

A strong Europe needs a new fiscal framework

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Articles and Op-eds

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“A strong Europe needs a new fiscal framework”

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Following Covid-19, the global economy is facing a new shock. The war in Ukraine and its widespread economic consequences threaten the nascent post-pandemic recovery. The economic loss for the euro area stemming from the current energy price hikes surpasses that of oil crises in the 1970s. For the euro area, as an energy importer, the price increase is effectively a transfer of income and wealth abroad to energy exporters. That loss cannot be compensated fully.

Nevertheless, the euro area has been able to weather this double shock relatively well because it could build on the strength and resilience gained after the financial crisis and the sovereign debt crisis a decade ago. Countries undertook crucial reforms to address macroeconomic vulnerabilities, making their economies more robust. Banks were made safer, and Europe’s architecture was strengthened with new institutions, including the European Stability Mechanism. All this has made our monetary union more resilient.

In addition, we are still benefitting from the protective umbrella the European Central Bank and the European institutions provided during the pandemic, including the European Commission’s recovery fund. This will help European countries pursue the sustainable transformation of their economies, which will also be helpful in the current energy crisis.

But more needs to be done. Current challenges require further steps to strengthen the euro area's resilience. Namely, we need a proper fiscal framework.

Why is this important? In our Economic and Monetary Union, monetary policy is fully centralised while fiscal policy is conducted at the national level. Consequently, it is necessary to coordinate fiscal policies to ensure sound government finances and preserve debt sustainability.

In the current crisis, governments are making efforts to shield people from the impact of overwhelming energy costs. Additional steps will be needed to protect firms from bankruptcies. We need to give companies a chance to adjust before competitiveness losses become more sustained. This puts pressure on public finances.

We need a fiscal framework that ensures the core objective of debt sustainability in a simple, clear, and credible way, without imposing a fiscal tightening that would imply unnecessary economic costs. The rules have become so complex that few people understand how and why certain decisions are taken. That is why many support a framework that looks at expenditures and has a medium-term orientation. We need to build a consensus to have a framework to which all countries can effectively adhere.

The new rules also need to allow for the green transformation beyond the Next Generation EU package. Europe will face the consequences of ageing populations at an accelerated pace. Difficult spending decisions often go at the expense of investment in the future. If governments do not make the necessary public investment in addition to efforts from firms and households, we will bear more severe consequences from climate change.

Kicking the can down the road and not revisiting the current fiscal framework is not an option as financial markets need confidence on the path of fiscal policy. A status quo would require recurrent exceptions, which would seriously risk undermining the framework's credibility. The European Commission is expected to put forward a proposal addressing the current shortfalls.

European governments must then agree on changes and improvements to the fiscal framework. The Netherlands is a country with a high credit rating and strong public finances. The Dutch Minister of Finance Sigrid Kaag, together with her Spanish counterpart, have expressed their willingness to engage constructively in a

discussion on an effective fiscal framework that preserves fiscal sustainability, but at the same time creates space to address the challenge of climate change and can go hand in hand with economic growth and job creation. It is in everyone's interest, including the Netherlands, that we reach consensus on that framework.

Bridging different views on the balance between solidarity and responsibility in our common European policy approach has been the basis for the additional resilience gained over the past decade. This will again be key for the next steps in fostering a strong and sustainable future for Europe.

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