



Overview

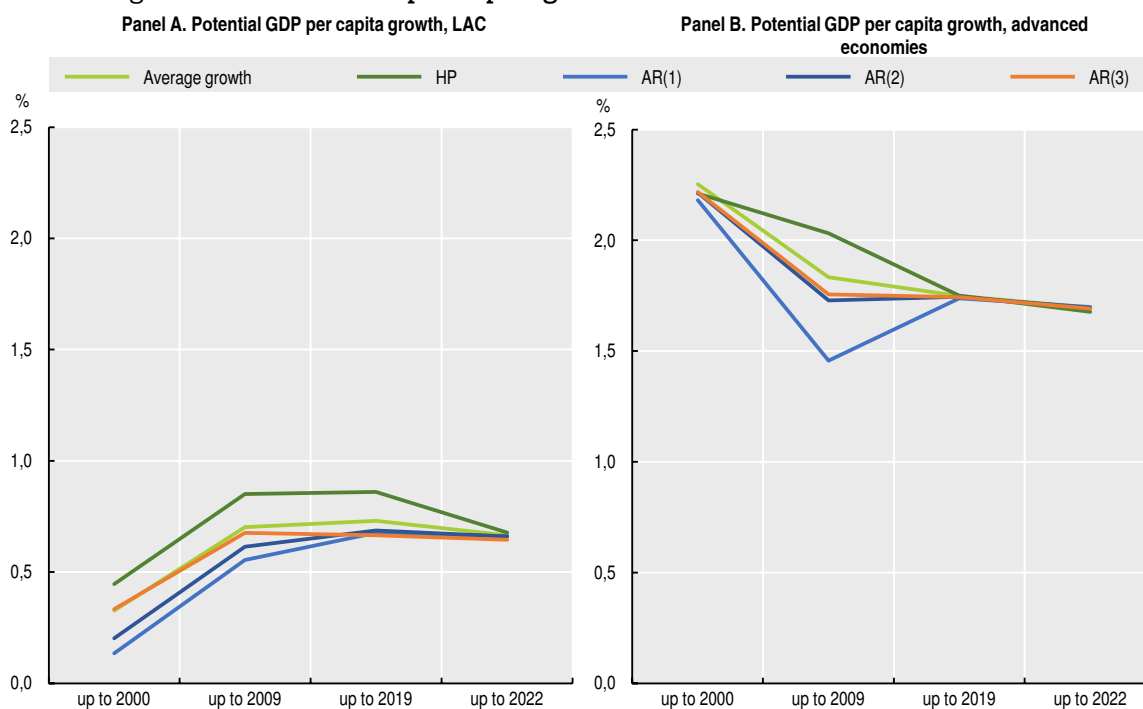
Towards a green and just transition

Latin America and the Caribbean (LAC) faces an ambitious agenda to leverage the green transition as an opportunity to achieve a more just and sustainable development model. The recovery requires adopting a systemic approach to tackle the challenges and harness opportunities of the green transition to improve citizens' well-being. The green transition is a once-in-a-generation social and economic opportunity. A green transition that is truly just should advance the transformation of LAC's energy and productive matrices, and develop new and more sustainable economic sectors while also promoting quality jobs and supporting workers and households throughout the transition. Making this possible demands the mobilisation of high amounts of resources by rethinking fiscal systems and applying innovative financial solutions; reaching broad consensus across income groups, generations and territories by crafting a new sustainable social contract; and working to forge new active regional and international partnerships.

LAC is experiencing sluggish economic growth with a disproportionate impact on the vulnerable populations

Following a robust economic rebound in 2021, growth in LAC economies will slow in 2022. This is driven by an increasingly adverse global backdrop, fiscal and monetary stimuli rollbacks, and low potential growth. Inflationary pressures are high, and most central banks in the region are reacting by raising policy interest rates. At the international level, the scenario is becoming more complex. Weaker global economic growth is expected due to Russia’s war of aggression against Ukraine and the zero-COVID policy of the People’s Republic of China (hereafter “China”) (OECD, 2022^[1]). How the complex international context will affect LAC overall remains uncertain but will be transmitted through terms of trade, as well as through volatility in international financial markets and the possible persistence of inflationary pressures. Modest growth rates also reflect low potential growth, a pre-pandemic structural challenge. Potential gross domestic product (GDP) per-capita growth in LAC remains stagnated at low levels (below 1% since 1980), and below that of advanced economies, hindering convergence (Figure 1).

Figure 1. Potential GDP per-capita growth in LAC and advanced economies



Note: AR stands for autoregressive model, which uses GDP per-capita growth data. The number of lags (1 and 2) was determined by analysing autocorrelation function and by choosing the model that maximised the log-likelihood. AR(1) Refers to an autoregressive model with one lag. To create a smoothed curve (lambda 100), the Hodrick-Prescott (HP) filter was used as an alternative model due to its resilience to short-term shocks. The LAC series refers to the 33 countries covered by the International Monetary Fund’s (IMF) World Economic Outlook database, October 2022.

