This booklet tries to respond as clearly as possible to what are sometimes complex topical questions. It includes a first part in the form of 10 questions accompanied by a glossary and a second part containing factsheets where more information can be found.
Since 2008 the global economy has been experiencing an economic and financial crisis that has had a major impact on the functioning of the euro area. Its repercussions can still be felt today in certain parts of the European Union. We thought it would be a good moment to take stock of the causes of the crisis and the measures the European Union has put in place to address them.

This teaching booklet, designed for students aged 17 and above, tackles — often complex — economic concepts in 10 questions. Graphs, charts and tables have been included to illustrate these concepts more clearly.

For teachers who wish to know more, the booklet is followed by a glossary and detailed factsheets.

We hope this tool will meet the demand for teaching materials about the crisis and illustrate the subject for you.

Please do not hesitate to send any reactions and comments to:

COMM-REP-BRU-PUBLICATIONS@ec.europa.eu

Jimmy Jamar
Head of the European Commission Representation in Belgium
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In 2008
the European Union and the rest of the world were hit
by an unprecedented economic and financial crisis that
continues to have a major impact on our economies.

Could we have avoided it?

Why did it erupt?

How have the European Union and
Belgium dealt with it?

This booklet tries to respond as clearly as possible to what are sometimes complex topical questions. It includes a first part in the form of 10 questions accompanied by a glossary and a second part containing factsheets where more information can be found.
What is an economic crisis?

These days, the term ‘crisis’ is used to denote a difficult economic situation. We talk about an ‘economic crisis’ or ‘recession’ when a country sees the total value of what it produces over a year *(gross domestic product)* fall in two consecutive quarters.

**Gross domestic product (GDP)**
Total value of what a country produces in 1 year (its income), which indicates that country's wealth. Expressed per number of inhabitants, it represents a given population's standard of living.

**Recession**
A contraction in GDP over two consecutive quarters.
What triggered the crisis?

What set everything off was the sub-prime crisis (risky mortgage lending), which surfaced in the United States in 2007.

American households could no longer repay the banks the money that they had borrowed to buy their homes. The interest rate on the loans had risen, increasing their mortgage repayments. As a result, banks were not getting back the money they had lent and put large numbers of repossessed homes up for sale, leading to a collapse in property prices.

A widespread feeling of mistrust set in, the banks decided to lend less and a liquidity crisis occurred. When the public noticed that the banks had stopped lending, they consumed less (fewer cars, clothes, books, computers, etc.). For fear of selling less, businesses produced fewer goods and made some of their workforce redundant. As a result, unemployment went up, spending fell further and the financial crisis started to affect the real economy.

**Liquidity crisis**
Denotes a situation in which a state or business does not have the necessary funds to meet its undertakings. In the banking sector, we talk about a liquidity crisis when the banks and other financial institutions refuse to lend each other money.
Could Europe have avoided the crisis?

In Europe, major budgetary imbalances weakened several euro-area countries buffeted by the economic shocks. This was because in recent decades, although we were producing a lot of wealth, many governments spent more than they earned. Belgium, for example, has a public debt equal to what it produces in a year. This means the country would have to work a whole year without spending anything to clear its debt. Furthermore, macroeconomic imbalances, such as an increasing gap between labour productivity and wages or significant losses on the export market, have emerged in certain countries. These imbalances were not taken seriously enough to begin with. A closer eye should have been kept on budgetary and macroeconomic policies to avoid increasing disparities in the competitiveness (labour force productivity) of the Member States and/or excessive spending within the euro area (see Factsheet 1).

**Competitiveness**
A country's ability to sell its products and services on national and foreign markets.

**Labour force productivity** = ratio of production (GDP) to the number of hours worked.

## Disparities between Member States
Change in growth rate between 2008 and 2015

<table>
<thead>
<tr>
<th>Rate of GDP growth in 2008 (change on previous year)</th>
<th>Rate of GDP growth in 2015 (change on previous year)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Key</td>
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<tr>
<td>Data not available</td>
<td></td>
</tr>
</tbody>
</table>

- 0.2 to 2.6
- 2.6 to 0.2
- 0.2 to 2.9
- 2.9 to 5.7
- 5.7 to 7.8
- Data not available
Low growth in **gross domestic product** since 2009 and weakening competitiveness have put further pressure on public finances and **balance-of-payments** deficits.

**Balance of payments**
Net inflows from trade in goods and services, income and current accounts.

The euro area has returned to growth, but unemployment remains high

**GDP growth (%)**

**Unemployment (% of the active population)**

The public deficit is starting to fall, but public debt in the euro area remains high

**Public deficit (%) GDP**

**Gross public debt (%) GDP**

**Public deficit**
A negative balance between the revenue and expenditure of the state, local authorities and social security institutions. When spending exceeds income, a country must borrow, which increases its debt (today's deficit is tomorrow's debt).

**Public debt**
Sum total of deficits accrued in the past.

**Gross domestic product (GDP)**
Total value of what a country produces in one year (its income), which indicates that country's wealth. Expressed per number of inhabitants, it represents a given population's standard of living.

