6 steps the IMF should take to stop enabling fossil fuels around the world

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The International Monetary Fund (IMF) has belatedly recognized that climate change affects countries’ macroeconomic stability, and that addressing it is therefore critical to its mandate. Last year, IMF Managing Director Kristalina Georgieva committed to a series of actions to center climate change in the Fund’s work. This is encouraging, but does not go far enough.

The IMF has a critical role to play in supporting countries to address climate-related risks and vulnerabilities, strengthen adaptive capacity, increase resilience, and ensure countries have adequate fiscal space to achieve a just transition away from fossil fuels and pursue alternative sustainable development pathways. However, the IMF is continuing to play an enabling role in fossil fuel expansion around the world, often working at cross-purposes with its own stated commitments and goals.

At a minimum, the IMF should work to “do no harm” on climate change and climate action. This means taking steps to stop enabling fossil fuel expansion around the world and undermining a just energy and economic transition across IMF member countries. Below are 6 steps the IMF and its shareholders should urgently take to this end, in meaningful consultation with civil society stakeholders.
1. Align the IMF’s mandate with climate goals.

Amend the IMF Articles of Agreement to shift the IMF’s mandate from that of pursuing endless GDP-based growth to that of achieving collective human well-being in harmony with planetary boundaries.

The IMF’s main purpose, as codified in its Articles of Agreement, is to promote international monetary cooperation, “Recognizing that the essential purpose of the international monetary system is to provide a framework that [...] sustains sound economic growth” (pg. 5).

The IMF’s mandate, rooted in Gross Domestic Product (GDP)-based economic growth, remains at odds with imperatives to stabilize the climate, exist within the earth’s biocapacity, and ensure collective human flourishing. This “growth” mandate is a barrier to global decarbonization efforts because it provides cover for the IMF to continue to promote policies that support fossil fuel expansion, while downgrading the significance of the shortcomings and costs of this approach.

IMF shareholders should amend the Articles of Agreement to align it with the goals of the Paris Agreement, the Beijing Platform for Action and other UN social conventions. Namely, instead of focusing on crudely-measured means like GPD, the IMF should focus on the improvement of human well-being in a way that is in harmony with earth’s ecosystems and that is just, with alternative indicators that actually measure social progress.

Underlying this mandate of economic growth—which is traditionally measured through the metric of GDP, or the total value of all goods and services produced in a country in a given year—are little-examined assumptions about the purpose that economic growth serves. Presumably, under these unspoken assumptions, economic growth is a means towards an end (improving the collective human condition). Yet it is often treated as an end in itself, as demonstrated by the use of productivity—not wellbeing—as its metric. An example of the perverse irony of GDP as a measurement, when air pollution from coal leads to cardiovascular and respiratory diseases and increases hospitalization spending, this boosts GDP.

Another problem with the mandate of economic growth, in addition to the fact it focuses on a means rather than on outcomes, is that growth has ecological limits. A growing body of research shows that a focus on GDP-based growth is leading us to over consume natural resources and disrupt the climate, jeopardizing current and future generations’ ability to live a good life, or survive at all. The argument that growth is compatible with action on climate change and observance of earth’s other planetary boundaries remains undemonstrated, studies show. Finally, the GDP-based growth metric does not account for externalized environmental and social costs like gender and other social and economic inequalities, biodiversity loss, mass species extinction, soil degradation, and more.

European countries are already considering the need to develop indicators that are “more inclusive of environmental and social aspects of progress” with their Beyond GDP initiative. It is past time for the IMF’s mandate to be updated and aligned with global climate, environment, and inclusive development goals.
2. End fossil fuel producer subsidies and confront the true social cost of greenhouse gases.

End support for fossil fuel producer subsidies and incentives – i.e. policy and tax reforms that make fossil fuel investments more profitable, like tax breaks for oil companies and low royalty rates – in loan conditions, technical assistance, and surveillance recommendations.

According to a 2021 working paper published by the IMF, “Globally, fossil fuel subsidies were $5.9 trillion in 2020 or about 6.8 percent of GDP”¹. The IMF recognizes that fossil fuel subsidies are expensive for governments (and therefore taxpayers), and reduces incentives for investment in clean energy and energy efficiency. The Fund has been supportive of initiatives to price greenhouse gases in order to provide the right incentives for the shift to cleaner fuels and economies, secure government revenue, and achieve domestic health gains (like fewer deaths from air pollution).

