

EUROPEAN COMMISSION

MEMO

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Fiscal Union

We are in a defining moment for European integration and for the European Union as a whole. The lessons of the past have taught us that further integration within the Euro area is indispensable to complete the economic and monetary union. A fiscal union is one of the main building blocks required to ensure smooth functioning of our common currency. This new architecture would provide a clear vision of the future of the EU's Economic and Monetary Union and guide the reforms and decisions necessary for the euro area and its Member States to tackle current challenges.

Since the beginning, the Commission has been committed to deepening monetary and economic integration of the European Union. In May 2008, the European Commission issued a communication marking 10 years of Economic and Monetary Union (see IP/08/716). It set out the need to improve the euro area's governance and coordination of economic policies. It recognised that this will involve both deepening and broadening economic surveillance arrangements to guide fiscal policy over the cycle and in the long term and, at the same time, address divergences in growth, inflation and competitiveness.

Considerable progress on strengthening EU economic governance has been made since then:

1. What have we achieved?

1.1 European Semester

The economic crisis revealed a clear need for stronger economic governance and coordination at EU level. This is why, in May (see IP/10/561) and June 2010 (see IP/10/859), the European Commission proposed to create a European Semester to introduce effective ex-ante coordination of fiscal and economic policy plans at European level, before decisions are taken on budgets at national level – in line with both the Stability and Growth Pact and the Europe 2020 Strategy.

This new governance architecture was approved by EU Member States on 7 September 2010. Before then, discussions between the EU and Member States on economic priorities and structural reforms took place through different processes. Reports were issued separately and decisions spread across the year with no clear synergies or linkages.



The European Semester begins with the presentation of the Annual Growth Survey (most recently in November 2011). This is where the Commission sets out the priority actions for the EU in terms of public finances, structural reforms and other growth-enhancing measures. The Annual Growth Survey forms the basis for discussions among Heads of State or Government at the Spring European Council, which sets the economic policy framework for the EU for the coming year. Subsequently the Member States submit their national reform programmes (on economic and employment policies) and stability or convergence programmes (on budgetary strategies) to the Commission for assessment. The results of that assessment, against the priority areas defined in the Annual Growth Survey, are the country-specific recommendations that are endorsed by the European Council in June.

1.2 "Six pack" laws

The "six-pack" set of EU legislation resulted in a strengthened Stability and Growth Pact. It was proposed by the Commission on 29 September 2010 (see IP/10/1199), approved by Council and EP on 28 September 2011 (see MEMO/11/647) and has entered into force on 12 December 2011 (MEMO/11/898). Comprising five Regulations and one Directive, the six-pack covers fiscal but also macroeconomic surveillance, and provides for sanctions on those euro area Member States that deviate from the rules. It has already proven to work.

It marks a major milestone in Europe's economic governance and crisis response as it represents a decisive step towards a functional framework to complement monetary union with a real economic union.

2. What is in the pipeline?

2.1 "2-pack" laws

These two draft regulations build on the "six-pack" rules by further strengthening the coordination of budgetary policy in the euro area. They were tabled by the Commission on 23 November 2011(MEMO/11/822).

The **first** draft regulation aims to further improve fiscal surveillance by establishing a common timeline and common rules to allow for more active prior on ex ante monitoring and assessment of the budgets of euro area Member States. Essentially, Euro area Member States would be required to submit their draft budgetary plans for the following year to the European Commission and the Eurogroup (made up of Economic and Finance Ministers of the 17 euro area Member States) in October, along with the independent macro-economic forecasts on which they are based. This will allow the Commission to issue an opinion on such draft budgetary plans which will feed into the national budgetary debate, notably concerning the appropriate implementation of EU policy guidance. In case a plan seriously breaches the EU fiscal rules, the Commission will ask the Member State in question to present a revised draft budgetary plan. This builds on the Stability and Growth Pact, under which Member States present the main characteristics of their medium-term public finance plans to the Commission and the Council in spring.

The **second** draft regulation aims to improve surveillance of the most financially vulnerable euro area Member States.

The "2-pack" is currently being scrutinised by both the European Parliament and the Council of Ministers. The Commission is working towards a fast approval of an ambitious version of its draft laws.

2.2 Fiscal Treaty

The Fiscal Treaty (Treaty on Stability, Coordination and Governance) is an intergovernmental treaty that was signed by 25 EU Member States on 2 March 2012. It demonstrates the willingness of the Member States to enshrine the very culture of financial stability in their legislation, mirroring the EU fiscal rules at national level. This had been a missing link in the EU budgetary surveillance framework. If a country does not properly implement the new budget rules in national law and fails to comply with a European Court of Justice (ECJ) ruling that requires it to do so, the ECJ can impose financial sanctions.

The Treaty is currently in the process of ratification by Member States.

2.3 Stability Bonds

In November 2011, the Commission presented, together with the two-pack, a Green Paper on "the feasibility of introducing Stability Bonds" (MEMO/11/820) to structure the political debate in the EU on the rationale, pre-conditions and possible options of financing public debt through European Stability Bonds.

Such common issuance of bonds by the euro-area Member States would imply a significant deepening of Economic and Monetary Union. It would create new means through which governments finance their debt, by offering safe and liquid investment opportunities for savers and financial institutions and by setting up a euro-area wide integrated bond market that matches its US Dollar counterpart in terms of size and liquidity. The fiscal framework underlying EMU would similarly undergo a substantial change, as Stability Bonds would need to be accompanied by closer and stricter fiscal surveillance to ensure budgetary discipline.

The Green Paper on Stability Bonds needs to be followed up with a roadmap that outlines the necessary deeper fiscal and economic integration in order to minimise moral hazard and ensure fiscal sustainability, in other words, the features of an economic - and political - union required to make mutualisation of debt rational.

3. The way forward

Recent years have seen an unprecedented strengthening of coordination of economic and fiscal policies at EU level. This has been accompanied by an expression of solidarity to support financially vulnerable euro area countries through the building-up of the euro area's firepower in the form of the EFSF, and the ESM (which should be effective in July). The renewed intensification of the sovereign debt crisis demonstrates the need to build further on these achievements, and map out the main steps towards full economic union, to complement and strengthen the existing economic and monetary union, as the European Commission has advocated and implemented in the past years. A fully-fledged economic union would require more decisions taken at European level when it comes to public expenditure, revenues and borrowing, and thereby a higher degree of political integration. This should obviously entail commensurate steps that ensure democratic legitimacy and accountability.