BLOG POST

FISCAL POLICY-MAKING IN THE TIME OF CORONAVIRUS:
TIME TO TRIGGER THE ESCAPE CLAUSES IN FISCAL FRAMEWORKS

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The current COVID-19 pandemic, with its severe implications for the public health sector and overall economic development, demands a massive and coordinated fiscal and monetary policy response from political decision makers at all levels of government across Europe. Even if the exact consequences of this crisis are very difficult to fully assess at the present moment, the following principles must apply: To save human lives and to soften the adverse impacts of the expected deep economic recession, it is of utmost importance for EU Member States and the EU institutions to commit to unlimited spending (to spend much as needed to resolve the crisis) and to its unconditional refinancing (to provide the States with the necessary liquidity to do so)[1,2].

Over the last three decades, the Stability and Growth Pact (SGP), the Fiscal Compact, and national and sub-national fiscal frameworks have considerably constrained fiscal policy-making across Europe. **Dealing with this unprecedented crisis requires the activation of the built-in 'escape clauses' of fiscal rules or at least the temporary suspension of those fiscal rules, for which no such clauses exist.**

This blogpost takes a detailed look at the clauses of the fiscal frameworks currently in place at both the EU and national levels that allow moving beyond the general deficit and debt limits under exceptional circumstances. It discusses if and how these clauses are currently triggered by governments and which specificities of particular fiscal frameworks might limit the capacity of political decision-makers to respond to the massive challenge of the epidemic appropriately.

This blog post also makes several policy suggestions: **(1) apply the most generous interpretation of existing escape clauses to create sufficient room for maneuver, (2) ensure a coherent application of escape clauses across different levels of government, and (3) suspend or adapt existing fiscal frameworks where they do not contain escape clauses or unduly constrain decisive fiscal policy-making in these extraordinary times.**

1. Guttenberg, Lucas & Hemker, Johannes (2020): Corona: A European Safety Net for the Fiscal Response. Jacques Delors Centre Policy Brief. (13.03.2020).
2. Claeys, Gregory (2020): What should be done to reduce euro-area spreads? Bruegel Blog Post. (18.03.2020).

The escape clause of the Stability and Growth Pact: An explicit commitment to a generous interpretation

Since its inception in 1997, the SGP constrains national fiscal policy-making among EU member states through a set of a fiscal rules and institutions. Following the Great Recession of 2009, the Six-Pack reforms of 2011 established an escape clause which allows EU Member States to deviate temporarily from existing fiscal rules as a response to 'unusual events' outside of the countries' control. For this clause to be valid, such events must have a major impact on the general government's financial position in a particular Member State or, following a severe economic downturn, on all Member States[3]. Furthermore, deviations from the fiscal rules must be, nonetheless, consistent with the medium-term fiscal sustainability of countries. In addition, the intergovernmental Fiscal Compact also entails an escape clause for exceptional circumstances, referring directly back to the SGP.[4]

The current pandemic with all its consequences undoubtedly represents an 'exceptional situation'. The Commission already confirmed this view on the 13th of March[5], stating that the 'full flexibility' of the SGP was going to be used. In particular, the Commission highlighted that "support measures such as those urgently needed to i) contain and treat the pandemic, ii) ensure liquidity support to firms and sectors, and iii) protect jobs and incomes of affected workers, can be considered as one-off budgetary spending"[6] and would thus be excluded from the European fiscal rule requirements. For the moment, the Commission has thus embraced targeted exemptions from the SGP requirements, which are directly linked to the mitigation of the virus outbreak[7].

In the same communication, the Commission, however, also stated that the escape clause could be activated in its more 'general' interpretation, allowing the exclusion of broader fiscal policy support from the deficit and debt limits that normally bind EU Member States. As tax revenues are very likely to fall significantly in the coming months across Europe, it seems necessary to agree on the application of this broader definition of the escape clause built in the European fiscal framework. Just ahead of the publication of this blogpost, on the 20th of March, Ursula von der Leyen has announced to exactly do this[8], which is a very welcome decision of the Commission. Rapid and decisive intervention by EU countries is essential in order to avoid adverse long-term effects of the current crisis through hysteresis and other negative economic consequences. It is also crucial to remember the lessons learned from the last financial crisis. While a significant fiscal stimulus was made in 2009, subsequent fiscal consolidation efforts started too early, already in 2010, which fostered the European debt crisis that led to a double-dip recession in many European countries.

