TASK FORCE ON CLIMATE, DEVELOPMENT AND THE INTERNATIONAL MONETARY FUND

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The International Monetary Fund, Climate Change and Development

A PRELIMINARY ASSESSMENT

Vulnerable Twenty Group

Intergovernmental Group of Twenty Four (G-24)

Centre for Social and Economic Progress (CSEP)

Financial Futures Center

United Nations ECLAC

北京大学国家发展研究院 National School of Development

AERC CREA

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Mongolia.
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About the Task Force on Climate, Development and the International Monetary Fund

The Task Force on Climate, Development and the International Monetary Fund is a consortium of experts from around the world utilizing rigorous, empirical research to advance a development-centered approach to climate change at the IMF. The Task Force believes it is imperative that the global community support climate resilience and transitions to a low-carbon economy in a just manner. As the only multilateral, rules-based institution charged with promoting the stability of the international financial and monetary system, the IMF has a vital role to play in supporting a globally coordinated response.

MEMBER ORGANIZATIONS

- Intergovernmental Group of Twenty-Four (G24)
- Vulnerable Group of Twenty (V20) Ministers of Finance
- African Economic Research Consortium
- Boston University Global Development Policy Center
- Centre for Social and Economic Progress
- Financial Futures Center
- Macro & Green Finance Lab, National School of Development, Peking University
- United Nations Economic Commission for Latin America and the Caribbean

Executive Summary

Climate change and climate change policies have significant "macro-critical" impacts nationally and across countries. The International Monetary Fund (IMF) has an important role to play in preventing and mitigating those impacts so member states, and in particular developing countries, can mobilize investment for structural transformation towards low-carbon, socially inclusive and resilient growth trajectories. In the past few years, the IMF has made important strides toward filling this role but is falling short of the leadership necessary to accelerate a global and just transition. This report by the Task Force on Climate, Development and the IMF identifies the strengths and shortcomings of the IMF's new approach to climate change from a development perspective and offers concrete proposals for how it can correct course. There is no time to waste as the macroeconomic implications of climate change are causing acute stress amid multiple crises in the world economy.

The United Nations Intergovernmental Panel on Climate Change has said it is "now or never" to make the investments necessary to limit warming to 1.5 C — without which the world faces catastrophic human, ecological and economic costs. The Independent High-Level Expert Group on Climate Finance estimates that trillions of dollars per year are needed to support emerging market and developing economies deliver on climate change goals and achieve the UN 2030 Sustainable Development Goals (SDGs). This stepwise mobilization of resources is required for countries to chart growth paths that speed up the low-carbon transition, support adaptation and resilience, address loss and damage, build resilience to climate shocks, and protect and restore natural capital while ensuring a just transition within and across borders. Domestic resources, however, will simply not be sufficient, and international cooperation will be essential to addressing the asymmetry in financial capacity and resources between advanced and developing countries.

The global community is in the middle of one of the warmest decades on historical record, with recent extreme weather events jeopardizing livelihoods and economic prospects in Pakistan, Nigeria, South Africa, small island developing states and numerous other climate-vulnerable countries and populations. Loss and damage from these occurrences have cost the most climate vulnerable economies upwards of 20 percent of gross domestic product (GDP) in this century, yet climate finance and climate ambition continue to be lacking. At the same time, the global economy is under enormous stress due to the "polycrisis" of the COVID-19 pandemic, war, climate shocks, social unrest and its compounded repercussions in the lack of fiscal space, debt distress, higher capital costs, high energy and food prices and slower than expected economic growth.

In a very short period, the IMF has admirably come to see climate change and climate change policy as macro-critical, drafted and approved a Climate Change Strategy, began incorporating climate change into bilateral and multilateral surveillance, and established a new lending facility partly dedicated to climate change in the Resilience and Sustainability Facility (RSF). Despite these important steps forward, this preliminary assessment finds that the IMF needs to show more leadership in three key areas:

- **Multilateral surveillance activities are adopting a "one-size-fits-all" approach of carbon pricing as a panacea for climate action.** Moreover, the IMF expects this carbon pricing-led approach to generate enough revenue to meet a substantial portion of the investment needs, therefore discounting the imperative for massive international and domestic resource mobilization and the need to focus on climate change and climate policy spill-overs across international borders. While regarded as the optimal option in theory, such an approach is too optimistic about the speed and orderliness of the transition and investment responses that carbon pricing will inspire. It also does not adequately reflect the reality of diverse national circumstances, partly a reflection of the narrow set of economic modeling approaches the IMF has deployed to analyze climate change.
- **Bilateral surveillance activities underestimate the macroeconomic implications of financing climate transitions in a financially stable manner.** Bilateral surveillance continues to press for carbon pricing as the core form of climate policy and as the main revenue source for resource mobilization rather than helping to orient macro-fiscal frameworks towards resource mobilization, investment, structural change and climate resilience.
- **The IMF lending toolkit lacks appropriate scale and overemphasizes short-term fiscal consolidation over long-run resource mobilization.** While the RSF has the potential to fill a major gap in the global climate finance architecture, it lacks the scale and design features necessary to trigger and sustain development-centered climate transformations. Moreover, the traditional IMF toolkit is developing a one-size-fits-all approach of "green fiscal consolidation" that is inconsistent with sustainable growth. The toolkit is not yet designed to help mitigate the balance of payments impacts of short-term climate shocks, loss and damage, and resilience in a manner that accelerates the intermediate and longer-term development paths necessary.

