

## **TOWARDS FISCAL UNION IN EUROPE: CHALLENGES, OPPORTUNITIES AND IMPLICATIONS**

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### **ABSTRACT**

The concept of fiscal union in Europe has been a subject of intense debate and discussion since the establishment of the European Union (EU). This paper examines the rationale behind fiscal union, explores the challenges and opportunities associated with its implementation, and analyzes its potential implications for member states and the EU as a whole. By understanding the underlying economic, political, and institutional dynamics, this paper aims to shed light on the path towards achieving a more integrated and resilient European economic and monetary framework.

**Keywords:** economic integration, fiscal union, fiscal discipline

### **1. Introduction**

The concept of fiscal union in Europe has been a topic of considerable interest and debate in recent years, driven by the need to strengthen the economic and monetary framework of the European Union (EU). Fiscal union, as a deeper level of fiscal integration, entails the coordination and harmonization of fiscal policies among member states to achieve collective economic stability and resilience. It represents a significant step towards greater economic solidarity, risk-sharing, and convergence within the EU.

Since its inception, the European Union has achieved remarkable progress in promoting economic cooperation, removing trade barriers, and fostering a single market. However, the global financial crisis of 2008 and the subsequent sovereign debt crisis exposed vulnerabilities within the eurozone and revealed the limitations of the EU's existing fiscal architecture. These crises underscored the need for a more robust mechanism to address economic imbalances, divergent economic conditions, and asymmetric shocks that can affect individual member states differently.

The fiscal union aims to overcome these challenges by providing a comprehensive framework for coordinated fiscal policies, fiscal discipline, and mechanisms for fiscal transfers among member states. It seeks to promote sustainable economic growth, mitigate the impact of economic shocks, and strengthen the eurozone's ability to withstand future financial crises. Additionally, fiscal union is seen as a means to enhance the EU's global standing, enabling it to play a more influential role on the international stage.

However, the road to fiscal union is not without obstacles. Implementing deeper fiscal integration raises a host of political, economic, and institutional challenges. Sovereignty concerns, moral hazard risks, and divergent fiscal capacities among member states are among the critical issues that policymakers must address. Balancing the interests and responsibilities of individual nations within a more integrated framework requires delicate navigation.

This paper delves into the rationale for fiscal union, examining its potential benefits and the opportunities it presents for the EU and its member states. It also investigates the challenges that lie ahead and discusses the implications for both EU institutions and national governments. By understanding the underlying dynamics and considering different approaches to fiscal union, we can gain insights into the path forward towards a more integrated and stable European economic and monetary union.

## **2. Rationale for Fiscal Union**

The rationale for fiscal union in Europe stems from the need to address economic imbalances, enhance economic stability, and foster greater solidarity among member states. The European Union's journey towards deeper fiscal integration is driven by several key factors such as:

- (1) **Economic Convergence:** The EU comprises member states with diverse economic structures and levels of development. Fiscal union aims to promote economic convergence by aligning fiscal policies and encouraging harmonization among member states. This convergence is essential to reduce disparities in economic performance and ensure more equitable growth across the eurozone.
- (2) **Addressing Asymmetric Shocks:** Asymmetric shocks, such as financial crises or external economic shocks, can affect individual member states differently. A common fiscal framework allows for collective risk-sharing and provides mechanisms to support countries facing adverse economic conditions. By pooling resources, fiscal union helps cushion the impact of shocks and stabilize the entire eurozone.
- (3) **Strengthening the Eurozone:** The euro currency plays a central role in the economic integration of eurozone countries. However, the absence of a comprehensive fiscal

framework has exposed the eurozone to vulnerabilities during times of crisis. Fiscal union seeks to strengthen the stability and credibility of the euro, enhancing its resilience and global standing as a reserve currency.