The Commission should also keep this in mind when designing national fiscal consolidation paths in the wake of the COVID-19 epidemic. As the Commission's 'Vade Mecum' states, the activation of the SGP's escape clause does "not mean putting the fiscal adjustment on hold indiscriminately. Rather, the

3. Regulation 1175/2011 Art. 5 & Art. 9 amending Regulation 1466/97 Art. 5 (1) & Art. 9 (1)
4. TSCG Art. 3 (1) c & Art 3 (3) b.
5. European Commission (2020): COVID-19: Commission sets out European coordinated response to counter the economic impact of the Coronavirus (13.03.2020).
6. European Commission (2020): Coordinated economic response to the COVID-19 Outbreak. (13.03.2020)
7. New York Times (2020): EU to Offer Greater Leeway Under Fiscal Rules for Crisis Spending. (13.03.2020).
8. European Commission (2020): Communication from the Commission to the Council on the activation of the general escape clause of the Stability and Growth Pact. (20.03.2020).

adjustment path is re-designed on a country-specific basis, to take into account the exceptional circumstances of the severe economic downturn in the euro area or in the EU as a whole"[9]. It also points out that temporary deviations from the fiscal rules can "be allowed *ex ante* or can be left out of consideration *ex post*". **For 2020, and maybe to a more limited extent in the following years, the Commission should give Member States a 'carte blanche' for battling the current crisis.** What we do not need in this situation are complicated political discussions between EU countries and institutions about exact measures, which often depend on national economic, political and social structures, but rather decisive action by all of them. Such debates should only become more central when the size of the economic shock and the impact of individual mitigation measures becomes clearer, at which point the question of fiscal sustainability will also have to be addressed.

What is meant by a 'carte blanche' is to provide the conditions that allow every country hit by the pandemic to use all the fiscal means necessary to ensure a functioning health care sector and to keep individuals and companies afloat in financial terms. To cushion the economic recession in the best possible fashion on the European level there should of course be coordination between the member states on fiscal stimulus measures. Particularly those countries with a bigger fiscal space (e.g. Germany and the Netherlands) should undertake bold fiscal policy actions to support the European economy.

Given the exogenous nature of the current shock, **it is – in any case – crucial that the European Central Bank (ECB) and the central banks of non-Euro countries ensure that monetary policies support the fiscal policy measures of national governments.** Reassuring measures in this regard have been taken with the creation of the Pandemic Emergency Purchasing Programme (PEPP) on the 18th of March 2020[10].

Escape clauses in national fiscal frameworks

Discretion-constraining fiscal frameworks exist not only at the European level but also at the national and subnational ones. The Fiscal Compact, as well as the Six-Pack and Two-Pack legislations, have been key in promoting such sets of fiscal rules and institutions. Some fiscal frameworks among EU Member States have nevertheless already existed before the last crises and were based on domestic policy initiatives.

Many national fiscal frameworks that were implemented to comply with the requirements of supra- and intergovernmental legislation are closely designed after the European fiscal framework model, often directly referring to it. This means that **national escape clauses are typically triggered automatically in accordance with the European escape clause.** For those countries (e.g. France[11], Italy[12]), no additional actions or coordination efforts are necessary to make use of the flexibility in its fiscal framework.

Some EU countries have, however, created domestic fiscal frameworks that are considerably more stringent than the European ones. While they often contain some sort of escape clause (though not all of them

9. European Commission (2019): Vade Mecum on the Stability & Growth Pact. 2019 Edition. (02.04.2019)
10. ECB (2020): ECB announces €750 billion Pandemic Emergency Purchase Programme (PEPP). (18.03.2020).
11. Assemblée nationale (2012): LOI organique n° 2012-1403 du 17 décembre 2012 relative à la programmation et à la gouvernance des finances publiques (LOPGFP).
12. Parlamento italiano (2012): Legge del 24 dicembre 2012, n. 243.

do, nor function like the European clause), they sometimes also include more restrictive requirements to make up for additional deficits and debt beyond the normal rule limits (e.g. Germany, see Box 1). The constitutional nature of national fiscal frameworks in some countries puts additional pressure on rule compliance, reducing flexibility where it might be needed in exceptional circumstances.

