Economic and monetary union and the euro

A well-functioning economic and monetary union and a strong and stable euro are the foundations for growth and jobs in Europe.
Section 1: Why do we need an economic and monetary union and the euro?

A common policy for a common currency

The euro: a landmark in European integration

The euro is a major achievement of European integration, a milestone for countries that were frequently at war with each other throughout history: economic integration and solidarity of this kind were indeed unthinkable in the past. By 2020 there will be a new generation of young adults who will have grown up using only the euro as their national currency.

What led to the adoption of the euro?

Despite being commonplace nowadays, the euro did not come about overnight. The launch of the euro was a major, but relatively recent, milestone in the story of European integration since the end of the Second World War — a story in which economic and political objectives have always been closely linked. It all started in the aftermath of the war when the priority was to ensure lasting peace and to reconstruct the European economy by strengthening cooperation between countries, especially in terms of free trade.

Beyond its economic dimension, the euro is a powerful, tangible symbol of European unity, identity and cooperation. The Maastricht Treaty launched the economic and monetary union (EMU) and, at the same time, committed the European Union ‘to continue the process of creating an ever closer union among the peoples of Europe’. The EMU required deeper integration at policy level and thus closer political integration. While the economic and monetary union applies to all EU countries, a number of specific rules apply to euro area countries given the fact that they share a common currency.

Almost 340 million EU citizens use the euro in their daily lives.

(1) Lithuania is the latest country to enter the euro area, as of 1 January 2015.
The euro: a brief history

— **Foundations.** The Treaty of Rome of 1957 based Europe’s reconstruction on the gradual development of a borderless common market involving the free movement of goods, services, people and capital between participating countries.

— **Long-term ambition.** From the 1960s and 1970s, the idea of an economic and monetary union (EMU) — in other words, a highly integrated single market (*) with a single monetary policy (*) and a single currency — became a new and recurring European ambition against the backdrop of a weak US dollar, oil crises and currency instability.

— **Harmonisation.** The European Monetary System, a precursor to the economic and monetary union, was launched in 1979 to stabilise exchange rates, limit currency fluctuations between countries and curb price increases (inflation). It represented a radical transfer of monetary policy to the European level.

— **Economic and monetary union (EMU).** By adopting the 1992 Treaty on European Union (better known as the Maastricht Treaty), EU governments agreed to launch the EMU. Its goal was to complete the single market, establish the European Central Bank (ECB) and deliver a stable single currency by the end of the century.

— **Euros in pockets.** Euro banknotes and coins were introduced as a new single currency in 2002, replacing national currencies — like the French franc, the German deutschmark and the Spanish peseta — in 12 European countries. Today, the number of EU countries participating in the euro (‘euro area’ or ‘eurozone’ countries) has grown from 12 to 19. See map below.

**WHICH COUNTRIES ARE IN THE EURO AREA?**

Date of entry into the euro area:

1 January 1999: Belgium (BE), Germany (DE), Ireland (IE), Spain (ES), France (FR), Italy (IT), Luxembourg (LU), the Netherlands (NL), Austria (AT), Portugal (PT) and Finland (FI)
1 January 2001: Greece (EL)
1 January 2007: Slovenia (SI)
1 January 2008: Cyprus (CY) and Malta (MT)
1 January 2009: Slovakia (SK)
1 January 2011: Estonia (EE)
1 January 2014: Latvia (LV)
1 January 2015: Lithuania (LT)

EU countries not using the euro:

Bulgaria (BG), Czech Republic (CZ), Denmark (DK), Croatia (HR), Lithuania (LT), Hungary (HU), Poland (PL), Romania (RO), Sweden (SE) and the United Kingdom (UK)

All EU countries are part of the economic and monetary union to some extent, but not all of them use the euro. Two countries (Denmark and the United Kingdom) opted out of the euro at the time of the Maastricht Treaty. Others have not yet met all of the economic criteria required by the Maastricht Treaty, regarding for instance the stability of prices and exchange rates, to adopt the euro.
What are the benefits of the economic and monetary union and the euro?

• The economic and monetary union underpins the euro: It deals with monetary policy (*) (price stability and interest rates), economic policy (*) and aspects of fiscal policy (*) (in order to limit governments’ annual deficits and debts — see Section 2). It aims to provide a stable and growth-friendly economic environment for the euro area and the single market, hence one of its main purposes is to ensure a strong and stable euro.

• The economic and monetary union ensures price stability: The independent European Central Bank (ECB) is in charge of monetary policy, including printing money, for the euro area. Its main objective is to maintain the stability of consumer prices and to safeguard the value of the euro by setting and adjusting the interest rates for ECB lending. To achieve this, it aims to maintain inflation rates at just under 2 % in the medium-term, a rate considered low enough for consumers to fully reap the benefits of price stability. (In the 1970s and 1980s, many EU countries had very high inflation rates, reaching 20 % or more in some cases. Inflation fell as they started preparing for the euro and, since the introduction of the euro, it has remained at around 2 % in the euro area.)

