



THE EUROPEAN
UNION
EXPLAINED

Fostering
stability,
growth and
prosperity
across Europe

Economic and monetary union and the euro

A well-functioning economic and monetary union and a strong and stable euro are the foundation for a growth-friendly economic environment in Europe.



THE EUROPEAN UNION EXPLAINED

This publication is a part of a series that explains what the EU does in different policy areas, why the EU is involved and what the results are.

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The European Union explained: Economic and monetary union and the euro

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Why do we need economic and monetary union?

A common policy for a common currency

The euro is a familiar feature of everyday life, used by over 332 million EU citizens for their daily requirements, to save for tomorrow and to invest in the future. Indeed, by 2020 there will be a new generation of young adults who will have known only the euro as their national currency. The story of the euro began when EU leaders agreed to launch an economic and monetary union (EMU), with a single currency, as part of the Maastricht Treaty signed in 1992. After several years of preparations, involving completing the single market and establishing the European Central Bank, between 1999 and 2002 twelve EU Member States withdrew their national currencies — like the guilder, the franc and the peseta — and joined together in the euro area, with one single currency: the euro.

Since then, the euro area has expanded to include 17 EU countries. It complements the frontier-free 'single market' where goods, people, services and capital move around freely within all EU countries. With 500 million consumers in 27 Member States, the EU is among the largest economies on the planet. It accounts for more than one third of world trade and one fifth of world production.

A well-functioning economic and monetary union is the foundation for a stable and growth-friendly economic environment for the euro area and the single market. Preserving a strong and stable euro is critical as it directly affects economic growth, people's jobs and the success of EU enterprises. It also influences the availability of investment capital, the sustainability of public finances and pensions, and the ability to fund welfare and social protection systems in Europe.

The economic and financial crisis that started in 2008 has highlighted the need to strengthen economic governance in the EU and in the euro area. Weak governance allowed some national debt and deficit levels to develop in an unsustainable way. This resulted in the sovereign debt crisis that affects certain EU countries, which are now obliged to pursue strict deficit reduction policies. In today's financially turbulent world, standing together as a major economic bloc, the EU has shown how it can weather the storm and support individual Member States that would otherwise be more vulnerable.



Over 332 million EU citizens use the euro for their daily requirements.

A single currency for Europe

The euro offers many benefits to citizens, to businesses, to trade, to economic growth and to Europe's voice in the world. In the 1970s and '80s many EU countries had very high inflation rates, some of 20 % and more. Inflation fell as they started preparing for the euro and, since its introduction, has remained around 2 % in the euro area. Price stability means that citizens' purchasing power and the value of their savings are better protected. For citizens, the euro put an end to the cost of exchanging currencies at borders. It made shopping and price comparisons across borders — including buying online — much easier and more transparent, thus boosting competition and keeping consumer prices down.

Both practical and political goals

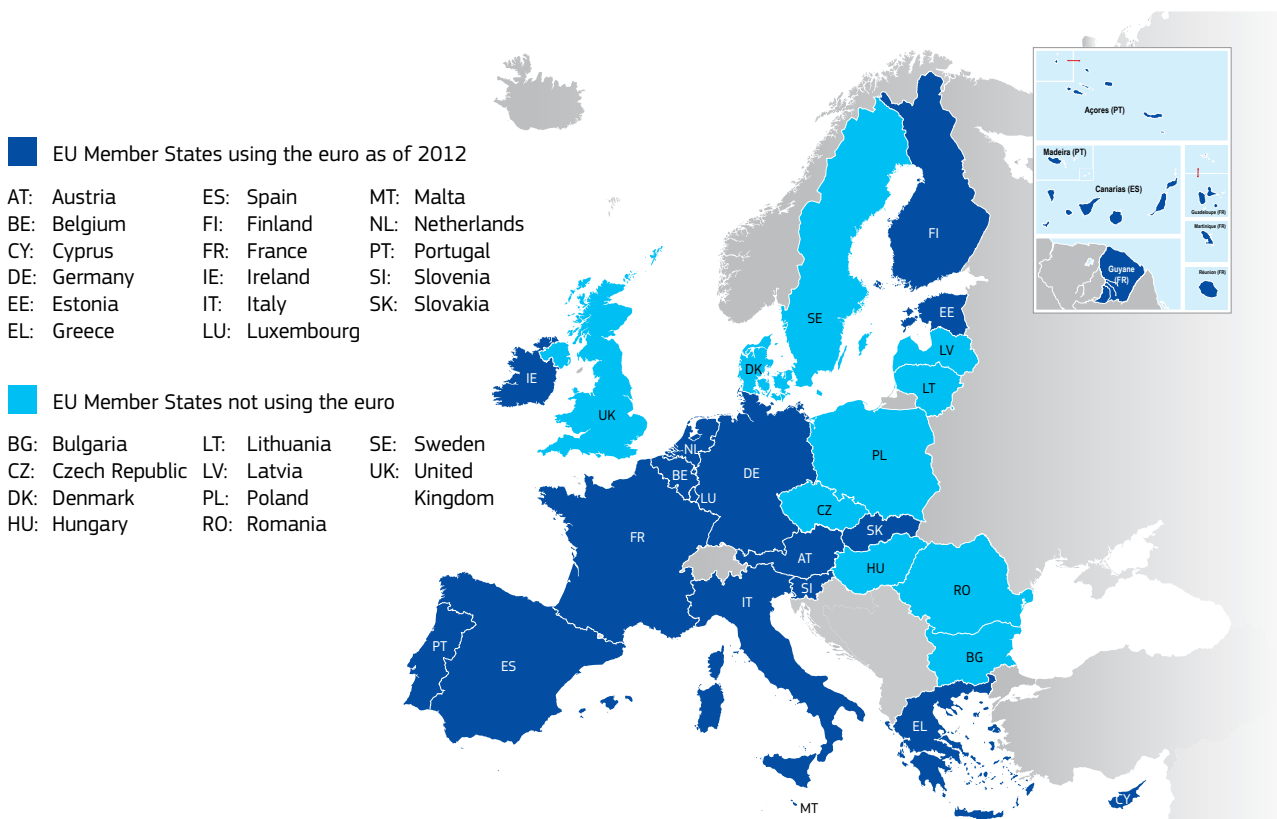
As well as offering tangible benefits, the euro is also a powerful symbol of European unity and identity. Launching the euro was more than an economic decision; it was also a political decision for more European integration.

