

Disyuntivas de la Política Monetaria para la transición verde.
Un enfoque teórico

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Abstract: This paper develops a theoretical model to analyze how monetary policy can support the green transition when the central bank is not fully independent. A government spending function combines three financing channels—taxation, deficit-financing money creation, and targeted “green” monetary accommodation—capturing the institutional tension between climate objectives and price stability. The model shows that the inflationary impact of green monetary accommodation differs from ordinary seigniorage and depends critically on the central bank’s credibility. When credibility is high, green accommodation can lower the effective cost of credit and foster low-carbon investment with only modest inflationary effects. When credibility is weak, its inflationary consequences converge to those of traditional seigniorage and the incentive to use it as disguised deficit financing strengthens. The results suggest that policymakers should strengthen central-bank mandates and communication strategies to preserve credibility, coordinate climate investment with transparent fiscal tools, and develop standardized data on green interventions so that future empirical evaluations can guide the design of sustainable monetary frameworks.

Resumen: Este trabajo desarrolla un modelo teórico para analizar cómo la política monetaria puede apoyar la transición verde cuando el banco central no es plenamente independiente. La función de gasto del gobierno combina tres canales de financiamiento—impuestos, creación de dinero para financiar el déficit y una acomodación monetaria “verde” dirigida—capturando la tensión institucional entre los objetivos climáticos y la estabilidad de precios. El modelo muestra que el impacto inflacionario de la acomodación monetaria verde difiere del de la emisión tradicional para financiar el déficit y depende de forma crítica de la credibilidad del banco central. Cuando la credibilidad es alta, la acomodación verde puede reducir el costo efectivo del crédito y fomentar la inversión baja en carbono con solo efectos moderados sobre la inflación. Cuando la credibilidad es débil, sus consecuencias inflacionarias convergen a las de la emisión

tradicional y aumenta el incentivo a utilizarla como un financiamiento encubierto del déficit. Los resultados sugieren que los responsables de política deben reforzar los mandatos y las estrategias de comunicación de los bancos centrales para preservar la credibilidad, coordinar la inversión climática con herramientas fiscales transparentes y desarrollar datos estandarizados sobre las intervenciones verdes para que futuras evaluaciones empíricas orienten el diseño de marcos monetarios sostenibles.

INTRODUCTION

Central banks have traditionally pursued the narrow objectives of price and output stability. Over the last decade, however, leading policy makers have begun to question whether these institutions should also confront the economic risks posed by climate change. Speeches by Schnabel (2021) at the European Central Bank and Brainard (2021) at the Federal Reserve underline that climate-related shocks can undermine financial stability and, through that channel, threaten the achievement of monetary objectives. Their remarks illustrate that the debate is no longer confined to environmental economics or fiscal policy: it has entered the core of central-bank discourse. This paper investigates under what conditions targeted green monetary accommodation can support decarbonization without undermining price stability.

The possibility of broadening the mandate of monetary authorities raises a fundamental question. Monetary and macroprudential instruments could, in principle, channel credit toward low-carbon activities and discourage investment in carbon-intensive sectors. At the same time, deploying these tools for climate purposes could create inflationary pressures, blur the institutional boundary between fiscal and monetary policy, and dilute accountability. The tension is particularly sharp in economies where seigniorage remains a relevant source of government finance and where central-bank independence is not firmly established. In such settings, the temptation to use “green monetary policy” as a politically acceptable form of money creation is difficult to dismiss.

This paper develops a simple theoretical model to examine that tension. We represent the government and the central bank as a consolidated authority in which the monetary arm operates with limited independence and faces a principal–agent problem. The government wishes to finance both conventional fiscal spending and green projects while maintaining price stability. Two instruments are available: targeted monetary accommodation for green projects and a macroprudential policy that raises the cost of credit to carbon-intensive sectors. Both instruments can reduce emissions, but they affect the cost of credit and, through that channel, output and inflation. The model characterizes the conditions under which a government with imperfectly independent monetary authorities will exploit green monetary policy and the inflationary consequences of doing so.

The paper develops a streamlined theoretical framework that isolates the key institutional channels through which climate objectives interact with monetary policy: deficit-financing money creation, targeted green monetary accommodation, macroprudential constraints on carbon-intensive finance, and the role of central-bank credibility. By abstracting from a full-scale climate DSGE structure, the analysis highlights the fundamental trade-offs between credit reallocation, inflation, and institutional independence that arise when monetary authorities are asked to support the green transition. The model therefore provides a complementary theoretical benchmark for the growing empirical and policy-oriented literature on green central banking.

