EUROPEAN CENTRAL BANK

EUROSYSTEM

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Eurosystem reply to the Communication from the European Commission "The EU economy after COVID-19: implications for economic governance" of 19 October 2021

1. The Governing Council of the European Central Bank (ECB) discussed the Communication from the Commission "The EU economy after Covid-19: implications for economic governance", with a focus on the reform of the Stability and Growth Pact.

2. The ECB Governing Council welcomes the Commission Communication relaunching the EU economic governance review and the related public debate. Increased government debt ratios and heterogeneity in the aftermath of the coronavirus pandemic reinforce the need for effective coordination of fiscal positions via the Stability and Growth Pact (SGP). The coronavirus crisis has also aggravated a number of pre-existing macroeconomic imbalances and given rise to new structural challenges, all of which need to be addressed. A well-functioning governance framework is vital for the identification, prevention and correction of macroeconomic imbalances.

3. The Governing Council stresses the importance of sustainable fiscal positions for price stability and sustainable growth in a smoothly functioning Economic and Monetary Union (EMU). In addition, in line with the ECB's monetary policy strategy statement, it recalls that the pronounced trend decline in the equilibrium real interest rate, if persistent, implies that the effective lower bound (ELB) on nominal interest rates will more frequently constrain the conduct of monetary policy. The stabilising role of fiscal policies is more important in proximity to the ELB, in view of their increased effectiveness. Countercyclical fiscal policy requires determined action during large recessions to avoid economic collapse, but it also crucially requires the rebuilding of buffers once the economy is firmly back on track so as to ensure debt sustainability. Well-designed fiscal and structural policies can support productivity and labour supply growth, helping to reverse the trend in the equilibrium real interest rate and thereby create monetary policy space.

4. The Governing Council agrees that the new framework should be simpler, more transparent and more predictable. To this end, it would help if rules were less complex and less reliant on the unobservable output gap, which could be operationalised through a stronger focus on an expenditure-based rule that does not rely on annual real-time estimates of such an indicator. The Governing Council also agrees that a realistic, gradual and sustained adjustment of public debt is important in order to rebuild fiscal space ahead of the next downturn. The SGP's debt rule would need to be reformed to guide such an adjustment.

5. Building on common fiscal rules, broadened, fully independent assessment by strong independent fiscal institutions could help to reduce the procyclical tendencies inherent in fiscal policymaking, while also supporting national ownership, which is essential for sustained implementation of the framework. Therefore, coordinated efforts for reinforcement of national independent fiscal institutions and expenditure frameworks should be continued.

6. The Governing Council agrees that fiscal policy should become more growth-friendly. Addressing the challenges of the green and digital transitions will require significant private and public investment. If effectively implemented, NextGenerationEU (NGEU), and in particular the Recovery and Resilience Facility, will support Member States in addressing this challenge and demonstrate the potential of EU-wide action. Sustained, nationally financed investment will also be needed, and will require either additional sources of revenue or a reprioritisation of expenditure, notably in countries with elevated debt ratios.

7. Completing Economic and Monetary Union remains essential to strengthen the euro area's shock-absorption capacity. This includes the completion of the banking union and capital markets union. In addition, a permanent central fiscal capacity, if appropriately designed, could play a role in enhancing macroeconomic stabilisation and convergence in the euro area in the longer run.