**Unemployment rate**
Percentage of the unemployed active population in comparison to the total active population.

Source: Services of the European Commission
European economy explained
Why did the banks have to be saved?

Banks lend each other money in what are known as **interbank loans**. When one bank finds itself in trouble, it means they are all potentially in trouble. The risk of a **domino effect** puts the whole banking system in danger.

In 2008, a number of banks were in difficulty in Ireland and the United Kingdom, but also in Belgium. Fortis, the leading banking-insurance group in the Benelux region, was forced into a **bailout plan** drawn up by the three Benelux countries. Then Dexia had to be nationalised. In October that year, ING and KBC needed to be bailed out by the Dutch and Belgian governments. This represented a considerable sum of money for Belgium, whose public debt was already very high before the crisis.

In the wake of this long series of financial interventions by governments, European stock markets lost a quarter of their value by late 2008. From the start of 2009, all sectors of the economy were affected by the crisis. European and international institutions (European Commission, European Central Bank and International Monetary Fund) and the Member States mobilised to prevent the banking crisis from spreading throughout the continent.
The key priority was to avoid an outbreak of panic. Fearing bank failures and the sudden withdrawal of household savings, the European Union decided to guarantee savers’ deposits up to €100 000 in the event of a bank going bankrupt.

Besides the need to avoid saver panic, the banks had to be saved and financial markets reassured in order to avoid a domino effect. This is why, in late 2012, the EU established the European Stability Mechanism (ESM) (see Factsheet 2).

At the end of 2008, the European Commission set up a €200 million European economic recovery plan to boost the economy, financed by national governments (1.5 % of GDP) and the EU budget (0.3 %). The plan also allowed for additional stimulus spending as long as it was targeted and temporary (socially beneficial investment) and an eye was kept on public deficits.
At first, it was thought that reassuring the financial markets and injecting large sums into the economy would be enough. That was not the case, however: by January 2009, economic indicators were collapsing, industry was receiving fewer and fewer orders and unemployment was rising.

Countries got into more and more debt, both to rescue their banks and to stimulate their economies. That same year, Greece became the first country whose public debt reached 130% of its GDP. In the wake of this development, other governments intervened to save banks that had lent money to Greece, but their public debt soared as a result, leading to a sovereign debt crisis.

The sovereign debt crisis had very different causes and effects from one country to another.

- In Greece, the finance minister announced a public deficit of 12.7% in 2009 (as opposed to the 6% previously declared), which triggered a loss of market confidence. One of the ratings agencies downgraded Greece’s sovereign rating (which indicates a country’s ability to repay its borrowings). While the rating was marked down, the interest rate at which the Greek government could borrow went up. As a consequence, investors lost confidence and the country teetered on the brink of bankruptcy.

- In 2010, Ireland guaranteed all the outstanding debts of its banks by recapitalising them with public funds, creating huge public indebtedness (banking crisis).

- In Portugal, households saw the cost of borrowing rise after its sovereign debt rating was downgraded (household crisis).
• In Spain, the **household crisis** was due to the bursting of the **property bubble**. The country's sovereign debt rating was also marked down because of the economy's weak growth prospects, which are closely linked to the property sector. Given the size of the Spanish economy within the euro area, this downgrade was even more worrying than Greece's.

• In 2012, a **banking crisis** hit Cyprus. The country decided to recapitalise its banking sector, as its banks were unable to access funding on the financial markets.

**Timeline of crises and reform measures**

A succession of crises have prompted reforms intended to consolidate Economic and Monetary Union (EMU), promote the fiscal responsibility of the Member States and stimulate investment in Europe.
Ireland, Greece, Spain, Cyprus, Latvia, Hungary, Portugal and Romania all received financial support from the European Union at certain times between 2008 and 2016. With the exception of Greece, all these countries have completed their **macroeconomic adjustment programme**.

Let’s return to the case of Greece to explain what happened. In 2010, Greece was on the verge of bankruptcy and had to borrow massively to remain solvent. **European solidarity** meant that allowing a Member State to collapse was unthinkable. Moreover, as Greece was part of the euro area, there was a risk of contagion (a risk that the euro area would lose credibility and the single currency would lose value). A solution was finally found: in May 2010, the country benefited from an initial support package worth €110 billion in the form of loan facilities. In return, Greece had to make substantial savings and submit a macroeconomic adjustment programme, as set out in the memorandum of understanding.

Other assistance programmes for Greece would follow. Financial firewalls were also introduced to prevent a crisis in one euro-area Member State from destabilising all the other countries that share the single currency (European Stability Mechanism – see Factsheet 2).
The crisis has at least had the advantage of speeding up the establishment of economic and financial governance on a Europe-wide scale. The Member States and European institutions have agreed upon a set of measures to stop these situations from happening again.

The measures cover the financial sector, especially banks, but also stricter management of Member States’ economic and budgetary policies. With regard to financial stability, the European Stability Mechanism was set up in late 2012, as mentioned above, to provide financial assistance to any euro-area Member State experiencing, or at risk of, financial difficulties.

