Przegląd Europejski, ISSN: 1641-2478
vol. 2020, no. 3
doi: 10.31338/1641-2478pe.3.20.4

Legislative changes within the Economic and Monetary Union after the 2007

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Abstract
The global economic crisis of 2007 revealed a number of weaknesses in the Economic and Monetary Union (EMU). The Member States, together with the European Union institutions have made an effort to save the euro area by introducing a number of reforms for the functioning of the EMU. This article focuses on the analysis of legislative changes introduced to the euro area after 2007 in the fields of fiscal, economic, banking, and financial assistance. The documents constituting the EMU legislative changes package were a subject of a detailed examination. The main research questions were focused on the essence of weaknesses in the functioning of the EMU and the future of the euro area.
Keywords: Economic and Monetary Union (EMU), EMU reform, Eurozone (euro area), euro currency, economic crisis, legislative changes package

Zmiany legislacyjne w ramach unii gospodarczo-walutowej po 2007 roku

Streszczenie
Ogólnoświatowy kryzys ekonomiczny z 2007 roku ujawnił szereg słabości unii gospodarczo-walutowej (UGW). Państwa członkowskie wraz z instytucjami Unii Europejskiej podjęty wysiłek ratowania strefy euro wprowadzając szereg reform w funkcjonowaniu UGW. Niniejszy artykuł koncentruje się na analizie zmian legislacyjnych wprowadzonych wewnątrz strefy euro po 2007 roku w wymiarach fiskalnym, gospodarczym, bankowym oraz pomocy finansowej. Szczegółowemu badaniu poddane zostały poszczególne dokumenty składające się na pakiet zmian legislacyjnych UGW. Główne pytania badawcze koncentrowały się wokół istoty słabości w funkcjonowaniu unii gospodarczo-walutowej oraz przyszłości strefy euro.
Słowa kluczowe: unia gospodarczo-walutowa (UGW), reforma UGW, strefa euro, waluta euro, kryzys ekonomiczny, pakiet zmian legislacyjnych

The implementation schedule and principles of functioning of the Economic and Monetary Union (EMU)[1] are set out in the report by Jacques Delors (1989) and the Maastricht Treaty (1992) establishing its legal basis. Then, they were supplemented during the European Council meeting in Amsterdam on 16–17 June 1997 with adopted resolutions[2], regulating – firstly – the cooperation between countries entering the single currency zone and those remaining outside of it (ERM II), and secondly – the issue of compliance with budgetary discipline (Stability and Growth Pact). Issues regarding the name of the single currency and the stages of its circulation were set out in the scenario adopted at the Madrid European Council on 15–16 December 1995. It was then supplemented by two regulations[3] of the Council of the European Union (EU), regulating the exchange rate of national currencies to euro and the legal status of euro, from its entry into force. From 1 January 1999, preparations for the adoption of euro and the functioning of the EMU seemed to be finalised and completed.

The global economic crisis of 2007 verified the mechanisms of the functioning of the euro area and unfortunately exposed many weaknesses. It turned out that the coordination of the economic policies of individual EMU Member States, including the maintenance of the budgetary discipline, was not sufficient to protect the euro area from the problem of growing indebtedness of some countries, leading to economic and political instability not only of the EMU, but of the entire European Union. Weaknesses in the banking system and lack of financial assistance mechanism for the EMU Member States in the event of emergency situations also became apparent. The EU institutions and the euro area countries had to react in two directions: on the one hand, solving their own economic problems and, on the other, responding to the challenges for the entire EMU, which arose from the effects of the economic crisis.

The above-mentioned actions define the subject of the research undertaken in this article. The central place is given to the issue of the EMU functioning in its various components, i.e. fiscal, economic, and banking. The importance of this issue increases, being present in both Polish and foreign literature.[4] The vastness of the issue generates the dominance of scientific articles devoted to the selected aspects, in particular the issues of fiscal policy and creation of a banking union. However, the literature lacks a comprehensive and chronological illustration of the legislative actions taken by the EU institutions and Member States aimed at supporting the euro area in the most difficult period of the economic crisis.

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[1] Also called "euro area" in EU regulations and "Eurozone" in various documents and publications.

[2] The following resolutions are meant:
1) Resolution of the European Council *on the establishment of an exchange-rate mechanism in the third stage of economic and monetary union*, Amsterdam, 16 June 1997, OJ C 236, 2.8.1997
2) Resolution of the European Council *on the Stability and Growth Pact*, Amsterdam, 17 June 1997, OJ C 236, 2.8.1997.

[3] The following regulations are meant:
1) Council Regulation (EC) No 1103/97 of 17 June 1997 *on certain provisions relating to the introduction of the euro*, OJ L 162, 19.6.1997.
2) Council Regulation (EC) No 974/98 of 3 May 1998 *on the introduction of the euro*, OJ L 139, 11.5.1998.

[4] It is worth mentioning the studies, among others: Dyson, Quaglia 2010; Geeroms, Karbownik 2014; Grosse 2018; Kawecka-Wyrzykowska 2015; Darvas, Martin Ragot 2018; Nowak-Far 2011; Poliński 2015; Sawicki 2012; Talani 2009; Wiliński 2019; Woźnicki 2017; Zaleska 2015.

The main research objective is to compile and analyse legislative changes taking place in the EMU in the field of fiscal policy, economic management, strengthening of financial cooperation, including the creation of a banking union. Due to the limited scope of the study, the author's deliberate intention was to subject a detailed examination of individual documents constituting the EMU legislative changes package. The time span of the research was set by the global economic crisis, which in 2008 exposed the structural weaknesses of the euro area, and to this day determines all legislative changes taking place in the EMU, as well as its future development plans.

The basic research method used to achieve the purpose of the research presented in this article was therefore a method of source criticism, used to verify documents introducing legislative changes within the EMU. It made possible not only to determine the course of qualitative transformations taking place within the euro area, but also was helpful in comparing the current legislative changes with the previous state. The research technique of the documents examination was based on a quantitative and qualitative analysis of their content.

The main hypothesis states that the contemporary economic crisis, in contrast to the commodity crisis of the 1970s, during which countries saved their economies more than the condition of the EU economy as a whole, integrated the euro area countries even more. It made people aware of the degree of interdependence within the euro area and the risks associated with its potential breakup. For this reason, during the economic crisis, both Member States and the EU institutions acted jointly to maintain and strengthen the EMU.

