



Guarantees 2.0: Meeting Climate Finance Needs in the Global South

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Introduction

To meet the global climate challenge, huge additional investment will be required over the coming decades to transform our energy, manufacturing, and transport systems, not only in developed countries, but also in emerging markets and developing economies (EMDEs) across the Global South. EMDEs, excluding China, require at least a sevenfold increase above current investment flows to meet clean energy needs alone in line with the Paris Agreement, not even counting additional needed investment in other climate projects.¹ Public funding, including that directed through traditional development finance institutions like the World Bank and regional multilateral development banks (MDBs), cannot come close to meeting these needs. The vast bulk of additional investment must come from the private sector.

To date, private investment flows to EMDEs for climate mitigation, particularly beyond the energy sector, have been almost negligible. Heads of state and senior international finance experts recognized this huge funding gap at the June 2023 Climate Finance Summit in Paris convened by French President Emmanuel Macron, but few new ideas emerged about how to address it.²

In the international finance community, there is growing recognition that vastly increased private-sector climate finance in EMDEs probably cannot be stimulated without more widespread use of the most efficient financial tool yet

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1 Tim Gould et al., *Scaling up Private Finance for Clean Energy in Emerging and Developing Economies*, International Energy Agency, June 2023, <https://www.iea.org/reports/scaling-up-private-finance-for-clean-energy-in-emerging-and-developing-economies>, 11.

2 Zia Weise and Zack Colman, "Paris Climate Finance Summit Delivers Momentum but Few Results," *Politico*, June 23, 2023, <https://www.politico.eu/article/paris-new-global-financing-pact-summit-macron-climate/>.

found for leveraging private capital, namely guarantees.³ Several new ideas about the use of guarantees have recently surfaced that are surveyed later in this paper; but none are at the scale that will be required.

To stimulate new private finance in EMDEs far beyond the levels potentially enabled by any other existing structure or recent proposal, this paper demonstrates the need for creating a guarantee facility that, over the next decade, would issue hundreds of billions of dollars of guarantees to portfolios of projects in EMDEs that are financed directly by qualifying major financial institutions.

This issue brief covers the status of current conversations in the financial community on scaling private investment, the growing recognition that guarantees are the most efficient financial instrument to attract private capital, a comparison of relevant existing guarantee proposals, and a description of a new proposal, called the Emerging Markets Climate Investment Compact (EMCIC), designed to significantly scale up private investment in EMDE climate mitigation.

The Climate Finance Challenge

Current global financial flows to climate investments are grossly insufficient to keep global warming below the 1.5 degrees Celsius limit, beyond which the most severe consequences of climate change will manifest (and indeed already are). The financial challenge is especially acute in EMDEs, where, excluding China, investment in the energy transformation currently stands at \$260 billion per annum against estimates by the International Energy Agency (IEA) that this number must increase sevenfold to at least \$1.4 trillion (and up to 1.9 trillion) per annum by the early 2030s.⁴ In addition to investments needed for clean energy generation, there is also a pressing need to decarbonize sectors such as transport, agriculture, industry, and waste, and to invest in development, adaptation, and resilience, but current investment flows are underdelivering in all these sectors.

The primary source of funding to EMDEs is presently public money. Rich, developed economy countries have finally met their COP21 pledge to provide an additional \$100 billion a year to help poorer countries reduce emissions and adapt to climate change, but these pledges are not yet reflected in actual investment volumes and in any event are nowhere near the levels of funding required.⁵ Certainly, more public money is needed, ranging from direct foreign investment and development assistance provided by governments to concessionary finance delivered by MDBs, development finance institutions (DFIs), and philanthropies to attract side-by-side private investment (so-called blended finance).

