Can monetary policy be progressive?

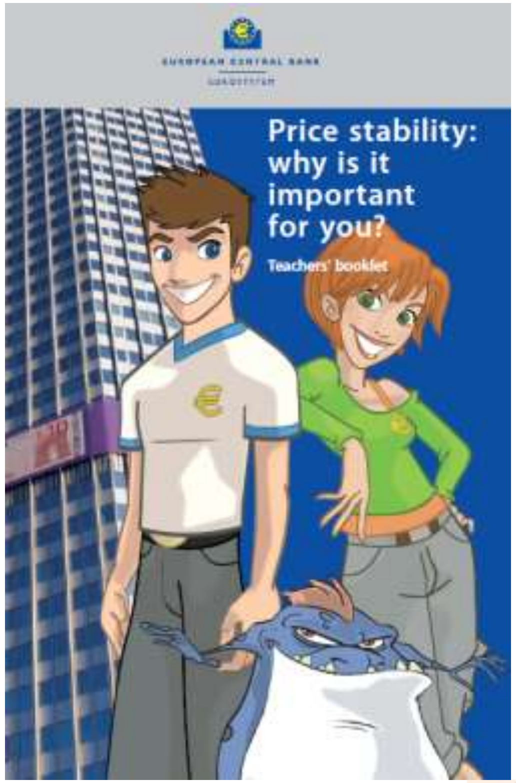
Clément Fontan (UCLouvain)

