REPORT

European Economic and Social Committee

EUROPEAN INDUSTRY AND MONETARY POLICY
The role of the EIB

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BASIC CONCLUSIONS

- Throughout the project we have examined and cross-checked the theoretical, legal and operational feasibility of:

    - a new monetary policy more closely geared towards the real economy, through more efficient transfer mechanisms that ensure that monetary resources given to the banking system are earmarked for their true purpose: lending to the real and productive economy.

    - a permanent link between the European Investment Bank (EIB) and the European Central Bank (ECB) for this purpose, in accordance with the criteria laid down in the Treaty on the Functioning of the European Union and in line with the specific functions and mandate of each of these institutions, whose compatibility has been clearly demonstrated in the project.

- It has become clear not only that there is no justification for a monetary policy that is uncoupled from the real economy, but also that developing the real economy should be an essential objective of monetary policy and that priority should be given to the particular link with the productive economy and growth.

- It has also been clarified that there may be different ways of enhancing the link between monetary policy and the productive economy:

    - Introduction of specific clauses or conditions to operations between the ECB and the banking system, concerning interest rates or allocation of funding, which ensure that the resources provided are allocated to the real and productive economy and not used for other purposes.

    - Institutional cooperation between the EIB - or the regional or national promotional banks or agencies - and the ECB/Eurosystem to make use of the experience and expertise of the EIB in order to ensure that resources generated by monetary expansion are appropriately directed towards the real and productive economy (including any financing of specific programmes relating to European Union investment policies). Of course, within the framework established for this type of action by the Treaty on the Functioning of the European Union.

Background to the project

The *Investment Plan for Europe*, better known as the Juncker Plan, highlighted how important having resources dedicated to the productive economy is for European policies to tackle the crisis and, ultimately, for the medium- and long-term future of the European economy. The simultaneous launch of the Juncker Plan and the long-term monetary expansion programmes prompted the European Economic and Social Committee to set up a project on *European Industry and Monetary Policy. The role of the European Investment Bank*, with the aim of sounding out potential points of convergence between the monetary expansion exercise and the provision of resources for investment in the euro area.

The project started by measuring both the scale of the figures involved in the long-term monetary expansion programmes (EUR 4 trillion so far, 37% of euro area GDP) and the difficult nature of the challenge that the project poses.

To get an idea of the scale of the figures handled, we can compare them with the euro area GDP:

	AMOUNT (EUR million)	**% EURO AREA GDP 2016** (Current prices)
JUNCKER PLAN	**21 000**	**0.2 %**
MONETARY EXPANSION PROGRAMMES	**3 990 643**	**37.2 %**
EURO AREA GDP 2016 (Current prices)	**10 733 164**	**100%**

Source: European Commission / ECB / Eurostat / Bundesbank / EKAI Center

The difficult nature of the challenge is due, firstly, to the surprising lack of analysis of this issue by monetary policy experts. Secondly, to the unknown factors which, at first sight, seem to arise in the sphere of European policies, the legal framework and, lastly, to the issues that will arise when implementing the potential options.

Progress of the project

The key stages in the progress of the project were as follows:

- Preliminary draft (February 2015)
- EESC Bureau decision (March 2015)
- Presentation of "Some basic concepts" and "Fundamental questions" (March 2015)
- Initial contact with the EIB and ECB (March 2015)
- Consultations with experts in a number of EU Member States (April-July 2015). 85 experts consulted. 50 replies. Subsequent drafts have been verified against each of them.
- PowerPoint presentations (continually updated throughout the project) (May 2015):
  - PRESENTATION OF THE PROJECT
  - European policies
  - TECHNICAL AND LEGAL ISSUES
  - MAIN PROVISIONAL CONCLUSIONS

- Presentation at industriAll (Brussels) (September 2015)
- Presentation at the Slovak Ministry of Finance (Bratislava) (November 2015)
- Round table, Brussels. (November 2015)
- All-day presentation, Bilbao. (November 2015)
- Checks and contacts – on both technical and institutional issues – with: EIB, ECB, EU Presidency, European Parliament, European Commission (January-November 2016) with specification of contact persons in key institutions.
- Analysis of possible changes to be proposed in the open market operations of the ECB (November 2016)
- Analysis of legal limits established by the Treaty on the Functioning of the European Union (March 2017)
- All-day presentation, Vilnius (April 2017)

Gearing monetary policy to the real economy

The first conceptual challenge was to determine how far monetary and investment policies could, or could not, act together. Although they use different instruments, the scope for interaction seems clear, insofar as both involve public resources earmarked for the European economy.

