

## **The Use of EU Instruments for Macro-Financial Stability : Implications for the EU and National Budgets**

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### **Abstract**

The euro crisis has forced member states and the EU institutions to create a series of new instruments to safeguard macro-financial stability of the Union. This study describes the status of existing instruments, the role of the European Parliament and how the use of the instruments impinges on the EU budget also through their effects on national budgets. In addition, it presents a survey of other possible instruments that have been proposed in recent years (e.g. E-bonds and eurobonds), in order to provide an assessment of how EU macro-financial stability assistance could evolve in the future and what could be its impact on EU public finances.

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# **The Use of EU Instruments for Macro-Financial Stability: Implications for the EU and National Budgets Making a virtue of necessity?**

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## **Executive Summary**

The financial crisis, the economic crisis that followed and finally the sovereign debt crisis of euro area member states have revealed shortcomings and deficiencies in the existing governance architecture for economic matters in the EU, and more heavily in the euro area. The economic governance framework (i.e. the coordination of budgets and economic policies among Member states) has appeared insufficient and inefficient in managing the challenges of the last few years, forcing the establishment or the reinforcing of macro-financial stability (MFS) instruments out of the planned governance structure, especially for the euro area: in the last few years a total of around €680 billion has been mobilised for financial assistance to EU countries in trouble and “to preserve financial stability and promote the return to sustainable growth” in the Union (EUCO 30/1/10).<sup>1</sup> The need for this level of financial resources was not predicted before the outbreak of the crisis. The Treaty on the Functioning of the European Union (TFEU) foresaw only the possibility of granting Union financial assistance to non-euro Member states (Art. 143), whereas the so-called ‘no bailout’ clause (Art. 125 TFEU) seemed to prohibit EU assistance to euro area member states (or at least guarantees for their national debts). To provide this level of resources, two channels have been used:

- *EU common MFS instruments.* The European Commission, acting in the financial markets on behalf of the EU, manages three assistance facilities, which are the European Financial Stabilisation Mechanism (EFSM) and the Balance-of-Payments (BoP) facility in connection with granting funds to EU member states, and the Macro-Financial Assistance (MFA) facility for non-EU countries.
- *MFS instruments of euro area member states.* Through the European Financial Stability Facility (EFSF), the 17 euro area member states have established a common fund based on national guarantees for granting funds to euro area countries. There are plans to replace the EFSF by July 2012 with the permanent European Stability Mechanism (ESM).

The MFA facility is a policy-based financial instrument to support partner non-EU countries experiencing financial crisis. Thus, even if it could be numbered among the EU’s MFS mechanisms, it is important to underline that it is not designed to assure the macro-financial stability of the EU, since it can only be used to provide assistance outside the Union. It is

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<sup>1</sup> European Council, Conclusions of the European Council of 16-17 December 2010, EUCO 30/1/10, Brussels, 25 January 2011.

mobilised on a case-by-case basis to provide support, combined with IMF programmes, to countries dealing with serious, but generally short-term balance-of-payments or budget difficulties. The first instrument designed to assure macro-financial stability for EU member states was the BoP facility that founds its legal basis on Art. 143 of the TFEU to provide medium-term financial assistance to non-euro member states with BoP difficulties. It was adopted in 1988 and reviewed in 2002, but it was designed only to cover assistance to non-euro member states, since it was not expected that assistance would be needed for member states benefitting from the stability of the single currency. The first action of the EU in providing financial assistance to euro area countries in trouble was conducted outside the specific provisions of the TFEU. Namely, the €80 billion financial assistance plan from the 16 euro area members to Greece was managed through as many bilateral loans even if pooled by the European Commission. Without acting as a borrower, the European Commission has coordinated and administered the disbursements to Greece. Yet only a few days after the Greek package was adopted, intensifying turbulence in the financial market induced the European Council of 10 May 2010 to create a much larger package of financial aid, which was initially billed as providing potentially up to €750 billion in funding. One element of this was the EFSM, with a lending capacity of up to €60 billion. Under the EFSM, the Commission acts as the Union's issuer in the markets, using the EU budget as a guarantee of the bonds in case of default by the borrower. The legal basis for setting up the EFSM was Art. 122(2) of the TFEU. In practice, the EFSM has applied the same mechanisms as the (non-euro area) financial assistance by the BoP, a mechanism. To create a reliable firewall against the spread of the crisis to the entire euro area, the euro area countries also committed themselves to support a separate credit mechanism, the EFSF, based on the €440 billion (later to become €780 billion) of guarantees provided by the different euro area member states. At first, the EFSF was supposed to remain a purely temporary structure: it is, in fact, a private company (more exactly a special purpose vehicle) established in Luxembourg and jointly controlled by (finance ministers of) the euro area states, through an intergovernmental approach. The EFSF will soon be superseded by a permanent mechanism, which will be implemented based on the international Treaty establishing the ESM.

To provide a better institutional framework for euro area financial assistance to its members, on 25 March 2011 the European Council decided to amend the TFEU (EUCO 10/1/11)<sup>2</sup>, adding a specific paragraph (No. 3) to Art. 136: "The member states whose currency is the euro may establish a stability mechanism to be activated if indispensable to safeguard the stability of the euro area as a whole." This offered the legal basis to fully deploy the permanent stability mechanism, the ESM, for safeguarding macro-financial stability at the euro area level. It is planned that the ESM will become operational in July 2012, with total subscribed capital of €700 billion and an effective lending capacity of €500 billion. The paid-in capital of the ESM will be made available more quickly than initially foreseen by the ESM Treaty, in respect of national procedures for ratification. Two tranches of capital will be paid in 2012 – the first one in July and the second one by October. Two further tranches will be paid in 2013 and a final tranche in the first half of 2014. In line with the ESM Treaty, the payment of the capital will be further accelerated if needed to maintain a 15% ratio between the paid-in capital and the outstanding amount of ESM issuances.

The spread of EU financial assistance mechanisms and the introduction MFS instruments backed by the EU budget give rise to financial and governance concerns. The EU budget is a

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<sup>2</sup> European Council, Conclusions of the European Council of 24-25 March 2011, EUCO 10/1/11, Brussels, 20 April 2011.

small financial instrument in relative terms, with inflexible rules and very narrow margins. This begs the question of how the EU budget can guarantee large levels of MFS support.

The design of the BoP facility and the EFSM ensures that the risks are greatly minimised, so that the EU budget is exposed to a clearly 'ring-fenced' risk. Four risks could be identified: i) market risk: assistance is provided in euros and thus cannot be affected by exchange rate fluctuations, leaving the market risk to be borne in full by the country benefitting from the assistance; ii) interest rate risk: the terms of repayment for the beneficiary country are determined back-to-back, mirroring the requirements of the bonds issued or any form of loan raised, including any management costs or interest. These will be designed to cover the exact same terms on which the EFSM or BoP instruments have raised the funding from the capital markets through the bond issuances, thus limiting the interest rate risk; iii) credit risk: this represents the most important risk, and a risk that the EU budget has to bear under the budget ceiling of 1.23% of GNI. Theoretically, if the repayment commitment is large enough, there is a risk that the margin between payment appropriations and the EU budget ceiling will become too small. Given the large margin in the budget until 2013 and the expected large margins from 2014 to 2020, the probability of the margin being too limited appears practically inexistent. Of course, a fall in EU GNI combined with unexpected increases in payment appropriations could in theory have an effect, given that the margin is just a fraction of 1% of GNI. The credit risk from 2020 onwards is hard to estimate, as at present the budget size in future Multiannual Financial Frameworks cannot be foreseen; iv) liquidity risk: beneficiaries are expected to repay their loan 14 days in advance of the date the European Commission has to pay the sums to creditors, thus securing the liquidity management.

Considering the third EU MFS instrument, the amounts of the financial assistance provided in grants under the MFA must be consistent with the budget appropriations established in the Multiannual Financial Framework and, each year, the budgetary authority has to authorise the yearly appropriations. The risks linked to MFA assistance are similar to those under the BoP facility and the EFSM; however, the risks of a non-repayment of the MFA provided in the form of loans appear higher under this MFS instrument, because the assisted countries are not EU member states. To address the possible adverse implications of non-repayment of the loan, the MFA uses as a guarantee for its loan operations the Guarantee Fund for external actions, which provides guarantees to external loans by the EIB, Euratom and MFA. Technically, the EU budget has a hard ceiling for payments of 1.23% of GNI. This means that the sum that the EU budget can guarantee each year cannot be above the difference between the expenditures of the budget in a given year and the ceiling for payments. The maximum amount guaranteed by the EU budget is €110 billion under the BoP and EFSM assistance, which is a multiple of the margin in any given year. To ensure the stability of the budget, the guarantees are set for the date the assistance is to be repaid; the repayment dates are spread into the future up to 2041. Individual repayments are predictable and the danger for the margins is low, except that after 2020 there is no EU budget margin for which to compare the payments. Moreover, the spread of the maturity dates ensures that the yearly exposure of the budget remains limited, but in some years maturity dates have accumulated, in particular for 2015 and 2021. Even if the exposure may seem particularly high, this does not necessarily mean that these amounts represent a serious and severe risk for the EU budget.

On governance, there are difficult issues to address, since a possible default by assisted countries on outstanding granted amounts could implicate a considerable political risk. The resources of the EU budget are an area of notable contention and a large default would have to be covered by the member states through the own resources key. There is a risk of effects



on annual budgetary discussions and even negotiations on the multiannual financial framework, depending on the size and timing of the impact. Furthermore, the own resources key would require the defaulting member state(s) to also participate in recovering the financial assistance and the UK rebate – and the reductions accompanying the rebate to the GNI contributions of Austria, Germany, the Netherlands and Sweden – would apply. This situation could have interesting and controversial repercussions. In fact, the defaulting member state(s) would remain liable to the EU: in case of a repayment, it would be in full, so the defaulting member state(s) would have paid in total in addition to the outstanding amount, its share of GNI plus the contribution to the rebates.

Although there is little risk that the stability of the budget is threatened by the operations owing to their present maximum size and repayment schedules, it is clear, however, that in particular for the EFSM, the EU budget perhaps does not represent the most appropriate instrument to operate as a guarantee for large assistance programmes to member states. The inability of the EU budget to raise funding autonomously to finance itself and to establish 100% risk coverage for all operations limits the budget's capacity to play a larger role in offering effective MFS instruments to EU member states, especially for the greater economies of the euro area. In fact, in case of a default of an assisted country, the Commission would initially draw on its cash reserves to service the debt provisionally and amend the yearly budget to incorporate the refinancing need. In this way, the budget lines created ad-hoc for the MFS instruments can be financed if called upon by the margin of the EU budget, between the payment appropriations and the own resources ceiling of EU budget. If these funds would be insufficient, the borrowings undertaken under the three EU MFS instruments are direct and unconditional obligations of the EU but are guaranteed by the 27 EU member states, which are legally obliged by the TFEU to provide funds to meet all of the EU's obligations. Thus in the case of a default of an assisted country, the EU member states have to step in and cover all the possible losses not already covered by the EU internal mechanisms. Thus, to understanding the effect on the EU budget is fundamental to assess the potential impact on the national budgets of the member states of possible defaults of the euro area countries currently assisted by the euro area MFS instruments: in case of combined default of currently assisted euro area member states, on their outstanding debts towards the other member states, the resources involved would seriously endanger the public finances of euro area member states.

Considering the democratic control of the European Parliament in the decisions related to the management of the MFS assistance, for the two instruments designed to assist member states and subject to the EU legal framework (the BoP and the EFSM) there is a relatively adequate public audit and parliamentary scrutiny. This is not entirely the case for the two MFS instruments managed by euro area member states, the EFSF and from July 2012 the ESM. As the ESM is supposed to have a permanent character it is even more important that its provisions for democratic control, currently deficient, should be strengthened. More information sharing and public scrutiny are needed for these instruments to enjoy the trust of European citizens. The by-laws of the ESM are still under negotiation and they should be used to fix the shortcomings in democratic accountability. The MFA decisions, following the entry into force of the Lisbon Treaty, are no longer taken by the Council alone, but in accordance with the ordinary legislative procedure (co-decision between the European Parliament and the Council), which ensure a full democratic control of the European Parliament in the definition of assistance activities to third countries.

Concluding, the EU budget does not represent the most adequate tool for MFS operations, in particular for the euro area member states, where providing financial assistance requires large amounts. For this reason EFSM is most likely going to be superseded by the ESM and

only remain active as a guarantee for existing commitments or/and as an instrument of last resort, without being the instrument of preference. Yet the ESM, despite its characteristic of permanence, cannot represent the definitive answer in terms of an EU instrument for macro-financial stability. Eurobonds, under the different forms proposed, could be a plausible EU facility for macro-financial stability that could be used in a more or less near future: they would imply the move from the current system, in which each country is responsible for its own debt, to a system of joint and several guarantee, in which all countries are jointly responsible for the common debt issued. The real benefit of the mutualisation of national sovereign debts would come from restoring confidence in the euro area, reassuring markets on the solvency of member states. Most of the schemes proposed in the recent period, entail a joint and several guarantee limited to a certain amount of the national debt; few have a joint and several guarantee on the whole national debt and only one takes into consideration a pro-rata liability. However, none of them is based mainly on the use of guarantees offered by the EU Budget, therefore resulting in almost no impact on the resources of the Union.

## Synthèse

La crise financière, la crise économique qui a suivi et enfin la crise de la dette souveraine des États membres de la zone euro ont révélé des failles et des carences dans l'architecture existante de gouvernance des questions économiques dans l'Union européenne et, de façon plus marquée, dans la zone euro. Le cadre de gouvernance économique (c'est-à-dire la coordination des budgets et des politiques économiques entre les États membres) est apparu insuffisant et inefficace pour gérer les défis des quelques dernières années, obligeant à mettre en place ou renforcer des instruments de stabilité macro-financière au sein de la structure de gouvernance prévue, en particulier pour la zone euro : au cours des quelques dernières années, un montant total d'environ 680 milliards d'euros a été mobilisé pour apporter une assistance financière aux pays de l'Union européenne en difficulté et pour «préserver la stabilité financière et promouvoir le retour à une croissance durable» dans l'Union (EUCO 30/1/10)<sup>3</sup>. Le besoin d'un tel niveau de ressources financières n'avait pas été prévu avant le début de la crise. Le traité sur le fonctionnement de l'Union européenne (TFUE) prévoyait uniquement la possibilité d'accorder une assistance financière de l'Union à des États membres n'appartenant pas à la zone euro (article 143), tandis que la clause dite de «non-sauvetage» (article 125 du TFUE) semblait interdire l'octroi d'une assistance de l'Union européenne aux États membres de la zone euro (ou à tout le moins de garanties de leurs dettes nationales). Pour fournir ce niveau de ressources, deux canaux ont été utilisés:

- *les instruments de stabilité macro-financière communs de l'Union européenne.* La Commission européenne, agissant sur les marchés financiers au nom de l'Union européenne, gère trois mécanismes de soutien, qui sont le mécanisme européen de stabilisation financière (MESF), le mécanisme de soutien des balances de paiement concernant l'octroi de fonds aux États membres de l'Union européenne et le mécanisme de soutien macro-financier destiné aux pays non-membres de l'Union européenne.
- *les instruments de stabilité macro-financière des États membres de la zone euro.* Au moyen du fonds européen de stabilité financière européenne (FESF), les 17 États membres de la zone euro ont établi un fonds commun fondé sur des garanties nationales pour accorder des fonds aux pays de la zone euro. Il est prévu de procéder, au plus tard en juillet 2012, au remplacement du FESF par le mécanisme européen de stabilité (MES) permanent.