Yet the IMF has failed, and continues to fail, to help countries address the true cost of fossil fuel dependence. On the contrary: the IMF continues to support fossil fuel producer subsidies and incentives in countries around the world, despite this being a problematic use of public money in support of established, profitable fossil fuel industries; despite macroeconomic harms and risks posed by fossil fuel development and by climate change – especially on the poor, among whom women predominate; and despite the urgent need for a transition of economies to alternative energy sources and economic development pathways.

A 2021 study by the NGOs Bretton Woods Project and ActionAid USA of Article IV reports conducted by the IMF (“health checks” of country economies; mandated under Article IV of the IMF’s Articles of Agreement) since the signing of the Paris Agreement found that “while the Fund advocated for fossil fuel subsidy removal or reform in 71 countries, these policies largely targeted consumer subsidies rather than affecting the economics of fossil fuel production. This focus on demand side measures is insufficient to achieve a just energy transition.”

A 2020 study by Heike Mainhardt found that the IMF’s loan program conditionalities in Mozambique and Mongolia supported the creation of: new tax policies providing subsidies for coal and gas; technical assistance for the development of these new tax policies; new legislation to facilitate foreign public finance for fossil fuels; the prioritization of mega fossil fuel projects for public investments; and the reduction in consumer subsidies for electricity (a regressive measure that often leads to social unrest and thus, often overturned).

In a recent case, a civil society alliance in Pakistan has raised concerns to the IMF that, as a condition for a resumption of an IMF loan program, the government of Pakistan has been forced to adopt a range of punishing fiscal measures that includes a devastating regime of taxes on solar panels, wind turbines, electric vehicles and related technologies. These measures are likely to cripple Pakistan’s nascent renewables energy market threatening the country’s ability to meet its environmental goals and international climate obligations, in direct contradiction to the IMF’s rhetoric about supporting low-carbon transitions. The recently approved IMF $688 million loan for Suriname requires increased regressive VAT taxes on citizens and non-oil sectors while upholding large tax breaks and ultra-low royalty rates for new oil investments.

If the IMF were properly calculating the social cost of greenhouse gases (GHG), it could help country policy makers determine whether the costs and benefits of a proposed policy are justified. In most cases, the social cost of policies that increase GHG emissions would be so high that these policies would be non-starters. As a first step, the IMF should – at the very least – stop making the problem worse by supporting distortionary fossil fuel producer subsidies and incentives.

¹ This figure includes estimates of explicit subsidies as undercharging for supply costs and producer subsidies (i.e., pre-tax subsidies), as well as implicit subsidies as undercharging for environmental costs and general consumption taxes (i.e., post tax subsidies less pre-tax subsidies).
3. Properly analyze the risks of fossil fuel investments.

Expand climate transition risk assessments beyond the 20 largest polluters to all member countries, especially those significantly dependent on fossil fuel exports and on the brink of new fossil fuel development, and improve the rigor and scope of these assessments.

The idea is simple: if governments knew the long-term financial and economic risks of fossil fuel investments, they would not be so eager to go down this pathway. Yet, despite its mandate to help countries with financial stability, the IMF has been a laggard in assessing climate-related financial risks across its operations. When it has done so, it has focused on physical risks (like damage to property and supply-chain disruptions), less so transition risks (like what happens to a coal-exporting country when they can no longer export coal due to decreased demand resulting from new climate policies). These analyses have been limited and uneven. As a result, the omission of adequate risk assessments have lent credibility to and spurred fossil fuel expansion around the world.

The IMF’s Article IV surveillance reports play an important role in influencing the policy environment of a country and the market’s perception of a country’s economic trajectory, and therefore, investment trends. When these analyses don’t adequately account for physical and transition risks of climate change, they result in macroeconomic projections (estimated GDP and government revenue growth rates) that are overly optimistic, sending problematic signals to investors and decision-makers that it’s safe and even prudent to invest.