In order to verify this hypothesis, the following research questions were posed: what weaknesses in the functioning of the EMU have the economic crisis highlighted? What legislative reforms have Member States implemented to rescue the euro area? Are the introduced legislative changes at various levels of functioning of the EMU sufficient for its future development?

The process of developing and implementing reforms within the EMU is a part of the intergovernmental approach, as one of the theoretical concepts of European integration. The countries constituted the main creative and decision-making center in the scope of the analysed legislative changes. They agreed during negotiations to deepen cooperation (including limiting their autonomy) due to their economic and political interests, but also decided to incur costs in the form of increased control of their broadly understood economic policy and implemented macroeconomic reforms. The EU institutions included in the reformed cooperation within the EMU have to support the Member States in implementing reforms, in accordance with the powers they have received from the Member States.

The question of whether the introduced legislative changes within the EMU are a form of cooperation referred to *new intergovernmentalism*, or whether they are simply a response of the union of states to real threats, may be a debatable issue. It is the fact that the heads of states gathered in the European Council have become more legally active than in the past, assuming an unprecedented leadership role. However, it does not

prejudge, as the supporters of the *new intergovernmentalism* believe, that the mistake of the *old intergovernmentalism* was the assumption that integration processes consist of seeking power and pursuing the national interest in the Council. It seems rather naive for the supporters of the new intergovernmental recognition that the decision-making process in the Council is based on negotiations between Member States seeking agreement (Schmidt 2016). Any negotiation changes made within the EMU prove that they were carried out in the interest not only of the euro area countries, but also of all European Union countries. Their intergovernmental nature results from current political conditions and the inability to carry out effective treaty changes. It is also doubtful that the supporters of the new intergovernmental government will assume that states are integrating, and at the same time oppose the further transfer of power to a supranational level (Czaputowicz 2017: p. 52). The plans to complete the EMU together with one of its elements, i.e. the political union, as well as proposals to establish a budget for the euro area or its finance minister, contradict this. The refugee crisis, Brexit, the radicalisation of the views of individual EU Member States, and the general devaluation of the European integration project, suggest that deepening integration and adopting a new treaty by unanimity seem impossible. For this reason, cooperation between states seems necessary to achieve any progress, and the open question remains whether it weakens the existing EU institutions and seeks to limit transnational trends.

The structure of the article has been subordinated to verification of the hypothesis and the need to find answers to research questions. The content was therefore divided into four parts, where modifications in the field of fiscal discipline are analysed in turn, followed by the transformation of the economic governance of the euro area, and the transformation of the banking system. The last part of the article is devoted to the future of the EMU and possible innovations to exploit the potential of the EMU.

Legislative transformations in the field of the fiscal policy of the EMU countries

Fiscal policy is one of the main macroeconomic policies whose development within the EMU is a competence of the Member States, with two exceptions, i.e. convergence criteria providing for limits for the level of the budget deficit and public debt. The Maastricht Treaty obliged states to comply with the limit values of 3% of GDP in relation to the budget deficit and 60% of GDP in relation to public debt. The EU Commission was granted the right to draw up reports on the budgetary policy if a country did not meet one of the two criteria or even if it met the fiscal criteria, but there was a risk of an excessive deficit. At that time, the Commission forwarded its opinion to the Council, which (after carrying out a comprehensive assessment of the state of the economy of a given country) could determine the existence of an excessive deficit and enact recommendations for a given Member State to change its disadvantage at a certain time. The Treaty even highlighted that if a country did not comply with the Council's recommendations, one or more disciplinary measures could be taken against it. In accordance with art.104c,

paragraph 11 of the Maastricht Treaty, "...Council may decide to apply or, as the case may be, intensify one or more of the following measures:

- to require the Member State concerned to publish additional information, to be specified by the Council, before issuing bonds and securities;
- to invite the European Investment Bank to reconsider its lending policy towards the Member State concerned;
- to require the Member State concerned to make a non-interest-bearing deposit of an appropriate size with the Community until the excessive deficit has, in the view of the Council, been corrected;
- to impose fines of an appropriate size." (Treaty on European Union 1992: art.104c, par. 11).

Moreover, art. 104b of the Treaty stated that the Community is not responsible for the debts of national, regional, local authorities, or any public entities of the Member States. This was to ensure a situation, in which each state was independently responsible for its own fiscal policy and commitments, so that other countries would not have to bear the consequences for the irresponsible policy of another state.

Despite the above-mentioned guarantees, they were insufficient for Germany in case of ensuring the stability of the single currency. The threat arising in the event of an excessive budget deficit was worrying for the German government, as rising inflation would weaken the position of euro, thus forcing the European Central Bank (ECB) to pursue a more restrictive monetary policy. To counteract this situation, German finance minister Theo Waigel proposed to conclude a formal agreement to maintain budgetary discipline in the long term, which was named *The Stability and Growth Pact (SGP).* The document was adopted as a resolution by the heads of states and governments in Amsterdam during the European Council meeting on 17 June 1997. It obliged the Member States to pursue sound budgetary policy after entering the third stage of the EMU. The Pact included the above-mentioned resolution, containing political guidelines for compliance with principles of a balanced budget, and two Council regulations:

1) No 1466/97 of 7 July 1997 *on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies* (the so-called "preventive part" applicable from 1 July 1998);

2) No 1467/97 of 7 July 1997 *on speeding up and clarifying the implementation of the excessive deficit procedure* (the so-called "corrective part" applicable from 1 January 1999).

The leitmotiv of the above-mentioned documents was close cooperation of states for healthy public finances, contributing to price stability and achieving conditions for economic growth, regardless of whether a given country adopted the common currency or not. The Council Regulation (EC) No 1466, obliged countries to submit macroeconomic programmes, which in the case of the EMU countries were called *stability programmes*, and in the case of countries outside EMU – *convergence programmes*. Based on them, the Commission and the Economic and Financial Committee assessed the economic situation, and then the Council assessed whether the country's economic plans were realistic and whether they guarantee achieving budgetary stability. The Council also

had the power of multilateral surveillance to monitor the implementation of stability and convergence programmes, with particular emphasis on controlling actual or expected mismatches between the budget heading and the medium-term budgetary objective or the adjustment path in this direction (Council Regulation (EC) No 1466/97: art. 6). In the event of significant discrepancies, in accordance with art.103 (4) of the Maastricht Treaty the Council had possibility to make recommendations and take the necessary adaptation measures, including making these recommendations public.