Le mécanisme de soutien macro-financier est un instrument fondé sur les politiques financières destiné à soutenir les pays partenaires n'appartenant pas à l'Union européenne qui sont confrontés à une crise financière. Ainsi, même s'il serait possible de le compter parmi les mécanismes européens de stabilité macro-financière, il est important de souligner que ce mécanisme n'est pas conçu pour assurer la stabilité macro-financière de l'Union européenne, puisqu'il ne peut être utilisé que pour fournir une assistance à l'extérieur de l'Union. Il est mobilisé au cas par cas afin d'apporter une assistance, en combinaison avec les programmes du FMI, à des pays confrontés à des difficultés sérieuses, mais généralement à court terme, en matière de balance des paiements ou de nature budgétaire. Le premier instrument conçu pour assurer la stabilité macro-financière des États membres de l'Union européenne a été le mécanisme de soutien des balances de paiement, dont la base légale figure à l'article 143 du TFUE, en vue d'apporter une assistance financière à moyen terme aux États membres n'appartenant pas à la zone euro confrontés à des difficultés en matière de balance des paiements. Il a été adopté en 1988 et révisé en 2002, mais il a été conçu

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<sup>3</sup> Conseil européen, conclusions du Conseil européen des 16 et 17 décembre 2010, EUCO 30/1/10, Bruxelles, 25 janvier 2011.



uniquement pour couvrir l'assistance aux États membres n'appartenant pas à la zone euro, car on ne prévoyait pas que des États membres bénéficiant de la stabilité de la monnaie unique pourraient avoir besoin d'une assistance. La première action de l'Union européenne en matière de fourniture d'une assistance financière aux pays de la zone euro en difficulté a été menée en dehors des dispositions spécifiques du TFUE. Plus précisément, le plan d'assistance financière de 80 milliards d'euros des 16 États membres de la zone euro au bénéfice de la Grèce a été géré au moyen de nombreux prêts bilatéraux, même si ceux-ci ont été mis en commun par la Commission européenne. Sans agir en qualité d'emprunteur, la Commission européenne a coordonné et administré le versement de l'aide à la Grèce. Pourtant, quelques jours seulement après l'adoption du paquet grec, l'intensification des turbulences sur les marchés financiers a conduit le Conseil européen du 10 mai 2010 à créer un paquet d'assistance financière beaucoup plus important, qui a été initialement présenté comme offrant un financement allant potentiellement jusqu'à 750 milliards d'euros. L'un des éléments de ce paquet était le MESF, dont la capacité de prêt pouvait aller jusqu'à 60 milliards d'euros. Dans le cadre du MESF, la Commission agit en qualité d'émetteur de l'Union sur les marchés, en utilisant le budget de l'Union européenne comme garantie des obligations en cas de défaillance de l'emprunteur. Le MESF a été mis en place sur la base juridique de l'article 122, paragraphe 2, du TFUE. En pratique, le MESF a appliqué les mêmes mécanismes que l'assistance financière (hors de la zone euro) fournie par le mécanisme de soutien des balances de paiement.

En vue de constituer un rempart fiable contre la propagation de la crise à l'ensemble de la zone euro, les pays de la zone euro se sont également engagés à soutenir un mécanisme de crédit distinct, le FESF, fondé sur les 440 milliards d'euros (montant qui devait passer ultérieurement à 780 milliards d'euros) de garantie fournis par les différents États membres de la zone euro. Dans un premier temps, le FESF était supposé rester une structure strictement temporaire: il s'agit en fait d'une société privée (plus exactement d'un véhicule ad hoc) établie au Luxembourg et contrôlée conjointement par les (ministres des finances des) États membres de la zone euro, au moyen d'une approche intergouvernementale. Le FESF sera bientôt remplacé par un mécanisme permanent, lequel sera mis en œuvre sur le fondement du traité international instituant le mécanisme européen de stabilité (MES).

En vue de fournir un meilleur cadre institutionnel à l'assistance financière de la zone euro à ses membres, le Conseil européen a décidé, le 25 mars 2011, de modifier le TFUE (EUCO 10/1/11)<sup>4</sup>, en ajoutant un paragraphe spécifique (le paragraphe 3) à l'article 136 : «Les États membres dont la monnaie est l'euro peuvent instituer un mécanisme de stabilité qui sera activé si cela est indispensable pour préserver la stabilité de la zone euro dans son ensemble». Cette disposition a fourni une base juridique au déploiement complet du mécanisme de stabilité permanent, le MES, pour préserver la stabilité macro-financière à l'échelle de la zone euro. Il est prévu que le MES soit opérationnel en juillet 2012, avec un capital souscrit total de 700 milliards d'euros et une capacité de prêt effective de 500 milliards d'euros. Le capital souscrit du MES sera mis à disposition plus rapidement qu'initialement prévu par le traité instituant le MES, concernant les procédures nationales de ratification. Deux tranches de capital seront versées en 2012 – la première en juillet et la seconde en octobre. Deux autres tranches seront versées en 2013 et une dernière tranche au cours du premier semestre 2014. Conformément au traité instituant le MES, le versement du capital sera encore accéléré, si nécessaire, afin de maintenir un ratio de 15 % entre le capital versé et l'encours des émissions du MES.

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<sup>4</sup> Conseil européen, conclusions du Conseil européen des 24 et 25 mars 2011, EUCO 10/1/2011, Bruxelles, 20 avril 2011.

La propagation de mécanismes d'assistance financière de l'Union européenne et l'introduction d'instruments de stabilité macro-financière soutenus par le budget de l'Union européenne donnent lieu à des préoccupations en matière financière et de gouvernance. Le budget de l'Union européenne est un instrument financier de taille limitée, en termes relatifs, soumis à des règles rigides et disposant de marges très étroites. Ceci soulève la question de savoir comment le budget de l'Union européenne peut garantir des niveaux élevés de soutien de la stabilité macro-financière.

La conception du mécanisme de soutien des balances de paiement et du MESF assure une importante limitation des risques, de sorte que le budget de l'Union européenne est exposé à un risque clairement «cantonné». Quatre risques ont pu être identifiés: i) risque de marché : l'assistance est fournie en euros et ne peut donc pas être affectée par les fluctuations des taux de change, laissant le pays bénéficiaire de l'assistance supporter l'intégralité du risque de marché; ii) risque de taux d'intérêt : les modalités de remboursement pour le pays bénéficiaire sont déterminées par réciprocité («back-to-back»), afin de refléter les exigences des obligations émises ou de toute forme de prêt levé, y compris les frais de gestion ou les intérêts. Ces modalités seront conçues pour couvrir exactement les mêmes conditions que celles en vertu desquelles le MESF ou l'instrument relatif à la balance des paiements a levé le financement sur les marchés financiers au moyen de l'émission d'obligations, limitant ainsi le risque de taux d'intérêt; iii) risque de crédit : il s'agit du risque le plus important et d'un risque que le budget de l'Union européenne doit assumer en respectant le plafond budgétaire de 1,23 % du RNB. Théoriquement, si l'engagement de remboursement est assez élevé, il existe un risque que la marge entre les crédits de paiement et le plafond du budget de l'Union européenne devienne trop réduite. Compte tenu de la marge importante prévue dans le budget jusqu'en 2013 et des marges importantes attendues de 2014 à 2020, la probabilité d'une marge trop limitée apparaît pratiquement inexistante. Naturellement, une chute du RNB de l'Union européenne associée à des hausses imprévues des crédits de paiement pourrait en théorie avoir un effet, étant donné que la marge ne représente qu'une fraction de 1 % du RNB. Le risque de crédit à partir de 2020 est difficile à estimer du fait qu'il n'est pas possible de prévoir à ce jour la taille du budget dans le futur cadre financier pluriannuel; iv) risque de liquidité : les bénéficiaires doivent rembourser leur prêt 14 jours avant la date à laquelle la Commission européenne doit verser les sommes aux créanciers, assurant ainsi la gestion des liquidités.

S'agissant du troisième instrument de stabilité macro-financière de l'Union européenne, les montants de l'assistance financière accordée sous forme de subventions en vertu du mécanisme de soutien macro-financier doivent être conformes aux crédits budgétaires établis dans le cadre financier pluriannuel et, chaque année, l'autorité budgétaire doit autoriser les crédits annuels. Les risques liés à l'assistance accordée en vertu du mécanisme de soutien macro-financier sont comparables à ceux liés au mécanisme de soutien des balances de paiement et au MESF; cependant, les risques de défaut de remboursement du soutien macro-financier accordé sous forme de prêts semblent plus élevés en vertu de cet instrument de stabilité macro-financière, car les pays bénéficiaires de l'assistance ne sont pas des États membres de l'Union européenne. Pour faire face aux éventuelles répercussions négatives d'un défaut de remboursement du prêt, le mécanisme de soutien macro-financier a recours, à titre de garantie de ses opérations de prêt, au Fonds de garantie relatif aux actions extérieures, lequel fournit des garanties aux prêts extérieurs accordés par la BEI, par Euratom et par le mécanisme de soutien macro-financier.

Techniquement, le budget de l'Union européenne est soumis pour les paiements à un plafond impératif de 1,23 % du RNB. Ceci signifie que la somme que le budget de l'Union européenne peut garantir chaque année ne peut dépasser la différence entre les dépenses

budgétaires pour une année donnée et le plafond des paiements. Le montant maximal garanti par le budget de l'Union européenne est de 110 milliards d'euros au titre de l'assistance accordée en vertu du mécanisme de soutien des balances de paiement et du MESF, ce montant étant un multiple de la marge pour toute année donnée. Pour assurer la stabilité du budget, les garanties sont établies pour la date à laquelle l'assistance doit être remboursée; les dates de remboursement sont réparties dans l'avenir jusqu'à 2041. Les remboursements individuels sont prévisibles et le risque concernant les marges est faible, si ce n'est qu'après 2020 il n'existe pas de marge budgétaire de l'Union européenne avec laquelle comparer les paiements. En outre, la répartition des dates d'échéance garantit que l'exposition annuelle du budget demeure limitée, mais, s'agissant de certaines années, les dates d'échéance se sont accumulées, en particulier pour 2015 et 2021. Même si l'exposition peut paraître particulièrement élevée, ceci ne signifie pas nécessairement que ces montants représentent un risque grave et sérieux pour le budget de l'Union européenne.

En matière de gouvernance, certaines questions sont difficiles à aborder car une éventuelle défaillance des pays bénéficiaires sur l'encours des montants accordés pourrait impliquer un risque politique considérable. Les ressources du budget de l'Union européenne constituent un domaine de dispute notable et toute défaillance importante devrait être couverte par les États membres selon la clef de répartition des ressources propres. Il existe un risque d'impacts sur les discussions budgétaires annuelles et même sur les négociations relatives au cadre financier pluriannuel, en fonction de l'ampleur de la défaillance et de la date à laquelle elle intervient. En outre, l'utilisation de la clef de répartition des ressources propres nécessiterait que le ou les États membres défaillants participent également au recouvrement de l'assistance financière et il serait fait application de la correction en faveur du Royaume-Uni – et des réductions qui accompagnent la correction apportée aux contributions RNB de l'Autriche, de l'Allemagne, des Pays-Bas et de la Suède. Cette situation pourrait avoir des répercussions remarquables et controversées. En fait, le ou les États membres défaillants resteraient responsables à l'égard de l'Union européenne : en cas de remboursement, celui-ci devrait être effectué dans son intégralité, de sorte que le ou les États membres défaillants auraient payé au total, outre l'encours, leur part du RNB ainsi que la contribution aux corrections.

Bien qu'il y ait peu de risques que les opérations menacent la stabilité du budget, du fait de leur taille maximale et des calendriers de remboursement actuels, il est clair, cependant, que, s'agissant en particulier du MESF, le budget de l'Union européenne n'est peut-être pas l'instrument le mieux adapté pour fonctionner comme une garantie pour les grands programmes d'assistance aux États membres. Le fait que le budget de l'Union européenne ne puisse pas lever de fonds de manière autonome pour se financer et mettre en place une couverture de risque de 100 % pour toutes les opérations limite sa capacité à jouer un rôle plus important en proposant des instruments de stabilité macro-financière efficaces aux États membres, en particulier pour les économies les plus importantes de la zone euro. En fait, en cas de défaillance d'un pays bénéficiaire d'une assistance, la Commission puiserait d'abord dans ses réserves de trésorerie pour rembourser la dette à titre provisoire et modifierait le budget annuel pour y intégrer le besoin de refinancement. De cette manière, les lignes budgétaires créées ad hoc pour les instruments de stabilité macro-financière peuvent être financées, si elles sont utilisées, par la marge du budget de l'Union européenne existant entre les crédits de paiement et le plafond des ressources propres du budget de l'Union européenne. Si ces fonds s'avéraient insuffisants, les emprunts contractés au titre des trois instruments de stabilité macro-financière de l'Union européenne constituent des obligations directes et inconditionnelles de l'Union européenne mais sont garantis par les 27 États membres de l'UE, qui sont légalement tenus en vertu du TFUE de fournir des fonds pour satisfaire à toutes les obligations de l'Union européenne. Ainsi, en cas de défaillance

d'un pays bénéficiaire d'une assistance, les États membres de l'Union européenne doivent intervenir et couvrir toutes les pertes éventuelles qui ne le sont pas déjà par les mécanismes internes de l'Union européenne.

Par conséquent, il est fondamental, pour évaluer l'incidence potentielle sur les budgets nationaux des États membres d'éventuelles défaillances de pays de la zone euro bénéficiant actuellement d'une assistance par le biais des instruments de stabilité macro-financière de la zone euro, de comprendre l'effet sur le budget de l'Union européenne : en cas de défaillance combinée des États membres de la zone euro actuellement assistés à l'égard de leurs dettes, les ressources concernées mettraient gravement en danger les finances publiques de tous les États membres de la zone euro.

Eu égard au contrôle démocratique du Parlement européen dans les décisions relatives à la gestion de l'assistance à la stabilité financière, pour les deux instruments destinés à aider les États membres et sous réserve du cadre juridique de l'Union européenne (le mécanisme de soutien de la balance des paiements et le MESF), il existe une vérification publique et un contrôle parlementaire relativement appropriés. Tel n'est pas tout à fait le cas pour les deux instruments de stabilité macro-financière gérés par les États membres de la zone euro, à savoir le FESF et, à compter de juillet 2012, le MES. Le MES étant censé avoir un caractère permanent, il est encore plus important que ses dispositions en matière de contrôle démocratique, actuellement déficientes, soient renforcées. Il est nécessaire d'améliorer le partage de l'information et le contrôle public pour que ces instruments bénéficient de la confiance des citoyens européens. Le règlement du MES est toujours en cours de négociation et devrait être utilisé pour combler les lacunes en matière de reddition de comptes démocratique. Les décisions en matière de soutien macro-financier, à la suite de l'entrée en vigueur du traité de Lisbonne, ne sont plus prises par le Conseil seul mais conformément à la procédure législative ordinaire (codécision du Parlement européen et du Conseil), laquelle assure un contrôle démocratique complet du Parlement européen dans la définition des activités d'assistance à des pays tiers.

En conclusion, le budget de l'Union européenne ne constitue pas l'outil le plus approprié pour les opérations de stabilité macro-financière, en particulier pour les États membres de la zone euro, lorsque l'apport d'une assistance financière nécessite des montants importants. Pour cette raison, le MESF va probablement être remplacé par le MES et ne rester actif qu'à titre de garantie des engagements existants et/ou d'instrument de dernier recours, sans être l'instrument de prédilection. Pourtant, le MES, en dépit de son caractère permanent, ne peut constituer la réponse définitive en matière d'instrument européen pour la stabilité macro-financière. Les euro-obligations, sous les différentes formes proposées, pourraient être un mécanisme de l'Union européenne plausible pour la stabilité macro-financière susceptible d'être utilisé dans un avenir plus ou moins proche : elles supposeraient le passage du système actuel, dans lequel chaque pays est responsable de sa propre dette, à un système de garantie conjointe et solidaire, dans lequel tous les pays sont conjointement responsables de la dette commune émise. Le véritable avantage de la mutualisation des dettes souveraines nationales viendrait du fait que celle-ci rétablirait la confiance dans la zone euro, en rassurant les marchés quant à la solvabilité des États membres. La plupart des régimes proposés récemment entraîne une garantie conjointe et solidaire limitée à un certain montant de la dette nationale; peu de ces régimes comportent une garantie conjointe et solidaire sur l'ensemble de la dette nationale et seul l'un d'entre eux prend en compte une responsabilité au prorata. Cependant, aucun d'entre eux n'est principalement fondé sur l'utilisation de garanties offertes par le budget de l'Union européenne, ce qui conduit ainsi à une incidence presque nulle sur les ressources de l'Union.



## Zusammenfassung

Die Finanzkrise, die darauf folgende Wirtschaftskrise und schließlich die umfangreiche Schuldenkrise der Mitgliedstaaten des Euroraums haben Mängel und Defizite in der bestehenden Governance-Architektur für wirtschaftliche Angelegenheiten in der EU und in noch größerem Maße im Euroraum aufgedeckt. Der Rahmen für die wirtschaftliche Governance (d. h. die Koordinierung der Haushalte und der Wirtschaftspolitik unter den Mitgliedstaaten) hat sich im Hinblick auf die Bewältigung der Herausforderungen der letzten Jahre als unzureichend und ineffizient erwiesen und erzwingt die Einrichtung bzw. die Verstärkung makrofinanzieller Stabilitätsinstrumente (MFS) außerhalb der geplanten Governance-Struktur, insbesondere im Hinblick auf den Euroraum: In den letzten Jahren wurde ein Gesamtbetrag in Höhe von ungefähr 680 Mrd. EUR mobilisiert, um EU-Länder in Schwierigkeiten finanziell zu unterstützen und um in der Europäischen Union „die Finanzstabilität zu wahren und die Rückkehr zu nachhaltigem Wachstum zu fördern“ (EUCO 30/1/10).<sup>5</sup> Der Bedarf an finanziellen Mitteln in diesem Umfang war vor Ausbruch der Krise nicht vorherzusehen. Der Vertrag über die Arbeitsweise der Europäischen Union (AEUV) sah lediglich die Möglichkeit der Bereitstellung von Finanzhilfe durch die EU an Nicht-Euro-Mitgliedstaaten vor (Artikel 143), wobei die sogenannte „No-Bailout“-Klausel (Artikel 125 AEUV) die Unterstützung von Mitgliedstaaten des Euroraums durch die EU (oder zumindest Garantien für die nationalen Schulden dieser Staaten) zu verbieten schien. Zur Bereitstellung von Mitteln in diesem Umfang wurden zwei Kanäle genutzt:

- *Die gemeinsamen MFS-Instrumente der EU.* Die Europäische Kommission, die auf den Finanzmärkten im Auftrag der EU handelt, verwaltet drei Fazilitäten zur Unterstützung, nämlich den Europäischen Finanzstabilisierungsmechanismus (EFSM), die Zahlungsbilanz-Fazilität im Zusammenhang mit der Zuweisung von Mitteln an EU-Mitgliedstaaten und die Fazilität zur Makrofinanzhilfe (MFH) von Nicht-EU-Ländern.
- *MFS-Instrumente der Mitgliedstaaten des Euroraums.* Mit der Europäischen Finanzstabilisierungsfazilität (EFSF) haben die 17 Mitgliedstaaten des Euroraums einen gemeinsamen Fonds zur Zuweisung von Mitteln an die Länder des Euroraums aufgebaut. Es bestehen Pläne, die EFSF im Juli 2012 durch den Europäischen Stabilitätsmechanismus (ESM) zu ersetzen.