- (4) **Enhancing Economic Stability:** Fiscal union facilitates a coordinated approach to fiscal policies, leading to greater macroeconomic stability within the eurozone. By harmonizing budgetary rules and objectives, fiscal union aims to prevent excessive deficits and ensure responsible fiscal management.
- (5) **Countering Fiscal Dominance:** In the absence of fiscal union, the economic policies of individual member states can influence the conduct of monetary policy. Fiscal dominance can lead to suboptimal monetary decisions and impair the effectiveness of the European Central Bank (ECB). Fiscal union helps to reduce fiscal dominance and strengthen the independence of the ECB in pursuing its monetary policy objectives.
- (6) **Promoting Solidarity and Cohesion:** The EU's founding principles include fostering solidarity and cohesion among member states. Fiscal union embodies these principles by providing a mechanism for financial assistance to countries in need. This mutual support fosters a sense of shared responsibility and helps maintain social and economic cohesion across the EU.
- (7) **Encouraging Long-Term Investment:** A well-designed fiscal union can support long-term investment initiatives, such as infrastructure projects, research and development, and education. By pooling resources and distributing them strategically, fiscal union can foster sustainable growth and enhance Europe's competitiveness on the global stage.
- (8) **Countering Moral Hazard:** Fiscal union is accompanied by increased fiscal discipline and oversight. It helps address moral hazard risks, where member states might engage in risky fiscal behaviors, relying on others to bear the consequences. Enhanced fiscal discipline and monitoring mechanisms ensure that member states adhere to agreed-upon fiscal rules.
- (9) **In conclusion,** the rationale for fiscal union in Europe is founded on the principles of economic convergence, stability, solidarity, and cohesion. By aligning fiscal policies, enhancing risk-sharing mechanisms, and promoting responsible fiscal management, fiscal union aims to create a more integrated, resilient, and prosperous economic and monetary union within the European Union.

### **3. Components of Fiscal Union**

Coordination, harmonization, and collective decision-making in fiscal matters. These components

aim to strengthen economic governance and fiscal discipline across member states while fostering risk-sharing and solidarity. Some key components of fiscal union include:

- (1) **Fiscal Rules and Frameworks:** Fiscal union relies on a set of common fiscal rules and frameworks that guide member states' budgetary policies. These rules typically include limits on budget deficits and public debt, aiming to ensure fiscal sustainability and prevent excessive borrowing. Examples of such rules are the Stability and Growth Pact and the Fiscal Compact.
- (2) **Budget Coordination:** Fiscal union requires close coordination among member states in the formulation of their national budgets. This coordination ensures that fiscal policies align with common EU objectives and do not undermine the stability of the eurozone as a whole. Regular dialogue and information exchange between member states and EU institutions facilitate effective budget coordination.
- (3) **European Fiscal Capacity:** A significant component of fiscal union is the establishment of a European fiscal capacity. This mechanism involves creating a common pool of funds, which can be used for targeted investments, countercyclical spending, or crisis response. The establishment of a European Monetary Fund (EMF) is one proposed form of a European fiscal capacity.
- (4) **Fiscal Transfers and Solidarity Mechanisms:** Fiscal union involves mechanisms for fiscal transfers between member states, aimed at supporting countries experiencing economic difficulties or shocks. These transfers promote risk-sharing and help prevent economic divergence among member states. Examples include the European Stability Mechanism (ESM) and the EU's Cohesion Policy funds.
- (5) **Joint Bond Issuance (Eurobonds):** Eurobonds, also known as joint bonds, are debt instruments issued collectively by eurozone member states. These bonds allow member states to pool their borrowing capacities, which can lead to lower borrowing costs for countries facing higher interest rates due to market perceptions of risk.
- (6) **Harmonization of Tax Policies:** Fiscal union may also entail greater harmonization of tax policies among member states. Harmonizing tax systems can reduce tax competition and prevent harmful tax practices that erode tax revenues in other member states.
- (7) **Fiscal Surveillance and Monitoring:** Fiscal union requires effective monitoring and surveillance of member states' fiscal policies. The European Commission, along with

other EU institutions, conducts regular assessments of national budgets and fiscal developments to ensure adherence to fiscal rules and guidelines.

- (8) **Fiscal Policy Coordination with Monetary Policy:** Coordination between fiscal and monetary policies is crucial for achieving macroeconomic stability. Fiscal union involves regular communication and collaboration between the European Central Bank (ECB) and national governments to ensure that fiscal and monetary policies are aligned to achieve common economic goals.
- (9) **Fiscal Capacity for Investment Projects:** Fiscal union can provide funds for strategic investment projects that benefit the EU as a whole, such as infrastructure, research and development, and climate change initiatives. These investments can boost economic growth and improve competitiveness across member states.