• The economic and monetary union supports economic growth: The pooling of economies and markets at European level brings the benefits of greater size as well as a common framework to improve internal efficiency, competitiveness and robustness both in the EU economy overall and in the economies of individual EU countries. That, in turn, supports economic stability, stronger economic growth and more jobs.

• The euro is practical for citizens: The advantages of the single currency are immediately obvious to anyone travelling between the 19 euro area countries. For instance, the euro put an end to the cost and hassle of exchanging currencies at borders. It has also made cross-border shopping and price comparisons — including for online purchases — much easier and more transparent, thus boosting competition and keeping prices down for the EU’s 500 million consumers. Finally, the European Central Bank has consistently ensured price stability in the euro area, thus better protecting citizens’ purchasing power.

The European Central Bank (ECB) ensures that inflation is maintained at around 2 % in the euro area.
• **The euro is good for business:** The euro also has significant benefits for European businesses. For example, stable interest rates, promoted by the economic and monetary union, help companies to invest more in jobs and wealth creation. The adoption of the euro also ended competition between national monetary policies and eliminated transaction costs for currency exchanges, reducing risks and allowing more capital to be released for productive investments. Price stability also gives companies the security to make longer-term plans and investments which can improve competitiveness (*). That is particularly important in our globalised economies where European companies compete with players from all continents.

• **The euro is a global player:** The euro serves Europe as a whole. It gives Europe a stronger voice, and more economic clout, in global trade. It provides a stable currency, backed by a major economic bloc — the euro area — that is more resistant to global shocks. And a currency of such strength and stability buttresses Europe’s position in the world economy. The euro stands alongside the US dollar as the currency of choice for transactions at the global level: it is the second most traded currency in foreign exchange markets, present in around 40% of daily global transactions. In fact, over €980 billion are in circulation and more than 100 million people outside of Europe use currencies which are pegged to the euro. Finally, since its launch in 1999, the euro area has continued to attract direct foreign investments from countries all over the world.

Throughout the financial crisis (see Section 2), the euro broadly maintained its value compared to other world currencies such as the US dollar, at around $1.3 for €1.
Section 2: What is economic and monetary union in practice?

Common principles for stability and growth

What are the basic rules of the economic and monetary union?

Economic and monetary union is in fact an umbrella term bringing together several different policies designed to promote growth in the EU and to preserve the strength and stability of the euro. The economic and monetary union covers monetary policy (‘monetary union’), fiscal policy and economic policymaking (‘economic union’). See the ‘economic and monetary union overview’ table below for an overall summary.

These policies are managed by either national or European authorities, or by a mixture of the two. Monetary policy is managed exclusively by the independent European Central Bank (see Section 1). Fiscal policy (taxation and public finances) is the responsibility of national governments. However, decisions concerning the public finances of individual EU countries can have an impact throughout the EU. The economic and monetary union therefore includes some essential rules concerning public finances, jointly designed and adopted by all EU countries, which are enforced by the European Commission to preserve economic stability. The main instrument for guiding and coordinating economic decision-making in EU countries is the Stability and Growth Pact. The Pact was originally introduced in 1999 and has been strengthened since 2011 (see Section 3).

The Stability and Growth Pact: keeping public finances in check

In order to work effectively, the economic and monetary union relies on all EU countries, especially those in the euro area, to comply with commonly agreed rules. In particular that includes keeping their public finances in order — in other words, ensuring an appropriate balance between spending and income in national budgets.

The government deficit is the amount by which government spending exceeds government income in a given year. The Stability and Growth Pact requires governments to ensure that their yearly deficits do not exceed 3 % of their total annual production (or gross domestic product (GDP)). EU countries submit their budgetary plans to the Commission; they are then assessed annually in the context of the European semester (see Section 3).

The public debt is the total amount of accumulated government deficits. When government spending exceeds government income (leading to a yearly deficit), the government concerned has to borrow money or raise taxes to fill the gap. A country’s public debt is therefore the total amount of money that a government owes over several years. The Stability and Growth Pact requires governments to ensure that their debts do not exceed 60 % of their GDP (or continue to be reduced at a satisfactory pace towards this proportion).

The existence of yearly deficits and overall debt, which can oblige governments to generate additional income, is not a problem in itself. It can be a means of investing in future economic growth. The purpose of the Stability and Growth Pact is to prevent excessive borrowing and unsustainable public debts, which burden economic development.
What happens if the rules are broken?