Die MFH-Fazilität ist ein politikbasiertes Finanzinstrument zur Unterstützung von Partnerländern außerhalb der EU, die mit einer Finanzkrise konfrontiert sind. Aus diesem Grund ist wichtig zu betonen, dass auch wenn diese Fazilität als MFH-Mechanismus der EU bezeichnet werden könnte, dieses Programm nicht zur Sicherung der makrofinanziellen Stabilität der EU bestimmt ist, da es nur dazu verwendet werden kann, außerhalb der EU Unterstützung zu leisten. Diese Fazilität wird von Fall zu Fall in Kombination mit IWF-Programmen eingesetzt, um Länder mit ernsthaften, im Allgemeinen jedoch kurzfristigen Zahlungsbilanz- oder Haushaltsschwierigkeiten zu unterstützen. Das erste Instrument, das zur Sicherstellung der makrofinanziellen Stabilität in den EU-Mitgliedstaaten konzipiert wurde, ist die Zahlungsbilanzfazilität, deren Rechtsgrundlage auf Artikel 143 AEUV basiert, um Mitgliedstaaten mit Zahlungsbilanzschwierigkeiten außerhalb des Euroraums eine mittelfristige finanzielle Unterstützung zu leisten. Die Fazilität wurde 1988 angenommen und 2002 überarbeitet, sie wurde jedoch nur für die Unterstützung von Mitgliedstaaten außerhalb des Euroraums konzipiert, da nicht davon ausgegangen wurde, dass

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<sup>5</sup> Europäischer Rat, Schlussfolgerungen des Europäischen Rates vom 16.-17. Dezember 2010, EUCO 30/1/10, Brüssel, 25. Januar 2011.

Mitgliedstaaten, die von der Stabilität der Einheitswährung profitieren, eine Unterstützung benötigen würden. Die erste Aktion der EU zur Bereitstellung von Finanzhilfe an Länder des Euroraums, die in Schwierigkeiten geraten waren, wurde außerhalb der entsprechenden Bestimmungen des AEUV durchgeführt. So wurde die Finanzhilfe in Höhe von 80 Mrd. EUR für Griechenland von den 16 Mitgliedern des Euroraums über ebenso viele bilaterale Darlehen abgewickelt, auch wenn diese von der Europäischen Kommission in einem Pool zusammengefasst wurden. Ohne als Darlehensgeber aufzutreten hat die Europäische Kommission die Auszahlungen an Griechenland koordiniert und verwaltet. Allerdings nur wenige Tage nach Annahme des Griechenlandpakets führten verstärkte Turbulenzen auf den Finanzmärkten dazu, dass der Europäische Rat am 10. Mai 2010 ein sehr viel größeres Finanzhilfepaket schnürte, das ursprünglich für die Bereitstellung von Finanzierungen bis zu 750 Mrd. EUR vorgesehen war. Eines der Elemente dieses Pakets ist der EFSM mit einer Darlehenskapazität von bis zu 60 Mrd. EUR. Im Rahmen des EFSM handelt die Kommission auf den Märkten als Emittent, der im Fall eines Zahlungsausfalls des Darlehensnehmers den EU-Haushalt als Garantie für die Schuldverschreibungen verwendet. Die Rechtsgrundlage für den EFSM basiert auf Artikel 122 Absatz 2 AEUV. In der Praxis wendet der EFSM dieselben Mechanismen an, wie die Finanzhilfe (für den Nicht-Euroraum) in Form der Zahlungsbilanzfazilität.

Zum Aufbau eines zuverlässigen Schutzwalles gegen die Ausweitung der Krise auf den gesamten Euroraum verpflichteten sich die Länder des Euroraums zur Unterstützung eines separaten Kreditmechanismus, des ESFS, der auf Garantien in Höhe von 440 Mrd. EUR (aus denen später 780 Mrd. EUR wurden) basiert, die von den verschiedenen Mitgliedstaaten des Euroraums bereitgestellt werden. Zunächst war die EFSF ausschließlich als vorübergehende Einrichtung gedacht: Tatsächlich handelt es sich hier um ein Privatunternehmen (eigentlich mehr um eine Zweckgesellschaft), das in Luxemburg gegründet wurde und von den (Finanzministern der) Euro-Mitgliedstaaten im Rahmen eines zwischenstaatlichen Ansatzes gemeinsam kontrolliert wird. Die EFSF wird bald durch einen ständigen Mechanismus ersetzt werden, der auf der Grundlage des internationalen Vertrags zur Einrichtung des Europäischen Stabilitätsmechanismus (ESM) umgesetzt wird.

Zur Bereitstellung eines besseren institutionellen Rahmens für die Finanzhilfe für die Mitglieder des Euroraums beschloss der Europäische Rat am 25. März 2011 eine Änderung des AEUV (EUCO 10/1/11)<sup>6</sup>, indem er zu Artikel 136 einen spezifischen Absatz (Abs. 3) hinzufügte: „Die Mitgliedstaaten, deren Währung der Euro ist, können einen Stabilitätsmechanismus einrichten, der aktiviert wird, wenn dies unabdingbar ist, um die Stabilität des Euro-Währungsgebiets insgesamt zu wahren.“ Dies bot die Rechtsgrundlage für eine vollständige Umsetzung des ständigen Stabilitätsmechanismus, des ESM, zur Sicherung der makrofinanziellen Stabilität auf der Ebene des Euroraums. Es ist geplant, dass der ESM mit einem gezeichneten Gesamtkapital in Höhe von 700 Mrd. EUR und einer effektiven Kreditkapazität von 500 Mrd. EUR im Juli 2012 einsatzfähig wird. Die Kapitalrücklagen des ESM werden schneller bereitgestellt, als zunächst im ESM-Vertrag im Zusammenhang mit den nationalen Ratifizierungsverfahren vorgesehen war. Zwei Tranchen der Kapitalrücklagen werden 2012 eingezahlt – die erste im Juli und die zweite im Oktober. Zwei weitere Tranchen werden 2013 eingezahlt und eine letzte Tranche im ersten Halbjahr 2014. Gemäß dem ESM-Vertrag wird die Einzahlung des Kapitals bei Bedarf weiter beschleunigt, um ein Verhältnis von 15 % zwischen den Kapitalrücklagen und dem ausstehenden Betrag der ESM-Ausgaben zu erhalten.

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<sup>6</sup> Europäischer Rat, Schlussfolgerungen des Europäischen Rates vom 24.-25. März 2011, EUCO 10/1/11, Brüssel, 20. April 2011.



Die Bandbreite der Unterstützungsmechanismen der EU-Finanzhilfe und die Einführung der MFS-Instrumente, die durch den EU-Haushalt gedeckt sind, wecken Bedenken im Hinblick auf die Finanzen und die Governance. Der EU-Haushalt ist ein relativ kleines Finanzinstrument mit unflexiblen Vorschriften und sehr engen Grenzen. Hierdurch drängt sich die Frage auf, inwiefern der EU-Haushalt MFS-Unterstützung in großem Umfang garantieren kann.

Die Konzeption der Zahlungsbilanzfazilität und des EFSM gewährleisten, dass die Risiken wesentlich minimiert werden, so dass der EU-Haushalt einem eindeutig „eingedämmten“ Risiko ausgesetzt ist. Vier Risiken können ausgemacht werden: i) *Marktrisiko*: Die Hilfe wird in Euro geleistet und kann daher nicht von Wechselkursschwankungen beeinträchtigt werden, so dass das Marktrisiko in vollem Umfang von dem Land getragen wird, das die Hilfe in Anspruch nimmt; ii) *Zinssatzrisiko*: Die Rückzahlungskonditionen werden für das begünstigte Land nach dem Back-to-back-Prinzip gestaltet, in dem die Bedingungen für die ausgestellten Schuldverschreibungen oder für andere Arten von Darlehen einschließlich aller Verwaltungskosten oder Zinsen sich genau entsprechen. Diese werden so konzipiert, dass sie genau dieselben Bedingungen abdecken, zu denen die ESFM- oder Zahlungsbilanzinstrumente die Mittel von den Kapitalmärkten mittels einer Ausstellung von Schuldverschreibungen aufgenommen haben, wodurch das Zinssatzrisiko eingeschränkt wird; iii) *Kreditrisiko*: Dies stellt das größte Risiko dar, zudem ein Risiko, das der EU-Haushalt unter der Haushaltsobergrenze von 1,23 % des BNE zu tragen hat. Falls die Rückzahlungsverpflichtung hoch genug ist, besteht theoretisch ein Risiko, dass die Spanne zwischen den Zahlungsermächtigungen und der Obergrenze des EU-Haushalts zu gering wird. Aufgrund der hohen Spanne im Haushalt bis 2013 und der erwarteten hohen Spannen von 2014 bis 2020 ist die Wahrscheinlichkeit, dass die Spanne zu klein wird, praktisch nicht gegeben. Selbstverständlich könnte ein Rückgang des EU-BNE in Kombination mit einem unerwarteten Anstieg der Zahlungsermächtigungen sich theoretisch auswirken, wenn man berücksichtigt, dass die Spanne nur einen Bruchteil von 1 % des BNE beträgt. Das Kreditrisiko ist ab 2020 schwer einzuschätzen, da zum gegenwärtigen Zeitpunkt der Haushaltsumfang künftiger mehrjähriger Finanzrahmen nicht vorhersehbar ist; iv) *Liquiditätsrisiko*: Von den Begünstigten wird erwartet, dass sie ihr Darlehen 14 Tage vor dem Zeitpunkt, an dem die Europäische Kommission die Beträge an die Gläubiger zurückzahlen muss, bezahlen und auf diese Weise das Liquiditätsmanagement sicherstellen.

Betrachtet man das dritte MFS-Instrument der EU, so müssen die Beträge, die im Rahmen der MFH als Finanzhilfe bereitgestellt werden, mit den Haushaltsmitteln, die im mehrjährigen Finanzrahmen festgelegt wurden, übereinstimmen und die Haushaltsbehörde muss die jährlichen Mittel bewilligen. Die mit einer MFH-Unterstützung verbundenen Risiken sind ähnlich wie die Risiken der Zahlungsbilanzfazilität und des EFSM; allerdings scheinen die Risiken einer Nichtrückzahlung der MFH, die in Form von Darlehen bereitgestellt wird, im Rahmen dieses MFS-Instruments höher, weil es sich bei den unterstützten Staaten nicht um Mitgliedstaaten der EU handelt. Um möglichen negativen Auswirkungen einer Nichtrückzahlung des Darlehens entgegenzuwirken, verwendet die MFH den Garantiefonds für externe Transaktionen, über den Garantien für externe Darlehen der EIB, Euratom und MFH bereitgestellt werden, als Garantie für ihre Darlehensvorgänge.

Technisch gilt im EU-Haushalt für Zahlungen eine feste Obergrenze von 1,23 % des BNE. Dies bedeutet, dass der Betrag, den der EU-Haushalt jährlich garantieren kann, die Differenz zwischen den Haushaltsausgaben in einem bestimmten Jahr und der Obergrenze für Zahlungen nicht überschreiten darf. Der durch den EU-Haushalt garantierte Maximalbetrag beläuft sich auf 110 Mrd. EUR für die Zahlungsbilanzfazilität und die EFSM-Unterstützung, was ein Mehrfaches der Spanne in den jeweiligen Jahren beträgt. Zur Gewährleistung der

Haushaltsstabilität sind die Garantien für den Termin festgelegt, zu dem die Unterstützung zurückzuzahlen ist; die Rückzahlungstermine sind auf die Jahre bis 2041 verteilt. Individuelle Rückzahlungen sind vorhersehbar und die Gefahr für die Spannen ist niedrig, mit Ausnahme des Umstands, dass nach 2020 keine EU-Haushaltsspanne für Vergleiche mit den Zahlungen zur Verfügung steht. Zudem gewährleistet die Verteilung der Fälligkeitstermine, dass die jährliche Exposition des Haushalts beschränkt ist; in bestimmten Jahren haben sich die Fälligkeitstermine jedoch angehäuft, insbesondere für 2015 und 2021. Sogar dann, wenn die Exposition besonders hoch zu sein scheint, bedeutet dies nicht notwendigerweise, dass diese Beträge ein ernsthaftes und schweres Risiko für den EU-Haushalt darstellen.

Hinsichtlich der Governance sind schwierige Aspekte zu bewältigen, da ein möglicher Zahlungsausfall der unterstützten Länder im Hinblick auf ausstehende bewilligte Beträge möglicherweise ein bedeutendes politisches Risiko darstellt. Die Mittel des EU-Haushalts sind ein Bereich, in dem große Spannungen auftreten können und ein umfangreicher Zahlungsausfall müsste von den Mitgliedstaaten durch ihre eigenen Mittel aufgefangen werden. Es besteht das Risiko von Auswirkungen auf die jährlichen Haushaltsdiskussionen und sogar auf die Verhandlungen des mehrjährigen Finanzrahmens in Abhängigkeit vom Umfang und dem Zeitpunkt der Belastung. Zudem würde der Rückgriff auf Eigenmittel ebenfalls erfordern, dass der bzw. die zahlungsunfähige(n) Mitgliedstaat(en) sich ebenfalls an der Erstattung der Finanzhilfe beteiligen und die **Korrektur zugunsten des Vereinigten Königreichs – sowie die Reduktionen, die mit der Korrektur im Hinblick auf die BNE-Beiträge von Österreich, Deutschland, den Niederlanden und Schweden einhergehen – wäre anwendbar**. Eine solche Situation könnte interessante und kontroverse Auswirkungen haben. Tatsächlich bliebe(n) der bzw. die zahlungsunfähige(n) Mitgliedstaat(en) der EU gegenüber weiterhin haftbar: Im Fall einer Rückzahlung müsste diese in vollem Umfang erfolgen, so dass der bzw. die zahlungsunfähige(n) Mitgliedstaat(en) zusätzlich zum ausstehenden Betrag den jeweiligen Anteil am BNE und außerdem den Beitrag zu den Korrekturen bezahlen müsste(n).

Obwohl das Risiko gering ist, dass die Haushaltsstabilität durch die Operationen aufgrund ihrer aktuellen Maximalhöhe und des Rückzahlungsplans gefährdet wird, ist jedoch klar, dass der EU-Haushalt insbesondere im Hinblick auf den EFSM nicht das am besten geeignete Instrument für die Bereitstellung von Garantien für umfangreiche Programme zur Unterstützung von Mitgliedstaaten darstellt. Die Unfähigkeit des EU-Haushalts, unabhängig Mittel zur Eigenfinanzierung zu beschaffen und eine Abdeckung der Risiken von 100 % für alle Operationen bereitzustellen, schränkt die Fähigkeit des Haushalts ein, eine größere Rolle bei der Bereitstellung von wirksamen MFS-Instrumenten für die Mitgliedstaaten der EU zu spielen, insbesondere im Hinblick auf die größeren Volkswirtschaften des Euroraums. Tatsächlich würde die Kommission bei Zahlungsunfähigkeit eines unterstützten Landes zunächst den Schuldendienst vorläufig aus Kassenmitteln leisten und den jährlichen Haushalt ändern, um den Refinanzierungsbedarf zu integrieren. Auf diese Weise können die ad hoc für die MFS-Instrumente festgelegten Haushaltslinien finanziert werden, falls sie im Zusammenhang mit den Zahlungsermächtigungen und der Obergrenze für Eigenmittel des EU-Haushalts durch die Spanne des EU-Haushalts abgerufen werden. Falls diese Mittel sich als unzureichend erweisen sollten, stellen die im Rahmen der drei EU-MFS-Instrumente aufgenommenen Mittel direkte und unbedingte Verpflichtungen der EU dar, die von den 27 Mitgliedstaaten, die gemäß AEUV gesetzlich dazu verpflichtet sind, Mittel zur Deckung der Verpflichtungen der EU bereitzustellen, garantiert werden. Folglich werden die EU-Mitgliedstaaten bei Zahlungsunfähigkeit eines unterstützten Landes in Anspruch genommen und müssen alle möglichen Verluste abdecken, die durch die internen EU-Mechanismen noch nicht abgedeckt werden. Folglich ist ein Verständnis der Auswirkungen

von möglichen Zahlungsausfällen in den Ländern des Euroraums auf den EU-Haushalt bei der Bewertung der möglichen Auswirkungen auf die nationalen Haushalte, die zum aktuellen Zeitpunkt durch MFS-Instrumente für den Euroraum unterstützt werden, von grundlegender Bedeutung: im Fall eines gleichzeitigen Zahlungsausfalls von Griechenland, Irland und Portugal im Hinblick auf ihre ausstehenden Schulden gegenüber der EU sowie eines Austritts der Länder aus dem Euroraum würden die öffentlichen Finanzen aller Mitgliedstaaten des Euroraums ernsthaft in Mitleidenschaft gezogen und hätten eine Situation zur Folge, in der alle Mitgliedstaaten des Euroraums möglicherweise nicht mehr in der Lage wären, die vereinbarten Garantien einzuhalten.