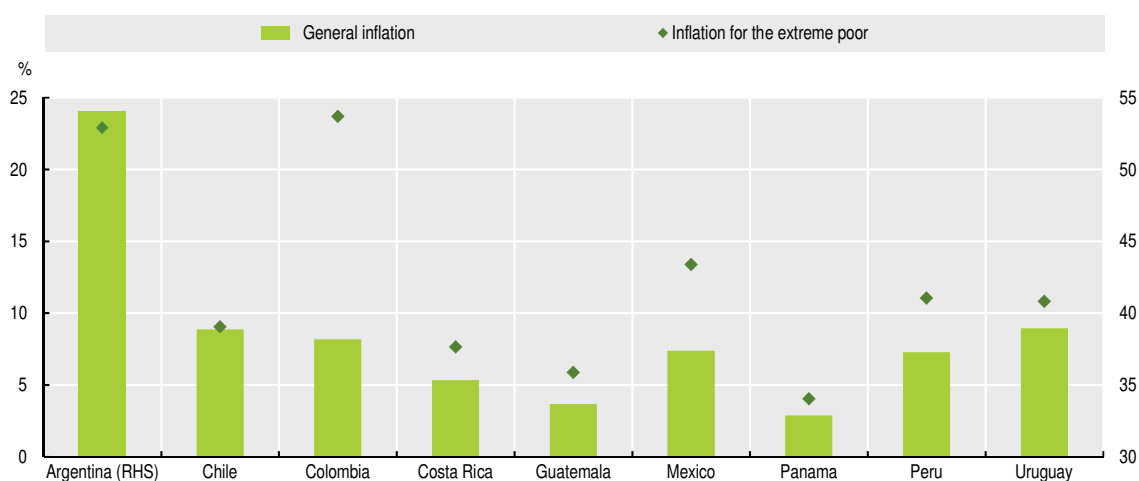
Source: Authors’ elaboration based on (IMF, 2022^[2]).

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With restrictive monetary conditions, the management of fiscal policy is at the core of the LAC recovery. As in other regions, as a response to inflationary pressures, most central banks have reacted appropriately with interest rate increases to anchor expectations. In the case of fiscal policy, LAC economies must balance support for the economic recovery with protecting the most vulnerable households and preserving fiscal sustainability.

The COVID-19 pandemic aggravated social challenges in the region, leading to increased levels of poverty and inequality. These are projected to increase in 2022, due mainly to the economic slowdown and rising inflation, especially in food prices, which affect the most vulnerable. In the first five months of 2022, extremely poor households in LAC faced an average price increase of 3.6 percentage points more than the nationally representative household (Figure 2). Estimates suggest that, by the end of 2022, 33.7% of the population will be in poverty and 14.9% in extreme poverty. As a response to worsening social conditions, governments should complement monetary measures with fiscal policies, including targeted safety net interventions. In parallel, gradually advancing towards universal, comprehensive, resilient and sustainable social protection systems will be essential.

Figure 2. Impact of inflation on overall population and on the extreme poor in 2022 in selected LAC countries



Notes: Year-to-date average of year-over-year growth of national consumer price indexes (CPI) vs. growth of extreme poverty lines 2022. Extreme poverty lines are based on the cost of a basic food basket that covers basic food needs and provides the minimum caloric requirement of the members of a reference household. The Chilean extreme poverty line also includes a share of non-food basic goods and services. For Colombia and Peru, the food and non-alcoholic beverages division of their CPI was used. For Panama, the data cover the districts of Panama and San Miguelito. Argentina is plotted on the right-hand side (RHS) axis.

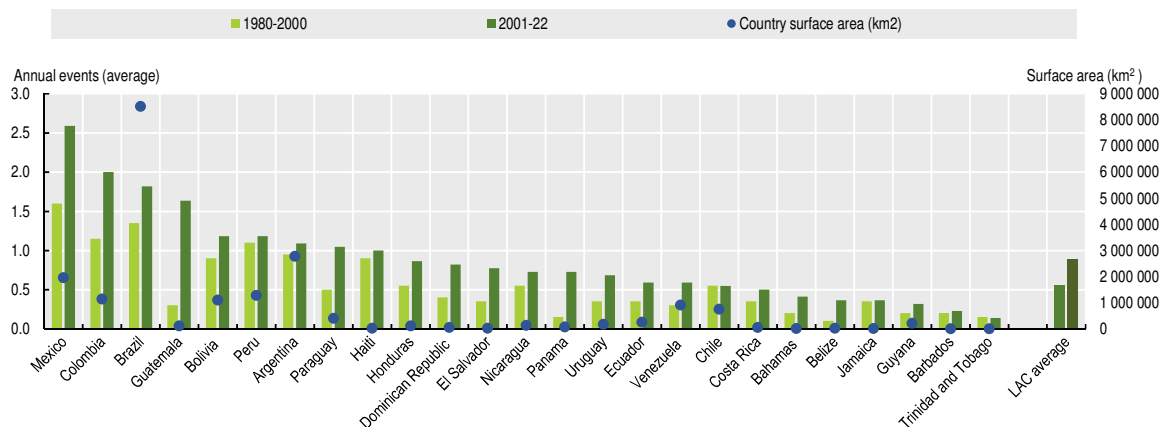
Source: Authors' elaboration based on data from national statistic offices on CPIs and poverty lines.

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A green and just transition can help the LAC region improve the development model and reduce its vulnerability to climate change

LAC is disproportionately affected by the consequences of climate change: 13 of the 50 countries most affected by climate change worldwide are in the region. The average quantity of extreme climate-related weather events in LAC increased in most countries between 2001 and 2022 compared to the previous two decades (Figure 3). In total, 17.1% of the 11 933 climate-related extreme weather events registered worldwide between 1970 and 2022 occurred in LAC. Warming temperatures, extreme precipitation events leading to floods, landslides and droughts, sea level rise, coastal erosion, ocean and lake acidification resulting in coral bleaching, and storm surges are expected to increase in frequency and severity, with adverse socio-economic consequences on populations (IPCC, 2022^[3]).