In parallel, a banking union has been set up. Until now, there has been a persistent mismatch between a financial system which has operated freely across borders and a regulatory framework which has functioned at national level without international coordination. European authorities existed but they had only an advisory status. Since 2011, a system for monitoring and supervising the financial sector has been put in place. Existing structures have been considerably strengthened and turned into proper watchdogs of markets, insurance companies and banks. Since November 2014, the European Central Bank, together with national bank supervisors, has been monitoring the financial stability of some 130 banks in the euro area and can force them to take corrective measures. This single bank supervisory mechanism is obligatory for all euro-area members and open to other EU Member States. The European Banking Authority is tasked with drawing up control procedures which the national bank supervisors will have to follow. The banks too are assuming their share of responsibility through what are known as stress tests, which are undertaken by the central banks. This will make it possible to avoid scenarios like those faced by the EU in which the national central banks had to intervene to save banks.
A special Crisis Resolution Fund has been set up from bank tax revenues. This amounts to forcing the banks to take out insurance. The EU has also adopted laws to limit bank directors’ bonuses and has asked certain countries to loosen their banking secrecy rules in the interest of greater transparency. Financial governance is therefore one area in which the institutions will have progressed enormously during the crisis.

Besides the banks, the crisis has significantly strengthened coordinated economic governance at European level. From retrospective crisis management by individual Member States in 2008, steps were taken to create several new regulatory pillars to coordinate budgetary and macroeconomic policies in 2009 (see Factsheet 3).

The European Union has taken on more powers with the creation in 2011 of a new working method known as the European Semester (referring to the fact that the decision-making schedule is spread out over 6 months — see Factsheet 4) as well as new monitoring systems. This cycle of monitoring and coordination is built around three main areas of economic policy: budget policies, macroeconomic policies and policies linked to the Europe 2020 objectives in the fields of education, training, energy, climate change and the fight against poverty and social exclusion (see Factsheet 6). Governments have recognised their responsibilities within the context of the crisis and have introduced stricter controls on their budget spending. They submit their budgets to the European Commission and the members of the Eurogroup for approval, and each year also present a national reform programme and a budgetary and economic stability programme for the next 3 years (see Factsheet 5).
What about Belgium?

A first element to point out is that it is primarily up to Belgium to decide what measures need to be taken.

The crisis has highlighted pre-existing economic, budgetary and financial imbalances. Belgium is therefore putting in place reforms to move out of the crisis and adjust to changes in society.

Basically, Belgium is facing three types of problems.

• First, its public debt is high (around 100 % of GDP). Its budget is not balanced because the country spends more than it earns each year (public deficit), including interest on its public debt. The Belgian authorities have undertaken the necessary measures to correct this situation, based on a roadmap known as a country-specific recommendation.

- Public debt: Sum total of deficits accrued in the past.
- Public deficit: A negative balance between the revenue and expenditure of the state, local authorities and social security institutions. When spending exceeds income, a country must borrow, which increases its debt (today’s deficit is tomorrow’s debt).

- Recommendation: Recommendation of the Council of the European Union designed to guide national policies and based on examination of each Member State’s economic, social and environmental performance over the previous year against the priorities set out in the Annual Growth Survey (AGS).

• Second, Belgium has to deal with the ageing of its population. The age pyramid is inverting following a fall in the birth rate. If this continues, expenditure on pensioners and health care for the elderly will no longer be met by the labour force. Belgium has already undertaken to reform its pension system but it is unlikely that this will be sufficient. More efforts will undoubtedly be required. This is a problem affecting a number of Member States.
Lastly, Belgium is faced with a loss of **competitiveness**. This means the country lags behind its neighbours in producing goods and services which provide attractive value for money. There are a number of reasons for this: payroll costs which are generally higher than in neighbouring countries, comparatively high energy costs and a weaker added value of manufactured goods. As Belgium is a small country in the middle of Europe, much of its revenue comes from its exports, especially to its neighbours (1). If costs are too high, there is a risk that businesses will move production abroad, which is potentially damaging for the Belgian economy.

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(1) With exports amounting to around 85 % of its GDP (2015), Belgium is highly dependent on external trade.
A number of problems have been dealt with, but what remains to be done?

Numerous measures have been taken by the European Union to improve economic and financial governance.

In order to complete the building blocks of an Economic and Monetary Union, the European Commission has set out a detailed timetable which will, in the medium term, enable the euro area to strengthen its budgetary capacity to support structural reforms for economies in trouble. In the long term, it will make it possible to create an independent budget for the euro area so as to give the Economic and Monetary Union the financial wherewithal to support Member States weakened by economic shocks (see Factsheet 7).

Ever since the economic and financial crisis hit, the level of investment in the EU has been insufficient. The Investment Plan for Europe launched in November 2014 (see Factsheet 8) attempts to change this and set Europe on a path towards economic recovery.
Glossary

Balance of payments
Net inflows from trade in goods and services, income and current accounts.

Competitiveness
A country’s ability to sell its products and services on national and foreign markets.

Economic governance
The way in which the economy of a country or business is managed and steered.

Economic partnership programme
Reform and budgetary consolidation programme which any euro-area Member State with an excessive deficit must abide by.