In Anbetracht der demokratischen Kontrolle des Europäischen Parlaments bei Entscheidungen im Zusammenhang mit der Verwaltung der MFS-Unterstützung besteht im Hinblick auf die beiden Instrumente, die für eine Unterstützung der Mitgliedstaaten konzipiert wurden und die den EU-Rechtsvorschriften unterliegen (die Zahlungsbilanzfazilität und der EFSM) eine relativ angemessene öffentliche Rechnungsprüfung und parlamentarische Kontrolle. Dies ist nicht unbedingt der Fall im Hinblick auf die beiden MFS-Instrumente, die von den Mitgliedstaaten des Euroraums verwaltet werden, die EFSF und ab Juli 2012 den ESM. Da der ESM als ständige Einrichtung vorgesehen ist, ist es umso wichtiger, dass die entsprechenden Mechanismen zur demokratischen Kontrolle, die aktuell mangelhaft sind, gestärkt werden. Um in den Genuss des Vertrauens der europäischen Bürger zu kommen, ist für diese Instrumente ein stärkerer Informationsaustausch und eine größere öffentliche Kontrolle vonnöten. Über die Statuten des ESM wird immer noch verhandelt und sie sollten genutzt werden, um die Mängel hinsichtlich der demokratischen Rechenschaftspflicht zu beheben. Die MFH-Entscheidungen werden nach dem Inkrafttreten des Vertrags von Lissabon nicht mehr länger vom Rat alleine getroffen, sondern in Übereinstimmung mit dem ordentlichen Gesetzgebungsverfahren (gemeinsame Entscheidung des Europäischen Parlaments und des Rats), das eine vollständige demokratische Kontrolle des Europäischen Parlaments bei der Festlegung von Unterstützungsmaßnahmen für Drittländer gewährleistet.

Schließlich stellt der EU-Haushalt nicht das angemessenste Instrument für MFS-Operationen dar, insbesondere im Hinblick auf die Mitgliedstaaten des Euroraums, wo für die Bereitstellung von Finanzhilfe große Beträge erforderlich sind (insbesondere im Fall einer möglichen zukünftigen Unterstützung von Spanien und Italien). Aus diesem Grund wird der EFSM sehr wahrscheinlich durch den ESM abgelöst und bleibt nur als Garantie für die bestehenden Verpflichtungen bzw. als letztes Hilfsmittel erhalten, ohne das Mittel der ersten Wahl zu sein. Allerdings kann der ESM trotz seiner Eigenschaft als ständige Einrichtung als EU-Instrument zur makrofinanziellen Stabilität nicht die letztgültige Antwort sein. Europäische Schuldverschreibungen in den verschiedenen vorgeschlagenen Formen könnten eine plausible EU-Fazilität für die makrofinanzielle Stabilität darstellen, die in der mehr oder weniger nahen Zukunft verwendet werden könnte: Sie würden die Transformation des aktuellen Systems, in dessen Rahmen jedes Land für seine eigenen Schulden verantwortlich ist, in ein System der gesamtschuldnerischen Bürgschaft einleiten, in dessen Rahmen alle Länder gemeinsam für die gemeinsamen Schulden verantwortlich sind. Der reale Nutzen der Zusammenlegung der nationalen Staatsverschuldungen ergäbe sich aus der Wiederherstellung des Vertrauens in den Euroraum, wodurch die Märkte durch die Zahlungsfähigkeit der Mitgliedstaaten beruhigt würden. Die meisten der in der jüngsten Vergangenheit vorgeschlagenen Modelle umfassen eine gesamtschuldnerische Bürgschaft, die auf einen bestimmten Umfang der nationalen Schulden beschränkt ist; wenige Modelle umfassen eine gesamtschuldnerische Bürgschaft auf die gesamte Staatsverschuldung und nur eines zieht eine anteilmäßige Haftung in Betracht. Allerdings basiert keines der Modelle in erster Linie auf der Verwendung der vom EU-Haushalt bereitgestellten Garantien; daher haben diese Modelle auf die Mittel der EU so gut wie keinen Einfluss.



# **The Implications for the EU and National Budgets of the Use of EU Instruments for Macro-Financial Stability**

## **Making a virtue of necessity?**

**Alessandra Casale, Alessandro Giovannini, Daniel Gros**

**Paul Ivan, Jorge Núñez Ferrer and Fabrizia Peirce\***

**CEPS Special Report/September 2012**

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### **Main Report**

#### **Background**

The financial crisis, the economic crisis that followed and finally the sovereign debt crisis of euro area member states have revealed shortcomings and deficiencies in the existing governance architecture for economic matters in the EU, and more heavily in the euro area. The economic governance framework (i.e. the coordination of budgets and economic policies among member states) has appeared insufficient and inefficient in managing the challenges of the last few years, forcing the establishment or the reinforcing of macro-financial stability (MFS) instruments out of the planned governance structure, especially for the euro area.

The severe financial tension seen in the EU shows how the Stability and Growth Pact (based primarily on Art. 121 and 126 TFEU) has failed to ensure the effective budgetary oversight required under the EU Treaties. For much of the past decade it has succeeded in adequately convincing financial markets that the euro area could efficiently manage the fiscal and economic differences among member states and that a convergence of all member states was underway. The outbreak of the crisis has broken the spell: some euro area member states (notably Greece, Portugal, Ireland, Spain and Italy) have come under acute pressure owing to swollen deficits, hence restricting their access to financial markets for refinancing their debts (Greece, Portugal and Ireland) or provoking higher interest rates on new bond issuances (Spain and Italy). As a consequence of this coordination failure, the Euro-Plus Pact, signed in March 2011 (EUCO 10/1/11),<sup>1</sup> was expressly designed to improve the fiscal strength and competitiveness of each member state; besides euro area countries it was signed by six member states outside the euro area (Bulgaria, Denmark, Latvia, Lithuania, Poland and Romania). Its signatories are bound to even greater economic coordination for competitiveness and convergence. The agreement has also introduced a review phase to be conducted on a yearly basis by Heads of State and Government. The Euro-Plus Pact has been integrated into the European semester, with the European Commission monitoring implementation of the commitments.

At the moment, the EU economic governance response is based on a new set of rules that entered into force on 13 December 2011 and that rests on four elements:

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<sup>1</sup> European Council, Conclusions of the European Council of 24/25 March 2011, EUCO 10/1/11, Brussels, 20 April 2011



- i) reinforcing the Stability and Growth Pact, which should deepen fiscal coordination and force the member states to make significant progress towards medium-term budgetary balances;
- ii) modifying the excessive deficit procedure;
- iii) establishing minimum requirements for national budgetary frameworks, in order to harmonise the quality standards; and
- iv) creating a new oversight mechanism that could prevent and correct divergences in competitiveness and macroeconomic imbalances within the EU.

Additionally, since 2010, the coordination of economic and fiscal policies has become part of the European semester. Put into practice for the first time during the first half of 2011, it is designed to ensure that all policies are analysed and assessed together, in order to promote EU common discussions on fiscal policy, macroeconomic imbalances and financial sector issues. In cases of serious imbalances, an excessive imbalance procedure can be opened for a member state to establish a corrective action plan.

But to ensure the economic stability of the EU and especially the euro area, the common rules are not sufficient per se and other macro-financial instruments have had to be established to assist individual member states in financial difficulty. For this reason, the EU has set up a wide range of temporary and permanent mechanisms in recent years. These financial assistance facilities have actually been created with the specific intent of supporting member states in managing economic and financial crises and preventing the contagion effects that could potentially put the stability of the entire euro area at risk (and also the EU). These instruments have since been used to support the distressed economies of Greece, Ireland and Portugal at the euro area level and to support Latvia, Romania and Hungary at the EU level.

First, this study intends to clearly describe the establishment, the institutional framework and the functioning of these financial assistance facilities for both euro area and non-euro member states. Section 2 seeks to assess the potential impact on the EU budget of the instruments – the European Financial Stabilisation Mechanism (EFSM), Balance-of-Payments (BoP) facility and Macro-Financial Assistance (MFA) – that are actually guaranteed by the EU budget, describing how they are categorised in the budget and assessing the risks to which the EU budget is exposed; it also assess the impact of defaults on outstanding amounts owed by euro area member states, showing what could be the indirect effect on EU budget through the impact on the member states' public finances. Afterwards, section 3 considers how the MFS instruments are accountable and the democratic control the European Parliament has over them. Finally, section 4 looks at the possible future development of MFS instruments, with consideration given to the proposal for so-called 'eurobonds'. Section 5 concludes.

## 1. The European instruments for macro-financial stability

Until now, in order “to preserve financial stability and promote the return to sustainable growth” (EUCO 30/1/10)<sup>2</sup> through granting financial assistance to EU countries facing financial problems, a varying set of macro-financial stability (MFS) instruments has been developed, amounting to around €680 billion. The need for this level of financial resources was not predicted before the outbreak of the crisis: the Treaty on the Functioning of the European Union (TFEU) foresaw only the possibility of granting Union financial assistance

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<sup>2</sup> Ibid.



to non-euro member states (Art. 143), whereas the so-called ‘no bailout’ clause, (Art. 125 TFEU) seemed to prohibit EU assistance to euro area countries (or at least guarantees for the national debt of euro area members). To provide this level of resources, two channels have been used:

- *EU common MFS instruments.* The European Commission, acting in the financial markets on behalf of the EU, manages three assistance facilities, which are the EFSM and the BoP facility in connection with granting funds to EU member states, and the MFA facility for non-EU countries.
- *MFS instruments of euro area member states.* Through the European Financial Stability Facility (EFSF), the 17 euro area member states have established a common fund based on national guarantees for granting funds to euro area countries. There are plans to replace the EFSF by July 2012 with the permanent European Stability Mechanism (ESM).

This section describes the MFS instruments according to this macro division, clearly differentiating the instruments that have repercussions on the EU budget (being based on the guarantees it has offered) and the euro area member states’ financial instruments, which rely instead on guarantees offered by the individual member states. For each one we describe the legal basis of its establishment, the institutional framework in which it operates and the functioning of the financial assistance (see Table 1).

### 1.1 EU macro-financial instruments

#### Key Findings

- Since the EU may not borrow to finance a budget deficit, the borrowing conducted under these mechanisms involves direct and unconditional obligations of the EU, but these are guaranteed by the 27 EU member states, which are legally obliged by the TFEU to provide funds to meet all of the EU’s obligations according to Arts. 310 and 323.
- The funds raised are in principle lent back-to-back to the beneficiary country, i.e. with the same coupon, maturity and amount.
- The EU (i.e. the Commission acting in the financial markets on behalf of the EU) enjoys a triple-A credit rating from the three major rating agencies, which reflects very strong member state support and the safety offered by the back-to-back lending mechanism.

The European Commission, acting in the financial markets on behalf of the EU, currently manages three MFS instruments, granting funds (through loans or lines of credit) to beneficiary countries by issuing debt instruments in the capital markets:

- BoP assistance, designed to assist EU member states that have not adopted the euro, up to €50 billion;
- the EFSM, intended to support euro area member states, up to €60 billion; and
- the MFA facility, designed to help non-EU member states.

Since the EU may not borrow to finance a budget deficit, the borrowing conducted under these mechanisms involves direct and unconditional obligations of the EU, but these are guaranteed by the 27 EU member states, which are legally obliged by the TFEU to provide funds to meet all of the EU’s obligations according to Arts. 310 and 323.

Table 1. Overview of MFS instruments

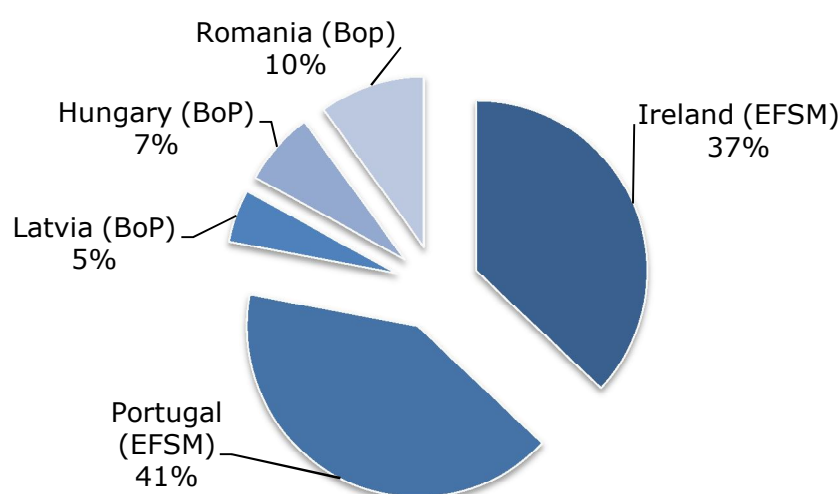
	EU common MFS instruments			Euro area member states' MFS instruments		
	Balance of Payments Assistance (BoP)	European Financial Stability Mechanism (EFSM)	Macro Financial Assistance (MFA)	Greek Loan Facility (GLF)	European Financial Stability Facility (EFSF)	European Stability Mechanism (ESM)
<i>Scope</i>	Financial assistance to non-euro member states	Financial assistance intended to support euro area member states	Financial assistance to EU neighbour countries	Financial assistance to Greece	Financial assistance to euro area member states	Financial assistance to euro area member states
<i>Validity</i>	Permanent instrument	Temporary instrument	Permanent instrument	Temporary instrument	Temporary instrument	Permanent instrument
<i>Legal basis</i>	Council Regulation (EC) No. 332/2002	Council Regulation (EU) No. 407/2010	Art. 212 TFEU Art. 209 TFEU	Memorandum of Understanding, 3 May 2010	EFSF (Amended) Framework Agreement	Treaty establishing the ESM
<i>Decision-making body</i>	ECOFIN Council	ECOFIN Council and Eurogroup Working Group	Council	Eurogroup	Eurogroup Working Group and EFSF Board of Directors	Eurogroup Working Group and EFSF Board of Directors
<i>Assistance modality</i>	Loans or credit lines	Loans or credit lines	Loans or grants	Loan to the Greek government	<ul style="list-style-type: none"> <li>– Loans</li> <li>– Intervention in primary and secondary bond markets</li> <li>– Precautionary programmes</li> <li>– Recapitalisation of banks</li> </ul>	<ul style="list-style-type: none"> <li>– Loans</li> <li>– Intervention in primary and secondary bond markets</li> <li>– Precautionary programmes</li> <li>– Recapitalisation of banks</li> </ul>

Source: Authors' elaboration.

In all three of the MFS instruments, the European Commission (in accordance with the Council) is authorised to borrow on the capital markets or from financial institutions in order to finance the loans, mainly issuing notes under the Euro Medium-Term Note Programme (EMTN), which is intended primarily for securities offerings in Europe. Following the increases in the EU's borrowing activity stemming from the establishment of the EFSM in 2010, the Programme Offering Circular was amended accordingly and the amount of the Programme has been increased by €60 billion to a total of €80 billion. If needed, the EMTN Programme can be further promptly increased to €110 billion (European Commission, 2010). The funds raised are in principle lent back-to-back to the beneficiary country, i.e. with the same coupon, maturity and amount; a partial exemption is represented by the Irish case, where a loan margin of 292.5 basis points is being paid by Ireland under the EFSM. This back-to-back principle represents a strong constraint on EU issuance (since the timing and maturities of issuance are dependent on the related EU lending activity), but at the same time it ensures that the EU budget does not assume any interest rate or foreign exchange risk. As EU assistance is of a medium-term nature, the maturity spectrum of the bonds is normally 5 to 10 years, but can range from 3 up to 15 years, according to the particular conditions of the loans.

