En 2024, l'Institut d'études européennes de l'ULB (IEE-ULB) a soixante ans ! Pour scander cette année anniversaire et très « européenne », il convie ses membres à réfléchir à des questions fondatrices de l'intégration européenne en 1964 et toujours d'actualité en 2024. Dans une forme courte et accessible, nos chercheurs proposent un portrait en mosaïque de l'Europe, entre continuités et mutations. Les auteurs sont libres de leurs propos qui ne représentent pas une position officielle de l'IEE-ULB.

What Can We Learn from Inflation to Futureproof Our Union?

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(Supra)national investment is required to address growing climate and geopolitical risks. To facilitate this, we must critically revisit our understanding of inflation drivers to revive fiscal policy and break a cycle of institutional overburdening in monetary policy.

Les risques climatiques et géopolitiques doivent être affrontés par des investissements (supra)nationaux. Pour faciliter cela, nous devons revoir de manière critique notre compréhension des moteurs de l'inflation afin de relancer la politique budgétaire et briser un cycle de surcharge institutionnelle de la BCE.

The fragility of the Eurozone is often characterised as resulting from a lack of fiscal integration and solidarity. While this is certainly part of the problem, the current episode of high inflation highlights that to futureproof our union we also need to revisit our understanding of inflation dynamics and associated policy measures. At a time when we have encountered and likely to continue facing complex supply-side price shocks triggered by geopolitical instability and climate change, relying primarily on central bank inflation management via interest rates and hence demand suppression, appears out of step with reality. Crisis periods, like the present one, provide a unique opportunity to update entrenched understandings in the face of new policy challenges. We need to broaden our discussions of inflation drivers beyond fiscal excess and wage pressures and re-evaluate accordingly the Eurozone's macroeconomic governance in a holistic manner.

Inflation Aversion as the Cornerstone of Eurozone Governance

The Eurozone's governance has from the outset been deeply structured by a German preoccupation with inflation, driven on the one hand by the historical experience of Weimar and on the other hand by an export-focused economic model. It is this concern with demand-driven inflation rather than merely a rejection of solidarity that is deeply rooted and still determines our economic governance set up as it stands today. Beyond the glorification of a fiscally restrictive stance, this is reflected also in the mandate of the European Central Bank (ECB). While Article 127 of the Treaty on the Functioning of the European Union stipulates a secondary objective to support the general economic policies of the Union, it is the primary objective of price stability that predominantly drives monetary policy.

The question arises whether the above framework is still relevant in a time where we have encountered and are likely to face recurrent supply-side price shocks triggered by geopolitical instability and climate change. The latter in particular is likely to have complex and extreme inflationary and disinflationary effects that appear ill-addressed by instruments as brute as interest rates. Should we thus review the ECB's role, and if so, how?

A New Role for the ECB?

In the treaty-mandated, technocratic vision of the ECB as guardian of stable money, there is little room for the consideration of other objectives that might fall under its secondary mandate. The latter are normally seen as problematic as they detract from its focus on price stability. Moreover, the central bank enjoys significant independence which is deemed necessary to fulfil its mandate of price stability vis-à-vis politicians' short-term interest in pork barrel politics. Including other, allegedly more political objectives, such as the fight against climate change in its policy considerations, is thus often viewed as undemocratic.

On the other side of the debate, there are those that wish for a greater focus on the secondary mandate to pursue additional objectives such as the fight against climate change. Proponents of this view are thus more inclined to weigh the costs of fighting inflation with the broader costs to the economy and may, for example, tolerate a slightly higher level of inflation to safeguard employment as well as apply a broader range of monetary policy instruments.

It is not clear, however, that to address pressing challenges such as climate change, we must fully abandon the idea of the ECB as a technocratic actor for stable money, i.e. a focus on its primary mandate of price stability. This is true not least as the rationale for putting central banks in charge of inflation control is rather easily applied to climate change action. If political actors shy away from inflicting short-term pain such as carbon taxation on their electorate for fear of repercussions at the ballot box, we might envision a role for the ECB to steer green investment via measures such as interest rate differentiation to increase price stability by diminishing dependency on fossil fuels and driving long-term gains in energy security.

Rethinking Monetary-Fiscal Coordination for a Sustainable Future

While there is thus a growing consensus that the ECB should do more, possibly with reference to its secondary mandate, I remain sceptical for several reasons.

Firstly, within the current economic governance set up that we have, imperfect as it is, I worry that this kind of intervention would, rightly or not, be characterised as an undemocratic competence creep and further damage the trust in democracy. Secondly, and in a similar vein, I fear that given the complexity of monetary policy, it would not engender the necessary change in the public debate on inflation. The current inflationary period, however, constitutes an important opportunity to push for these discussions on inflation and scholars, such as Isabella Weber, have made important progress in this direction. Building on her work on sellers' inflation, it is therefore important to promote a broader discussion on supply- versus demand-driven inflation dynamics, and a critical appreciation of appropriate policy measures.

I therefore believe that we should, yes, aim to educate on and politicise monetary policy, but not solely with the aim of adding tasks to our central banks' already long to-do list. Rather, we need to move beyond an exclusive reliance on central banks and what has been characterised as the medieval medicine of interest rate changes to fight inflation. Importantly, this involves discussing how fiscal policy measures such as a green golden rule, which excludes increases in net green public investment from fiscal compliance indicators, could support the central bank in its price stability mandate by furthering green investment. If fiscal restriction can thus be inflationary in the current context, this should lead us to abandon a democratically and economically instability-inducing reliance on emergency politics and off-balance sheet vehicles to finance our future.