If the European Commission finds that an EU country has breached the common Stability and Growth Pact rules on deficits/debts, it can start procedures to rectify the situation. If the breaches are not of a temporary or exceptional nature, the Commission recommends that EU finance ministers launch proceedings against the country in question using the excessive deficit procedure (*). Unless a majority of EU finance ministers reject the recommendation, the country concerned must submit a detailed plan to bring its deficit or debt levels within the limits set by the pact and according to a given deadline. (See Section 3 for further information.)

These rules, approved by all EU countries and EU institutions, demonstrate that economic decision-making is a matter of common concern and shared responsibility — especially within the euro area. While the monitoring aspects of the Stability and Growth Pact apply to all EU countries, fines for breaches of the rules can only be imposed upon euro area countries. Generally speaking, every EU country, and in particular the euro area countries, needs to have confidence in the fact that prudent policymaking is the norm, that mechanisms exist to identify and correct divergences and that good economic housekeeping in one country will not be jeopardised by more spendthrift behaviour elsewhere.
Who manages the economic and monetary union? — a shared responsibility

The economic and monetary union is managed by several EU and national institutions, each with its own role. This management process is known as ‘economic governance’ and involves the following actors.

**THE EUROPEAN COMMISSION** — Makes economic forecasts and monitors a range of economic indicators for all EU countries to ensure that they comply with the jointly agreed Stability and Growth Pact rules. The Commission assesses the economic situation and makes regular recommendations to the Council of Ministers, representing the governments of all EU countries (the finance ministers take decisions in the Ecofin Council (*)).

**THE EUROPEAN COUNCIL** — Heads of state or government from all EU countries set out the main policy orientations.

**THE EURO SUMMIT** — At least twice per year, the heads of state or government of the euro area countries meet to coordinate the governance of the euro.

**EU COUNCIL OF MINISTERS (‘ECOFIN COUNCIL’)** — The Council of Ministers brings together ministers from all EU countries, with different council formations according to the policy field. The ‘Ecofin Council’ is composed of finance ministers from all EU countries who coordinate and legislate on EU economic and financial policy in a number of areas. These areas include: economic policy coordination, economic surveillance, monitoring of EU countries’ budgetary policies and public finances, the euro (legal, practical and international aspects), financial markets, capital movements and economic relations with non-EU countries. On the basis of the Commission’s proposals, they take decisions which are legally binding for EU countries.

**EUROGROUP** — Finance ministers from all euro area countries meet to discuss euro-related matters, usually ahead of the Ecofin Council, where decisions are formally adopted (see above).

**EUROPEAN PARLIAMENT** — Shares the job of formulating laws with finance ministers (in the Ecofin Council) and exercises democratic oversight of the management of the economic and monetary union.

**NATIONAL GOVERNMENTS** — Set their national budgets within agreed limits for deficits/debts and implement decisions taken by the EU Council of Ministers. They are responsible for economic policies, education, labour, social policy and pensions, to mention but a few.

**EUROPEAN CENTRAL BANK** — Independently manages monetary policy in the euro area: stabilises prices by setting interest rates so as to control inflation in the medium-term.

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The European Central Bank (ECB) and the Eurosystem explained in 3 minutes.

To watch the video, see: https://www.youtube.com/watch?v=TAIcFwG1QBg
How did the economic and financial crisis occur?

The crisis, which has deeply affected many countries both inside and outside of the euro area since late 2009, is in fact the culmination of several crises and factors, including a financial (or banking) crisis, an economic crisis and a sovereign debt crisis (*), coupled with hardship for people in some EU countries.

From 2000: debts and economic divergences ...

For a number of years, many EU countries had built up significant debts and deficits. The Stability and Growth Pact was reaching its limits: by 2004 several countries had broken its rules, which proved difficult to enforce. A common currency requires the economic actors from participating countries to have enough flexibility to adapt to economic change. However, economic divergences between countries, in terms of workforce productivity and wages, were growing. In addition, some countries were no longer competitive in economic terms. These imbalances built up over many years and were not properly addressed in some countries; at the same time, the EU did not have at its disposal the tools to address them. In fact, it had a full monetary union without a full economic union underpinning it.

2007–08: a global financial crisis

In 2007 and 2008, several major US banks including Lehman Brothers, the fourth largest US investment bank, went bankrupt as a result of risky lending on the mortgage market (bursting of the US ‘subprime’ lending bubble). Given the interconnectedness of the global economy, financial contagion ensued in banks all over the world. Banks stopped lending to each other and credit dried up. To prevent the whole banking system from collapsing, between 2008 and 2011 EU countries inside and outside of the euro area responded by injecting around €1.6 trillion into their banks by means of guarantees and direct capital (almost 13 % of the EU’s GDP), which added to their existing deficits and debt.