The main challenge to moving forward lay in the legal analysis from the point of view of the Treaty on the Functioning of the European Union, which states in Article 127 that the "primary objective" of the Eurosystem is to "maintain price stability". This appeared to be the greatest institutional obstacle to any approach of channelling the resources generated by monetary expansion towards the specific objectives of investment policy.

The project clarified that monetary policy transmission and the price stability objective are basically implemented via bank loans, and bank lending as a tool is therefore an integral part of monetary policy. Monetary policy is meaningless unless it is brought to bear on the real economy by expanding or contracting the monetary base, or by managing interest rates. It was found that the basic aim of monetary policy is to ensure that the banking sector increases or reduces lending to the real economy to the extent necessary to have a real impact on money supply and, consequently, on price stability. The link between monetary policy and lending to the real economy is therefore clear.

The need for a new monetary policy focus

The project highlighted the importance of monetary policy's indirect nature, as injecting/withdrawing resources into or from the real economy does not happen directly, but through the banking system, be it via interest rates, loans to financial institutions or supplying liquidity through the acquisition of assets. However, the resources channelled to the banking system are almost never made conditional on a specific purpose. Rather, they are handed over to the banks, who are entirely free to use or not use them in pursuit of monetary policy objectives, to replenish their own funds, to acquire financial assets or to make investments outside the euro area.

There is no specific data on the extent to which the banks apply the resources received for monetary policy purposes or to other ends. Information provided by the European Central Bank, however, reveals that a substantial part of these resources are not used to that end. By way of reference, according to the October 2016 *Bank Lending Survey*, banks reported that the funds generated under the Asset Purchase Programme (APP) had "contributed considerably" or had "contributed somewhat" to fostering lending in only 11% of banks in the case of resources received by selling marketable assets and in only 29% of the banks in the case of resources received through increased customer deposits generated by the APP.

It is clear that central bank transactions with financial bodies as part of monetary policy are, in practice, a form of public aid. What is shocking from a conceptual point of view is that this aid is not tied by any conditions requiring it to be used for the general interest, which is the intention.

The TLTRO ("targeted" longer-term refinancing operations) programmes are particularly relevant here, as they demonstrate the legitimacy of imposing conditions on the supply of liquidity to banks in order to ensure that it is used for bank credit. The question that then arises is why the other monetary expansion programmes are not implemented as "targeted" programmes, or why they do not include comparable reporting obligations.

It is crucial that the euro area review the overall focus of its monetary policy and take the measures needed to ensure that it connects with the real economy and, as far as possible, avoids liquidity being diverted to the speculative economy, investment outside the euro area or simple refinancing of banks.

Lastly, the project has confirmed that monetary policy is indissolubly linked not only to investment policy, but also to growth policy. The underlying reason is that, logically, price stability does not depend on money supply alone but also on demand for money. Since economic growth is, in the medium and long term, the factor that most influences demand for money, taking account of the impact of monetary expansion on growth is not a matter of choice, but rather a necessity for monetary policy.

This means that since, as set out above, monetary policy should in any case be tightly focused on credit for the real economy as a whole, then it is also clear that within the real economy, the priority focus of monetary expansion should be on the productive economy, which is capable of boosting economic growth.

In practice this should entail, firstly, having adequate information on how far the resources received by the banking system are channelled to the productive economy. The second priority should probably be to direct monetary expansion towards productive activities, either through direct allocation of resources or through differentiated interest rates. Nothing would seem more logical than for open market operations to include different base rates for, respectively, those used for productive activities, non-productive bank credit and – where considered acceptable – other purposes.