Figure 3. Frequency of climate-related extreme weather events in LAC, 1980-2022

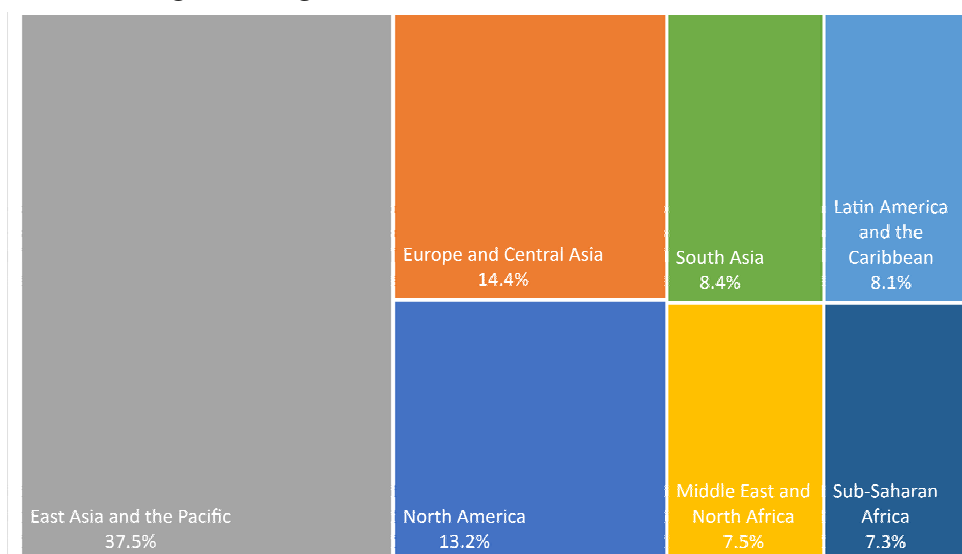


Notes: Based on (Alejos, 2018^[41]), extreme weather events were defined as a natural disaster resulting in 100 000 or more people affected, or 1 000 or more deaths, or at least 2% of GDP in estimated economic damages. The following natural disasters were considered: landslides, storms, droughts and floods. The secondary axis refers to the countries' surface area. Source: Authors' elaboration based on data from (EM-DAT, n.d.^[5]); (IDB, 2021^[6]); (Alejos, 2021^[7]); (FAO, 2018^[8]).

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Despite the increasing consequences of climate change, the region shows a steady increase of total greenhouse gas (GHG) emissions. From 1990 to 2019, the level of emissions rose by 1 223 million tonnes of carbon dioxide equivalent (Mt CO₂e), representing a 61% increase. LAC's share in total GHG emissions (8.1%) (Figure 4) is proportional to its share in total world population (8.4%), slightly higher than its share in global GDP (6.4%) but lower than the per-capita emissions of other regions with similar development levels. These emissions levels, together with the high costs of inaction, highlight the benefits of urgently adopting adaptation and mitigation policies.

Figure 4. Regional shares of total GHG emissions, 2019



Notes: Emissions including land use change and forestry (LUCF) reported in gigatonnes (Gt) of CO₂e. Total emissions do not include bunker fuels. The Climate Analysis Indicators Tool (CAIT) was used as the data source as it is the most comprehensive dataset on Climate Watch and includes all sectors and gases. Climate Watch Historical GHG Emissions data (previously published through CAIT Climate Data Explorer) are derived from several sources. The use of LUCF or agriculture data is cited as (FAO, 2022^[9]). Fuel combustion data is cited as (OECD/IEA, 2021^[10]).

Sources: (Climate Watch, 2022^[11]); (FAO, 2022^[9]); (OECD/IEA, 2021^[10]).

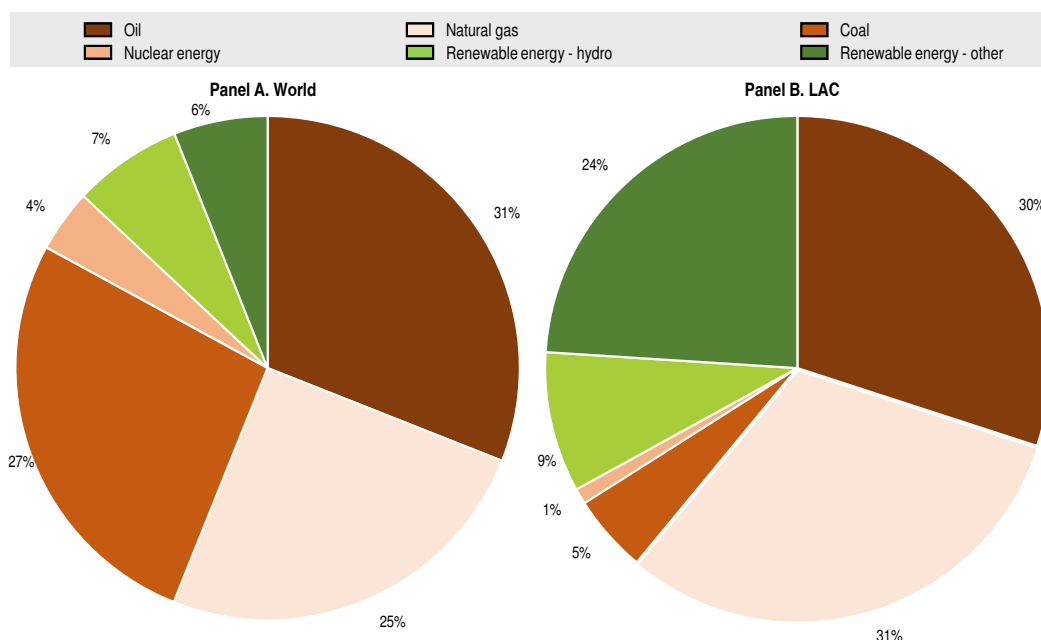
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The green transition should not, however, focus exclusively on fighting climate change. The recovery context is a timely opportunity to combine economic and social measures with green policies, advancing a just transition that could help achieve greater levels of well-being. A systemic approach can help policy makers reprioritise climate action towards improving systems’ functioning and accelerate the transition to systems that are net zero emissions by design. If focused on effectively transforming the systems that underpin LAC’s economy and society, the green transition has potential to improve significantly every aspect of Latin Americans’ lives.