2023 Rethinking ETUC conference

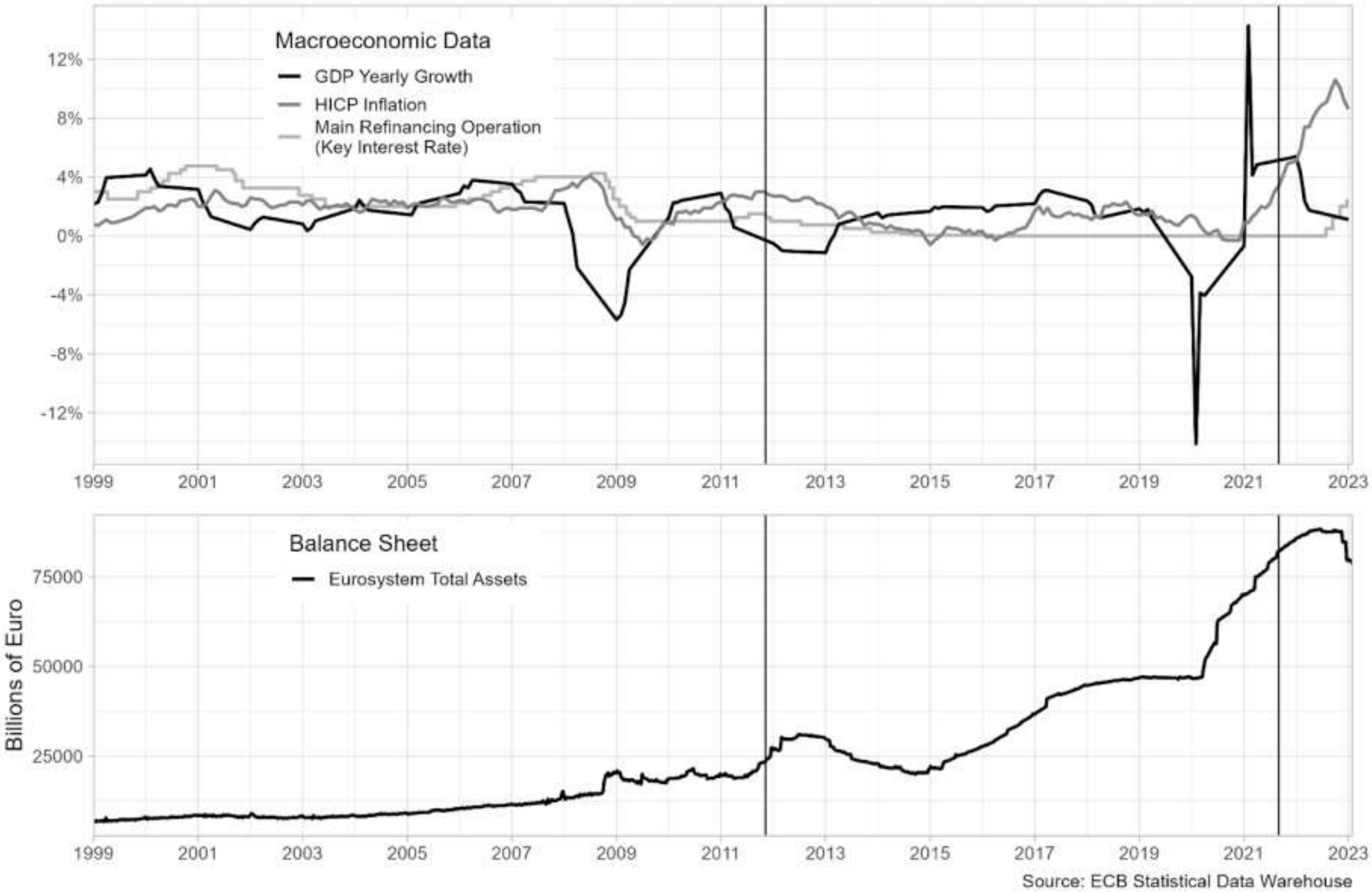
UCLouvain

Context

- Since mid-2021, reemergence of inflationary pressures in the EU
- In reaction, the ECB raised its interest rates for the first time since 10 years & end asset purchases
- Lagarde says that the ECB must do more to tackle the inflation monster.
- But is it the same “end of 20th century monster” against which the ECB was designed? Or is it a new beast in demand of new policy solutions?
- How does the ECB deal with social and ecological costs related to its policy?
- Can we find better alternatives?
- Analysis of ECB discourse & policies since 1998 ; 3 different eras