The role of the European Investment Bank (EIB)

In theory, there can be several different ways of ensuring that monetary policy is linked to the real economy – and preferably, to the productive economy. The TLTRO programmes or "targeted" monetary expansion programmes clearly demonstrate that it is theoretically feasible to establish such a link through the clauses governing monetary expansion programmes approved by the European Central Bank.

In practice, however, cooperation with the European Investment Bank (or other national or regional promotional banks or agencies) as an EU investment policy instrument is a practical and realistic way of effectively achieving these objectives. It would in particular enable the efficiency of monetary policy to be enhanced significantly, making it possible to achieve better results and greater impact on the real economy while mobilising fewer resources.

The close connection between price stability and the expansion of credit and economic growth demonstrates the compatibility and complementarity of the mandates and basic aims of the Eurosystem on the one hand, and the European Investment Bank and the regional and national promotion banks and agencies on the other.

Working closely with the European Investment Bank, the project has shown that there are a number of possible options for this structural collaboration between the European Central Bank and the European Investment Bank:

- Directing resources generated by open market operations to an EIB-managed fund, ownership of which could be held by the ECB or the EIB.
- Delegating certain powers of decision or proposal to the EIB regarding the resources generated by ECB monetary expansion.
- Harnessing the EIB's know-how through systematic consultation (possibly in the form of regular reports or individual reports for new programmes) with regard to ECB operations, on the imposition of conditions designed to ensure that operations are directed to the real economy, etc.
- Directly funding the EIB (or regional or national promotional banks or agencies) using loans or bonds acquired by the ECB, within the framework set up by the Treaty on the Functioning of the European Union.

It was confirmed at every stage of the project that structural cooperation between the ECB and EIB can be effected by means of various instruments, which are capable of resolving the challenges posed by aspects such as the risk borne by the Eurosystem, the sharing of operational risk between the Member States and the euro area, interest rates, deadlines and liquidity. This must be done while ensuring that EIB intervention does not distort the policies put in place in these areas by the ECB.

Structural cooperation between the ECB and EIB could be established through a Cooperation Agreement between them, which might provide an appropriate framework for sharing points of view, strategic and operational challenges and creating an atmosphere of mutual cooperation. This agreement would be based on respect for the independence and freedom of decision of both parties and would, in that respect, comply with the European Central Bank's principle of independence. In any case, it would be drawn up in full compliance with the criteria on Eurosystem activities laid down in the Treaty on the Functioning of the European Union.

New clauses in open market operations

The project has analysed the different theoretical options for ensuring that the European Central Bank's open market operations are directed to bank credit – and preferably to the productive economy – by introducing clauses such as the following:

- As a basic starting point, establishing in the contracts themselves that banks are obliged to allocate the resources received exclusively to bank credit.
- The commitment that the bank credit generated by the resources provided by the ECB will be transferred to the final recipient at preferential rates, minimising the financial advantage for intermediary banks.
- The possible establishment of preferential rates for productive credit in relation to other types of credit to the real economy. The preferential nature of these rates would be reflected both in open market operations and in loans to the final recipient.
- The channelling of the resources provided by the ECB through specialised entities – or specialised funds – with a limited scope of activities and focused as much as possible towards credit to the real and productive economy.
- The establishment of more strict requirements in relation to the evolution of the loan portfolio of the institution receiving the ECB funds (a concept already used in the TLTRO I and TLTRO II programmes, but which could perhaps be stricter).
- The possible formalisation of operations between the ECB and the banking system as credit accounts for financial institutions, which would be used exclusively as those institutions formalise credit transactions with the final recipient.
- Commitments to providing information from time to time on operations carried out using the funds provided by the ECB.

Follow-up by other European Union bodies

Regardless of the decisions that the ECB and EIB may take in connection to the possible measures indicated, other European Union bodies may carry out systematic monitoring and reporting activities that could be very significant for the purposes of fostering the link between the expansion of the monetary base and real and productive economy.

These systematic activities may consist of annual reports specifically focusing on the link between monetary base expansion and real and productive economy, which could be drawn up by the European Parliament or the European Economic and Social Committee, or entrusted to external institutions or consultants. Adequate public dissemination of that report would be an essential element of this proactive role.

