THE IMF'S CLIMATE CHANGE DEBATE

Masood Ahmed

The institution has a role to play in addressing this threat, but there are limits on how far it should go

Climate change poses a special challenge to the International Monetary Fund. While the IMF's *World Economic Outlook* offered its first substantive discussion of the matter back in 2008, the executive board didn't agree on a strategy for helping member countries address it until 2021. To this day, the issue provokes strong reactions both from those who want the IMF to do more and from those who argue that it has already strayed beyond its core mandate and expertise.

Why should an issue that is widely considered an existential threat to the planet raise such controversy about the work of the IMF? In part, not everyone appreciates the seriousness and urgency of addressing climate change and its risks for global prosperity. Even some of those who do maintain that it has little to do with the core mission of the IMF.

The executive board laid the basic question to rest in its 2021 strategy paper. "Climate change has emerged as one the most critical macroeconomic and financial policy challenges that the IMF's membership will face in the coming years and decades," the board wrote. "Climate change is bound to affect macroeconomic and financial stability through numerous other transmission mechanisms, including fiscal positions, asset prices, trade flows, and real interest and exchange rates.... No country can expect to be spared entirely."

The emphasis on "macroeconomic and financial stability" is important because that is the lodestar guiding the Fund's activities. "Macro-criticality" has long been the test for determining what issues the Fund should address. Even so, there's an ongoing debate over just how extensive the IMF's involvement should be and what form it should take.

Turbines from the Roth Rock wind farm spin next to the Mettiki Coal processing plant in Oakland, Maryland.

CHIP SOMODEVILLA/GETTY IMAGES

Two schools of thought

One camp starts from the historical purpose and core expertise of the IMF. It argues for limiting the organization's focus on climate change to what is strictly necessary to deliver on the core mandate. In this view, the immediate and longer-term implications of climate change for the fiscal, monetary, financial, and external accounts of member countries and for the global economy are very much the Fund's business.

This suggests a strong case for the IMF to research, assess, and advise on various policy tools—in these same domains—that countries can deploy to adapt to climate change. Helping countries build the institutional capacity to design and implement such policies would also be an important corollary of the need to focus on climate change.

The case for the Fund's engagement becomes less clear for this group if the organization extends its coverage to advising on policies or mechanisms for slowing climate change, or if it takes on the task of mobilizing private financing to tackle climate mitigation. For example, the Fund has long studied and advised on the removal of subsidies for fossil fuels, but linking this to a country's mitigation commitment is more controversial. The Fund shouldn't assess the progress countries make on their international green transition commitments on policies and financing, or report on that as part of its surveillance process, this group argues.

Those who urge restraint on the part of the IMF do not claim that these issues are unimportant. Rather, they say it is not the job of the IMF to deal with them. They voice concern that focusing on these areas would draw the Fund's attention and energy away from pressing macroeconomic and financial risks that no other institution is geared to address. For them, the Fund's strength comes from sticking to its core business and avoiding the mission creep that has diluted the effectiveness of some other international organizations.

Overloading the IMF's surveillance or its program conditionality would risk diluting its focus on core fiscal, monetary, and financial risks, this group argues. Fund staff members may not have the necessary expertise in these areas, and it would be difficult and costly to build an effective skills base in a competitive market, according to this point of view. It might also lead the Fund to "poach" staff from other organizations with a more direct mandate for dealing with climate change. And in an era of tight organizational budgets, more resources devoted to addressing climate change might well come at the expense of retaining the staff needed to deal with core macroeconomic and financial issues. The conservative culture of the institution is an asset to preserve, this group maintains.

"It is neither feasible nor sensible to retreat from the advances the IMF has already made in building climate change into its work."

Those in the other camp start from a very different point. Climate change is already affecting the lives of billions of people and poses an existential threat to future generations. Thus, this group maintains, it is incumbent on every organization to do whatever it can to address the threat. If this entails a change in focus, business models, or skill sets, that needs to be dealt with but should not become a reason to stand on the sidelines.

From this perspective, the IMF is an underused player on the global stage, and the actions that the Fund has taken to date simply do not go far enough. The history of the IMF is rich with instances when the organization adapted to meet the changing needs and priorities of its members, this group argues. Climate change is simply the next big global challenge that requires the institution to evolve.

The IMF has already taken steps to develop frameworks and tools for integrating aspects of climate change into its surveillance, technical assistance, and lending work, but many technical questions remain unexplored. These range from building state-of-the-art tools and research approaches for assessing climate risks to building macro fiscal and financial frameworks that incorporate the substantial investments needed to transition to a low-carbon economy and the policy tools that will make those frameworks operational.