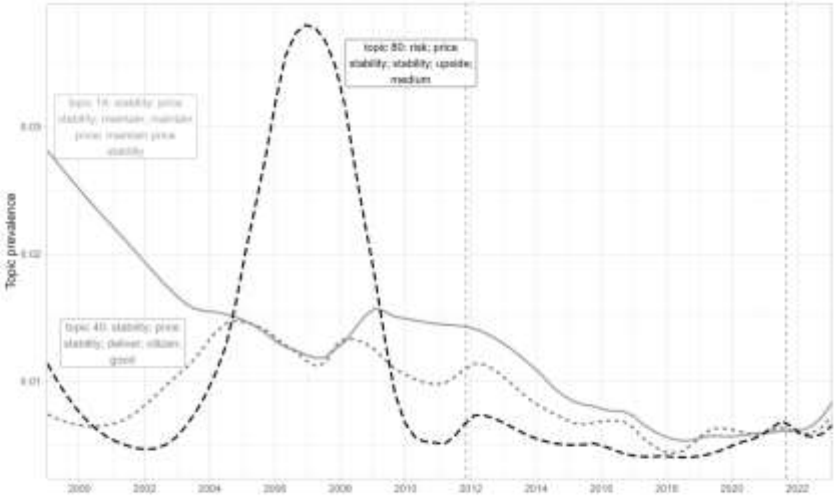
The three eras of the ECB

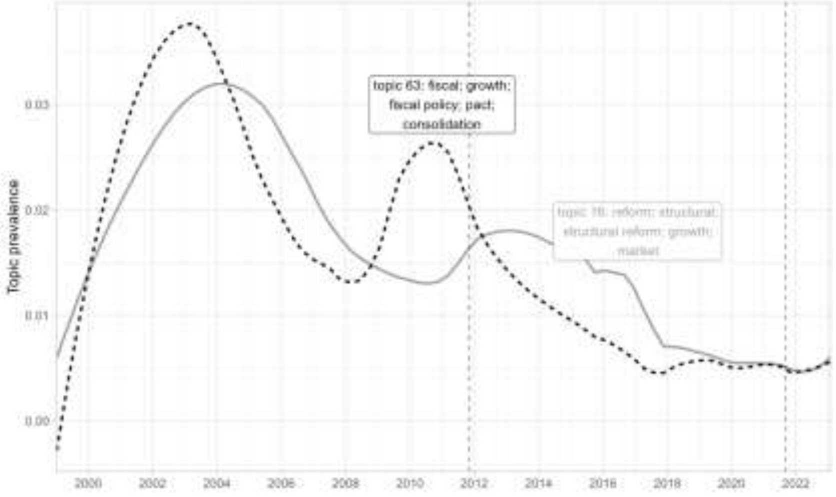


1. Inflation nutters: the CBI era
2. Growth enhancers: the secular stagnation era
3. Zugzwang ECB: The new inflation era

The CBI era (1999-2011)

- Policy priority: establishing anti-inflationnary reputation
  - The credibility issue: responsivness to democratic demands is inflationnary
  - The (misperceived) Bundesbank template
- Inflation nutters:
  - “price stability a necessary condition for sustainable growth and job creation” (Trichet)
  - “any blurring of responsibilities can potentially lead to a loss of credibility for the central bank”
  - “A central bank is an anchor of confidence.”
  - The 2011 raise in interest rates
- Pressures to other players:
  - Fiscal issues & SGP rules (2003-5 breach)
  - Flexibilization of labor market to solve unemployment, ie wage indexation/minimum wage
  - Risks of wage price spiral (2007 inflation)





“Although monetary policy cannot lift the euro area's growth potential, the benefits of price stability for growth are evident, as stable prices provide the proper environment for structural reforms to work.

While the ECB will maintain its commitment to the maintenance of price stability, other policy-makers should assume responsibility for increasing the growth potential of the euro area. This, in turn, is the best allocation of responsibilities to contributing to sustainable non-inflationary growth”

The stagflation era (11-21)

Policy priorities: financial stability & the missing inflation puzzle

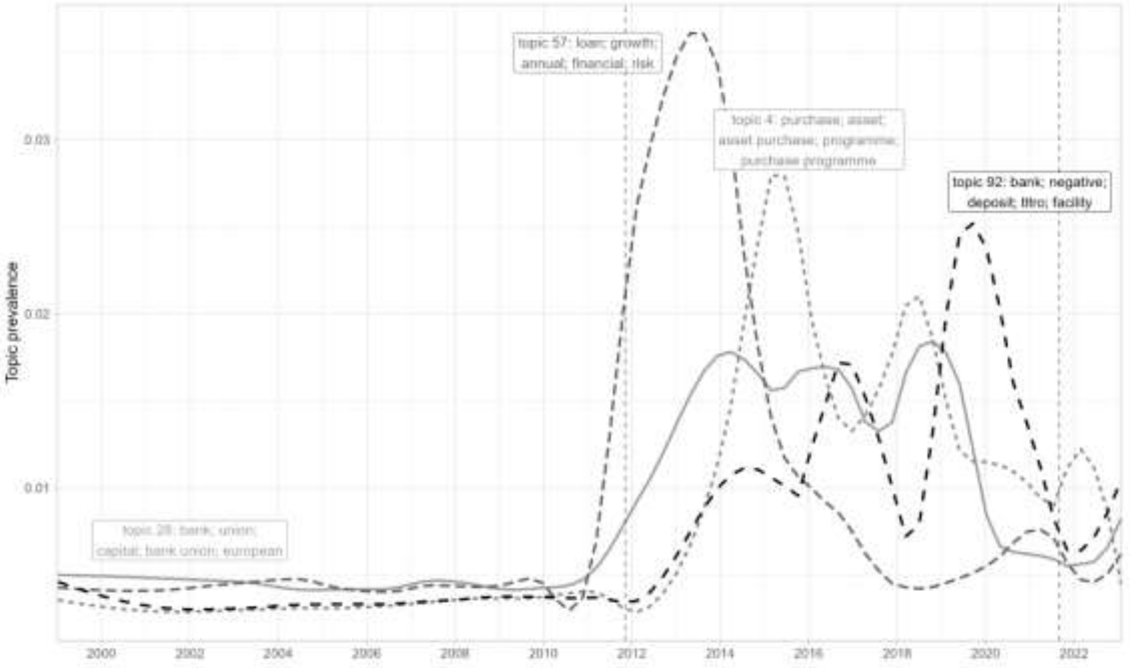
Growth enhancers?

