Gender Equality: Canada-EU Comprehensive Economic and Trade Agreement', UNCTAD. 2020.

132 De Beule, F., Dewaelheyns, N., Schoubben, F., Struyfs, K., & Van Hulle, C., 'The influence of environmental regulation on the FDI location choice of EU ETS-covered MNEs', *Journal of Environmental Management,* 2022.

133 Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups

134 Spinaci, S., 'Corporate sustainability due diligence. How to integrate human rights and environmental concerns in value chains', BRIEFING: EU Legislation in Progress, EPRS, European Parliament, 2023.

135 Ibid.

136 Navarra, C., 'Corporate due diligence and corporate accountability: European added value assessment', EPRS, European Parliament, 2020

137 Antràs, P., 'De-Globalisation? Global Value Chains in the Post-COVID-19 Age', *National Bureau of Economic Research*, 2020.

stagnated around 45 % until the Covid-19 crisis with an isolated peak in 2018[138] (for details on the methodology see Borin & Mancini[139]). The growing tensions with China, the advent of the Covid-19 pandemic, and the Russian invasion of Ukraine have made policy makers deeply aware of the vulnerability implied in production processes spread out throughout the world.[140] The rise of concepts such as "reshoring", "safeshoring", "nearshoring", and "friendshoring" gives evidence to the change in the political mood. More importance is being placed on security than on economic efficiency. This shifting of priorities manifests itself in the attempt to shift manufacturing activities back to their home markets or into countries that are diplomatically friendly. This is done both to keep sensitive technology out of geopolitical competitors' hands, as well as to safeguard against possible disruptions of supply. The phenomenon is not strictly bound to manufacturing, since also rich economies are making attempts to source their raw materials domestically.

The attempt at reducing the breadth and depth of value chains has significant economic consequences for the countries that are excluded from them. The most direct effect is that affected countries are cut off from most of the potential advantages that can come from international trade and from participation in global value chains. At the same time there are countries that should see a surge of new foreign investments if they hold considerable reserves of critical raw materials. If this trend persists, countries that are rich in raw materials should see their participation in GVCs strengthened, while countries whose participation in global trade is mostly based on intermediate goods should see a decline in their participation.

2.4. Reduction of policy space

There is a potentially negative side to the extensive scope and breadth of contemporary trade agreements. As the trade agreements cover many more aspects than mere trade, there is a risk that the partnership agreements that the EU establishes with LDCs can severely constrain their policy space. The attempt at improving trade performance by homogenising rules and reducing non-tariff barriers could ultimately become counterproductive. Rodrik[141] identifies four policy domains that are vulnerable to policy space encroachment. These are intellectual property rights, capital account liberalisation, investor state dispute settlement mechanisms, and regulatory standards.

The clauses defending intellectual property rights can have a detrimental effect towards developing countries by further extending the period during which companies, that are almost always located in richer countries, can extract monopoly rents. The strict enforcement of intellectual property rights can further aggravate the technological lag of developing countries as well as it can be responsible for elevated humanitarian costs. The repudiation of patents on anti-AIDS drugs by Brazil in the early 2000s and the significant effect that this act had in the global fight against AIDS is a case in point.[142] The reduction of capital controls enforced by many trade agreements reduces the ability of countries to shield themselves in moments of severe financial stress. Investor-state dispute settlement mechanisms allow foreign investors to sue the government for the enactment of policy changes that they consider to be detrimental to their profits. As this is done in international arbitration panels that do not follow the host country's legal code it can be seen as a way of

138 Alvarez, J. B., Baris, K. V., Crisostomo, M. C. R., de Vera, J. P., Gao, Y., Garay, K. V., Gonzales, P. B., Jabagat, C. J., Juani, A. S., Lumba, A. B., Mariasingham, M. J., Meng, B., Rahnema, L. C., Reyes, K. S., Pedro, M. P. S., & Yang, C., 'Recent Trends in Global Value Chains', World Trade Organization, 2021.

139 Borin, A., & Mancini, M., 'Measuring What Matters in Global Value Chains and Value-Added Trade', The World Bank, Washington, DC., 2019.

140 Smorodinskaya, N. V., Katukov, D. D., & Malygin, V. E., 'Global value chains in the age of uncertainty: Advantages, vulnerabilities, and ways for enhancing resilience', *Baltic Region*, 13(3), 2021, p.p. 78–107.

141 Rodrik, D., 'What Do Trade Agreements Really Do?', *Journal of Economic Perspectives*, 32(2), 2018b, p.p. 73–90.

142 Cueto, M. & Lopes, G., 'AIDS, Antiretrovirals, Brazil and the International Politics of Global Health, 1996–2008', *Social History of Medicine*, 34(1), 2021, p.p.1–22.

circumventing a weak legal code.[143] Moreover, the fact that foreign investors can sue the host country for enacting policy changes has a detrimental effect over the enactment of industrial policy. Lastly, the homogenization of regulatory standards in various domains of the economy such as product and labour standards, and competition law, has the effect of taking away from LDCs the possibility of developing them themselves. Even though trade agreements are negotiated between all the parties involved, the negotiating power between them can vary greatly.[144] In practical terms this means that developed countries, through the trade agreements they establish, have a large influence on the regulatory standards of developing countries. However, policy makers in rich countries influence the whole process of regulatory standards design in a way that satisfies the interests of their domestic consumers, for self-evident political reasons and for coherence towards their mission. This creates contradictory effects from the point of view of developing countries. Finally, while there is evidence that policy constraints that are imposed on developing countries may increase the volume of trade in the short term, their effect on the long-term development of a country as well as on the distribution of wealth inside it may not be as clear.[145]

2.5. Use case: Mozambique's graphite sector – gaps and challenges

The economy of Mozambique is mostly based on the primary sector with agriculture accounting for over 70 % of employment but for only 25 % of the value added, and it is characterised by a strong prevalence of subsistence agriculture. Its service sector accounts for about 48 % of the total value added but only for 21 % of employment. The service sector is mostly based on traditional non-tradable services such as retail and transport.[146] From 2015 to 2019 mining has increased its importance in the economy, passing from a 6.7 % of the value added to a 12.1 %. This value is expected to grow even more because of the expansion of petrochemical drilling in the Cabo Delgado province in northern Mozambique, and of the expansion of graphite mining that we describe below. Although mining was responsible for 12.1 % of the value added in 2019, it had a very limited impact on employment, accounting for only around 1.4 % of the active population.[147]

Mozambique's main exports consist of fossil fuels, metals and minerals. Fossil fuels accounted for about 32 % of Mozambique's exports in 2021, for a total of USD 2.4 billion approximately (around 15 % of Mozambique's GDP). The export of mineral products accounted for around 29 % of Mozambique's exports in 2021, corresponding to USD 2.18 billion. Out of these there are three commodities that are particularly relevant for the Mozambican economy. Aluminium, that is the greatest single metal export of the country and is defined by the EU as a critical raw material[148], copper that is the second largest metal export, not defined as a critical raw material but still of strategic importance, and graphite which has seen a great expansion of its production and exports since 2017.

In 2022 Mozambique was the world's second biggest producer of graphite, behind China, accounting for 170,000 metric tons of production, which represent approximately 13 % of the world's total production. The figure of 2022 represents a 125 % increase from the production of the

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143 Tienhaara, K., 'Regulatory Chill and the Threat of Arbitration: A View from Political Science', *SSRN* Scholarly Paper 2065706, 2012.

144 Afzal, M. H. B., 'Power and Trade Agreements between Developed and Developing Countries', APSA Preprints, 2019.

145 Wonnacott, R. J., 'Free-Trade Agreements: For Better or Worse?', *The American Economic Review*, 86(2), 1996, p.p. 62–66.

146 Jones, S., Sarmento, E. F., Van Seventer, D. &. Tarp, F, 'Structural features of the Mozambique economy through the lens of a 2019 social accounting matrix', *WIDER Working Paper* 2022, 2022.

147 Jones, S., Sarmento, E. F., Van Seventer, D. &. Tarp, F. 2022, Ibid.

148 EU Commission, 'Communication from the commission to the European Parliament, the council, the European economic and social committee, and the committee of the regions on Critical Raw Materials Resilience: Charting a Path towards greater Security and Sustainability', 2020.

previous year. In addition, Mozambique's reserves of graphite are estimated to be of 25,000,000 metric tons, around 7.6 % of the world's total reserves.[149] The European Commission's study on the critical raw materials for the EU places the global supply share of Mozambican graphite at 5.4 % and the EU's graphite supply currently sourced from Mozambique at 13 %.[150] More than 50 % of Mozambique's graphite production has the EU as its destination[151], underlying the weight that the EU has towards this sector.

Graphite is a key resource in the production of anodes in lithium-ion batteries. For this reason, the demand for graphite has risen and will continue to rise as the world strives to undertake its ecological transition, particular with regards to energy storage.[152] Lithium batteries are a key component in the production of electric vehicles. Graphite is also used in other industrial applications, such as the production of refractories for steelmaking due to its electrical and thermodynamic properties. The World Bank estimates that the global demand for graphite will increase by around 500 % by 2050 to achieve the scenario of global warming of a 2-degree increase.[153] This makes a steady supply of graphite doubly important for the EU as it strives for carbon neutrality and for maintaining its position as a hub of vehicle production. The expected increase in demand would require a significant expansion of production, thus allowing Mozambique to profitably sustain the expansion of its graphite production.

As of 2023 there are three active large-scale graphite mining concessions in the Cabo Delgado province.[154] The first is located in the Balama region, operated by "Twig Exploration and Mining", that started operations in 2018 and is owned by the Australian based Syrah Resources[155]. The second is "GK Ancuabe Graphite Mine'', located in the Anucabe region. This mine was reopened in 2017 and it is owned by the German-based firm "AMG Graphite".[156] The third concession, located in the Montepuez region and comprising two mines, is operated by "Suni Resources", that has recently been bought by the UK-based company "Tirupati Graphite" from the Australian-based company "Battery Minerals". Under the Mozambican law there also exist mining certificates, that only apply to small-scale and artisanal mining, and can only be held by Mozambican nationals. Nonetheless most of the Mozambican graphite extraction is in foreign hands.

The production of graphite has resulted in material benefits for the province of Cabo Delgado, where all the graphite extraction in Mozambique takes place. Since graphite mining recommenced in 2017 the percentage of people in the province that worked in mining rose from 0.1 % to 1.3 % in 2022. Moreover, Twig Exploration and Mining, and GK Anacube Graphite have consistently placed in the top contributors in the Cabo Delgado province in terms of tax revenues.[157] However these benefits have not substantiated themselves in the structural transformation of the region. Indeed, the share of workers in the manufacturing sector has decreased since 2014/2015. This decrease implies that the increase in graphite extraction has not had a considerable effect in the

149 U. S. Geological Survey., 'Mineral commodity summaries 2023', In Mineral Commodity Summaries ,2023.

150 Directorate-General for Internal Market, Industry, Entrepreneurship and SMEs, 'Study on the critical raw materials for the EU 2023: Final report', Publications Office of the European Union, 2023.

151 UN, UN Comtrade database, website.

152 Hund, K., Porta, D. L., Fabregas, T. P., Laing, T., & Drexhage, J., 'The Mineral Intensity of the Clean Energy Transition', The World Bank, 2020.

153 Hund, K., Porta, D. L., Fabregas, T. P., Laing, T., & Drexhage, J. 2020, Ibid.

154 Instituto Nacional de Minas, Mapa Portal do Cadastro Mineiro de Moçambique, website.

155 Twigg Exploration and Mining, website.

156 AMG Graphite, 'GK Ancuabe Graphite Mine', website.

157 Namaganda, E., Otsuki, K. & Steel, G., 'Understanding the cumulative socioenvironmental impacts of energytransition-induced extractivism in Mozambique: The role of mixed methods', *Journal of Environmental Management*, 338, 117811, 2023.

industrialization of the region. Without this structural transformation the local share of value added will keep being low.

Table 1 – Percentage of Mozambican workers in the province of Cabo Delgado by type of activity

Type of activity	2022	2019/2020	2014/2015
Agriculture, forestry and fishing	86.2	83.7	86.6
Mining	1.3	1.5	0.1
Manufacturing	1.8	3.7	3.7
Energy	0.0	0.0	0.0
Construction	0.5	1.1	0.1
Transport and communications	0.9	0.3	0.3
Commerce and finance	3.9	4.8	4.3
Administrative services	0.9	1.3	0.6
Other services	4.7	3.4	4.2

Source: Instituto Nacional de Estatística: Inquérito sobre Orçamento Familiar (2016[158]; 2021[159]; 2023[160]).