Towards a transformational change of the energy and productive matrices to reduce GHG emissions and promote quality jobs

A more sustainable and diversified energy matrix will support LAC in reducing emissions, harnessing the potential of its vast renewable energy resources and driving universal access to energy. The region is endowed with high potential renewable energy resources; at present, they represent 33% of total energy supply compared to 13% globally (Figure 5). Over the last two decades, many LAC countries have made substantial progress in building renewable energy markets and diversifying their energy mix. In 2020, renewable energy accounted for 61% (952 TWh) of regional electricity generation, broken down as 75% from hydroelectricity and 25% from solar, wind, biomass and geothermal. Significant variations exist across the region, however. While Brazil generates 84% of its electric power from renewables, Jamaica relies on imported oil derivatives for 87% of its electricity generation.

Figure 5. World and LAC total energy supply matrix, 2020



Notes: Total energy supply consists of production + imports – exports – international marine bunkers – international aviation bunkers +/- stock changes. “Renewable energy – other” includes biofuels, solar, wind and geothermal energy. Source: Authors’ elaboration based on (Sistema de Informacion energetica de Latinoamerica y el Caribe (SieLAC), 2020_[1,2]).

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Looking ahead, LAC countries producing electricity from renewables, given their abundance of low-cost renewable energy and relatively clean electricity matrices, can position themselves as green hydrogen industrial hubs. This could help support decarbonisation of hard-to-abate sectors such as heavy industries and transportation – for which no viable alternatives to fossil fuels currently exist. Under certain conditions, natural gas can be considered as a transitional activity towards a net-zero economy. The repurposing existing oil and gas infrastructure could help create a hydrogen industry (e.g. using pipelines for transport or depleted oil and gas reservoirs for carbon capture utilisation and storage projects). Moreover, sustainable hydrogen can promote vertical and horizontal linkages along its value chain, creating value added and promoting innovative industries. The region also has a strategic position to supply key minerals for the energy transition. In 2017, 61% of global lithium reserves, 39% of global copper, and 32% of global nickel and silver reserves were in LAC. Achieving universal access to electricity is crucial. Across LAC, a total of 17 million people have no access to electricity, especially in rural areas and among poorer households and indigenous and Afro-descendant populations.

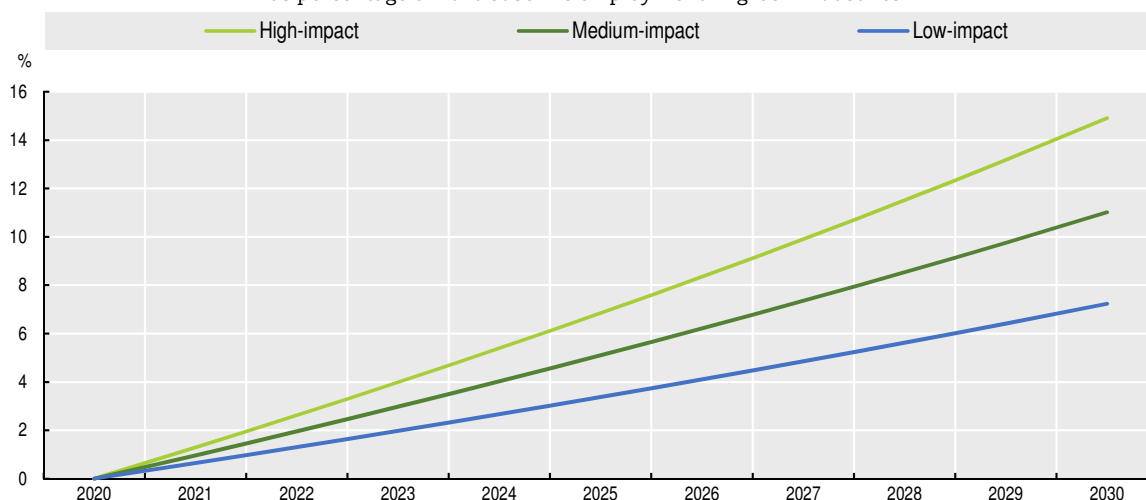
Industrial, circular and blue policies can transform LAC's production structure and are key components of a green and just transition. Renewed industrial policies are needed to encourage and attract investments in green innovation. So far, the region's gross domestic expenditure in research and development (GERD) has been only 0.3% of GDP in 2018 (vs. 2% of GDP in the OECD) and remains highly government-driven (56.5% of the total). The transition to a circular economy is expected to have net positive effects on GDP growth and employment while reducing GHG emissions. Net effects expected for Chile, Colombia, Mexico and Peru are increased GDP (from 0.82% in Chile to 2.03% in Peru) and job creation (from 1.1% in Chile and Colombia to 1.9% in Peru). The blue economy can also contribute to LAC development, but its potential remains unexploited. In 2018, the total GDP contribution of ocean services was estimated at USD 25 billion for LAC and USD 7 billion for Caribbean countries alone. In terms of employment, fishery and aquaculture employed more than 2.5 million people.

