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Post-pandemic fiscal priorities for the euro area

The Coronavirus pandemic came as an unprecedented common external shock, it has been the most severe and widespread economic contraction of our lifetime. Countries have spent huge amounts on healthcare, and on containing the economic consequences of the pandemic.

To support countries' efforts and avoid growing divergences between Member States, the EU rolled out a huge package to support workers, businesses and countries. As part of this, the ESM offers all euro area countries a precautionary credit line to cover direct and indirect healthcare costs related to the pandemic. Additionally, the extraordinary €750 billion 'Next Generation EU' recovery fund was designed to mitigate the impact of the pandemic on economic growth and to provide further financial assistance to the most affected countries.

Without these public sector measures, the recession would surely have been deeper and there would be a greater risk of divergences between countries within the euro area. When the EU makes this comprehensive public funding available, we need to ensure its efficient use. All the more so, as the fiscal situation will remain challenging for many countries in the medium term amid uncertain future economic developments.

I see four additional risks for future growth:

First, the potential growth rate is likely to be lower than before the crisis unless the recovery fund is highly successful.

Second, companies may survive in the short term by taking out loans, but high debt loads may impair their future ability to invest. An increase in insolvencies seems unavoidable.

Third, banks, although safer than in the past financial crisis, are still struggling with persistent low profitability and may see an increase in non-performing loans due to the pandemic. So, although encouraged to continue to support the economy, they may not have the capacity to continue providing sufficient credit for investment going forward.

And finally, higher public deficits and debt are a necessary response to the crisis, but it will not be easy to reduce fiscal deficits over the next few years to sustainable levels.

Given these challenges, government measures need to be targeted,

cost-effective and focus on longer-term growth. Next Generation EU rightly fosters competitiveness and investments while supporting the greening and digitalisation of the economy to create a stronger, more innovative and sustainable EU.

Furthermore, EU fiscal rules are rightly suspended until next year to accommodate the large increase in government spending and the decrease in revenues. Let me stress that the Stability and Growth Pact has worked better than widely believed. Just before the pandemic, the euro area was doing significantly better in fiscal terms than the rest of the world, providing more budgetary leeway when the crisis broke. However, the pact needs to be reformed to make it less complex and to improve its implementation.

Nowadays, the capacity of governments to service debt is higher than the levels envisaged in the EU Treaty, although by how much is a matter for debate. Like many others, I would argue that we have to rely more on observable variables. It would be useful to have an expansion path for expenditures, for example, to prevent public expenditures from growing faster than trend growth. I would also argue that the overall 60% debt limit could be reconsidered while the annual 3% deficit limit remains relevant.

The discussion has been overshadowed by the ongoing pandemic crisis, but we must take the opportunity to think ahead, about how our fiscal rules can help governments, parliaments and markets understand how fiscal policies will evolve in future.

As a final point, the agenda for deepening the Economic and Monetary Union (EMU) remains even more valid than before the crisis: completing banking union, creating a capital markets union, setting up a fiscal capacity for macroeconomic stabilisation and implementing the ESM reform.

All this serves the longer-term objectives of creating a safer, more robust euro area and of promoting the international role of the euro.