The Maastricht Treaty of 1993 expressed this political dimension by forming the economic and monetary union (EMU) and establishing the European Union 'to continue the process of creating an ever closer union among the peoples of Europe'. EMU required a deeper policy integration and thus closer political integration.

As well as direct benefits for citizens, there are other strategic reasons for sharing a single currency. One is to promote economic convergence, meaning that the euro area economies over time become more integrated. This creates more wealth, as it boosts the free movement of goods and services for trade, capital for investments and people for leisure and work.

The benefits for enterprise are also significant: stable interest rates encourage companies to invest more to create wealth and jobs; and with no currency exchange costs, more capital is released for productive investments. Stability also gives companies the security to make longer-term plans and investments that improve competitiveness — particularly important in view of the globalisation of markets.

The euro also offers advantages for Europe as a whole. It supports global trade and provides a stable currency, backed by a major economic bloc — the euro area — that is resistant to global shocks. And a currency of such size, strength and stability gives Europe a stronger position in the world economy. The euro stands alongside the US dollar as the currency of choice for transactions throughout the world, and the euro area attracts direct foreign investments from the rest of the world.



EMU: managing the single currency

The decision to create an economic and monetary union was taken by the European Council in the Dutch city of Maastricht in December 1991, and was later enshrined in the Treaty on European Union (the Maastricht Treaty). Economic and monetary union takes the EU one step further in its process of economic integration, which started in the 1950s.

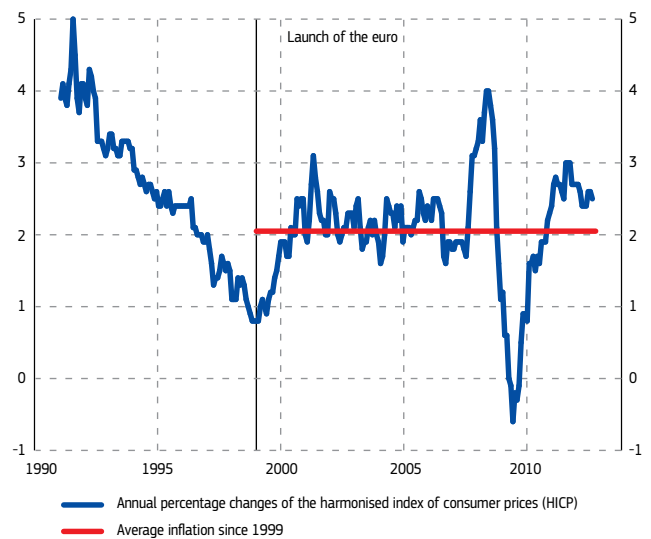
In principle, all EU countries are part of the EMU, although not all use the euro. There are basically two reasons why some countries do not use the euro. Either they decided via an 'opt-out' in the Maastricht Treaty not to take part in the third stage of EMU of adopting the euro (Denmark, United Kingdom), or they first need to fulfill certain convergence criteria before they can adopt the euro. Before introducing the euro, a Member State's economy must fulfill these criteria which concern price and exchange rate stability as well as sound and sustainable public finances. These convergence criteria were designed to ensure that a Member State's economy was sufficiently prepared for the adoption of the single currency.

The euro area

Since the euro was launched, euro area membership has grown from 12 to 17 countries. However, all EU countries are part of the economic and monetary union.

The aim of economic and monetary union is to foster balanced and sustainable economic growth within the EU. Economic integration brings the benefits of greater size, internal efficiency and robustness to the EU economy as a whole and to the economies of the individual Member States. This, in turn, offers opportunities for economic stability, higher growth and more employment — outcomes of direct benefit to EU citizens. Within EMU, there are several policies aimed at reinforcing economic stability.