The Council Regulation (EC) No 1467/97 had disciplinary value because its art.13 provided the possibility of applying financial sanctions in a situation of the persistent excessive deficit, which was the result of a policy erroneously pursued by a given state. Their use was only possible for countries participating in the EMU and was an instrument to deter euro area countries from non-compliance with budgetary discipline. Financial sanctions were to be the last stage of the excessive deficit procedure, in a situation where a given country did not implement the Council's recommendations. At that time, such a state could demand an interest-free deposit (within 10 months from the date of the budget deficit report), which could be converted into sanctions after two years if excessive deficit, in the Council's view, had not been corrected. The funds coming from the sanctions were to be part of the EU budget (part of "other revenue") and be allocated among countries not reporting excessive deficits. The minimum amount of the sanction could be 0.2%, increasing by 0.1% for each percentage point above the 3% limit. The maximum rate of financial sanctions could not exceed 0.5% of the country's GDP (Council Regulation (EC) No 1466/97: art. 12). Sanctions were not to be imposed on the countries, where the average GDP dropped by 2% or more and in situations deemed exceptional (due to an unusual event beyond the control of the country concerned).

The provisions formulated in this way were to guarantee that individual countries would conduct responsible fiscal policy. Their first real test became the period from 2001, when the general deterioration of the economic situation translated into economic indicators, including convergence criteria, began to be felt. Portugal was the first country to exceed its budget deficit reference value in 2001, followed by Germany and France in 2002, the Netherlands, and Greece in 2003. Germany and France were in the most difficult situation, when it came to the budget deficit, with a deficit in 2002 of successively 3.5% (compared to 2.8% in 2001) and 3.1% (compared to 1.5% in 2001). It soon became clear that the full application of the rules of the Stability and Growth Pact was also associated with political considerations. It was difficult to make decisions about sanctions in relation to the two largest EU economies and the two largest payers of the EU budget.

Consequently, in November 2003 the Council of the EU (acting by qualified majority) did not adopt the Commission's recommendations (their consequence would be sanctions), but accepted the commitment of both countries to reduce the budget deficit to an acceptable level by 2005. This led to a dispute between the Commission and the Council, which had to be decided by the European Court of Justice, which further undermined confidence in the Pact. Many analysts felt that in its current form its principles were exhausted, explaining that it was too strict. The Pact was more positively assessed

by Romano Prodi – then President of the European Commission – calling it "stupid, like all inflexible decisions" (*Prodi disowns…* 2002).

In this situation, the reform of the rules of the Stability and Growth Pact was obvious, approved at the European Council meeting in Brussels on 22 and 23 March 2005. Its legislative framework was specified in two Council regulations: 1055/2005 and 1056/2005[5] amending previously existing regulations, 1466/97 and 1467/97 respectively. The new pact, in the conditions of economic and budgetary diversification of individual countries, introduced various medium-term goals, while the old principles were limited to stating that in the medium-term the states should achieve a balance or surplus in the budget. It was about maintaining the 3% of GDP limit, however, taking into account the economic characteristics of each country, in particular the debt-to-GDP ratio, potential economic growth, demographic problems, and pension reforms.

Key changes from the point of view of the applicability of the pact's principles, including sanctions, occurred in the corrective part. First of all, the concept of exceptional exceeding of the reference value has been redefined. From then on, exceeding the 3% of GDP of the budget deficit was not perceived restrictively, as states could refer to exceptional circumstances, which included, among others implementation of pension reforms, severe economic downturn, implementation of the Lisbon Agenda, high financial contribution to supporting international solidarity and achieving European policy goals, in particular the unification of Europe (Council Regulation (EC) No 1056/2005: art. 1). This meant, *de facto*, that from now on states could justify their excessive expenses with a variety of circumstances that should be included by the Commission in its report. In addition, it was considered that when taking the steps leading to the decision on the existence of an excessive deficit, the general government deficit should be taken into account. This meant that countries with a public debt ceiling of 60% of GDP, a budget deficit above 3% of GDP was not considered excessive.

The reform of the Stability and Growth Pact led to a paralysis of its key rules, i.e. financial sanctions. The possibility of their application was a key instrument to deter countries from carrying out irresponsible fiscal policy having a negative impact on the economic growth and stability of the entire euro area. From 2005, its role was reduced to a document coordinating and supervising the budgetary policy of states with an emphasis on the large economic diversification of states and their great freedom in shaping and conducting national budgetary policy.

The global economic crisis has exposed the weaknesses of fiscal policy coordination within the European Union, and basically the lack thereof. Multilateral violations of the pact's rules by the euro area countries (Greece, Portugal, Italy, Germany, France, the Netherlands, and Austria) testified to the ignorance of the EU institutions and the

[5] The following documents are meant:
1) Council Regulation (EC) No 1055/2005 of 27 June 2005 *amending Regulation (EC) No 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies*;
2) Council Regulation (EC) No 1056/2005 of 27 June 2005 *amending Regulation (EC) No 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure*, OJ L 174 of 7 July 2005.

Member States. Therefore, in the face of the deepening debt crisis of many euro area countries, it was paradoxical that European decision-makers recognised that the principles of the pact should be strengthened in order not to allow financial destabilisation in the future. Thus, the idea of tightening budgetary discipline, which at the end of the 1990s was originally proposed by German Finance Minister Theo Waigel, returned. The rules of the *Stability and Growth Pact* have been modernised by adopting of the so-called "six-pack" (entered into force in December 2011), the *Treaty on Stability, Coordination and Governance* (entered into force in January 2013) and the "two-pack" (entered into force in May 2013).

Legislative changes commonly referred to as the six-pack create a package of six legal acts strengthening the coordination not only of fiscal policy, but more broadly the coordination of economic policy of the European Union, which will be discussed in the next part of the article. Table 1 illustrates the content of the adopted documents and their application in relation to the reformed Stability and Growth Pact for the second time and economic governance in the EMU.