A green transition is a good opportunity to create quality jobs for LAC citizens. While some jobs in brown sectors will most likely be lost as countries move towards a net zero carbon model, if effective policies are put in place, many others jobs can be created in green sectors by 2030 (Figure 6). These include policies to favour green investments as well as active labour market policies (ALMPs) to facilitate the transition from brown to green sectors and from informal to formal jobs. Net job creation will indeed depend on the magnitude of investments. In a high-impact scenario in which additional public and private investments contribute to an increase of 3 percentage points in the value added of green sectors (compared to the business-as-usual scenario), the green transition could add 10.5% more net jobs of total employment in brown and green sectors.

Labour market and social protection policies play a crucial role, both in stimulating the creation of high-quality new jobs and in cushioning the downside consequences of the transition towards cleaner economies. Well-designed ALMPs, such as training programmes, hiring incentives or placement services, are crucial to promoting green jobs and boosting the skills of those workers who will lose their actual jobs. Life-long learning will be central, although currently, only 15% of LAC workers receive some form of training, compared to 56% at the OECD. Well-targeted social policies, such as income support measures or conditional cash transfer programmes, can play a positive role in minimising the temporary income losses of families with workers negatively impacted by green policies.

Figure 6. Job creation in green sectors in LAC, 2020-30

Change in employment in green sectors in LAC, under various green policy scenarios compared to the BAU, as percentage of 2020 baseline employment in green industries



Notes: LAC countries included are Argentina, Bolivia, Brazil, Colombia, Ecuador, Guatemala, Mexico, Paraguay and Uruguay. The data refer to an unweighted average over the countries' forecasts. Green sectors are defined in each country by first identifying the number of green tasks that workers perform in their occupations and then by examining the top ten industries across which those jobs are distributed. The baseline scenario assumes that, in each green sector, value added and employment will follow the same dynamic as in the past ten years. The counterfactual scenarios are defined according to the impact of a green policy that aims to boost investment in fixed and human capital, with a positive impact on value-added growth in each green sector. The high-impact scenario assumes that the value added in each sector will increase by 3 percentage points per year, adjusting to the new equilibrium. The medium-impact scenario assumes that the value added will increase by 2 percentage points per year, while the low-impact scenario assumes it will increase by 1 percentage point per year. In all forecasts, total factor productivity will increase by 1 percentage point due to lower climate damages and new technology-induced change. Employment change is forecast using the estimated short-term elasticity to the value added, applying a panel dynamic model, defined by each sector and country, in the last ten years.

Sources: Authors' estimates based on Labour Force Surveys, National Accounts data by industries, (Vona et al., 2018^[13]) and (Hardy, Keister and Lewandowski, 2018^[14]).

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Financing the transition requires environmentally sustainable fiscal policies and strategies to mobilise resources from both public and private sectors

The LAC region faces the challenge of financing the green transition under a tight fiscal space. A 2.5°C global warming scenario could cost the region between 1.5% and 5.0% of its GDP by 2050. Since the cost of inaction is high, countries must develop environmentally sustainable fiscal policies. These include infrastructure plans with adaptation and mitigation goals. These policies also entail focusing on more and better spending on clean energy and energy efficiency, and on phasing-out fossil fuel subsidies and support measures, particularly to the most affluent population.

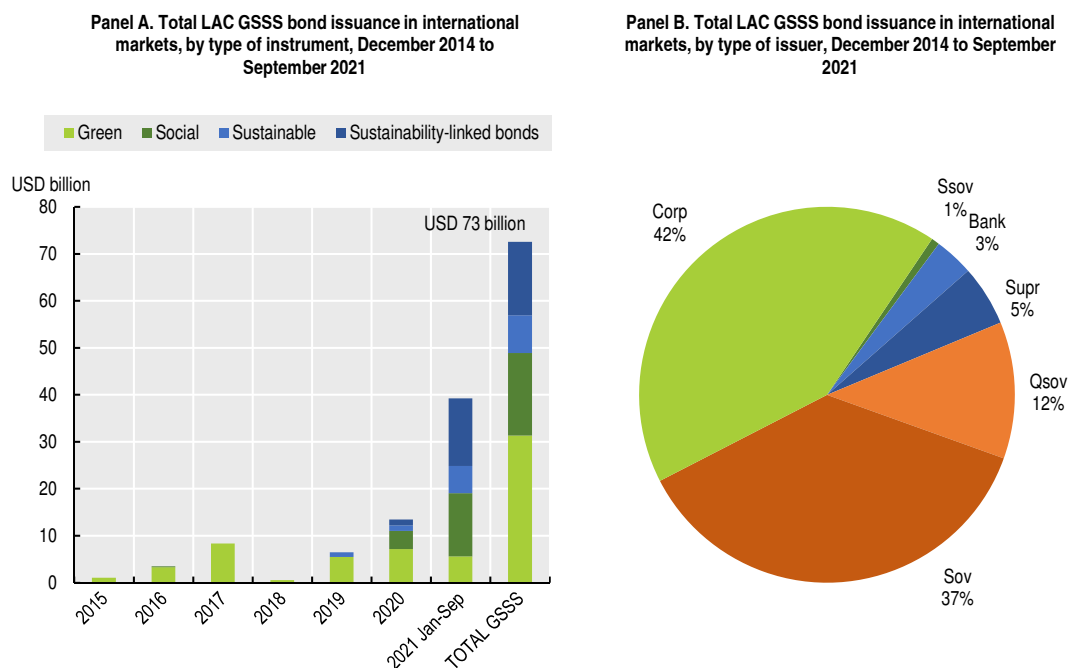
In addition, the region needs to mobilise new ways to generate additional revenues, such as environmentally-related taxes, emissions trading systems (ETS) and scaling up debt tools. On average in LAC, environment-related tax revenues amounted to only 1% of GDP in 2020, just half of the estimated OECD average of 2% of GDP. Scaling up tools of debt, such as green, social, sustainable and sustainability-Linked (GSSS) bonds, debt-for-nature swaps, catastrophe bonds, and natural disaster clauses, can also help raise additional revenues to ensure flows of resources target climate action. The GSSS market reached an accumulated USD 73 billion from 2014 to September 2021, of which green bond issuance accounted for USD 31 billion alone followed by social with USD 17 billion (Figure 7, Panel A).