2009: economic crisis

The EU economy went into a deep recession in 2009. EU countries designed economic stimulus policies to counter the economic downturn.

2010–12: sovereign debt crisis

In late 2009, some of the most exposed euro area economies (for instance Ireland, Greece and Portugal) could no longer sustain their soaring debt and confront the financial crisis simultaneously. That resulted in a ‘sovereign debt’ crisis. Financial market investors lost confidence both in those countries’ ability to pay back their debts and in their overall competitiveness. The interest that investors demanded for government bonds (*) became so high that they could no longer borrow on the financial markets by selling new bonds. And since a share of those bonds was held by investors in other euro area countries — for example banks — the crisis became a much wider problem. Banks lost confidence to lend to businesses and to private households, resulting in a ‘credit crunch’.

In order to overcome the crisis, public finances had to be brought back to order and structural reforms had to be undertaken to claw back competitiveness. The euro area countries established the European Stability Mechanism (ESM) which provided significant loans to those countries most in need (see Section 3). A mild economic recovery became apparent in 2011, though the EU economy suffered a slight recession again in 2012.

2013–14: recovering from the crisis

In 2013 the EU economy slowly began to recover from the protracted recession. EU economic policy focused on sustainable growth and job creation and allowed countries to continue to consolidate their public finances at a slower and tailor-made pace, according to individual circumstances. At the same time, EU countries have understood the need to intensify structural reforms to unlock growth in Europe.

The major challenge remains to spur job creation. Greece and Spain in particular have unemployment rates of over 25 %. The European Commission and EU countries have launched a wide range of measures to get the unemployed back into education, training and employment and to promote strong and durable economic growth.

For more information on the EU’s growth strategy, called the Europe 2020 strategy, see Section 3, below, on the ‘European semester’ or consult http://ec.europa.eu/europe2020/index_en.htm
Section 3: How is the EU working to boost growth?

Emerging stronger together from the crisis

Lessons learnt: stepping up cooperation

One key lesson learnt from the crisis is the extent to which EU — and especially euro area — countries count on each other to thrive: if one prospers, others benefit; if one falters, others suffer. Acting according to the concept of offering solidarity in return for solidity, euro area countries assisted Ireland, Greece, Cyprus and Portugal with conditional financial assistance, notably to help them to avoid accumulating excessive debts and get back on track towards economic prosperity and new jobs (see illustration below). Meanwhile, Spain was provided with conditional financial assistance to repair its banking sector.

Ireland, Spain and Portugal successfully completed and exited their assistance programmes, in December 2013, January 2014 and June 2014 respectively, reflecting a return in market confidence, an improved economic outlook and declining unemployment.

The guiding principle is that stronger mutual solidarity can only be pursued in return for stronger individual responsibility, which in turn can only emerge from a profoundly democratic process.

Another important lesson is that countries in an interdependent economic system like the euro area cannot allow deficits and debt to accumulate indefinitely. Similarly, economic divergences between EU countries in terms of growth and competitiveness cannot be left uncorrected: monetary union is insufficient without deeper economic union, which requires closer political integration. That is why, since 2010, national governments have decided to reinforce their cooperation at EU level by introducing a series of new measures, outlined below. The purpose of these measures is to give the EU the means to act effectively, both to prevent similar crises and to kick-start growth and jobs across the European economy. They imply a significant strengthening of economic and political cooperation, particularly between euro area countries, now and in the future.

A video from the European Commission explaining the economic and financial crisis: how the EU has found solutions to tackle the financial crisis, how it is reinforcing its economic and monetary union and how this is paving the way towards a political union.

To watch the video, see: https://www.youtube.com/watch?v=OB3zNcFYgIO
Financial assistance for Greece

In late 2009, the Greek government admitted that its public deficit was much higher than previously reported. That was due to overspending (for instance in the oversized and inefficient public sector), tax evasion and inadequate national economic policies leading to rigid market structures, often dominated by powerful organised interest groups.

To save Greece from bankruptcy and to enable it to honour its obligations towards the welfare benefits of Greek citizens and the wages of its public employees, the euro area countries and the International Monetary Fund (IMF) have, since 2010, provided Greece with loans worth nearly €240 billion, to be paid back over a long period.

In exchange for this support, the Greek authorities have been addressing the country’s weaknesses through a wide range of measures. They aim to make the country’s public finances sustainable while protecting the most vulnerable, make the tax system fairer and more efficient, modernise public administration to better respond to the needs of the Greek population, repair the banks so that they can start lending to households and businesses again, and change laws that impede the country’s businesses from competing, investing and creating jobs.