Table 1. Six-pack and its application

Title of the document	**Stability and Growth Pact**	**Economic management**
Regulation (EU) No 1173/2011 of the European Parliament and of the Council of 16 November 2011 on the effective enforcement of budgetary surveillance in the euro area	V	
Regulation (EU) No 1174/2011 of the European Parliament and of the Council of 16 November 2011 on enforcement measures to correct excessive macroeconomic imbalances in the euro area		V
Regulation (EU) No 1175/2011 of the European Parliament and of the Council of 16 November 2011 amending Council Regulation (EC) No 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies		V
Regulation (EU) No 1176/2011 of the European Parliament and of the Council of 16 November 2011 on the prevention and correction of macroeconomic imbalances		V
Council Regulation (EU) No 1177/2011 of 8 November 2011 amending Regulation (EC) No 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure	V	
Council Directive 2011/85/EU of 8 November 2011 on requirements for budgetary frameworks of the Member States	V	

Source: own investigation, based on the https://eur-lex.europa.eu.

The introduced changes emphasise greater control over the financial stability of countries, not only as before through the budget deficit below 3% of GDP, but also public debt up to 60% of GDP (Council Regulation (EU) No 1177/2011: art. 1). This means that the public debt criterion has been included in the content of the Stability and Growth Pact and that the excessive deficit procedure may also apply to countries whose public debt has exceeded 60% of GDP, even when the deficit level is at the required level. The new rules of the pact also applied to public expenditure, which could not grow faster (growth above the set threshold) than the potential medium-term GDP growth, unless they were covered from other sources.

The main purpose of the newly introduced control element was to ensure that extraordinary budget revenues (resulting from cyclical economic recovery) were allocated to debt reduction (*Reforma zarządzania…* 2011: p. 3). One of the most important elements of the reform was the introduction of financial sanctions in the preventive part of the pact (only for countries with euro), in the form of an interest-bearing deposit of 0.2% of GDP, if the country concerned did not comply with the Council's recommendations. In order to streamline the decision-making process regarding the imposition of sanctions (both in the preventive and corrective part), the principle was set, so that the decision to apply sanctions is adopted if, within 10 days of the adoption of the recommendations by the Commission, the Council does not reject it by a qualified majority. An additional novelty was the introduction of sanctions for manipulation of statistical data regarding fiscal criteria not exceeding 0.2% of a given country's GDP (Regulation (EU) No 1173/2011: art. 4, 5, 6, 8). Finally, the six-pack provisions envisaged strengthening the national budgetary framework, including obligation of the Member States to ensure appropriate accounting and statistical standards, and to conduct multi-annual budgetary planning.

The above package of legal regulations in the field of fiscal policy has been additionally supplemented by the *Treaty on Stability, Coordination and Governance in the Economic and Monetary Union*. The first ideas to conclude such a treaty appeared in 2011, when in the statement of 9 December 2011 the heads of state or government of the euro area, bearing in mind the need to face the challenges of the EMU in the face of the ongoing crisis, proposed a new fiscal agreement and enhanced coordination in the economic policy area. Ultimately, the treaty was signed on March 2, 2012, by all then Member States except Great Britain and Czech Republic, and it entered into force on 1 January 2013.[6]

The so-called fiscal pact, in the part entitled "Fiscal Compact" (Title III), increased budgetary control through the adoption of the so-called balanced budget rules (the so-called golden rules).[7] It means that the general government balance must be balanced or have a surplus. The requirement is considered fulfilled when the annual structural balance of the general government corresponds to the medium-term budgetary objective

6 Now the *Treaty on Stability, Coordination and Governance in the Economic and Monetary Union* has ratified by all EU Member States. The United Kingdom withdraws from the European Union and becomes treated as a "third country" (non-EU country) as of 1 February 2020.

7 Title III of the Treaty related to the budgetary issues, i.e. "Fiscal Compact", covers all EMU countries as well as Bulgaria, Romania and Denmark on a voluntary basis.

for the country concerned,[8] where the lower ceiling of the structural deficit can be 0.5% of GDP at market prices. It can be raised to 1% of GDP, but when the value of public debt is lower than 60% of GDP and there is a low risk of losing the long-term sustainability of public finances. In the event of significant deviations from the medium-term objective or the adjustment path leading to its achievement, a corrective mechanism is automatically activated based on the principles, which the European Commission will present regarding the nature, scope and timing of corrective action (Treaty on Stability 2012: art. 3–9).

All elements of the balanced budget rule have been entered into the national law of the signatory countries in accordance with the provisions of the fiscal pact. Furthermore, if the Commission or any Member State considers that another country is not following corrective recommendations, they may independently submit a complaint about that particular country at the Court of Justice, whose judgments are legally binding. If the rulings are not implemented, any state may bring the case to the Court and request a financial penalty. If the Court finds that a country has not complied with its judgment, it may impose a penalty of 0.1% of that country's GDP. Finally, the pact in art. 6, in order to coordinate better the national debt issuance plans, obliged the signatory countries to provide *ex ante* information on their public debt issuance plans to the Council of the EU and the European Commission.

All legislative changes in the field of fiscal policy of the EMU member states are closed by the so-called two-pack, the content of which consists of two regulations in force since May 30, 2013:

1) Regulation (EU) No 472/2013 of the European Parliament and of the Council of 21 May 2013 *on the strengthening of economic and budgetary surveillance of Member States in the euro area experiencing or threatened with serious difficulties with respect to their financial stability*;

2) Regulation (EU) No 473/2013 of the European Parliament and of the Council of 21 May 2013 *on common provisions for monitoring and assessing draft budgetary plans and ensuring the correction of excessive deficit of the Member States in the euro area*.

Above-mentioned documents generally emphasise coordination and supervision of fiscal policy pursued by the states. The first (regulation) consideres that enhanced surveillance should cover euro area countries affected or threatened by serious financial difficulties. The experience of the economic crisis has shown how quickly the economic problems of one country can move to other EMU countries, thus weakening the entire euro area and the European Union. Therefore, in order to avoid a domino effect in the future, Regulation (EU) No 472/2013 introduced special supervision over countries, which due to their problems may be a source of crisis for the entire euro area.

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[8] The value of the medium-term budgetary objective is understood as the value of the structural balance (structural deficit). Medium-term budgetary objectives differ from one Member State to another. Pursuant to Regulation (EU) No 1175/2011 of the European Parliament and of the Council of 16 November 2011 *amending Council Regulation (EC) No 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies*, they are set within a specific range between -1% of GDP and the balance or surplus, in terms of cyclical changes, after adjustment for one-off and temporary measures. They are reviewed every three years.