INFLATION HAS BEEN KEPT AROUND 2 % IN THE EURO AREA



Source: Eurostat. Data prior to 1996 are estimated on the basis of non-harmonised national consumer price indices (CPIs).

Monetary policy — which deals with price stability and interest rates — is run independently by the European Central Bank (ECB) in the euro area. It aims for stable and low consumer price inflation and achieves this by setting the interest rates for the bank's lending. The ECB's monetary policy's primary objective is to maintain price stability and to safeguard the value of the euro. In doing so, it aims at inflation rates of below, but close to, 2 % over the medium term. The ECB considers 2 % as low enough for the economy to fully reap the benefits of price stability. This target inflation rate is also important for ECB's commitment to provide an adequate margin to avoid the risk of deflation.

Fiscal policy — which concerns decisions about taxation, spending and borrowing — is still the responsibility of the Member States' governments. However, budgetary decisions taken in the Member States can have an impact throughout the euro area and the entire EU. These decisions must therefore conform to rules set at EU level, which put limits on government debt and deficit.

Other economic policymaking — such as decisions about the labour market, pension systems and other policy areas in the economy — is also the responsibility of the Member States' governments and is coordinated at EU level in the annual European semester (see chapter 'What the EU does').

Who does what?

All EU countries are part of the EMU, although not all use the euro. The EMU is managed by several EU and national institutions, each with its own role. This management process is known as economic governance and it is achieved through an institutional structure which comprises the following actors.

THE EUROPEAN PARLIAMENT — shares the job of formulating legislation with the Council and exercises democratic oversight of the economic governance process.

THE EUROPEAN COUNCIL — the Heads of State or Government from all EU countries set out the main policy orientations.

THE COUNCIL — finance ministers from all EU countries coordinate policies, decide on proposals from the Commission and take decisions which can bind individual EU countries.

THE EUROGROUP — finance ministers of the euro area countries decide on matters concerning the euro.

THE EUROPEAN COMMISSION — proposes orientations for the conduct of economic and fiscal policy to the Council, monitors performance and ensures that EU countries comply with decisions and recommendations of the Council.

THE EU COUNTRIES — set their national budgets within agreed limits for deficit and debt, determine their own structural policies involving labour, pensions and capital markets, and implement Council decisions.

THE EUROPEAN CENTRAL BANK — independently implements monetary policy for the euro area, with price stability as the prime objective.



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The European Central Bank has the exclusive right to authorise the issuance of euro banknotes. Their production is shared between the national central banks. Euro coins are issued by the EU countries of the euro area in volumes approved by the ECB.

How the EU goes about it

Policies for stability and growth

To ensure stability and prevent decisions in one country causing ‘spillover’ effects elsewhere, economic policies are in part regulated at EU level. The key EU instrument for coordinating and guiding economic policymaking in the Member States is the Stability and Growth Pact (SGP). It sets two main rules.

- The government debt (the amount the state has borrowed) may not exceed 60 % of GDP (the total value of what a country produces in a year). Borrowing is fine when a country invests for future growth, but if it is too high, then it may become a burden on economic development.
- The national deficit (the amount by which spending exceeds revenues in a given year) may not be greater than 3 % of GDP. When spending exceeds income then a country must borrow to fill the gap, which adds to the government debt.

Economic policymaking through the Stability and Growth Pact has evolved with time to meet the challenges of the day. And it continues to do so. In particular, the recent economic crisis has highlighted the need to strengthen economic governance in the EU and in the euro area.

The EU has a monetary union, with a single currency in the euro area and a European Central Bank, but economic union is less advanced. Over time, EU countries have developed differently in terms of growth, inflation and competitiveness and there is a need to address and prevent possible negative spillovers from these divergences by means of a higher degree of economic coordination. In the current crisis a number of EU countries face economic challenges, not least some of those in the euro area. Concrete steps have therefore been taken recently to increase the coordination of Member States’ economic policies, to exit the crisis and to get back on track with stability, jobs and sustainable growth.

Stronger surveillance of national budgets

The Stability and Growth Pact was reinforced in December 2011, when a new package of EU legislation entered into force. It is also known as the ‘six pack’ — as it comprises six pieces of legislation which strengthen EU economic governance.

The **reinforced SGP** introduced more transparency and greater surveillance by the Commission of Member States’ national budgets.

- There are now stronger rules preventing the build-up of excessive deficits. In particular, where a country has a deficit above the 3 % limit then it must demonstrate that it is taking budgetary measures to reduce its deficit over the medium term.
- Where the debt limit is breached — above the SGP limit of 60 % of GDP — a Member State must show that it is taking measurable actions to reduce the level of debt according to an agreed timetable.
- Stronger financial sanctions can be imposed progressively on euro area countries that do not take corrective measures to reduce excessive deficit and debt levels — including having to deposit funds as a guarantee and ultimately facing fines.