In October 2021, just following the release of the IMF's official Climate Change Strategy, the Task Force on Climate, Development and the IMF was launched as a consortium of research institutes and experts from around world using rigorous, empirical research to advance a development-centered approach to climate change at the IMF. In its initial strategy report, the Task Force emphasized the role of the IMF in facilitating the investment mobilization needed for new green growth trajectories in a fiscally sound and financially stable manner by integrating climate change across the IMF's three core functions: multilateral surveillance and global leadership, bilateral surveillance and capacity development, and a climate-aligned IMF lending toolkit. The Task Force thus advanced five principles to guide the IMF's efforts: adopt the global role in addressing the macroeconomic implications of climate risk, climate action and asymmetries across countries related to impacts, capacities, needs and ambition; align short-term stability concerns with longer-term sustainable and resilient growth pathways; tailor policy advice to member country contexts and needs; empower national and stakeholder ownership of policy; and reconcile shared climate goals with equity and appropriate burden sharing.

Based on these principles, this new report provides a preliminary assessment of the IMF's initial implementation of its Climate Change Strategy. The end of this executive summary provides a detailed set of policy recommendations that the IMF could implement to correct course on each of its three key activities. Broadly speaking, the IMF will need to do the following:

- **Broaden multilateral surveillance activities to strengthen focus on an investment-led approach to a resilient and just transition**, cross-border spillovers, loss and damage and the necessary global cooperation on resource mobilization.
- **Strengthen bilateral surveillance** by deploying better analytical tools to analyze climate risks and their macro-critical impacts as well as the resource mobilization needs of member states, and **support capacity building** in developing countries to strengthen climate policy analysis and the development of domestic markets for sustainable finance.
- **Scale and reform the IMF lending toolkit in line with the Paris Agreement on climate change**, including the RSF, to align short-term and longer-run financing horizons without jeopardizing debt sustainability and growth prospects.

POLICY RECOMMENDATIONS

Multilateral Surveillance

- Provide enhanced guidance on how to assess the impact of carbon pricing and non-pricing-based policies and measures that developing countries use to reduce greenhouse gas emissions.
- Expand analytical work on medium- and long-term cross-boundary spillovers arising from climate policies to better understand their impacts given diverse national circumstances.
- Devote more attention to climate-related debt issues and the need to support adaptation, loss and damage and state-contingent instruments to improve debt sustainability.
- Embrace the full implications of a just transition and intensify efforts to catalyze multilateral cooperation to deliver the climate finance needed for mitigation, adaptation, and loss and damage.

Macro-Financial Aspects

- Build on state-of-the-art existing tools and research approaches to assess climate risks for sovereign fiscal and financial stability.
- Ensure the comparability of climate scenarios for sovereign physical climate risk assessment with supervisory scenarios, such as the Network for Greening the Financial System.
- Better identify and analyze the full spectrum of climate-related risks (acute and chronic physical risks, transition risks and spillovers, and compounding risks) and their transmission channels to the agents and sectors of the economy and finance as well as identify how these risks are amplified.
- Analyze how current limitations, in terms of scenarios, metrics and macroeconomic models affect the outcomes of IMF risk assessment and policy recommendations (including trade-offs on inequality, environmental sustainability and financial stability).

- Assess the impact of green financial sector interventions (such as green monetary and prudential policies, public finance and co-finance) and their complementarities with green fiscal policies.

Fiscal Aspects of Surveillance

- The transition to net-zero will substantially impact fiscal revenues for many countries and will require heavy upfront investments to implement policies to support the low-carbon transition. Macro-fiscal frameworks need to reflect the investments required for adaptation and mitigation as well as the revenue and expenditure impacts of the climate transition. These should recognize countries' diverse characteristics and circumstances.
- Retool debt sustainability analyses to incorporate revenues and expenditures associated with transitioning to a low-carbon, climate-resilient economy alongside climate shocks and spillovers.
- Incorporate investments associated with loss and damage into debt sustainability analyses, fiscal frameworks and programming. Estimates of adaptation and mitigation needs should be mapped out by country.

IMF Lending Toolkit

- Incorporate the increasing incidence of macro-critical climate shocks and transition spillovers into assessments of the adequacy of IMF resources and increase IMF resources accordingly through quotas and new issuances of Special Drawing Rights.
- Incorporate climate change and natural disaster clauses into all IMF lending instruments and debt restructurings.
- Scale up the Catastrophe Containment and Relief Trust and the RSF, make the RSF more affordable and enshrine member-state driven climate strategies.
- Consider using RSF funding as collateral and credit enhancement for restructured and new bonds to support development and climate change.
- Substitute green fiscal consolidation measures for investment-led growth stimulus programs with green multipliers.