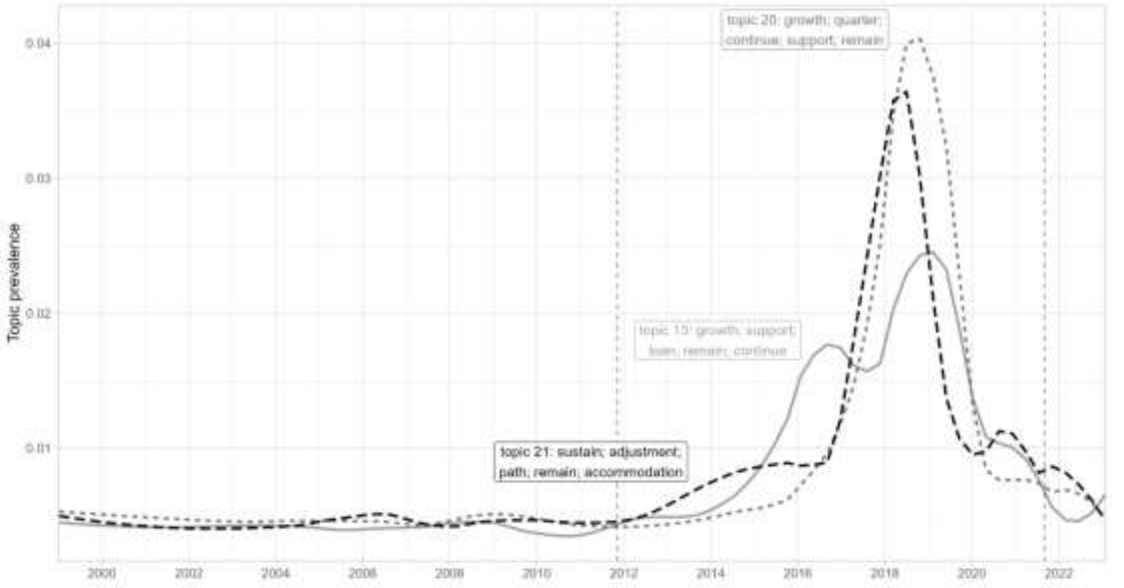
- Price stability alone is "not a sufficient condition of financial stability"
- Questioning the secular stagnation thesis & the Philipps curve
- "to achieve a sustained adjustment in the path of inflation wage growth has to be stronger"

Shifts in external advice

- Since 2015, call for fiscal & wage expansion "fiscal policy mistakes made in 2011-12 should not be repeated so that we do not suffer from avoidable double dip recessions."
- "Firms' profit margins became structurally so high since30 years that rising wages do not lead to inflation anymore"
- But: "over the longer-term, however, monetary policy cannot increase growth"