The European Commission monitors a range of economic indicators for each EU Member State to confirm that the rules of the reinforced Stability and Growth Pact are being adhered to. It reports, monitors and assesses the economic situation in the EU countries and makes recommendations to the Ecofin Council of ministers of economy and finance from all EU Member States and to the Eurogroup on a regular basis. The Eurogroup comprises the finance ministers from the euro area countries, and takes decisions on matters concerning the euro and the euro area.

When an EU country does not adhere to the set rules, the European Commission can initiate procedures to rectify the situation. In this role, the Commission issues recommendations to the Council. After the Council has adopted them, the EU country concerned has to take the necessary action to prevent deviations from policy, and to correct them where they arise.

To redress earlier weaknesses in economic governance, the voting rules of the Council now give a stronger role for Commission recommendations on a country. A majority of the EU countries must vote against the recommendation or proposal for it not to be adopted. However, while the surveillance and monitoring aspects of the reinforced SGP apply to all EU Member States, the possibility of financial sanctions only applies to those in the euro area.

Sound public finances

Also referred to as 'the fiscal compact', the **Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (TSCG)** is an intergovernmental treaty that was signed by 25 EU Member States in March 2012. It demonstrates the willingness of those Member States to enshrine the very culture of financial stability in their legislation, requiring them to have their national budgets in balance or in surplus. This rule has to be incorporated into national law and countries are to take action if their public deficits exceed the agreed limits. It also strengthens the rules of the Stability and Growth Pact by making corrective actions more automatic. The treaty applies to all signatory countries, with firmer commitments for euro area countries. It is planned to enter into force no later than 1 January 2013, once 12 euro area countries have ratified it.

EU leaders welcome the signature of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, signed by 25 Member States in March 2012. José Manuel Barroso, President of the European Commission (on the left) and Herman van Rompuy, President of the European Council (on the right).



Did you know?

- In 2011 the EU countries in the euro area had a lower deficit on the state budgets (4.1 % of GDP) than the United States (9.6 % of GDP) and Japan (8.2 % of GDP).
- In 2011 the EU countries in the euro area had a lower government debt (87 % of GDP) than the United States (102.9 % of GDP) and Japan (229.8 % of GDP).

Early warning system of macroeconomic imbalances

The depth of the economic crisis in some EU countries revealed that more forward-looking surveillance is needed to prevent economic divergences between their economies, in particular, differences in competitiveness — the ability of a country to successfully sell its products and services in the markets at home and abroad.

The legislative package of December 2011 put in place the **macroeconomic imbalance procedure (MIP)** as the new mechanism to identify imbalances in Member States' economies much earlier than before. It monitors national economies in detail and alerts the EU institutions to potential problems ahead.

The MIP uses a scoreboard that tracks changes in 10 economic indicators, such as export market shares, labour costs, private sector debt and house prices. In this early warning system, the Commission identifies any signs of potential emerging macroeconomic imbalances which require an in-depth review. Such a review can have three results:

- (1) the situation is unproblematic > the procedure stops;
- (2) there are imbalances > the Commission makes recommendations in the European semester;
- (3) there are severe imbalances > the Commission recommends that the Council declare the existence of an excessive imbalance and adopt recommendations to the EU country to correct this situation based on a clear roadmap with milestones to 'rebalance' its economy.

Examples of such imbalances are wage rises that are not in line with productivity increases or rapidly rising house prices. Ultimately, similar financial sanctions as present under the reinforced SGP can be applied to a euro area country if no corrective action is forthcoming.

Structural reforms to foster competitiveness

Also in 2011, the euro area countries agreed a series of measures in the **Pact for the Euro**. This reflects the deeper interdependence of their economies and the intention to intensify the coordination of national economic policies. Six countries outside the euro area have also joined the pact: namely, Bulgaria, Denmark, Latvia, Lithuania, Poland and Romania.

The main objective of the pact is to improve competitiveness and thereby to foster a higher degree of growth and economic convergence within the participating EU countries. It focuses on policy areas that are mainly the responsibility of the Member States themselves, such as competitiveness, employment and sustainable public finances. The participating EU countries are committed to a set of concrete actions to be achieved within the next 12 months based on indicators and principles contained in the pact.

The Pact for the Euro (Euro+ Pact)

The Euro+ Pact is an important instrument for linking economic and fiscal policy to other policy areas that are closer to everyday economic activity, such as those for industry, education, and research and development.

Firewalls to protect financial stability

From late 2009 and early 2010, certain euro area countries were beginning to have problems financing their debts. Market uncertainty led to normal government borrowing operations becoming costly and eventually impossible. At the time, EU countries reacted quickly by putting in place so-called 'firewall' confidence-building measures to help to finance the debts of countries facing temporary difficulties in borrowing money from financial markets.

The **European financial stability mechanism** allows the European Commission to borrow up to a total of



The EU is taking measures to reform and strengthen its financial services sector.

€60 billion from financial markets on behalf of the EU to lend to any EU country in difficulty. Countries receiving loans have to submit a macroeconomic adjustment programme to restore financial markets' confidence in their ability to repay their debts and to restore long-term competitiveness.