External debt
The total debt incurred by the economic operators in one country with those outside it.

External deficit
Negative trade balance. This is the monetary difference between the value of a country’s exports and imports in goods and services.

Fund
A sum of money deposited into an account, ready for use.

Gross domestic product
Total value of what a country produces in 1 year (its income), which indicates that country’s wealth. Expressed per number of inhabitants, it represents a given population’s standard of living.

Labour force productivity
Ratio of production (GDP) to the number of hours worked.

Liquidity crisis
Denotes a situation in which a state or business does not have the necessary funds to meet its undertakings. In the banking sector, we talk about a liquidity crisis when the banks and other financial institutions refuse to lend each other money.

Macroeconomic adjustment programme
Reform and budgetary consolidation programme which any Member State in receipt of financial aid must comply with according to a well-defined schedule.

Property bubble
A significant gap between the price of a property and its intrinsic value.
Public debt
Sum total of deficits accrued in the past.

Public deficit
A negative balance between the revenue and expenditure of the state, local authorities and social security institutions. When spending exceeds income, a country must borrow, which increases its debt (today’s deficit is tomorrow’s debt).

Ratings agency
A firm or institution whose job is to allocate a financial rating to administrations (governments, etc.) or companies on the basis of certain criteria laid down by regulation or through market stakeholders.

Recession
A contraction in GDP over two consecutive quarters.

Recommendation (country-specific recommendation)
Recommendation of the Council of the European Union designed to guide national policies and based on examination of each Member State’s economic, social and environmental performance over the previous year against the priorities set out in the Annual Growth Survey (AGS).

Reverse qualified majority
Decisions relating to excessive deficits are taken by reverse qualified majority. Potential penalties are therefore approved unless they are opposed by a qualified majority of the Member States.

Stimulus spending
Public expenditure designed to kick-start the economy, i.e. to increase productive activity and reduce unemployment during periods of low growth or recession.

Stress tests
Simulations of extreme but plausible economic and financial conditions which test what the effects on banks are and how well they can face up to them.

Structural deficit
Public deficit corrected for measures linked to the economic cycle (e.g. rise in unemployment benefits during a recession).
1. Economic cycles

The economy is cyclical: periods of growth are followed by periods of recession. Periods of recession are defined by a slowdown in economic activity, potentially resulting in job losses, unemployment, budget deficits and bankruptcies. It is extremely difficult to identify the underlying causes of a recession. Often, economists disagree on how much importance should be attributed to the different factors (political, financial, technological, psychological, etc.) that explain the changes in consumer habits and/or investments that determine the rhythm of these cyclical contractions and expansions.

Counter-cyclical economic policies can be used by governments to minimise the impact of a recession on the economy. Monetary policy (injecting money into the economy, potentially creating inflation) or fiscal policy (reducing taxes to stimulate private entrepreneurship or increasing public spending through investment, potentially creating budget deficits) can be used to stimulate economic activity and temper these cycles. To a certain extent, ‘automatic stabilisers’ (1) (e.g. unemployment benefits) can also mitigate the negative impacts on consumption that may result from a sudden increase in the number of job seekers.

(1) *Automatic stabiliser*: a regulatory, passive economic measure that can temper the effects of an economic shock faced by a country experiencing an economic peak or trough. In times of crisis, unemployment benefits temper the effects of higher levels of unemployment on a country’s consumption.
As, in euro-area countries, monetary policy is controlled by the European Central Bank, national governments respond by adjusting fiscal policy (2).

The European Union may have established a monetary union, but the economic union has not yet reached the same stage of development. Over time, growth, inflation, competitiveness, public deficits and public debts have evolved at different rates in different EU Member States. It is therefore important to address these discrepancies and prevent potential negative repercussions by strengthening economic coordination. The consequences of decisions affecting monetary policy are felt far more quickly than those affecting fiscal policy. For example, an increase in interest rates can be implemented overnight whereas the time required to implement changes in fiscal policy must be taken into consideration when forecasting their impact.

**Economic and Monetary Union (EMU)**

**Imbalance between economic and monetary policy**

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(2) Part of the economic policy of Member States is set at European level.

**Within the EMU, a number of policy orientations have been developed with the aim of strengthening economic stability.**

Monetary policy = managed entirely independently by the European Central Bank, whose main objective is to maintain price stability and the value of the euro by setting the interest rates applicable to bank loans. It is the only organisation authorised to print money.

Fiscal policy = taxation and public spending; these fall within the competencies of national governments which must comply with the regulations issued by the European Union.

Other economic policies = the labour market or pension schemes, but also social policy: these fall within the competencies of national governments and are coordinated by the European Union as part of the European Semester (see Factsheet 4).
2. Assistance to Greece and the financial firewalls put in place by the European Union

The purpose of the European Union’s financial firewalls is to prevent a potential crisis in one euro-area Member State from destabilising all the countries that share the single currency.

As Greece was in urgent need of support, the European Union initially provided financial assistance in the form of bilateral loans, as an expression of **European solidarity** with one of its Member States *(see reverse)*.