Its most important element should be extended access to information necessary for close monitoring of the economic, budgetary and financial situation as well as regular reporting to the relevant committee of the European Parliament and the Economic and Financial Committee.

Analogous solutions should be applied to countries seeking financial assistance under the European Financial Stability Mechanism or other international organisations, including the International Monetary Fund. Decisions to include a given country in the enhanced supervision are made by the European Commission, notifying the European Central Bank, European Supervisory Authorities, and the European Systemic Risk Board. The country covered by enhanced supervision is obliged to take all actions and take into account comments addressed to it, in order to eliminate or alleviate financial problems. However, countries benefiting from financial assistance mechanisms (e.g. under the European Stability Mechanism) must submit additional financial data, accept control visits carried out by the Commission and remain under supervision until at least 75% of the financial assistance has been repaid.

The Regulation (EU) No 473/2013, by introducing a common budgetary schedule, included the budgetary policy of the euro area countries in the so-called European Semester, which will be discussed in the part on economic governance. This will ensure greater synergy between the budgetary policies of EMU countries and the economic policy coordination framework in the context of the annual surveillance cycle.

Legislative transformations in the field of economic governance in the EMU

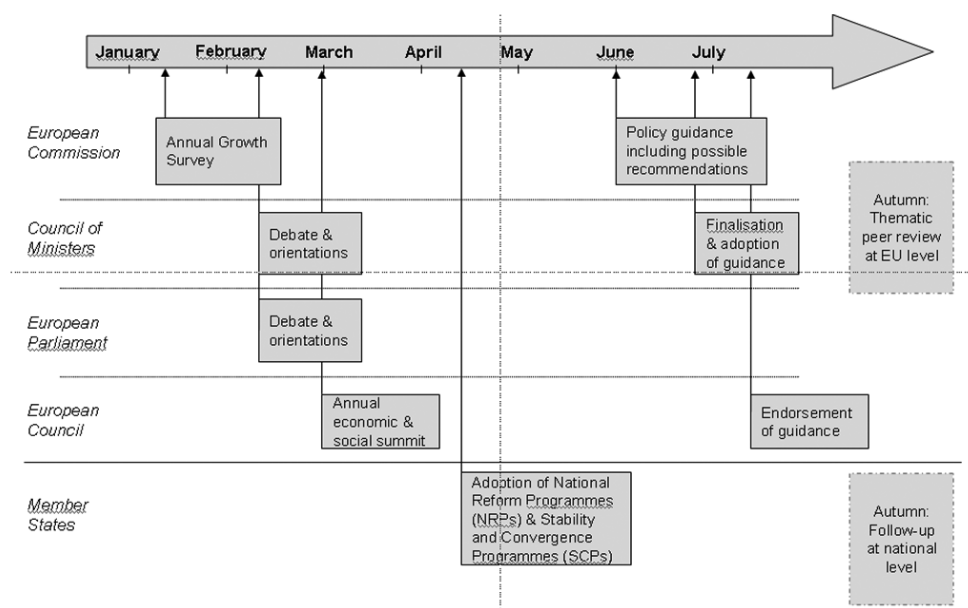
The economic crisis in the euro area has revealed a number of weaknesses. As the European Commission indicates, one of them was the excessive focus on the level of the budget deficit instead of the total amount of public debt. There was also a lack of supervision over competitiveness and macroeconomic imbalances (e.g. increase in lending and overheating on real estate markets). These errors began to be corrected with the adoption of the six-pack, adding to the broadly regulated cooperation in the field of fiscal policy, legal regulations in the field of economic governance. Their center is the European Semester for economic policy coordination established under the Regulation (EU) No 1175/2011, which is an integral part of the package of six legal acts.

The tasks of the European Semester, which has been active since 2011, are primarily: supporting economic growth in line with the objectives of the *Europe 2020* strategy, ensuring the sustainability of public finances (including in-depth control of individual budgets), and preventing excessive macroeconomic imbalances. Works within the European Semester include: development and control of the implementation of the broad economic policy guidelines of the Member States and the EU, development and analysis of the implementation of employment guidelines, submission and evaluation of the stability programme (in the euro area countries) and convergence programmes (in the non-euro area countries), submission and assessment of the Member States' National Reform

Programme in support of the EU strategy for growth and employment, and supervision to prevent macroeconomic imbalances (Regulation (EU) No 1176/2011).

The European system, therefore, ensures that Member States present and discuss their budget plans and economic policies with each other. The European Commission gives the right to produce the annual growth survey starting the European Semester cycle (November), provide guidance before decisions are taken at the national level, observe and finally publish country-specific recommendations. Other EU bodies are also involved in the cycle of the European semester, including the European Council, the Council, and the European Parliament. With appropriate competences, the European Council adopts economic priorities on the basis of Commission recommendations and approves recommendations for the Member States. The Council examines the Annual Growth Survey and discusses recommendations to the Member States. Parliament, on the other hand, conducts economic dialogue on both issues. A detailed schedule of activities under the European Semester was presented in the *Communication from the Commission COM(2010) 367 final* of 30 June 2010, illustrated by Figure 1.

Figure 1. Schedule of activities under the European Semester



Source: *Communication from the Commission COM(2010) 367 final* of 30 June 2010, Annex 2: European semester of policy coordination.

In accordance with the two-pack (Regulation (EU) No 473/2013), enhanced budget cooperation of the euro area countries has been included in the cycle of the European Semester. It means, among others, a common budget schedule and common budgetary

rules covering euro area countries. Their integral part is the obligation to submit mid-term budget plans (stability programmes) annually by 30 April at the latest, together with the priorities of their policies for growth and employment for the following year (national reform programmes) (Regulation (EU) No 473/2013: art. 13). By 15 October, countries using euro currency are required to publish a draft budget for the following year, on which the European Commission issues an opinion, and in case of violation of the rules of budgetary discipline, it can call on the country to amend the budget plan. On the other hand, the countries subject to the excessive deficit procedure must, apart from budgetary projects, also submit economic partnership programmes including plans for detailed budgetary and structural reforms leading to deficit reduction (e.g. pension and tax reforms). Countries benefiting from financial assistance (under e.g. the European Stability Mechanism or the IMF loans) are exempt from the obligation to submit similar plans, as they agree with the Commission, the ECB and possibly with the IMF a macroeconomic adjustment programme, which is, in fact, the sum of economic partnership programmes and plans containing annual budgetary targets. The budgetary schedule ends on 31 December, when the budget is adopted and published.