This form of finance has, however, struggled to attract the private capital needed. Organisation for Economic Co-operation and Development data suggest that between 2016 and 2020, some \$28 billion per annum of climate finance provided by MDBs and DFIs attracted only \$9.1 billion per annum of private investment, a leverage ratio of just 30 cents for each dollar.⁶ This may help to explain why, of the \$785 billion in private capital invested in energy transition assets globally in 2021, less than 10 percent (\$67 billion) went to EMDEs.⁷ Reaching the necessary \$1.4+ trillion of annual investment by 2030 will require massively increased engagement by mainstream market actors such as pension funds, investment banks, asset managers, insurance companies, the bond market, private equity firms, and sovereign wealth funds.

Why MDB Reform Alone Cannot Meet the Challenge

One avenue that has been suggested to achieve this ramp-up of private investment is major reform of how the MDBs and DFIs engage with the private sector, in the hope of dramatically improving the very low rate of leverage. This was the focus, for example, of the recent summit convened by President Macron in Paris. Such reform would, however, need to be wholesale—most mainstream private investors find blended finance deals to be anathema due to their com-

3 Carolien van Marwijk Kooij, Jesse Hoffman, and Jeroen Huisman, "Better Guarantees, Better Finance," Blended Finance Taskforce, June 2023, <https://www.blendedfinance.earth/better-guarantees-better-finance>.

4 Gould et al., *Scaling up Private Finance*, 11.

5 Maha El Dahan, Kate Abnett, and Sarah Marsh, "Rich Nations to Meet Overdue \$100 Billion Climate Pledge This Year," Reuters, May 2, 2023, <https://www.reuters.com/world/europe/uaes-jaber-urges-donors-deliver-100-bln-pledge-developing-countries-2023-05-02/>; and Emma Rumney et al., "A Pledge to Fight Climate Change Is Sending Money to Strange Places," Reuters, June 1, 2023, <https://www.reuters.com/investigates/special-report/climate-change-finance/>.

6 Van Marwijk Kooij, Hoffman, and Huisman, "Better Guarantees, Better Finance."

7 Ananthakrishnan Prasad et al., *Mobilizing Private Climate Financing in Emerging Market and Developing Economies*, Staff Climate Notes, International Monetary Fund, July 2022, <https://www.imf.org/-/media/Files/Publications/Staff-Climate-Notes/2022/English/CLNEA2022007.ashx>.

plexity, bureaucracy, and the length of time required to close them—and even if ambitious reforms could be achieved, they would likely take many years to work through.

This route alone—although it still needs to be pursued—will not, therefore, solve the problem. Instead, policymakers and the private sector need to look to a solution that allows mainstream investors to work as they normally do as much as possible, in terms of relationships and processes, but that delivers a mechanism that enables them to massively increase their activities in EMDEs while not (for prudential reasons) commensurately increasing the risk to their portfolios from investing in countries and technologies with which they are not yet familiar. Summarizing the problem, BlackRock CEO Larry Fink pointed out at the Paris summit that of the often-cited “thirty-seven trillion dollars of eager private capital looking for investment opportunities” in global financial markets, eighty percent or more was senior debt that could not be invested without investment grade ratings. “Something would have to be done,” he suggested, to reduce risk for mainstream investors, sufficient to overcome the ratings barrier.

To achieve the massive scale-up needed in private finance flows, truly new and transformative structures are required that will not only provide risk cover, but also actively encourage new investor networks and partnerships to be built—especially between local/regional financial institutions and their Global North counterparts. The objective must be to promote the development of both financing techniques for, and pipelines of projects in, critical climate sectors and technologies beyond energy.

Guarantee Instruments as the Way Forward

There is a growing recognition that the best basis for such structures is far more widespread use of the most efficient financial tool yet found for leveraging private capital, namely guarantees. Experience to date with different kinds of guarantees, in various EMDE settings, suggests they can create up to thirty-times multiples of investment-grade private capital deployed for every committed public dollar in concessionary money—many orders of magnitude higher than blended finance will ever likely reach, even if the finance community can achieve ambitious MDB and global financial architecture reform.⁸

⁸ Van Marwijk Kooij, Hoffman, and Huisman, “Better Guarantees, Better Finance.”

⁹ Van Marwijk Kooij, Hoffman, and Huisman, “Better Guarantees, Better Finance.”