The role of the corporate sector has become increasingly significant in the region. Over the period December 2014 to September 2021, corporates led total GSSS bond volumes with a share of 42% of the total LAC GSSS bond issuance, while sovereigns represented 37%, quasi-sovereigns 12% and supranational issuers 5% (Figure 7, Panel B).

Financial strategies will have to enhance private and public sector resource mobilisation, in part by engaging key actors including subnational, national and international development finance institutions (DFIs). Enhancing green fiscal frameworks (e.g. through green golden rules) will be crucial as will expanding sustainable finance frameworks to ensure that public and private investments effectively reach environmentally sustainable projects. Since the private sector will account for most of the investment needed to undertake the transition, the public sector will have to create the necessary incentives to redirect these investments toward sustainable projects. To facilitate this, it will be necessary to improve and expand sustainable finance frameworks to ensure that the right regulatory tools are in place (e.g. sustainability standards and green, sustainable, or transition taxonomies). Mechanisms to avoid greenwashing will be critically important.

Developing compensation mechanisms (e.g. in-kind transfers, ALMPs, self-employment and entrepreneurship programmes) will be crucial for vulnerable households affected negatively by climate reform. Well-targeted cash transfers and in-kind transfers will continue to be essential, together with compensation policies to support the relocation and retraining of workers, promote decent work in rural areas, develop new business models, and provide support for displaced workers.

Figure 7. Total LAC GSSS bond issuance in international markets, by type of instrument and issuer, December 2014 to September 2021



Note: Panel B: Sov = sovereign. Corp = corporate. Ssov = sub-sovereign (states, cities and provinces). Supr = supranational. Qsov = quasi-sovereign. Quasi-sovereign issuers are defined as companies with full or partial government ownership or control. Supranational issuers are defined as entities formed by two or more central governments to promote economic development for the member countries. The “bank” category refers to commercial banks. Other non-bank financial institutions are included in corporates.

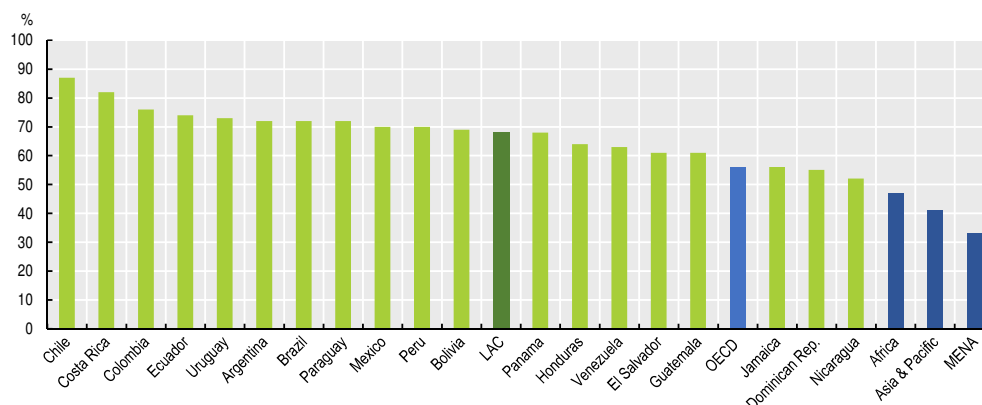
Source: (Núñez, Velloso and Da Silva, 2022^[15]).

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Advancing the green transition will require institutional mechanisms to foster consensus and build a long-term vision underpinning a new social contract

LAC citizens are broadly concerned about the seriousness of climate change - and relatively more so than other regions globally. This suggests that the recovery could represent a “critical juncture” for advancing towards a new, sustainable social contract. On average, 68% of citizens in LAC recognise that climate change is a very serious threat to their country in the next 20 years (Figure 8). In sharp contrast to some countries, such as the United States, concern about climate change in LAC is consistent across the political spectrum (Evans and Zeichmeister, 2018^[16]). The importance LAC citizens place on the green agenda could make the green transition the cohesive element of a wider social contract for the region.

Figure 8. Share of citizens who agree that climate change is a very serious threat to the country in 20 years, 2019



Notes: Question for Figure 8: “Do you think that climate change is a very serious threat, a somewhat serious threat, or not a threat at all to the people in this country in the next 20 years? If you don’t know, please just say so”.