The **European financial stability facility** is an emergency fund with an effective lending capacity of €440 billion to euro area countries in difficulty. 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. A group of experts, referred to as 'Troika', composed of staff from the European Commission, the European Central Bank and the International Monetary Fund (IMF), regularly assess the progress of the agreed reforms.

As these two financial backstops were constructed as temporary measures, the euro area countries in the autumn of 2012 created a new and permanent financial backstop — the **European Stability Mechanism (ESM)**. It is now the cornerstone of the European firewall and an integral part of the EU's comprehensive strategy to ensure financial stability in the euro area. Its lending capacity is currently set at €500 billion and conditional financial assistance will be available to those countries that have ratified the treaty on stability, coordination and governance. The ESM thus complements the reinforced surveillance by giving the possibility to offer conditional financial assistance to euro area countries when needed.

These 'firewall' facilities have not only resolved the immediate difficulties experienced by some countries in repaying their debts, but have also boosted the confidence of financial markets and helped to ensure financial stability of the euro area as a whole.

What the EU does

How the EU coordinates economic decision-making

An important lesson learned from the financial crisis is that economic policymaking in the EU needs better coordination. European governments recognise that they have to share economic and political responsibility because their economies are so interdependent, particularly in the case of the euro area countries. Working together, long-term solutions are put in place rather than quick fixes driven by short-term objectives.

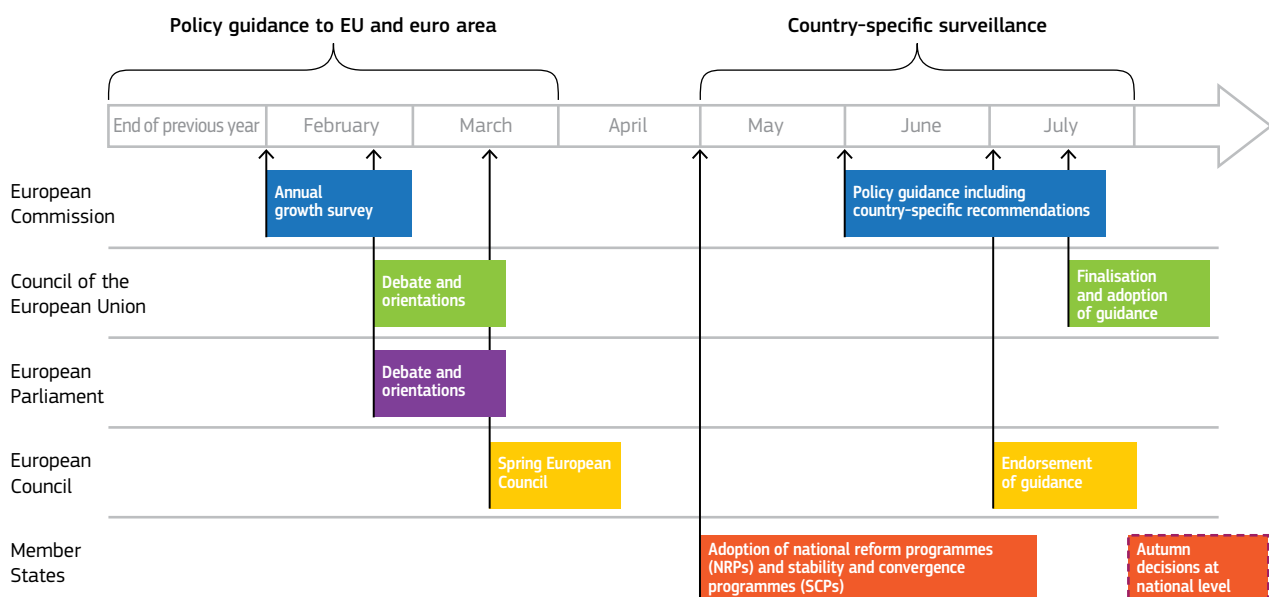
To achieve this, in 2010, a new approach towards surveillance and coordination was agreed: **the European semester**. This involves a strict annual timetable for collecting, analysing and assessing a broad range of economic indicators. The European semester is an inclusive process, involving all the European institutions concerned with economic policymaking as well as governments and national parliaments of the EU countries. It ensures that Member States promote sustainable competitiveness and job creation. The timetable for the annual European semester is shown in the chart and its milestones are as follows.

BETWEEN THE END OF THE PREVIOUS YEAR AND JANUARY — The European Commission launches the semester by publishing its annual growth survey which sets out proposals for EU priorities in the coming year, including the economic and fiscal policies and reforms needed to ensure stability and growth.

MARCH — The European Parliament and government ministers meeting in the Council of the European Union discuss the proposals set out in the annual growth survey. At the spring European Council the leaders of the EU countries issue guidance for national policies based on these.

APRIL — The EU countries adopt and submit their national reform programmes (NRP) for boosting growth and jobs, and their stability or convergence programmes (SCP) for ensuring sound public finances.

