Stranded Assets

The IMF Has a Blueprint for Helping the Climate Without Hurting Economic Growth

It models a package of policies it says would enable the world to get to net zero carbon emissions by mid-century.

By Kate Mackenzie
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In a year when Covid-19 has dominated the International Monetary Fund's agenda, the organization's quiet rethinking of climate change in its latest World Economic Outlook report didn’t make much of a splash outside the Twitter feeds of development economics wonks. While the rest of the climate and energy world was poring over a different WEO — the International Energy
Agency’s World Energy Outlook — the IMF’s comprehensive assessment of what the energy transition will mean for economies was relatively overlooked.

For decades, the need to cut emissions has been dogged by questions that essentially boil down to: how much will it cost, and is it worth it? Unlike the IEA’s analysis, which excludes the impacts of climate change altogether, the IMF’s role requires it to grapple with the implications for economies of acting versus not acting on global warming. The standard models addressing these tend to have limitations — many of them ably critiqued by my fellow Bloomberg Green contributor Gernot Wagner — but the underlying assumption is often that cutting emissions means sacrificing growth.

In its new report, the IMF takes a different tack, arguing that there is no trade-off between the two. It also goes further than a lot of climate economists by factoring in the so-called “co-benefits” from cutting emissions — the often neglected side effects, such as fewer deaths from air pollution, and reduced traffic.

The IMF’s climate chapter models a package of policy measures that it says would enable the world to get to net zero carbon emissions by mid-century. In addition to a carbon price starting at a modest $6 to $10 per ton, the package includes 80% subsidies for renewable energy production, a swathe of green public investments, compensation for households, and a supportive fiscal approach — that is, being prepared to load up on debt for the next decade. The IMF points out, reasonably enough, that we seem to be in a low-for-long interest rate environment.

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Cleverly, the IMF tests its measures against those reductive cost/benefit models — both the old school modelling by William Nordhaus, which is notorious for downplaying the damage caused by climate change, and the newer methodology developed by Marshall Burke, Solomon Hsiang and Edward Miguel in 2015 that found up to a quarter of global GDP could be affected by 2100 if emissions aren’t cut. The IMF still concludes that its proposed measures are net beneficial throughout the rest of the century. Even using the model where climate action is most harmful to growth — Nordhaus’ — the IMF’s projections show only a slight drag on GDP from 2037 to 2050, before the longer term benefits kick in. Even this, the IMF authors say, would be negated by benefits from lower air pollution and reduced traffic.

The IMF’s WEO chapter builds on other evidence published this year that green measures are good for economic growth, particularly when it comes to recoveries. It also adds to the growing understanding among policy makers that climate change is far more risky than most models would have us believe. The Network for Greening the Financial System — a coalition of dozens of central banks and financial supervisors — noted last year that higher cost estimates were more “robust”, and that most attempts to model the cost of climate change leave out effects such as catastrophic events and sea level rise.
The IMF’s new approach might herald a tipping point not just in the institution’s thinking about climate change, but the mainstream views of economics and policy making. The fund’s Fall 2012 World Economic Outlook included the argument that austerity measures might counteract growth, marking the crumbling of a prevailing orthodoxy that had long been advanced by the IMF itself.

Still, the IMF has to figure out how to implement its new thinking. A Dutch think tank, Recourse, last week published analysis suggesting that the IMF’s Article IV country reports don’t take climate change seriously enough. Its detailed review of the reports on Indonesia, India, South Africa, the Philippines and Mozambique found that climate change was only identified as a macroeconomic risk for the last two. The IMF analysis, Recourse argued, seemed to play down the risks of South Africa and Indonesia’s heavy reliance on export earnings from coal, and of Mozambique being on the cusp of becoming a big exporter of both coal and natural gas. The report cites numerous instances where seemingly neutral IMF recommendations in areas such as tax or infrastructure would effectively lock in more dependence on fossil fuels.

High level models are well and good, but as the Recourse report demonstrates, the details of implementation are what matters. That probably isn't lost on IMF Managing Director Kristalina Georgieva. “Macro decisions have micro consequences,” she told Bloomberg Economics’ Stephanie Flanders last month, in a wide-ranging interview that also highlighted a little-known fact about her background: her PhD was, it turns out, in environmental economics.

Kate Mackenzie writes the Stranded Assets column for Bloomberg Green. She advises organizations working to limit climate change to the Paris Agreement goals. Follow her on Twitter: @kmac. This column does not necessarily reflect the opinion of Bloomberg LP and its owners.

((Corrects name and title of IMF Managing Director Kristalina Georgieva.))