Although central banks can complement climate policy, fiscal instruments remain the primary and more direct means of financing and steering the low-carbon transition. Monetary interventions can help at the margin—especially by lowering the cost of capital for green projects—but they inevitably create a trade-off: the same tools that support green investment also influence inflation and central-bank credibility. The trade-off is also temporal in nature: short-run inflation (by raising the cost of credit for current, carbon-intensive investments) v. long-run—uncertain—environmental and financial stability. Any climate-oriented use of monetary policy must therefore be weighed against the need to preserve price stability and the independence of the monetary authority.

The rest of the paper is organized as follows. Section II reviews the related literature and positions the paper in three strands: environmental policy, central-bank structures and mandates, and principal–agent models of monetary policy. Section III presents the theoretical model and some implications of its setting. Section IV solves the government’s optimization problem, obtains the equilibrium conditions, and examines the resulting trade-offs. Section V concludes with implications for both monetary institutions and climate policy.

LITERATURE REVIEW

The academic debate relevant to our framework spans three strands of work.

The first strand examines environmental policy, with the majority of contributions focusing on fiscal instruments and a smaller but growing set exploring monetary or green-finance tools. Ferrari and Landi (2020, 2022) use Dynamic Stochastic General Equilibrium (DSGE) models to analyze the effects of central-bank purchases of green assets and the potential inflationary consequences of the green transition. Carattini et al. (2021) study how climate policy interacts with financial frictions and show that macroprudential measures such as taxes or subsidies on banks’ assets can complement carbon taxes, although macroprudential policy alone cannot correct the pollution externality. Papoutsis et al. (2022) develop a multisector growth model in which unconventional monetary policy with climate externalities can influence the composition of output and hence emissions. Pfister and Valla (2021) discuss how climate risks may influence inflation and growth, creating new challenges for the conduct of monetary policy. Other contributions highlight the implications of financial markets and green innovation: Schoenmaker (2021) studies how central-bank portfolios biased toward high-carbon corporate bonds affect the cost of capital; Steffen (2021) provides a comparative analysis of green financial policy across OECD countries; and Spyromitros (2021) shows that the impact of monetary policy on green innovation depends on the quality of domestic institutions. Holland (2010) examines alternative ways of introducing carbon emissions and abatement in economic models and shows how carbon taxes and cap-and-trade schemes influence production through both output and substitution effects, while Pindyck (2015) warns against overconfidence in climate-policy models and questions the reliability of their forecasts. Jaumotte et al. (2021) argue that a combination of initial green investment, rising carbon taxes and targeted transfers can help achieve net-zero emissions by 2050. CEPAL (2023) provides a regional perspective by analyzing how both advanced and developing economies incorporate climate considerations into financial and monetary strategies.

The second strand focuses on central-bank structures and mandates. Orphanides (2013) warns that overburdening monetary policy with additional objectives can undermine credibility and independence. Boneva et al. (2021) examine how monetary policy can respond to climate change while preserving price stability. D’Orazio and Popoyan (2022, 2023) show that the adoption of climate-related financial policies is more likely when central banks have broad monetary policy mandates and separate financial-stability governance structures. Dikau and Volz (2018) describe how central banks can align financial-stability objectives with sustainable development and the instruments available to them. Eliet-Doillet and Maino (2023) analyze the European Central Bank’s 2021 strategy review and the potential for unconventional monetary policy to contribute to climate action. Cullen (2023) takes the opposite view, arguing that the tools available to central banks are inadequate to produce a meaningful reduction in emissions. Taken together, these studies reveal both the opportunities and the institutional risks of giving central banks a direct role in the low-carbon transition.

The third strand provides the principal–agent foundation for our model. Barro and Gordon (1983) present the classic time-inconsistency framework in which a monetary authority with discretionary power may generate an inflation bias. Masciandaro and Russo (2022, 2023) adapt this framework to climate policy, modelling the trade-offs faced by a central bank asked to support green objectives under limited independence. Their approach motivates our representation of the government–central-bank relationship as a principal–agent problem, while the money in public finance approach (Walsh, 2017) inspires the consolidated government budget constraint used in our model. The broader perspective on institutional quality and extractive institutions offered by Acemoglu and Robinson (2013) reinforces the relevance of agency frictions in emerging economies, where political incentives can shape the credibility of monetary commitments.

