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Green subsidies: what about the Global South?

Climate action is not simply a domestic policy issue. If the West does not address the needs of developing countries, they will be left behind

The world is watching as the United States and the European Union engage in tense discussions over their new, unilateral, domestic climate-policy measures. Although these efforts are individually lauded — especially by those who have lamented the lack of climate leadership by the US and EU since the signing of the Paris Agreement over seven years ago — they are at odds with each other about the appropriate mechanisms for addressing the global climate crisis.

What is more, climate action is not simply a domestic policy issue. As the US and the EU continue to pursue aggressive climate action at home, they must not neglect the essential technological and financial support developing countries need to do the same. The newly approved EU Carbon Border Adjustment Mechanism (CBAM) and the US Inflation Reduction Act (IRA) could inadvertently do just that.

Both initiatives have received their fair share of attention, underscoring the opportunities and shortcomings of such contrasting approaches to climate action. On the one hand, the CBAM, which amounts to a global carbon tax levied on imports to the EU, could worsen income inequality and welfare distribution, if not designed well, between rich and poor economies. On the other hand, the IRA, as a set of new industrial policies, is a much more controversial approach, involving as it does large amounts of public funds — subsidies — to build up green technology industries, from electric vehicles to renewable-energy products and a host of other sectors.

The effects of the controversial IRA

Subsidies on their own can be controversial, as they tend to give domestic products a leg up compared with imported competitors. The subsidies on offer in the IRA, however, are categorically prohibited under World

Trade Organization (WTO) rules, because they are linked to reshoring supply chains to the US and its trade-agreement partners.

The IRA's reshoring provisions also appear as a transparently anti-China move, making its implementation one more policy explicitly about excluding China from the global race to cut emissions through green industrial development. Simultaneously, the IRA does not include funding to support the most climate-vulnerable countries — a glaring gap in light of the increasing importance of providing loss-and-damage funds for climate-vulnerable countries, as promised at the United Nations climate summit last November in Egypt.

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European leaders have voiced concerns about the IRA, including whether the EU can benefit from carve-outs given it does not have a trade agreement with the US, as well as the negative impact the IRA might still have on European economies. And Europe is far from the only region with these concerns.

South Korea, Japan and India have also spoken up about the potential impacts of the IRA on their industries: India's official in charge of the G20 summit in New Delhi in September, Amitabh Kant, has called it 'the most protectionist act ever drafted in the world'. India and Indonesia have started to respond with their own domestically oriented industrial programmes: India's 'Make in India' and Indonesia's restriction on nickel exports.

Concomitantly, Europe's leaders are ready to retaliate against the IRA with similarly aggressive industrial policies. Although the EU spent much of 2022 focused on finalising and rolling out the CBAM, the French president, Emmanuel Macron, the Belgian prime minister, Alexander de Croo, and the European Commission president, Ursula von der Leyen, have all recently called for a weakening of state-aid constraints, to promote policies targeted at green technology companies. Even the US climate envoy, John Kerry, has encouraged the EU to increase its 'green spending'.

Given that the EU has historically been quite strict about subsidies by the member states, proposing to pour euros into strategic green industrial investments indicates a definite shift in thinking. It is a clear sign that the EU does not want to be left behind in the new structural transformation — even if that means likely running afoul of its own trade-agreement commitments.

Helping those in need of a transition

Some have argued that such an aggressively green industrial stance by the US and the EU will ultimately benefit everyone — driving down the price of, and increasing access to, essential technology. As others have noted, this has already led to developing countries seeing in it an open window for their own policy-making.

The long-term impact of these efforts, however, is uncertain. Neither the IRA nor the EU with its CBAM and proposed green industrial policies seems to have in view the unique challenges of climate-vulnerable countries and the impacts of new tariffs and high-income-country subsidies on the climate and development goals of low- and middle-income countries. Unilateral climate policies should be modified to help the international community achieve shared climate and development goals.

First, new tariffs, such as those in the CBAM, should come with mechanisms for distributing revenue streams to countries that need help with the energy transition. Secondly, industrial policies, as with those described in the IRA, need to include mechanisms to transfer quickly newly developed technologies and share knowledge with countries that need climate resilience to be linked to economic diversification and development. Moreover, domestic subsidy programmes must be accompanied with funds set aside for least-developed and developing economies that need to finance their own climate mitigation and adaptation and recover from climate disasters, as promised in the world's most recent commitments in Egypt.

The world needs a structural economic transformation on a par with the 19th-century industrial revolution. Unless the US and the EU concretely address the needs of developing countries, they will however be left behind — risking not only their financial stability and human wellbeing but also the global community's ability to achieve a climate-resilient future.

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