With the activation of the EFSM for Ireland and Portugal, the EU has become a frequent benchmark issuer: since 2011, around €40 billion has been raised through 11 issues of bonds (for both the BoP and EFSM – see Figure 1). During 2011, around €30 billion was raised through seven transactions, while in 2012 (up to April) around €11 billion has been issued: €3 billion in 30-year bonds in January, €3 billion in 20-year bonds in February, €1.8 billion in 26-year bonds and €2.7 billion in 10-year bonds in April. For the remainder of 2012, the EU is scheduled to raise €2 billion (in September or later) to fund loans for Ireland and Portugal. Annual interest and principal obligations range from €1.3 billion in 2012 to a maximum of €10 billion in 2021.

Figure 1. EU issuances (2009–April 2012)




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Source: European Commission, DG ECFIN.

Table 2. EU credit rating

Agency	Rating	Comments
Fitch Ratings	AAA/stable	<ul style="list-style-type: none"> <li>• Rating of the EU based on the support it receives from its 27 member states</li> <li>• Highly conservative and prudential rules set up by the EU on lending and borrowing activities</li> <li>• EU debt service relies on several layers, including coverage of EU borrowings by the EU budget and member states' obligations to provide the funds necessary to balance the budget*</li> </ul>
Moody's	Aaa/stable	<ul style="list-style-type: none"> <li>• Firm commitment of 27 member states</li> <li>• Multiple layers of protection for loan repayments</li> <li>• Conservative budget management*</li> </ul>
Standard & Poor's	AAA/negative outlook	<ul style="list-style-type: none"> <li>• The EU benefits from multiple layers of debt-service protection sufficient to offset the current deterioration in member states' creditworthiness</li> <li>• The outlook is negative, reflecting in S&amp;P's view the negative outlooks for 16 of the 27 member states**</li> </ul>

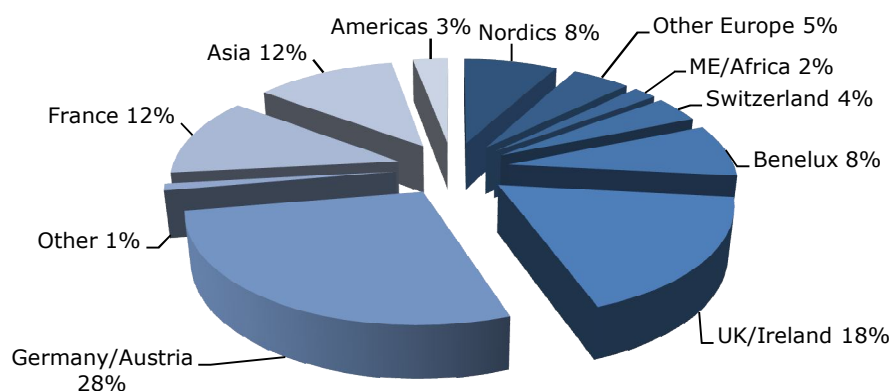
\* As of March 2012 \*\* As of January 2012

Source: European Commission, DG ECFIN.

The EU (i.e. the Commission acting in the financial markets on behalf of the EU) enjoys a triple-A credit rating from the three major rating agencies (Table 2), which reflects very strong member state support and the safety offered by the back-to-back lending mechanism. In turn, this creates a situation in which the risk of investing in an EU bond is entirely unrelated to the credit risk of the related EU loan to a beneficiary country. In January 2012, Standard & Poor's (S&P) downgraded the outlook for the EU from stable to negative, mainly owing to the similar downgrade to a negative outlook for 16 of the 27 EU member states. Yet this change should not represent a serious issue for the creditworthiness of the EU (in the European Commission's view), and above all it should not have a serious impact on the performance of EU bonds in financial markets.

Figures 2 and 3 show the composition of the investors in EU bonds. It appears that European actors represent around 80% of all the investors in EU bonds, with a predominance of investors coming from currently AAA-rated countries (Germany, Austria, France, Switzerland and Nordic countries). A relevant percentage (12%) is represented by Asian investors. Differentiating the investors by type, the highest percentage is represented by fund managers (30%), followed by banks (26%), insurance and pension funds (21%) and National Central Banks (21%).

Figure 2. Investor distribution by region

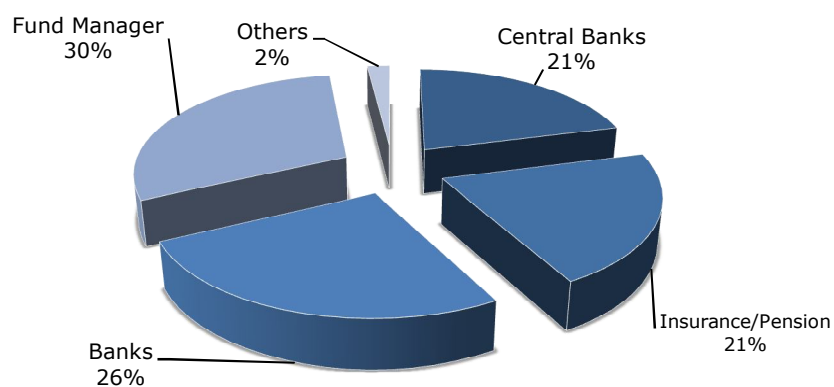



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Note: As of 30 April 2012; all issues.

Source: European Commission, DG ECFIN.

Figure 3. Investor distribution by type




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Note: As of 30 April 2012; all issues

Source: European Commission, DG ECFIN.

### 1.1.1 *Balance-of-Payments assistance*

#### Key Findings

- The EU has to intervene when a country encounters financial difficulties or threats to its economic stability as specified in the Treaty (Art. 143 TFEU). If these imbalances affect the balance of payments and the country in question is not a member of the euro area, the EU can activate the programme of BoP assistance.
- The BoP assistance provides medium to long-term financial resources with the objective of stabilising the situation and allowing the member state to return to easily raising funds directly in the market.
- The EFC, acting on the basis of a request submitted by a member state facing financial trouble, decides whether to grant the country financial assistance. The decision, made after a formal request by the Commission and after consulting the Economic and Financial Committee, must be taken by a qualified majority.
- The Commission, in collaboration with the EFC and other programme partners must conclude with the member state a Memorandum of Understanding, containing the precise details of the economic policy measures needed, following a path laid down by the Council.
- Assistance may be provided in the form of either loans or lines of credit, with the disbursement procedures handled by the Commission. The total outstanding amount of loans that can be granted to member states collectively is limited to €50 billion.
- At the moment there is only a precautionary programme, which has been activated for Romania, for up to €1.4 billion.

The EU has to intervene when a country encounters financial difficulties or threats to its economic stability as specified in the Treaty (Art. 143 TFEU). If these imbalances affect the balance of payments and the country in question is not a member of the euro area, the EU can activate the programme of BoP assistance. This mechanism, even if created before the recent sovereign debt crisis, was established with assumptions very similar to those currently applicable to the sovereign debt crisis in the euro area, i.e. providing medium to long-term financial resources with the objective of stabilising the situation and allowing the member state to return to easily raising funds directly in the market.

When the first BoP support Regulation was adopted in 1988 (Council Regulation (EEC) No. 1969/88),<sup>9</sup> it was not expected that assistance would be needed for member states benefitting from the stability of the single currency. Thus the Regulation only remained in force until the final stages of completing the European monetary system, which became a reality in 1999. In view of the enlargement and the risks of countries needing assistance, however, the Regulation was revived and amended in 2002 (Council Regulation (EC) No. 332/2002),<sup>10</sup> but only for non-euro member states and with a support ceiling that was even slightly reduced compared with the original (€12 billion compared with the real value of €16 billion of the 1988 instrument).

<sup>9</sup> Council Regulation (EEC) No. 1969/88 of 24 June 1988 establishing a single facility providing medium-term financial assistance for Member States' balances of payments, OJ L 178, 8.7.1988.

<sup>10</sup> Council Regulation (EC) No. 332/2002 of 18 February 2002 establishing a facility providing medium-term financial assistance for Member States' balances of payments, OJ L 53/1, 23.2.2002.



*Institutional framework.* A country in difficulty or seriously threatened by difficulties in its balance-of-payments conditions can send a request for EU assistance to the European Economic and Financial Committee (EFC). The EFC, acting on the basis of a request submitted by a member state facing financial trouble, decides whether to grant the country financial assistance. The decision, made after a formal request by the Commission and after consulting the Economic and Financial Committee, must be taken by a qualified majority. In the event that the plan is accepted, the resolution must contain the following elements:

- the technical details of the loan, i.e. the agreed amount, the length of the programme (usually five years), the system agreed for the disbursements and their number, along with other useful information applying to the programme;
- specifications of the needed economic policy measures that the member state has to implement. These are prescribed by the Commission in consultation with the European Central Bank (ECB) and are designed to enable the recipient country to restore its financial equilibrium and then regain access to the financial markets; and
- explicit approval of the economic and financial adjustment programme presented by the assisted member state.

Moreover, to fully establish an EU assistance programme, the Commission, in collaboration with the EFC and other programme partners (such as the IMF) must conclude with the member state a Memorandum of Understanding (MoU), containing the precise details of the economic policy measures needed, following a path laid down by the Council. These conditions are usually related to measures of fiscal consolidation (i.e. reducing the government deficit by reducing expenditures or increasing taxes), structural reforms (e.g. labour market reforms and liberalisation of the economy) and public administration reforms (i.e. increasing governance effectiveness and privatisation), to stabilise the financial sector and support growth (e.g. improve administrative capacity to absorb EU funds more effectively). Safeguards against fraud are also included to protect member states, as they ultimately bear the default risk of these loans.

Throughout the duration of financial assistance, the Commission (and its partners) reviews the progress of the member state in these areas every six months, with the possibility to modify them in accordance with the member state, or suspend the release of any further instalment if the country does not show progress along the agreed path. But the decision on each instalment must be taken by the Council, in consultation with the Commission.

*How the financial assistance functions.* Assistance may be provided in the form of either loans or lines of credit, with the disbursement procedures handled by the Commission. The funds must be raised in a manner that ensures the lowest possible cost; until now they have been collected directly from the market by issuing debt securities. For each programme there is a planned disbursement schedule agreed by all programme partners, which can nonetheless be modified taking into consideration the greater or lesser financial needs of the country, according to the developments under the programme.

The total outstanding amount of loans that can be granted to member states collectively is limited to €50 billion. This cap is the result of subsequent decisions taken to increase it during the financial crisis, given that the initial amount was €12 billion, later increased to €25 billion in December 2008 (Regulation (EC) No. 1360/2008)<sup>11</sup> and then raised to the current

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<sup>11</sup> Council Regulation (EC) No. 1360/2008 of 2 December 2008 amending Regulation (EC) No. 332/2002 establishing a facility providing medium-term financial assistance for Member States'

level in May 2009 (Regulation (EC) No. 431/2009).<sup>12</sup> Once raised in the financial markets by the Commission, these funds are given to the state only in euros by transferring them to a special account at the National Central Bank (NCB) of the country. All the operations are under the supervision of the European Court of Auditors (see section 3.1).

Table 3. Overview of BoP assistance programmes

Country	Agreed amount	Disbursed	Period covered by the assistance	Status of the programme
Romania II	1.4	-	Until March 2013	Precautionary (not activated)
Latvia	3.1	2.9	Until January 2012	Completed
Romania I	5.0	5.0	Until June 2011	Completed
Hungary	6.5	5.5	Until November 2010	Completed
<b>Remainder for utilisation: 34</b>				

Note: \* As of May 2012, € billion

Source: European Commission, DG ECFIN.

*Current level of utilisation.* At the moment there is only a precautionary programme, which has been activated for Romania, for up to €1.4 billion. Requested by the country in February 2011, it was accorded by the Council in May 2011 to stimulate economic growth with an emphasis on structural reforms, while improving fiscal sustainability and consolidating financial stability (Council Decision 2011/288/EU).<sup>13</sup> This programme follows the first assistance programme provided to Romania in 2009-11. More specifically, in May 2009, multilateral financial assistance to Romania was agreed for the overall amount of €20 billion, comprising €5 billion from the EU under the BoP assistance programme, €13 billion from the IMF and another €2 billion from the World Bank, the European Investment Bank (EIB) and the European Bank for Reconstruction and Development (Council Decision 2009/459/EC).<sup>14</sup> The repayment of the 2009 loan will start in 2015, and will include the principal and the interest (the average interest rate on the amounts disbursed by the European Commission is around 3%).

The first BoP assistance programme, after its reintroduction in 2002, was activated in 2008, when the EU provided €6.5 billion to Hungary to relieve the pressures on the country's financial markets, as a part of an international financial programme amounting to €20 billion (Council Decision 14953/2/08).<sup>15</sup> Yet only €5.5 billion was actually disbursed and access to

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balances of payments, OJ L 352/11, 31.12.2008.

<sup>12</sup> Council Regulation (EC) No. 431/2009 of 18 May 2009 amending Regulation (EC) No. 332/2002 establishing a facility providing medium-term financial assistance for Member States' balances of payments, OJ L 128/1, 27.5.2009.

<sup>13</sup> Council Decision 2011/288/EU of 12 May 2011 providing precautionary EU medium-term financial assistance for Romania, OJ L 132/15, 19.5.2011.

<sup>14</sup> Council Decision 2009/459/EC of 6 May 2009 providing Community medium-term financial assistance for Romania, OJ L 150/8, 13.6.2009.

<sup>15</sup> Council Decision 14953/2/08 of 4 November 2008 granting mutual assistance for Hungary

the unclaimed EU financial assistance (€1 billion) expired in November 2010, when the programme officially ended. Still, on 21 November 2011 the Commission (and the IMF) received a request from the Hungarian authorities for new financial assistance under the BoP mechanism. This request was not approved by the Council, which additionally adopted a decision suspending the €495 million in scheduled commitments for Hungary under the EU's cohesion fund, owing to insufficient measures taken by the country to correct its budget deficit.

The third programme activated under BoP assistance concerns Latvia (Council Decisions 2009/290/EC and 2009/289/EC).<sup>16</sup> In light of a rapidly deteriorating economic situation and concerns about the health of the banking sector, the Latvian authorities applied in late 2008 to the EU, IMF and regional neighbours for financial assistance. The EU agreed to contribute €3.1 billion under a three-year lending programme as part of multilateral financial assistance amounting to €7.5 billion. The EU financial assistance was actually disbursed in four instalments totalling €2.9 billion, instead of the six instalments and €3.1 billion initially scheduled. Repayments will start in 2014, including the principal and interest (the average interest rate on the amounts disbursed by the European Commission is around 3.2%). On 19 January 2012, Latvia officially completed the assistance programme, while post-programme oversight will run until a large part of the EU-funded loans are repaid (see Table 3).

### 1.1.2 *European Financial Stabilisation Mechanism*

#### Key Findings

- The EFSM represents the MFS instrument launched by the EU to tackle the problems associated with the sovereign debts of euro area countries. It was introduced in May 2010, immediately after approval of the bilateral loans extended specifically for the case of Greece. In fact the mechanism reproduces the same scheme used for BoP assistance with the intention of supporting euro area countries.
- The institutional mechanisms of the EFSM are partially modelled on those of BoP assistance, since the procedure follows the same pattern described in section 0, but in this case more important than the role played by the Economic and Financial Committee is that played by the Eurogroup Working Group, a configuration of the EFC in which only the euro area member states, the Commission and the ECB are represented.
- Every six months, since the establishment of the EFSM, the Commission has had to review and forward to the Economic and Financial Committee and to the Council its view on whether the exceptional circumstances justifying the establishment of this MFS instrument are still present, and thus whether the EFSM should be maintained.
- The EFSM can establish loans or credit lines, up to a total of €60 billion. The functioning mirrors that of the BoP assistance programmes. However, a peculiarity of the EFSM is the possibility (not granted to the BoP facility) to borrow from capital markets more funds than those actually disbursed.
- The EFSM assistance was activated for the first time in December 2010 in support of Ireland for a total of €22.5 billion. Moreover, in May 2011 it gave assistance to Portugal totalling €26 billion.

<sup>16</sup> Council Decisions 2009/290/EC of 20 January 2009 providing Community medium-term financial assistance for Latvia, OJ L 79/39, 25.3.2009 and 2009/289/EC of 20 January 2009 granting mutual assistance for Latvia, OJ L 79/37, 25.3.2009.

The EFSM represents the MFS instrument launched by the EU (Council Regulation (EU) No. 407/2010)<sup>17</sup> to tackle the problems associated with the sovereign debts of euro area countries. It was introduced in May 2010, immediately after approval of the bilateral loans extended specifically for the case of Greece by the euro area member states. The mechanism reproduces the same scheme used for BoP assistance with the intention of supporting euro area countries: although the Regulation states that it has been designed for all the EU members, the EFSM assistance should be activated “taking into account the possible application of the existing facility providing medium-term financial assistance for non-euro-area member states’ balances of payments”<sup>18</sup>, thus limiting its activity mainly to euro area member states. In other words, it provides medium-term support for member states that are experiencing or are seriously threatened by a severe financial disturbance due to events beyond the control of the member state concerned. The EFSM does not exclude recourse by the assisted member state to financing programmes outside the EU, and in the case of multilateral assistance programmes (in particular through the IMF) the Commission examines whether EFSM assistance is compatible with the external financing.