Some questions on the Treaty on European Union

A. OBJECTIVES OF MONETARY POLICY

As set out above, our primary concern in relation to the Treaty on European Union was to assess to what extent fostering the link between monetary expansion and the real and productive economy is compatible with the objectives of monetary policy as governed by the Treaty on the Functioning of the European Union. Not only did the project verify that compatibility, it also confirmed that the link with the real and productive economy is an essential and integral aim of price stability and of the set of monetary policy objectives laid down in the Treaty.

The project has also been examining and checking any other criteria in the Treaty that could hinder or limit any of the options analysed.

B. INDEPENDENCE OF THE EUROPEAN CENTRAL BANK

This was one of the more carefully analysed issues in the project. A more conceptual or theoretical analysis might have proposed a potential amendment to the Treaty that would create new options; however, the project opted to work on the basis of the current wording of the Treaty on European Union.

In this context, the independence of the Central European Bank is not an obstacle to the focus and proposals of the project, but rather a guiding criterion. This means that any potential proposals to be introduced, insofar as they affect the decisions to be taken by the ECB, cannot be imposed on the ECB by other EU public institutions.

C. PROHIBITION OF MONETARY FINANCING OF PUBLIC BODIES

There is some uncertainty as to how Article 123(2) of the Treaty on the Functioning of the European Union should be interpreted, as the use of the phrase "supply of reserves" appears to give rise to two interpretations:

a) According to a broad interpretation, "supply of reserves" refers to any type of "provision of resources" by the Eurosystem to publicly owned banks.

b) According to a restrictive interpretation, "supply of reserves" refers exclusively to certain short-term Eurosystem operations.

While it is true that a limiting provision must be interpreted restrictively, the broad interpretation of the phrase "supply of reserves" would mean having to take into account restrictions with regard to the possible options for structural cooperation between the Eurosystem and the EIB, in the event that this cooperation was structured via direct funding using loans or bonds acquired by the ECB.

In any case, Article 125 of the Treaty on the Functioning of the European Union allows the Council, where necessary, "on a proposal from the Commission and after consulting the European Parliament" to "specify definitions for the application of the prohibitions referred to in Articles 123 and 124 and in this Article", as was done in Regulation No 3603/93.

The only consequence of this is that if the proposed cooperation is funded directly by the EIB using loans or bonds acquired by the ECB, it must take place within the framework set out by the Treaty on the Functioning of the EU.

D. PRIVILEGED ACCESS TO FINANCIAL INSTITUTIONS

The prohibition of "privileged access" to financial institutions laid down in Article 124 of the Treaty on the Functioning of the European Union does not appear to present any difficulties for the options analysed in this project. In the light of the interpretation of Council Regulation No 3604/93, it seems clear that the limitation set out in Article 124 that prohibits "privileged access to financial institutions" does not count the Eurosystem among those institutions. Moreover, this limitation in the Treaty does not seek to restrict the activities of the financial institutions, but rather to restrict any measures that may force or encourage those financial institutions to create "privileged access" to their resources. Since the project does not propose any options that force or encourage the Eurosystem to carry out or not carry out certain actions, but instead directs its ideas and proposals, as required, to the European Central Bank itself, it seems clear that the content of Article 124 of the Treaty on the Functioning of the European Union does not hinder or restrict the options analysed in this project.

Subsequent actions

On the basis of the conclusions set out in this document, potential steps to be taken for the implementation of its proposals include:

- dissemination of the content and results of the analysis, providing information first and foremost to the institutions that have the most direct responsibility. In particular, along with the ECB and EIB, the European Parliament, the European Commission and representatives of the Member States;
- specifically, providing the ECB with the analysis and, where appropriate, the adoption of any corresponding decisions, while fully respecting its institutional independence;
- examining the feasibility of institutions such as the European Parliament or the European Economic and Social Committee committing to developing an instrument to monitor systematically the link between the monetary policy operations of the European Central Bank and the real and productive economy, and to disseminate the results of that monitoring.

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