

# Should the ECB engage in a green monetary policy?

ECB Watchers Conference

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Hans Peter Grüner

University of Mannheim and CEPR, London

# The arguments in favor

Only buy bonds with proper reporting of climate change risks.

Evaluate those risks and take them into account - consistently with other risks.

The ECB must take all risks of assets on its balance sheet properly and consistently into account.

**A technical argument**

Identify green bonds and give preferential treatment to them – not based on the risk that they carry but on externalities of firms' activities.

Climate ch. triggers financial crises. The ECB must prevent that (caters for preconditions of functioning monetary policy)

Climate change can lead to inflation.  
=>  
The ECB must prevent climate change.

**Primary objective arguments**

Markets fail to properly price climate externalities in bond prices.

Help the EU to prevent climate change if this is not conflicting with price stability.

**Secondary mandate arguments**

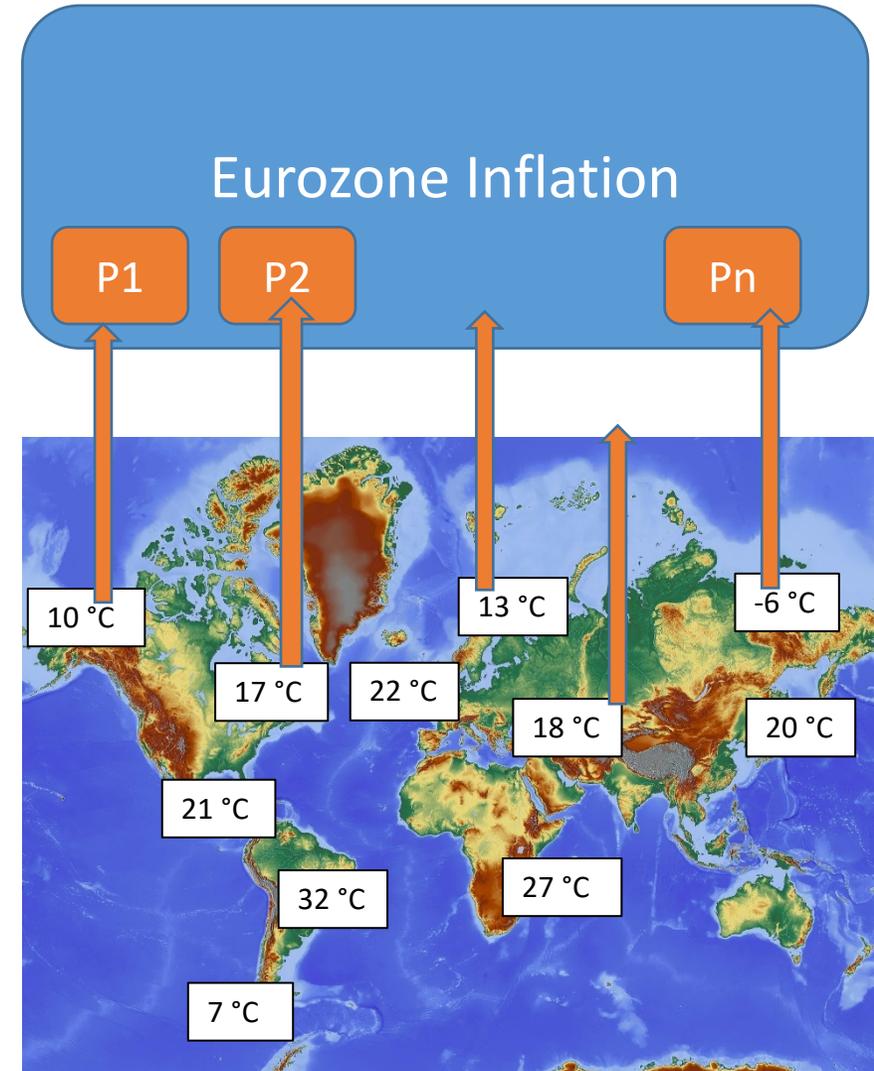
# Primary Objective: Climate change may lead to inflation/ inflation volatility

