IMF: Environmental Mandate & Activities
International Monetary Fund

Environmental Mandate

The IMF is an international organization governed by and accountable for 188 countries that make up its near-global membership. The IMF's primary purpose is to ensure the stability of the international monetary system.

However, they believe that whilst economic development is critical for lifting people out of poverty and raising living standards for the broader population, it also causes harmful side effects with particular reference to the environment. As this has the potential to produce sizeable costs for the macro-economy, the IMF propose that fiscal instruments such as emissions taxes, trading systems with allowance auctions, fuel taxes, charges for scarce road space and water resources, etc. can and should play a central role in promoting greener growth. In turn these instruments should:

- be effective at reducing environmental harm—so long as they are carefully targeted at the source of the problem (e.g., emissions);
- be cost-effective (i.e., they impose the smallest burden on the economy for a given environmental improvement)—so long as the fiscal dividend from these policies is exploited (e.g., revenues are used to strengthen fiscal positions or reduce other taxes that discourage work effort and investment);
- strike the right balance between environmental benefits and economic costs—so long as they are set to reflect environmental damages.

Environmental Activities

The IMF's work includes research on 'getting the prices right' to reflect environmental side effects in energy prices as an example of creating the right incentives to help countries address climate change and other environmental challenges. Fiscal instruments, either environmental taxes or systems of pollution rights sold by the government, are the most effective instruments for exploiting near and longer-term options for reducing emissions (e.g., investments in renewables and energy efficiency) while at the same time providing a potentially valuable source of government revenue.

The IMF recently published a handbook for policymakers, 'Fiscal Policy to Mitigate Climate Change', with many practical suggestions for designing and implementing fiscal instruments to reduce greenhouse gas emissions. In addition, a paper prepared for the IMF Board 'Energy Subsidy Reform: Lessons and Implications' measures both direct subsidies for energy, and indirect subsidies from the failure to charge for environmental side effects, and provides practical guidance for implementing subsidy reform.

In work for the G20 in collaboration with the World Bank and others, IMF staff evaluated a range of alternative fiscal instruments as a source of revenue for climate finance, including carbon taxes and other domestic instruments, and charges on international aviation and maritime fuels. The Fund promotes the use of fiscal reform to address environmental problems through:

- analytical work - for example, staff published a collected volume of papers on designing fiscal policy to mitigate greenhouse gases; the IMF assesses the magnitude of energy subsidies; and staff quantify environmental damages to provide guidance on appropriate levels of energy taxes in different countries.
- technical assistance - to member countries interested in environmental tax reform.
- outreach activities - including regular presentations by staff at conferences (e.g., UN climate meetings) and events the IMF cosponsors with other international organizations and research institutes.

However, there is also ample scope for reforming tax systems to deal much more effectively with broader environmental and related problems that can be a significant drag on economic growth, such as the health and productivity impacts of poor air quality, and severe congestion of major urban centres. The key challenges are to restructure existing energy tax systems to directly target the source of environmental harm (e.g., by taxing emissions or driving on busy roads rather than electricity consumption or vehicle sales), to better align tax levels with the scale of environmental harm, and to overcome practical challenges of higher energy and transportation costs.

Earlier IMF papers lay out core principles of green tax design and focus on case studies for Chile and Mauritius. A 2014 IMF report (covering over 150 countries) provides estimates for taxes on fossil fuel products to reflect pollution and other environmental impacts associated with energy use, while underscoring the large environmental, health, and fiscal benefits from tax reform and the critical role of finance ministries in administration and ensuring efficient use of revenues.

A recent IMF paper and book published in September 2013 put the magnitude of subsidies for fossil fuel energy sources at about $2 trillion worldwide in 2011, including both direct fiscal costs and implicit subsidies from the failure to charge for environmental damages or tax energy at the same rate as other consumption products. The paper and book draw on case studies to provide practical guidance (e.g., on better targeted instruments commonly available to protect the poor) for implementing energy price reform. In the case of petroleum products for example, reducing subsidies could significantly reduce greenhouse gas emissions in many countries, while at the same time reducing fiscal deficits. The IMF is also involved in updating these estimates. Another recent study defines and measures the concept of “green investment” and explains recent trends.