



Industrial Policy and the Green Transition

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Outline of today's course

- 1. European central bank (ECB) in times of crisis**
2. The role of the ECB in the green transition: green objectives (and policies?)
3. Renewed conflicts in inflationary context

ECB since the Great Financial Crisis

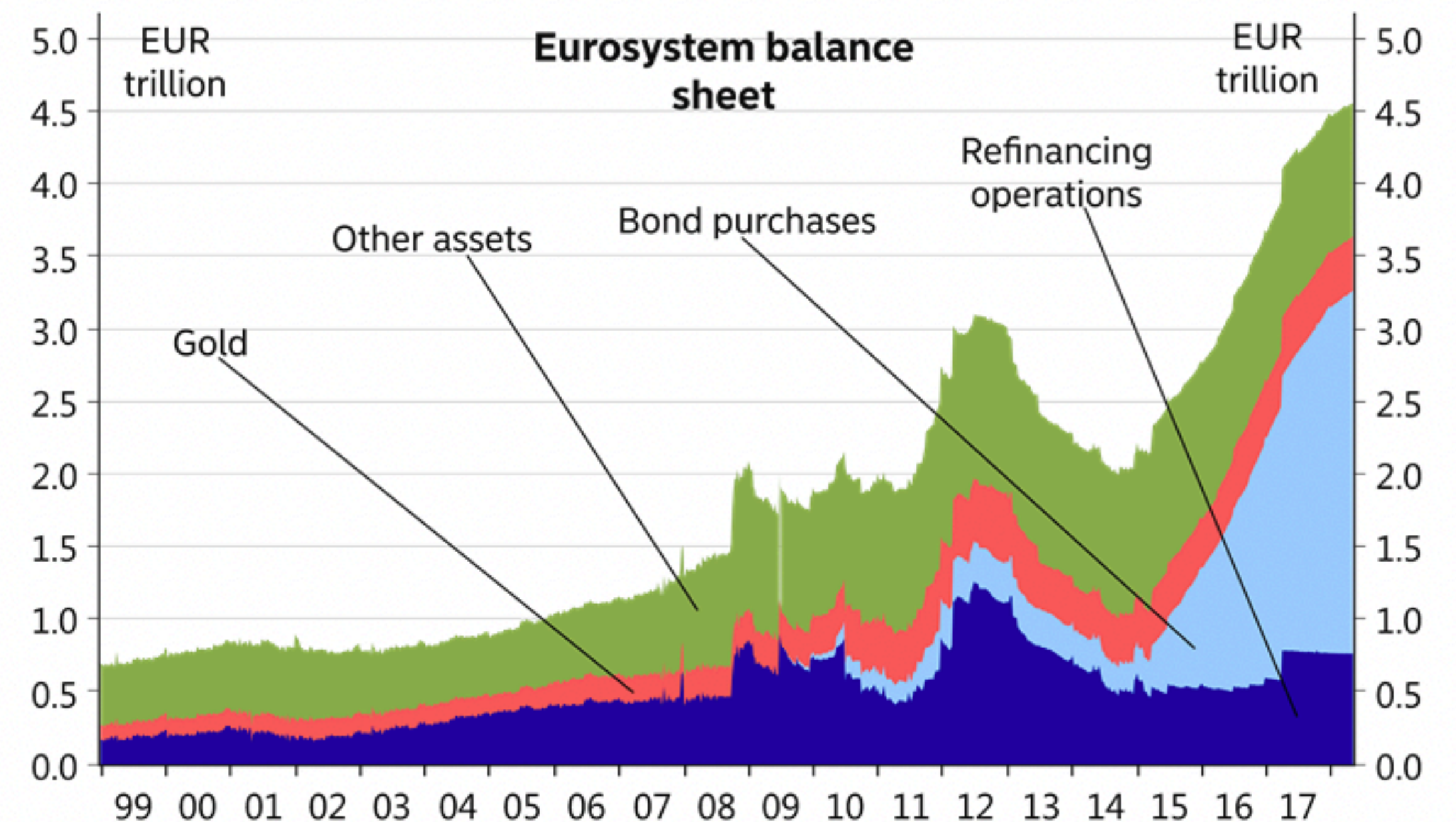
- Central banks in general, and ECB in particular, were conventionally perceived as technocratic and conservative institutions (Bowman et al. 2012)
- Euro-crisis (2011-2013): “Whatever it takes” (Mario Draghi) to save the euro
- COVID 19 crisis : Massive intervention to keep the economy afloat
- Monetary policies
 - Low (even negative) interest rates
 - Unconventional monetary policies