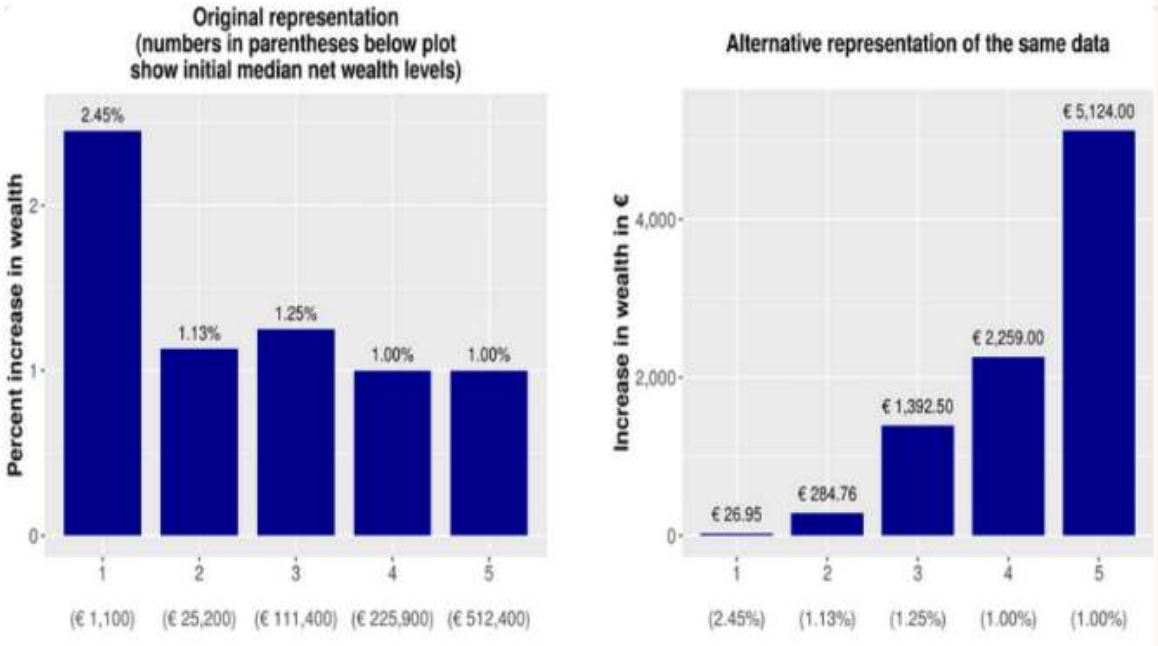
- 2 major policy changes in summer 2021
  - Climate Action Plan (climate is price stability)
  - Revision of monetary strategy (Sensibility to tradeoffs)





Focus: Asset purchases & inequalities

- Asset purchases: main ECB answer to crises
- Direct (inequalitarian) effects vs indirect (equalitarian effects)
- ECB evolutions
  - 2010-18: Inequalities as a side effect, not in our mandate
  - 2018-20: Purchases decrease inequalities
  - Since 18: more complex understanding of structural inequalities, lamentation on weakened trade unions, more nuance on purchases’ effect & sensibility to inequalities
  - …but still not a full fledged operational objective, ECB laggard in comparision with Fed

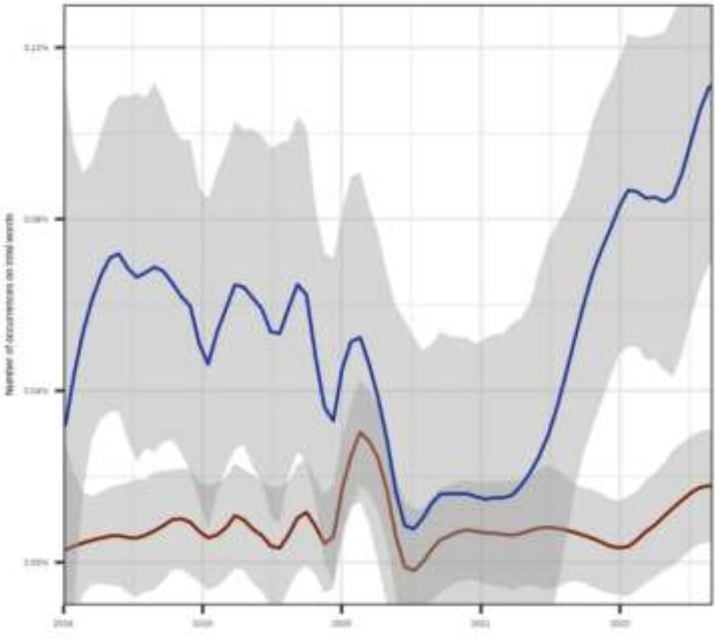


Two representations of the alleged effects of the ECB Asset Purchase Programme on the median net wealth by wealth quintile (data and original plot from Ampudia et al. 2018)