In 2010, it then set up two temporary emergency funds to manage the crisis: the **European Financial Stability Facility (EFSF)** for euro-area Member States and the European Financial Stabilisation Mechanism (EFSM) for all EU Member States.

At the end of 2012, these temporary funds were replaced by the **European Stability Mechanism (ESM)**. This **intergovernmental financial institution** provides financial assistance to euro-area Member States experiencing, or at risk of experiencing, financial difficulties. The ESM applies lower interest rates than on the market, issues loans to Member States in difficulty, finances bank recapitalisations, etc.

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### European Financial Stability Facility (EFSF)
- **Beneficiaries:** euro-area countries
- **Lending capacity:** €440 billion guaranteed by euro-area countries

### European Financial Stabilisation Mechanism (EFSM)
- **Beneficiaries:** all EU Member States
- **Lending capacity:** €60 billion guaranteed by the EU budget

### European Stability Mechanism (ESM)
- All **euro-area countries** form part of this body
- **Intergovernmental** financial institution
- **Permanent fund** with the world’s largest capital reserve
- **€500 billion** lending capacity
- Assistance measures strictly implemented on the basis of the **macroeconomic adjustment programme** (decided on jointly by the Member State, the Commission, the European Central Bank, the International Monetary Fund (IMF) and any other lenders)
- **Monitoring programme** to prevent the cause of financial instability from recurring
Assistance programmes for Greece

- **First assistance programme in 2010:** €110 billion: €80 billion in the form of lending facilities made available by other euro-area countries and €30 billion from the IMF.

- **Second assistance programme in 2012:** €130 billion for a period of 3 years (2012-2014) in the form of loans issued by the European Financial Stability Facility (EFSF). The euro area’s finance ministers (Eurogroup) decided to reduce the cost of borrowing and granted a longer repayment period.

- **Third assistance programme in 2015:** up to €86 billion for a period of 3 years (2015-2018) via the European Stability Mechanism (ESM).

http://www.esm.europa.eu/
3. Stability and Growth Pact revisions

The Stability and Growth Pact was established in 1997 to extend efforts to reduce budget deficits undertaken by countries wishing to adopt the euro (Maastricht criteria (3) — 1992).

Under the pact Member States are obliged to include their medium-term budget objectives (current year + 3 years) in their convergence or stability programme (the programme name depends on whether or not they belong to the euro area — see Factsheet 4). Member States are therefore unable to accumulate debt to an extent that may endanger stability in the euro area. Member States are also obliged to correct excessive government budget deficits according to a very detailed calendar. The pact stipulates two main criteria: the budget deficit must be less than 3 % of GDP, and public debt must be less than 60 % of GDP or must diminish significantly (by 5 % a year for 3 consecutive years — 2011 Revision: Six Pack).

The pact has been reformed several times through the 2005 revision, the Six Pack (2011), the Two Pack (2013) and the Treaty on Stability, Coordination and Governance including the Fiscal Compact (2013).

The Six Pack (2011) is a package of six legislative measures, four of which reinforce the Stability and Growth Pact. It adds a criterion for expenditure to the medium-term objective. This stipulates that the annual increase in public spending may not exceed a certain reference rate linked to medium-term potential GDP growth, to ensure that growth serves to reduce public debt and not to increase public spending. The package also introduced a new surveillance mechanism called the Macroeconomic Imbalance Procedure, which includes an Alert Mechanism Report to monitor 14 indicators and flag up macroeconomic imbalances (see Factsheet 5).

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(3) Maastricht criteria (1992) — convergence criteria for adoption of the euro.
1. Government budget deficit < 3 % of GDP.
2. Public debt < 60 % of GDP.
3. Inflation: the rate at which the general price levels in a country increase over a 1-year period may be no more than 1.5 percentage points above the inflation rate in the three euro-area countries with the lowest inflation at a given moment.
4. Interest rates: no more than 2 percentage points above the average rate in the three best-performing EU Member States in the area of price stability.
5. Exchange rates: the country’s exchange rate (the price at which one currency can be exchanged for another) must remain within a certain bracket to demonstrate that the economy is stable enough to adopt the euro.
The **Two Pack** (2013) reinforces surveillance of national budgets and establishes a common budget calendar for all Member States. Member States are required to submit their medium-term fiscal plan to the Commission each year before 15 April. By 15 October, before they are submitted at national level, Member States must have submitted their budget proposals for the following year, explaining how they aim to achieve their medium-term objectives. If the Commission’s analysis reveals that the Member State is unlikely to respect the recommendations it has received, the Commission can demand that the national budget proposal be amended. The Two Pack stipulates that independent bodies (independent fiscal consultants) shall monitor the compliance of budgetary measures decided nationally and prepare macroeconomic forecasts.

The **Treaty on Stability, Coordination and Governance** (2013) includes the Fiscal Compact, which requires Member States to incorporate their medium-term objectives into national legislation (euro-area members may be fined 1% of GDP per year for non-compliance). Furthermore, the structural deficit must be less than 0.5% of GDP in order for public spending to be financed by government revenue and not by debt (except in certain circumstances: recession or unforeseen events beyond Member States’ control. If debt is less than 60% of GDP, a structural deficit of up to 1% of GDP is acceptable). The aim is to address the deep structural causes of a deficit in order to restore growth and revive a struggling economy. If the structural deficit (*) is exceeded, the Fiscal Compact triggers an automatic correction mechanism. Member States are required to include in national legislation information as to when and how they plan to make adjustments for future budgets.