ECB since the Great Financial Crisis

- Politicization of the ECB
- Challenge of the notion of “market neutrality”, including from within the ECB itself
- Calls for greening the central bank
 - Pressure from civil society and politicians
 - Conflicts within the ECB
- Tools available to the ECB to influence capital allocation
 - Monetary policies (conventional and unconventional instruments)
 - Supervision of Euro area’s largest banks (European Supervisory Mechanism in the framework of the Banking Union)

ECB since the Great Financial Crisis

- The ECB took on a much bigger role than its conventional intervention in the economy.
- Due to a context of ‘institutional loneliness’ (Verdun 2017), where central banks seemed to be the “only game in town”.
- ECB took the role of fighting crises
- Lender of last resort
- Injecting counter-cyclical liquidities



ECB “green turn”

- ECB “four-year action Plan” (2021)

“The ECB’s Governing Council is strongly committed to further incorporating climate change considerations into its monetary policy framework”

- Rupture with the notion of “market neutrality” that central bankers used to justify their monetary policies
- Narrative justifying the green turn: Tackling the climate crisis is part of ECB’s primary mandate - maintaining price stability (Massoc 2024)

ECB “green turn”

- Banking supervision
 - supervisory stress test in 2022 on climate-related risks
 - “we will insist that continued non-green lending without incorporating in your assessments and decisions clients’ credible and science-based Paris-aligned transition plans is no longer compatible with sound risk management” (Franck Elderson, 2023)
 - Banks’ transition plans

“With these decisions,
we are turning our
commitment to fighting climate
change into real action”



“Climate change requires
action, and the window of
opportunity is closing fast. We at the
ECB must be committed to doing
our part”



Rupture with previous leadership

“It is up to political leaders, not central bankers, to fight climate change”



- ECB has one **primary mandate** : maintaining price stability, climate change is not part of it
- ECB is bounded by the principle of **market neutrality**, which requires for ECB policies not to influence capital allocation

Conflicts about green ECB within the political and social arenas

- Big push to green ECB
 - Civil society (Positive Money, WWF...)
 - Left/Right divide at the EP (the European Greens, S&Ds, also Renew Europe)



- Big push to green ECB: what are the arguments?
 - Climate change is an existential threat - and every institution should do their part
 - EU is bounded by Paris Agreement and ECB must align with EU policy goals (secondary mandate)
 - Climate change is actually affecting price stability, so it's part of ECB' primary mandate to address climate change
 - Reliance on fossil fuel is causing price instability (war in Ukraine), so it's part of ECB' primary mandate to address climate change (and more particularly promoting sustainable energies)


- Opposition to the greening of ECB : what are the arguments (based on readings)?
 - Politicisation of central banking and risk for primary mandate
 - Doesn't have a democratic mandate to do so
 - All kinds of things can affect the economy and price stability: why should the ECB stop at fighting the climate crisis?
 - Other tools are more effective tools (carbon tax, direct spending)
 - Technocrats must be neutral and accountable
 - It's the task of politicians to do green industrial policy (not central bankers)

- **ECB green engagements**

NGFS: At the Paris “One Planet Summit” in December 2017, eight central banks and supervisors established the Network of Central Banks and Supervisors for Greening the Financial System (NGFS). Since then, the membership of the Network has grown dramatically, across the five continents.

Glasgow meeting of the United Nations Climate Change Conference (COP 26) in 2021: the ECB issued a climate pledge.²⁹² Its statement starts as follows: “(...) the ECB pledges to contribute, within its field of responsibility, to decisive action by policymakers to implement the Paris Agreement and mitigate the consequences of climate change”, recalls the Paris Agreement’s aim of making financial flows compatible with the green transition and reiterates the financial sector’s ‘key role’ “by mobilising funds towards a more sustainable economy” and makes undertakings relating to specific actions.