The effectiveness of guarantees has been reasserted by a June 2023 report by a group of financial institutions and nonprofits called the Blended Finance Task Force, entitled *Better Guarantees, Better Finance*.⁹ Citing the low levels of leverage being attained by traditional, blended finance approaches, the report calls for “more catalytic use of public capital to scale existing guarantee products and create new green guarantee facilities to reduce the cost of capital by mitigating the perception of country/currency risk.”

It also calls for “guarantees to have a structural link to pipeline development and to be applied for energy and infrastructure as well as investments in other sectors like food and nature.” In particular, the report recommended development of much larger and more ambitious structures than have been proposed to date, using sovereign balance sheets of multiple countries to significantly scale up private investment in EMDEs.

Existing Guarantee Proposals

Guarantees of loans or equity investments backed by countries’ (sovereign) balance sheets have been used in the past in a collection of specific and limited ways, including by the World Bank, US Agency for International Development, and others. The Multilateral Investment Guarantee Agency (MIGA), a part of the World Bank group, has offered political risk insurance and credit enhancement guarantees, primarily to EMDE governments which lend to private investors—in effect, reinsuring the EMDE government’s obligation to repay.

Recently, several ideas and innovative proposals for such transformative structures have been introduced, but alignment on the path forward remains to be seen. Many of the proposals focus on the use of guarantees of private investment supported by sovereigns through their own balance sheets. These ideas include the following:

The Asian Development Bank’s **Innovative Finance Facility for Climate in Asia and the Pacific (IF-CAP)** proposes to provide guarantees to existing loans already on its balance sheet so that these can be sold or securitized to private investors, using the proceeds for new loans. ADB would provide the capital for \$3 billion in guarantees to free up \$15 billion in loans, a leverage ratio of 5:1.

The **European Fund for Sustainable Development Plus (EFSD+)**, provides partial guarantees and technical assistance to finance projects in partner countries. The fund allocates €39.7 billion in guarantees from the European Union to make available €135 billion in private investment, a leverage ratio of 3.4:1.

The **Green Guarantee Company** provides guarantees to debt instruments within climate investments, primarily loans and bonds. The company gathers funding from many public and private sources, with a capital target of \$600 million to mobilize \$6 billion in loans and bonds, a leverage ratio of 10:1.

RELP (formerly Greenmap)/iTrust is proposing to raise funds to provide partial guarantees to private investments to cover off-taker (i.e., buyer) liquidity risk and certain country-level risks. RELP, a nonprofit organization, hopes to secure funding from various public and private sources to provide \$12.5 billion in guarantees. The structure is derived from a similar guarantee instrument that Argentina* utilized to attract investment in renewable energy and is targeted at solar energy investments in countries with government-owned utilities.

The **Bridgetown 2.0** initiative would provide liquidity support by rechanneling at least \$100 billion of special drawing rights through the International Monetary Fund/MDBs, restructure country debt with long-term low interest rates, increase official sector development lending to \$500 billion, mobilize \$1.5 trillion per year in private investment with \$100 billion in foreign exchange guarantees, reform the governance of financial institutions, and create an international trade system to support a green, just transformation.

A New Solution to Scale Up Investment

Each of the proposals canvassed above has important and exciting possibilities, but each has substantial limitations in size, scope, and risk coverage. For example, the iTrust proposal focuses on financing new renewable energy projects in countries with government-owned utilities. IF-CAP is focused on recycling existing MDB loans by pooling and collateralizing them, then selling them to private investors to free up preexisting approvals of sovereign shareholder funding. MIGA focuses on reinsuring government loans of which private investors are often leery. The Bridgetown 2.0

agenda addresses only currency risk at an expected leverage ratio of 15:1.

To attract private capital in size and in time, a new investment structure is needed to address a very broad range of projects at an ambitious overall scale and cover virtually all risks, potentially including currency risk. It should emphasize measures that must be taken to enhance project pipeline flow, and focus on requiring major global private investors to become familiar with investing in emerging market economies.