The experience of the EMU's functioning until the crisis and during its first wave has shown European decision-makers that excessive focus on budgetary discipline has caused a deficit of macroeconomic control mechanisms. After 1999, the countries belonging to the euro area, instead of continuing the process of economic convergence, followed the opposite *de convergence scenario.* They required the candidates for the euro area to comply with the convergence criteria, while they ceased to fulfill them. National governments and European institutions have not responded to the growing problem of the European Union's macroeconomic imbalance, which has led to a serious differentiation in competitiveness that prevents effective single monetary policy. Only as a result of the crisis there was decided to address this issue and to join the multilateral surveillance procedure[9] under the Regulation (EU) No 1176/2011 (a part of the six-pack) – a mechanism was added to prevent and correct macroeconomic imbalances, which has become part of the European Semester. Its first stage is a warning mechanism aimed at detecting increasing macroeconomic imbalances. To this aim, the Commission prepares an annual *Alert Mechanism Report* (AMR) based on an economic indicator table containing indicative thresholds. According to the *Alert Mechanism Report 2018* (Statistical Annex), the current table includes 14 indicators divided into three parts:

1) indicators of external imbalance and competitiveness (e.g. changes in the current account balance, changes in the international investment position, export markets share),
2) internal imbalance indicators (e.g. level of private sector debt, changes in the financial market, changes in the housing market),
3) employment rates (e.g. long-term unemployment, unemployment of young people aged 15-24, etc.). [10]

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9 referred to the Article 121 of the *Treaty on the Functioning of the EU*.

10 The appropriate prudential thresholds for macroeconomic indicators are indicated in the document: European Commission (2017), *Alert mechanism report 2018 and statistical annex*, www.ec.europa.eu

The alert mechanism is intended to indicate countries that are exposed to imbalances or which are already affected by such a problem. Exceeding one or several indicative thresholds should not be perceived as a macroeconomic imbalance, because, as indicated in point 14 of Regulation (EU) No 1176/2011: "Conclusions should not be drawn from an automatic reading of the scoreboard: economic judgement should ensure that all pieces of information, whether from the scoreboard or not, are put in perspective and become part of a comprehensive analysis." The added value of the alert mechanism is the fact, that changes in macroeconomic imbalances are considered by the Commission at the level of the entire EU and the euro area, which *de facto* means that the mechanism covers EMU countries and those without the single currency.

The effect of the analysis of economic data is the indication by the Commission of the countries for which a detailed assessment of the situation should be prepared, which is then discussed in the Council (or in the Eurogroup – in case of EMU countries). In the event of serious macroeconomic imbalances, an excessive imbalance procedure should be initiated, which may include: addressing recommendations to the country concerned, additional oversight requirements, and for euro area countries sanctions in the form of an interest-bearing deposit or penalty – 0.1% of GDP in a year previous (pursuant to the Regulation (EU) No 1174/2011). A deposit is required if the Council, acting by a reverse qualified majority, considers that the country has not taken corrective actions. However, the penalty is imposed in two cases, i.e. when two Council recommendations were issued and the country concerned did not provide a sufficient corrective plan, and when two subsequent Council decisions finding non-compliance of the corrective action taken by the given country with the Council's recommendations were adopted.

The fiscal pact, despite the words "coordination and governance in the EMU" in its title, does not contain additional legislative solutions affecting established economic governance in the EU. It only obliged the Member States to take all actions and measures essential for the proper functioning of the euro area. At the same time, this pact confirmed the need to pay attention not only to the balance of public finances, but also to fostering competitiveness, promoting employment and reinforcing financial stability (Treaty on Stability 2012: art. 9). Article 11 of this treaty also obliged Member States to consult the planned economic reforms at the EU level in advance.

The importance of the established EU economic governance is enhanced by its connection with the EU cohesion policy. In the period 2014–2020, support from the *European Structural and Investment Funds* (ESIF) is closely linked to respecting the principles of EU economic governance. Currently, all ESI Funds are subject to compliance with procedures related to economic governance in the EU as set out in Chapter IV of the Regulation (EU) No 1303/2013 of the European Parliament and of the Council of 17 December 2013 establishing common provisions for the ESI Funds. On this basis, the Commission may ask a Member State to reprogram a part of its financing, where economic and employment problems justify it.

This kind of change, however, allows the transfer of money within regions, but it can also mean that the money will be transferred to other purposes than planned.

It is different in the second situation, where the Commission has the right to propose to the Council to suspend funding from the ESI Funds in a situation, where the country concerned fails to comply with economic governance procedures. The decision to apply this type of sanction is possible through the so-called reversed qualified majority and will be effective from January 1 of the year following the decision. The current ESIF provisions in force strongly strengthen the implementation of the *European strategy for growth and employment (Europe 2020)*, but at the same time increase control by the EU. Earlier, similar regulations applied only to the Cohesion Fund and only in relation to the excessive deficit procedure, and now they apply to all structural and investment funds and to all indicators included in the assessment of the macroeconomic balance of EU countries.

Legislative transformations in the field of financial stability

An integral part of management reforms in the euro area in response to the challenges of the economic crisis was taking steps to restore and create financial stability through tools such as banking union and financial assistance. The first wave of the crisis made European decision-makers aware of how strong the interdependence of governments and banks is and how much impact banks' liquidity problems have on the financial stability of states. To protect against the collapse of the banking system, European governments provided support at an unprecedented amount of EUR 1.6 trillion, equivalent to 13% of the EU's annual GDP.[11]

The need to strengthen the supervision of the banking system seemed necessary, as expressed by the leaders of the euro area during the summit of the EMU on 29 June 2012. The banking union is to ensure the creation of a secure banking system throughout the European Union (non-Euro zone countries may also participate in it)[12] and that insolvent banks are liquidated or restructured with minimal economic impact. It consists of several elements. The first is the single supervisory mechanism, which is responsible for controlling banking institutions, thus contributing to their greater stability. It has operational capacity since 4 November 2014, pursuant to Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions.