The implementation of these measures is monitored by the European Commission, the European Central Bank and the IMF, which report regularly to their respective members (the European Commission reports to euro area countries). Lenders pay out loans in regular instalments provided that Greece assures them that it is complying with its reform commitments.

Ownership of the measures by Greece and social fairness are prevailing priorities in order for the reform programme to bring about a successful economic turnaround.

With the support of EU countries and the special ‘Task force’ dedicated to providing targeted technical assistance to Greece, a wide range of reforms are being tackled. These include streamlining social security funds, supporting the national anti-corruption strategy, increasing the efficiency of tax collection and building a leaner and more efficient public administration.

Exiting the crisis, restoring growth

The EU has taken decisive action to prevent future crises and to restore growth by better coordinating economic decision-making.

1. The ‘European Semester’: A new approach to economic cooperation

Europe 2020 (*) is the EU’s strategy for economic growth and job creation until 2020. The cornerstone of Europe 2020 is the European semester, set up in 2010 as a yearly cycle of economic policy coordination and dialogue involving European institutions, EU governments and national parliaments. As part of this exercise, the Commission carries out an annual health check (‘annual growth survey (AGS)’) of the economies and finances of EU countries and publishes the survey every November, which is then discussed in depth by national and EU authorities. In May–June the following year, the Commission makes economic and budgetary policy recommendations tailored to each country (‘country-specific recommendations’) which are subsequently discussed and adopted by all EU leaders and finance ministers. They are designed to help get growth moving again, boost job creation, improve training and education opportunities and apprenticeships, assist small and medium-sized companies in accessing finance, stimulate growth by enhancing research and innovation and much more besides.

The European semester strengthens the economic and monetary union as a whole. By working together, long-term solutions are put in place to ensure stability and growth rather than quick fixes driven by short-term objectives. It also provides a framework and a binding

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The cost of borrowing for governments in five EU countries

Source: European Commission

10-year sovereign bond yields
ECONOMIC AND MONETARY UNION AND THE EURO

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ANNUAL GDP GROWTH IN THE 28 EU COUNTRIES

-5  -4  -3  -2  -1  0  1  2  3  4  5
96 98 00 02 04 06 08 10 12 16 14
Real GDP growth, EU-28

The European semester strengthens European economic management by closely coordinating national economic policy-making in the EU.

annual timeline for managing the new anti-crisis and pro-growth measures adopted since the start of the crisis (see points 2–4 below).

2. A COMPREHENSIVE STRATEGY TO ENSURE FINANCIAL STABILITY

Reinforced prevention of excessive deficits and debts ...

To avoid the build-up of excessive deficits and debt, the Stability and Growth Pact (see Section 2) was reinforced in December 2011 when a new package of EU laws came into force. The package was nicknamed the ‘six-pack’ because it contained six pieces of legislation designed to strengthen economic management in the EU.
The reform made the Stability and Growth Pact more transparent and binding, but also more flexible. On the one hand, enforcement of the rules has been stepped up: if an EU country breaches the commonly agreed deficit/debt limits then it must demonstrate that it is taking appropriate action to fix the situation according to a clear timetable. Recommendations made by the Commission for specific countries are now better enforced. Financial penalties (including fines), which can be imposed on euro area countries if they fail to balance their accounts, kick in earlier and can be gradually stepped up. On the other hand, the reform increased the flexibility of the Stability and Growth Pact. In basic terms, it increased the possibilities for taking into consideration specific economic conditions in each country at various stages of the process, rather than using a one-size-fits-all approach when applying the rules.

In 2012, all EU countries, except the Czech Republic and the United Kingdom, strengthened their commitment to the Pact when they signed an international agreement called the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, also known as the ‘Fiscal Compact’ (NB In 2014 the Czech Republic subsequently confirmed its intention to sign the treaty). It demonstrates those countries’ willingness to enshrine a culture of financial stability in their national legislation by requiring them to have their national budgets in balance or in surplus. It makes corrective action more automatic by extending new voting rules and requires firmer commitments from euro area countries.

In May 2013, two new pieces of legislation — the ‘two-pack’ — entered into force. The ‘two-pack’ reinforces economic and budgetary cooperation (and thereby the Stability and Growth Pact) even further between euro area countries. In particular, it strengthens the coordination and monitoring of national budgetary policies. From now on, as a last annual milestone in the European semester, the Commission analyses and makes recommendations on the draft yearly budgetary plans of euro area countries (sent to the Commission by 15 October) before the budgets are passed by national parliaments. The Commission assesses these plans, as well as the prospects of the euro area as a whole, thus better coordinating fiscal policies overall. It bases its assessment on the requirements of the Stability and Growth Pact and closely monitors the extent to which countries have implemented the ‘country-specific recommendations’. The Commission issues its opinion by 30 November each year. If it identifies any particularly serious non-compliance with the obligations of the Pact, it can request a revised draft budgetary plan within a specified deadline. The ‘two-pack’ also steps up the Commission’s monitoring of euro area countries facing severe financial difficulties and makes parts of the Fiscal Compact binding under EU law. The aim is to ensure that national budgets are balanced and that euro area countries in particular do not accumulate excessive deficits and debts, thereby avoiding future economic crises.