To achieve these objectives, a successful guarantee facility will need to have the following features:

- It will be simple to access and will fit with the ways of working of private capital owners and managers.
- It will be able to be used for a wide range of investments and in as wide a spectrum of countries as possible.
- It will incentivize private capital through its size and potential for good returns.
- It will incentivize the development of partnerships between local and international capital sources, in particular to help unearth and evaluate local investment opportunities.
- It will reduce the cost of capital for EMDE businesses and project developers, thus increasing the number of viable projects (the much discussed “missing pipeline”).
- It will build green finance capacity among investors, investees, and policymakers in local and international markets.
- Because of its high leverage potential, it will be an efficient use of public funds.
- It will also ideally be designed to be able to start small to test the concept and design, but then expand at a rate limited only by its productivity.

To address these challenges of access, operability, return, and efficiency requirements noted above, this paper

*A previous version of this issue brief misstated which nation’s guarantee instrument RELP had based its structure upon. It was Argentina’s.

Table 1: Summary and Comparison of Guarantee Proposals

| Proposal | Guarantees to | Guarantees cover | Guarantee amount | Guarantees mobilize | Leverage | Funding |
|--|---|---|--------------------------------|---|------------|--|
| IF-CAP | Existing loans | Defaults on existing loans | \$3 billion | \$15 billion in loans | 5:1 | ADB callable capital (World Bank) |
| European Fund for Sustainable Development Plus (EFSD+) | Private investments | Partial coverage including currency risk | €39.7 billion total | €135 billion in investment | 3.4:1 | Provided by EU to many implementing institutions |
| Green Guarantee Company | Governments issuing bonds | Loans and bonds | \$600 million | Mobilize \$6 billion in loans and bonds | 10:1 | Public and private sources |
| MIGA | Public and private investment | Partial coverage of political risks and credit enhancement | \$1.1 billion in FY21 | Unknown | Unknown | World Bank |
| REL P's iTrust | Program-based guarantees (portfolio) | Off-taker liquidity risk and certain country-level risks | \$12.5 billion | Unknown | 20:1 | Public and private sources (contingent liabilities on sovereign balance sheets) |
| Bridgetown 2.0 | Just green transition investments in developing countries | Foreign exchange risk | \$100 billion in FX guarantees | \$1.5 trillion per year | 15:1 | Sovereign funds/ UN member states |
| Proposed EMCIC | Portfolios of projects by institutional investors | Up to 100 percent of noncurrency-related portfolio loss minus profits above hurdle rate | \$50 billion | Up to \$500 billion in investments | Up to 30:1 | Cash capital from public and private sources and callable capital from sovereigns and philanthropies rated AA and AAA. |

proposes the Emerging Markets Climate Investment Compact (EMCIC) facility. Under this compact, a group of governments—potentially joined by major corporations and philanthropies—would provide, during the decade of 2025 to 2035, guarantees of up to 100 percent covering the equivalent of \$500 billion in climate mitigation investments in EMDEs.

To allow a wide range of contributors to its capital, EMCIC would be a dedicated vehicle set up for the purpose of providing guarantees and could either be stand-alone or housed as a separate entity within an existing international financial institution (IFI). EMCIC would seek a high investment grade rating (AA/AAA), which would be based on a combination of cash and callable capital. Cash capital will mainly be used to cover expected losses for the next two years, with callable capital available to cover unexpected losses beyond these.

Though capital would mainly be provided by sovereigns, EMCIC would be structured in such a way as to allow both corporations and philanthropic foundations (the ten largest of which have assets of nearly \$350 billion) to provide either type of capital. While callable capital could only come from highly rated providers—twenty-two countries are currently rated AA or AAA—cash capital could come from any source, allowing a wide range of actors to take part. For example, fossil fuel companies may view the use of windfall profits to provide cash capital for the vehicle as an efficient way to deliver pledges to support the building of renewables infrastructure. Callable capital could also be provided by way of a bond issuance—the principal of the bond being available to be called at any time—allowing an even wider range of potential contributors to the capital of the facility. (Returns on the bond would arise from a share of guarantee fees and income from investment of the principal while awaiting any call.)