Supervision is carried out under the joint cooperation of the European Central Bank (ECB) with national supervisory authorities and on the basis of uniform legal provisions for all countries participating in the banking union. The ECB is responsible for overseeing all major euro area banks (around 85% of bank assets), and the national institutions over smaller banks. The second element of the banking union, operating since January 1, 2016, is a single resolution mechanism created under the Regulation (EU) No 806/2014 of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment

[11] Data from: www.ec.europa.eu.

[12] Until now, countries from outside the euro area, which have expressed their wish to join the banking union are Bulgaria and Croatia. Both countries are preparing for membership of the EMU, entering earlier the ERM II mechanism and the banking union.

firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund. It watches over, among others, the bankruptcy process of banks, so that in the future it has the least impact on taxpayers and the economies of individual countries. In this case, too, the rules are uniform for all participating states of the banking union.

In the structure of the second element of the discussed union, the main decision-making body operating at the EU level is the Uniform Restructuring and Resolution Board, while the joint resolution fund planned for 2023 is to be financed by the banking sector. The third element complementing the banking union will be the *European Deposit Insurance Scheme* (EDIS) proposed by the European Commission on 24 November 2015 to further integrate the banking system of participating countries. It is to be built on existing national deposit guarantee systems by combining them and is to provide individual depositors with an equal level of protection (EUR 100,000). Its introduction will be gradual, because within 8 years (planned until 2024) it is to take over the functions of guaranteeing deposits in the countries participating in the banking union. The so-called third pillar of the banking union is to be compulsory for euro area Member States and voluntary for the other EU Member States wishing to join the banking union (see: European Commission 2015).

In addition, a number of initiatives have been launched to create a more secure financial sector in the single market. They constitute a "simple rulebook" for all financial market participants in the EU Member States. They fall under the Directives 2013/36/EU and 2014/59/EU, as well as Regulation (EU) No 575/2013. Their task is to ensure greater financial market security through, among others, common conditions for establishing banks, supervision principles, liquidity requirements, or crisis management in the event of bankruptcy or threat of bankruptcy (Jurkowska-Zeidler 2016: p. 5–6).

An important challenge for euro area countries in the context of the economic crisis was the lack of credit mechanisms (analogous to those in the European Monetary System in 1979–1998) established in the event of emergencies. The creators of the EMU did not foresee negative scenarios, and only as a result of the contemporary economic crisis European leaders began to decide on establishing temporary mechanisms of financial assistance for the most indebted countries.

In 2009 and 2010, the *European Financial Stability Mechanism* (EFSM) and the *European Financial Stability Facility* (EFSF) were created, which ceased to operate in September 2012 following the entry into force of the intergovernmental agreement establishing permanent financial support under the *European Stability Mechanism* (ESM). Euro area countries are its members. The ESM has a capital of EUR 704.8 billion, of which EUR 80 billion comes from contributions from EMU countries, and the remaining funds are demand capital from euro area countries (*Frequently asked questions…* WWW). The ESM provides loans to euro area countries in very difficult economic situations, thus contributing to the stabilisation of the entire euro area. The system includes a diversified aid system, however, two types of aid have been used so far, i.e. loans under the macroeconomic adjustment programme and loans for the indirect recapitalisation of banks.[13]

[13] Only Spain has so far benefited from the bank recapitalisation program, transferring all the funds granted under the ESM for the restructuring of the banking system.

At the moment (as of January 2020), no country uses ESM credit assistance. Greece, Cyprus and Spain benefited from ESM loans, and their programmes ended in August 2018, March 2016, and December 2013 respectively.[14]

Legislative changes in financial stability are complementary to the provisions establishing new European institutions responsible for the supervision of financial markets. They fall within the concept of the *European System of Financial Supervision* comprising three European Supervisory Authorities (ESAs), the *European Systemic Risk Board* (ESRB), and national supervisory authorities. The new offices are to supervise in turn the banking sector (*European Banking Authority*), the insurance sector (*European Insurance and Occupational Pensions Authority*), and the capital sector (*European Securities and Markets Authority*). Their main task is to develop uniform provisions contributing to the creation of a uniform financial supervision system (so-called micro-prudential supervision). The above-mentioned *European Systemic Risk Board* is responsible for macro-prudential supervision, which is responsible for collecting and analysing information enabling the detection of systemic threats. The organisational composition of the ESRB indicates that it cooperates closely with the ECB and the three supervisory authorities. The chairman is the president of the ECB, and the members are representatives of the central banks of the EU countries and the chairman of the three European Supervisory Authorities.

Legislative plans related to the future of the euro area

The European Union is entering a crucial phase in facing the challenges posed by its functioning in the euro area. The mechanisms introduced so far as a response to the crisis have proved sufficient to control the current economic problems of the euro area, but they do not guarantee sufficiently stable conditions for the economic development of euro area countries and the stability of the entire European Union. The debate on the prospects for the development of the EMU since the *Communication from the Commission COM (2012) 777 final/2* has now become the part of a deeper discussion on the future of Europe as a whole, along with topics such as migration, security and defense, the social dimension of integration, and long-term financial framework and the activities of EU institutions. The planned changes in the euro area to the fullest extent are presented in a document entitled *Completing Europe's Economic and Monetary Union,* known as the Five Presidents' Report[15] presented on 22 June 2015. The changes then became the

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[14] Ireland and Portugal have benefited from earlier financial support instruments. Ireland applied for financial assistance to the EU and the International Monetary Fund (IMF) in November 2010. In total, it received support in the amount of 67.5 billion euros, of which 17.7 billion came from EISF, 22.5 billion from the European Commission, 22.5 billion from the IMF, 4.8 billion from bilateral loans granted by some EU Member States. In April 2011, Portugal received financial assistance from the European Financial Stability Facility of EUR 26 billion and in addition from the European Commission and the International Monetary Fund for EUR 26 billion (EUR 78 billion in total). They completed their 3-year EFSF programs in December 2013 (Ireland) and in June 2014 (Portugal). Data from: www.esm.europa.eu.

[15] Presidents of the European Commission (Jean-Claude Juncker), the European Council (Donald Tusk), the Eurogroup (Jeroen Dijsselbloem), the European Parliament (Martin Schulz), and European Central Bank (Mario Draghi). (see: Juncker et al. 2015)

basis for the presentation by the European Commission on 6 December 2017 of a communication discussing the action plan for completing the EMU (*Communication from the Commission COM (2017) 821 final*). The continuation of actions taken is also envisaged in the strategy of the new Commission chaired by Ursula von der Leyen for the years 2019–2024 (*6 Commission Priorities…* WWW).

