ARAB MONETARY FUND (AMF)

HIGH-LEVEL POLICY POSITIONS TOWARD CLIMATE CHANGE

On the Road to COP 28 and IMF-World Bank Annual Meetings

(Dubai and Marrakech, 2023)

Arab Monetary Fund
October 2023

Introduction

The Arab region went through two natural disasters recently, the earthquake in Morocco and the flooding that has devastated Libya. We offer our sincerest condolences to the government and people of Morocco and Libya for the life's trajectory lost and the extensive damage caused. We stand ready to offer our assistance. The flooding in Libya is a reminder of the extreme weather events that have become more prevalent worldwide as a result of climate change and the importance of public policy to address climate change.

The public policy environment is critical for addressing climate change challenges and risks. **The Arab region is among the highly impacted regions by climate change**, **although it has a limited carbon footprint**. The increase in temperature, extreme weather events, and decline in the precipitation rate, with their significant impact on desertification, food insecurity, forced displacement, are only examples of such impact.

As a technical secretariat of the Council of Arab Finance Ministers and the Council of the Arab Central Banks and Monetary Authorities' Governors, **we support a credible and well-designed public policy** that enables the delivery of a rapid and orderly energy transition consistent with the goals of the Paris Agreement and the Net Zero emission target **while giving due consideration** to the affordability of energy and security of supply. If policies do not effectively deliver on all three aspects of the energy trilemma (affordability[1], security[2], and environmental sustainability[3]), this may negatively affect societies and economies and undermine public support for the energy transition. This is meant to be a **summary and not a comprehensive** position.

Support for the Paris Agreement and the Net Zero Emission Target

The Arab region has recognized the urgency of addressing climate change and has made efforts to position itself towards a sustainable future. **Arab countries support the implementation of the Paris Agreement[4] and achieving the Net Zero emission target.** Many Arab countries have already announced their commitment toward the Net Zero emission target and defined roadmaps to achieve that. Arab countries are increasingly embracing renewable energy sources, such as solar and wind power, in order to diversify their sources of energy and decrease greenhouse gas emissions. They also play a leading role in the so-called offsetting measures, such as planting trees and carbon-capture technology. This transition not only helps mitigate climate change but also offers significant economic opportunities by creating jobs and stimulating innovation in the renewable energy sector.

---

[1] **Affordability** refers to a country's ability to provide universal access to affordable, fairly priced, and abundant energy for domestic and commercial use.
[2] **Security** of supply refers to a country's capacity to meet current and future energy demand reliably, withstand and bounce back swiftly from system shocks with minimal disruption to supplies.
[3] **Environmental sustainability** of energy systems represents the transition of a country's energy system towards mitigating and avoiding potential environmental harm and climate change impacts.
[4] Twenty Arab countries are parties to the Paris Agreement.

Additionally, the Arab region recognizes that combatting climate change requires international cooperation and collaboration and that solidarity and fairness are core principles that underpin any multilateral regime. The Middle East Green Initiative launched by Saudi Arabia in 2021 is an excellent example of the region's efforts. It represents a model for solidarity and fairness in addressing climate change risks. The region actively participates in global climate change negotiations and initiatives. It had hosted COP 27 last year and will host COP 28 this year. Through these platforms, Arab countries voice their concerns, contribute to the global discourse, and work towards finding solutions to climate change challenges.

Moreover, the Arab region is committed to achieving sustainable economic development while addressing climate change. They understand that sustainable development is crucial for long-term economic stability, social well-being, and environmental protection. Countries in the region increasingly incorporate sustainability into their policies and practices, seeking to balance economic growth with environmental preservation.

Avoid compromising objectives

The primary challenge of public policy design toward the energy market is how to improve on each aspect of the energy trilemma, namely affordability, security of supply, and environmental sustainability, without compromising on another. We believe focusing on one aspect will not be a viable policy option. Ultra-reliable (secure) and low-carbon energy is of no use if it is unaffordable for businesses and consumers. Likewise, cheap energy (affordable) is not suitable for businesses and consumers if it is not reliable or secure (e.g., it doesn't work most of the time, or it is hard to bounce back from system shocks) or harms the environment.
Avoiding compromising on the previous objectives could be achieved through simultaneously (i) **supporting innovation,** (ii) **targeting emissions and not energy sources**, and (iii) **recognizing the difference in terms of initial conditions for different countries**.

Innovation would support a reliable and cost-effective supply of low-carbon and renewable electricity, electricity storage, low-carbon and green hydrogen, and effective use of carbon removal technologies. It will also **enhance energy efficiency,** which has a major role in the energy transition and can improve energy affordability and sustainability. Robust policy frameworks can support developing and rapidly deploying low-emission technologies while maintaining businesses' competitiveness. **For the innovation policy framework to be robust and effective, it has to be realistic** (preserve business competitiveness), **strong** (encourage significant investment in new technologies), **predictable** (clear long-term objectives[5]), and **sustainably funded**.

Fossil fuel is playing and will continue to play a critical role in the global energy mix, as it represents slightly more than 80 percent of global energy consumption as

[5] Long-term policy helps provide confidence that high-cost, high-risk innovation efforts on near-zero or zero emission industry technologies will pay off.

of 2022[i]. **Targeting fossil fuels instead of emissions from energy sources** could endanger energy security by reducing upstream and downstream investments, increasing energy costs, and making many countries vulnerable to future energy shocks. It could also discourage investment in carbon removal technologies, delaying achieving the Net Zero target. Previous and recent energy shocks have resulted in resorting to highly polluting energy sources, deterioration in energy and food security, higher inflation, and a decline in economic activities and consumer welfare. **Investments in increasing production capacity and carbon removal technologies should be maintained** to reduce vulnerability to energy shocks without compromising low-carbon objectives.