THE EUROPEAN SEMESTER TIMELINE



The European semester aims to strengthen economic governance through better coordination of national economic policymaking in the EU.

JUNE — After assessing NRPs and SCPs during May, the Commission issues specific recommendations for each EU country. These are then discussed by the European Council in June.

JULY — The recommendations for each EU country are formally adopted by government ministers meeting in the Council of the European Union. On the basis of these recommendations, each country then formulates its own national budget for presentation to its national parliament.

Ensuring stability

Euro area countries submit stability programmes which set out their individual budgetary positions compared to the rules of the Stability and Growth Pact and show how these are expected to develop over the following 3 years. The underlying economic assumptions are given to allow an assessment of how robust the programme might be to external events. All EU countries outside the euro area submit convergence programmes which contain the same information and also allow oversight on how their economies are converging with those of the euro area. The stability and convergence programmes are an important part of the surveillance arm of EU economic governance — giving insights to other EU countries and forming the basis for recommendations for improvements.

Ensuring growth

National reform programmes are policy documents that set out a 3-year strategy, updated annually, describing the actions needed to boost growth and jobs. They concern national activities in the fields of education, employment, research and development, and social welfare. Each NRP fixes clear targets, such as the unemployment rate, the level of workers' skills, R & D investment as a percentage of GDP or the number of early school leavers, and then sets out the actions being taken to achieve these. These are key instruments for guiding efforts to make national economies more competitive, more sustainable and more inclusive for all citizens.

What happens when the rules are broken?

The reinforced Stability and Growth Pact (SGP) allows for **stronger preventive action** which aims to prevent the EU countries from getting into an excessive deficit situation and thus committing grave policy errors. The preventive arm of the Stability and Growth Pact requires Member States to make significant progress towards medium-term budgetary objectives.

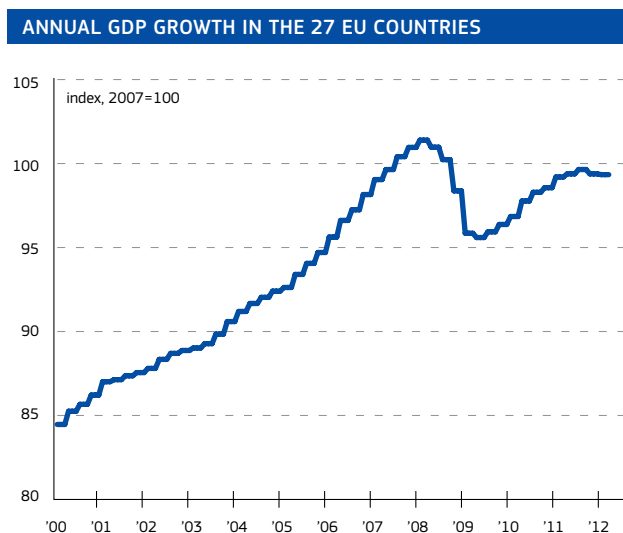
However, if an EU country has a government deficit or a level of national debt that exceeds the ceilings laid down in the Stability and Growth Pact, then an **excessive deficit procedure (EDP)** is triggered. When assessing stability and convergence programmes as part of the European semester, if the Commission finds that the SGP limits have been breached, and that this is not a temporary or exceptional event, then it makes a proposal to the Council to launch an EDP against the country concerned. In this case, following a strict timetable, the Council makes recommendations to the country and sets deadlines for corrective actions to bring the deficit or debt level within the SGP limits over time.

The EDP is an expression of the fact that economic decision-making, particularly within the euro area, is a matter of common concern. It gives confidence to each EU country that prudent policymaking is the rule, that mechanisms exist to identify and correct divergences from the common rules, and that good economic housekeeping at home will not be endangered by more spendthrift behaviour elsewhere. However, where a euro area country fails to comply with the recommended corrective actions, then financial sanctions can be applied.

In addition, if an EU country shows serious macroeconomic imbalances, an **excessive imbalance procedure** can be opened. The Member State concerned will have to submit a corrective action plan with a clear roadmap and deadlines for implementing corrective action. Ultimately, financial sanctions can be imposed on euro area countries if no corrective action is forthcoming.

The EU economy: more control, more growth, coming out of the crisis

Today, the European semester is the instrument for guaranteeing that economic policymaking in the Union better serves the needs of its citizens and their single currency, the euro. It ensures that economic policy decisions — both at EU level and in the Member States — are better integrated and in line with the shared vision of EU policies for growth and jobs as clearly set out in the Europe 2020 strategy. The challenge that EU and national policymakers are addressing can be seen in the following chart which shows GDP growth in the EU over recent years.



Source: European Commission.

Steady economic growth since the launch of the euro went hand in hand with rising employment and living standards for EU citizens. The economic crisis that started in 2008 caused a sharp drop in growth, and also in jobs. Indeed, many of the millions of jobs created in the EU up to 2008 were lost as the crisis took hold. The purpose of the new economic governance framework implemented through the European semester is to ensure that economic growth follows an upward path, that employment is increased and that the EU economy is better protected against such crises in the future.