Mozambique is a good example of this: In 2016, the IMF projected that liquefied natural gas (LNG) production in Mozambique would start in 2021, that its GDP in 2021 alone would jump 34%, and that Mozambique could make up to half a trillion dollars over the LNG projects’ lifetimes. Today, the two largest LNG projects are indefinitely on hold because of conflict around the project site (foreseen by civil society), and one of the projects’ foreign investors has been sued for investing in contradiction to its climate commitments. A think tank has estimated that even if the projects do go forward, which is not guaranteed, most of Mozambique’s gas is already potentially stranded (i.e. valueless) because of volatile oil prices and shifts in market demand, and potentially even a liability for the country because of unfavorable contract terms and sovereign guarantees covering the investments.

Encouragingly, last year, the IMF Executive Board approved a new Comprehensive Surveillance Review (CSR), updating the way it conducts surveillance and the advice that it gives as part of its mandate. IMF staff were newly mandated to analyze climate transition risks to countries’ economies and financial systems, and to devise policy advice to address these risks. However, the IMF only committed to doing this for the 20 largest polluting countries, once every 3 years, and not for countries like Mozambique, Suriname, and Tanzania that are not historic polluters, but that are on the brink of massive new fossil fuel development. The CSR is being followed this year with the publication of a guidance note to instruct all country missions and staff conducting reviews on how to assess these risks. But with only a vague PowerPoint shared publicly about the expected content of this guidance note, it is difficult to gauge how meaningful the IMF’s approach will be.

Among the types of risks associated with fossil fuel development that the IMF should support countries with is the risk that mixed-ownership fossil fuel projects pose to host country government balance sheets if they don’t perform as expected and become stranded assets. The IMF could help determine which parties hold affected assets and related liabilities of fossil-fuel lock-in and non-performing stranded risk between the financial sector, public sector, and major economy export credit agencies, and point to any nationally unfavorable risk-sharing arrangements. Such an analysis can help the IMF to guide governments on how to better manage risk exposures. In addition, this can be linked to financing facilities to help countries reduce fiscal pressures related to transition risks, through refinancing fossil fuel contracts, and through other means. Under its updated surveillance mandate, the
IMF should also advise fossil-fuel dependent countries when there is a need to diversify their economies and divest from fossil fuels to avoid fiscal and financial risks, and help countries do this in a way that is fiscally sound and financially stable. This should include recommendations to unwind from investor-state dispute settlement (ISDS) provisions in free trade agreements and bilateral investment treaties – which allow foreign companies to sue host governments for canceling projects or limiting investments – that jeopardize the fiscal and financial aspects of a country’s transition.

4. Reform policy advice to enable a green transition.

Analyse how IMF policy orthodoxy drives fossil fuel expansion and undermines countries’ green transitions, commit to “do no harm”, and develop new policy advice to enable a just transition to low carbon economies.

While the IMF has been increasingly vocal about the risks of climate change and the actions needed to address this, it has not stopped to analyze how its own conventional macroeconomic policy prescriptions are contributing to the problem. The IMF should urgently study how its own policy advice is preventing countries from moving beyond their dependence on fossil fuels, and commit to –at a minimum– “do no harm”. It should then work to develop new policy advice that is aligned with goals of international climate commitments and that will enable countries to transform their energy sectors and economies, in meaningful consultation with experts and civil society stakeholders.

A recent report by ActionAid USA and the Bretton Woods Project explored how the IMF’s existing policy advice in its Article IV surveillance is undermining a just energy transition across many IMF member countries. It found that, since the Paris Agreement was enacted, the IMF’s policy advice endorsed, or directly supported, the expansion of fossil fuel infrastructure in 105 member countries. It also found that the Fund supported the privatization of state-owned power and energy enterprises in 69 countries, reducing the ability of governments to make the drastic changes that are needed to mitigate climate change from a public goods perspective (like retiring fossil fuel plants early without being sued by foreign investors), and leaving them at the mercy of the private sector mandate to increase shareholder returns. This is in addition to the IMF’s continued support for fossil fuel producer subsidies and incentives, as well as for fiscal consolidation (austerity), which limits the fiscal space that countries have to take climate action.