- **Actual policies**

- EU taxonomy (Regulation (EU) 2020/852). 
 - A. requirements for labelling items as in conformity with ESG standards (avoiding ‘greenwashing’)
 - B. Gas and nuclear are exempted... (The Luxembourg Minister for Energy tweeted on 6 July 2022: “I deeply regret that today @Europarl_EN failed to object to the delegated act under the #EUTaxonomy, allowing #gas & #nuclear to be part of the EU sustainable finance policy”)
 - C. Agricultural sector is exempted

- **Actual policies**

- 1. Including climate change variables and risks into account in policy-setting**



Inducing climate related risks into the expectations of business and households an element of long-term prediction scenario planning. Include climate risks in risk assessment, models, forecasts and including it in the financial
Coeuré 2018: A clear presentation of how climate change would affect monetary policy. Identification of the shocks, their distribution and persistence that affect the devising of monetary policy, while discussing options to change course in respect of monetary policy portfolios. HOWEVER, his analysis shied away from a more robust interpretation of the mandate.

- 2. The ECB's own funds**



A quick win in greening a central bank's activities concerns the bank's own funds, i.e. its capital, and its own pension fund's investments. This underscores the importance of a proper taxonomy (Lagarde 2020)

- 3. Greening bank lending: green TLTROs** (Targetted Long Term Refinancing Operations)



When banks report on their on-lending activities they receive an extra advantageous interest rate on their borrowing, in current circumstances: will be paid by the ECB for on-lending. A greening of such operations would entail that the criterion for the ECB's subsidy is widened to include an element of sustainability: solely on-lending which supports activities that are considered 'green' or that contribute to the transition to a CO2-free economy will be subsidised (Van Klooster and van Tillburg 2020)

- **Actual policies**

- 5. Favouring or requiring green collateral** ✓

The ESCB Statute requires lending by the Eurosystem to be effected “based on adequate collateral” (Article 18.1, second indent, in fine)

Frank Elderson: the mandate and the requirement of adequate collateral necessitate that climate change risk (physical risk, transition risk) are taken into account.

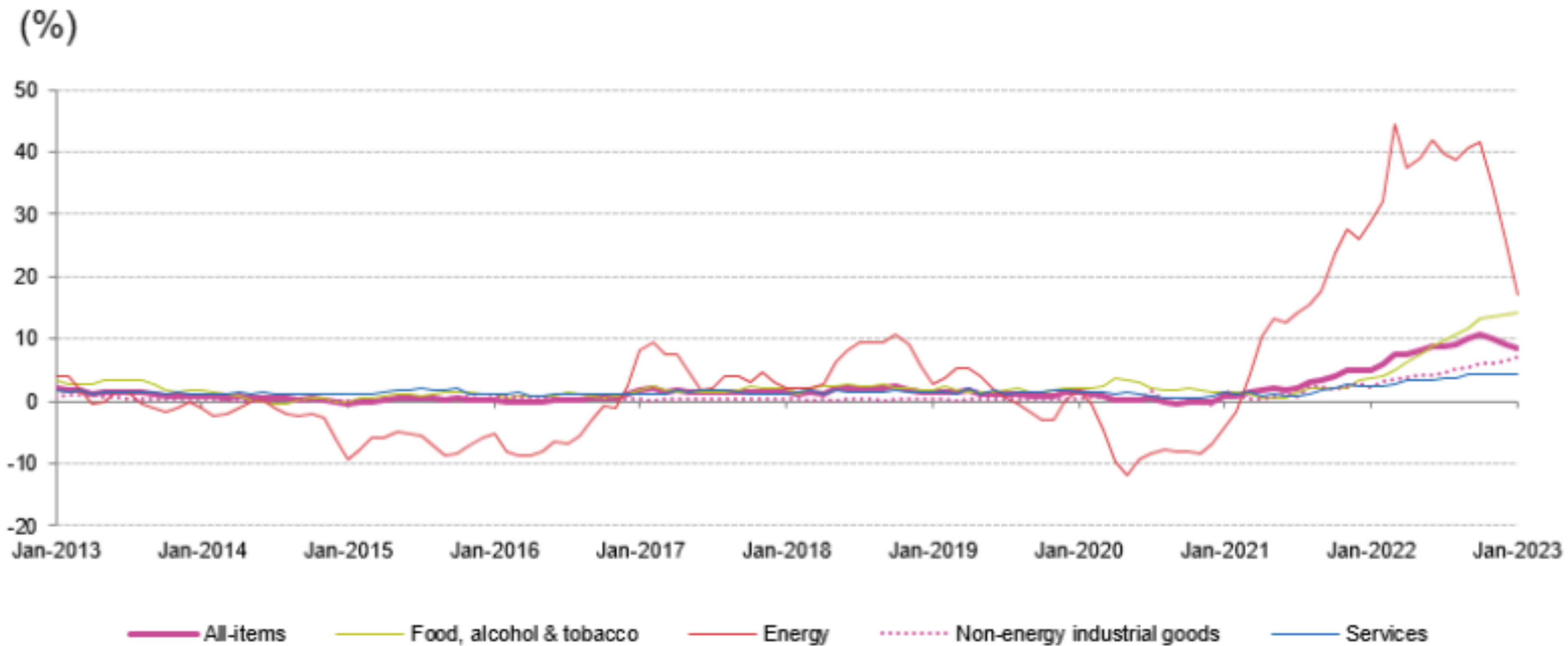
- 6. Greening asset purchasing programmes** ✓