- Floods or droughts raise food prices
- Mitigation policies can affect consumer prices through higher production costs.
- “These issues clearly lie at the heart of our mandate.”  
Frank Elderson: <https://www.ecb.europa.eu/press/blog/date/2021/html/ecb.blog210213~7e26af8606.en.html>
- Losses from disasters could impair credit creation
- Disruption to the financial system
- Effectiveness of monetary policy could be hampered

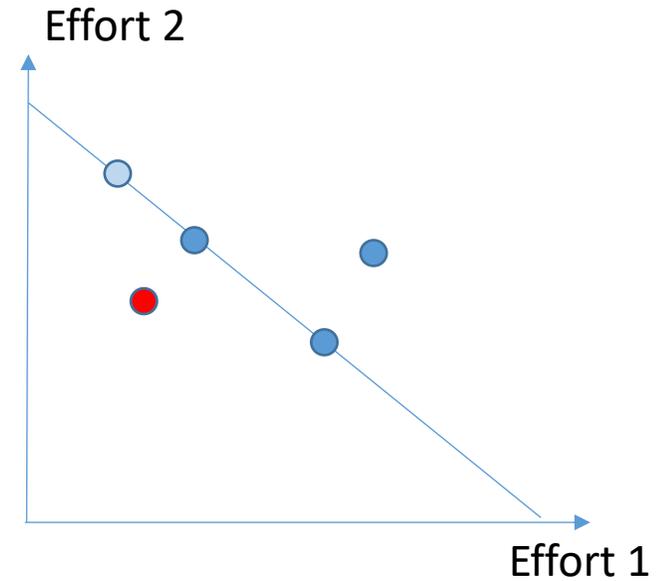
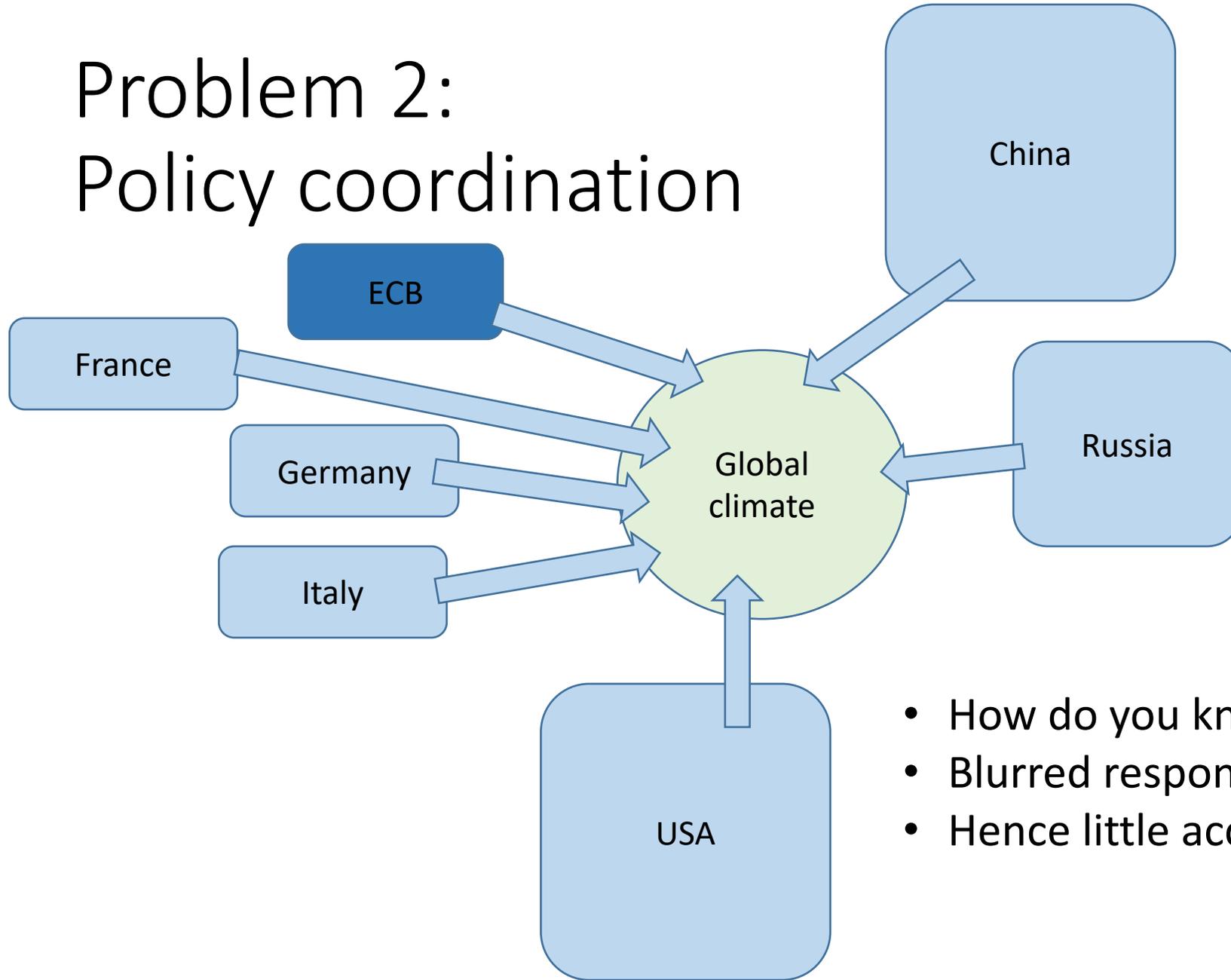


