

## **GREEN MONETARY POLICY OF EUROPEAN UNION AND CANADA: AN INVESTIGATION**

**Malar Maran RATHNASWAMY**

*Punjab Technical University, Jalandhar, India*

[cyclopsmaran@gmail.com](mailto:cyclopsmaran@gmail.com)

**Malar Mozhi RATHNASWAMY**

*Punjab Technical University, Jalandhar, India*

[r.malarmozhi89@gmail.com](mailto:r.malarmozhi89@gmail.com)

**Malar Kumaran RATHNASWAMY**

*Punjab Technical University, Jalandhar, India*

[malarkumaran9@gmail.com](mailto:malarkumaran9@gmail.com)

**Alexandru-Mircea NEDELEA**

*Stefan cel Mare University of Suceava, Romania*

[alexandru.nedelea@usm.ro](mailto:alexandru.nedelea@usm.ro)

**Abstract:** *The greening monetary policy incorporates essential enduring policy decisions towards low carbon economy without deviating from the main functions of monetary policy. The challenges are safeguarding low carbon assets while the investors prefer carbon-intensive investments. European Central Bank of European Union and Bank of Canada in Canada are central banks and their priorities on greening monetary policy having different strategies and priorities. This paper investigates them.*

**Keywords:** *Financial stability, price stability, low carbon economy, green finance*

**JEL Classifications:** *E50, E52, F63, F64*

### **I. INTRODUCTION**

Central banks are specifically engaged with normal functions of sustaining with price stability and financial stability in the economy for economic growth using monetary policy. The central banks are the supervisors of banks and monetary policy in general under single supervision mechanism but there are multiple institutions including the central banks supervise financial system and monetary policy. Central banks maintain neutrality and they are free from bias. Giving preference to green monetary policy has become complex as it is not the normal functions of monetary policy. There is a need for institutional support including legal fortification. The challenges of climate change are global and the Paris Agreement aims to reduce carbon emission towards low carbon economy. The green finance is considered essential for low carbon economy. The green bond, carbon pricing and Clean Development Mechanism are some of the policies to achieve low carbon economy. Therefore, the green monetary policy may be important in the investigation limiting to European Union and Canada.

### **II. GREEN MONETARY POLICY**

The Bretton Woods system played its important in the aftermath of Second World War until 1970s even though it has slowly faded away since 1960s. The World Wars created more problems than the results. One of the main reasons is to establish Bretton Woods System to restore economic stability consisting financial stability and price stability. To achieve there are two instruments of control of inflation and regulation of foreign exchange rate. The price stability became the serious issue and it was considered the monetary would be able to control inflation. The Bretton Woods system is unknown to the green finance. The monetary policy prefers high carbon assets and discourages clean alternatives. The central banks buy and accept collateral assets in preference to low-carbon assets. The ‘Green Quantitative Easing’ refers to provide finance to low-carbon economy. The central banks carry out a

detailed reports and analysis of market structure to make investments on low carbon economy. The European Investment Bank will take initiatives in this regard. The central banks may adopt the best practices of integration of environmental, social and governance (ESG) into investment strategy. Institutional investors have committed to buy \$ 60 trillion, Green finance is a new system of finance and business in two aspects: one is to achieve sustainability and another is greening economy with reduction if environmental degradation. Green finance promotes ecological environmental benefits and contributes to environmental protection industry. Green finance has the benefit of market oriented mechanism in which the market conditions apply and there are financial products which include Environmental Funds and Biodiversity Funds and other such priority funds. The central banks have to accept the financial risks of climate change and they need to provide \$18tn. In the balance sheet (Financial Times (2017). Large resources of economic investments are required to make in 'green sectors' to build low-carbon society (Ceres (2014); IEA (2012); McCollum et al (2014); WEF (2013).