These three literatures—environmental policy, central-bank mandates and principal–agent models—jointly motivate the theoretical framework developed in the next section and clarify the economic and institutional trade-offs faced by a monetary authority considering climate objectives.

While these strands clarify the policy debate and provide the theoretical ingredients for linking climate objectives and monetary policy, none of them combines the agency framework with an explicit comparison of green monetary accommodation and fiscal seigniorage within a single model. Our paper contributes in two ways. First, it develops a principal–agent framework in which a government with limited central-bank independence calibrates two instruments—targeted green monetary accommodation and macroprudential policy—to finance green projects while respecting an inflation target. Second, it shows how the inflationary impact of money creation depends on the purpose of issuance: financing fiscal deficits produces a full one-to-one pass-through to prices, whereas financing green projects generates a weaker, conditional effect. This distinction, absent from the existing literature, sharpens the policy debate on whether central banks can support the green transition without undermining price stability.

THE MODEL

We examine the interaction between monetary policy and the transition to a low-carbon economy in a setting where the government and the central bank form a consolidated public sector but do not share perfectly aligned objectives. The government values both conventional fiscal expenditure and the financing of green investment projects, while society appreciates price stability. Because the central bank enjoys only limited independence, the government cannot perfectly control the instruments that determine money creation and the cost of credit. The delegation of operational monetary policy therefore generates a principal–agent relationship: the government acts as principal, the central bank as agent, and differences in objectives generate the classic agency tension familiar from the literature on time-inconsistency (Barro and Gordon 1983; Walsh 2017).

Within this framework the government has two distinct channels of monetary financing. It can resort to deficit-financing money creation, the traditional form of seigniorage, or it can promote green monetary accommodation, targeted liquidity provision that lowers the cost of financing low-carbon projects. The central bank also controls a macroprudential instrument, denoted ρ , which raises the cost of credit to carbon-intensive activities. Both forms of monetary financing and the macroprudential policy influence the economy's price level through their impact on the cost of credit.

The cost of credit $\square C$

$$c = \hat{c} - (\pi - \pi^e) + \rho \quad (1)$$

where $\hat{c}$ is the market-driven baseline cost of credit and $(\pi - \pi^e)$ represents unexpected inflation. Inflation surprises lower the real cost of credit, while the macroprudential instrument raises it. The central bank can also alter the baseline cost of credit through the rate of green monetary accommodation m_g . Let $\theta \in [0, 1]$ capture the effectiveness or credibility of monetary policy. A calibrated cost of credit is then

$$c_{\text{cal}} = \tilde{c} - (\pi - \pi^e) + \rho \quad (2)$$

with

$$\tilde{c} = \hat{c} - \theta m_g \quad (2')$$

The parameter θ summarizes the probability, as perceived by private agents, that green monetary accommodation remains targeted and reversible rather than evolving into generalized deficit monetization. Therefore, we will treat θ as a “central bank credibility” parameter. Green monetary accommodation lowers the baseline cost of credit proportionately to θ . When $\theta = 0$ the central bank cannot influence the market baseline and $\tilde{c} = \hat{c}$; when $\theta = 1$ its policy is fully effective.

Green monetary accommodation, m_g should not be interpreted as unrestricted money creation, but as targeted liquidity provision operating through regulated financial intermediaries. In practice, such policies could take the form of preferential refinancing facilities, climate-tilted collateral frameworks, or directed credit schemes that lower the cost of financing for a subset of investment projects.

This interpretation is consistent with the literature on unconventional and green monetary policy, which emphasizes that central banks can affect relative credit conditions across sectors through balance-sheet and regulatory tools rather than uniform policy-rate changes (Gertler and Karadi, 2011; Ferrari and Landi, 2020, 2022; Papoutsis et al., 2022).