# Problem 1: Lack of information and control

- Energy, food prices, etc.: Relative prices are concerned here.
- Predictability is very (!) low.
- Noone (not even the ECB) knows what happens in general equilibrium to the price vector in Europe if several exogenous variables change (the temperatures at various places).
- This is a general problem.



# Problem 2: Policy coordination



- How do you know how much you should do?
- Blurred responsibility.
- Hence little accountability.

# Problem 3: Precedence

- War affects price stability.
- War affects financial stability.
- Should the ECB support the common foreign policy on government bond or commodities markets?
- No: This necessitates a lot of judgement.
- The ECB lacks the appropriate democratic legitimacy.
- There are more legitimate alternatives.



Source: Pixabay, <https://pixabay.com/de/photos/putin-der-pr%c3%a4sident-russland-5277284/>

# Secondary objective

Article 127 (ex Article 105 TEC)

1. The primary objective of the European System of Central Banks (hereinafter referred to as 'the ESCB') shall be to maintain price stability. **Without prejudice to the objective of price stability, the ESCB shall support the general economic policies in the Union with a view to contributing to the achievement of the objectives of the Union as laid down in Article 3 of the Treaty on European Union. ...**

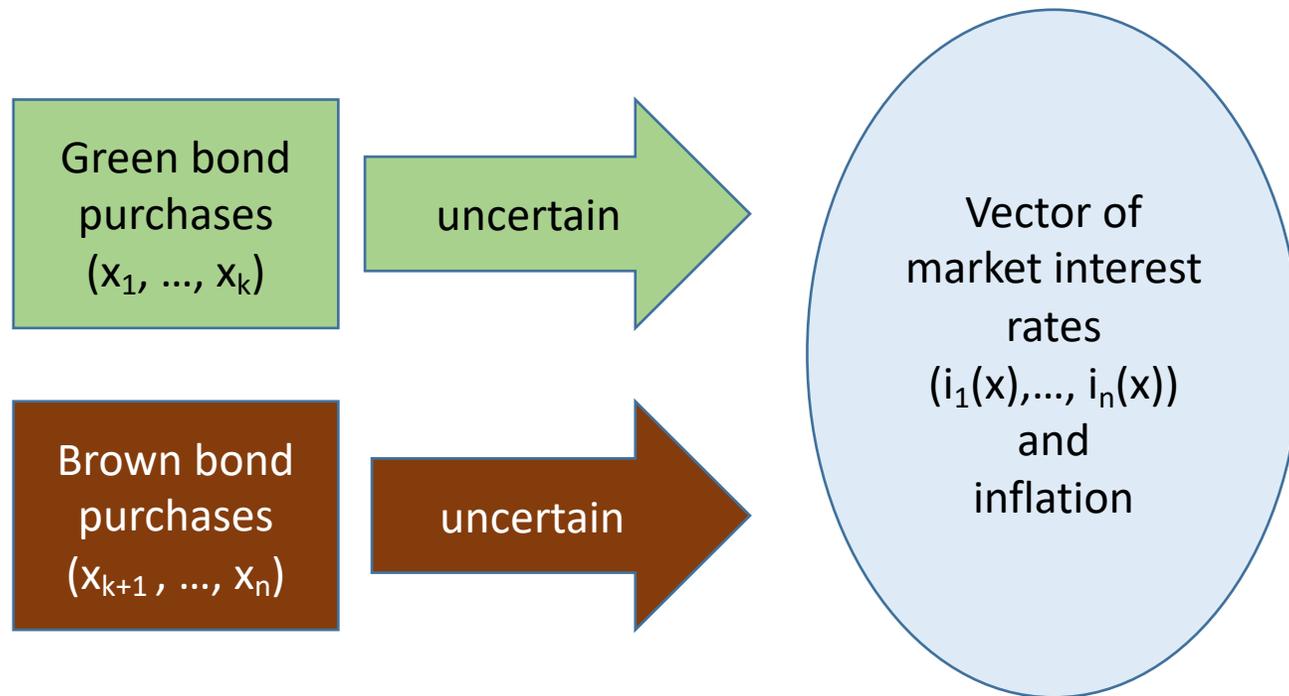
# A lot to do...

Article 3(ex Article 2 TEU)

- The Union shall ... work for ... **a high level of protection and improvement of the quality of the environment.**
- It shall promote **scientific and technological advance** .... **combat social exclusion and discrimination**, and shall promote social justice and protection, equality between women and men, **solidarity between generations** and **protection of the rights of the child**. It shall promote economic, social and territorial cohesion, and solidarity among Member States. It shall .... **ensure that Europe's cultural heritage is safeguarded and enhanced.**
- In its relations with the wider world, the Union shall uphold and promote its values and interests and contribute to the protection of its citizens. It shall contribute to peace, security, the sustainable development of the Earth, **solidarity and mutual respect among peoples, free and fair trade, eradication of poverty and the protection of human rights**....
- You will need another two towers for the new employees.

# Compatibility with the ECB's primary objective

A simple „model“ based on unknown and uncertain elasticities of supply and demand