Mobilizing climate financing

Many countries face constraints on fiscal and debt sustainability even as they come under pressure to invest more in accelerating their low-carbon transition. The Fund needs to help countries find the right balance and to adapt its own debt sustainability frameworks to reflect these flows, according to people in this camp. The IMF should devote more resources to and put a higher priority on advancing this research and analytical agenda, they argue.

It is now widely accepted that low- and middle-income countries will need to spend trillions of dollars a year for climate-related adaptation, mitigation, and resilience. It is also clear that while governments will have to mobilize the better part of this financing domestically, a substantial share will need to come from external public and private sources. For example, emerging market and developing economies other than China will have to spend about $2.4 trillion a year by 2030, according to estimates by the Independent High-Level Expert Group on Climate Finance, commissioned by the United Nations Climate Change Conferences of 2021 and 2022. About $1 trillion a year of that will have to come from external sources.

Raising that much money has proved to be much more difficult than expected. In that context, accessing the IMF's $1 trillion in financing capacity seems like low-hanging fruit to people in this group. The argument that these resources need to be safeguarded for a possible global financial crisis is not convincing if that means neglecting financing of the green transition, which could make such a crisis more likely, according to this line of reasoning.

The IMF set up the Resilience and Sustainability Trust (RST) in 2022 to help countries finance resilience and green transition projects. But those who want the IMF to do more argue that the RST is too small—with total disbursements so far of just $1.4 billion—and that the requirement for a regular IMF financing program to accompany such funding makes it less attractive for many countries because of the associated conditionality and reputational stigma.

Moreover, like regular IMF financing, the RST just adds more debt—even though over a much longer maturity period—limiting many countries. That concern prompted some people in this group to call for a reexamination of current policies for issuing and deploying special drawing rights (SDRs), which bolster the official reserves of member countries. During the pandemic, the IMF issued SDRs equivalent to $650 billion, which, notwithstanding the fact that 67 percent went to rich countries that didn't need this financing, greatly relieved pressures on some low- and middle-income countries. Why not, ask those who want the IMF to expand its climate change footprint, have large and regular distributions of SDRs? At the same time, perhaps the institution should change the SDR allocation rules and target countries that need them and/or link allocations to spending on climate change, they argue.

The IMF could also use its convening power to mobilize global action and financing to address climate change. As a global organization where finance ministers and governors meet regularly, the Fund could raise awareness of the policy and financing actions that only they can take to address climate change, this group suggests. According to the IMF's 2021 strategy paper, "climate change mitigation is a global public good and requires an unprecedented level of cross-country policy cooperation and coordination. As a multilateral institution with global reach, the IMF can assist with coordinating the macroeconomic and financial policy response."

One step at a time

It is easier to outline the points of dispute over the IMF's climate change mission than to resolve them. This is another manifestation of the broader ambiguity in the international response to climate change. The communiqués of world leaders regularly recognize the seriousness of the threat and the need for urgent and coordinated action. And yet, concrete policies and financing commitments languish.

In this context, it is simply not realistic to expect the IMF's membership to agree to a bold new consensus that would make the fight against climate change a core IMF priority. For now, we should also rule out making regular distributions of SDRs to finance climate-related spending or tasking the Fund or its governing bodies to play a central role in mobilizing international policy and financing responses.

At the same time, it is neither feasible nor sensible to retreat from the advances the IMF has already made in building climate change into its analytical, surveillance, and capacity-building work. Rather, the focus on these aspects will need to deepen as countries feel more pressure to address climate threats and seek the Fund's help. The RST should become a more significant source of IMF financing. The Fund also has an important contribution in terms of intellectual leadership or through the power of ideas for shaping public thinking and awareness of the links between climate change and the economic prospects of its member countries.

Perhaps the IMF's best way forward on climate change will be to "cross the river by feeling the stones," as the Chinese say: one step at a time. The Fund has already made considerable progress in integrating climate change into its activities. It has, after a hesitant start, strengthened its partnerships with the World Bank and other institutions with complementary skills and mandates. And it has recruited a cadre of specialists who can help link the climate change agenda to the traditional focus and skills of the institution. The demands for going further are only likely to grow. The challenge for the institution will be to harness them in ways that both serve the membership and attract broad support. F&D

MASOOD AHMED *is president of the Center for Global Development, a Washington-based think tank.*