EMCIC's guarantee would cover pools of direct private investments—probably mainly loans, but equity could also be covered—in selected EMDEs, made by large global investors that meet certain qualifications to participate. EMCIC's ambition would be to attract a set of “anchor” guarantee clients—perhaps fifteen to twenty major global asset owners or managers and commercial or investment banks—each looking to build guaranteed portfolios of \$25 billion to \$50 billion over the ten-year course of the compact, in partnership with local and regional counterparts.

To qualify to use the EMCIC facility, EMCIC investors would agree to respect a set of due diligence and underwriting

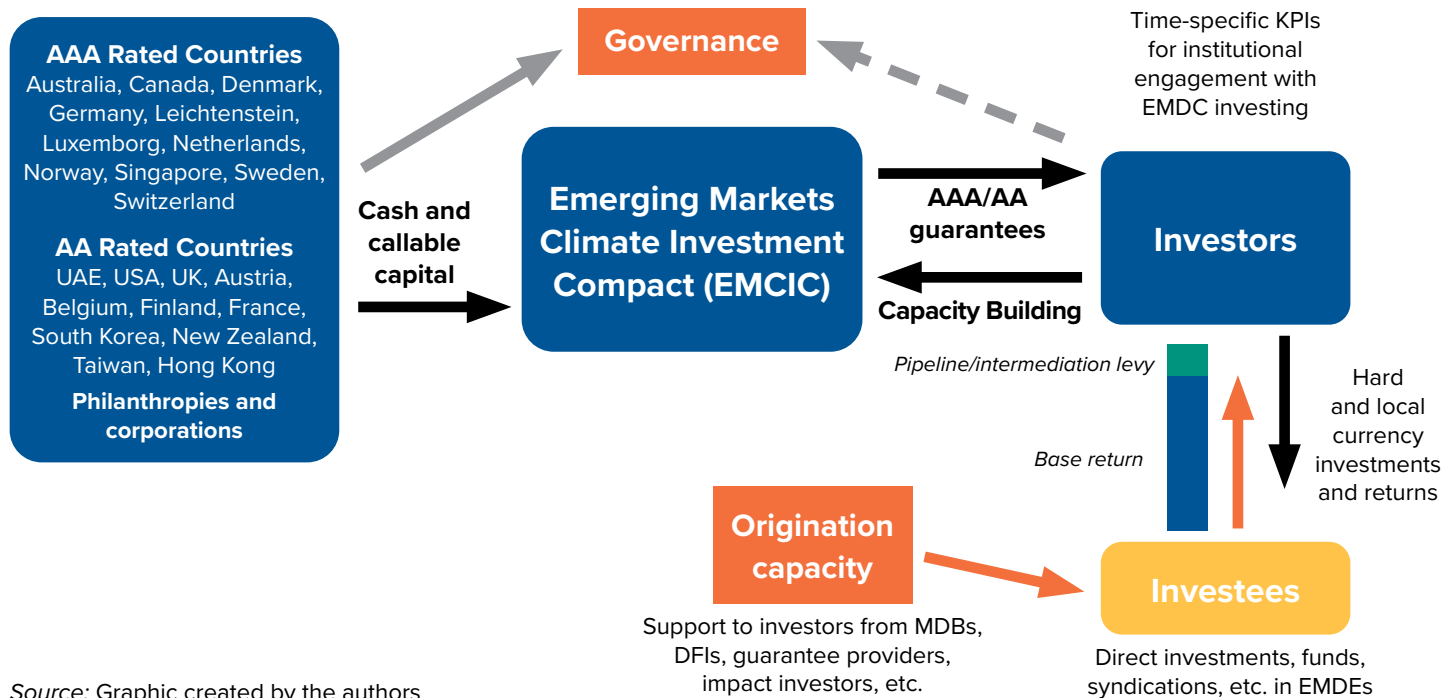
standards that must be met for a transaction to be guaranteed, but having done so would be able to assign guarantees to projects on their own recognizance, up to an annual limit. They would not need approval on a project by project basis by EMCIC. Rather, EMCIC would rely on *ex post facto* checking, on a sample basis, of adherence to the underwriting standards, with powers to prohibit noncompliant investors from obtaining additional guarantees and accessing other components of the facility if standards were not met. EMCIC would also have a strong internal dispute resolution capability for dealings with investors.

