FISKALRAT Austria

# Policy statement by the Austrian Fiscal Advisory Council: “Enhancing the EU fiscal framework”

## Background

The European Commission’s recent assessment of the EU fiscal framework[1] identified the strengths of the current system (e.g. reduction of public debt levels, better coordination of national economic policies) as well as its weaknesses (e.g. the insufficient preservation of public investment levels during periods of fiscal consolidation, the limited ability to steer the fiscal stance at the EU level in the absence of a central fiscal capacity with stabilization features, the complexity of fiscal rules and the procyclicality of fiscal policies). The following issues pose special challenges when it comes to applying the current set of fiscal rules: supporting sustainable growth after overcoming the health crisis; creating sufficient fiscal space for future-oriented investment; and most prominently, reducing continually high public debt levels and returning to a path of convergence between member states. Moreover, there is a fundamental conflict between rules-based fiscal policies aimed at ensuring fiscal discipline and more flexible fiscal requirements that allow for maintaining balanced public finances over the business cycle without loss of credibility and without abandoning the principal target of sound fiscal positions.

Bearing this in mind, the Austrian Fiscal Advisory Council, in its recommendations to the Austrian government of June 2021, suggested that the government actively engage in the upcoming reform of the EU fiscal framework, calling for reform steps that adequately address today’s unprecedented challenges and the relevant policy areas (overcoming the COVID-19 pandemic, fighting climate change, implementing digital transformation). To balance fiscal discipline and flexibility within a rules-based fiscal policy framework, special attention should be paid to resolving issues that entail conflicting objectives. Given that the reform of the EU fiscal framework is now taking place under completely new conditions created by the COVID-19 pandemic, the following additional aspects are of particular relevance:

- Conflicts in defining a fiscal policy anchor:
    - The historic economic slump and the related support and stimulus measures went hand in hand with an increase in public deficits and public debt. At the moment, consistently low interest payments and the low interest rate environment provide for fiscal space and the opportunity to carry out investment projects to support the economic upswing and, in particular, to create an infrastructure capital stock (addressing economic priorities like digital transformation and green investments) which can generate high long-term macroeconomic yields. These goals must not interfere with sustainable fiscal policies, however.
- Reliability of fiscal rules in times of crisis, in particular when applying business cycle smoothing:
    - The procedure the European Commission currently applies to smooth the business cycle has two interesting characteristics: First, new data points change calculated past values, and second, there is a systematic bias toward the most recent data point. As a consequence, the output gap is significantly underestimated in boom periods and overestimated in times of economic crises. This should be taken into account when interpreting the output gap and the structural balance, in particular in exceptional

[1] European Commission. 2021. Communication. The EU economy after COVID-19: implications for economic governance. October 19. https://ec.europa.eu/info/files/economic-governance-review-communication_en.

economic situations when such interpretations require particular caution. Moreover, the enhancement of the fiscal framework should be informed by the results gained from evaluating different procedures of business cycle smoothing.

- The establishment of an expenditure rule as an operational tool to achieve an overriding debt target allows for more flexibility, but at the expense of simplicity. Using specific expenditure aggregates makes it possible to implement different fiscal policy targets which are, however, becoming increasingly complex.

## Guiding principles for a reform of the Stability and Growth Pact (SGP) – the Austrian Fiscal Advisory Council's perspective

- Avoid making substantial changes to the SGP that would entail lengthy Treaty (TFEU) revision procedures and ratification processes in the member states;

- Rely on the SGP's current strengths and underlying ideas as well as on previous experience when reorienting and adjusting the SGP to present challenges:

  - Maintain the SGP's primary objectives (Maastricht criteria);

  - Launch an excessive deficit procedure (EDP) in case of noncompliance with the Maastricht criteria, thereby ensuring closer monitoring and more ambitious targets than would be possible in the preventive arm of the SGP;

  - Focus the reform on the adjustment paths (speed and level of adjustment) for fiscal indicators, in particular with regard to the debt ratio;

  - Reduce complexity by focusing on an operative lead indicator (medium-term expenditure growth corrected for changes in discretionary revenues) and a general escape clause;

- Allow special treatment for investment expenditure (investment clause);

- Ensure the necessary ecological transformation (e.g. via EU-level funds);

- Increase the credibility and binding force of rules-based fiscal policy by setting ambitious targets based on uniform criteria that pay closer attention to different frameworks and conditions in individual member states while guaranteeing sustainable public finances;

- Step up efforts toward fiscal consolidation in economically normal or good times, in particular when debt levels are high.