Dirk Schoenmaker: “a tilting approach to steer or tilt the allocation of the Eurosystem’s assets and collateral towards low-carbon sectors, which would reduce the cost of capital for these sectors relative to high-carbon sectors”.

Conflicts intensifies with rising inflation

Inflation: what do you learn from this graphic?

Euro area annual inflation and its main components, January 2013 - January 2023 (estimated)



Source: Eurostat (online data code: prc_hicp_manr)

Conflicts intensifies with rising inflation



Jan Wüstenfeld @JanWues · 23m

Replying to [@ecb](#) and [@Isabel_Schnabel](#)

You fail to achieve your primary mandate, price stability, so why do you continue to expand your mandate? Namely, green monetary policy. Why do you think that here you know what you are doing, while history has shown that you don't really know what's happening in the real world?

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Bacchus Octoginta @boctoginta · 1h

Replying to [@ecb](#) and [@Isabel_Schnabel](#)

The only mandate ECB has is price stability. Why are you wasting your time and resources on climate related initiatives while your only mandate is in shatters? [#AskECB](#)

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Sebastian Golatta @SGolatta · Jan 24

Replying to [@FrankElderson](#) and [@ecb](#)

Is such a direction not outside the ECB's mandate? If so, this action is not legitimate. Has it been discussed? Who made this decision?

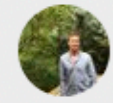
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Dirk Ehnts @DEhnts · 4h

The ECB would not hire workers who don't understand inflation, so this should not be a surprise.

Students should think hard about where they study because some programs take climate change and sustainability seriously and others don't ...