The compact would cover new investments and loans made during its ten-year window with guarantees of up to 100 percent of the noncurrency risks of investments (though the latter risk could also potentially be covered via a tie-up with a currency hedge provider such as the Currency Exchange Fund (TCX)). Though guarantees would be on an individual project basis, EMCIC would actively manage its overall portfolio risk—via periodic limits on individual investors and on countries/regions and sectors/technologies—and the massive diversification in the overall EMCIC portfolio over time should significantly reduce the risk level of the facility as a whole. To the extent that equity investments were covered by its guarantees, EMCIC would also have the potential to set a hurdle rate for each investor's portfolio returns, enabling the claw back of some potential losses against excess returns elsewhere in the portfolio and thus reducing calls on EMCIC's capital to meet losses.

Growing private sector experience in EMDE investing would, however, be a specific objective of EMCIC. To qualify as a firm eligible to be a recipient of its guarantees (and thus be provided the opportunity for potentially very significant investment returns), investors would agree, alongside the underwriting standards mentioned above, to a set of time-specific, measurable key performance indicators (KPIs) on engagement with EMDE investing. These KPIs would incentivize the investor, over the course of the compact, to develop extensive expertise in evaluating emerging market risks, create financing techniques for new low-carbon technologies and sectors, and establish a meaningful presence in local markets (either with on-site participation or via partnerships with local financial market actors delivering the same effect). The meeting of KPIs could, for example, lead to reductions in the cost of guarantees as they were progressively met.

It is probable that, at the outset, EMCIC would target its guarantees at investments in larger, low-to-middle income

Figure 1: EMCIC Structure and Participating Parties



Source: Graphic created by the authors

countries with better developed private sectors, where investable pipeline is most likely to be found and, for that reason, are most likely in turn to be attractive to both international and domestic investors. If successful, EMCIC would be mobilizing the private capital that blended finance providers are presently seeking to lever into these markets. This would allow MDBs and DFIs to pay more attention to smaller and less well-developed markets, where their enormous origination experience could be best used, thus also driving forward the objectives of initiatives such as the Bridgetown agenda. Guarantees will only be available for private-sector projects and businesses, not for national government projects which are already (or could be) covered by arrangements with MDBs and DFIs. The possibility of projects involving partnerships between, for example, municipalities and the private sector could, however, be investigated.

Because the portfolio of guarantees would ramp up relatively slowly over the first couple of years, the program has a built-in "test period" feature, with the cash commitments required from individual countries being in the tens of millions of dollars per year at the outset.

In regard to the issue of project pipelines, often cited as a barrier to investment, EMCIC should contribute in several ways, both structurally and through a levy feature. Structurally, it should create an arbitrage between the cost of guarantees (say 2 percent to 3 percent) and investment returns that could be higher by some 10 percent or more. To the extent that investors used part of this arbitrage to reduce finance costs, more businesses and projects would become viable, expanding the available pipeline. The engagement KPIs that investors would sign up to under the compact would encourage the development of partnerships with local finance actors, who will have pipelines that would otherwise likely not be visible to international investors.

In addition to these structural features, EMCIC would use a small levy (of a few basis points) in addition to the guarantee fee to fund initiatives (such as the UK's Climate Finance Accelerator) that seek to use capacity building to identify and develop pipelines of investable projects. The levy could also fund enabling environment initiatives and capacity and institution building at the local level, thus reducing the need for public funding for such initiatives.

An outline graphic of the EMCIC structure and participating parties is shown in Figure 1. Where reference is made to “investments,” these include, unless otherwise specified, both equity and debt. This paper does not address certain additional features highlighted in the graphic such as origination support and portfolio quality, which are included in the proposal.

