

European Fiscal Board

THE ROLE OF FISCAL POLICY IN MITIGATING THE COVID-19 CRISIS

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MAIN LESSONS FROM MITIGATING THE COVID-19 CRISIS IN 2020

Some **shocks are too large** to be handled by national fiscal policies, even when unconstrained by rules

Reliance on some **central fiscal capacity** became necessary - and acceptable to all MS

This '**common narrative**' was based on three elements:

- The **exceptional size** and truly **exogenous nature** of the shock
- The **asymmetries** in its impact on MS, healthwise and sectorally
- The self-interest in an **interdependent EU/EMU**

But these points also underline why the collective initiatives were made **temporary**

LESSONS SPECIFIC TO THE EURO AREA

The 'common narrative' also comprised **smooth implicit coordination of monetary and fiscal policies** - both provided massive stimuli

The **policy mix in the euro area is complex** due to decentralized fiscal policies combined with limits to the ECBs capacity to be a lender of last resort to national governments

The **collective fiscal initiatives**, notably the **NGEU**, helped financial stability and should have eased the pressure on the ECB - **will implicit coordination survive the recovery?**

LESSONS FOR THE LONGER-TERM FISCAL FRAMEWORK

A **general escape clause** was activated in March 2020 to give MSs and the Commission **essential flexibility** in fiscal policy, until - at least - the end of 2021

Deactivation is to be state-dependent: recovery to pre-pandemic aggregate income

The **EFB advocates significant reforms** of the fiscal framework and rules **before deactivation**; well-identified deficiencies have become more obvious in crisis

LESSONS FOR THE LONGER-TERM FISCAL FRAMEWORK (cont.)

Ideally, the **future fiscal framework** should better combine three desirable features:

- Underpin **fiscal sustainability**
- **Reduce pro-cyclical** policies
- Improve the **quality of public expenditures**

A **tall order**, may be mission impossible, certainly far from a 'common narrative', since

- '**low-for longer**' **borrowing costs**, greatly improving sustainability, and
- growing **hope in the potential of fiscal policy** in demand management

have combined to **potentially improve fiscal stabilisation**

The **NGEU strengthens joint EU influence** on how, not just how much, governments spend - if COM/Council is prepared to modify national investment and reform plans

LESSONS FOR THE LONGER-TERM FISCAL FRAMEWORK (cont.)

Reforming the fiscal rules requires **modesty, firmness and enforceability**: emphasis on '**gross policy errors**' and on better balance between **sustainability and stabilization**

Paths for debt reduction by high-debt MSs should become

- **nationally differentiated**
- **realistic** to generate market confidence in enforceability
- targeted by **expenditure benchmarks**

The **3% reference value** for headline deficits to be retained; increasingly unobservable annual **structural deficits** to be phased out

More important role for independent analytical input at EU and national levels (IFIs)

Thank you for your attention

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