*Institutional framework.* The institutional mechanisms of the EFSM are partially modelled on those of BoP assistance (see section 0). The activation of the funding through the EFSM takes place only after the expressed request of financial support is made by a euro area member state (containing an assessment of its financial needs) and, simultaneously, the presentation of a macroeconomic adjustment programme, outlining the measures the country must take to restore its economic stability as agreed with the Commission. Then, the procedure follows the same pattern described in section 0, but in this case more important than the role played by the Economic and Financial Committee is that played by the Eurogroup Working Group (EWG), a configuration of the EFC in which only the euro area member states, the Commission and the ECB are represented.

The disbursement of loans (or the opening of credit lines) granted to member states is managed by the Commission, which verifies at regular intervals (usually quarterly) whether the economic policy of the beneficiary member state accords with the agreed adjustment programme contained in the MoU. Moreover, the release of each instalment is decided by the Council, in consultation with the EWG and the Commission. Finally, the Court of Auditors has the right to carry out financial controls and audits in order to verify the legality of financial assistance granted by the EU.

Every six months, since the establishment of the EFSM, the Commission has had to review and forward to the Economic and Financial Committee and to the Council its view on whether the exceptional circumstances justifying the establishment of this MFS instrument are still present, and thus whether the EFSM should be maintained. Although the Commission in the last Communication has concluded that “the exceptional events and circumstances that justified the adoption of Regulation n°407/2010 still exist and that the Mechanism should, therefore, be maintained” (European Commission, 2010), it is likely that once the ESM enters into force the EFSM will cease to provide new assistance and exist only as a guarantee for existing commitments.

*How the financial assistance functions.* The EFSM can establish loans or credit lines, up to a total of €60 billion. The functioning mirrors that of the BoP assistance programmes (see section 0 for the detailed description). In this case, however, the ECB acts as the fiscal agent for the

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<sup>17</sup> Council Regulation (EU) No. 407/2010 of 11 May 2010 establishing a European financial stabilisation mechanism, OJ L 118/1, 15.5.2010.

<sup>18</sup> Ibid.

administration of the loans between the European Commission and the central bank of the beneficiary. A peculiarity of the EFSM is the possibility (not granted to the BoP facility) to borrow from capital markets more funds than those actually disbursed, to optimise in this way the cost of funding. More specifically, once the decision to grant a loan has been made by the Council, the Commission can borrow on funds and keep them in a dedicated cash or securities account that is handled in accordance with the rules applying to off-budget operations. But these funds cannot be used for any purpose other than to provide financial assistance to member states already receiving EFSM assistance. The costs incurred by the Union in implementing the financial assistance are entirely borne by the beneficiary.

*Current level of utilisation.* The EFSM assistance was activated for the first time in December 2010 in support of Ireland for a total of €22.5 billion (Council Decision 17211/10),<sup>19</sup> representing one-third of an international bailout package comprising IMF, EFSF and bilateral loans from the UK, Denmark and Sweden. Programme disbursements are being made over 3 years, with an average maximum maturity of 12.5 years. Up to April 2012, €18.4 billion has been disbursed to Ireland (backed by bonds with an average maturity of 11 years) and the remaining €4.1 billion is scheduled to be disbursed by the end of this year. Further funding requirements will be financed by EFSF operations and by the IMF, as agreed in the initial EU/IMF agreement.

In May 2011 (Council Decision 10231/11),<sup>20</sup> the EFSM gave assistance to Portugal totalling €26 billion, also in this case as part (one-third) of the total bailout package funded by the IMF and the EFSF amounting to €78 billion. As of May 2012, €20.1 billion has been disbursed, backed by bonds with an average maturity of 12 years (see Table 4).

Table 4. EFSM assistance programmes

Country	Agreed amount	Disbursed	Period covered by the assistance	Other partners
Ireland	22.5	18.4	2010-13	IMF, EFSF and bilateral loans from the UK, Denmark and Sweden
Portugal	26	20.1	2011-14	IMF and EFSF
<b>Remainder for utilisation: 11.5</b>				

Note: \* As of May 2012, € billion

Source: European Commission, DG ECFIN.

<sup>19</sup> Council Decision 17211/10 of 7 December 2010 on granting Union financial assistance to Ireland

<sup>20</sup> Council Decision 10231/11 of 17 May 2011 on granting financial assistance to Portugal



### 1.1.3 EU Macro-Financial Assistance

#### Key Findings

- The MFA facility is a policy-based financial instrument to support partner non-EU countries experiencing financial crisis. Thus, even if it could be numbered among the EU's MFS mechanisms, it is important to underline that it is not designed to assure the macro-financial stability of the EU, since it can only be used to provide assistance outside the Union. It is mobilised on a case-by-case basis to provide support, combined with IMF programmes, to countries dealing with serious, but generally short-term balance-of-payments or budget difficulties.
- Since 1990, 55 MFA decisions have been approved, with total commitments amounting to €7.4 billion and effective disbursements of €5.3 billion; 23 countries have benefited from support by the MFA, with loan sizes ranging from €15 million to €870 million. The MFA instrument also includes grant assistance, which since 2007 has disbursed €177 million.
- A country seeking MFA must send a written, formal request to the Commission. Then the request must be submitted to the ad hoc committee, composed of representatives of the member states and chaired by a representative of the Commission (who nevertheless does not take part in the committee vote). The requirements for establishing an MFA programme are defined by the five 'Genval Principles' agreed in 1995 by the Economic and Financial Affairs Council.
- Throughout the duration of the assistance, the Commission has to inform the European Parliament and the Council of developments, providing them with the relevant documents. In addition, the annual appropriations of funds must be authorised by the budgetary authority within the limits of the agreed financial framework.
- The year 2010 was one of the most active in the operation of the MFA instrument for a decade, reflecting the impact of the global economic crisis and the slow exit from the crisis of the EU's neighbourhood. In 2010 three MFA programmes were successfully implemented: two programmes for Kosovo (agreed in 2006) and Lebanon (starting in 2007) respectively, and one for Georgia (agreed in 2009).

The MFA facility is a policy-based financial instrument to support partner non-EU countries experiencing financial crisis. Thus, even if it could be numbered among the EU's MFS mechanisms, it is important to underline that it is not designed to assure the macro-financial stability of the EU, since it can only be used to provide assistance outside the Union. It is mobilised on a case-by-case basis to provide support, combined with IMF programmes, to countries dealing with serious, but generally short-term balance-of-payments or budget difficulties. The objective of the MFA is not to build a stand-alone, specific assistance programme, but rather to fill a foreseen, residual gap in external financing that emerges in the assistance programmes of multilateral institutions.

In 1990 the European Council decided to extend the BoP support for member states to third countries, as a consequence of the expectation that the economies in transition would need to be bolstered. The MFA instrument is designed to support political and economic reforms in



connection with IMF and World Bank programmes. The first beneficiaries were Israel and Algeria in 1991 and again in 1996. Yet from 1994 onwards, the MFA started to play an increasing role in Eastern Europe and particularly the Western Balkans. The countries targeted tend to be potential candidates for European neighbourhood countries, with positive spillover effects on the EU economy. Since 1990, 55 MFA decisions have been approved, with total commitments amounting to €7.4 billion and effective disbursements of €5.3 billion; 23 countries have benefited from support by the MFA, with loan sizes ranging from €15 million to €870 million. The MFA instrument also includes grant assistance, which since 2007 has disbursed €177 million. Notably, this amount is budgeted in the external action budget, and thus does not create future risks.

*Institutional framework.* In contrast with the situation under the EC Treaty, who did not provide the legal framework for MFA, the Art. 212 TFEU, governing economic and financial cooperation with third countries, includes MFA, thus providing the legal basis for the MFA decisions adopted since the entry into force of the Lisbon Treaty. Yet, if the recipient country of MFA is a developing country, the decision would be adopted on the basis of Article 209 TFEU, which governs the EU's development cooperation. Thus, with the entry into force of the TFEU, legislative decisions on individual MFA operations are taken by the European Parliament and the Council under the ordinary legislative procedure (co-decision). However, MFA support actually has no legal framework defining the overall strategy and objectives and the interventions are based on individual decisions based on a draft Regulation: this can further lengthen the decision-making process (European Commission, 2011b). For this reason the Commission has proposed a specific framework regulation to streamline the procedure for adopting MFA decisions (European Commission, 2011d), but it has not yet been approved by the Council or European Parliament.

A country seeking MFA must send a written, formal request to the Commission. Then the request must be submitted to the ad hoc committee composed of representatives of the member states and chaired by a representative of the Commission (who nevertheless does not take part in the committee vote). Following a positive vote by the committee on the specific programme, in conjunction with the requesting country the Commission drafts an MoU containing all the implementing acts required (policy procedures and terms of assistance). The requirements for establishing an MFA programme are defined by the five 'Genval Principles' agreed in 1995 by the Economic and Financial Affairs Council (ECOFIN) (European Commission, 2011e):

- i) *Exceptional character.* The programme must be discontinued when the recipient country can rely on financing from other international financial institutions or private capital.
- ii) *Scope.* It is reserved to those countries politically important to the EU and which fully respect democracy, rule of law and human rights.
- iii) *Complementarity.* It is warranted only if there is a residual, external financing gap in international programmes for financial assistance.
- iv) *Policy-based conditionality.* It is conditioned on the observance of specific macro-economic performance and structural adjustment criteria.
- v) *Financial discipline.* The amounts provided under MFA have to be consistent with the annual EU budget ceilings.

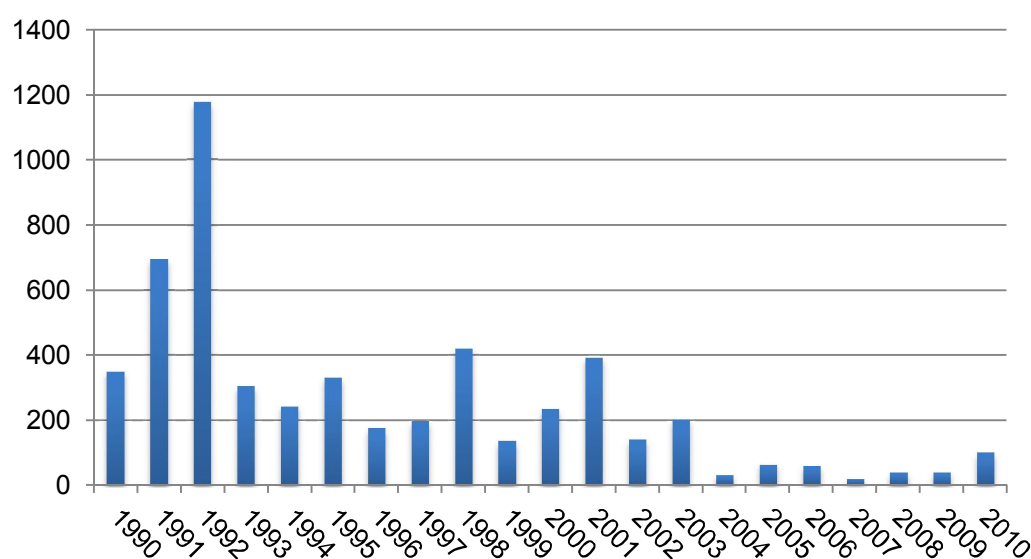
Throughout the duration of the assistance, the Commission has to inform the European Parliament and the Council of developments, providing them with the relevant documents.

In addition, the annual appropriations of funds must be authorised by the budgetary authority within the limits of the agreed financial framework.

*How the financial assistance functions.* The MFA facility can be activated only if an IMF or World Bank programme is already active for the same country and the same period. Support from the MFA takes the form of loans or grants, or a combination of both. The experience with MFA operations in the 1990s showed that most MFA support (86% in terms of financial volume) took the form of loans; but in 2000, the grant increased, and over the period 2000-04, 47% of the total MFA took the form of grants. In the case of a loan, the Commission is entitled to borrow the necessary funds on the capital markets or from financial institutions on behalf of the Union and on-lend them to the beneficiary country. All the operations must be denominated in euros and not permit any EU involvement in the process of the transformation of maturities, or in any exchange or interest rate risk. All the disbursements have to be deposited at the central bank of the beneficiary country, according to the progress made by the country and after the decision of the Committee. Indeed, overall supervision of the implementation of the MoU is assigned to the Commission, which can carry out spot checks and inspections to verify whether the objectives have been met and formulate specific, additional recommendations to improve future operations. If the conditions pertaining to support from the MFA facility are not met, the Commission can temporarily suspend, reduce or cancel the disbursement of the assistance. Finally, all the costs involved in raising and managing the funds are borne by the beneficiary country.

*Current level of utilisation.* The year 2010 was one of the most active in the operation of the MFA instrument for a decade, reflecting the impact of the global economic crisis and the slow exit from the crisis of the EU's neighbourhood. Over the previous ten years, use of the MFA facility progressively declined owing to a relatively stable, global economic environment characterised by an abundant supply of relatively cheap private capital (EPEC, 2009) (Figure 4). In 2010 three MFA programmes were successfully implemented: two programmes for Kosovo (agreed in 2006) and Lebanon (starting in 2007) respectively, and one for Georgia, with the latter having been among the four programmes approved by the Council on 30 November 2009. In relation to the other three operations decided at that Council meeting – in favour of Bosnia and Herzegovina, Serbia and Armenia – no disbursements took place in 2010 or in early 2011, owing to increasing delays encountered by the Commission in agreeing the economic conditions for the programmes with the beneficiary countries. In 2010 another two MFA programmes were adopted, this time for Ukraine (€500 million) and the Republic of Moldova (€90 million in grants) (Figure 5). At present, the programme for Ukraine represents the second largest MFA programme ever decided, with €500 million on top of the €110 million remaining undisbursed from the 2002 MFA programme (thus summing to €610 million). During the first semester of 2011, no loan disbursements took place.

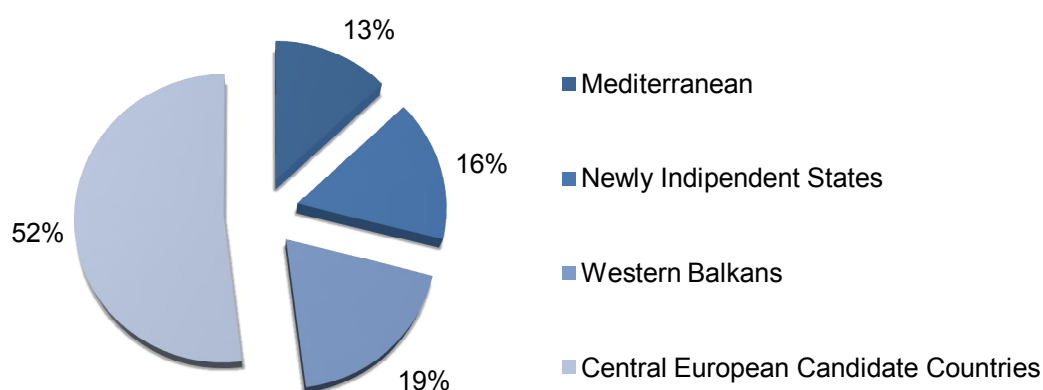
Figure 4. MFA disbursed from 1999 to 2010



Note: € million

Source: European Commission, DG ECFIN.

Figure 5. MFA regional distribution over the period 1990-2010



Source: European Commission, DG ECFIN.

## 1.2 Macro-financial instruments of the euro area member states

In addition to the MFS facilities available at the EU level, euro area member states have decided to establish other instruments intended to preserve the financial stability of the entire euro area. These instruments have assumed a crucial role in recent years, since the debate at the political level about managing the sovereign debt crisis has primarily focused on defining the appropriate tools to deal with the increasing financial difficulties of euro area peripheral countries. There are currently three MFS instruments designed for the euro area:

- the Greek Loan Facility (GLS), set up as first response by the euro area to the financial difficulties of Greece;

- the European Financial Stability Facility (EFSF), which currently represents the largest financial assistance fund existing at the European level to deal with the financial difficulties of member states; and
- the European Stability Mechanism (ESM), which is intended to replace the role of the EFSF by July 2012 and act as a permanent financial mechanism to assure euro area stability.

### 1.2.1 Greek Loan Facility

#### Key Findings

- On 2 May 2010, the Heads of State and Government of the EU member states approved an assistance package providing funds, together with the IMF, of up to €110 billion for a three-year adjustment programme (until June 2013).
- This purely intergovernmental system clearly represented an interim solution before the establishment of more structured (EFSF) or permanent (ESM) mechanisms.
- Under the GLF, the Commission has not acted as a borrower on behalf of the EU (as it does under the EFSM or BoP facility), but the Commission has been entrusted by the euro area member states with coordinating and administering the disbursement to Greece. For this reason, the Hellenic Republic and the Commission signed an MoU agreeing on a programme to correct fiscal and external imbalances.

