FISCAL AFFAIRS

Special Series on Fiscal Policies to Respond to COVID-19

This is one of a series of notes produced by the Fiscal Affairs Department to help members address the COVID emergency. The views expressed in this paper are those of IMF staff and do not necessarily represent the views of the IMF, its Executive Board, or IMF management.

Greening the Recovery

Fiscal policy across the globe is rightly focused on fighting the COVID-19-induced economic crisis. But the climate change crisis remains, as does the need for decisive policy action to address it. Indeed, decisions taken now to address the COVID-19 crisis may shape the climate, and human health, for decades. This calls for fiscal policymakers to "green" their response to this crisis to prevent one crisis leading to another. Public support for such measures may be higher after the COVID-19 crisis.

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I. CONTEXT: THE COVID CRISIS WON'T CHANGE THE CLIMATE, BUT THE RESPONSE WILL

The COVID-19-induced economic crisis does not change the basic climate challenge, or the proper response to it. Even a prolonged global recession would have only a modest impact on the stock of atmospheric greenhouse gas emissions. Thus raising the cost of emissions, central to addressing the externality problem at the heart of climate change, remains essential. And the policy action required also remains ambitious, for example, containing global warming to 2°C or less would require rapidly phasing in measures equivalent to a global tax of at least $75 per ton by 2030, whereas the current global average carbon price is $2 per ton.[1]

Decisions taken now will shape the climate for decades. The combined impact of a health and economic crisis poses a grave threat to economies and human lives and has, appropriately, triggered rapid and extraordinary policy action around the world. The depth of the crisis and the scope of the response mean that the policy steps taken now are likely to have lasting effects on the global economy and will shape societies for decades to come. This in turn will affect emissions and the climate. For example, unless the right energy prices are put in place, the extra investment induced by stimulus will be misallocated between clean and dirty sectors.

Fiscal policymakers should thus create a "green" recovery. In the immediate crisis-containment phase, the scope to do so may be limited, given the necessary overriding priority of providing urgent relief for households and firms, which should not be delayed or undermined by climate considerations. But as economies stabilize

[1] Based on studies summarized in IMF, Fiscal Monitor, October 2019.

and shutdowns ease, the scope and need for broad-based fiscal stimulus will increase, especially for green measures that both boost aggregate demand and employment. And even in the crisis-containment phase, there could still be policy actions that support climate goals without undermining the effectiveness of crisis-containment policies.

Public support for green policies may rise after the COVID-19 crisis. Policymakers will be able to make the case that, as with pandemics: (1) climate crises may look remote but can strike quickly (2) preparedness is essential and takes years and (3) the cost of preparing is dwarfed by the cost of not preparing. Indeed, curbing emissions would likely reduce the risk of respiratory diseases (e.g., from air pollution). [2]

Finance ministries should aim to make these policies and projects "shovel-ready." Stimulus packages are already being designed and these climate-conscious policies and projects will need to be rapidly made ready so they can be incorporated. This preparatory phase may also include building up capacity within finance ministries to help manage the implementation phase of the green aspects of the stimulus.

II. ACTION: POLICY MEASURES TO GREEN THE RECOVERY

Each country's situation will be different, for example, in their macroeconomic conditions, fiscal space, extent to which broad-based stimulus packages have already been launched, capacity to incorporate climate considerations, the ambition of their climate commitments, and the importance placed on other policy objectives. But some principles can still help fiscal policymakers green their response to the COVID-19 crisis.

Chose to support green, rather than brown, activities

- Public investment projects could focus on:
  - boosting climate-smart infrastructure (e.g., renewable energy, modernizing the electric grid, public transport, improving digital infrastructure to build on the global teleworking experience)
  - developing and adopting climate-smart technologies (e.g., battery/hydrogen/carbon capture)
  - supporting adaptation (e.g., flood protection, resilient roads and buildings)
  - avoiding carbon-intensive investments (e.g., fossil-fuel power and high-emissions vehicles)

- Public works programs to provide income support to the poor affected by the crisis could be aimed at projects that support adaptation (e.g., irrigation).

- Debt guarantees and other support could be extended to green industries/activities in preference to brown industries/activities.

Make support to brown activities conditional on making progress on climate

- Crisis support for carbon-intensive industries/firms could require commitments to emissions reduction targets and/or ensuring an equitable transition to a low-carbon economy (e.g., paying to close coal mines and providing early retirement and re-training packages for their workers, sales shares for zero-emission vehicles, and developing clean fuels for international transportation).

[2] See, for example, IMF World Economic Outlook, Chapter 3, October 2017, and Finance & Development, June 2018.

- Large firms that receive longer-term public support could be required to disclose their carbon footprints.

Price carbon right

- Low oil prices and the need to rebuild fiscal positions make raising carbon taxes (or closely related instruments, such as fuel taxes) and eliminating fossil fuel subsidies especially opportune. For many countries, a $75 per ton carbon tax would increase pump prices by less than the recent collapse in global oil prices.

- Carbon taxes can usefully be reinforced with measures like feebates to promote zero-emissions vehicles and improvements in energy efficiency, and should be supported with measures to assist low-income households and disproportionately affected workers and communities.

- Support to transport and other sectors most directly affected should not be provided in forms that undermine carbon pricing objectives, for example, by reducing fuel or trip-related expenses.

Assess the climate impact of support measures

- Stimulus measures should be screened for their climate impact, both positive and negative. Environmental standards should not be relaxed.

- Stimulus measures could be required to be assessed on their climate impact and reported in the budget, provided it does not result in significant delay. (More generally, countries should avoid halting their effort towards “green budgeting”—the integration of environmental and climate dimensions in budgeting processes.)

Make the financing green

- Consider financing the additional climate spending with green bonds.

- Private finance could be mobilized for green investment (e.g., through targeted and transparent guarantees).

- Require banks that receive public support to disclose the climate readiness of their portfolio.

Develop a new, ambitious, medium-term climate plan

- Finance ministries could work with other ministries to present a revised emissions plan (“Nationally Determined Contribution”) that reflects their country’s new emissions outlook and polices ahead of the delayed, but critical, UN Climate Change Conference.

Coordinate and support others

- To scale up mitigation and avoid one country’s efforts being undermined by others, like-minded countries could agree to a carbon-price floor, with a higher floor for advanced countries. Consideration could also be given to complementing a carbon-price floor with a “carbon border adjustment” applied to the carbon content of imports from countries not taking adequate steps on mitigation.

- Financial support from higher-income countries could be increased to low-income and vulnerable countries to help them reduce their emissions, adapt to the consequences of climate change, and, most immediately, replenish their disaster funds that may have been depleted by the response to the COVID-19 crisis.