The security situation in the Cabo Delgado province has negatively affected the output of the mineral sector. The situation was one of the main contributors to the disruption of the supply of graphite in the years of 2020 and 2021, when the Islamist insurgency was at its highest level of intensity.[161] Nevertheless, the reduction of production due to the intensification of the conflict is hard to separate from the reduction created by the reduction of commodity demand brought about by the Covid-19 pandemic.

Table 2 – Quantity of graphite extracted by year in Mozambique (tons)

Year	2016	2017	2018	2019	2020	2021	2022
Quantity extracted (tons)	0	802	106,773	113,803	18,159	77,116	165,939

Source: Instituto Nacional de Estatística: Indicadores Básicos do Ambiente (2023[162]).

In 2013 Mozambique implemented a strategic plan for mineral resources (Politica Estrategica Para os Recursos Minerais).[163] This plan had the stated goal of utilising the country's mineral wealth as a driver of development and poverty reduction without compromising environmental and intertemporal sustainability. In practice it aimed to thoroughly chart the country's mineral deposits; to encourage mining and fossil fuel extraction; to integrate the products of mining into national

158 Instituto Nacional de Estatistica (INE), Inquérito aos orçamentos familiares 2015, 2016.

159 Instituto Nacional de Estatistica (INE), Inquérito sobre o rendimento familiar 2019/20, 2021.

160 Instituto Nacional de Estatistica (INE), Inquérito Sobre Orçamento Familiar 2022, 2023.

161 Global Centre for the Responsibility to Protect, 'Mozambique', Website.

162 Instituto Nacional de Estatistica (INE), 'Indicadores Básicos do Ambiente: 2018 – 2022', 2023.

163 Resolução 89/2013 do Concelho de Ministros de 31 de Dezembro 2013.

manufacturing; to increase the participation of national stakeholders in the mining sector; and to foster the formation of education and investigation centred on the mining sector.

The challenges related to the graphite mining in Mozambique fall into many of the pitfalls exposed above, in section 2.1. Even though mining is by a considerable extent the biggest producer of revenue for the Cabo Delgado province, the amount of employment in the sector is merely 1.3% of the labour force in 2022. Not only is the overall percentage small, in many cases the projects establish complex and contradictory relations with the local communities. In the case of Twigg Exploration and Mining, 94 % of their workers are from Mozambique and around 50 % are from the local communities.[164] In this case, the share of the local population employed over the total labour force is not negligible. Nonetheless the community itself would expect this share to be higher and to produce more considerable local benefits[165]. Moreover, the community is seriously concerned with the environmental consequences of the mining activities. The intensification of mineral exploitation in the Cabo Delgado province has also shown negative consequences in this domain. Namaganda et al. [166] have found a significant reduction in vegetation cover in the areas around mining and liquefied natural gas concessions. This is not only explained by the deforestation caused directly by the projects, but also by the people who are forcefully dislocated from their homes and are forced to burn forests to create farmlands in the places they have been resettled to. Further effects of environmental degradation are the increase in air pollution, manifesting in high levels of particulate matter, and in groundwater contamination during periods of heavy rain. Finally, given the perception of a continued practice of expropriation, frequently by force, of mineral resource wealth the local communities would expect the benefits from the mining activities to be higher[167]. When this does not materialize it ends up fuelling resentment. The insurgency in Cabo Delgado can also trace some of its causes to the mismanagement of the mineral resources of the region, notably the ruby reserves discovered in 2009. The grievances emerging from the failure to distribute mineral wealth together with the easy access to valuable commodities fuelled the conflict.[168]

Considering corporate due diligence (section 2.2), although the large mining projects in Mozambique have social and environment management plans, in many cases the local government does not have the required resources to properly monitor the activity of the mining firms. This forces governments to rely on self-reporting by the companies themselves to enforce the following of proper due diligence. This can be problematic as firms may have an incentive to overlook some violations. Moreover, even with the best intentions on the part of the firms, outside auditing can identify inadequacies that internal auditing may not highlight.[169]

Lastly, the graphite extracted in Mozambique has very little use inside the Mozambican economy. The main use for graphite is to produce refractories and batteries, neither of which is produced by Mozambican manufacturing.[170] Therefore, Mozambique exports most of its graphite in an unprocessed state, missing out on the potential benefits of participating in the high value-added parts of the graphite value chains.

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164 Twigg Exploration and Mining, website.

165 Alberdi, J., & Barroso, M., 'Broadening the Analysis of Peace in Mozambique: Exploring Emerging Violence in Times of Transnational Extractivism in Cabo Delgado', *Global Society*, 35(2), 2021, p.p. 229–246.

166 Namaganda, E., Otsuki, K., & Steel, G., 'Understanding the cumulative socioenvironmental impacts of energy transition-induced extractivism in Mozambique: The role of mixed methods', *Journal of Environmental Management*, 338, 117811, 2023.

167 Wiegink, N.; 'Dislocation of the Dead: Land, Burial and Resettlement around Coal Mines in Mozambique'; In C. Navarra, & Undelsmann Roderigues C. (Eds.); *Transformations of Rural Spaces in Mozambique*. 2021. p.p. 91-104.

168 Alden, C., & Chichava, S., 'Cabo Delgado and the Rise of Militant Islam: Another Niger Delta in the Making?', South African Institute of International Affairs, 2020.

169 Namaganda, E., Otsuki, K., & Steel, G., Ibid.

170 UN, UN Comtrade database, website.

The contradictions related to the mineral sector leave Mozambique at a turning point. A great deal of its economy and its exports is intimately tied with the ecological transition, while at the same time it is heavily dependent on the export of fossil fuels. In fact, the energy crisis that was triggered by the Russian-Ukrainian war has led Mozambique to expand its liquefied natural gas production in the northern province of Cabo Delgado.[171] Furthermore, it has started exporting liquefied natural gas to the EU, in part as a substitute for the cut of supply of Russian gas.[172] This happens at the same time as graphite mining is seeing a large expansion due to the industrial commodity needs of the ecological transition.

On this crossroad the EU can have a significant impact on the Mozambican economy through the employment of development cooperation, particularly aid for trade, in order help to steer it into a socially and economical sustainable path. Among many interventions of the EU development cooperation in Mozambique we signal the EU-led PROMOVE initiative, which is in place since 2018, and focuses on the construction of rural roads (EUR 124 million), and on the access to electricity in rural areas (EUR 94 million). Both aspects are crucial for addressing both multidimensional poverty, and the creation of additional value added by foreign companies. Moreover, in the framework of the Global Gateway initiative (section 1.4) the EU is engaged in diverse programmes having the aim of attracting private investments, creating business opportunities, boosting and diversifying trade between Mozambique and the EU, promoting domestic industrialization and local manufacturing. Such programmes are currently discussed in the Mozambique - EU Global Gateway Investment Forum 2023, among others initiatives. Additionally, among the EU-Africa flagship projects for 2023, funded as well within the Global Gateway framework, Mozambique hosts initiatives that aim to improve the reliability and sustainability of the power supply (National Control Centre for Energy Infrastructure), to invest on digital literacy and skills for youth (VaMoz Digital), and to create employment opportunities in the energy industry for youth (EMPREGO). The role of development aid and aid for trade is further explored in sections 3.4 and 3.5.

2.6. Persisting gaps and challenges related to climate finance

2.6.1. Lacking monetary funding of climate adaptation and mitigation in LDCs

Despite the EU and its Member States being large contributors to international public climate finance[173] (see 1.4.2), there is still a persisting gap in international climate finance for developing countries, especially when it comes to climate change adaptation.[174] In order to provide a broader overview, we highlight that the OECD states that the financial gap to reach the Sustainable Development Goals in developing countries increased by 56 % after the Covid-19 pandemic, and it has been estimated that it corresponded to USD 3.9 trillion in 2020.[175] By narrowing the focus to the climate change domain, UNEP (2023) estimates that the current adaptation finance gap in developing countries, due to their particular exposure to effects of change in climate trends, could range from USD 194 billion to USD 366 billion per year.[176] According to the V20, the 20 most vulnerable economies have lost approximately USD 525 billion because of temperature and precipitation patterns affected by climate change. On a more positive note, total climate-related Official Development Assistance (ODA) provided by developed countries (Development Assistance

[171] Aljazeera, 'Mozambique okays resumption of $20bn Cabo Delgado gas project', website, 26 April 2023.

[172] Reulf, W., 'Mozambique's first LNG exports to Europe seen by early November', Reuters, 21 October 2023.

[173] European Council, 'Climate Finance', Website.

[174] World Economic Forum, 'Climate Adaptation Finance Gap can save millions of lives', 2023.

[175] OECD, 'Global Outlook on Financing for Sustainable Development 2023', 2022.

[176] UNEP, 'Adaptation Gap Report 2023: Underfinanced. Underprepared. Inadequate investment and planning on climate adaptation leaves world exposed', 2023.

Committee-DAC members) for developing countries increased to 45 billion USD in 2020, starting from 35 billion USD in 2019. However, it represents only 33.7% of the total bilateral allocable ODA.[177] If we consider also the climate-related multilateral public spending, the export credits and the mobilized private spending from developed countries to developing countries, we observe a total amount of 83.3 billion USD for climate finance in 2020.[178] However, this spending still falls short of the stated USD 100 billion per year target (see section 1.4.2).[179] These figures show the persisting financing gap at the international level to provide the necessary funding to tackle climate change.[180] The second large climate finance gap is related to the share devoted to adaptation initiatives, with respect to mitigation programmes,[181] and this will be discussed in section 2.6.3.

As we will discuss in sections 2.6.3 and 2.6.4, data are available on EU institutions (excluding EIB) and Member States disbursement for climate-related development finance, with breakdowns by geographical areas, recipient income groups, economic sectors, and broad category of climate policies (mitigation or adaptation).[182] According to the European Council, in 2022 the EU and the Member States contributed EUR 28.5 billion in climate finance from public funding, and, additionally, they mobilised EUR 11.9 billion of private finance to assist developing countries in mitigation and adaptation measures (see 1.4.2).[183] However, a precise evaluation of the impacts of such disbursements in LDCs is challenging, due to the overlapping of a myriad of initiatives and of reporting, monitoring and evaluation procedures, as Cichocka and Mitchel (2022) highlight, among others.[184]

Nevertheless, it is important to reflect on crucial challenges related to effectiveness of climate finance in LDCs. In general, it is necessary to highlight the lack of transparency and of coherence in international climate financing. In the past 30 years, at least 94 green climate funds have been created on international level to finance a green transition for developing countries, 81 of which were still active until 2022.[185] This great number of funds, including different application provisions, monitoring and evaluation schemes or reporting, poses serious challenges of transparency and measurement of the success achieved on an aggregated level.[186] LDCs often do not dispose of the necessary capacities to apply for climate financing, if bureaucratic obstacles remain to grow.

Looking at targeted action for LDCs, the principle of Common but Differentiated Responsibilities and Respective Capabilities (CBDR-RC), as enshrined in Art. 3(1) of the UNFCCC, has to date been applied into climate financing only in a very limited way. The Paris Agreement includes some provisions for the special circumstances of the LDCs to be taken into account (e.g. articles 9(4), 11(1), 13(3)), and in the meantime, some dedicated mechanisms have been established (e.g. the Least Developed Countries Fund). Yet, mechanisms that would give more effectiveness to this principle are yet to be put in place, such as allowances for longer transition periods for decarbonisation, effective technology transfer mechanisms, financing mechanisms that match LDCs' financing needs,

177 OECD, 'Climate-related official development assistance in 2021: A snapshot', 2023, p. 2.

178 OECD, 'Aggregate Trends of Climate Finance provided and mobilised by Developed Countries in 2013-2020', Report, 2022, p. 6.

179 V20, 'Climate Vulnerable Economies Loss Report', 2022.

180 Climate Action Network (CAN), 'Strengthening the Africa-EU partnership through action on climate impacts', Europe Briefing, 2022.