Box 1 – The constitutional requirements for the German debt brake's escape clause

The constitutional German debt brake allows both the federal government (Bund) and the governments of the federal states (*Länder*) to trigger an escape clause "in the event of natural disasters or exceptional emergencies beyond the control of the state and seriously affecting the financial situation of the state"[13]. To declare such as situation at the federal level, an absolute majority of the German Bundestag is necessary. As Art. 115 (2) of the German constitution further demands, the use of this escape clause has to be linked to the adoption of a 'reimbursement plan' for the debt incurred beyond the generally applicable deficit limits. It further specifies that such a reimbursement has to be done "within a reasonable period of time"[14].

In this regard, the German debt brake goes beyond the requirements of the European fiscal framework. While national fiscal consolidation paths can be delayed through the triggering of the European escape clause, thus allowing for the accumulation of additional debt not foreseen previously, the German fiscal framework demands that any additional debt must be repaid to avoid any accumulation of debt over time. Especially in the aftermath of an exceptional crisis, this might put too much emphasis on fiscal consolidation, potentially hampering an economic rebound after the slump. However, as Bajohr (2016:34) mentions, there is some leeway for the German parliament to interpret this extension to the escape clause, as it can both amend initial reimbursement plans and also decide on what a 'reasonable period of time' means[15]. In this regard, German political decision makers should opt for a lenient approach to the interpretation of its own constitution and give fiscal policy enough breathing room in the years following the current epidemic. The same applies to other countries, also calling for the ECB to ensure that national governments have enough wiggle room to address the immediate and medium-term economic impacts of the ongoing crisis.

Depending on individual national fiscal frameworks, the triggering of an escape clause and also its termination are done either by the government, the parliament or by independent bodies, which are typically national fiscal councils that are integrated within domestic fiscal frameworks. In some countries, the role of fiscal councils is rather to assess if the triggering of an escape clause by the government is justified. In the coming months, it is imperative that those responsible for making and evaluating decisions on national fiscal rule escape clauses are attentive to the gravity of the current crisis and the need for decisive fiscal policy measures as a means to attenuate the economic fallout.

Escape clauses built into national and sub-national fiscal frameworks should be interpreted in a generous manner, just as for the European level. This should also include a lenient approach to required fiscal consolidation plans that lay out the post-crisis path.

Some countries among the EU Member States lack a 'classic' escape clause for their national fiscal frameworks. In Slovakia, for example, a debt rule based on the Maastricht criterion, but more stringent in terms of the debt limit, is linked to quasi-automatic sanctions when certain thresholds are reached. While the Slovak fiscal framework was established at a time with low public indebtedness, a strong reaction by the national government might make it necessary to reach debt levels that trigger the domestic sanction

13. Deutscher Bundestag (2019): Grundgesetz für die Bundesrepublik Deutschland. (15.11.2019). Art. 115 (2) & Art. 109 (3).
14. Bundesministerium der Finanzen (2015): Kompendium zur Schuldenbremse des Bundes.
15. Bajohr, Stefan (2016): Die Schuldenbremse: Politische Kritik des Staatsschuldenrechts. Springer VS. Wiesbaden.

mechanisms which are enshrined in the country's constitution[16]. The framework contains also a number of situations in which these sanctions should not be triggered (war, a strong fall in nominal GDP, natural disasters) but this still does not amount to the same kind of escape clause as exists on the European level.

If the current epidemic is not considered to fit any of these three exceptions (it might fall under the natural disaster paragraph), and if new public debt would make the country reach the highest sanction level, a vote of non-confidence would be automatically scheduled in parliament. Only sufficient support for the government could then suspend the more drastic set of sanctions (which include expenditure freezes) for a period of 24 months.