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(*) Structural deficit: public deficit corrected for measures linked to the economic cycle.
4. European Semester

In order to keep public finances healthy, encourage economic growth and prevent excessive macroeconomic imbalances in the European Union, an annual coordination calendar called the European Semester has been established. This new procedure, which was implemented in 2011, addresses the potential contagion impacts of differing economic policies.

The cycle includes the following phases.

In the preparatory phase (November) the Commission publishes its Annual Growth Survey (AGS) which is based on an analysis of the current situation and follow-up of the previous year. The analysis defines the EU’s priorities in order to stimulate growth and create employment during the following year. The AGS includes an analysis of progress made towards achieving the Europe 2020 objectives (see Factsheet 6) and a report on employment. In parallel, the Commission publishes its Alert Mechanism Report, which lists Member States whose economies may potentially experience economic imbalances and for which a more in-depth review of their economic situation is required. In addition, in November the Commission expresses its opinion on budget proposals (see Factsheet 3, Two Pack) for euro-area Member States and on the economic partnership programmes for euro-area Member States presenting an excessive deficit.

In the first phase (March), which deals with policy orientation at EU level, the Heads of State or Government (European Council) refer to the Commission’s Annual Growth Survey to formulate the European Union’s major guidelines with regard to economic policy. The European Council meets at the Spring Summit to decide on orientations for budgetary and structural reforms and potential growth areas.

In April, the Member States submit their stability or convergence programmes, which illustrate the viability of their public finances. They also submit their national economic reform programmes, which include measures to work towards smart, sustainable and inclusive growth (Europe 2020 strategy — see Factsheet 6). The Commission evaluates these programmes and, if necessary, formulates country-specific recommendations. The European Council then endorses these recommendations (see ‘Who does what in the European Semester?’).

The last phase (end of June, beginning of July) is the implementation phase in which the Council formally adopts the recommendations.
Economic governance: who does what?
Within the Economic and Monetary Union (EMU), responsibility for economic policy is shared between the following.

-> The European Council
All the European Union’s Heads of State or Government. They define the main policy orientations.
Euro Summit: meeting of the Heads of State or Government of the euro area. Held at least twice a year (president elected for 2½ years at the same time as the President of the Council).

-> The EU Council or Council
Ministers from all the EU Member States. They coordinate policy, give their opinion on Commission proposals and take decisions, which may be binding in nature.

-> The EU Member States
They set their national budgets within the debt and deficit threshold framework and determine their own structural policies involving labour, pensions and capital markets.

-> The Eurogroup
Finance ministers of the euro-area countries (+ permanent president). They coordinate policies that are of common interest for the euro area.

-> The European Commission
Proposes orientations for the conduct of fiscal and economic policy to the Council, monitors performance and oversees the implementation of Council decisions (in other words the commitments of Member States themselves and commitments under the treaties).

-> The European Parliament
Shares legislative power with the Council and exercises democratic control over economic governance, particularly through the new economic dialogue (5).

-> The European Central Bank
Independently implements monetary policy for the euro area, with price stability as its prime objective.

(5) Economic dialogue
The European Parliament can invite the President of the Council, of the Commission and, if required, the President of the European Council or the President of the Eurogroup to discuss matters linked to the European Semester. Each Member State may also be invited to take part in the dialogue.
Who does what in the European Semester?

**Preparatory phase**
- **November**: ANALYSIS OF THE SITUATION and follow-up to the previous year
- **December**: develops euro-area recommendations

**Phase 1**
- **January**: POLICY GUIDANCE at EU level
- **February**: Council of the EU • studies the AGS and adopts conclusions • accepts euro-area recommendations
- **March**: European Parliament provides an opinion on employment guidelines

**Phase 2**
- **April**: COUNTRY-SPECIFIC objectives, policies and plans
- **May**: Member States outline their specific objectives, priorities and plans
- **June**: Council of the EU agrees on final country-specific recommendations
- **July**: European Council endorses them

**Phase 3**
- **IMPLEMENTATION**: MEMBER STATES take into account the recommendations in the process of national decision-making on the next year’s national budget

**European Commission** does the analysis
- gives its opinion on Member States’ draft fiscal plans
- studies the AGS and adopts conclusions • accepts euro-area recommendations

**European Parliament** provides an opinion on employment guidelines
- Eurogroup ministers debate the Commission’s opinions on draft fiscal plans
- Member States adopt their budgets by 31 December

**European Council** (Heads of State or Government): provides policy orientations
- endorses them

**Council of the EU**
- agrees on final country-specific recommendations
- adopts them

**In-depth reviews** of countries with potential macroeconomic imbalances

**Annual Growth Survey (AGS)** gives its opinion on Member States’ draft fiscal plans

**Alert Mechanism Report**

**Budgetary and structural policies**

**Macroeconomic imbalances**

A new cycle starts again towards the end of the year, when the Commission gives an overview of the economic situation in its Annual Growth Survey for the coming year.