In conclusion, the components of fiscal union in Europe encompass a comprehensive framework that promotes fiscal discipline, coordination, and risk-sharing among member states. By establishing common fiscal rules, enhancing budget coordination, and creating mechanisms for fiscal transfers, fiscal union aims to strengthen the economic and monetary resilience of the European Union as a whole.

#### **4. Challenges to Fiscal Union**

Implementing fiscal union in Europe faces several significant challenges, ranging from political, economic, and institutional obstacles to differing national interests and public opinions. Some of the key challenges include:

- (1) **National Sovereignty Concerns:** Fiscal union requires member states to relinquish a degree of sovereignty over their fiscal policies to adhere to common rules and frameworks. Some countries may be hesitant to cede control over their budgetary decisions, as it may be seen as a loss of national autonomy and decision-making power.
- (2) **Divergent Economic Conditions:** EU member states have diverse economic structures and levels of development, leading to varying fiscal capacities and priorities. Aligning fiscal policies to accommodate these differences can be challenging, as countries may have conflicting interests regarding spending priorities, tax policies, and fiscal deficits.
- (3) **Moral Hazard Risks:** Deeper fiscal integration and risk-sharing mechanisms may create moral hazard risks, where member states might engage in riskier fiscal behavior, knowing that they can rely on others for support in times of crisis. This could lead to a lack of fiscal discipline and an increased burden on fiscally responsible countries.

- (4) **Political and Public Opposition:** Public sentiment towards fiscal union varies across member states. Some populations may be skeptical of pooling resources with other countries or providing financial assistance to less fiscally responsible nations. Political opposition to fiscal integration can also arise, making it difficult for policymakers to reach consensus on key fiscal union measures.
- (5) **Asymmetry in Fiscal Capacity:** Member states have different levels of fiscal capacity and public debt. Implementing fiscal transfers and solidarity mechanisms can raise concerns about the fairness of burden-sharing, as countries with stronger economies may be required to contribute more to support those facing economic difficulties.
- (6) **Optimal Currency Area Criteria:** The optimal currency area theory suggests that for a monetary union to be successful, member states should have a high degree of economic integration and symmetry in economic conditions. Some argue that the eurozone does not meet all the optimal currency area criteria, making it challenging to achieve effective fiscal integration.
- (7) **Legal and Institutional Hurdles:** The EU's complex institutional framework and decision-making processes may pose challenges to swift and decisive action on fiscal matters. Requiring unanimous agreement among member states for certain fiscal initiatives can hinder progress and limit the effectiveness of fiscal union measures.
- (8) **Historical and Cultural Differences:** European countries have diverse historical, cultural, and political backgrounds, which can influence their approach to fiscal policies and economic governance. These differences can result in differing attitudes towards fiscal union and impact the willingness to cooperate and integrate further.
- (9) **Coordinating Tax Policies:** Harmonizing tax policies across member states is a complex task due to varying tax structures, rates, and revenue needs. It requires addressing tax competition concerns and finding common ground on tax policies that may be sensitive issues for individual countries.
- (10) **Transition and Adjustment Costs:** Implementing fiscal union may involve significant transition and adjustment costs for member states. Harmonizing fiscal rules, budgetary policies, and institutions may require substantial efforts and financial resources.

In conclusion, while fiscal union in Europe holds the potential for enhanced economic stability and solidarity, it faces several critical challenges. Overcoming these hurdles requires a delicate balance between national interests, political will, and institutional reforms to create a more integrated and resilient economic and fiscal framework for the European Union.

## **5. Opportunities and Benefits**

Fiscal union in Europe offers various opportunities and benefits that can strengthen the economic and monetary framework of the European Union (EU) and foster greater cooperation and solidarity among member states. Some of the key opportunities and benefits include:

- (1) **Economic Stability and Resilience:** Fiscal union promotes greater macroeconomic stability and resilience within the eurozone. By coordinating fiscal policies and aligning budgetary objectives, member states can collectively respond to economic challenges and reduce the risk of economic fluctuations and crises.
- (2) **Risk-Sharing and Solidarity:** One of the primary advantages of fiscal union is the establishment of mechanisms for risk-sharing and financial solidarity among member states. In times of economic downturns or asymmetric shocks, fiscal transfers and financial assistance can help stabilize economies and prevent the exacerbation of economic disparities.
- (3) **Convergence and Cohesion:** Fiscal union contributes to the convergence of economic conditions among member states. Through coordinated fiscal policies and investment initiatives, less-developed regions can benefit from targeted support and investment, promoting greater cohesion and balanced growth across the EU.
- (4) **Enhanced Monetary Policy Effectiveness:** Closer coordination between fiscal and monetary policies can lead to better alignment of economic objectives. Fiscal union can help reduce conflicts between fiscal and monetary policy goals, enhancing the effectiveness of the European Central Bank's (ECB) monetary policy.
- (5) **Improved Access to Financial Markets:** The issuance of joint bonds, known as Eurobonds, under fiscal union can improve member states' access to financial markets. These common debt instruments are backed by the collective strength of eurozone economies, leading to reduced borrowing costs for member states.
- (6) **Increased Investment in Key Projects:** Fiscal union can provide a mechanism for funding strategic investment projects that benefit the entire EU. These projects, such as infrastructure development, research, and innovation, can boost economic growth, productivity, and competitiveness across member states.
- (7) **Fiscal Discipline and Sustainability:** A well-designed fiscal union reinforces fiscal discipline and encourages responsible budgetary management among member states. Common fiscal rules and oversight mechanisms help prevent excessive deficits and debt



accumulation, contributing to long-term fiscal sustainability.

- (8) **Enhanced Global Standing:** A more integrated and stable European economy resulting from fiscal union can strengthen the EU's global standing and influence. The euro can become a more attractive reserve currency, providing benefits in international trade and finance.
- (9) **Reduced Financial Market Speculation:** Fiscal union and joint debt issuance can help mitigate financial market speculation against individual member states. By pooling resources and sharing financial burdens, fiscal union can enhance market confidence and reduce the risk of speculative attacks on eurozone countries.
- (10) **Collective Bargaining Power:** Fiscal union provides member states with greater collective bargaining power in international negotiations and trade agreements. A united approach in economic matters strengthens the EU's ability to assert its interests on the global stage.
- (11) **Optimal Currency Area Benefits:** A fiscal union can enhance the eurozone's characteristics as an optimal currency area, making the monetary union more robust and better equipped to address asymmetric shocks and imbalances.

In conclusion, fiscal union in Europe presents numerous opportunities and benefits that can lead to a more integrated, stable, and prosperous economic and monetary union. By promoting economic stability, convergence, and cooperation, fiscal union strengthens the EU's resilience against economic challenges and fosters greater solidarity among member states.

## **6. Institutional and Political Implications**

The pursuit of fiscal union in Europe carries significant institutional and political implications that can shape the future of the European Union (EU) and its member states. These implications involve complex challenges related to decision-making processes, institutional reforms, and political dynamics. Some of the key institutional and political implications of fiscal union are as follows:

- (1) **Strengthening European Institutions:** Fiscal union requires strengthening existing EU institutions and potentially creating new ones to oversee fiscal policies, coordinate budgetary decisions, and manage fiscal transfers. Enhancing the role of institutions like the European Commission, Eurogroup, and European Parliament is essential for effective fiscal governance.
- (2) **Decision-Making Processes:** Fiscal union involves adopting common fiscal rules and frameworks, which necessitates changes to decision-making processes within the EU.



The move towards qualified majority voting on certain fiscal matters may be considered to expedite decision-making, as unanimity among member states can impede swift action.

- (3) **Balancing National Interests:** The pursuit of fiscal union requires striking a balance between national interests and the collective interests of the EU. Member states may have differing fiscal capacities and priorities, and reconciling these interests to reach common objectives can be challenging.
- (4) **Democratic Accountability:** Fiscal union entails significant shifts in economic decision-making power from national governments to EU institutions. Ensuring democratic accountability in fiscal matters becomes crucial to maintain citizens' trust and legitimacy in the decision-making process.
- (5) **Treaty Reforms:** Implementing fiscal union may require amending existing EU treaties or creating new ones. Treaty reforms can be a lengthy and complex process, involving negotiations among member states and ratification by national parliaments, which can pose challenges.
- (6) **National Parliaments' Role:** As fiscal union evolves, the role of national parliaments in approving EU budgetary decisions and fiscal measures may need to be reassessed. Balancing the involvement of national parliaments with the need for efficient and coordinated fiscal governance is a delicate task.
- (7) **Public Perception and Political Will:** Public opinion plays a vital role in determining the success of fiscal union. Public perception of fiscal integration, risk-sharing, and solidarity may influence political will and impact the implementation of fiscal union measures.
- (8) **Addressing Euroscepticism:** Eurosceptic sentiments in some member states pose challenges to deeper fiscal integration. Policymakers need to address concerns and communicate the benefits of fiscal union to counteract potential resistance.
- (9) **Multi-Speed Europe:** Fiscal union may lead to the emergence of a multi-speed Europe, where some member states integrate more closely than others. This dynamic can raise questions about the EU's future cohesion and the potential for different tiers of membership.

