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Climate risks: Central banks to the rescue?

Some fear 'mission creep' on the part of central banks but the climate crisis requires collective action on all fronts. Finance is one of those fronts.

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For The Straits Times

A recent International Monetary Fund (IMF) blog stated that "climate change presents huge risks to the functioning of the world's economies", highlighting the imminent dangers posed by climate change to global macroeconomic and financial stability.

Globally, the task of keeping prices in check and preserving financial stability is one conventionally entrusted to central banks.

What can central bankers do to pre-empt and mitigate the adverse impacts of climate change on the real economy and financial stability?

It turns out that they have been doing a fair bit, with signs of a transnational consensus emerging on various aspects.

CLIMATE COOPERATION

Central banks globally have assumed quite an active position in recent times in articulating the adverse impact of climate change on their mandates, and setting the discourse on how they can perform both a pre-emptive and mitigative role in this regard.

At the international level, several standard-setting bodies and international organisations constituted by central bankers and financial supervisors have emerged to undertake research and brainstorm policy responses to tackle macroeconomic and financial risks emanating from climate change.

Examples of such bodies include the Network of Central Banks and Supervisors for Greening the Financial System consisting of over 90 members, with Singapore being one of the handful of founding member states; the industry-led Task Force on Climate-related Financial Disclosures (TCFD); and Task Force on Climate-related Financial Risks constituted by the Basel Committee on Banking Supervision; and the G-20 Sustainable Finance Working Group which was recently relaunched under the joint chairmanship of the United States and China.

Most of these bodies are working in the areas of developing a green taxonomy to clearly define green and brown activities; encouraging climate-related disclosures by private sector entities; trying to quantify the impact of climate change on various macroeconomic indicators; incorporating climate change into system-wide stress tests; and taking forward the research agenda on climatic risks.

At the recent Group of Seven elected heads of state meeting in London, the leaders backed the proposal of mandatory climate-related disclosures by firms, an endeavour spearheaded by central banks through the TCFD.

The IMF has also incorporated climate risks into its financial stability surveillance and assessment frameworks of countries.

The work done at the international level is also reflected in domestic policy actions by central banks.

For instance, a subset of economies – Hong Kong, China, France, Singapore and the United Kingdom – have initiated climate-related stress tests for the financial sector.

THE CLIMATE DEBATE

While the "greening of finance" is well under way in Singapore, under the guardianship of the Monetary Authority of Singapore, and to varying degrees in other countries, it would be a mistake to assume that there is an international consensus on the role of central banks with regard to the climate crisis.

On one side, the European Central Bank, spearheaded by its president, Ms Christine Lagarde, has emerged as an ardent advocate of an even more activist role for central banks in tackling climate change-related financial risks. This includes the "greening" of monetary policies via the preferential purchase of green assets in quantitative easing programmes and in making investment decisions pertaining to its own portfolio.

On the other side of the Atlantic, Federal Reserve chairman Jerome Powell reiterated in a recent speech that climate change will not be a top determinant in setting the US Fed's policies, as that would go beyond its current mandate. Concerns have been expressed also on the specific policy tools proposed by central banks to tackle climate-related financial risks.

The privileging of green assets vis-a-vis brown ones is argued to be incompatible with the principle of free market pricing.

Where there are market failures, it is up to the government to intervene – for instance, by imposing a carbon tax – rather than central banks.

Mr Paul Tucker, former deputy governor of the Bank of England, has mounted a controversial attack against the preferential allotment of credit to green sectors, drawing a corollary with arms manufacturers.

He has said that since wars are also detrimental to financial stability, does this mean central banks should restrict credit to companies manufacturing arms and ammunition?

From outside the central bankers' community, several researchers have commented on the overreach of central banks – "mission creep" – in attempting to play a prominent role in climate change.

Economist John Cochrane of the Hoover Institution has alluded to the erosion of central bank independence and confidence in their technocratic nature due to their intervention in politically charged policy issues, such as climate change and, increasingly, inequality and social justice as well.

Others have warned that central banks cannot be the only game in town in managing climate change and they certainly are not responsible for climate policy, which lies squarely with the government.

Notwithstanding the normative concerns surrounding the extent of central banks' activist approach in mitigating climate-related risks, there appears to be a growing consensus among stakeholders that the climate crisis is a super-wicked problem which requires collective action by various entities on different fronts.

Central banking and finance is just one of the fronts, albeit a critically important one.

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