Countries differ in their capacity to adapt and transit to lower emissions. Countries with limited fiscal space and vulnerable states are usually the least responsible for climate change but among the most impacted. While they need to introduce policies for climate adaptation, including climate-smart agriculture, scaling up social spending, climate-resilient infrastructure, and strengthening social safety nets, the international community should provide support to these countries and shield them from policies that could worsen their conditions. Sizeable and sustained international support—especially grants, concessional financing, technology dissemination, and capacity development—is urgent to avoid worse outcomes, including forced displacement and migration[ii]. For these reasons, to achieve the relevant policy objectives while avoiding unintended consequences, it is essential that climate policies – like any other policies – are well-designed and sizable and sustainable international support is provided to countries that need it. **We support a just energy transition that delivers decent work, quality jobs, fair pay, and supports the livelihoods of local communities**.

Climate change and financial stability

Financial systems play a crucial role in financing the transition to a sustainable economy and allocating and mitigating climate-related risks. We believe that climate change could increase financial stability risks through the adverse effects of increased natural disasters, chronic climate shifts (e.g., lower rain), climate policies, technological advances, and changes in consumer preferences. Such adverse effects can result in direct financial risks, prompting a reassessment of asset values, changing the cost and availability of credit, or affecting the timing or reliability of cash flows. They can also create risks to economic activity, which can generate or amplify financial risks.

We think more research and analysis is needed to fully incorporate these risks into financial stability monitoring, including substantial and reliable improvements in data and models. Domestic and international transparency efforts regarding climate-related financial exposures would help clarify the nature and scope of financial stability risks related to climate change.

We support the Basel Committee principles for the effective management and supervision of climate-related financial risks. We think that supervisory authorities should **remain vigilant for the financial stability risks that could result from**

cutting important industries from adequate and affordable financing, including insurance and climate policies that could compromise the affordability and security of energy sources, impacting businesses' profitability and cash flow. Such policies will indirectly impact financial stability.

Role of central banks in addressing climate change

Central banks are operating within well-defined mandates of price stability and financial stability. Some argue that central banks should be more active in mobilizing the resources needed to finance the transition to a carbon-neutral economy. **We think broadening central banks' mandates to mobilize such resources could lack the legal basis and risk achieving their primary objectives.**

Central banks have an essential role in fighting climate change and catalyzing policy decisions affecting financial markets. **They can contribute within their existing mandates as price stability and financial stability are important preconditions for financial markets to allocate and price climate-related risks.**

We think that **central banks' policy instruments are not an appropriate substitute for policy action that the government should take.** Engaging in quasi-fiscal activities to mobilize resources for the climate change transition could undermine the independence of central banks and, consequently, their ability to achieve their core mandates. We think that central banks meeting their policy objectives complement climate policies.

Hydrogen

Hydrogen can play an important role in helping the world achieve the Net Zero target. It could be pivotal in decarbonizing transportation and industrial sectors as a fuel, where electrification alone is not commercially or technically feasible. **Both green and blue hydrogen have a crucial role to play,** and its deployment speed and scale will depend on regional factors, including access to affordable and abundant renewables. The growth of this sector will require government and policy support for initial scale-up and further deployment. **We encourage developing schemes to provide certification of low-carbon hydrogen** as this will help build a trusted market and international trade in this valuable tool for decarbonization.

Carbon capture

Direct emissions from energy-intensive heavy industry (e.g., iron, steel, cement) are estimated to make up between one-fifth and a quarter of global greenhouse gas emissions[iii]. Many of these industries require high-temperature heat that is hard to produce from electricity produced by renewable. While hydrogen could provide a low-carbon alternative, it will require further research and development, rapid deployment, and quick scaling to decarbonize the sector.

Carbon capture, utilization, and storage (CCUS) can play an important role in decarbonizing industries and enables the production of some low-carbon fuels and

dispatchable power. CCUS can also support large-scale CO2 removals globally by permanently storing carbon captured directly from the air. **We support public policies that provide viable and stable business models for each part of the CCUS value chain** - capture, transport, use, and geological storage. Alongside these policy frameworks, **we support the development of a robust regulation framework** to enable the growth of a safe and responsible CCUS industry.

Climate finance

Climate finance is crucial for the Arab region and globally to implement the necessary measures to address climate change effectively. Countries, particularly those economically vulnerable or with limited fiscal space, require financial support to make the energy transition and undertake climate mitigation and adaptation initiatives. They often rely on international funding mechanisms, such as the Green Climate Fund, and climate finance initiatives to finance their climate-related projects. **We support increasing climate concessional finance from developed countries to support developing countries' implementation of the Paris Agreement to combat climate change and achieve sustainable development goals.**

Finally, **for public policy toward climate change to be effective**, it must be **credible** and **well-designed**. **Credibility** means stakeholders see it as durable and not subject to a high probability of policy reversal. This is important to encourage all stakeholders, including private sector investors and financiers, to act, including investing and providing long-term financing at a feasible cost. Avoiding compromising affordability, security, and environmental sustainability objectives in the energy transition policy design is critical to ensuring wide counties' implementations and preserving public support, reducing the likelihood of policy reversal. **A well-designed** public policy should enable the delivery of a rapid and orderly energy transition while giving due consideration to the affordability of energy and security of supply. It should ensure that sizable and sustainable international support is provided to countries that need it. It should use the most appropriate policy instruments that ensure decent work, quality jobs, fair pay, and support the livelihoods of local communities.

[i] Fossil Fuels Remain Strong in 2022 Globally, Despite Increases in Renewable Energy - IER (instituteforenergyresearch.org)
[ii] Climate Challenges in Fragile and Conflict-Affected States, IMF August 2023.
[iii] Decarbonizing heavy industries, Center for Strategic and International Studies, October 2020.