181 Ibid.

182 OECD, Data on Climate Related Finance Overview, Website.

183 Council of the EU, 'Council approves 2022 climate finance figure, Press Release', 2023, website.

184 Cichocka, B., & Mitchel, I., 'Climate Finance Effectiveness: Six Challenging Trends', CGDEV, 2022.

185 Le Houérou, P., 'Climate Funds : Time to clean up', Working Paper hal-04027247, HAL, 2023.

186 Cichocka, B., & Mitchel, I., 'Climate Finance Effectiveness: Six Challenging Trends', CGDEV, 2022.

and effective recognition of LDCs' carbon budget.[187] Moreover, a constant challenge is the difficulty of acknowledgment of the specific development needs in LDCs, which is mirrored at the European level in policy documents like, for example, the EU Adaptation Strategy (see 2.6.3).[188] Lundsgaarde (2023) assessed cooperation strategies with LDCs in Africa based on the EFSD+ (European Fund for Sustainable Development Fund Plus, see 1.4.2), and underlines the importance to better integrate the mechanism into country programmes through policy dialogue, amongst others. 20.5 % of the total EFSD+ mechanism, amounting in an anticipated possible allocation of 2.1 billion EUR, have a potential to be covered by the mechanism for the support of a green transition in LDCs.[189] Regarding attention to local contexts and local ownership at multiple levels, in the analysis of the Multi-Annual Indicative Programme (MIP) for Sub Saharan Africa under the NDICI, the Climate Action Network claims that a stronger effort is needed in grounding EU climate actions in local realities, assessing local needs and enabling building capacities for locally led initiatives, taking also into account indigenous climate-related knowledge.[190]

Cichocka and Mitchell (2022) assess the following main challenges related to climate finance effectiveness in low- and middle-income countries, which include LDCs.[191] First, since 2015 ODA for climate is placed below the average as regards the share of approved funding which is actually delivered, creating constant challenges with executing climate projects on the ground. Second, a strong utilization of the "loans" tool raises concern over debt sustainability. Third, they observe a proliferation of providers and a simultaneous shrinking of project sizes. Fourth, climate finance – in particular mitigation finance – appears increasingly as not being allocated towards specific recipients. Fifth, when the allocation of mitigation finance is specified, the recipients tend to be middle-income countries rather than the poorest economies (see also 2.6.4). Sixth, climate finance providers could improve programmes implementation through country institutions. Lastly, if compared to other sectors of interventions, there is less availability of evaluation studies of climate programmes. Probably this gap stems from a lack of common methodologies on evaluating climate project performance, as well as from low transparency by providers on the expected and achieved results of their climate projects.

2.6.2. Private sector mobilisation

Already in 2017 the EU called on the private sector to help to "build capacity to mainstream environmental sustainability, climate change objectives and the pursuit of the green growth into national and local development strategies" and "to make better use of science, technology and innovation to promote environmental sustainability".[192] Furthermore, the EU launched in 2019 the International Platform on Sustainable Finance as an important step to scale up the mobilisation of private capital towards environmentally sustainable investments.

The Global Gateway initiative relies heavily on private investments attraction. Although it is too early for driving assessments of the initiative, typical difficulties related to public actions aimed at mobilizing private investments may arise. In general scholars highlight complex challenges in

187 UNCTAD, 'The Least Developed Countries Report 2022 - The low-carbon transition and its daunting implications for structural transformation', 2022.

188 Adinesa, A., 'The changing global financial architecture', Article, New African Magazine, 2023.

189 Lundsgaarde, E., 'The future of EU blended finance and guarantees: An assessment of cooperation strategies with least developed countries in Africa', IDOS Discussion Paper, No. 2/2023, German Institute of Development and Sustainability (IDOS), 2023.

190 Climate Action Network (CAN), 'Strengthening the Africa-EU partnership through action on climate impacts', Europe Briefing, 2022.

191 Cichocka, B., & Mitchel, I., 'Climate Finance Effectiveness: Six Challenging Trends', CGDEV, 2022.

192 European Commission, DG INTPA,, 'The New European Consensus on Development', 2019.

catalysation of private investments through public initiatives. [193] For example, a recent study in Zambia estimates that for every USD in concessional financing for a large solar energy programme by the International Finance Corporation only about 28 cents of private finance was catalysed.[194] Additionally, it is not evident to what extent the Member States will be willing to support Global Gateway with public funds.[195] As the Global Gateway was launched only at the end of 2021, this observation should be closely monitored in LDCs to drive further conclusions.

For clarification purposes on how to unlock private investment the EU established a High Level Expert Group on scaling up sustainable finance in LMICs (HLEG) in September 2022. It encourages to draw inspiration and lessons from existing multi-stakeholder platforms like the Just Energy Transition Plans (JETPs), currently being deployed in Vietnam, South Africa, Senegal and Indonesia, and the Climate Finance Leadership Initiative (CFLI), currently operating in India and Colombia.

Despite regular reporting mechanisms from the EU to international consortia like the UNFCCC or OECD on overall EU climate finance, the lack of transparency on stakeholders, partners, and efficiency is hindering a sound analysis of European support in LDCs.[196]

2.6.3. The climate adaptation funding gap

For a long period, EU climate finance stayed mainly targeted to mitigation policies, while adaptation finance continues to lag behind. At the same time researchers assessed that international finance flows to developing countries are estimated to be 5-10 times below the assessed needs in adaptation.[197]

According to OECD data, the bilateral adaptation-related development finance from the EU institutions (excluding the European Investment Bank) and the Member States increased from 5.6 billion USD in 2012 to 17.4 billion USD in 2021, considering initiatives in which the adaptation goal appears as either principal or significant. However, from 2020 onwards the spending for initiatives in which adaptation figures as principal goal started to decrease.[198] The EU Report under the UNFCCC 2022 ('Eighth National Communication and Fifth Biennial Report') also documents that between 2019 and 2020 the total committed bilateral adaptation finance by the European Commission decreased, and in particular for Africa, South and Central America, Asia and Oceania.[199] Considering the multilateral channels, which encompasses the European Commission (EC) and also the European Investment Bank (EIB), we observe that the largest share of climate finance is still devoted to mitigation. During 2019 and 2020, 56 % of the climate finance by the EC and the EIB was committed for mitigation goals and 28 % for adaptation initiatives, while for 16 % the purpose was cross-cutting.[200]

One reason for the discrepancy between adaptation and mitigation investment is that climate adaptation and resilience investments are mainly publicly funded and do not represent a high return on the capital invested, contrary to investments in (clean) energy technologies, which

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193 Pauw, P., 'Mobilising private adaptation finance: developed country perspectives', *International Environmental Agreements*, 2017.

194 Emery, T., 'Solar can't scale in the dark', Energy for Growth Hub, 2023.

195 Koch, S., et al., 'The European Union's Global Gateway should reinforce but not replace its development policy', German Institute of Development and Sustainability, 2023.

196 EU Report under the UNFCCC, 'Eighth National Communication and Fifth Biennial Report', 2022.

197 Sustainable Development Goals, Goal 13, Progress and Info, Website.

198 OECD, Data on Climate Related Finance Overview, Website. Data are provided as "commitments", expressed in USD million, 2021 constant prices. Adaptation and mitigation figures may include overlapping activities.

199 EU Report under the UNFCCC, 'Eighth National Communication and Fifth Biennial Report', 2022, p. 276-277.

200 Ibid., p. 274.

theoretically attract a higher amount of private financing.[201] According to some research, the benefits of adaptation policies cannot be always easily quantified and often they are attributed to local communities over time rather than to investors, who expect the kind of returns associated to mitigation actions.[202] Another aspect of adaptation action is its effectiveness in implementation (see also 2.6.1). A UNEP analysis on the climate adaptation planning adequacy and effectiveness across all 196 UNFCCC parties revealed heavy deficits especially on inclusiveness, implementability and monitoring and evaluation indicators.[203]

By addressing LDCs issues, the EU Adaptation Strategy states that EU external action "must target adaptation more effectively, through a humanitarian-development-peace nexus approach to reach the most exposed, vulnerable, conflict-prone or marginalised communities, leaving no one and no place behind".[204] Yet, it is lacking a coherent approach on how to reach this objective. The EU underlines the will to partner with "proactively partners in climate action", which are not further specified. Understanding climate vulnerability (see 1.3.2) is essential for effective climate adaptation measures. This includes also taking into account population dynamics to reduce exposure to impacts of climate change and strengthen adaptive capacities, especially in LDCs.[205] Although showcasing existing partnerships with supra-regional African initiatives, there is still a missing concrete implementation guideline. Moreover, there is further a gap in fully acknowledging the specific vulnerability factors of LDCs and there is lack of attention to dedicated mechanisms to strengthen agricultural systems in LDCs to stabilise both food security and economic stability.[206]

2.6.4. Regional concentration of financing

Large volumes of international and European climate finance that has been provided and mobilised have been concentrated in a limited number of developing countries with high population. Regarding aggregate trends of climate finance provided and mobilised by developed countries, in the time span 2016-2020 the top 10 recipient countries, which accounted for 58 % of the recipient countries' population, received 34 % of the total climate finance provided. The share grasped 50% if we consider the top 20 recipients, which accounted for 74 % of the total recipient countries' population. Therefore, between 2016 and 2020 the 46 LDCs represented only the 17% of the total climate finance provided and mobilised by developed states.[207]

At European level, the 2022 Midterm Review of the European Union by the OECD underlines the structural challenges of the EU to increase resources to the LDCs. In 2019, LDCs received 23.1 % of the EU institutions' gross bilateral ODA (USD 4.1 billion), reflecting a slight decrease compared to the 24.4 % (2016) assessed during the 2018 OECD review. In particular, less than a quarter of EU ODA, including climate support, reached the most vulnerable LDCs. Finally, according to OECD data on

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201 UNCTAD, 'The Least Developed Countries Report 2022 - The low-carbon transition and its daunting implications for structural transformation', Report, 2022.

202 EU, Forging a climate-resilient Europe - The new EU Strategy on Adaptation to Climate Change, Impact Assessment Report, 2021.

203 UNEP, 'Adaptation Gap Report 2021. The Gathering Storm – Adapting to Climate Change in a Post-Pandemic World', 2021.

204 EU Commission, 'Forging a climate-resilient Europe – the new EU Strategy on Adaptation to Climate Change', COM(2021) 82 final, 2021.

205 Schensul, D., & Dodman, D., 'Population Adaptation: Incorporating Population Dynamics in Climate Change Adaptation Policy and Practice', in Martine, George and Daniel Schensul (eds.), The Demography of Adaptation to Climate Change, New York, London and Mexico City: UNFPA, IIED and El Colegio de México, 2013.

206 Jones, A., & Bilal, S., 'Tailored, multidimensional and coherent: Towards a renewed EU partnership with least developed countries', ECPDM Discussion Paper, 2022.

207 OECD, 'Aggregate Trends of Climate Finance provided and mobilised by Developed Countries in 2013-2020', Report, 2022, p. 12. The 40 Small Island Developing States (SIDS) received 2% of the total climate finance, while the 57 fragile states received 22% of it. As these three groupings partly overlap, the figures cannot be added up.

commitments to bilateral channels by the EU institutions (excluding the European Investment Bank) and the Member States, in 2021, 17% of the total climate-related development finance was devoted to LDCs. Regarding adaptation-related development funding, 21% was directed towards LDCs, while for mitigation funding LDCs received 11% of the total issued by the same institutions.[208] In turn, this mirrors the global trend of climate finance flows in 2020/21, which shows that the share of climate-related commitments to African countries (26 %) was considerably less than for other regions.[209]

2.6.5. Loss and damage

The measurement of losses generated by climate change is still posing evaluation challenges. Some scholars argue that the measurement cannot be represented only in terms of economic value, as the targeted assets are highly relevant for people with limited resources.[210] Thus, the losses in terms of well-being may be significantly higher than the economic losses experienced. So far, there is no international agreement on financing costs related to loss and damage from fast-onset events related to climate change.