…and financial support for those most in need

In autumn 2012, euro area countries set up a new, permanent emergency fund (or ‘firewall’) called the European Stability Mechanism (*) with a total lending capacity of €500 billion. It is among the largest of its kind in the world. It can make financial loans available to euro area countries facing temporary difficulty in borrowing money from financial markets because of concerns over their debt levels. Its lending is based on strict conditions which include bringing public finances back to sustainable levels, in line with the Stability and Growth Pact, and continuing with structural reforms. It thereby boosts the confidence of financial markets in the capacity of those countries to repay their debts and to restore competitiveness over time. Overall, it helps to ensure the financial stability of the euro area as a whole.

In 2009 and 2010, two temporary emergency funds (or ‘firewalls’) were set up to help EU countries struggling with their debts: the European Financial Stability Facility (*) and the European Financial Stabilisation Mechanism (*). A new, permanent fund was set up at the end of 2012, called the European Stability Mechanism (*), which has since then provided significant loans to euro area countries in difficulty.
The **European Globalisation Adjustment Fund** is another instrument which was used to mitigate the negative effects of the crisis. The Fund supports people who lose their jobs as a result of globalisation (for example, the outsourcing of a company’s activities outside of the EU) but also as a result of major economic and financial crises. It provides training, mentoring and careers advice to workers and the self-employed. The fund will have a total budget of over €1 billion for the 2014–20 period.

Finally, in the area of regional policy, funding for regional investment projects was delivered more rapidly to EU countries as a response to the crisis, particularly to those receiving economic assistance packages. In addition, to alleviate strain on national budgets at a time of budgetary limitations, the EU contribution to regional projects was increased while the national contributions expected decreased.

### Summary of measures taken by the EU institutions and EU countries since 2010 to better coordinate their economic policies, prevent deficit/debt crises and provide assistance to countries facing financial difficulty.

<table>
<thead>
<tr>
<th>Purpose</th>
<th>Countries concerned</th>
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<tbody>
<tr>
<td><strong>European semester</strong> (since 2010)</td>
<td>Coordination of economic policies</td>
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<tr>
<td><strong>Stability and Growth Pact</strong> (reinforced by ‘six-pack’ legislation in 2011 and by the ‘two-pack’ in 2013)</td>
<td>Economic/budgetary coordination and surveillance in order to avoid excessive deficits/debts in EU countries</td>
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<tr>
<td><strong>Fiscal Compact</strong> (Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (TSCG), 2012)</td>
<td>Deficit/debt prevention</td>
</tr>
<tr>
<td><strong>European Stability Mechanism</strong> (2012)</td>
<td>Support mechanisms</td>
</tr>
<tr>
<td><strong>European Globalisation Adjustment Fund</strong> (set up in 2006)</td>
<td>Support mechanisms</td>
</tr>
</tbody>
</table>
3. ANTICIPATING AND CORRECTING MAJOR ECONOMIC IMBALANCES

The crisis exposed the depth of economic imbalances between certain EU countries, for instance in terms of competitiveness and productivity. These imbalances are particularly problematic when they concern euro area countries because working together under a common system means, for instance, that countries cannot temporarily compensate for a loss of competitiveness by adjusting exchange rates to devalue their currencies. (Devaluations of this kind are usually followed by inflation, which over time undoes the effects of competitive devaluation in any case.) The fewer economic imbalances there are between EU countries, the stronger the EU — and especially the euro area — is as an economic bloc.

The EU has therefore reinforced its monitoring of its members’ economies, with a particular focus on the euro area countries. The ‘six-pack’ of 2011 also introduced a macroeconomic (*) imbalance procedure, a new early warning system to identify and avoid potential imbalances much earlier than before. The Commission monitors a range of economic indicators that can affect overall competitiveness such as house prices, labour costs and foreign and intra-EU exports. Imbalances may, for instance, include wage increases which are not in line with productivity, or rapidly rising house prices which are not in line with overall household expenditure.

If excessive imbalances are detected, the Commission draws up recommendations — which the Council of Ministers addresses to the country concerned — to rectify the situation. The government of that country then has to establish a corrective action plan. Ultimately, a number of financial sanctions can be applied to euro area countries which persistently do not comply with recommendations (see ‘Excessive imbalance procedure’ (*)), whereas for non-euro area countries, EU funds can be suspended.