Max Jerneck @MaxJerneck · 14h



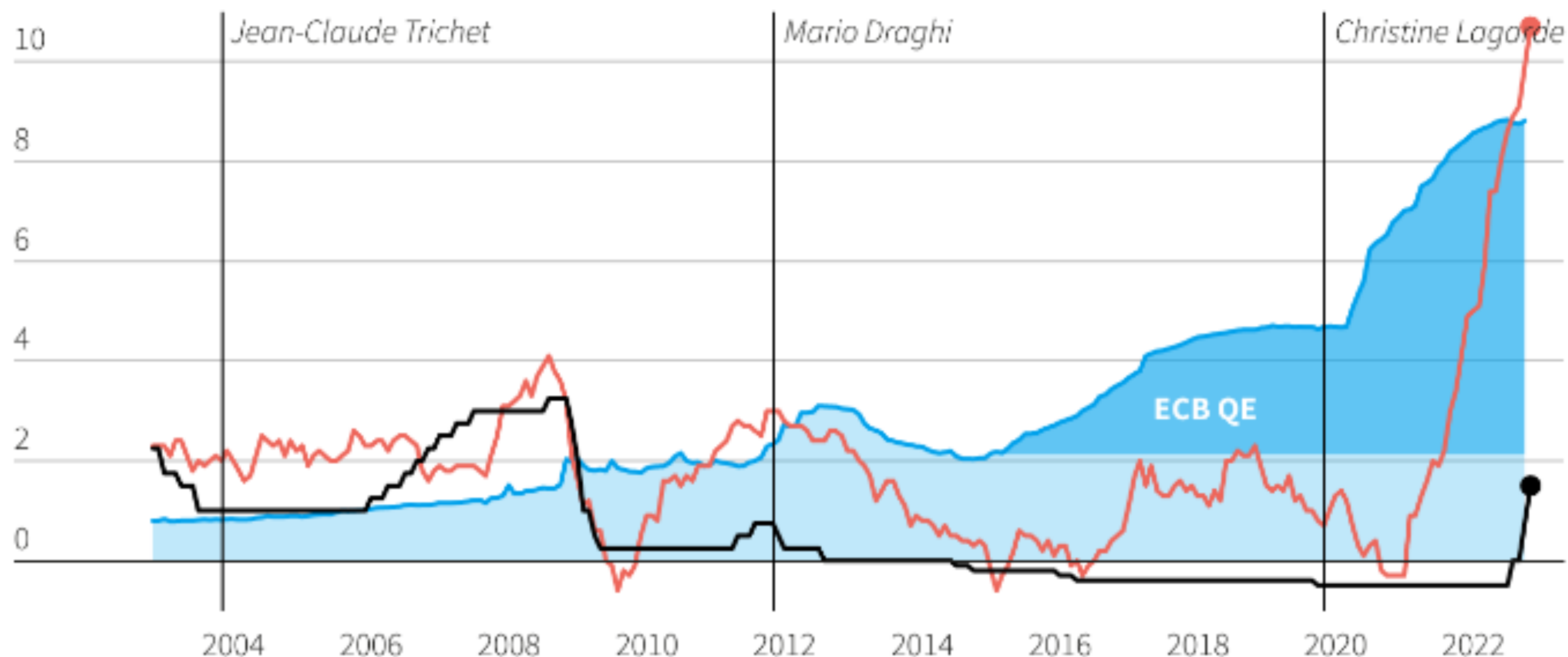
FRANKFURT — A top European Central Bank official stunned employees by saying people who don't buy into the institution's green objectives aren't welcome to work there.

Frank Elderson, one of six members of the ECB's executive board, told an internal meeting: "I don't want these people anymore."

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ECB hikes policy rate by another 75bps

● Policy rate (%) ● Euro zone inflation (%) — ECB balance sheet (€ trln)