After long discussions at the COP27, the EU already agreed on the participation in a novel Loss and Damage Fund, while the US and Japan rejected to support such a measure.[211] Due to the limitations of economic loss measurement, it is essential that the discussion on the modalities of use of this fund include the non-economical dimensions, including losses in well-being and livelihood. To contribute in a sufficient way, the EU needs to consider additional forms of financing, as contributions through the NDICI would be rather small compared to the gaps to be addressed.[212]

2.6.6. Use case: Carbon border adjustment mechanism

The European carbon border adjustment mechanism (CBAM) is a tool that gives a price to the CO_2 equivalent emitted during the production of carbon intensive goods imported in the EU, and that encourages cleaner industrial production in non-EU countries. By putting a price on the embedded carbon emissions generated in the production of given items imported into the EU, the CBAM will generate an equivalence between the carbon price of imports and the carbon price of domestic production, and it will guarantee that the EU's climate objectives are not undermined. The CBAM is designed to be compatible with the rules of the World Trade Organization. The CBAM entered into force on May 16, 2023, after two years of design and discussion. The transitional phase will start on October 1, 2023, with accounting and reporting on GHG emissions for partners and the EU. The phasing in of CBAM is until 2026, replacing existing mechanisms of EU ETS allowances. The goal is to further prevent carbon leakage while encouraging industrial decarbonisation. It will initially apply to imports of given carbon-intensive goods: cement, iron and steel, aluminium, fertilisers, electricity and hydrogen. With this scope, when fully phased in, CBAM will capture more than 50 % of the emissions in ETS covered sectors. CBAM could be an effective instrument to substantially reduce carbon leakage, as a USD 44 per tonne carbon tax could cut leakage by more than half, from 13.3 % to 5.2 %, according to recent estimations.[213]

Between 2018 and 2020 80 % of LDCs were classified as commodity dependent, including highly emitting commodities such as minerals, metals, and fuels, which are also inputs in carbon-intensive

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208 OECD, Data on Climate Related Finance Overview, Website.

209 OECD, 'Climate-related official development assistance in 2021: A snapshot', 2023.

210 Hallegatte, S., & J. Rozenberg, 'Climate change through a poverty lens', *Nature Climate Change*, 7(4), 2017.

211 EU, 'EU agrees to COP27 compromise to keep Paris Agreement alive and protect those most vulnerable to climate change', Press Release, 21 November 2022.

212 CAN, 'New resources for public climate finance and for the Loss and Damage Fund', 2023.

213 UNCTAD, 'A European Union Carbon Border Adjustment Mechanism: Implications for developing countries', 2021`.

value chains - all of which are now covered by the European CBAM (see 2.1).[214] For these reasons the UNCTAD warns that reducing global emissions could negatively affect exports of LDCs. The CBAM might pose high costs on LDCs, like for example the direct cost of certificates, which intended to reflect the cost that a producer within the EU would have to pay under the Emissions Trading System (ETS) for carbon emissions equal to those embodied in the goods to be imported into the EU. Other costs are associated to compliance costs, costs of setting up arrangements for calculating, registering, monitoring and reporting emissions, costs for complying with the CBAM regulation's demands, investment costs for reducing emissions, and costs to prevent or reduce competitiveness losses due to CBAM (see 2.1.3). Yet not all LDCs would be equally concerned by these costs. Although the provision is especially consequential for BRICS countries, some LDCs are especially involved. Aluminium exporting countries, like Mozambique, Cameroon, Guinea and Sierra Leone, as well as steel exporting LDCs like Zimbabwe and Zambia will be exposed to these costs.[215] Mozambique is also amongst the countries potentially most socio-economically influenced by the CBAM. It has been estimated that 2 % of the Mozambican jobs (more than 250,000 jobs) and 6 % of the wage bills are exposed to the impact, as the country has a weak system of social protection (less than 25 % of the workforce is covered).[216,217]

In the initial EU CBAM assessment, the EU already highlighted that exports from LDCs to the EU can provide important foreign exchange earnings for these countries and represent a significant share of their GNI.[218] However, to avoid new global divides between countries with a low and high-carbon export structure, there is a need for targeted support to LDCs (see 2.1). Therefore, the EU should consider more the possible undesirable effects of the mechanism. For example, one of these negative effects could be the de facto reduced access to the EU market of businesses and traders (in particular, Small and Medium Enterprises) from poorer and more vulnerable countries, which may not have the capacity to integrate the rising EU standard requirements into their processes or may not comply with all of them.[219]

Affected developing countries are now faced with the burden to adapt to the new green paradigm in trade posed by the EU (see 2.1.3).[220] This of course accelerates the need for shifting into low-carbon growth paths, especially for industries, and thus this could encourage investments in energy-efficient technologies, cleaner energy sources and technologies that reduce GHG emissions from production. However, the question of which categories of countries and of citizens are paying for this development is still not answered. Additionally, there is the severe risk of undermining the ongoing development efforts in LDCs, also financed by the EU so far.

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214 Ibid.

215 Brandi, C., 'Priorities for a development-friendly EU Carbon Border Adjustment (CBAM)', IDOS, 2021; Institute for European Environmental Policy, 'What can climate vulnerable countries expect from the CBAM?', Briefing, 2021; Monaisa, L., & Maimele, S., 'The European Union's Carbon Border Adjustment Mechanism and its implications for South African exports', Trade and Industrial Strategies, Policy Brief, 2023.

216 Magacho, G., Espagne, É. & Godin, A., 'Impacts of CBAM on EU trade partners: consequences for developing countries', *AFD Research Papers*, 2022.

217 Concerns on the impact of the CBAM on LDCs have also been expressed during the interviews conducted by the authors to the Trade and Industrial Policy Strategy Office (Pretoria, South Africa) and to the Agence Française de Développement (AFD, Paris, France).

218 EU Commission, 'Accompanying the document Proposal for a regulation of the European Parliament and of the Council establishing a carbon border adjustment mechanism' Staff Working Document Impact Assessment Report, (SWD/2021/643 final), 2021.

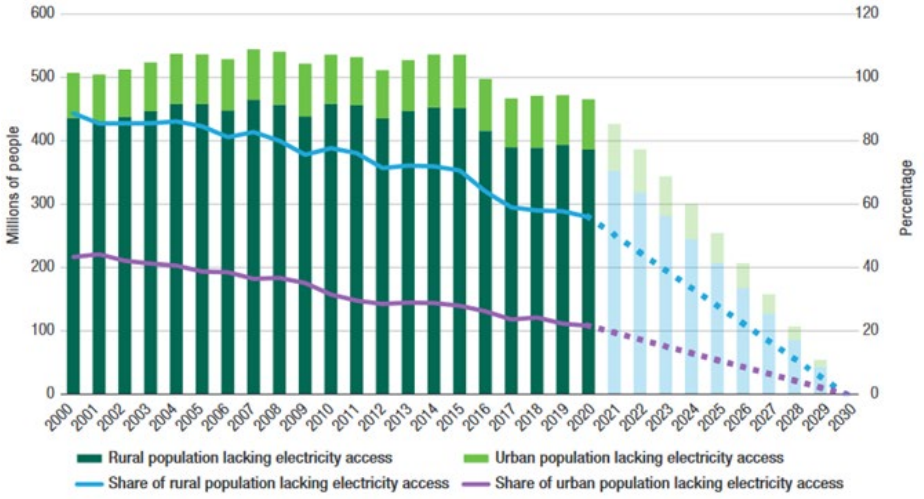
219 Jones, A. & Bilal, S., 'Tailored, multidimensional and coherent: Towards a renewed EU partnership with least developed countries', ECPDM, 2022.

220 Böhringer, C., Fischer, C., & Rosendahl, K.E. et al., 'Potential impacts and challenges of border carbon adjustments', *Nature Climate Change* 12, 2022, p.p. 22–29.

2.6.7. Bottleneck: Energy poverty

In 2019, more than half of the population living in LDCs lacked access to electricity. This corresponds to approximately 570 million individuals, and to two thirds of the world population without electricity.[221] Energy transition to low-carbon energy sources in developing countries has been slow and access to energy still remains an issue in most LDCs. In the IEA Stated Policies Scenario (STEPS) around 672 million people are projected to remain without electricity access in 2030, 85 % of whom will be located in Africa (also, see Fig. 6).[222] Access to electricity is necessary for the many adaptation

Figure 6 – Access to electricity in LDCs



Source: UNCTAD Secretariat calculations based on UNCTADstat database and the World Bank, World Development Indicators database [accessed June 2022].
Note: Figures beyond 2020 are forecasted using UNCTADstat population projections, and assuming a linear decline in the share of rural/urban population lacking access to electricity, consistent with the achievement of universal access by 2030.

Source: UNCTAD, Least Developed Countries Report, 2022.

strategies, such as the use of air conditioning and fans in homes, working spaces and hospitals to alleviate heat stress and enable healthier lives and economic productivity. For example, Sub-Saharan African countries present both low energy consumption and low economic growth, whereas both are critical to build resilience to shocks, including those generated by climate change. Additionally, energy is clearly the backbone for a green industrialisation (see section 2.1.3).[223] On an individual scale, about 2.4 billion people still rely on inefficient and polluting cooking systems, mainly in Asia and in low-income African countries.[224] It has been estimated that the costs of investing in green energy infrastructure could be up to 33 % higher than for conventional energy infrastructure.[225]

Given the limited resources available in LDCs, this fact requires a well-designed balance between short-term rescue spending and longer-term investments (e. g. to build sustainable and resilient infrastructure, to support health and education systems, to restore financial buffers to preserve the credibility of their fiscal frameworks).

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221 UNCTAD, 'Over half of the people in least developed countries lack access to electricity', Article, 2021.

222 IEA, SGD7 Progress and Data, Website.

223 World Economic Forum, 'Technology is the key to transforming least developed countries. Here's how', Article, 2022.

224 Widuto, A., 'EU Progress towards Sustainable Development Goal 7 (SDG 7)', EPRS, 2023.

225 Rozenberg, J. and Fay, M., 'Beyond the Gap: How countries can afford the infrastructure they need while protecting the planet', *Sustainable Infrastructure Series*, The World Bank, 2019.

Moreover, a high concentration of investments occurs in a few middle-income countries (MICs), leaving Least Developed Countries (LDCs) behind in their ambitions to increase (green) energy access (in line with 2.6.4). [226]

2.6.8. Lack of considering the gendered dimension of climate change and poverty

The Gender Equality Strategy, launched by the European Commission in March 2022, enhances "gender mainstreaming by systemically including a gender perspective in all stages of policy design in all EU policy areas, internal and external" and explicitly adopts intersectionality is a horizontal principle for its implementation. Gender equality and women's empowerment are also declared as core objectives of EU external action. Yet, despite these commitments of the EU, there is some concern on the fact that gender mainstreaming appears to be key policy areas and it is often treated as procedural, rather than substantive.[227] In its resolution of 17 February 2022, the European Parliament acknowledged that women still face structural and cultural barriers to participation in many processes of the energy and climate transition.

Despite the existence of a comprehensive gender indicator approach within the NDICI programming, there is no targeted consideration of the different systematic power asymmetries related to gender dynamics within the EU climate action implementation so far. The European Green Deal has been widely criticized by NGOs and Civil Society Networks for failing to include the social and gender dimensions of the 2030 Agenda.[228] There is an explicit need of including gender transformative approaches to adaptation and loss and damage, especially in LDCs. In these countries, a high share of women does not own economic properties, such as land or agricultural inputs, which raises the problem of accounting for lacking land ownership and loss and damage calculation.[229] The weakness of the gendered dimension is raising the potential of pushing more people that are already especially vulnerable to climate change into poverty. Additionally, this might lead to situations of maladaptation. For example, the introduction of sustainable technologies in households does not necessarily address the power inequalities already in place. A study on some areas of Bangladesh shows that the introduction of solar home systems has been perceived by many women as a source of additional workloads.[230] This is clearly not an argument against technology-based projects, such as those promoting the installation of solar home systems, but similar examples show the complexity of addressing the multiple sources of vulnerabilities, included the gender-based ones. A gender-based approach requires a careful ex-ante identification of the sources of discrimination that reduce women's resilience toward climate-related and other shocks.

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226 Meattle, C., Padmanabhi, R., Fernandes, P., Balm, A., Wakaba, E., Chiriac, D. & Tonkonogy, B.,., 'Landscape of Climate Policy in Africa', Climate Policy Initiative, 2022.

227 Allwood, G., 'Gender and EU External Climate Policy' in Gunnhildur Magnusdottir & Annica Kronsell (eds) *Gender, Intersectionality and Climate Institutions in Industrialised States*, New York: Routledge, 2021.

228 Franklyn, S., Hiller, N., & Oger, A., 'The UN High Level Political Forum (HLPF) on the Sustainable Development Goals, 5-15 July 2022, New York', Briefing requested by the ENVI committee, 2022.

229 Climate Action Network (CAN) Europe, 'Strengthening the Africa-EU partnership through action on climate impacts. The importance of gender transformative approaches to adaptation and loss and damage', Briefing, 2022.

230 Wong, S., 'Climate change and sustainable technology: re-linking poverty, gender, and governance', *Gender & Development*, 17(1), 2009.