4. STRICTER SUPERVISION OF BANKS: PROTECTING THE TAXPAYER

The sovereign debt crisis was intertwined with the financial crisis: in the absence of an EU-level framework for supervising banks’ behaviour, EU governments had to rescue a number of their banks individually and haphazardly using taxpayers’ money. That contributed in some EU countries to increased debts, recession and, ultimately, a prolonged financial, economic and social crisis.

In order to construct a robust framework for regulating the financial sector, in 2009 the European Council recommended establishing a ‘Single Rulebook’ for all banking institutions in the EU single market. Since 2010, the Commission has proposed nearly 30 additional measures to ensure that all financial actors, products and markets in EU countries are properly supervised. New pan-European authorities have been set up, partly to assess the ability of banks across the EU to withstand potential financial shocks. The purpose is to ensure that banks behave responsibly, have sufficient lending capacity and can guarantee bank deposits made by EU citizens.

However, to break the vicious circle between banks and sovereign debts, EU leaders recognised that a stronger financial sector alone is not enough, particularly in the euro area countries where a more integrated approach is necessary. They therefore committed to a banking union (*) in June 2012. Based on Commission proposals for setting it up progressively, the European Central Bank (ECB) has, for example, become the chief supervisor of euro area banks. Other proposals include EU instruments for restructuring failing banks, such as a rescue fund for euro area banks(2), financed by levies on banks at the national level. The goal is to ensure that the financial sector foots the bill for its own failings whilst keeping costs minimal or null for European taxpayers.

(NB For more information on the Banking Union, see the ‘EU Explained’ publication on ‘Banking and Finance’.)

(2) Non-euro area banks can also participate should they decide to join the system.
The series of crises that built up from 2008 in Europe and across the globe have arguably been among the most hard-hitting since the Great Depression of the 1930s: a major test for European solidarity and integration.

By working together in close cooperation, the European Union and EU countries have contained the crisis and laid the foundations for economic recovery. They have overhauled the economic and monetary union in order to ensure financial stability and growth in the EU by strengthening economic cooperation and monitoring at European level. The European Central Bank played a key role through its interest rate policy, thereby reassuring the markets. The EU has reinforced its crisis management capacity on several fronts, to ensure that euro area countries in particular avoid accumulating unsustainable debts, deal with economic imbalances and do not put taxpayers on the hook for rescuing failing banks in the future.

While major progress has been made, the economic and monetary union is not yet complete. In 2012, the Commission published a ‘Blueprint for a deep and genuine economic and monetary union’ as a contribution to the ongoing discussions on its future. The blueprint sets out ways in which the economic and monetary union can be further strengthened over the coming years and proposes a calendar for reforms. It suggests that the euro area countries integrate more quickly and more deeply than the EU at large, whilst still leaving it open for other countries to participate in the future if they so wish. Concretely it proposes the following for the euro area:

— a banking union, including strict oversight of financial markets and banks (already in place) and common rules and funds for dealing with banks in difficulty, to ensure banks behave responsibly and to protect the taxpayer;

— a deeper economic union to underpin the monetary union, with targeted investments to boost growth and competitiveness, as well as a stronger social dimension;

— a fiscal union (*) to ensure sound public finances and to deepen financial solidarity between countries in times of crisis.

Whereas the banking union is being set up in the euro area countries, deeper economic and fiscal union will require changes to the EU treaties. Closer cooperation on banking, economic and fiscal policies needs to go hand-in-hand with stronger mechanisms to legitimise decisions taken in common, ensuring the necessary democratic accountability of European governments and participation of citizens in EU policymaking. In other words, the Commission will strive to develop a true political union.

Next steps

Social fairness is an essential counterpart of the stability of the euro and the solidity of public finances.

— In the short-term: to ensure financial stability, the Commission will build on a review of the ‘two-pack’ and ‘six-pack’ legislation, designed to avoid excessive deficits and debts in EU countries, whilst making proposals for strengthening the social dimension of economic and monetary union.

— In the medium term: the Commission will improve the way in which conditional financial support is granted to euro area countries in difficulty by reinforcing the democratic legitimacy of its intervention structures and by better taking into account the social impact of economic reforms required in those countries.
Why do we need the economic and monetary union and the euro?

COMPETITIVENESS — The ability of a country to successfully sell its products and services in markets at home and abroad, as well as to attract foreign investment.

ECONOMIC POLICY — At European level, the coordination of economic decisions and reforms (for example concerning education, the product market, the labour market and pensions) to ensure balanced, sustainable and inclusive economic growth. (See also ‘Europe 2020 strategy’, below)

FISCAL POLICY — Balance between government income (through taxation) and government spending, as well as the structure and content of taxes and expenditure.