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European Semester 2017
Situation under the Macroeconomic Imbalances Procedure and the Stability and Growth Pact

Stability and Growth Pact

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<th>Countries in excessive deficit procedure (corrective arm)</th>
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<td>Macroeconomic imbalances are addressed under a</td>
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<td>stability support programme</td>
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Commission recommends to abrogate Excessive Deficit Procedure - May 2017
5. Surveillance mechanisms

-> Surveillance mechanisms for monitoring budgetary imbalances
The most important instrument is the Stability and Growth Pact, which lays down two essential criteria: public deficit (< 3 % of GDP) and public debt (< 60 % of GDP or alternatively 5 % a year for 3 consecutive years). Should a country exceed these thresholds, an excessive deficit (or debt) procedure can be initiated, unless exceptional circumstances apply (recession or the deficit is a result of financing investments intended to bring about structural improvements to the economy, e.g. investment in the pension system or infrastructure).

Recommendations in the form of roadmaps specify deadlines for implementing corrective measures. Regular progress reports must be submitted to the European Commission. Financial sanctions (for euro-area Member States only) are applied progressively should the recommendations not be complied with. Initially, a deposit must be made with the European Central Bank, which ultimately can be converted into a non-recoverable fine. These sanctions are applied automatically, unless a qualified majority of Member States disagrees in the Council (reverse qualified majority — enabling decisions to be taken more quickly).

-> Mechanisms for monitoring macroeconomic imbalances
In addition to strengthening budgetary regulation, the EU also introduced a new monitoring framework called the Macroeconomic Imbalance Procedure (Six Pack, 2011). This includes a rapid alert mechanism which flags up macroeconomic imbalances more quickly. It uses a panel of 14 macroeconomic indicators such as export market share, labour costs, private sector debt, public administration debt,
unemployment, property prices, etc. In 2015, three additional indicators relating to employment were added to the dashboard (employment rate, long-term unemployment and youth unemployment) to offer a better insight into the social context in which any macroeconomic imbalances arise. This alert system may result in in-depth reviews for certain countries. If a macroeconomic imbalance is identified, the Member State is invited to take the necessary measures to ensure the situation does not deteriorate. If the imbalance is excessive, the Member State must implement the recommended measures in a very strict timeframe in order to redress the economic balance or face sanctions.

In 2011, the Competitiveness Pact or Euro Plus Pact was signed by the euro-area Member States (plus six other countries: Bulgaria, Denmark, Latvia, Lithuania, Poland and Romania) to strengthen economic coordination between participating Member States. It seeks to improve competitiveness and encourage growth and greater economic convergence between the countries concerned. It focuses on political themes that fall, to a large extent, within the competencies of the Member States, such as competitiveness, employment and the viability of public finances. Differences in competitiveness result in major internal EU trade imbalances. Participating countries commit to implementing a series of concrete measures approved and revised annually by the Heads of State or Government.

How can the vicious circle be broken?

- Single Banking Supervisory Mechanism
- Firewalls (EFSF/EFSM -> ESM, IMF)
- Bank restructuring, stress tests, recapitalisation and financing
- Structural reforms: Europe 2020 strategy
- Sustainable sovereign debt
- Fiscal discipline
- Improved governance: Stability and Growth Pact, Macroeconomic Imbalance Procedure, Fiscal Compact
- Economic growth
- Fiscal consolidation, quality of public finances

(6) For example: throughout the 10 years that preceded the launch of the euro, interest rates on mortgages fell in the European Union, consequently reducing monthly mortgage repayments. However, this situation resulted in property prices rising significantly and the construction sector experiencing strong growth. When the financial crisis hit, many households and construction companies had substantial levels of debt, which led to a sharp drop in prices. Consequently, when the percentage of total household expenditure allocated to mortgage repayments exceeds 6%, a Macroeconomic Imbalance Procedure is implemented. Private sector debt can leave a country extremely vulnerable to economic shocks.

Another important macroeconomic indicator is each EU country’s export market share to the rest of the world. This indicator measures the variation of the average amount of goods and services exported over the last 5 years. The alert is triggered if the indicator drops below 6%.

(7) In-depth review: evaluation conducted by the Commission to assess the scale and nature of the economic imbalances.
6. Europe 2020 strategy

With the Europe 2020 strategy the European Union aims to create a more competitive and sustainable economy with a higher employment rate.

--> Priorities

Smart growth --> investing in education, research and innovation (‘Digital agenda for Europe’, ‘Innovation union’, ‘Youth on the move’).

Sustainable growth --> prioritising a low-carbon economy and competitive industry (efficient use of resources, an industrial policy in an age of globalisation).

Inclusive growth --> concentrating on creating jobs and reducing poverty (a strategy to develop new skills and new jobs, a European platform to combat poverty).

--> Five objectives to be achieved by 2020

**Employment**: 75 % of the population between the ages of 20 and 64 in employment.

**Research and development**: 3 % of GDP invested in research and development.

**Climate change and energy sustainability**: 20 % reduction in greenhouse gases from 1990 levels, 20 % increase in energy efficiency and 20 % of energy from renewable sources.