In conclusion, the institutional and political implications of fiscal union in Europe are multifaceted and require careful consideration and negotiation among member states. Addressing these implications is crucial for successfully navigating the path towards deeper fiscal integration and building a stronger, more resilient, and cohesive European Union.

## **7. Policy Coordination and Harmonization**

Policy coordination and harmonization are essential aspects of fiscal union in Europe. These mechanisms aim to align fiscal policies and promote cooperation among member states to achieve common economic objectives and maintain the stability of the eurozone. Policy coordination and harmonization involve several key elements such as:

- (1) **Macroeconomic Policy Coordination:** Fiscal union requires member states to coordinate their macroeconomic policies, including fiscal, monetary, and structural policies. This coordination ensures that these policies work in synergy rather than contradicting one another, leading to more effective economic outcomes.
- (2) **Budgetary Policy Coordination:** Member states need to align their budgetary policies with common EU objectives. This involves coordinating decisions on public spending, taxation, and deficit levels to maintain fiscal discipline and adhere to agreed-upon fiscal rules and targets.
- (3) **Alignment with EU Objectives:** Fiscal policies of member states should be in line with broader EU economic objectives, such as promoting sustainable growth, reducing unemployment, and ensuring price stability. Policy coordination ensures that national actions contribute to the achievement of these shared goals.
- (4) **Fiscal Rules and Frameworks:** Harmonizing fiscal rules and frameworks is crucial for consistent and predictable fiscal policies across member states. These rules may include limits on budget deficits, public debt levels, and other budgetary parameters to promote fiscal discipline and sustainability.
- (5) **Fiscal Surveillance and Peer Reviews:** Regular fiscal surveillance and peer reviews by EU institutions help monitor member states' fiscal policies and provide feedback on their alignment with agreed-upon rules and objectives. This enhances transparency and accountability in fiscal decision-making.
- (6) **Structural Reforms and Convergence:** Policy coordination extends beyond fiscal matters to include structural reforms aimed at enhancing economic convergence among member states. These reforms may focus on labor markets, product markets, and other areas to foster competitiveness and growth.
- (7) **Targeted Investment Initiatives:** Coordinating investment initiatives is essential to ensure that strategic projects receive support and funding in areas of common interest. Targeted investments can boost economic growth, improve infrastructure, and enhance innovation.

and research.

- (8) **Fiscal Capacity for Crisis Response:** Fiscal union may involve establishing a fiscal capacity to respond to economic crises collectively. This capacity can provide a safety net for member states facing severe economic downturns, minimizing the need for individual countries to bear the full burden of economic shocks.
- (9) **Social and Welfare Policies:** Policy coordination includes harmonizing social and welfare policies to ensure a level playing field and prevent significant discrepancies in social standards among member states.

In conclusion, policy coordination and harmonization are critical components of fiscal union in Europe. By aligning fiscal policies and promoting cooperation, these mechanisms contribute to the stability, convergence, and resilience of the European economic and monetary union. Effective policy coordination fosters an environment of collective responsibility and solidarity, enabling member states to address economic challenges collectively and achieve shared economic objectives.

## **8. Path Forward: Gradual vs Radical Integration**

The path forward towards fiscal union in Europe involves a crucial strategic decision between gradual and radical integration. Each approach presents distinct advantages and challenges, and policymakers must carefully consider the potential implications and the political feasibility of each path. Below, we explore the characteristics of both gradual and radical integration:

### ***Gradual Integration***

#### **(1) *Advantages***

- (1) **Incremental Progress:** Gradual integration allows member states to take measured steps towards fiscal union, ensuring that each phase is well-implemented and assessed before proceeding further.
- (2) **Political Feasibility:** Gradual integration may be more politically feasible as it accommodates varying national interests and reduces resistance from member states with concerns about sovereignty and fiscal autonomy.
- (3) **Building Consensus:** Gradual integration allows time to build consensus among member states and gain public support for deeper fiscal cooperation.