Facing a dramatic rise in risk premiums on its government bonds, and increasingly aware that with a public deficit out of control its ability to refinance its financial needs on the capital markets would become impossible at sustainable interest rates, at the end of April 2010 Greece formally requested international financial assistance. On 2 May 2010, the Heads of State and Government of the EU member states approved the Greek Loan Facility (GLF) an assistance package providing funds, together with the IMF, of up to €110 billion for a three-year adjustment programme (until June 2013). Under this programme, the other 16 euro area countries provided up to €80 billion through pooled bilateral loans, coordinated and administrated by the European Commission, in liaison with the ECB. This purely intergovernmental system clearly represented an interim solution before the establishment of more structured (EFSF) or permanent (ESM) mechanisms.

Under the GLF, the Commission has not acted as a borrower on behalf of the EU (as it does under the EFSM or BoP facility), but the Commission has been entrusted by the euro area member states with coordinating and administering the disbursement to Greece. For this reason, the Hellenic Republic and the Commission signed an MoU agreeing on a programme to correct fiscal and external imbalances. The release of the tranches has been based on observance of quantitative performance criteria defined by the Commission and on its positive evaluation of progress made by Greece (in the same way described in section 1.1.2 for the EFSM). Moreover the tasks of the Commission comprise, on behalf and under the instruction of the euro area member states providing the support, the opening of an account in the name of the Lenders with the ECB, and the use of that account for processing of all payments on behalf of the Lenders and from the Borrower, the co-ordination of the process for disbursements, certain calculations, distribution amongst Lenders of payments and the provision of information to Lenders regarding breaches of the Loan Facility Agreement or requests for waivers by Greece.

As the first Greek programme did not achieve its objectives, on 14 March 2012 euro area finance ministers approved financing of a second economic adjustment programme for Greece, up to €130 billion until 2014, of which €102 billion is managed under the EFSF and €28 billion is provided by the IMF. Since the undisbursed tranches of the GLF are to be released by the EFSF, the last disbursement made in December 2011 could be considered the last activity of this mechanism, excluding the repayment by Greece of the already disbursed tranches scheduled to start in 2014.

### 1.2.2 *European Financial Stability Facility*

#### **Key Findings**

- Launched in May 2010, its main goal is to provide funds to distressed euro area member states at lower interest rates than those otherwise available to them. The EFSF is a société anonyme incorporated in Luxembourg. It is structured as a temporary, credit-enhanced, special purpose vehicle with minimal capitalisation, which has been created to raise funds from the capital markets on its investment grade rating.
- Since the EFSF is a private company, it does not entail any formal active participation by the EU institutions, even if the Commission and the ECB each have observers on the EFSF board, and the latter is headed by the chairman of the ECOFIN.
- Although the main objective of the EFSF instrument is to provide financial assistance through direct loans to member states in financial trouble, it could provide assistance to euro area countries through the use of other, more flexible financial instruments: precautionary programmes, financing the recapitalisation of financial institutions and intervention in the secondary markets to avoid contagion.
- The EFSF, acting as a private company, issues bonds backed by guarantees given by the 17 euro area member states. Initially the EFSF was set up with only €440 billion of guarantees given by its members, then on 24 June 2011, the European Council agreed to increase the maximum guarantee commitments to €780 billion, resulting in an effective lending capacity of €440 billion.
- On 26 October 2011, Heads of State and Government of euro area member states decided to maximise the capacity of the EFSF, in order to build a more solid firewall against financial speculation and to try in this way to prevent any possible contagion effect of the crisis: the Sovereign, partial risk participation (offering partial risk protection to investors buying the newly issued bonds of a member state) and the Co-investment fund (entailing the establishment of one or more special purpose vehicles).
- Like the EFSM, the EFSF currently finances two ad hoc assistance programmes – for Ireland (€17.7 billion) and Portugal (€26 billion) – resulting in a total lending activity of €40.2 billion. In addition, at a meeting on 26 October 2011, euro area Heads of State and Government agreed to a second financial assistance programme for Greece (€180 billion).

In addition to the resources managed at the EU level through the EFSM, the euro area member states decided to provide additional funds to euro area countries in trouble through the European Financial Stability Facility (EFSF). Launched in May 2010, its main goal is to



provide funds to distressed euro area member states at lower interest rates than those otherwise available to them. Moreover, on 21 July 2011 the Heads of State and Government of the euro area agreed to further increase the EFSF's scope of activity, introducing the possibility to activate a precautionary programme, finance the recapitalisation of financial institutions and intervene in the secondary markets to avoid contagion.

*Institutional framework.* The EFSF is a société anonyme incorporated in Luxembourg. It is structured as a temporary, credit-enhanced, special purpose vehicle with minimal capitalisation, which has been created to raise funds from the capital markets on its investment grade rating (Olivares-Caminal, 2011).. The establishment of this private company was agreed by the euro area member states on 9 May 2010, with the signing of the EFSF Framework Agreement and it was incorporated in Luxembourg under Luxembourgish law on 7 June 2010. Moreover, on 21 July 2011 a new Amended EFSF Framework Agreement was signed, enlarging the Fund's activity without changing its institutional structure (EFSF, 2011b).

The EFSF is a very small organisation, and its staff is composed of around 25 persons. Its operability is possible thanks to the German Debt Management Office (front and back office) and the EIB, which provide support for its activities. At the moment, the Chief Executive Officer is Klaus Regling (the former Director General of the European Commission's Directorate-General for Economic and Financial Affairs), while the Board of the EFSF is composed of high-level representatives of the 17 euro area member states (i.e. deputy ministers or secretaries of state or director generals of national treasuries). Each participating member state can apply to be represented by a Director, subject to the approval of other member states, which may also decide on the removal of any one of the elected Directors. The board also has to decide on its representative at the EWG, in order to ensure close coordination between EFSF and the Eurogroup. The voting mechanism reflects the participation of the states, i.e. each Director's vote is commensurate with the contribution key for the EFSF capital. As regards the voting and majorities, the agreement requires unanimity for all crucial decisions, e.g. the assignment of a loan, approval of an MoU, increases in authorised and/or issued and paid-up share capital (EFSF, 2011a). A qualified majority, representing no less than two-thirds of the total guaranteed commitments, is applied to those procedures that are not specified in the list of decisions by consensus, e.g. the EFSF disbursements related to a programme already approved, operational aspects of debt issuance and details about the application of alternative strategies for funding. Since the EFSF is a private company, it does not entail any formal active participation by the EU institutions, even if the Commission and the ECB each have observers on the EFSF board, and the latter is headed by the chairman of the ECOFIN.

EFSF financial assistance is released after an official request is made by a euro area member state to the other euro area member states. Then the EWG has to inform the Council, which charges the Commission in liaison with the ECB and the IMF to undertake a rigorous analysis of the sustainability of the public debt of the member state, assessing its financing needs. On this basis, the Commission negotiates (always jointly with the IMF and the ECB), a macro-economic adjustment programme and drafts it in the MoU. The MoU, together with the main terms and conditions of the loan facility agreement, is proposed by the Commission to the Council. Then the EFSF board, following endorsement by the Council, decides on the granting of financial assistance and the terms and conditions under which it is provided. Once the programme is approved by the Council, the Commission signs the MoU with the member state on behalf of the euro area members. During the assistance programme, the Commission (together with the IMF and the ECB) is responsible for monitoring activities,

reporting directly to the Council and to the EFSF Board of Governors, which decide on the disbursement of the new tranches of the loan.

*Additional financing activities.* Although the main objective of the EFSF instrument is to provide financial assistance through direct loans to member states in financial trouble (the same kind of programme as the EFSM, the BoP and the IMF), on 21 July 2011 the Heads of State and Government of the euro area member states decided to enlarge the scope of the EFSF. Their aim was to provide assistance to euro area countries through the use of other, more flexible financial instruments. Thus, at the moment the EFSF can

- ✓ *activate precautionary programmes.* The objective of this instrument is to intervene before member states face difficulties in raising funds in the capital markets, thus preventing crisis situations. Once the precautionary assistance has been activated, the member state is not deemed a 'programme country' (thus trying to avoid negative financial market effects stemming from such a reputation) and the EFSF gives a preferential credit line to overcome an external temporary shock and cover the member state's financial needs. This liquidity facility can be released in three forms:
  - i) the Precautionary Conditioned Credit Line (PCCL), drawn as a loan or primary market purchase, is given only to member states that present fundamentally sound economic and financial conditions and is based on pre-established conditions that the beneficiary remains committed to maintaining sound and credible policies in the future;
  - ii) the Enhanced Conditions Credit Line (ECCL), which works like the PCCL but is reserved for member states that have worse economic and financial conditions and thus have to adopt (in accordance with the Commission and the ECB) corrective measures; and
  - iii) the Enhanced Conditions Credit Line with Sovereign Partial Risk Protection (ECCL+), which additionally offers sovereign, partial risk protection to primary bonds. Indeed, the EFSF provides a certificate to the holder, offering a fixed amount of credit protection equal to a percentage of the principal amount of the sovereign bond issued by the assisted member state.
- ✓ *intervene in the primary and secondary markets.* As part of a standard or a precautionary programme, the EFSF can intervene in the primary (and/or secondary) market to maintain or restore access to the financial market of the assisted member state(s). While the unique limitations in the event of primary market intervention are the conditions listed in the MoU and the purchase limit of 50% of the final amount issued under the assistance, in the case of secondary market intervention, the procedure is more complex. That is because the ECB acts in the market on behalf of the EFSF and it requires around two to three days. For activation, the process starts with a formal request from a member state to the Eurogroup president (although in exceptional circumstances, the ECB could issue an early warning to the Eurogroup Working Group). Then the ECB has to draft a specific report containing the risks to euro area stability related to the financial difficulties of the member states and assessing the financial needs for EFSF intervention.
- ✓ *finance the recapitalisation of financial institutions.* This intervention is reserved solely for non-assisted member states, since a standard EFSF assistance programme already covers the needs of the country's financial sector. The declared objective is to limit contagion of financial stress by ensuring the capacity of a government to finance the recapitalisation of financial institutions at sustainable borrowing costs, thanks to the EFSF assistance. The loan is not directly in favour of the financial institutions, since the

EFSF loans to the member states are on the basis of an already specified restructuring/resolution plan agreed at the national level between the member state and the private sector. The institutional procedures for the EFSF intervention are softer than a standard programme: the official request must be made by a member state to the Eurogroup Working Group, which has to assess the request, following the independent advice given by the Commission in liaison with the ECB, and (where appropriate) with the relevant European financial supervisory authorities.

*How the financial assistance functions.* The EFSF, acting as a private company, issues bonds backed by guarantees given by the 17 euro area member states. Initially the EFSF was set up with only €440 billion of guarantees given by its members, then on 24 June 2011, the European Council agreed to increase the maximum guarantee commitments to €780 billion, resulting in an effective lending capacity of €440 billion (due to the 165% over-collateralisation requirement to keep the AAA rating on its issuances). Still, it must be recognised that owing to the current rating of the guarantors (especially according to S&P's ratings), the effective lending capacity available under the EFSF is less than €440 billion; indeed, not all guarantees are taken into account for the purposes of rating the debt securities issued to secure a AAA rating (Olivares-Caminal, 2011).

Table 5. EFSF contribution keys

Country	Rating*	Guarantee commitments	Contribution key	Amended guarantee commitments**	Amended contribution key**
Austria	AA+/Aaa/AAA	21,639	2.78	21,639	2.99
Belgium	AA/Aa3/AA	27,032	3.47	27,032	3.72
Cyprus	BB+/Ba1/BBB-	1,526	0.2	1,526	0.21
Estonia	AA-/A1/A+	1,995	0.26	1,995	0.27
Finland	AAA/Aaa/AAA	13,974	1.79	13,974	1.92
France	AA+/Aaa/AAA	158,488	20.31	158,488	21.83
Germany	AAA/Aaa/AAA	211,046	27.06	211,046	29.07
Greece	SD/C/B-	21,898	2.81	-	0
Ireland	BBB+/Ba1/BBB+	12,378	1.59	-	0
Italy	BBB+/A3/A-	139,268	17.86	139,268	19.18
Luxembourg	AAA/Aaa/AAA	1,947	0.25	1,947	0.27
Malta	A-/A3/A+	704	0.09	704	0.1
Netherlands	AAA/Aaa/AAA	44,446	5.7	44,446	6.12
Portugal	BB/Ba3/BB+	19,507	2.5	-	0
Slovakia	A/A2/A+	7,728	0.99	7,728	1.06
Slovenia	A+/A2/A	3,664	0.47	3,664	0.51

Spain	A/A3/A	92,544	11.87	92,544	12.75
<b>Total</b>		<b>779,783</b>	<b>100</b>	<b>726,000</b>	<b>100</b>

\* S&P/Moodys/Fitch

\*\* After the step out of Greece, Ireland and Portugal

Note: As of April 2012

Source: EFSF

The percentage contribution key of the guarantees given by each member state is defined in accordance with their share of the paid-up capital at the ECB (Table 5). At the same time, the key percentages of the guarantees provided by the individual member states could vary among different bonds by reason of either a guarantor becoming a stepping-out guarantor or the introduction of a new member state to the euro area, i.e. the adherence of a new euro-area member state to the EFSF.

The stepping-out mechanism is a particular feature of the EFSF: in the event that a member state experiences severe financial difficulties and requests EFSF support (or benefits from financial support under a similar programme), it may ask other euro area members to suspend its commitment to provide further guarantees to the EFSF's new bond issuances (but the guarantees provided for previous loans are still valid). If the remaining guarantors (deciding unanimously through the EWG) agree to this request, then the country becomes a 'stepping-out guarantor' and it is not asked to provide guarantees or incur any new EFSF loans. Thus, the percentage contribution key of the remaining member states has to be adjusted accordingly for the issuance of the new liabilities resulting from new EFSF assistance programmes. When the EFSF was established, Greece already had the status of a stepping-out guarantor, while Ireland became a stepping-out guarantor on 3 December 2010 and Portugal did so with effect from 16 May 2011.

To raise the money required to facilitate or provide financial assistance, the EFSF is entitled to issue bonds or notes, commercial paper, debt securities or other financing arrangements backed by timely, unconditional, irrevocable and several guarantees given by the member states on a pro rata basis. The pricing structure for the loans is defined as the EFSF cost of funding plus the margin equal to 200 basis points before the third year of the loan (increased to 300 basis points in respect of any loan that remains outstanding). The debt instruments issued by the EFSF are designed to be serviced by the loan repayments that the EFSF expects to receive from the borrowers, implying a perfect match between repayments and scheduled payments. If a borrower fails to fulfil its obligations on time, funds have to be drawn first of all directly from the guarantees provided by the member states on a pro rata basis, then from a loan-specific cash buffer (its definition has not been revealed), and finally from the cash reserves set up during EFSF lending activity.

Table 6. EFSF rating

Agency	Rating	Comments
Fitch Ratings	AAA/Stable	<ul style="list-style-type: none"> <li>The increase in the EFSF's capacity is intended to be achieved without extending the underpinning guarantees.</li> <li>The credit enhancement is provided by the 'over-guarantee' mechanism and cash reserves in place.*</li> </ul>
Moody's	Aaa/Stable	<ul style="list-style-type: none"> <li>No Aaa-rated country has lost its top-notch rating.</li> <li>Aaa-rated guarantees are sufficient by themselves to cover all of the associated debt service.**</li> </ul>
Standard & Poor's	AA+/negative outlook	<ul style="list-style-type: none"> <li>The credit enhancements needed to offset the reduced creditworthiness of EFSF guarantors are not likely.</li> <li>The outlook on the long-term rating for the EFSF is therefore being revised to negative from developing and affirming the 'AA+/A-1+' ratings.</li> <li>The negative outlook on the long-term rating mirrors the negative outlooks of France and Austria.**</li> </ul>

\* As of October 2011, \*\* As of February 2012

Source: European Commission, DG ECFIN.

The EFSF has been assigned the best possible credit rating, according to the ECB's list of eligible marketable assets. The main reason for this creditworthiness is that the guarantees from its AAA members are sufficient by themselves to cover all of the associated debt service if the supported countries do not honour their debt obligations. Moreover, the rating derives from the fact that the liquidity reserves invested in AAA-rated securities should additionally cover all of the potential liabilities of the EFSF (see Table 6).

The Framework Agreement does not contain any maturity limitations for the loans or for the funding instruments, since they are defined on a case-by-case basis (EFSF, 2011a). Nevertheless, at the euro area summit on 21 July 2011, it was agreed that maturities would be extended to a minimum average of 15 years and up to 30 years (EFSF, 2011b). Moreover, in November 2011, a diversified funding strategy was introduced, creating (in addition to long-term bonds) a short-term bill programme: since the end of 2011, the EFSF has held regular auctions of three-month and six-month bills. This idiosyncrasy in the fundraising results in a situation whereby the funds raised are no longer attributed to a particular country (Ireland or Portugal), but are instead pooled and then disbursed to programme countries according to the disbursement plan agreed with each country during the definition of the assistance programme. To avoid inconvenience in the financial markets between the EFSM and the EFSF, the issuance calendar of the two is closely coordinated. This element is especially important, since EFSF investors are the same as those for the EFSM (banks, pension funds, central banks, sovereign wealth funds, asset managers, insurance companies and private banks). Finally, it must be noted that the EFSF, owing to its private nature, does not operate as an international financial institution (like the IMF or the World Bank), so it does not have any kind of preferred creditor status in the event of restructuring debt processes for assisted countries.