According to the above-mentioned the Five Presidents' Report (Juncker et al. 2015), the general task for the Member States is to complete the construction of the EMU by 2025 at the latest, by the mutual and parallel interpenetration of four unions: economic, financial, fiscal, and political. They must develop each other, and all euro area countries must participate in each of them. The economic union is to serve primarily deeper convergence eliminating existing disparities between countries and creating conditions for economic growth and employment. The financial union is above all the completion of the banking union, mainly through the implementation of the law establishing a uniform deposit guarantee system and accelerating work on the capital markets union. The fiscal union relating to budgetary policy, although it has been heavily modernised with the reforms of the Stability and Growth Pact, should be finalised with the establishment of a single fiscal stabilisation mechanism for the entire euro area that will more effectively protect the EMU against macroeconomic shocks. A political union was not defined in the report, but rather used to illustrate planned activities for democratic accountability, legitimacy, and institutional strengthening.

The key issue is the inclusion of the existing intergovernmental management instruments of the euro area in the EU legal framework. The authors of the report see the need to strengthen the role of the European Parliament and national parliaments, the need to develop rules for the joint representation of the euro area in international financial institutions and to strengthen the role of the Eurogroup, which is beginning to be attributed to the role of central control of key issues for the euro area, including representing the interests of the single currency both inside and outside the EMU. An interesting proposition is the suggestion of creating a euro area tax authority, with the reservation that euro area Member States would continue to decide on taxation and the distribution of budgetary expenditures. Nevertheless, a deeper EMU requires an in-depth discussion on fiscal policy and in the proposed tax authority, the authors of the report see the possibility of playing the role of a platform for joint discussion. The above-mentioned proposals should be implemented in stages, and all activities should be implemented by 2025 at the latest.[16]

As indicated by the European Commission, a number of proposals of the five presidents have already been implemented under existing cooperation mechanisms, in accordance with the adopted timetable for the first stage (from 1 July 2015 to 30 June 2017). The role of the European Semester was increased, and greater emphasis was placed on

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[16] Specific proposals for action – see *Annex 1: Roadmap Towards a Complete Economic and Monetary Union*, in: Juncker at al. (2015), *Completing Europe's Economic and Monetary Union*, https://ec.europa.eu/commission/sites/beta-political/files/5-presidents-report_en.pdf

social aspects. Budgetary cooperation was strengthened through the creation of a *European Fiscal Board*, the *Structural Reform Support Service* was established to assist the EU Member States in developing and implementing structural reforms as part of their policies to create jobs and economic growth, and several steps were taken to deepen the banking union. Currently (the second stage), the euro area countries together with the EU institutions are working on solutions with a much more binding character crowning the modernisation and construction of the EMU, so that they can be fully implemented by 2025 at the latest (the third stage).

The key changes that have been carried out so far include strengthening the European Stability Mechanism, which was originally to be replaced by the planned European Monetary Fund. It is the ESM that will provide the common backstop mechanism for the Single Resolution Fund, the funds of which will be used for the resolution of banks on the verge of bankruptcy, when the previously used methods in the form of debt conversion or cancellation fail.

The discussions around the *Eurozone Budget* ended with the establishment of the *Budgetary Instrument for Competitiveness and Convergence* (BICC), which is a part of the EU's general budget. At the moment, it is temporary because it is planned for 2021–2027, and only after this period it will be possible to determine whether it was the seed of the *Eurozone Budget* or only fulfilling the function of an instrument to support reforms of the EMU. Undoubtedly, however, this issue will be decisive for the political completion of the EMU.

The most difficult challenge in the near future will be the finalisation of the banking union by establishing a *European Deposit Insurance System*. A number of risk-free operational models have been proposed for EDIS. They differ in the degree of centralisation, the scope of protection, and mutual financing. This points to divergent positions of individual countries, although the will to work out a common solution is emphasised at all Euro Summits.

Discussions are still open on the capital markets union, the joint representation of euro area countries in the International Monetary Fund, and the incorporation of the *Treaty on Stability, Coordination and Governance in the EMU* and the *ESM Agreement* into EU law. This means that these issues will be the subject of negotiations in the near future, which will certainly gradually change the EMU.

Conclusions

Legislative changes in the euro area in response to the economic crisis seem appropriate and comprehensive. The EU has contributed to strengthening budgetary, economic, financial and the entire banking system cooperation, which undoubtedly had a calming effect on the euro area. Currently, in the EU there are more stringent regulations regarding the EMU in the broad sense, there is definitely better coordination of individual countries' policies at the EU level and better enforcement of their feasibility.

The actions undertaken so far have lacked the establishment of joint external representation of the euro area in the International Monetary Fund with the president of the Eurogroup as a representative of the euro area. This fact weakens not only the image of the euro area outside but also the crisis management system of the EMU, where IMF's loans are an important element. A joint representation of the euro area at the IMF would also enable the provision of a joint transfer of the euro area at the IMF on issues such as programmes and reviews, economic and fiscal policy, macroeconomic surveillance, exchange rate policy and financial stability (Proposal for a Council decision COM(2015) 603 final).

Plans are needed to complete the EMU. One of its pillars – monetary policy – works well, as demonstrated by European Central Bank functioning. It is organised at a supranational level and perhaps it is a form that should be used for the second pillar of the EMU – economic policy, so that it can fully and effectively fulfill its tasks in the field of, among others economic growth, fighting unemployment or pursuing a fiscal policy. The current form of cooperation under the European Semester, the fiscal pact, the "six-pack" and the "two-pack" is too dispersed, involving too many national and EU institutions, which in consequence deprecate the responsibility for economic policy. Better transparency and simplification of procedures are needed. This will require changes towards centralisation of budgetary policy and deepening of political integration, as already mentioned in the "Werner report" in 1970, and now in the Five Presidents' Report is written, that for the euro area to gradually evolve towards a true economic and monetary union, it will have to move from a system of principles and guidelines for national economic policy-making systems to a system of further sharing of sovereignty within joint institutions, most of which already exist and can gradually take over these tasks. In practice, this will require the Member States to accept increasingly joint decision-making on individual elements of their national economic budgets and policies.

It seems that the proposed direction of changes is necessary. However, whether they can be achieved in the current intra-EU and international conditions remains an open question.

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