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Towards a future-proof EU fiscal framework

Member states' fiscal outcomes ultimately emanate from domestic political choices across policy domains and from exposures to exogenous shocks. The financial and the sovereign debt crisis, pointed to the need for a closer coordination of national fiscal policies to address the risk of spill-overs within the Economic and Monetary Union. This resulted in a strengthened Stability and Growth Pact, a review process of euro area countries' draft budgetary plans, and the golden «balanced budget» rule of the intergovernmental Fiscal Compact.

These coordination tools have been instrumental in guiding member states towards sounder fiscal positions. In the context of the EU economic governance review and related public consultation, initiated by the European Commission in February 2020, a reflection has started on whether improvements to the common fiscal rules are necessary based on both a backward- and forward-looking assessment.

However, since the review was launched, the world has changed considerably in the wake of the coronavirus pandemic. The focus of fiscal policy is now squarely on facilitating the resolution of the acute health crisis and mitigating the socio-economic fallout of COVID-19, which has triggered the worst economic downturn since the Great Depression. Member states have acted swiftly and decisively by directing the necessary resources to health and civil protection services, supporting liquidity and credit for businesses, and protecting the incomes and jobs of workers.

As part of a broader European coordinated policy response to complement these national efforts, the European Commission, supported by the Council, activated the SGP's general escape clause to temporarily set aside the budgetary requirements that would normally apply, in order to tackle the economic consequences of the pandemic.

Large-scale national fiscal stimulus coordinated at EU level was undoubtedly the right response to avoid permanent damage to the economy's growth potential and ultimately, to debt sustainability. Nevertheless, it is clear that the public deficit and debt levels relative to GDP will be increasing significantly. These will have to be put on a downward path, which in particular for public debt proved difficult in some countries already before the crisis. At the same time, national fiscal policies should not become procyclical, but rather provide adequate support for rebuilding the economy. This is also related to the issue of the appropriate aggregate fiscal stance to increase the effectiveness of monetary stimulus. In addition, fiscal policy will have to cater for new priorities such as

environmental sustainability and the digital transition.

Looking ahead, it will be important to achieve a common understanding on how to ensure that the EU's fiscal framework remains fit for purpose and is able to reconcile these different objectives. Striking the right balance will require careful consideration but should be feasible. If the fiscal rules were for instance to further promote public future-oriented investment, preferably in areas consistent with EU priorities such as environmental sustainability or the digital transition, this would not only be conducive to the economic recovery, but also constitute an opportunity for increasing the economy's growth potential and competitiveness. This would in turn benefit the long-term sustainability of public debt.

Possible trade-offs could also be eased by having a fiscal framework that encourages a more growth-friendly composition of national budgets. This could be achieved through a better prioritisation and targeting of national public expenditure as well as through less distortionary taxation. This in turn underscores the importance of pursuing fiscal and structural reforms.

Finally, it will be important to ensure that possible changes to address the above-mentioned challenges do not come at the expense of the transparency and predictability of the common fiscal rules, which should remain an anchor of confidence for markets and citizens. ●