Source: Authors’ elaboration based on (Lloyd’s Register Foundation, 2020^[17]).

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In practice, as the green transition may involve a shift of resources among economic sectors and political constituencies that could trigger the opposition of some interest groups, to build consensus it will be important to establish inclusive and shared platforms for reaching a negotiated stance. Encouraging the participation of citizens, civil society groups, women, indigenous and local communities throughout the policy-making process can promote greater local ownership and generate more inclusive policies that appropriately consider local needs. Policy makers should also bring on board the private sector by raising awareness of responsible business conduct (RBC) practices and establishing stronger integrity policies to avert the risk of environmental policy capture by powerful groups. In addition, adapting the strategy to specific socio-political contexts is vital, as is devising empowering and empathic communication strategies about the proposed green reform agenda. In turn, strategies must include specific compensation mechanisms for vulnerable groups that may be negatively affected in the short term.

As the green transition affects virtually every domain of public policy, policy makers should work more strategically and achieve better co-ordination across sectors and levels of government to ensure a coherent green agenda. An integrated approach will be needed to balance economic, social and environmental trade-offs while also leveraging policy spillovers among these fields.

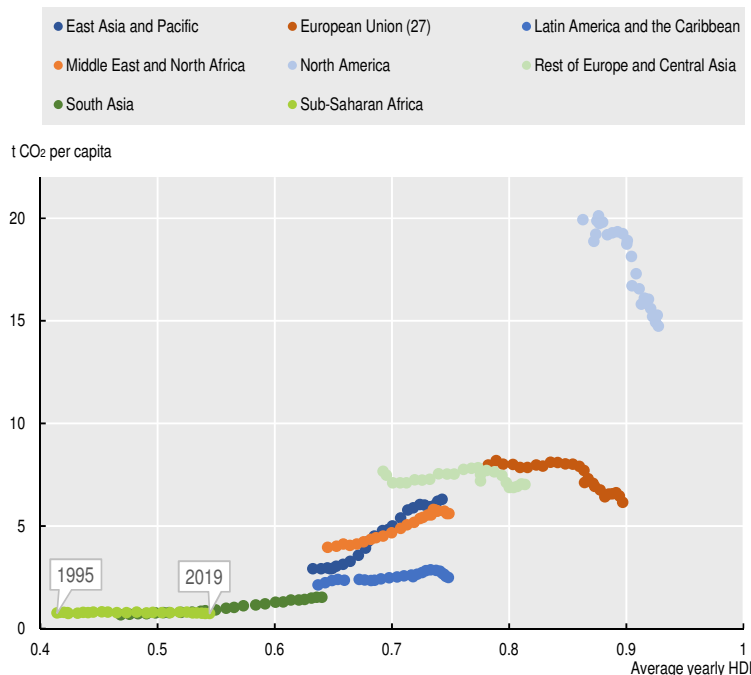
Linking policy objectives with long-term plans is also key to ensure consistent implementation over time, beyond short-term political cycles. Governments need to

articulate a long-term vision to align their actions. This can be done through frameworks such as national development plans (NDPs), nationally determined contributions (NDCs) coupled with climate strategies, and defined policies and regulations to underpin their pledges. NDCs establish concrete targets and policies, setting the basis for the contributions of various stakeholders in national efforts to achieve the long-term goals of the Paris Agreement. While most LAC countries have already submitted an update to their NDCs, Costa Rica’s 2020 update is among the few that are rated 2°C compatible (CAT, 2020_[18]). Argentina, Brazil, Colombia, Costa Rica and Panama have set only unconditional targets. In contrast, the majority of LAC countries also set conditional targets, meaning that implementation of these commitments depends on the delivery of international financial and technical support. This highlights the critical importance of collective action and co-operation at both national and international levels for achieving the goals of the Paris Agreement.

LAC should profit from an international green agenda that proposes new partnerships for the region’s development as well as new tools to foster the transition

Considering the global nature of the increasingly urgent need to reduce CO₂ emissions, all countries are called to participate in individual and collective efforts. Decoupling economic development from CO₂ emissions has proven possible, as illustrated by the recent trajectories of certain regions (Figure 9). At the same time, LAC countries should play a predominant role in this global agenda by sharing experiences of sustainable development with other regions and having a leading voice at climate negotiations. Climate change has shown that continuing a path of exponential growth of CO₂ emissions is no longer an option. LAC countries can reach higher human development index (HDI) levels while meeting low emissions targets.