Finally, while around one-third of the IMF’s budget goes towards capacity development (i.e., technical assistance) – including helping equip finance ministries and central bankers to address climate risks in designing fiscal, monetary and prudential policies – the content of this technical assistance remains opaque. According to a recent report by Recourse, the IMF only publishes reports of 5% of its technical assistance missions. An analysis of four of those cases that were public –Georgia, Maldives, Uganda and Philippines– found that despite all four countries having ambitious climate targets in their Nationally Determined Contributions (NDCs) to the Paris Agreement, the IMF gave little consideration to and “failed to consider key aspects of the shift to a low-carbon future”. The IMF should develop guidance on the technical assistance it provides, including through the publication of toolkits (as has occurred in technical assistance provision relating to fiscal policy reform) and materials setting out methodologies. It should also ensure greater disclosure and enhanced transparency around IMF technical assistance provided, as well as the participation of civil society, academics, national climate bodies, and other stakeholders in the review of this content.
5. **Address the connection between debt and fossil fuel dependency.**

   *Build up the toolbox to help countries manage debt without doubling down on fossil fuel extraction.*

Many countries are doubling down on fossil fuel-related development, even embarking on new fossil fuel development, as a way to manage high levels of public debt. Sometimes this is because the country has large fossil fuel reserves, but no other readily available or scalable revenue option that could be used to pay down debt. And in all cases this is because there is no adequate multilateral debt workout mechanism that could reduce the pressure on governments to pursue extractives-based debt servicing.

There is also little support for climate-vulnerable countries to lower the cost of borrowing for the transition to renewable energy and alternative economic activities: a recent report shows that climate vulnerabilities (like increased risk of impacts from extreme climate events) increases the cost of debt for countries in the Global South because of higher interest rates. These countries did little to cause the climate crisis, but face its worse impacts, and this takes a drastic toll on government budgets and balance of payments, often increasing debt. The higher countries’ existing debt, the less money they have to transition and become more resilient, and the more reluctant creditors are to lend, which drives up interest rates, in a vicious, deeply unjust cycle.

The IMF needs to acknowledge the perverse incentive that debt has on countries’ investment in fossil fuels, and help countries address their debt in a way that doesn’t increase their dependency on them. This should include reforming how the IMF conducts debt sustainability analyses, exploring options for the cancellation of countries’ debt as a deterrent to fossil fuel expansion, and providing support for the diversification of economies and the transition to alternative economic development pathways. The IMF also needs to help climate-vulnerable countries lower the cost of borrowing so they can take needed climate actions like shifting away from fossils.

The IMF and the World Bank jointly conduct Debt Sustainability Analyses (DSAs) to assess countries’ ability to take on new debt (i.e. loans), and the likelihood that countries will be able to pay back their debt in the future. They do this by making projections of how much revenue countries will have in the future to service debt. These analyses are used in lending and borrowing decisions not only by these institutions themselves, but also by other lenders. They are also used to determine countries’ debt restructuring and relief terms under the WB/IMF framework.

But there are several issues with how DSAs are conducted that have implications for countries’ fossil fuel dependency. The first is that IMF/WB debt sustainability analyses often rely on shaky assumptions that fossil fuel projects will bring in a flood of future revenue, disregarding less rosy scenarios, transition risks, and the inherent volatility of fossil fuel markets. When they make these kinds of over optimistic projections about expected windfalls from fossil fuels, countries are empowered to not only pursue risky fossil fuel development, but also to take on more debt than they will realistically be able to pay back in the future. When these revenue projections don’t bear out (and they often haven’t), countries could be left with more debt, arising from fossil-fuel lock-in and general over-confident borrowing. Additionally, investments in alternative economic activities are displaced, delaying countries’ transitions to green economies. The other concern with how DSAs are conducted is that they only assess the ability of countries to pay back creditors –not their ability to meet development, human rights and climate obligations. By narrowly defining countries’ future financial needs, the DSA enforces a system where creditors are prioritized over the public interest and urgently needed climate action.

Considering its dismal track record, the IMF should adopt more sober projection methodologies and work with outside experts and stakeholders in making projections about expected fossil fuel returns, to prevent further fossil fuel entrenchment and reckless lending. The IMF should also work with the World Bank to urgently reform the DSA to more broadly define countries’ financial obligations, so that investments in people and the planet
are assured and prioritized. An optimal DSA should also be used to incentivize countries to take climate action, rewarding countries for decarbonization measures that improve debt sustainability.

