Q&A

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Priorities of the Croatian Presidency in the context of Covid-19

What are the priorities of the Croatian Presidency in the economic and financial area to face up to the health and economic crises?

Croatia started its first Presidency of the Council of the European Union (EU) from 1st of January 2020 at a particularly eventful period for the EU as a whole, bearing both numerous challenges and opportunities. I will mention only few; the beginning of the new institutional cycle, negotiations with the UK after Brexit, negotiations and agreement on the Multiannual Financial Framework 2021-2027 (including on the sectoral legislation).

Our Presidency program is built upon the Strategic Agenda priorities, focusing in particular on the proposals and initiatives contributing to uniform and sustainable economic growth, raising convergence, strengthening competitiveness of the Union (including deepening of the Economic and Monetary Union) and responding to demographic challenges.

However, we and the EU as a whole have found ourselves facing unexpected and global threat. The COVID-19 pandemic represents unprecedented challenge with severe socio-economic consequences. New circumstances have changed our way of life and require prompt and adequate response. I could witness that the whole EU is determined to respond to this crisis in the spirit of solidarity. We, as the Presidency of the Council of the European Union have already taken certain steps to ensure coordinated actions at the level of both the EU and Member States.

Furthermore, the Eurogroup in inclusive format has recently reached an agreement on the Economy Package in an amount close to half a trillion Euros. This Package of financial assistance includes several crisis response instruments which implementation should ensure the ground for the recovery of the EU economy.

In the field of financial services, it is expected that banks and other financial institutions have a key role to play in dealing with the effects of the COVID-19 outbreak by maintaining the flow of credit to the economy. If the flow of bank credit is severely constrained, economic activity will decelerate even more sharply, as undertakings struggle to pay their suppliers and employees.

Against this background, the European Union and Member States are taking various, exceptional measures to incentivize banks to continue to play their role. These measures include, for instance, government-backed loan guarantees or payment deferrals. Similar or other measures, which do not entail the involvement of the public sector, are being taken or are being contemplated. Their common objective is to ensure that loan payment modification or forbearance (restructuring, refinancing or simply deferral of payments) is an effective tool available to banks to deal with financing households and corporates experiencing temporary difficulties.

To ensure that banks can play their part in supporting the economy through the COVID-19 period, policy makers and regulators want to bring as much certainty to the matter as possible.

It is crucial that banks continue financing households and corporates, including small and medium enterprises (SMEs) experiencing temporary difficulties amid the COVID-19 pandemic. To this end, making full use of the flexibility provided in the prudential and accounting framework is essential at a time when sufficient financing to cover financial pressures is vital for the economy.

In light of the current situation, the EIOPA announced and published recently a statement on dividends distribution and variable remuneration policies in the context of COVID-19. The insurance companies are expected to follow up on EIOPA's statements to take timely and comprehensive measures to preserve their capital position, including the temporary suspension of all discretionary distributions, and to continue to act in the best interests of consumers.

The Croatian Presidency will continue to closely monitor the evolution of the situation and to coordinate between European and national measures. Where necessary, we stand ready to take further actions, including legislative measures, if appropriate, to mitigate the impact of COVID-19.

What are the initiatives required to restore confidence in the European Union, whose heterogeneous performance worries the markets (possible use of EMS, corona bonds etc...)?

After extremely long and exhaustive meeting of the Eurogroup in inclusive format one has to admit that we have done it. We reached an agreement even if it took us more than sixteen hours, and even if some divisions among Member States came to the surface again.

I am proud that we have overcome our differences and showed European solidarity and unity in these difficult times.

We have already seen a rapid, massive, co-ordinated impulse from the monetary and fiscal authorities and from the regulators. Nearly 3% of GDP of fiscal measures, enhanced flexibility, and additional liquidity schemes of 16% of GDP. That was our first line of defence emerging at the national level.

And now, on top of that, we agreed on Comprehensive economic policy response at EU level which focuses on three safety nets – one for workers, one for businesses and another one for countries.

Regarding the workers, we welcomed the creation of a temporary European instrument to support national safety nets in this crisis – so called SURE proposal. This will put together our collective financial strength at the national and European levels, to channel up to €100 bn to the national systems facing the greatest pressures. Additional layer of EU protection for jobs is needed as we currently rely solely on the safety nets that are in place at member states level. These take many forms – schemes to support short-time work, unemployment benefits and many other schemes. This will now be taken forward and fine-tuned in the legislative process.