Under this interpretation, the effectiveness of green monetary accommodation depends on institutional credibility, motivating the role of the parameter θ in governing its impact on the effective cost of credit. This idea follows the logic of fiscal dominance highlighted by Sargent and Wallace (1981). When money creation is used to finance fiscal deficits, agents expect it to be non-reversible in the absence of future fiscal adjustment, so its inflationary impact does not hinge on monetary credibility. Conversely, we assume the effectiveness of green monetary accommodation depends on market beliefs about its scope, reversibility, and insulation from fiscal pressures, which is why credibility plays a central role in determining its impact on credit conditions. When central bank credibility is low, agents interpret green accommodation as a precursor to generalized monetary expansion, causing it to become inflationary and indistinguishable from standard money creation, consistent with the logic of fiscal dominance.[1]

Carbon emissions ε decline with tighter macroprudential policy and with green monetary accommodation,

$$\varepsilon = y - \rho - \theta m_g \quad (3)$$

Aggregate output y follows a Lucas-type supply function,

$$y = \hat{y} + \alpha_1(\pi - \pi^e) + \alpha_2 \rho \quad (4)$$

where $\alpha_1 > 0$ captures the positive effect of unexpected inflation on output and α_2 reflects the contractionary effect of macroprudential tightening.[2]

Inflation itself depends on deficit-financing money creation m_d and on the difference between output and emissions,

$$\pi = m_d + \beta_1(y - \varepsilon) \quad (5)$$

Substituting (4) and (3) in (5) gives

$$\pi = m_d + \beta_1(\rho + \theta m_g) \quad (5')$$

Both targeted monetary accommodation and macroprudential policy thus exert upward pressure on prices through the credit channel, but their effect is scaled by the parameter $\beta_1 \in (0, 1)$, whereas deficit-financing seigniorage m_d passes through to inflation on a one-to-one basis.

The restriction $\beta_1 < 1$ reflects the fact that green monetary accommodation and macroprudential policy affect inflation through indirect channels rather than through an immediate expansion of aggregate demand. Unlike conventional monetary financing, green accommodation operates through targeted credit facilities subject to eligibility constraints and bank intermediation, ultimately affecting the economy through changes in relative prices, sectoral composition, and production costs. As a result, only a fraction of the injected liquidity is effectively transformed into spending, while the remainder is either sterilized or remains on bank balance sheets.

The consolidated government maximizes the gross spending function

$$g = t - \omega_1 \frac{t^2}{2} + \omega_2 (\pi - \pi^e)^2 + \omega_3 (c_{cal} - \hat{c})^2 + \omega_4 (y - \hat{y})^2 \quad (6)$$

where $\omega_i > 0 \forall i = 1, \dots, 4$.

This expression is the heart of the model. The first term represents tax revenue while the second introduces Laffer-curve concavity.[3] The third term captures the use of unexpected inflation to generate seigniorage. The fourth term measures the fiscal revenue created when the government deliberately steers the cost of credit away from its market baseline—through green monetary accommodation—so as to channel finance toward low-carbon projects. The final term recognizes that a positive output gap enlarges the resource base available for public spending. Together these components summarize the government's trade-off between financing conventional expenditure and financing green investment while maintaining price stability.

Building on this formulation, several additional relationships follow directly from the definition of the calibrated cost of credit. The condition for the government to exploit a deviation between the calibrated and the market-determined cost of credit is

$$c_{cal} - \hat{c} > 0. \quad (7)$$

Using the definitions in (1), (2) and (2'), this inequality can be written as

$$-\theta m_g - (\pi - \pi^e) + \rho > 0 \quad (8)$$

which is equivalent to the requirement

$$\rho > \theta m_g + (\pi - \pi^e). \quad (9)$$

These expressions formalize the idea that the consolidated authority can raise the effective cost of credit above the level expected by the market only if the macroprudential instrument ρ is sufficiently tight relative to the combined effect of green monetary accommodation m_g and the surprise component of inflation. In other words, to reallocate liquidity toward the fiscal channel the government needs either a sufficiently restrictive macroprudential stance, limited green accommodation, or a small inflation surprise, given the credibility parameter θ .

The implications of this mechanism can also be expressed in terms of output. Using the Lucas-type supply function (4), the output gap can be written as

$$y - \hat{y} = \alpha_1 (\pi - \pi^e) + \alpha_2 \rho \quad (10)$$

which links the effect of the output gap directly to unexpected inflation and the macroprudential stance. Equations (7) – (10) therefore summarize the conditions under which the calibrated cost of credit can deviate from its market baseline and how this deviation, together with the output gap, feeds back into the government's spending objective.