### ***Challenges***

- (1) **Slow Decision-Making:** Incremental progress may lead to slower decision-making

processes, especially when unanimity is required for certain fiscal measures.

- (2) **Limited Impact:** Gradual integration may not address immediate challenges or provide the necessary tools to respond effectively to economic crises.
- (3) **Coordination Complexity:** Coordinating different fiscal policies and rules during the transition period may be complex and may not lead to a comprehensive fiscal framework.

### ***Radical Integration***

#### ***Advantages***

- (1) **Swift Action:** Radical integration can lead to quick and decisive action, addressing urgent economic challenges and providing a more comprehensive response to crises.
- (2) **Stronger Fiscal Tools:** A radical approach allows for the establishment of a more robust fiscal framework with mechanisms for risk-sharing and solidarity.
- (3) **Enhanced Stability:** Radical integration can foster greater stability, as member states commit to deeper fiscal cooperation, reducing the risk of future economic crises.

#### ***Challenges***

- (1) **Political Resistance:** A radical approach may face significant resistance from member states that are hesitant to relinquish fiscal sovereignty and transfer more powers to EU institutions.
- (2) **Treaty Revisions:** A radical path typically requires significant treaty revisions, which can be time-consuming and require unanimous agreement among member states.
- (3) **Coordinating Diverse Economies:** Rapid integration may not account for the diverse economic structures and fiscal capacities of member states, potentially leading to imbalances.

#### ***Hybrid Approach***

Alternatively, a hybrid approach that combines elements of both gradual and radical integration could offer a balanced path forward. This approach involves taking bold steps in specific areas while gradually implementing other measures. For example, a more immediate establishment of a fiscal capacity for crisis response could be paired with a gradual convergence of fiscal policies over time.

The choice between gradual and radical integration is a complex decision that requires a careful evaluation of economic, political, and institutional considerations. Policymakers need to strike a balance between the need for swift action to address current challenges and the importance of building consensus and ensuring political feasibility. A well-planned and well-communicated

path forward is essential to foster cooperation among member states and achieve a sustainable and effective fiscal union that enhances economic stability and resilience in Europe.

## **9. Conclusion**

In conclusion, the concept of fiscal union in Europe represents a transformative and challenging endeavor that holds immense potential for strengthening the economic and monetary framework of the European Union (EU). The rationale for fiscal union arises from the need to address economic imbalances, enhance stability, and promote solidarity among member states. However, pursuing fiscal union involves navigating numerous complexities and considerations, as explored in this paper.

The components of fiscal union encompass a range of policies, rules, and mechanisms aimed at coordinating fiscal policies, promoting risk-sharing, and fostering convergence among member states. These components provide a blueprint for a more integrated and resilient European economic and monetary union.

While the opportunities and benefits of fiscal union are significant, the challenges it poses cannot be ignored. National sovereignty concerns, divergent economic conditions, and moral hazard risks are among the critical hurdles to overcome. Addressing these challenges requires a delicate balance between national interests, political will, and institutional reforms.

Institutional and political implications of fiscal union involve significant shifts in decision-making processes, treaty reforms, and the need to balance national interests with collective EU objectives. Democratic accountability and public support are essential to ensure the legitimacy and success of fiscal union initiatives.

Effective policy coordination and harmonization are crucial for achieving the goals of fiscal union. Coordinating fiscal policies, harmonizing tax structures, and aligning with EU objectives can foster economic stability, resilience, and cohesion across the eurozone.

The path forward towards fiscal union involves a strategic decision between gradual and radical integration, with each approach presenting advantages and challenges. A hybrid approach that combines elements of both paths may offer a balanced solution.

Overall, fiscal union represents a significant step towards deeper economic cooperation and solidarity within the EU. By addressing challenges, seizing opportunities, and navigating the complexities, European policymakers can lay the groundwork for a more integrated, stable, and prosperous European economic and monetary union, fostering a stronger and more united Europe for generations to come.

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