The second safety net is for businesses facing difficulties, in particular SMEs. In that respect support has been shown for the initiative of the EIB to create a pan-European instrument which aims to guarantee €200 bn of lending with a focus on SMEs.

Finally, the safety net for member states will take the form of Pandemic Crisis Support building on the existing ECCL credit line of the ESM amounting close to €240bn. This is an important safeguard for all euro area countries during these times of crisis. It will be available to all ESM members, with standardised terms, on the basis of an up-front assessment by the European institutions.

Any euro area country requesting this support remains subject to the EU's economic and fiscal co-ordination and surveillance frameworks. The only requirement to access the credit line will be that the country would commit to using these funds to support domestic financing of direct and indirect healthcare, cure and prevention related costs due to the COVID 19.

I fully agree with all measures mentioned above, but one thing is important to emphasize. Crisis caused by COVID-19 pandemic does not recognize Schengen borders or euro area borders. It is a crisis affecting all member states. All 27 of us. Having that in mind, it is important to think about member states outside the euro area which do not have the ESM at their disposal. For these member states, the safety net for crisis times is quite limited. We are all part of the single market and significant negative spill overs can still happen between euro area and non-euro area member states. In that context, I am satisfied that the Balance of Payments Facility, an instrument for non-euro area member states, is part of the Report of the Eurogroup in inclusive format. As it is rightly stated in the Report, this instrument should be applied in a way which duly takes into account the special circumstances of the current crisis.

It is important to think about the period when the crisis ends and plan accordingly, as we need to be prepared to go back to normal. That is why it is of great importance that Eurogroup in inclusive format has already discussed this issue and agreed to work on a Recovery Fund, which would represent strong impulse to investments that we will need to build a better, greener, more resilient and more digital economy.

Finally, I want to emphasize that the Croatian Presidency has so far ensured that all the legislative proposals at the Council level are adopted and will further work to ensure smooth dynamic and reaching of agreements at the Council level. ▶

▶ The COVID-19 pandemic poses a big challenge for the European economy. We will act together in solidarity and we will deliver solutions consisting of necessary progress in strengthening the European Union.

What are your views regarding evolutions of the EU economic governance: when should the Stability and Growth Pact be restored? Does it need renovating? What measures would finally make it effective?

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.

This has led to further improvements in fiscal results in Member States and in strengthening of their national fiscal frameworks.

Nominal deficits were significantly reduced, which confirms the success of the deficit criteria. On debt criterion, although there has been a trend of decreasing public debt to GDP ratio in recent years it has remained close to historically high levels in many Member States. Part of the explanation lies in the pro-cyclical nature of debt developments and the low economic growth and inflation in some Member States.

More demanding part of the Stability and Growth Pact relates to the preventive mechanism. In this area, we can see that Member States have made progress towards meeting their medium-term budgetary targets (MTOs) after 2011, but in recent years fiscal efforts have gradually diminished while large fiscal positions remain. On the expenditure rule, in most Member States the increase in primary expenditure was less than or equal to the growth of potential GDP in the post-2011 period, suggesting an increasing control over expenditure growth.

However, at the same time, there has been an increase in the complexity of the fiscal framework itself, which today constitutes an extensive system of rules and procedural steps.

Although the overall developments in fiscal outcomes are positive, questions are increasingly raised about the need to further improve the fiscal framework. Some of the objections are related to weak implementation of fiscal rules, pursuing of pro-cyclical policies, use of unobservable variables (output gap and fiscal elasticities) that are prone to ex-post revisions affecting the current assessment of compliance with the rules, etc.

In our discussion at EU level we always emphasize that simplicity, flexibility and predictability are desirable features of a well-designed fiscal framework. However, a trade-off between these characteristics is necessary. Predictable and flexible rules cannot be simple. Simple and predictable rules, on the other hand, cannot be adapted to changing economic conditions. Finally, simple and flexible rules are not predictable.

In the context of the EU economic governance review (Six-Pack, Two-Pack 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.

Nevertheless, Stability and Growth Pact was one of the most important topics at the EU finance ministers' meetings.

On 23rd March, EU finance ministers agreed with the assessment of the Commission, that the conditions for the use of the general escape clause of the EU fiscal framework – a severe economic downturn in the euro area or the Union as a whole – are fulfilled.

The use of the clause will ensure the needed flexibility to take all necessary measures for supporting health and civil protection systems and to protect EU economies, including through further discretionary stimulus and coordinated action.