MONETARY POLICY — System in which a monetary authority (at EU level: the European Central Bank, (ECB)) controls money supply by printing banknotes and by authorising volumes of coins to be minted by euro area countries, and controls inflation by adjusting interest rates to ensure price stability.

SINGLE MARKET — Successor to the ‘Common Market’ of the 1960s–1970s. Promotes the free movement of goods, services, people and capital within a single trade block.

EXCESSIVE DEFICIT PROCEDURE — Procedure launched by the Commission if an EU country breaches either the deficit OR debt limits laid down in the Stability and Growth Pact, in order to bring that country’s deficits/debts in line with the common targets.

GOVERNMENT BONDS — Loans taken out by national governments, which sell bonds to investors in order to raise money and pay back their debts. These loans are accompanied by a promise to repay the face value on the maturity date with, in addition, periodic interest payments.

MACRO- AND MICROECONOMICS — Macroeconomics concerns the study of large-scale economic indicators such as national income, unemployment and inflation in order to understand the economy as a whole. Microeconomics focuses on smaller-scale agents such as companies and consumers in specific markets and how their behaviour affects supply and demand, and thus prices.

SOVEREIGN DEBT CRISIS — Situation where investors, considering that a government will potentially fail to pay back its debts on government bonds, demand higher and higher interest rates on those bonds, thus further deepening the sovereign country’s existing deficits and debts.

How is the EU working to boost growth?

ALERT MECHANISM REPORT — The macroeconomic imbalance procedure (MIP) is a surveillance mechanism that aims to identify potential risks early on, prevent the emergence of harmful macroeconomic imbalances and correct any existing imbalances. The annual starting point of the Procedure is the Alert Mechanism Report, based on a scoreboard of indicators.

BANKING UNION — A further step towards economic and financial integration in EU and euro area countries, with the aim of strengthening and extending the regulation and supervision of the banking sector in Europe.
EUROPEAN FINANCIAL STABILITY FACILITY (EFSF)/EUROPEAN FINANCIAL STABILISATION MECHANISM (EFSM) — Two ‘firewalls’ or financial support systems, constructed as temporary measures for EU countries in difficulty, now replaced by the European Stability Mechanism (see below) for any new requests for financial support. The ‘Facility’ was set up as an emergency fund with a lending capacity of €440 billion for euro area countries and is still responsible for support schemes previously agreed upon for Greece, Ireland and Portugal. It raises funds on financial markets which are backed by guarantees of the euro area countries. Assistance is given under strict conditions based on an economic adjustment programme for the country concerned. The ‘Mechanism’ allows the Commission to borrow up to €60 billion from financial markets, on behalf of the EU, to lend to any EU country in difficulty.

EUROPEAN STABILITY MECHANISM (ESM) — Established in 2012, the ESM is a permanent mechanism for crisis resolution in euro area countries which built on the principles behind the EFSF and the EFSM (see above), set up as temporary support measures. With a lending capacity of up to €500 billion, the ESM relies partly on paid-in capital to issue debt instruments in order to finance loans and other forms of assistance to euro area countries in financial difficulty. To be eligible for ESM loans, the country in question must first have signed the European ‘Fiscal Compact’, after which it must follow a specific adjustment programme. Two programmes of that kind were approved: in 2013 for Cyprus (with a full economic adjustment programme) and in 2012 for Spain (with an adjustment programme for Spain’s financial sector).

EUROPE 2020 STRATEGY — The EU’s growth strategy for 2010–20, focusing on ‘smart, sustainable and inclusive’ growth. (See http://ec.europa.eu/europe2020/index_en.htm or the ‘European Union explained’ edition specifically dedicated to the Europe 2020 strategy.)

EXCESSIVE IMBALANCE PROCEDURE — Procedure launched by the Commission when a euro area country presents serious economic imbalances (in terms of growth and competitiveness). It is the corrective arm of the macroeconomic imbalance procedure, the EU’s early warning system which indicates emerging imbalances.

FIREWALL — Mechanism which helps to finance the debts of countries facing temporary difficulties in borrowing money from financial markets, under strict conditions. (See European Financial Stability Facility/European Financial Stabilisation Mechanism, above).

FISCAL UNION — Sharing a common budget with a central fiscal authority, like in the United States. Common bonds could finance euro debt rather than individual country bonds. This is a long-term vision, as it would require a revision of the EU treaties.
Find out more

- For an overview of EU economic and financial affairs: http://ec.europa.eu/economy_finance/index_en.htm
- For information on the European Central Bank: http://www.ecb.int
- Questions about the European Union? Europe Direct can help: 00 800 6 7 8 9 10 11
  http://europedirect.europa.eu