3. Policy options

3.1. Policy option 1: Foster internal integration in LDCs

In order to increase the internal spillovers resulting from international trade a stronger connection is necessary between the firms that participate in global value chains and the rest of the economy. Following policies to foster the internal integration of firms that participate in global value chains could have desirable impacts in the domain of wages and inequalities, and therefore, in turn, on poverty reduction. Policy Options 1, 2 and 3 address the main challenges in the trade domain explained in sections 2.1, 2.2, 2.3, and 2.4. Challenges and policies in this domain are also summarised in Figure 7 below. In the framework of Policy Option 1, we consider two avenues of action.

The first avenue is to encourage the concentration of value added in lower stages throughout global value chains. One of the evident ways in which this idea could be applied is in the consolidation of extraction and early stages of processing in the same region. Empirical studies have shown that in developing countries exports of processed agricultural goods have had a better track record in terms of value added in their exports when compared with non-processed agricultural goods.[231] An increase in the geographical consolidation of global value chains would also have the effect of reducing the hurdles that strict industrial standards place on the internal integration of GVCs. Since there is a reduced need to accommodate inputs from varied locations, the demands for standardisation from upstream participants in the value chain would be reduced. This happens because intermediate goods produced in the same region are more likely to be similar and also because there is a higher need for standardisation whenever intermediate goods cross borders, due to informational and organisational discontinuities. The static efficiency of a highly dispersed value chain may not be the most desirable structure under a long-term dynamic lens.

Furthermore, the concentration of foreign firms that are involved in global value chains in special economic zones and tax havens could also be discouraged. The fact that foreign firms operate under different legal standings further aggravates the detachment between native firms and those that operate in global markets.[232]

In practical terms, this can be achieved by the manipulation of rules of origin so that they favour products that have had a higher proportion of their value added in LDCs. This could be done by increasing the threshold of value added in LDCs that is needed for them to have duty free access to the European market. A very high fragmentation of global value chains would thereby be discouraged. Depending on the particularities of the partner countries and the regions in which they are inserted, it could be more effective either at country or regional level. This does enter into conflict with the current EU policy of removing practically all tariff lines to exports from countries under Economic Partnership Agreements or the Everything but Arms scheme. A policy of blanket tariff reduction renounces the possibility of applying localised positive incentives. In other words, if a third country already has duty free access to the European market, it becomes impossible to reward industries in LDCs that produce high local value added through tariff reductions. As it is the EU that determines the collective customs policy of all its members, this policy should be implemented at the EU level. Nonetheless, it runs the risk of global value chains simply abandoning natural resource-poor regions altogether.

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[231] Grumiller, J., Raza, W. G., Staritz, C., Grohs, H. & Arndt, C., 'Perspectives for export-oriented industrial policy strategies for selected African countries: Case studies Côte d'Ivoire, Ghana and Tunisia', Austrian Foundation for Development Research (ÖFSE), 2018.

[232] Frick, S. A., & Rodríguez-Pose, A., 'Special Economic Zones and Sourcing Linkages with the Local Economy: Reality or Pipedream?', *The European Journal of Development Research*, 34(2), 2021, p.p. 655–676.

The second avenue of action is to address the fundamental problems that explain why firms do not establish deep value chains in LDCs. These problems are usually the lack of strong institutions to guarantee the rule of law, deficiencies in the provision of healthcare and education, and poor infrastructure.[233] European development aid should continue to emphasise the development of transport, education, energy infrastructures, and capacity building, at the same time that it strives to improve the rule of law. When considering the rule of law, it is worth pointing out that some activities may thrive under regimes with weak rule of law, notably around the exploitation and destruction of natural resources and biodiversity. The increase in deforestation and illegal mining in recent years in Brazil is emblematic of this trend.[234] The importance of stopping environmental degradation underlines the need for the improvement of the rule of law in developing countries. In this case, the added value from acting at the EU level would stem from benefits such as efficiency of scale, effectiveness, and coordination of action supporting the rule of law in LDCs.

There are nonetheless risks that should be heeded when encouraging policy changes in LDCs. If these policy changes are presented as the counterpart to the financing of development projects, or as the counterpart to the sealing of a trade agreement, there is a chance that they will be seen by the LDCs as an imposition. This poses two problems: the first is that it reduces the space for local policy making and the other is that a political commitment to the new rules is possibly lacking. A balance needs to be struck between the hard conditionalities to development aid, and what can be done in more harmonious accord with local governments through the support of local development plans.

This policy option mostly aims to answer to the policy gaps raised in Section 2.1 concerning the upgrading of industrial structure and dependence on the export of primary goods. This could entail directly encouraging the amount of value that is added in LDCs through the upgrading of their industrial structure, as well as creating the incentives for a greater extent of the GVCs to be located inside the country, beside mere resource extraction. If successful, an increase of local added value could help reduce income poverty by increasing the amount of stable, well-paid jobs (sustained by higher productivity),[235] but also by allowing, through taxation of the higher added value, greater resources for the government to use in its own poverty reduction schemes.

3.2. Policy option 2: Establish tighter standards of due diligence

The excessive power that transnational firms yield over developing countries should be supervised, to guarantee that they do not use their prominent position as a way to circumvent human rights and environmental regulations. The EU's legislative proposal on corporate sustainability due diligence (under discussion at the time of writing – October 2023),[236] is a desirable initiative in the tightening of due diligence standards. It forces the 50 000 largest companies to identify potential environmental and human rights violations and to take measures to prevent and to put an end to the critical practices. Moreover, by making companies legally liable for their environmental and human rights violations, the directive would contribute to the internalisation of the social costs created by these companies. Ideally, European firms should be held to the same environmental and human rights standards independently from the location in which they operate, both as a way to guarantee a level playing field between them but also as a matter of principle and adherence to the

[233] Flentø, D., & Ponte, S., 'Least-Developed Countries in a World of Global Value Chains: Are WTO Trade Negotiations Helping?', *World Development*, 94, 2017, p.p. 366–374.

[234] de Area Leão Pereira, E. J., de Santana Ribeiro, L. C., da Silva Freitas, L. F., & de Barros Pereira, H. B., 'Brazilian policy and agribusiness damage the Amazon rainforest', *Land Use Policy*, 92, 2020.

[235] Lavopa, A., Szirmai, A., 'Industrialization, employment and poverty', *MERIT Working Papers,* 2012-081, 2012.

[236] European Parliament Legislative Observatory, Corporate Sustainability Due Diligence, 2022/0051(COD).

values on which the EU is built. For this reason, the tightening of due diligence standards should be carried out at the European level instead of merely at the level of the Member States.

The EU Conflict Mineral Regulation is a further step in the direction of improving corporate due diligence at the European level. It applies to minerals and metals – gold, tin, tungsten, and tantalum. The regulation forces importing firms to audit their supply chain to ensure that the minerals were sourced responsibly. The regulation affects between 600 and 1 000 importers in the EU, and indirectly around 500 smelters and refiners inside and outside the EU. Due to the size of its market, this regulation can have a considerable direct and indirect effect on the improvement of corporate due diligence in LDCs.[237] Nonetheless, there are parts that could be improved, such as by increasing the number of minerals that are covered by the regulation, as more minerals than the four covered are used to finance military insurgencies. Some authors consider that the indirect effects would not be significant due to the EU lacking effective leverage over the smelters.[238]

Improved due diligence standards have been shown to improve company outcomes in the long term.[239] They reduce risks, improve the relationship with stakeholders leading to higher productivity,[240] and improve firms' reputations. Furthermore, the need to carefully audit a supply chain for environmental and human rights violations has the effect of deepening a firm's knowledge of its own supply chain. This allows firms to practise more efficient management of their value chains.

Lastly, it is of extreme importance that due diligence regulation encompasses the whole of the supply chain and not just suppliers that are formally subordinated to other companies. In many cases, the largest part of environmental and human rights violations is perpetuated by external suppliers, with either no awareness on the part of the leader firm, or with tacit acceptance.[241] No true change in corporate due diligence is possible if the whole of the supply chain is not placed under the same regulation. If action is only taken at the level of the leader firms, most of the actual production process would be left out. Furthermore, subsidiaries and suppliers, when operating in LDCs, have a higher likelihood of being inserted in a legal framework that is less demanding on due diligence standards. The widening of due diligence standards to suppliers could also nudge foreign firms operating in least developed countries to comply with the EU's standards lest they become excluded from their supply chains. In countries where the EU does not have a very high participation in the value chains, the results would probably be modest. In order to affect the corporate practices in third-party countries, the EU has more leeway through the employment of the CBAM that was explored in Section 2.6.6.

This policy option aims to answer the problems raised in Section 2.2 concerning the failures of corporate due diligence, as it directly aims to tighten the European laws in that regard. It affects poverty reduction by reducing the negative consequences of high natural resource endowments, meaning that the population of LDCs can take greater advantage of their countries' resources. A reduction in the rate of environmental degradation also has the effect of reducing poverty caused by climate change and by increased vulnerability to natural disasters.

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237 Regulation (EU) 2017/821 of the European Parliament and of the Council of 17 May 2017

238 Macchi, C., 'A Glass Half Full: Critical Assessment of EU Regulation 2017/821 on Conflict Minerals', *Journal of Human Rights Practice*, 13(2), 2021, p.p. 270–290

239 Weissman, E., Mittal, A., Chung, C., Zhou, K. & Suladze, G., 'Quantifying the Cost Benefits Risks of Due Diligence for RBC', OECD, 2016.

240 Bağlayan, B., Landau, I., McVey, M. & Wodajo, K., 'Good Business: The Economic Case for Protecting Human Rights', SSRN Scholarly Paper 3304959, 2018.

241 Young, S. B., Fernandes, S. & Wood, M. O., 'Jumping the Chain: How Downstream Manufacturers Engage with Deep Suppliers of Conflict Minerals', *Resources*, 8(1), 2019.

3.3. Policy option 3: Foster regional integration

On the back of receding extension of global value chains, there is a case to be made about furthering regional integration. The EU itself recovered from the devastation of war and became one of the world's richest economies on account of its regional integration. For this reason, the EU integration process could serve as a role model for LDCs.

In this regard, the way that the EU negotiates its Economic Partnership Agreements in the framework of Regional Economic Zones could provide an incentive to further deepen economic integration at the regional level. Nonetheless, this integration should be conducted in a way that fosters capacity building in the countries concerned. The establishment of a series of bilateral deals at the regional level may in fact hinder the regional integration process, as these deals can vary drastically, making regional integration more difficult.[242] This means that economic policy tools, particularly those related to trade, should be developed at a regional level by the developing countries themselves. The collective development of these tools at the regional level would allow the region to integrate itself in international trade without erecting internal trade barriers. For this reason, the EU should privilege negotiations with regional blocks over bilateral negotiation whenever it is feasible.

Historically countries that have tried to improve their development position by participating intensely in global trade have had a mixed track record. Generally, the main hurdles were in upgrading from commodity extraction to higher value-added activities, as discussed above. The deepening of regional interaction could help mitigate these hardships by allowing LDCs to pull together and operate value chains of greater complexity and value added than what would be possible in the framework of bilateral treaties.[243] This consolidation could also hold direct advantages for the EU as more consolidated value chains are less prone to disruption, while it also facilitates implementation of due diligence laws.

One recently opened avenue to support the deepening of regional integration was the signing in 2018 of the Africa Continental Free Trade Agreement by all 54 countries on the continent.[244] There is still a large gap between signing an agreement of this scale and actually implementing it. Nonetheless, this should be seen by the EU as an opportunity to encourage the process of regional integration in Africa. If it comes to fruition, this trade agreement could see Africa expand its participation in value chains of strategic significance for its own climate transition, such as the production of lithium batteries and automotive production.[245] Researchers estimate that it also holds the potential to raise 40 to 227 million people out of poverty[246] and to significantly reduce food insecurity.[247] This potential is evident when we consider that intra-African trade involves more technologically advanced manufactured goods compared to trade with partners outside the region.[248, 249]

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242 Meissner, K. L., 'A case of failed interregionalism? Analyzing the EU-ASEAN free trade agreement negotiations', *Asia Europe Journal*, 14(3), 2016, p.p.319–336.

243 Hafez, M., 'From division to unity: Transnational integration and the power of the AFCFTA', Publications Office of the European Union, 2023.

244 AFCTFA, website.

245 AfCFTA Secretariat, 'Which Value Chains for a Made in Africa Revolution', UNDP.,2021.

246 Echandi, R., Maliszewska, M., & Steenbergen, V., 'Making the Most of the African Continental Free Trade Area: Leveraging Trade and Foreign Direct Investment to Boost Growth and Reduce Poverty', The World Bank. 2022.