Conclusion

There is broad consensus that investment volumes to EMDEs must increase significantly to meet the challenges of the climate crisis. However, even the most ambitious current initiatives to reform existing multilateral institutions will not come close to addressing the problems at the scale necessary. Instead, EMCIC could use its high rating and guarantee-based structure to offset project risk for investors and leverage the amount of private investment in EMDEs at a far greater multiple than any other approach currently being proposed.

EMCIC would be a simple-to-access facility providing cover for a wide range of investors and investment types in EMDEs. It would help scale up mainstream institutional investment for climate mitigation in the critical decade 2025-2035, broaden the categories of projects that can be financed, build human and institutional capacity for green finance, and, to the extent possible, enable lower interest rate loans and lower-return-cost investments to entrepreneurs and developers in markets in the Global South.

The proposed structure and characteristics of EMCIC have been discussed with a range of stakeholders, but all remains open for adaptation as a result of further expert input. The proposed next stage in the development of the concept is the formation of a working group of interested parties to take the concept to the next level of detail. Such parties would be potential clients (e.g., global banks, asset managers, and owners), governments, and corporate/philanthropic funders; however, there also will be a need for expertise in modeling, legal inputs, and guarantees.

About the Author

Ian Callaghan is a project and investment banker by background, and his project finance experience includes the £20 billion Eurotunnel facility. He was one of the pioneers of developing country impact investing, which he has been involved with since 2005. He has specialized in emerging market climate finance since 2015 and is engaged both as an intermediary in transactions and as the co-founder of the Climate Finance Accelerator. This is a UK government capacity building program, presently operating in nine of the larger emerging markets in Asia, Africa, and Latin America, to which he acts as adviser.

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Berlin was a co-founder with Reed Hundt in 2010 of the Coalition for Green Capital, an organization that works with governments at the international, national, state, and local levels to establish green bank finance institutions to accelerate the deployment of renewable energy, energy efficiency and clean transportation. Prior to that, he chaired the Environmental and Climate Change practices at the law firm of Skadden Arps where he was recognized as one of the leading climate-change attorneys in the United States and internationally. He has extensive legal and policy expertise on US and international environmental issues including clean energy; corporate compliance; environmental, social, and corporate governance; biodiversity; and forestry.

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George Frampton is a distinguished senior fellow and the director of the Transatlantic Climate Policy Project at the Atlantic Council Global Energy Center. He was a former chair of the White House Council on Environmental Quality (CEQ) and is the co-founder and chief executive officer of the Partnership for Responsible Growth, an organization started in 2015 to build a bipartisan dialogue around carbon pricing as a key element in addressing climate change.

In 2019, he was the Richard Holbrooke inaugural fellow at the American Academy in Berlin, where he organized and presented at a number of workshops and conferences on the relationship between European and US climate policy.

Frampton's background combines science, economics, and law. Before chairing the CEQ from 1998 to 2001, he served as assistant secretary of the interior for fish, wildlife, and parks and as president of The Wilderness Society. He has been senior of counsel at Covington & Burling LLP, working in the firm's climate and clean energy practice, and a partner at Boies, Schiller & Flexner LP.

He served as deputy director and chief of staff for the Nuclear Regulatory Commission's investigation into the Three Mile Island nuclear accident; assistant independent counsel during the investigation of Edwin Meese III; and special counsel to the State of Alaska in 1985. From 1973 to 1975, Frampton served as an assistant special prosecutor with the US Department of Justice on the Watergate Special Prosecution Force where he worked on the grand jury investigation and trial of President Nixon's top aides in the Watergate cover-up.

Frampton has a degree in physics from Yale College, a Master of Laws in advanced economic theory from the London School of Economics, and a JD from Harvard Law School, where he was managing editor of the Harvard Law Review. In 1971, Frampton served as law clerk to Supreme Court Justice Harry A. Blackmun.

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List as of July 28, 2023



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