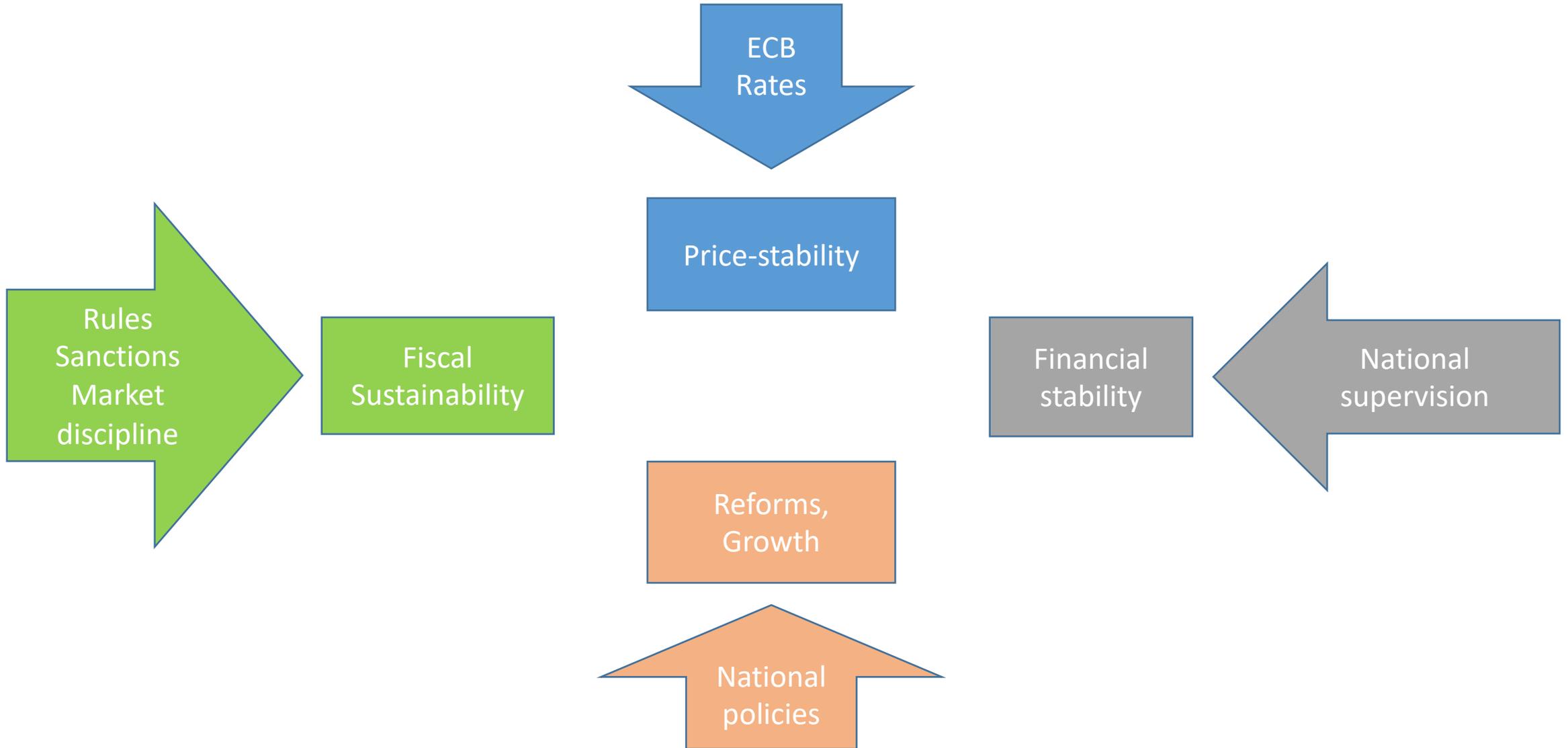
# Other potential conflicts of interest

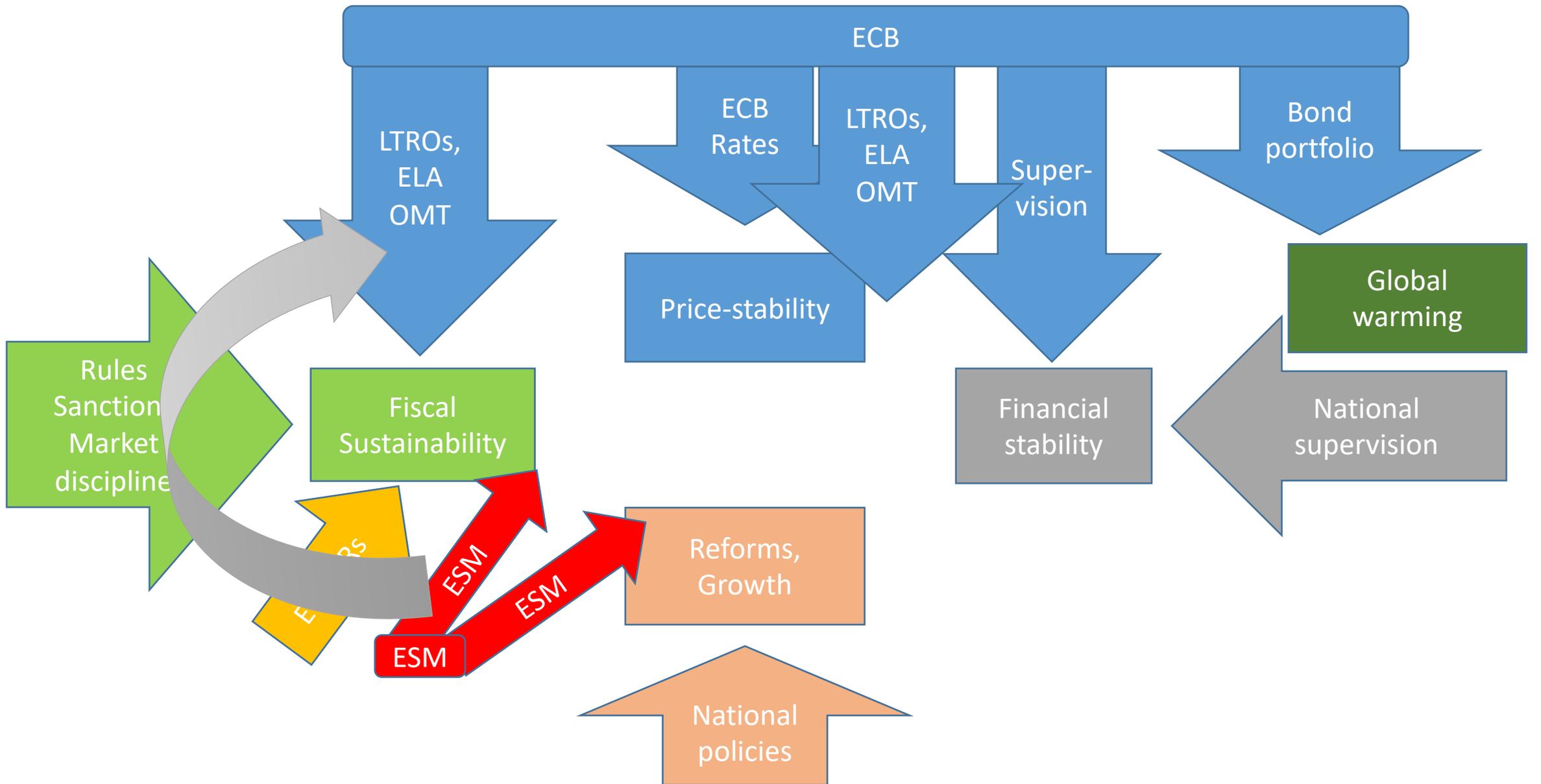
- There may not be a need for corporate bond purchases. Incentives to buy too much?
- Restructure QE or PEPP portfolio?
- Will this trigger inequality between green and brown economies?
- How about uniform transmission across countries?