247 Joint Research Centre of the European Commission, 'Potential effects of the African Continental Free Trade Area (AfCFTA) on African agri-food sectors and food security', Publications Office of the European Union. 2021

248 Hafez, M., 2023, Ibid.

249 Policy recommendations in favour of trade regional integration have also been expressed during the interviews conducted by the authors to the UNCTAD (Geneva, Switzerland).

To help to ensure the fruition of the Africa Continental Free Trade Agreement, the EU could offer technical support to complement economic reforms in areas such as education and transport infrastructure that underpin the free trade agreement and form the preconditions for it to fulfil its development ambitions. Furthermore, the EU should, through its development aid programmes, support the building of the infrastructure necessary to respond to the demands of further economic integration. An ambitious implementation of the EU-Africa Global Gateway Investment Package could strongly contribute to helping to ensuring the sustainability of this agreement. We highlight two of the EU-Africa Global Gateway Investment Package's ambitions for 2030 that could make a significant step in this direction: i) the ambition on economic consolidation consisting of strengthening continental and regional economic integration and accelerating Africa's industrial development; and ii) the ambition on transport consisting of integrating the African and European multimodal transport networks in line with the regional and continental frameworks and tailoring these networks to the economic potential of an African Continental Free Trade Area.[250]

The EU's advantage in undertaking this task rests on the high level of resources mobilised by the Global Gateway initiative and also through the EU's capacity to negotiate trade agreements with a whole regional block and to bring the same block closer together as a result. This approach holds the considerable risk that, despite the EU's best efforts, the Africa Continental Free Trade agreement may not come to fruition. Regional economic integration in Africa faces various economic and political hurdles that have in great part disrupted most previous attempts.[251,252] These challenges will be exacerbated when attempting economic integration at continental wide level. Therefore, the prospective of a continent-wide trade agreement should not obfuscate efforts to foster integration on a narrower regional basis.

This last point mostly focuses on answering Section 2.3 on the challenges posed by the reshoring of global value chains. It aims to find a way of keeping some of the economic advantages of global value chains while maintaining a higher share of value added in the region. It also addresses Section 2.4, although not entirely, as increased regional economic integration implies a wider policy space for the participating countries than under bilateral agreements. The principal poverty reduction mechanism resulting from increased regional integration would be the creation of well-paid jobs in the manufacturing sector sustained by newly formed or expanded regional value chains. Consequently, it would help directly reduce income poverty and indirectly, through increased taxation, allow for an expansion of public services.

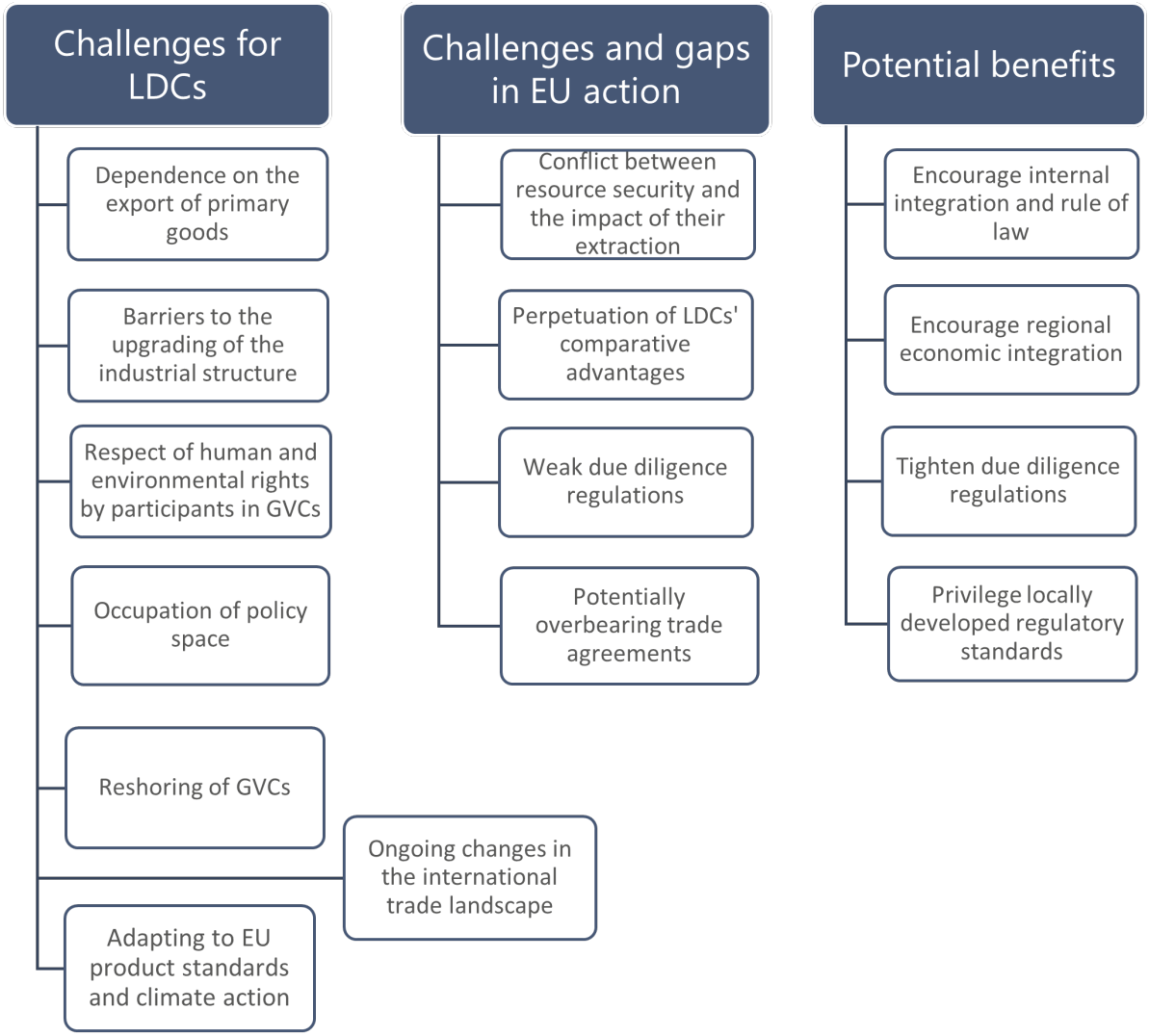
Figure 7 summarises the main challenges in the trade domain explained in Sections 2.1, 2.2, 2.3, and 2.4, and the corresponding proposals explained in Policy Options from 1 to 3 in section 3.

[250] Berger, A., Brandi, C., Stender, F., Brown, E. k, Apiko, P., & Woolfrey, S., 'Advancing EU-Africa cooperation in light of the African Continental Free Trade Area', European Think Tanks Group, 2020.

[251] Hailu, M. B., 'Regional Economic Integration in Africa: Challenges and Prospects', *Mizan Law Review*, 8(2), Article 2, 2014.

[252] Jiboku, P. A., 'The Challenge of Regional Economic Integration in Africa: Theory and Reality', *Africa's Public Service Delivery & Performance Review*, 3(4), 2015.

Figure 7 – Challenges and benefits of EU trade action towards LDCs.



Source: Authors.

3.4. Use case: Mozambique's graphite sector – policy recommendations

The policy recommendations mentioned above (Sections 3.1, 3.2, and 3.3) can be concretely applied to the case of the graphite sector in Mozambique. Concerning the fostering of internal integration of GVCs, the lack of infrastructure is one of the main obstacles that foreign firms face in expanding the depth of their value chains in Mozambique. For example, Mozambique is placed 103rd in the World Bank's Ease of Doing Business Index on the category of access to electricity.[253] The processing

[253] The World Bank, 'Ease of Doing Business Scores', website.

of mineral materials is often highly energy intensive and requires a reliable power grid to run profitably. Furthermore, its transport infrastructure requires extensive investment, both in roads and railways.[254] In this regard, the EU's PROMOVE initiative for inclusive growth and poverty reduction in rural Mozambique could have positive effects on the amount of value added remaining inside the country. Under the umbrella of the PROMOVE initiative, initiated in 2018, European development aid places a considerable focus on the reparation and construction of rural roads (€124 million), and on access to rural energy services (€94 million). Both aspects are considered essential for development and poverty alleviation, and not only for the development of greater value added by foreign companies.[255] Roads are essential for improving access to resources, jobs, and services – in this sense they are crucial for multidimensional poverty reduction and development. It is important to be aware that the improvement of transport infrastructure alone is not sufficient to foster internal economic integration. Nonetheless, when investing in transport infrastructure, it is important that investments are made to improve connections between communities and not merely between the points of extraction and the points of export of raw materials.[256] Currently the initiative only covers the provinces of Zambezia and Nampula, while its expansion to other provinces such as Cabo Delgado could encourage the opening of firms in the graphite value chain in the province.

Concerning the adoption of tighter due diligence standards, the overall results would be tempered as they would only affect EU based firms. Nonetheless, one of the main graphite mines in Mozambique is owned by a European-based firm, AMG Graphite, so the effects should not be negligible. As Mozambican local authorities lack the resources to thoroughly monitor foreign mining firms, the imposition coming from outside could prove an effective stopgap measure. However, the risk exists that the enforcement of external due diligence laws might discourage the strengthening of local enforcement capabilities, and this danger should be properly addressed.

On regional integration, in 2021 Mozambique only exported US$18 500 of graphite to countries in Africa, representing less than 1 % of the US$24 500 000 of graphite that Mozambique exported in total in the same year.[257] There is thus considerable space for the regionalisation of the graphite value chain. This is especially true considering the increased demand for graphite anodes for batteries in the foreseeable future. The EU can spur this integration by having development aid on region-wide project implementation decided by regional bodies, or by negotiating the trade agreements at a regional level instead of nationally. In this regard, the EU established an Economic Partnership Agreement with the Southern Africa Development Community that also includes Mozambique. This agreement entered into force in 2018 and grants goods produced in Mozambique tariff free and quota free access to European markets.[258] Furthermore, the Economic Partnership Agreement also aims to increase economic integration in the whole of the Southern Africa Development Community. The PROMOVE programme also involves trade facilitation. One of the programme's provisions seeks to increase the government's reform capacity. This aims to allow it to better enforce trade rules as well as to better guarantee the provisions of the Economic Partnership Agreement. Poor enforcement of trade rules, as well as weak rule of law are generally considered some of the strongest barriers to LDCs' fruitful participation in global value chains. This could be leveraged to increase regional integration if these trade rules are homogenised at a regional level. However, it may also pose challenges, as better guarantees in trade deal provisions, potentially negotiated in under asymmetric power relations, might have the effect of further deepening the dependence on extra-regional trade at the expense of intra-regional trade. Similar

254 The World Bank, 'Ease of Doing Business Scores', website.

255 Delegation of the European Union to Mozambique, 'The European Union and Mozambique', website.

256 Schwanen, T., 'Towards decolonised knowledge about transport', *Palgrave Communications*, 4(79), 2018.

257 UN, UN Comtrade database, website.

258 Council Decision (EU) 2016/1623 of 1st June 2016 on the signing, on behalf of the European Union and provisional application of the Economic Partnership Agreement between the European Union and its Member States, of the one part, and the SADC EPA States, of the other part.

reflections are also pertinent for the diverse initiatives that involve private sector investments in the Global Gateway framework. In this framework, the EU has the opportunity to exercise a steering role, directing the myriad of mobilised private investments toward development and poverty reduction outcomes.

3.5. Address structural conditions of LDCs

3.5.1. Policy option 4: Strengthening capacity for climate-informed decisions

Policy Option 4 suggests increased transparency and efficiency in EU climate action, such as sharing insights on the specificity of local climate change effects in LDCs through the gathering of data. It is related to the challenges presented in Sections 2.6.1, 2.6.3, 2.6.4, and 2.6.8. These data could not only be gender disaggregated but they could also consider different income groups and geographies. Furthermore, they could be accessible and updated regularly, monitoring the effects of EU climate action on LDCs. Gathering and providing the data on the EU level would allow all stakeholders (EU, Member States and LDCs) to draw informed conclusions, avoid repeated action in LDCs, and potential trade-offs. Increasing transparency and sharing insights on the interconnectedness of climate measures considering these outcomes is crucial for effective action and avoidance of contradictory effects on local impoverishment. This policy option could enable coordinated and integrated approaches, considering climate vulnerabilities and inequalities, to understand the impact of industrial or economic policies in LDCs. The EU should also support strengthened capacity in collecting and measuring climate impacts in LDCs. This could include deeper collaboration with existing mechanisms, such as the African Adaptation Initiative, which aims to enhance climate information services. Risks arise, however, if the power and justice intersections in locally led adaptation measures within the LDCs are insufficiently estimated or known,[259] or if the knowledge gathered is not used for climate-informed policy-making by LDCs or EU entities and Member States. This policy option aims at the disclosure of potential poverty-increasing behaviour in climate policies in LDCs.