A video from the European Commission explaining the economic and financial crisis and the EU's response to it: 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.

Reinforcing the financial sector

The origins of the crisis did not develop overnight, but over many years. It is true that the economic and financial crisis was originally triggered by the bursting of the US subprime bubble culminating in the collapse of the Lehman Brothers investment bank in September 2008. However, the imbalances which had built up within the euro area before the outburst of the crisis — the build-up in some Member States of large government debts and deficits, macroeconomic imbalances, coupled with increased differences in competitiveness — made it very difficult for some EU countries to effectively confront both the financial crisis and the emerging debt crisis simultaneously. In this situation, many European banks faced serious difficulties. A vicious circle was created in which banks stopped lending to each other, leading to a shortage of credit which in its turn led to a crisis of confidence and so to less lending between banks.

Many European governments had to give major banks urgent financial support on a huge and unprecedented scale to save them from bankruptcy. From late 2009 and early 2010 certain euro area countries were beginning to have problems financing their debts and needed to offer investors ever higher interest rates (the so-called sovereign debt crisis).

Between 2008 and 2012, European governments provided banks with financial support, mainly in the form of guarantees and capital injections, to prevent a collapse of the banking system. This support peaked at €1 540 billion and declined to €1 050 billion in June 2012.

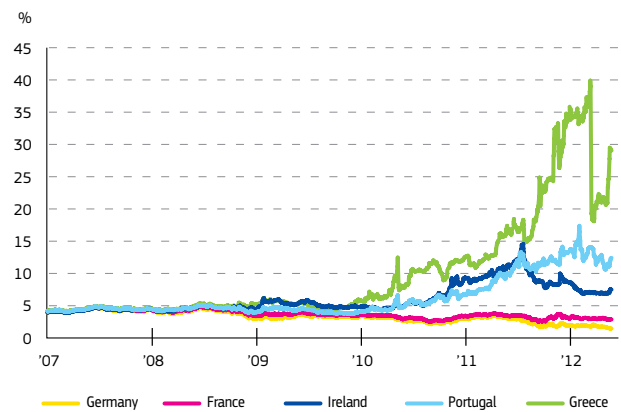
Faced with the worst crisis in a generation, Europe's governments and institutions have worked together to tackle the immediate challenges of the sovereign debt crisis (such as the inability of Ireland, Greece and Portugal to access bond markets) and to put in place measures to prevent such crises in the future. It is clear that, without a stable banking sector and without public debt under control, there is little chance that growth will return. Without stability there is no confidence. And without confidence we will not achieve growth, create jobs or increase prosperity.

To reform and strengthen the EU's financial service sector, new pan-European authorities have been set up to supervise more strictly the financial institutions in the EU. To ensure that healthy banks are not harmed by handouts to unhealthy banks, the European Commission has supervised Member States' massive bank bailouts under the EU's state aid rules, and the European Banking Authority has supervised annual stress tests to assess the ability of 90 systematically important banks in 21 countries to withstand potential financial shocks.

Alert to divergences

A key element to prevent crisis in the future is to make the economies of the EU countries more integrated. Although non-adherence to the rules of the SGP contributed to the depth of the crisis in Europe, it also highlighted the need for more convergence between EU economies. The following chart shows that in the period after the introduction of the euro until the start of the crisis, the cost of borrowing for euro area governments was relatively low and fairly similar. However, during that time imbalances in certain Member States and divergences between euro area countries continued to develop.

THE COST OF BORROWING FOR GOVERNMENTS IN FIVE EU COUNTRIES



10-year sovereign bond yields.

Source: European Commission.

As the crisis went on into 2009 and 2010, these borrowing costs diverged rapidly as financial markets became doubtful about the fiscal sustainability and competitiveness of some EU countries. For some of those countries, interest rates on government bonds became so high that they could not borrow on the financial markets any longer. So, although at first sight there seemed to have been economic convergence before the crisis, it rapidly became clear that this was too superficial. The crisis revealed quite large divergences between euro area economies which made it very difficult for some of them to respond effectively. These divergences were found in areas such as workforce productivity and overall economic competitiveness. This is why the macroeconomic imbalance procedure and the agreements of the Pact for the Euro are so important, since they extend economic surveillance at EU level to exactly these areas of national economies and monitor the appearance and scale of such divergences.