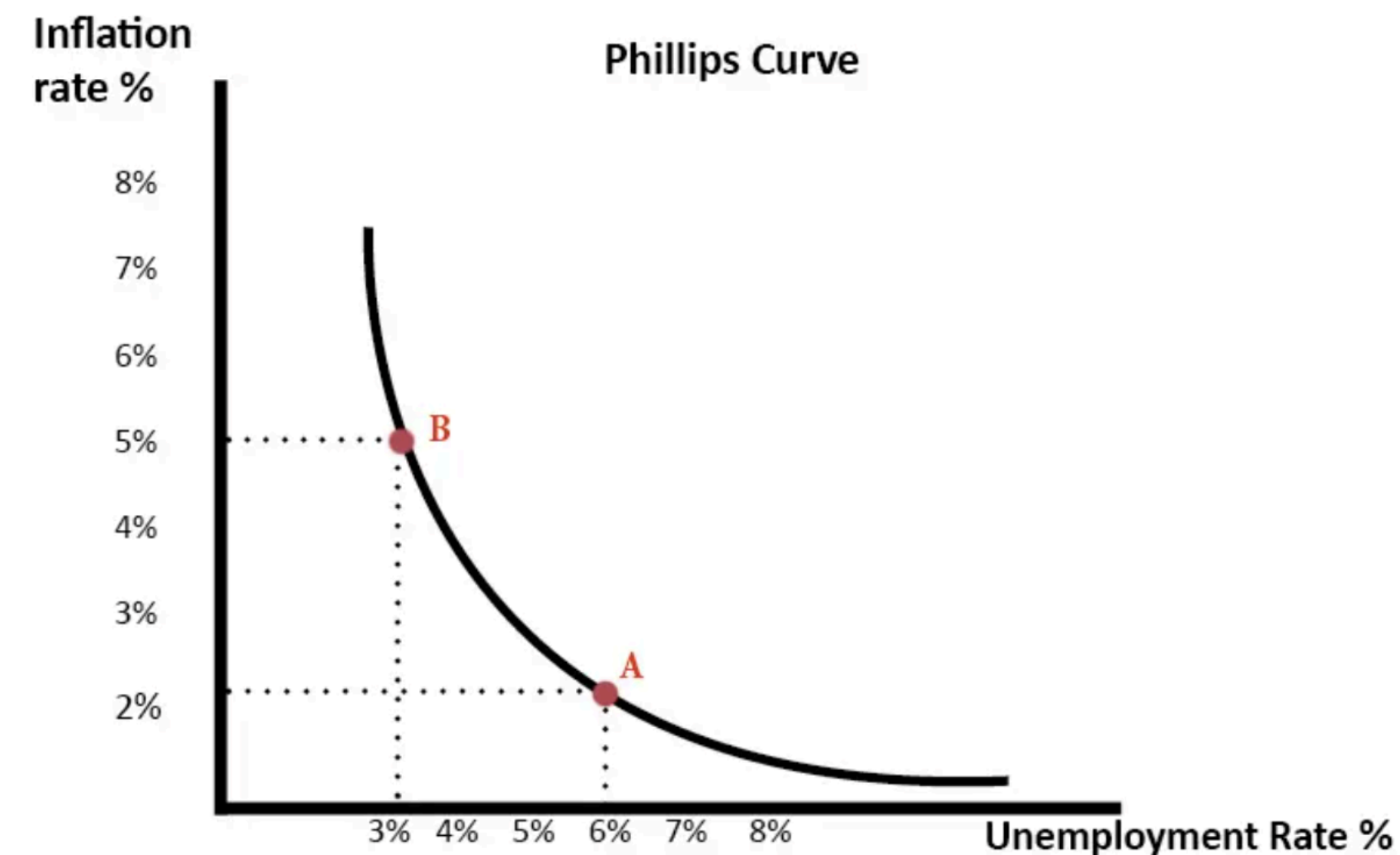


Source: Refinitiv Datastream | Reuters, Nov. 2, 2022 | Vincent Flasseur

- Traditional anti-inflation strategy (Blanchard 1986)

Too much demand drives prices high => need to “Cool down the economy”

Increase interbank IR => reduce capacity to borrow of HH and firms => reduce demand



BUT

- Is the economy overheating?
 - Where does inflation come from?
 - (imported) energy prices (see chart)
 - “while a rate rise can bring down excessive spending it does not increase the supply of natural gas from Russia or create alternative sources of energy” (van’t Klooster 2022)

- Based on your reading of van't Klooster 2022 and response by Isabel Schnabel:
 - What are the potential downfalls regarding rate hikes?
 - Is van't Klooster skeptical about interest rates' increase in general?
 - If you were a central banker, would you be a “**green swan**” (advocate for differential interest rates); a **dove** (acting counter-cyclical in general and being skeptical about conservative monetary policies) a **hawk** (giving priority to the price stability mandate and advocate for more restrictive monetary policies)?

Wrap-up

- The greening of ECB monetary and supervision policies
- A clear engagements and policiy proposals
- Limited actual policies and renewed tensions in the context of the return of inflation

What's next?

- GIP and geo-politics