Equation (6) also provides the mechanism through which central-bank credibility affects inflation. When θ is high, green monetary accommodation m_g reduces the cost of credit effectively, making it possible to expand green investment without generating large inflationary pressures. When credibility is weak, the distinction between green and deficit financing blurs: the inflationary effect of m_g converges to that of ordinary seigniorage m_g , and the government has a stronger incentive to exploit targeted accommodation as disguised money creation.

The trade-offs captured by equation (6) connect to several strands of economic research. Work on green finance and credit reallocation shows how targeted central-bank operations can shift resources toward low-carbon sectors and alter relative prices (Ferrari and Landi 2020, 2022; Papoutsis et al. 2022). Studies of directed technical change and productivity spillovers demonstrate that such reallocation can generate long-run gains in total factor productivity (Acemoglu et al. 2012; Aghion et al. 2016), which, in turn, reduces the long-run marginal cost of production and moderates inflationary pressures. Research on climate-related risks for monetary policy (Pfister and Valla 2021; D'Orazio and Popoyan 2022, 2023) emphasizes that credibility and institutional design determine whether central banks can pursue these objectives without undermining price stability.

By embedding these insights in a single spending function, the model extends the classic time-inconsistency framework of Barro and Gordon (1983) and Walsh (2017). It distinguishes two qualitatively different types of money creation—deficit financing m_d and green monetary accommodation m_g —and shows how the inflationary consequences of the latter depend on the credibility parameter θ . This provides a parsimonious but powerful representation of the institutional trade-offs that arise when monetary authorities are asked to support the green transition.

SOLUTION

The government ultimately determines the tax rate t and the two channels of money creation in order to maximize the spending function g . From the first-order conditions of this problem follow the optimal levels of ordinary seigniorage m_d and green monetary accommodation m_g . Substituting these optimal choices back into the relationships that define credit costs, output and inflation yields the corresponding equilibrium values.

The first-order conditions yield

$$t = \frac{1}{\omega_1} \quad (11)$$

The optimal tax rate is therefore inversely related to ω_1 , which captures taxpayers' tolerance for higher rates: a higher ω_1 implies a lower equilibrium tax rate.

The optimal levels of the two forms of money creation are

$$m_d = \frac{-\alpha_1[\alpha_2 + (\alpha_2 + 2\alpha_1)\beta_1]\rho - \alpha_1\pi^e\omega_4 + (-\pi^e + 2\beta_1\rho)\omega_2}{\omega_2 + \alpha_1^2\omega_4} \quad (12)$$

$$m_g = \frac{\rho[\omega_2 + \alpha_1(\alpha_1 + \alpha_2)\omega_4]}{\theta(\omega_2 + \alpha_1^2\omega_4)} \quad (13)$$

These expressions show how the choice of seigniorage m_d and targeted green accommodation m_g depends on the macroprudential stance ρ , the expected inflation rate π^e and the structural parameters of the economy. Notably, credibility θ appears only in the denominator of m_g : when credibility is high, a given macroprudential policy requires a smaller amount of green accommodation to achieve the same effect.

Substituting the optimal instruments into the structural relationships—the inflation equation (5'), the cost of credit definitions (1) – (2'), the output equation (4), and the spending function (6)—yields the equilibrium values of inflation, the effective cost of credit, and output.

The equilibrium inflation rate is

$$\pi = \frac{-\rho\alpha_1\alpha_2\omega_4 + (\omega_2 + \alpha_1^2\omega_4)\pi^e}{\omega_2 + \alpha_1^2\omega_4} \quad (14)$$

Because $\alpha_2 < 0$ and all other parameters are positive, π remains positive whenever expected inflation π^e is non-negative. This reproduces the classic result that money creation—whether to finance deficits or to support green projects—generates positive inflation. If the macroprudential instrument ρ is set to zero, optimal inflation coincides with expected inflation: attempts to stimulate output through surprise inflation are neutralized by rational expectations (i.e. the public anticipates the government's stance), and employment and output do not rise. This is the standard neutrality-of-money outcome.