Better protection for citizens and consumers

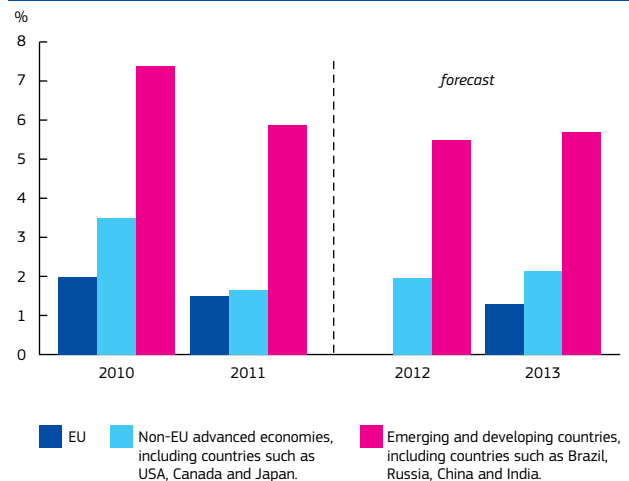
An example of how the macroeconomic imbalance procedure (MIP) is contributing to greater stability is to be found in the house price indicator. During the decade when the EU was preparing to launch the euro, the interest rates paid on mortgages fell in the EU countries — so the monthly cost of buying a home became lower.

However, in the absence of controls, this in turn led to rapid rises in house prices in some EU countries — reaching over 30 % a year in some cases — and a boom in construction. When the financial crisis hit, many households found themselves with high debts, as did many construction companies — leading to rapid falls in prices, the closure of companies and the loss of jobs. The MIP takes the rate of increase in house prices relative to overall household expenditure as one of its economic indicators and raises an alert if this exceeds 6 % a year in any EU Member State. By using this indicator, the MIP is measuring an important factor in private sector indebtedness that can make an economy more vulnerable to economic shocks. And by taking actions to stay within this limit, a Member State can help protect its economy — and the EU economy overall — against such shocks.

Boosting global competitiveness

Another example of how the MIP is tracking economic performance is the indicator on share of world trade. The European Union is one of the leading trading partners in global markets, a lead that is strongly supported by the single currency and the single market. Trade is vital for our economic growth, for the success of EU enterprises and for ensuring high employment and better jobs for EU citizens. And EU world trade is important for political reasons: as a major world trading partner the weight and voice of the EU in world affairs is strong, particularly in the World Trade Organisation, but also in many other international arenas and third countries.

REAL GDP GROWTH IN THE EU COMPARED TO OTHER ECONOMIES OUTSIDE THE EU



Source: European Commission. In the year 2012, the growth forecast for the EU is zero.

Under the MIP, the European Commission tracks the changing share of exports to countries outside the EU for each EU country. The indicator measures this share as the change in the sum of goods and services exported, averaged over 5 years. Of course, some countries export more than others, but a rapid change in this share could indicate a fall in a country's competitiveness on world markets. The threshold to trigger an alert is a fall of 6 % or more.

Outlook

Forward-looking policies for long-term stability and growth

The large and persistent economic imbalances accumulated over time were also at the root cause of the economic crisis. And not only did they cause great difficulties for the individual EU countries concerned, they also demonstrated huge spillover effects on economic stability in the euro area and the EU as a whole. This made clear the extent of interdependence of the euro area and EU economies.

The reinforced Stability and Growth Pact and the macroeconomic imbalance procedure — both managed through the European semester — are intended to ensure that, in future, problems are identified before they arise and corrective steps are taken. They represent a deepening and a widening of economic governance in Europe.

- **DEEPER:** because the reinforced SGP, together with the Treaty on Stability, Coordination and Governance, brings much more rigour to the identification and prevention of fiscal deficits and excessive debt levels in the EU countries.
- **WIDER:** because the MIP broadens economic surveillance of Member State economies to include a range of indicators that can alert policymakers to incipient threats that may require a timely response.

And the role that coordination plays in managing EU economic policymaking is also deeper and wider — the EU countries are now called upon to exert more peer pressure on each other to ensure that troublesome events in individual economies are treated as a matter of common concern. Working together to resolve Europe's current economic problems is the best way to create sustainable jobs and to ensure future prosperity in all EU countries.

Working together to resolve Europe's current economic problems is the best way to create sustainable growth and jobs in all EU countries.



This new framework for economic governance is being implemented against the backdrop of the Europe 2020 strategy — the European Union's strategy for growth in the current decade. Economic policies are vital to the ambition to deliver smart, sustainable and inclusive growth to Europe's citizens. So the task of economic governance for the future is to set the conditions for stable growth that will:

- foster competitiveness among EU enterprises to help them compete globally, develop their businesses and create new jobs;
- boost employment by supporting measures for job creation;
- ensure sustainable public finances to protect pensions and welfare systems; and
- reinforce financial stability to protect economies, jobs and prosperity against external shocks.

In addition, over the coming years the euro area will probably integrate even further. This needs:

- a fiscal union to ensure sound public finances across Europe and solidarity mechanisms for crisis situations;
- a banking union to ensure stronger supervision of financial markets; and
- a deeper economic union with targeted investments to boost growth and competitiveness.

Moving towards more decisions made at European level on financial, fiscal and economic policies also requires stronger mechanisms to legitimise the decisions taken in common and to ensure the necessary democratic accountability and political participation; in short, a true political union.

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>
- ▶ **To watch the video 'Emerging stronger from the crisis: the European vision':**
<http://www.youtube.be/OB3zNcFYqjO>
- ▶ **Questions about the European Union?**
Europe Direct can help: 00 800 6 7 8 9 10
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