“The challenges central banks are facing today are fundamentally different from the ones that were relevant when they gained broad political independence. Inflation is less of a concern to many people, in large part reflecting the achievements of central banks over time. As a result, expectations towards central banks have changed

Inflation may not be a serious threat to society at the current juncture. But the factors that motivated central bank independence four decades ago, and the safeguards that were put in place to protect it, remain important pillars of stability and prosperity”

3. The new inflation era



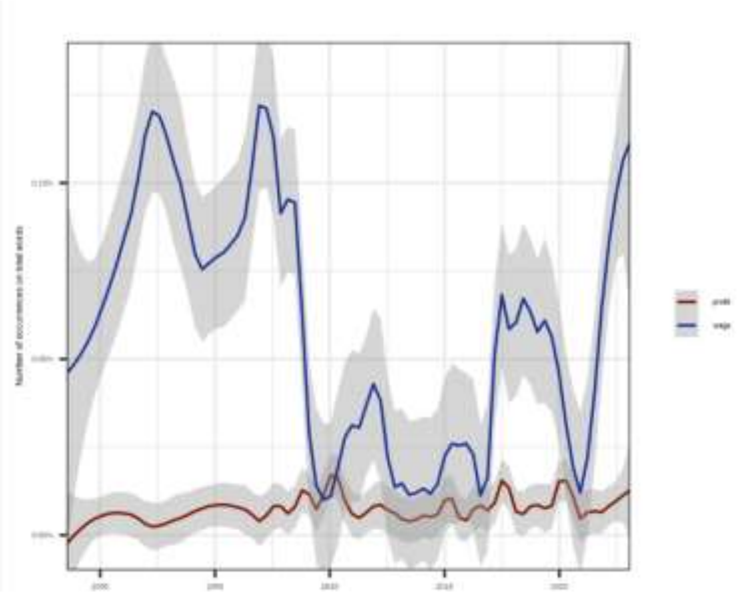
Policies priorities: Covid bottlenecks, energy, war, inflation.

Zugzwang central banking

- Recognition of policy tradeoffs btw price stability and other objectives
- Making the ECB’s “monetary policy framework climate change-proof” is necessary to avoid “fossilflation” and “greenflation.”
- But the rise in IR may discourage efforts to decarbonise our economies rapidly
- Anchoring inflation expectations as a cure-all solution

Mixed messages

- Calls for fiscal restriction but with a twist « to protect the most vulnerable parts of society from the consequences of the energy and food price shocks” + green investments
- Main worry about wages but new discourse slowly taking place on profits



- “As we head into 2023, a changing world brings with it new challenges, but also opportunities. (...).But some things never change: namely, the ECB’s commitment to price stability. We will play our part in Europe’s next chapter by bringing inflation back to our 2% target.”

Is there a way out?

- ECB policymakers have continued to reframe its role and purpose in the hope of avoiding policy discussions on regime change.
- But this leads to Zugzwang central banking, where every possible move is a bad move
- But other solutions exist
    - Why not a European Credit council (E.Monnet)?
    - Why not dual interest rates (Van’t Klooster)?
    - Risks of inflated responsabilities: EP must offer guidance on secondary objectives (every progressive academic)


Comment

The ECB needs political guidance on secondary objectives

While EU Treaties clearly stipulate that the ECB “shall support the general objectives of the European Union”, it is not appropriate to simply stand b

Publishing date 22 April 2021

Authors Grégory Claeys Pervenche Berès Stanislas Jourdan Nik de Boer Panicos Demetriades Sebastian Diessner Vivien Schmidt Jens van 't Klooster