Furthermore, the general escape clause will allow the Commission and the Council to undertake the necessary policy coordination measures within the framework of the Stability and Growth Pact, while departing from the budgetary requirements that would normally apply, in order to tackle the economic consequences of the pandemic.

This has proved that SGP has built in flexibility for the crisis times. However, question on how fiscal rules can prevent pro-cyclical fiscal policies and ensure that fiscal buffers are created during good economic times still remains?

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 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.

By mentioning structural reforms, one has to reflect on the MIP procedure, an indispensable part of EU economic governance which helps to identify and correct macroeconomic imbalances. We are all aware that the level of implementation of the structural reforms is still unsatisfactory and progress is needed in this respect. One possible solution to improve the correction of macroeconomic imbalances is to reach an agreement on the Reform and Investment Support Program (better known as the BICC and CRI), as it would provide incentives for Member States (in terms of financial resources) to implement structural reforms. We strongly support reaching an agreement on this file, and we hope it will be done during our Presidency.

What should be the regulatory priorities of the Commission to effectively progress towards more cross-border private risk sharing through the Banking Union?

For the EU as a whole new legislative framework introducing specialized insolvency regime for banks and possibly other financial institutions where best practices from most advanced Member States in terms of legal and operational aspects of dealing with insolvency of financial institutions should become mandatory for all Member States. The priority is to make insolvency proceeding more effective, simpler and faster than the current practices in many Member States, even though banks are complex institutions with long maturity of assets. We believe that co-legislators must come to the solution of removing institutions from the market in a reasonable timeframe, in a rather simpler and cheaper way for all included players – meaning for taxpayers, resolution authorities and the creditors and debtors themselves.

All types of creditors should benefit from more efficient system focused not on procedural and legal aspects of insolvency proceedings but on market-based solutions. It is important to have specialized mechanism for insolvency of financial institutions (not just banks) with strict and clear timeline for actions with sole purpose of reducing value destruction to the minimum and with very modest cost of entire proceedings (role model could be FDIC and/or Dutch and UK experience). Efficient, swift and value-preserving removal of market participants is essential in prevention of moral hazard and is a cornerstone of any initiative to enhance cross-border private risk sharing in the Banking Union.

Budgetary cost in case of failing banks in any participating Member State should in medium term be zero with positive impact both on financial stability and international role of the euro in sense that it would reduce the probability of financial crisis and facilitate recovery from such crisis if it occurs.

More efficient market should by definition create more competitiveness, reaping all the benefits of the Banking Union as a true single jurisdiction which will eventually lead to level playing field, reducing the need of litigation and naturally facilitating resolution of disputes.

The development of capital markets is important for the financing of the CEE region: what are the key priorities and are they appropriately addressed by on-going initiatives at the EU or regional level?

In terms of economic and financial developments, CEE countries lag behind other EU countries. Fostering development of capital markets, as an important part of financial system, should be high on the list of priorities for the CEE countries. The reason is that capital markets are equally essential for countries' economic growth as conventional banking financing and only if combined, they represent well diversified pool of financing opportunities.

While capital markets in developed member states have been continuously broadening financing options and savings opportunities for retail investors, the development of capital markets in CEE keeps lagging behind its more developed peers and banking sector still dominates as a source of finance or saving channel (e.g. deposits).

During first phase of implementation of capital markets union various impediments for the development of CEE capital markets such as structural, regulatory, supervisory and cultural were identified. Although number of measures to address and resolve these were already introduced, during the following period focus of EU policy makers should be on how to best tailor next set of measures that would benefit countries with less developed capital markets. At the same time, CEE member states, understanding the specificities of their markets, should commit to implementing such measures in a way that would deliver best effects.

One of the key priorities is to introduce capital markets to SMEs and retail investors. One of the measures to introduce educational activities to improve their financial literacy. In addition, we have to (re)build investors' trust in capital markets and encourage them in reorienting part of their savings from bank deposits to financial instruments on capital markets. In order to achieve it, we have to ensure that investor protection measures deriving from sound and prudent legal and regulatory environment are properly implemented. At the same time, we have to bear in mind that protection of investor implies providing transparent, quality information that are presented in understandable and simple way.

To conclude, I think that the obstacles the CEE countries are facing are well identified through the EU policy initiatives, however when creating specific measures to address them we have to make sure that no one gets left behind, or that they benefits only the parts of the EU with an already liquid and developed capital markets. "One size fits all" approach should be avoided whenever possible and those that propose and draft legislation have a responsibility to ensure that the legislation is fit for purpose, scalable, robust and proportionate. ●