The IMF should also urgently build up its toolbox to support countries facing debt distress to not embark on new fossil fuel projects. As due compensation for keeping their fossil fuels in the ground, IMF support to countries in this situation should include options like debt cancellation, rechanneling of Special Drawing Rights (SDRs) from high-income to low-income countries, and support with identifying and financing for alternative revenue generating activities. Financing should take the form of grants, not loans, to not further drive vulnerable countries into debt. This support should be rooted in the recognition, reaffirmed in the Paris Agreement, that the countries that are historically responsible for causing climate change owe a historical debt to developing countries to support their transition and adaptation. The largest contributors to climate change are also the largest shareholders of the IMF, with dominant quotas and voting power at the IMF Board. This historical debt that is owed, and the global imperative to stay within 1.5 degrees Celsius in average global warming, mean that the IMF can draw on political commitments for climate finance already made by its major shareholders under the Paris Agreement to advance these debt treatment and financing options for countries on the brink of new fossil fuel development.
6. Ensure countries have resources to move away from fossils.

Help countries build fiscal space for energy sector transitions and alternative, sustainable development pathways.

Despite the IMF’s rhetoric around the importance of a “green and inclusive” recovery to the Covid-19 pandemic, recent reviews of IMF Covid-era loans suggest worrying pressure for countries to prematurely return to fiscal consolidation (i.e. austerity). Countries cannot take action to mitigate and adapt to climate change without space in their budgets to do so. Covid-19 and the climate crisis should mark a turning point that sees the IMF move to supporting countries to build fiscal space, including through progressive taxation and investment in quality public services.

The promotion of austerity through loan conditions and surveillance advice is only one way in which the IMF is limiting the fiscal space that countries have to shift their economies away from fossil fuels. Another way the IMF does this is through the troubling practice of surcharges, which are additional payments, on top of normal interest payments and other fees, that heavily indebted countries are required to pay to the Fund. The IMF should end this practice, as experts, civil society, and US members of Congress have called for.

In addition, despite the promising news about a new IMF facility being created to help countries address climate risks, to be financed with rechanneled SDRs from high-income countries, the new Resilience and Sustainability Trust as currently conceived may increase the debt burdens of climate vulnerable countries, unless concessional terms are agreed on. The IMF should encourage its shareholders to support SDR rechanneling mechanisms that retain the unconditional, and grant-based nature of SDRs. The IMF should also encourage a new issuance of SDRs, which would help all countries boost their reserve assets so as to be able to free up more resources to invest in climate action, including the shift away from fossil fuels.
The IPCC’s report from February 2022 on Impacts, Adaptation and Vulnerability confirmed our worst fears: Overshooting 1.5 degrees, even temporarily, leads to severe and irreversible outcomes, increasing heat waves, longer droughts, extreme precipitation, and more intense typhoons. The report confirms that those at the forefront of this global emergency - the most vulnerable economies and people - will be the first and most affected. The latest AR6 report also states that it’s “now or never” to limit global warming to the 1.5-Centigrade limit of the Paris Agreement. Supporting strategies of the most vulnerable economies and communities to build resilience should not involve support for industries that harm them.

As the leading multilateral financial institution focused on international monetary cooperation, the IMF is uniquely positioned to help countries address the global issue that is climate change. It is heartening that the IMF is taking increasing steps to center climate change and intersecting macro-critical issues in its work. However, in order for its actions to have the purportedly desired impact, they must be coherent within the broader context of the Fund’s work. The recommendations outlined above aim to highlight some of the inconsistencies and even contradictions of the Fund’s work in relation to its climate commitments that are continuing to drive fossil fuel expansion around the world. While these recommendations are not intended to comprehensively cover all that the Fund could do within its purview to help address climate change, they are proposed as an essential foundation for this work, to eliminate the counterproductive actions of the IMF vis-a-vis climate, and to ensure that at a minimum, the Fund adopts an approach to “do no harm.” The IMF and its shareholders should rise to the moment and ensure the IMF’s critical role in the global financial system is deployed towards an equitable global green transition.