Figure 9. CO₂ emissions per capita versus HDI, 1995-2019



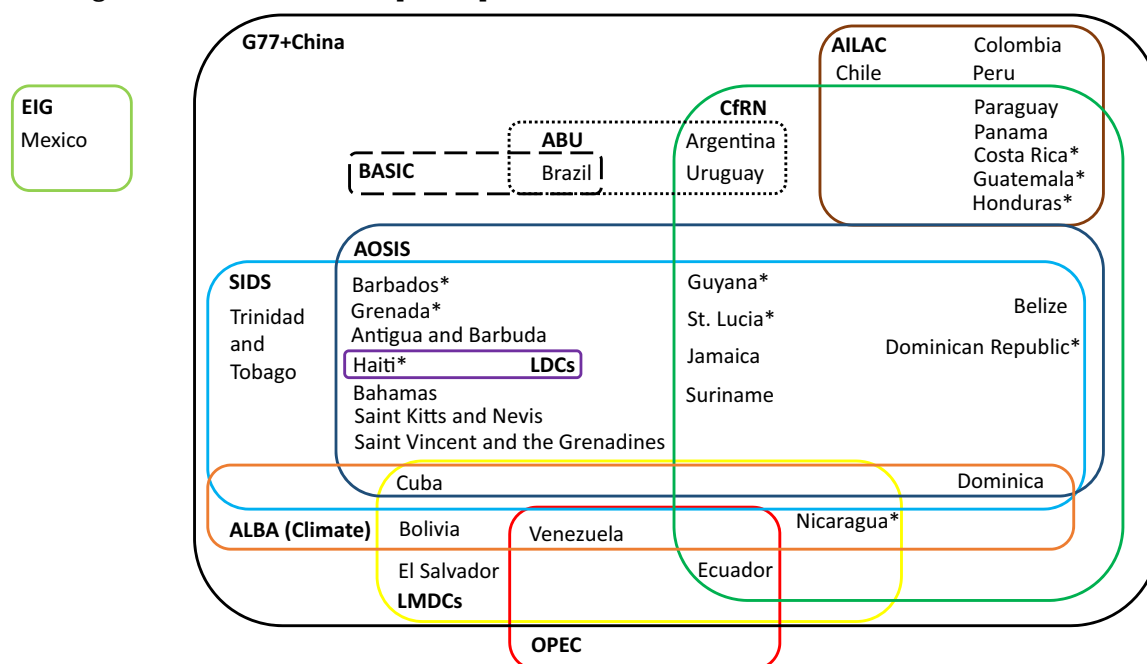
Note: Climate Watch Historical CO₂ Emissions excluding LUCF.

Source: Authors’ calculations based on (Climate Watch, 2022_[11]) and (UNDP, 2022_[19]).

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To date, as each country negotiates within multiple climate-related international coalitions, the LAC region has lacked a unified voice in the international arena (Figure 10). This is the result of both the existing fragmentation of LAC regional integration processes and subregional economic ties. Preventing further fragmentation of environmental policies and the politicisation of environmental instruments is crucial to harness the full potential of the green transition. In many ways, LAC’s fragmented voice in climate negotiations constitutes a missed opportunity, especially considering that the region hosts 50% of the planet’s biodiversity. Future efforts will need to prioritise enhanced policy dialogue and a regional environmental agenda.

Figure 10. LAC countries’ participation in climate-related international coalitions



Note: *Members of the Climate Vulnerable Forum (CVF). A-B-U = Argentina, Brazil and Uruguay. AILAC = Independent Alliance of Latin America and the Caribbean. ALBA = Bolivarian Alliance for the Peoples of Our America. AOSIS = Alliance of Small Island States. CfrN = Coalition for Rainforest Nations. EIG = Environmental Integrity Group. LDCs = least-developed countries. LMDCs = like-minded developing countries. OPEC = Organisation of the Petroleum Exporting Countries. SIDS = small island developing states. Figure is a non-exhaustive representation of coalitions in the region; some coalitions relate to the environment as part of a broader agenda.

Source: Authors’ elaboration based on (Delgado Pugley, 2021^[20]); (Klöck et al., 2020^[21]) and (Watts and Depledge, 2018^[22]).

Trade is one of the channels through which the green transition will impact the LAC region. It represents a challenge in that, over the last two decades, LAC has consistently posted a deficit in its trade in environmental goods (environmental specific services, environmental sole-purpose products, adapted goods and environmental technologies). Three-quarters of the region’s imports of environmental goods come from China, the United States and the European Union, while intraregional imports account for just 5% of total expenditure. Moreover, regional export capacity is highly concentrated: between 2018 and 2020, just one country (Mexico) accounted for 84% of regional exports of environmental goods.

The European Green Deal may have implications for LAC countries, potentially affecting trade between the two regions. In particular, as the EU Green Deal increases demands for traceability, transparency, compliance and due diligence, as well as low-carbon, organic and sustainable production and reinforcement of the circular economy, LAC countries

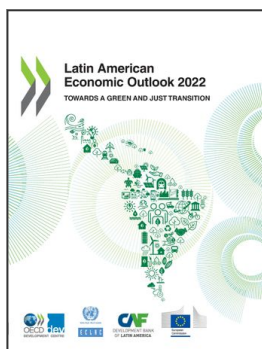
will need to adapt to these new international environmental standards and regulations. LAC countries that trade with Europe have the opportunity to align national climate change mitigation plans so as to use “the new rules of the game” to execute a productive transition.

Indeed, the trade channel holds opportunities as well. The transition to a circular economy requires LAC countries to design specific public policies for the entire life cycle of products, including production, consumption, waste management and recycling. Public and private investments and co-operation are critical for increasing capacity building, innovation and technology transfer. Transitioning to the circular economy also depends on the co-ordination of LAC’s national and international efforts. From reducing tariffs and non-tariff barriers to enhancing the granularity of international trade classifications, harmonising standards for circular economy goods could help firms, countries and regional actors adopt sustainable practices.

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From:
Latin American Economic Outlook 2022
Towards a Green and Just Transition

Access the complete publication at:
<https://doi.org/10.1787/3d5554fc-en>

Please cite this chapter as:

OECD, *et al.* (2022), "Overview: Towards a green and just transition", in *Latin American Economic Outlook 2022: Towards a Green and Just Transition*, OECD Publishing, Paris.

DOI: <https://doi.org/10.1787/41464f87-en>

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