The financial crisis and recession have forced the participants of international monetary system to rely less on the US lead international monetary system as it has failed to meet the challenges of them during the financial crisis and recession. China has gained a strong clout in the international monetary system and it has resulted in less dependence on US Federal Reserves. The BRIC Nations (Brazil, Russia, India and China) have found new role in the in the international monetary system. The great modernization of monetary policy has grown outside the agreements and treaties and best practices and norms developed through the US Federal Reserves, European central banks and the IMF. The breakdown of Britton Woods's system had several reasons and one of them is the inability tackling the policies of growth with the monetary policy. In the new framework of international monetary system the US will not continue to be the sole leader but to content with the largest stakeholder of the international monetary system (Subacchi (2010). The ECB realized very late the impact of financial crisis believing that the crisis was purely of US crisis. It lowered the interest rate as the monetary policy could not find the solutions quickly due to the resistance of Bundesbank.

### **III. GREEN MONETARY POLICY IN CANADA**

Sustainable finance is growing as transition to low carbon economy in Canada. Canada is keen to promote the developing countries which are vulnerable and the poorest, in the transition to renewable energy, reorient business and finance for achieving sustainable development and becoming closer to nature. The recent global COVID-19 pandemic has displayed the necessity of global efforts for global solutions. Canada has supported with % 2.65 billion in 2015 on the commitment of climate finance over the period of five years and in the recent 2021 G7 leaders Summit it has its commitment to \$ 5.3 billion in the next five years (Canada, 2021). In 2011, the Government of Canada and International Finance Corporation have established the IFC-Canada Climate Change Program for promoting private sector finance for clean energy and Canada has contributed CA \$ 351.8 million (IFC, 2019). . The world and governments have recognised that the sustainable financial investments are essential for sustainable economic future. Canada has launched the Sustainable Finance Action council to achieve low-carbon economy in May 2021(Department of Finance, 2021). This is in furtherance of meeting its commitment in 2030 of Paris target and achieving net-zero emissions by 2050. Canada aspires to achieve low carbon economy since 2016 (McCarthy Tetrault, 2021).

The Bank of Canada, central bank of Canada is yet to become the greenest towards the Paris target implementation. The Bank of England is one of the leading green banks in this regard. In the Financial System Review meeting the Governor of the Bank of Canada has recognised the importance of becoming green bank. The pricing is not done in case of assets which are exposed to climate related risks and it is considered as 'vulnerability'. If this is contained adequately and timely then it may lead financial crisis. (Kevin Carmichael, 2021). Polices on reduction of GHG emissions by 30 % below 2005 in 2030 are vigorously pursued in Canada (OECD, 2016). The Governor of Bank of Canada asserts that the Bank of Canada will not go for climate activism as it is practiced in European Central Bank and the Bank of England (David Parkinson, 2021).

### **IV. GREEN MONETARY POLICY IN EUROPEAN UNION**

The core function of the European Central Bank (ECB) is to achieve price stability and the next important function is to promote economic growth. The Federal Reserve of USA has two objectives which include maintaining price stability and maximizing employment. Article 127 (1) , the Treaty on the Functioning of the European Union, specifies the central banks in the Eurosystem of the European Union shall maintain price stability and support economic growth in pursuant to Article 3 of the Treaty of the European Union. Article 3 (3) of the Treaty of

European Union stipulates the internal market of the European Union shall promote sustainable development. This principle gives direction to the greening monetary policy (Dirk Schoenmaker, 2019).

## V. CONCLUSION

In European Union, European Central Bank is the single supervisor of monetary policy in Euro zone while it regulates the monetary policy with the national competent authorities in other Member States of European Union. The Bank of Canada is one of the authorities to regulate monetary as there is multiple supervision mechanism of banks and financial institutions. The Office of the Superintendent of Financial Institutions (OSFI) supervises the federally regulated financial institutions. The Bank of Canada aims for stable and efficient financial system in Canada. Other agencies like the Canada Deposit Insurance Corporation (CDIC) and the Financial Consumer Agency of Canada (FCAC) are regulating and protecting the federal system of insurance and consumers of financial products and services respectively. The Bank of Canada, OSFI, CDIC, FCAC and the Department of Finance consist of the Financial Institutions Supervisory Committee and this form the Senior Advisory Committee. These committees discuss and share information pertaining to the supervision of federally regulated financial institutions. Hence, there is no single institution to promote green monetary policy in Canada unlike European Central Bank in European Union. However, the Bank of Canada is the central bank of Canada and it has to implement the monetary policy. The Minister of Finance has overall responsibility for all matters of the financial sector of Canada (Bank of Canada, 2012).

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