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Singapore—High inflation, rising interest rates, falling currencies, and volatile oil prices, on top of an economic slowdown and post-pandemic budget woes, may increase pressure on the Asean+3—the 10 members of the Association of Southeast Asian Nations, together with China, Japan, and South Korea—to scale back efforts to mitigate climate risk. While this policy shift may make fiscal sense, it is a mistake that could have grave repercussions for the region and, ultimately, lead to slower economic growth and greater financial instability.

If not addressed, the risks climate change poses to Asean+3 countries could have far-reaching implications for the region’s agricultural production, water availability, energy security, transport and infrastructure, tourism industries, and coastal resources. Over the past two years, flooding, cyclones, droughts, rising sea levels, and landslides have become increasingly frequent, making Myanmar, the Philippines, Vietnam, and Thailand among the world’s 10 most climate-vulnerable countries. These countries suffered some of the highest fatalities and biggest economic losses from weather-related disasters between 1999 and 2018.

However, the transition to a low-carbon economy carries risks of its own. For starters, industries heavily reliant on fossil fuels are facing greater regulatory burdens. A large portion of the region’s oil, gas, and coal reserves may end up being left in the ground and discounted or entirely written off. Shifts in energy policy are also likely to increase banks’ credit risks. If Indonesia, the Philippines, and Vietnam meet their commitments under the 2015 Paris agreement, for example, coal-fired power plants valued at $60 billion will become stranded assets in 15 years, rather than 40.

The green transition would most likely also affect the profitability of coal mines elsewhere in the region, such as in Indonesia. And the European Union’s efforts to shift away from palm oil biofuel and encourage the use of deforestation-free products may turn land banks in Malaysia and Indonesia into stranded assets. Despite these transition risks, doing nothing would ultimately be costlier for Asean economies.

To be sure, Asean countries have taken some steps to mitigate climate risks. Brunei has implemented coastal protection structures. Indonesia has promoted mangroves and climate-tolerant crop varieties. Laos has developed sustainable crop-management techniques. And Malaysia has pursued climate-adapted technology and organic farming.

Notwithstanding such efforts, more must be done to meet the Asean+3 countries’ renewable energy goals. Several initiatives could support these: the Asean Plan of Action for Energy Cooperation, for example, aims to increase renewable energy to 23 percent of the region’s energy supply by 2025, compared to 14 percent in 2017. And the 2021 forum on the carbon neutrality goals of China, Japan, and South Korea has outlined concrete ideas for achieving net-zero emissions through trilateral cooperation on innovation and technology.

Carbon pricing is essential to the green transition. Asean+3 countries have held discussions on balancing pricing schemes against the need to stimulate economic growth. In July 2021, China launched the operation of its national emissions trading system (ETS), designed to be an “important market-based instrument," to help China achieve its climate goals. One year on, though still dealing with data-quality issues, China's ETS is the world's largest in terms of covered emissions, and prices are rising steadily. While there have been calls for a regionwide carbon tax, this idea seems unlikely in the short term, given differences in tax regimes. Nonetheless, a carbon tax will likely remain a key focus of discussions among the Asean+3 in the next few years.

Promoting sustainable finance will also be essential to a successful transition, as the financial sector could drive an economy-wide shift. In the past few years, many central banks and financial supervisors in Asia have implemented, or have begun to implement, such measures despite ongoing capacity and resource constraints.

In the short term, there is significant scope for Asean+3 central banks and financial regulators to incentivize the transition to a low-carbon economy, by directing firms and lenders to reduce carbon usage and focus on renewable energy and green technologies. Such measures would encourage a similar shift across the economy, leading companies to price climate risks into their products and services.

By promoting low-carbon policies and encouraging green finance, policymakers could spur new renewable energy sectors and stimulate economic growth. Moreover, reducing reliance on dollar-denominated fossil fuels would enable Asean+3 countries to shift government revenues from maintaining large foreign-exchange reserves toward domestic policies.

To minimize the damaging effects of climate change on their population and economies, Asean+3 policymakers must implement risk mitigation policies that help prevent regional spillovers, and encourage the emergence of new industries and technologies. Doing so would also boost energy security. Shutting down the sun and the wind is much harder than blowing up a gas pipeline. Project Syndicate

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