3.5.2. Policy option 5: Investment in energy security and efficiency

The COVID-19 pandemic erased some of the previous advances in access to sustainable energy, while high prices are raising the costs of renewable installations. Policy measures and mobilisation of public and private capital for renewable energy will therefore be crucial in the coming years.[260] The EU could actively provide support for a just and socially responsible transition to sustainable energy that responds to the specific economic development and industrialisation ambitions of LDCs (see Section 2.6.7). Investing in this necessary infrastructure for socio-economic development in LDCs could not only create more and better job opportunities for people in emerging industries, but could also improve living standards at household level through electricity access. This could have positive consequences on monetary poverty reduction. Furthermore, this could be realised within the framework of the Global Gateway strategy, through the promotion of technology transfer and long-term investment strategies for green development pathways. Moreover, the EU could support the implementation of integrated energy approaches.[261] Progress is particularly needed in terms of energy efficiency, clean cooking solutions and access to electricity. To ensure long-lasting green energy transitions in LDCs, the regulatory framework and capacity could be strengthened and better supported.[262] Genuine partnerships in sourcing critical raw materials and energy supplies

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259 Rahman, M.F, M.F., Falzon, D., Robinson, Sa. *et al*, 'Locally led adaptation: Promise, pitfalls, and possibilities', *Ambio*, 52(10), 2023, p.p. 1543-1557.

260 Widuto, A., 'EU Progress towards Sustainable Development Goal 7 (SDG 7)', EPRS, 2023.

261 IEA, 'Tracking SDG7 – The energy progress report 2021', Report, 2021.

262 The World Bank, 'Breaking Down Barriers to Clean Energy Transition', Article, 2023.

from Africa by building industrial capacity, localising value chains, and sharing technologies could build the backbone of the EU's external energy policy.[263]

To fulfil the ambitious EU energy agenda, which is to be equipped with further climate targets in 2024, it is important to consider its external impacts on LDCs. The EU plays an essential role in the provision of a platform to ensure energy security, energy efficiency and a just energy transition. Associated risks refer to the involvement of the private sector (see 2.6.3), high costs of energy access and transition for firms and individuals in LDCs, and maladaptation due to poor planning without considering political power structures within LDCs.

3.5.3. Policy option 6: Recycling the revenues from CBAM for the green transformation in LDCs

To avoid shifting the burden of carbon prices onto LDCs through the establishment of the CBAM and thus increasing vulnerability (see Sections 1.3.2 and 2.6.6), the EU could provide and invest in capacity to monitor, report, and verify the carbon content of exporting countries.[264] Furthermore, throughout the trial phase of the CBAM, the EU could consider establishing mechanisms that allow the recycling of generated revenues towards the development of green transformation in LDCs, i.e. in technological and capacity-building support.[265] Both options could reduce the possible exacerbation of multidimensional poverty in LDCs affected by the CBAM, due to job losses caused by reduced access to the EU market for businesses and traders (in particular, small and medium-sized enterprises). Capacity-building at different institutional levels could also improve educational conditions in LDCs in the long term, to enable structural change. Yet, these measures need to be planned, implemented and monitored sensitively to avoid structural change at the cost of individuals, and potentially increasing poverty.

A possible implementation mechanism could be the establishment of a dedicated fund for LDCs using the revenues from existing support channels (e.g. bilaterally and multilaterally, including the mechanisms established under the UNFCCC). Recital 74 of the CBAM Regulation mentions the separate provision of climate finance through the EU budget and ends with a reference to a possible future channelling of CBAM revenue into the EU budget, which could be further detailed and developed.[266] Efficient and strict targets on LDCs would be essential. As these approaches are established as European policy, European action would be necessary and could not be replaced by individual action by Member States.

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263 Usman, Z., Abimbola, O. & Ituen, I., 'What does the European Green Deal mean for Africa', Carnegie Endowment for International Peace, 2021.

264 Eicke, L., Weko, S., Apergi, M. & Marian, A., 'Pulling up the carbon ladder? Decarbonization, dependence, and third-country risks from the European carbon border adjustment mechanism', *Energy Research & Social Science* 80, 2020.

265 Brandi, C., 'Priorities for a development-friendly EU Carbon Border Adjustment (CBAM)', IDOS, 2021; Gore, T., Blot, E., Voituriez, T., Kelly, L., Cosbey, A., & Keane, J., 'What can climate vulnerable countries expect from the CBAM?', IEPP Briefing, 2021.

266 European Commission, 'Accompanying the document Proposal for a regulation of the European Parliament and of the Council establishing a carbon border adjustment mechanism', Staff Working Document impact assessment report, (SWD/2021/643 final), 2021.

The Global Climate Change Alliance+ (GCCA+): Selection of lessons learned

Lacking focus on needs of the most vulnerable: high costs of new technologies made it more difficult for the poorest households to benefit from the programme.

Gender dimension: few actions with specific focus on women.

Lacking focus on awareness raising: despite having started in 2007 and supported more than 80 countries, awareness appears to remain limited amongst developing countries as well as in the EU Member States.

Lack of maintenance funds: some interventions were discontinued when funding ceased.

Measurement: a proper measurement system of outcomes was lacking.

Resilience: the instrument seems to have improved recipients climate resilience only marginally .

Source: ECA, Special Report 04/2023, The Global Climate Change Alliance(+) – Achievements fell short of ambitions

3.6. Boost climate finance in efficiency and additionality

There is an existing need at international level to address climate fund fragmentation in the development context, while also improving the quality and effectiveness of existing climate finance. For example, it would be necessary to reduce the number of existing mechanisms, for the achievement of higher coherence and efficiency, and to ensure sufficient additionality of new climate finance. In particular, we identified three policy options.

3.6.1. Policy option 7: Establishment of (re)new(ed) adaptation and loss and damage mechanisms for LDCs

Strengthening the guiding role of the EU in climate action, and effectively coordinating efforts to achieve climate justice for LDCs amongst Member States would be crucial. This could allow targeted action to eradicate poverty and adapt to climate change in LDCs (2.6.1, 2.6.3), and to raise awareness for other Member States and non-EU states in addressing climate change effects in LDCs more precisely.

Taking lessons learned from the GCCA (+) (see box), there is a window of opportunity to establish an improved financing mechanism targeted at the most vulnerable people, to reduce the costs of access and participation, possibly by focusing on other sectors or methods, to consider gender dimensions of climate change in LDCs (2.6.8) and to leverage added-value through awareness raising. Measures in the domain of adaptation interventions that focus on wide-ranging climate resilient development and on poverty and inequality reduction are increasingly seen as essential to minimise loss and damage generated by climate change.[267] Additionally, the inclusion of local climate action networks or actors in a bottom-up approach could provide essential insights into fulfilling effective adaptation support on the ground.[268]

Another option could be directing financial assistance in LDCs towards long-term adaptation mechanisms and effective measures of loss and damage, in order to sustain their management of the unavoidable effects of climate change that are already occurring in LDCs. The EU already agreed to create a new UNFCCC fund dedicated to Loss and Damage (L&D Fund, see Section 2.6.5), and its contribution could be aligned with the principles of effectiveness and additionality. Yet, there is little evidence and few best practices to learn from, which bears the risk of inefficient funding. Amongst practitioners and scholars some agreement exists on the creation of such a solidarity fund. The

[267] Woolf, D., Solomon, D., & Lehmann, J., 'Land restoration in food security programmes: synergies with climate change mitigation', *Climate Policy*, 18(10), 2018, p.p. 1260–1270.

[268] Mimura, N., Pulwarty, R.S., Duc, D.M., Elshinnawy, I., Redsteer, M.H., Huang, H.Q., Nkem, J.N., & Sanchez Rodriguez, R.A., 'Adaptation Planning and Implementation, Climate Change 2014: Impacts, Adaptation, and Vulnerability', Part A: Global and Sectoral Aspects. *Contribution of Working Group II to the Fifth Assessment Report of the Intergovernmental Panel on Climate Change*, 2014, p.p. 869–898.

mobilisation of finance to which the EU already agreed, could also be justified by the direct enactment of the 'polluter pays' principle, applied to developed countries' governments and private companies.[269] Such a mechanism would entail disaster risk reduction, as well as preparedness, adaptation, and resilience policies. LDCs call for a minimum amount of US$100 billion for the L&D Fund in addition to existing funding streams such as ODA, climate finance, and others.[270] Until 2023, a total of up to US$430 million was pledged to L&D by Germany, Austria, the US, France and Denmark, among others, following the COP26 in Glasgow.[271] Most of these pledges are allocated to the Global Shield and Santiago Network, and some are directed to L&D on the ground for the most vulnerable and affected populations. As this amount is not yet sufficient to cover the call for assistance from LDCs, the EU taking a leading role could motivate other stakeholders to contribute to such a new fund. Moreover, this policy option could improve multidimensional poverty reduction in LDCs, especially by improving disaster preparedness and risk reduction in most vulnerable regions and strengthening resilience of the population.

3.6.2. Policy option 8: Support a tailored approach in climate finance for LDCs

Addressing the need for more accessible climate finance for LDCs, EU financing tools could consider context-specific approaches to address most climate vulnerable countries and thus reduce regional concentration of financing (see Section 2.6.4). This could include a new climate financing approach separate to ODA, framing climate finance not necessarily as a developmental issue, but rather as a global concern. The use of grants or concessional rates could be encouraged, to avoid pushing LDCs into unsustainable debt.[272] Another consideration to take into account is LDCs' weaker institutional capacity. Climate finance initiatives could ensure transparent and efficient bureaucracy, for example through standardised processes and easily accessible entry points. The analysis of the Green Climate Fund by Garschagen and Doshi (2022) uncovered that LDCs, especially in Africa, who are in specific need and targeted by the funding, have not yet received adaptation project funding at all.[273] Drawing from this international experience, the EU could further support building stronger capacity for the development of bankable projects, if necessary, through technical assistance, as well as supporting regulatory frameworks.[274] By explicitly targeting a LDC-tailored approach in climate finance, EU action could address multidimensional poverty eradication at a macroeconomic level. This could then more comprehensively address all dimensions of poverty reduction in LDCs, including health, education and living standards.

The EU has a strong standing and leveraging power with (multilateral) banks to jointly develop such a tailored approach, and ensure full inclusion of LDCs' needs, despite the lack of best practices or past evidence on effectiveness. Another aspect could be to further enhance the capacity for bankable projects and creation of actual access to these financing mechanisms.[275] If these aspects are not properly considered, the risk of inefficiency of finance would emerge.

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269 Pill, M., 'Towards a funding mechanism for loss and damage from climate change impacts', *Climate Risk Management*, 35, 2022.

270 Anisimov, A., 'A survey of existing funding streams related to Loss and Damage: positioning the future L&D fund', IDDRI, 2023.

271 Richards, J-A., Schalatek, L., Achampong, L., & White, H., 'The loss and damage finance landscape: A discussion paper for the Loss and Damage community on the questions to be resolved in 2023 for ambitious progress on the Loss and Damage Fund', Heinrich-Böll-Stiftung Washington, DC, 2023.

272 Usman, Z., et al., 'What does the European Green Deal mean for Africa', Carnegie Endowment for International Peace, 2021.

273 Garschagen, M., & Doshi, D., 'Does funds-based adaptation finance reach the most vulnerable countries?', *Global Environmental Change*, 73, 2022.

274 Karkare, P. & Medinilla, A., 'In search of shared benefits: Europe and Africa in a global green transition', ECPDM, 2023.