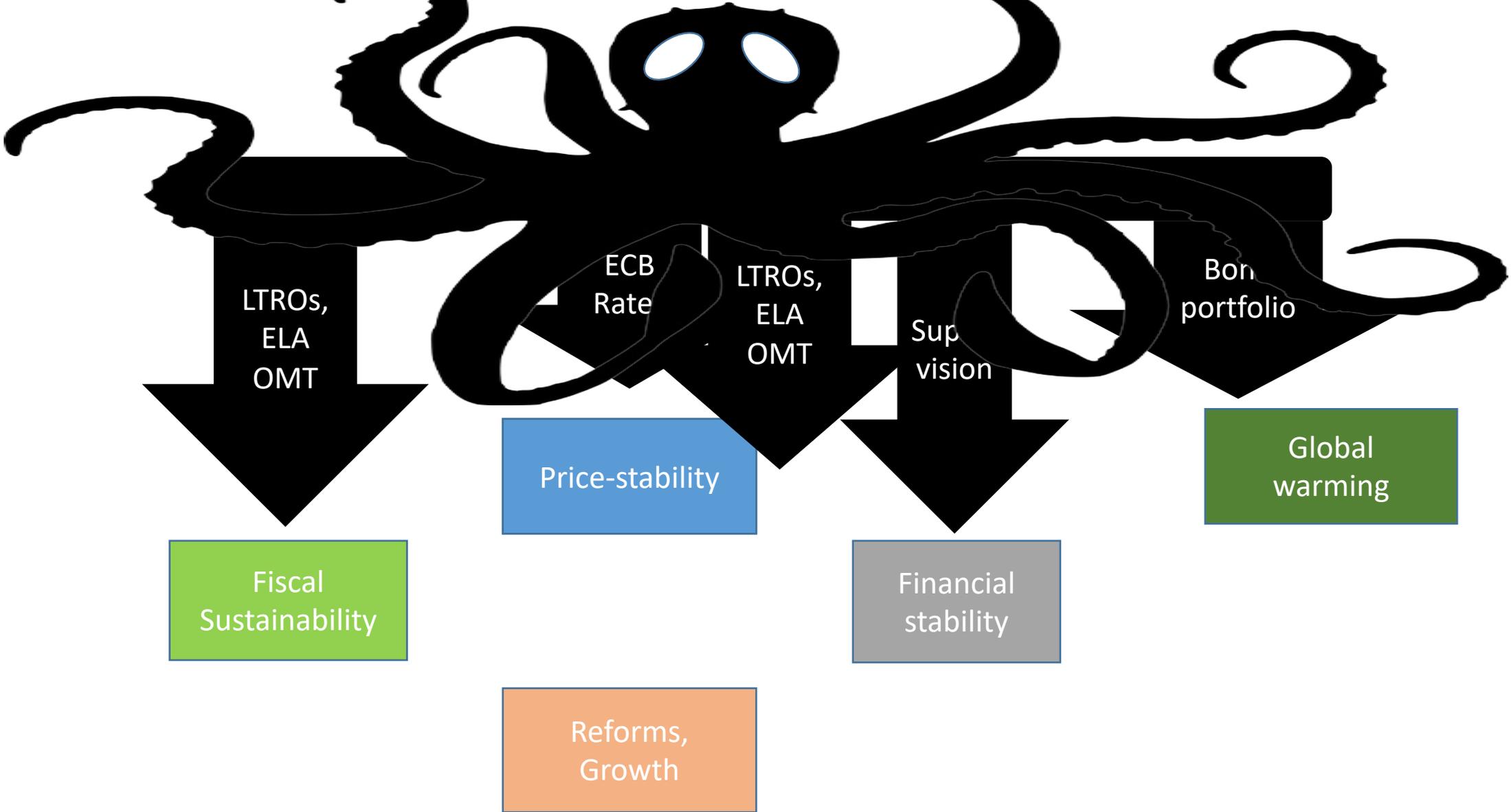
# Emission bias in ECB corporate bond portfolio?

- Current market neutrality interpretation “appears to hamper an efficient allocation of resources”.
- “does not reflect the significant externalities that climate change exerts on society.”  
[https://www.ecb.europa.eu/press/key/date/2021/html/ecb.sp210303\\_1~f3df48854e.en.html](https://www.ecb.europa.eu/press/key/date/2021/html/ecb.sp210303_1~f3df48854e.en.html)
- “exclusion of emission-intensive sectors”
- “more sophisticated “tilting” approaches...”
- **CO2 tax directly addresses the emissions.**
- **What if EMU member states have different CO2 taxes/ policies?**
- **Green effect varies with monetary policy stance (Monika’s paper?).**

# General concern: Maastricht







Source: <https://pixabay.com/de/vectors/silhouette-tintenfisch-vektor-grafik-3311636/>

# Europe's policy octopus

- **Coordination?**
- **Making clear messages becomes more difficult.**
- **Accountability gets lost.**
- **Who controls the ECB? (you are not elected)**
- **Independence at risk.**
- **Keep it simple!**
- **Make clear what you stand for and stick to that.**
- **Particularly important when inflation is high.**