Given the exogenous nature of the current crisis, it might be necessary to rethink such an approach, which potentially punishes governments that have little to blame themselves for in terms of policy-making. Given the constitutional nature of the fiscal framework and the fragmented party system, it may be difficult to achieve a consensus on reform in this regard, but other options such as moving from a gross to a net debt concept in the national context might help to overcome unnecessary political complications when dealing with the mitigation of and recovery from the massive shock.

The need to ensure a coherent approach to escape clauses across different levels of government

Especially in federal countries such as Germany and Austria, also sub-national units (*Länder*, regions, etc.) have established proper fiscal frameworks. In the EU context, this is particularly an issue for Germany, where the *Länder* have or share a number of important responsibilities regarding the country's economy. Especially where subnational units are part of the macroeconomic management of a country and have major responsibilities for the public health sector, fiscal frameworks could become problematic and might require the application of escape clauses or could even be suspended in order to respond to the epidemic appropriately.

The Austrian federal state of Upper Austria, for example, passed a regional debt brake in 2018[17]. However, it includes an escape clause for exceptional situations, which is applied in accordance with the national Austrian fiscal framework. This framework is itself linked to the European escape clause. Already before confinement measures were taken, the regional government decided to trigger the clause[18], since the *Länder* have certain key competences in the field of public hospitals. The coherent link of escape clauses across different levels of government seems essential if it should allow for coordinated policy actions.

In the German federal state of Bavaria, the regional constitutional debt brake does not contain any clear-cut escape clause[19]. The Bavarian government thus had to declare a 'disaster situation' and used this to suspend the federal state's debt brake for at least one year[20]. This shows that **even in the absence of escape clauses in fiscal rules to deal with exceptional situations, it is possible to take such measures in the**

16. Slovak National Council (2011): Constitutional Fiscal Responsibility Act no. 493/2011.
17. Oö. Landtag (2017): Landesgesetz zur Sicherung der Stabilität des öffentlichen Haushalts. Oö. Stabilitätssicherungsgesetz.
18. ORF (2020): Land OÖ hebt Schuldenbremse auf. (13.03.2020).
19. Bayerische Verfassung Art. 82
20. Merkur (2020): Krise schlägt durch. Börsen-Crash wegen Coronavirus: Radikale Zwangsmaßnahme geplant. (16.03.2020).

presence of corresponding need and political will. At the same time, it highlights that fiscal frameworks should, in general, be prepared for dealing with extraordinary situations.

In addition, the **European institutions should be attentive to ensure that escape clauses are applied coherently across different levels of government**, convincing countries that interpret their national escape clauses more restrictively than on the European level to permit more fiscal wiggle room.

Final remarks

To briefly summarize, there is enough flexibility to deal with the current exceptional circumstances due to the Coronavirus inside most of the existing fiscal frameworks in Europe. **The built-in escape clauses must be triggered now to allow for decisive and coordinated fiscal policy measures backed by a supportive ECB**. Given the nature of the ongoing epidemic, and the lessons from the European debt crisis, **fiscal policy support should be substantial and should not be replaced with consolidation too soon.** Wherever possible, a lenient interpretation of the requirements for debt reimbursement and consolidation paths should be applied. And where existing fiscal frameworks do not include escape clauses or where the institutional rules risk political infights, fiscal rules should be at least temporarily suspended, and in the medium-term revised to allow appropriate fiscal policy-making for when the next exogenous shock hits the EU Member States.

Committing the necessary resources to stem the immense challenge posed by the epidemic in a coordinated way and ensure their refinancing through the ECB are the only means to pass this difficult period relatively unscathed. They will also help to protect and strengthen the European project in the long run.

While the main message of this blogpost has been to really make use of all necessary fiscal means to overcome the current difficulties, this does not mean that governments should be inattentive to who and which causes money is actually flowing. If there is any opportunity in this crisis it is to use the exceptional fiscal fire power to address an exceptional situation to steer the economy also towards a more sustainable economic and environmental model in line with the Commission's ambitions of the European Green Deal.

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