The optimal effective cost of credit is

$$c = \hat{c} + \rho + \frac{\alpha_1\alpha_2\omega_4\rho}{\omega_2 + \alpha_1^2\omega_4} \quad (15)$$

The last term is necessarily negative, so the sign of the deviation of c from the market-driven baseline $\hat{c} + \rho$ is ambiguous. Depending on parameter values, the consolidated authority could produce an effective cost of credit below the market baseline—a form of credit subsidy, which is in turn the objective pursued by the authorities to keep inflation low. The magnitude of this adjustment depends on α_1 , which measures the sensitivity of output to unexpected inflation.

When central-bank credibility is high—so unexpected inflation has only modest real effects—the denominator $\omega_2 + \alpha_1^2\omega_4$ is larger, the negative adjustment is smaller, and the macroprudential channel has a weaker impact on credit costs. When credibility is low the opposite holds and the macroprudential channel becomes more powerful.

Equilibrium output growth is

$$y = \hat{y} + \alpha_2 \rho - \frac{\alpha_1^2 \alpha_2 \rho \omega_4}{\omega_2 + \alpha_1^2 \omega_4} \quad (16)$$

The sign of Δy depends on the natural growth rate $\hat{y}$ and the government's policy stance. A government that places high priority on climate objectives will set the macroprudential instrument $\Delta \rho$ to reduce output and therefore emissions. If climate policy is not a priority it can set ρ close to zero, eliminating the second and third terms and leaving output growth at the natural rate. Conversely, when the economy is operating above its natural rate and climate mitigation is urgent, a higher ρ contracts the output gap and lowers emissions.

CONCLUSIONS

This paper develops a framework to examine how monetary policy can support the green transition when the central bank is not fully independent. By embedding a government spending function that combines taxation, deficit-financed seigniorage and targeted green monetary accommodation, it captures the institutional tension between fiscal objectives and the mandate for price stability. This spending function is the central innovation, extending the classic Barro–Gordon time-inconsistency model to a setting in which credit can be deliberately steered toward low-carbon projects.

We show that ordinary seigniorage and green monetary accommodation have distinct inflationary effects that depend on the credibility of the monetary authority. When credibility is high, targeted green accommodation lowers the cost of credit and fosters low-carbon investment with only modest inflationary consequences. When credibility is weak, its inflationary impact converges to that of traditional seigniorage and the incentive to use it as disguised deficit financing strengthens. The optimal policies derived in equations (11)–(16) highlight this trade-off and clarify when green monetary policy remains a distinct instrument.

These findings contribute to three strands of the literature. First, they complement research on green finance by providing a formal mechanism through which central-bank operations can reallocate credit toward low-carbon sectors without abandoning the inflation objective. Second, they enrich the debate on central-bank mandates by showing how limited independence and credibility shape the inflationary consequences of climate-oriented monetary policy. Third, they extend the principal–agent framework of time-inconsistent monetary policy to a context in which the central bank is asked to pursue environmental goals alongside price stability.

Empirical research on green monetary policy is still in its infancy. Many of the instruments that would allow central banks to support a low-carbon transition—such as climate-tilted collateral frameworks or targeted green lending facilities—are recent and in some countries only experimental. Comparable time-series data on these measures are sparse and not yet standardized across countries. For this reason, the present analysis remains intentionally theoretical, and future empirical work will depend on the gradual accumulation of more comprehensive and consistent data.

Policy implications follow directly. For central banks, credibility is the decisive safeguard: without a strong commitment to price stability, green monetary tools lose their distinctive role and become indistinguishable from ordinary deficit financing. For governments, using green monetary accommodation as disguised seigniorage is counterproductive because the inflation cost is highest precisely when credibility is low. Combining ambitious green investment with an independent, credible monetary authority allows a country to accelerate the low-carbon transition without sacrificing long-run price stability. In developing economies, where monetary financing of fiscal deficits is common, adding climate objectives to the central bank's mandate can therefore entail significant risks.

The success of green monetary policy hinges less on the availability of new instruments than on the institutional architecture that governs their use. Credibility and clear mandates remain not only the traditional pillars of monetary stability but also the necessary conditions for central banks to play a constructive role in global decarbonization. A related challenge, left for future research, is the international dimension: because capital markets and exchange rates transmit monetary actions across borders, uncoordinated climate-oriented interventions can create spillovers in exchange rates and cross-country capital flows. Understanding how central banks might coordinate their climate policies—or how national actions might interact through exchange-rate channels—remains an important area for further study.

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