**Education**: compulsory education drop-out rate less than 10 %; 40 % of the population between the ages of 30 and 34 with a higher education qualification.

**Fight against poverty and social exclusion**: number of people affected or threatened by poverty and social exclusion reduced by at least 20 million.
An economic governance system has been established to coordinate political measures at national and European levels. During the preparatory phase of the European Semester, the Commission publishes its Annual Growth Survey, which includes an analysis of progress made towards the Europe 2020 objectives.

https://ec.europa.eu/info/strategy/european-semester_en
7. A detailed plan for a genuine, comprehensive economic and monetary union

In July 2015, the five presidents of the European institutions (European Parliament, Council of the European Union, Eurogroup, European Commission and European Central Bank) presented an ambitious but pragmatic roadmap for completing EMU.

Extract from *The Five Presidents’ Report* (Completing Europe's Economic and Monetary Union, 2015):

‘Europe is emerging from the worst financial and economic crisis in seven decades. The challenges of recent years forced national governments and EU institutions to take quick and extraordinary steps. They needed to stabilise their economies and to protect all that has been achieved through the gradual and at times painstaking process of European integration. As a result, the integrity of the euro area as a whole has been preserved and the internal market remains strong.

However, as economic growth and confidence return to much of Europe, it is clear that the quick fixes of recent years need to be turned into a lasting, fair and democratically legitimate basis for the future. It is also clear that, with 18 million unemployed in the euro area, a lot more needs to be done to improve economic policies.

Europe’s Economic and Monetary Union (EMU) today is like a house that was built over decades but only partially finished. When the storm hit, its walls and roof had to be stabilised quickly. It is now high time to reinforce its foundations and turn it into what EMU was meant to be: a place of prosperity based on balanced economic growth and price stability, a competitive social market economy, aiming at full employment and social progress. To achieve this, we will need to take further steps to complete EMU.’
In their report the five presidents propose making progress on four fronts simultaneously.

**ECONOMIC UNION**
‘First, towards a genuine Economic Union that ensures each economy has the structural features to prosper within the Monetary Union.’

**FINANCIAL UNION**
‘Second, towards a Financial Union that guarantees the integrity of our currency across the Monetary Union and increases risk-sharing with the private sector.’

**FISCAL UNION**
‘Third, towards a Fiscal Union that delivers both fiscal sustainability and fiscal stabilisation.’

**POLITICAL UNION**
‘And finally, towards a Political Union that provides the foundation for all of the above through genuine democratic accountability, legitimacy and institutional strengthening.’
8. The Investment Plan for Europe

Since the economic and financial crisis hit in 2008, investment in Europe has fallen by 15%, slowing down the economy. Both public and private investors are more reluctant to finance riskier projects.

The Investment Plan for Europe, also known as the ‘Juncker plan’, was launched in 2015 with the aim of helping investment in Europe to recover in the wake of the crisis and boosting competitiveness.

This plan comprises three elements.

- **The European Fund for Strategic Investments (EFSI)** in partnership with the European Investment Bank (EIB), which aims to mobilise €315 billion of investment by 2017.
- A unique technical support hub and a portal with information on investment projects to support investment in the real economy.
- Legislative and structural reforms to create a favourable climate for investment.

---

**European Fund for Strategic Investments**

16 billion

European Fund for Strategic Investments

5 billion

European Fund for Strategic Investments

Investors ➔ Strategic projects for Europe ➔ Investments

- **Multiplier effect**

  - **Initial contribution of €21 billion from public funds** (€16 billion from the EU budget + €5 billion from the EIB)
  - Allows funds to be raised on the markets (through bond issues) so the EIB has €63 billion available
  - The projects selected by the EIB attract additional public and private funds, allowing investment to the value of €315 billion to be achieved over 3 years, or 15 times the amount originally available.
The EFSI is primarily a **guarantee fund** that covers initial project losses. This will create a multiplier effect, allowing additional private investment to be attracted.

The EFSI supports **two main types of projects**.

- **Major projects relating to a sector with good future prospects** (e.g. strategic infrastructure projects, transport, digital networks, renewable energy, urban development, research and innovation, and education).

- **Innovative projects carried out by small and medium-sized enterprises** (SMEs) (acquisition of stakes, microloans) or mid-cap companies (loans for research and development projects, risk capital for prototypes). These projects are generally financed via the European Investment Fund, a subsidiary of the EIB, which provides guarantees to national banks that want to lend to these companies.

**Who can apply for funding from the EFSI?**

- Companies of various sizes, including SMEs and mid-cap companies (up to 3 000 employees)
- Public institutions
- National development banks or other banks that issue loans
- Custom investment platforms.
What is an economic crisis?

Could Europe have avoided it?

Saving the banks

Domino effect

Who had to foot the bill?

Who helped the Member States?

Accelerating economic reforms

What about Belgium?

What remains to be done?
What is an economic crisis?

Trigger: Could Europe have avoided it?

Saving the banks

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