275 UN,' Improving Finance for the Least Developed Countries', Draft Report, 2023.

3.6.3. Policy option 9: Clear and SDG-guided mobilisation of the private sector

The EU has promised €300 billion for meaningful investment in infrastructure in developing countries until 2027, which is partly yet to be mobilised. To follow this promise and using its leveraging power in relation to the European private sector, there is a potential high added value of action at the EU level. Initiatives at the EU level could improve credibility toward private investors. They would trust efficient coordination efforts among multiple European actors. Such a steering task could be implemented within the Global Gateway initiative. The result would be the enlargement of the amount of climate finance that could be used to close the increasing adaptation financing gap internationally (2.6.1, 2.6.3). Yet, this mobilisation should be transparent and sustainable. Due to the shortcomings in the mobilisation of the private sector in various sectors covered by the Global Gateway (2.6.2), the EU could further explore the potential of this innovative financing tool. Thus, the EU could establish a clear definition of what private sector mobilisation entails. Further, it could ensure that this involvement occurs in line with the SDGs and with extensive transparency obligations. A set of guidelines and strategies could be set up based on the findings of the High Level Expert Group on scaling up sustainable finance in LMICs (HLEG, see Section 2.6.2). There is a potential risk of private sector profit-oriented action, which would undermine efforts in SDGs in LDCs, if the needs of LDCs are not sufficiently considered. This policy option could have positive effects on monetary and socio-economic poverty reduction if private sector mobilisation entails sustainable direct investment in infrastructure and development of industry, or if it addresses the development of educational capacities in LDCs to contribute to a specific part of a GVC.

3.7. Climate justice: Addressing inequalities and vulnerabilities

Following the intention of climate justice, developed countries and their industries, including in the EU, have contributed largely to emissions in past decades (see 1.3.1). This justifies the EU's responsibility to support the countries mostly affected by climate change. Some scholars argue that the policymaking still lacks consistency in delivering justice in the achievement of the ultimate goal of the UNFCCC, in the implementation of adaptation decisions, and in ensuring equitable LDCs participation in the process.[276] As shown throughout this paper, the EU institutions do consider the specific circumstances of LDCs in facing climate change effects to some extent. Yet, the motion for a European Parliament 'Resolution on the impacts of climate change on vulnerable populations in developing countries', while discussed by different parties in 2021, yet its adoption was rejected. Greater consideration could be given to capacity-building to adapt to climate change, and to strengthen resilience to climate impacts in LDCs for especially vulnerable population groups (see Sections 1.3, 2.6). On an institutional level this could include support for creating knowledge and skills development to address gaps in climate change adaptation planning and facilitate countries' direct access to international climate change financing. On an individual level, this could aim at strengthening the access to information on climate events that affect a person's vulnerability, such as access to and usage of early warning systems, or further resilience enhancing methods, such as considering and sharing indigenous knowledge.

3.7.1. Policy option 10: Coherent implementation of existing gender-sensitive mechanisms in mainstreaming and targeted action

Given the assessed gender imbalances within climate vulnerability and poverty, putting women at the core of EU action in LDCs could tackle both issues simultaneously – if designed considerately and in an inclusive way (see Section 2.6.8). Many areas of convergence exist to build upon, including

[276] Abeysinghe, A., & Huq, S., 'Climate Justice for LDCs through Global Decisions', in Clare Heyward, and Dominic Roser (eds), *Climate Justice in a Non-Ideal World*, Oxford, 2016.

the EU adaptation strategy[277] and its gender action plan III, that committed to gender transformative actions to shift gender-power relations,[278] but this would also require greater coherence in the EU's climate diplomacy and in the Global Gateway financing strategy. The NDICI could support gender-sensitive initiatives throughout its operations, including dedicated climate programmes that specifically address gender concerns. There is a further need to implement Resolution (2017/2086(INI)) on women, gender equality and climate justice throughout EU action.[279] Careful consideration of maladaptation due to lacking focus on gender-dimension and power inequalities for European external climate action is needed.

Furthermore, EU development cooperation could support more adaptation initiatives addressing the gender-specific impacts of climate change, mainly in the domains of food security, water governance, agriculture, energy, health and disaster management, and strengthen the capacity of women to participate in local climate politics. This policy option pays specific attention to the hidden dimensions of poverty, such as systematic inequalities and vulnerabilities. Implementing such provisions could improve poverty eradication measures in LDCs and moreover contribute to climate action equally.

Action at the EU level is essential in implementing and designing resolutions to raise awareness for other actors in climate action, especially Member States. The EU could thus ensure coherence in the gender, climate action and poverty eradication policy fields. Trade-offs with the funding of other action on the development agenda might arise, yet the outcomes of integrating a gendered approach to achieve climate justice and poverty alleviation is promising.

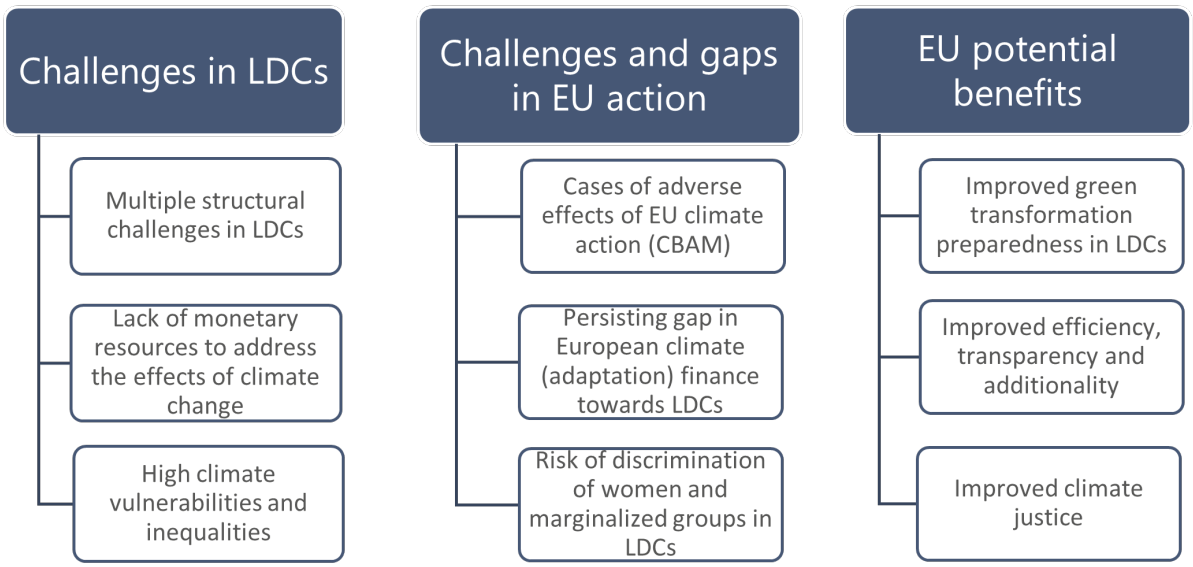
Figure 8 summarises the main challenges in the climate domain explained in Section 2.6, and the corresponding proposals explained in Policy Options from 4 to 10 in Section 3.

[277] European Commission, 'Strategy on Adaptation for Climate Change', COM(2021) 82 final, 2021.

[278] Joint Communication to the European Parliament and the Council on the EU Gender Action Plan (GAP) III – an ambitious agenda for Gender Equality and women's empowerment in EU external Action, European Commission, 2020.

[279] European Parliament, Resolution on women, gender equality and climate justice (2017/2086(INI)), 2018.

Figure 8 – Challenges and benefits of EU climate action towards LDCs



Source: Authors.

3.8. Overview of the different policy options (PO)

Table 3 evaluates in a synthetic way the ten policy options (PO) in the trade and climate domains, assessed along three axes: first, the level to which the corresponding challenge is addressed; second, the level of European added value in implementing that policy; third, the level of feasibility of implementation. In all POs, the related challenges are expected to be addressed from a medium to a high level, with the exception of PO 8 (Support for a tailored approach in finance for LDCs). As explained above (3.6.2) PO 8 suffers from a lack of best practice or past evidence on effectiveness, although the EU has experience with such action, and from the risk of finance inefficiency in the case of lack of access to the financing mechanisms. The level of European added value regards the extent to which an action at the EU level would increase the outreach, the efficiency and the outcomes of the action itself with respect to similar measures taken either by single Member States or by other international organisations. This dimension is placed at levels from medium to high in all POs, except in PO 7 (Establishment of renewed adaptation and Loss and Damage mechanisms for LDCs), for which coordinated action at the international level may be comparatively more efficient. The feasibility of implementation is from medium to high for all POs, except for PO 3 (Foster regional integration), for which difficulties related to the discouragement of bilateral deals may arise, and for PO 9 (Clear and SDG-guided mobilisation of the private sector), for which obstacles may emerge in relation to incentives for the private sector to invest in different directions. The feasibility of PO 6 (Recycling the revenues from CBAM for the green transformation in LDCs) is difficult to assess, given the very recent establishment of the CBAM mechanism.

Table 3 – Overview of the different policy options (PO) in trade and climate action

Axes	PO1	PO2	PO3	PO4	PO5	PO6	PO7	PO8	PO9	PO10
Challenges significantly addressed	+++	+++	+++	++	++	+++	+++	+	++	+++
EU Potential Benefits	++	+++	++	+++	++	++	+	+++	++	+++
Feasibility of implementation	++	++	+	+++	++	?	++	+++	+	++

Source: Authors. The axes are ranked as low (+), medium (++) and high (+++). PO are referred to the Policy Options (from 1 to 10) explained in section 3.

4. Conclusion

The analysis illustrates some aspects of the ways in which EU external action on climate and trade policies could affect development achievements, including poverty eradication, in least developed countries (LDCs).

Participation in global value chains (GVCs) can be a very expedient way for countries to develop their economies and, in the process, to lift their citizens out of poverty. GVCs can provide high-paid jobs, stoke the transmission of technical know-how, and increase a country's capital stock in a relatively short time. The EU has a long track record of promoting trade and GVC inclusion throughout the world. The developmental outcomes of GVC participation will therefore hinge on how this economic integration will be structured. The analysis conducted showed how the EU could foster a deeper economic integration by aiming to increase the proportion of value that is added within its LDC trading partners. Moreover, it could tighten its due diligence standards so that European firms operating in LDCs are not actively contributing to the degradation of environmental and human rights. Lastly, the EU could foster regional integration among LDCs so that they can follow a virtuous sustainable development path. The European value added rests on the fact that the details of the trade agreements between European Member States and external partner countries are established at the EU level. It is also only at the EU level that effective and fair due diligence regulation could be enacted. Therefore, the EU could effectively shape the structure of international trade to improve its effects on development and poverty reduction.

Regarding EU external policies in the environmental domain, it is evident that a conspicuous need for integrated solutions exists, to enable action against climate change and simultaneously benefit poverty eradication in LDCs. Contributing explicitly or implicitly to the overarching goal of poverty eradication of EU action in LDCs, the showcased challenges and policy options in this study focused on the following potential paths for EU external action. The EU could aim to improve and support green transformation preparedness in LDCs by raising capacity to make climate-informed decisions at any level, both within the EU and LDCs themselves, and it could accelerate investment in energy security and efficiency. In the specific case of the transitional phase of the Carbon Border Adjustment Mechanism (CBAM), which started in October 2023, the EU could consider the impact on LDCs and discuss possibilities to shift the burden from LDCs' adaptation to the newly imposed trade obligations of a green transition. At a European level, the concern of policy coherence and the absence of clear, measurable and time-bound EU-wide targets to report on for all the SDGs led to a new resolution adopted by the European Parliament in June 2022.[280] The resolution concerns the new high-level EU 2030 Agenda implementation strategy that aims to govern the coherent implementation of the Sustainable Development Goals until 2030.[281] It provides an opportunity to monitor and govern the success of SDG implementation. Overall, the European added value of the proposed measures appears significant, and derives indeed from the EU acting as a coordination platform on the external effects of policies and partnerships for GVCs and climate action. Action at the EU level could allow improved efficiency, transparency and additionality of external climate finance targeted at LDCs, to ameliorate green transformation preparedness in these countries, and to improve climate justice overall.

[280] European Parliament, Implementation and delivery of the Sustainable Development Goals (SDGs), 2022.

[281] The strategy includes a new governance structure, a revised set of concrete measurable, EU-wide, and time-bound targets, an updated monitoring system and indicators and a single financial plan to achieve the EU's SDG objectives. A special focus is set on dedicated methodologies on inequalities (SDG 10) and on the alignment of public and private spending with the SDGs.

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Progress on the United Nations Sustainable Development Goals has been insufficient, not least because of shocks such as the COVID-19 pandemic and recent wars. The cost of this lack of progress is borne by 'least developed countries' – low-income countries with low indicators of socio-economic development, as defined by the UN.

This study reviews the European Union's role in policies that affect poverty in these contexts. It identifies 12 challenges that could be addressed to some extent by further EU action on development policy, climate action, trade and global value chains, and by the EU as an actor in multilateral forums, in line with the policy coherence for development principle.

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