*Instruments for maximising EFSF financing capacity.* On 26 October 2011, Heads of State and Government of euro area member states decided to maximise the capacity of the EFSF, in order to build a more solid firewall against financial speculation and to try in this way to prevent any possible contagion effect of the crisis. Two options have been identified to leverage EFSF resources, without increasing the guarantee commitments already given by the member states, but up to now neither of them has been used. The amount of additional resources available thanks to the use of the two options crucially depends on the precise structure of the new instruments and on the EFSF's credibility in the market. Fundamental in this sense would be the market conditions and the soundness of the countries benefiting from EFSF support facilities, as well as the credit rating of the euro area member states providing guarantees for the EFSF. Moreover, financing procedures under both options are strictly linked to the drafting of an MoU, in order to establish policy conditionality for EFSF intervention and appropriate monitoring and oversight procedures. The two options currently available are the following:

- ✓ *Sovereign, partial risk participation.* This option is intended to offer partial risk protection to investors buying the newly issued bonds of a member state. The EFSF would provide a partial protection certificate (separately tradable), which could give the holder an amount of fixed credit protection of 20-30% of the principal amount of the sovereign bond. Thus, the EFSF certificate would only be effectively operative after a credit event (a default, restructuring or moratorium) and it would entitle the holder to claim against this loss in EFSF bonds. This option is primarily designed to be part of a precautionary programme, in order to sustain the demand for the new issues of a member state and lower its interest rates. The member state must issue its sovereign bonds in line with its normal issuance process, but this process must take place in conjunction with the EFSF issuance at the same time (and with the same maturity) as the partial risk protection by a special purpose vehicle created ad hoc in Luxembourg, which would not be legally connected to the EFSF or member states.
- ✓ *Co-investment fund (CIF).* This option entails the establishment of one or more special purpose vehicles. Each CIF is intended to facilitate the funding of a member state and support its sovereign bonds in the primary or secondary markets (or both). This vehicle could be established using a combination of public and private funds, to enable the enlargement of the resources available for the EFSF's financial assistance instruments. The CIF must be established with a predefined lifetime. From an institutional point of view, it would appear as a subsidiary of the EFSF, domiciled in Luxembourg, and its Board of Directors would be appointed by the EFSF. Its structural design is intended to attract a wide range of investors (risk capital investors, sovereign wealth funds and the IMF) thanks to the creation of three layers: a first-loss tranche, a participating tranche and potentially a third layer of a rated, senior debt tranche that would satisfy every investor's risk profile.

Table 7. EFSF assistance programmes

Country	Agreed amount	Disbursed	Period covered by the assistance	Other partners
Ireland	17.7	12	2010-13	IMF, EFSM and bilateral loans by the UK, Denmark & Sweden
Portugal	26	9.6	2011-14	IMF and EFSM
Greece II	179.6	103.7	2011-15	IMF
<b>Remainder for utilisation: 216.7</b>				

Note: As of May 2012, € billion

Source: EFSF.

*Current level of utilisation.* Like the EFSM, the EFSF currently finances two ad hoc assistance programmes – for Ireland (€17.7 billion) and Portugal (€26 billion) – resulting in a total lending activity of €43.7 billion. As of May 2012, around 50% of the funds had been disbursed to the two countries, with a current average maturity of around ten years for Ireland and six years for Portugal (Table 7).

In addition, at the meeting of 26 October 2011, euro area Heads of State and Government agreed to a second financial assistance programme for Greece: the details of this programme were agreed by the Eurogroup on 21 February 2012, which decided to use the EFSF as a vehicle for the second round of Greek loans, totalling €180 billion. The EFSF must not only manage the undisbursed tranches of the GLF (€61 billion, of which €9.2 billion has already been disbursed), but also provide additional funds for banking sector recapitalisation in Greece (€48 billion, of which €25 billion has already been disbursed) and undertake the following other actions:

- *refinance private sector involvement.* The EFSF has to provide its bonds to holders of bonds under Greek law as part of the voluntary debt exchange. These short-term bonds (one and two years) will subsequently be rolled over into longer maturities up to a total amount of €30 billion (of which €29.7 billion had already been disbursed as of May 2012);
- *finance accrued interest.* To enable Greece to repay accrued interest on its outstanding sovereign bonds, during the refinancing of private sector involvement Greece has given investors EFSF six-month bills, which will be subsequently rolled over into longer maturities. The amount of accrued interest could increase up to €5.5 billion (of which €4.82 billion has already been disbursed as of May 2012); and
- *buy back the Eurosystem bonds.* To buy back from the Eurosystem National Central Banks those bonds issued or guaranteed by Greece (which are held by NCBs as collateral for monetary policy operations by the Eurosystem), the EFSF has released to Greece €35 billion in 1-year bonds to be used in the debt exchange.

### 1.2.3 *European Stability Mechanism*

#### **Key Findings**

- On 24 June 2011, the European Council established a permanent crisis resolution mechanism for the euro area, the ESM, with a planned lending capacity amounting to €500 billion. It is established as an intergovernmental organisation under public international law and is based in Luxembourg. As a permanent mechanism, from 1 July 2012, when it is planned to become operational, the ESM is expected to take over the tasks currently fulfilled by the EFSF and EFSM, using the same instruments currently available for the amended EFSF.
- The ESM will enter into force as soon as member states representing 90% of capital commitments have ratified it – the common objective established by the Council is July 2012, a year earlier than originally planned in the first ESM Treaty.
- The procedure to establish a country assistance programme is similar to that of the EFSF. Furthermore, according to the latest version of the ESM Treaty, the granting of financial assistance is conditional (as of 1 March 2013) on ratification by the member states of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (aka the fiscal compact).
- The ESM is planned to become operational as of mid-2012 with total subscribed capital of €700 billion and an effective lending capacity of €500 billion. Of this €700 billion, €80 billion is in the form of paid-in capital shares, while €620 billion is in callable shares; these amounts are split among euro area member states according to their capital contribution key in the ECB.
- The paid-in capital shares of the ESM have been planned to be made available more quickly than initially foreseen in the first ESM Treaty: two tranches of capital are expected to be paid in 2012, a first one in July, a second one by October. Another two tranches are planned to be paid in 2013 and a final tranche in the first half of 2014.
- While the EFSF (like the EFSM and the BoP facility) has the same credit right as any other sovereign claim, the ESM – owing to its nature as an intergovernmental organisation – is designed to have preferred creditor status in a similar way as the IMF, even if it accepts the preferred creditor status of the IMF over the ESM.
- The ESM is designed to consolidate all the new assistance programmes in favour of euro area member states from July 2012. Yet since the €500 billion lending capacity is planned to be reached only in 2014, during the transition phase the EFSF may be engaged in new programmes to ensure an overall lending capacity of €500 billion.

On 24 June 2011, the European Council established a permanent crisis resolution mechanism for the euro area, the ESM, with a planned lending capacity amounting to €500 billion. It is established as an intergovernmental organisation under public international law and is based in Luxembourg. As a permanent mechanism, from 1 July 2012, when it is planned to become operational, the ESM is expected to take over the tasks currently fulfilled by the EFSF and EFSM, using the same instruments currently available for the amended EFSF (see also the detailed description in section 1.2.2):

- *provide direct loans* to countries in financial difficulty backed by issuing bonds or other debt instruments in the international financial markets;
- *intervene in the debt primary and secondary markets* to increase the liquidity of a member state in the sovereign bond market and maintain or restore its access to the financial market;
- *establish a precautionary programme* to provide assistance to a member state before the complete deterioration of its financial conditions; and
- *finance recapitalisations of national financial institutions* through loans to member state governments that are not under a standard assistance programme.

*Institutional framework.* The first step in establishing the ESM took place on 25 March 2011, when the European Council adopted a decision to amend the TFEU, adding a new paragraph to Art. 136: “The Member States whose currency is the euro may establish a stability mechanism to be activated if indispensable to safeguard the stability of the euro area as a whole. The granting of any required financial assistance under the mechanism will be made subject to strict conditionality.”

To concretely enforce this Treaty provision, the euro area member states have signed the Treaty establishing the European Stability Mechanism, which has actually been signed twice, in order to include the new instruments agreed for the amended EFSF. After the first signature on 11 July 2011, on 2 February 2012 the euro area member states decided to make the ESM more effective by signing a new treaty, including new financing tools, a direct link to the ‘fiscal compact’, a new emergency decision-making procedure and an alignment with IMF practices as regards private sector involvement. The ESM will enter into force as soon as member states representing 90% of capital commitments have ratified it – the common objective established by the Council is July 2012, a year earlier than originally planned in the first ESM Treaty.

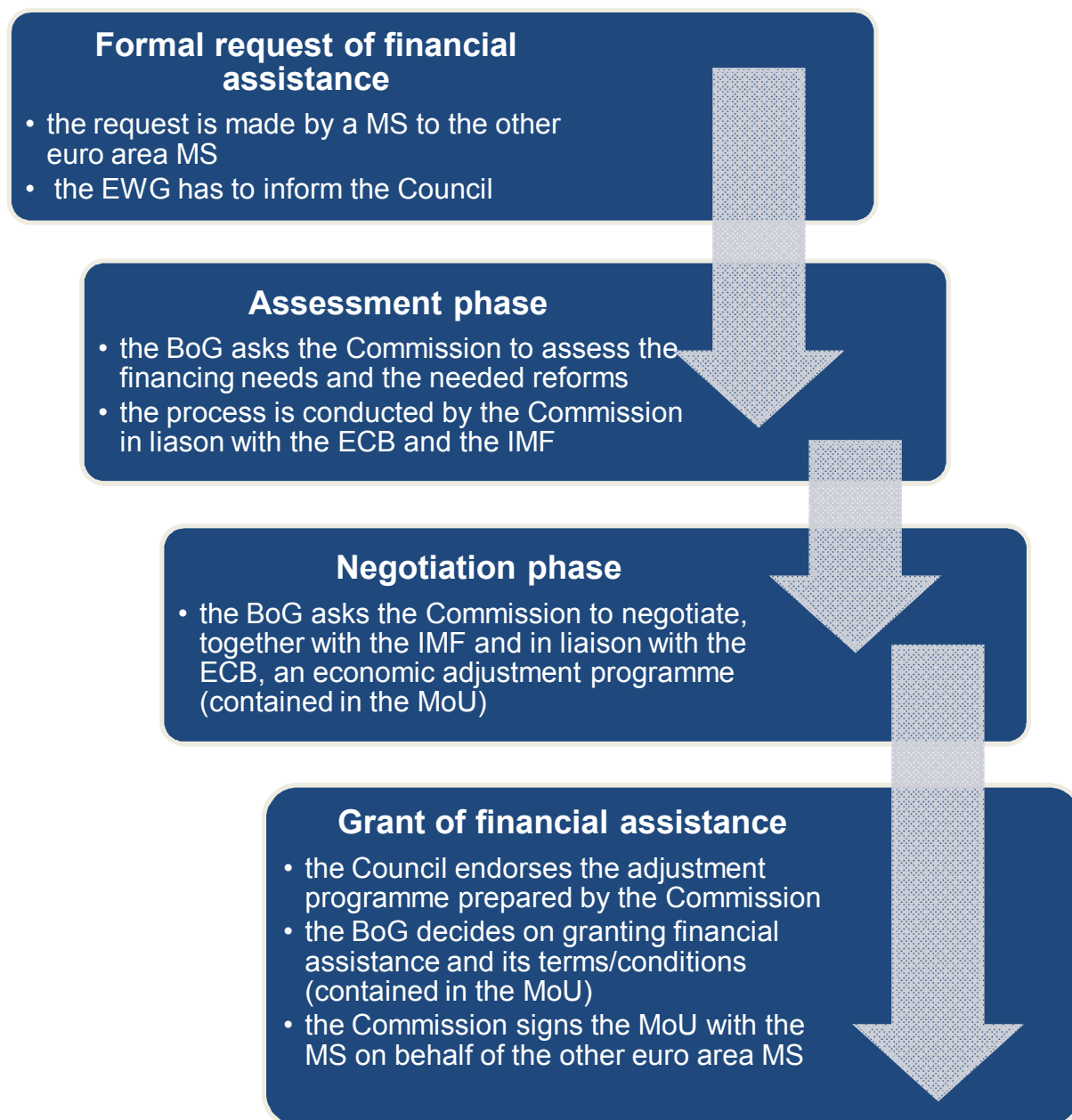
The governing structure of the ESM is based on a Board of Governors composed of the ministers of finance of the euro area member states, along with the European Commissioner for Economic and Monetary Affairs and the ECB President as observers. The Board of Governors appoints a Managing Director responsible for the day-to-day management of the ESM. The other main institutional body is the Board of Directors, chaired by the Managing Director and made up of one Director (and alternate Director) appointed by each euro area member state. The most important decisions are taken by the Board of Governors with unanimity; the new Treaty signed in February 2012 provides for an emergency procedure whereby a decision to grant financial assistance can be taken by a qualified majority of 85% of the votes cast. Yet this emergency procedure can only be used when the Commission and the ECB both identify that the decision to grant or implement financial assistance involves a threat to the economic and financial sustainability of the entire euro area.

Additionally, the ESM Treaty provides the possibility for non-euro member states to participate in financial assistance programmes under the ESM for euro area member states. This mechanism must be established on an ad hoc basis; already Denmark, Sweden and the UK are involved in providing bilateral assistance to Ireland to complement the EFSM/EFSF/IMF programme. In the case of joint financial assistance, the non-euro member states could participate in ESM meetings related to that specific programme and could access any available information useful for monitoring activities. Moreover, the ESM should support equivalent creditor status for those involved in bilateral lending alongside the ESM.

The procedure to establish a country assistance programme is similar to that of the EFSF (see section 1.2.2 and Figure 6 for a detailed description). Furthermore, according to the latest

version of the ESM Treaty, the granting of financial assistance is conditional (as of 1 March 2013) on ratification by the member states of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (aka 'fiscal compact'), and thus on implementation of the balanced budget rule as specified in that Treaty within the agreed timeline.

Figure 6. ESM Financial assistance approval procedure



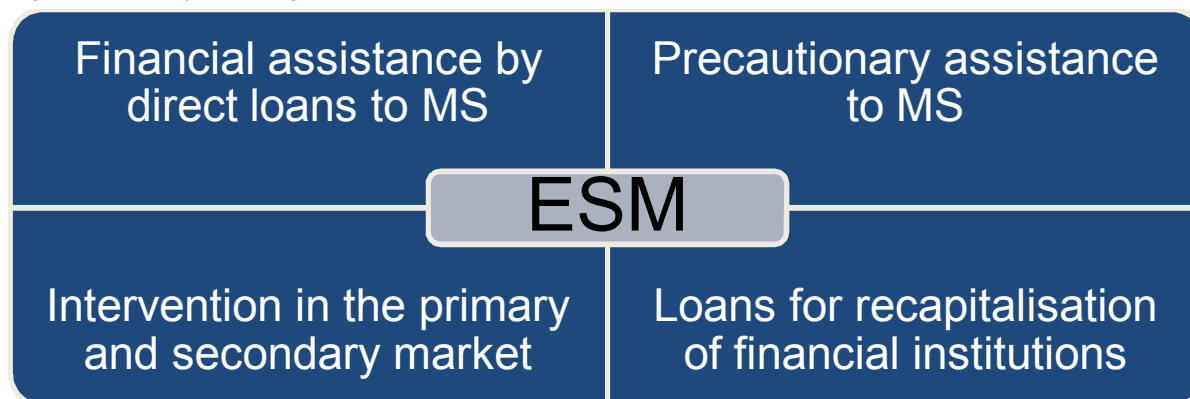
Source: Authors' elaboration.

*Financing activities.* The ESM has been designed as a permanent instrument for the euro area to mobilise funding and provide financial assistance to its member states that are experiencing or are threatened by severe financing problems, in order to safeguard the financial stability of the euro area as a whole. To achieve this objective, the ESM is able to use the same range of instruments that have been put in place for the EFSF. In addition to the direct loans to beneficiary member states, the ESM could provide precautionary financial



assistance and loans to member states for the recapitalisation of financial institutions; moreover, it would be able to purchase the sovereign bonds of beneficiary member states on the primary and secondary markets (see section 1.2.2 and Figure 7 for a detailed description).

Figure 7. ESM financing activities



Source: Authors' elaboration.

*How the financial assistance functions.* The ESM is planned to become operational as of mid-2012 with total subscribed capital of €700 billion and an effective lending capacity of €500 billion. Of this €700 billion, €80 billion is in the form of paid-in capital shares, while €620 billion is in callable shares; these amounts are split among euro area member states according to their capital contribution key in the ECB (see Table 5). Any new euro area member state adopting the euro will become an ESM member with full rights and obligations as of the entry into force of the decision of the Council taken in accordance with Art. 140(2) TFEU.

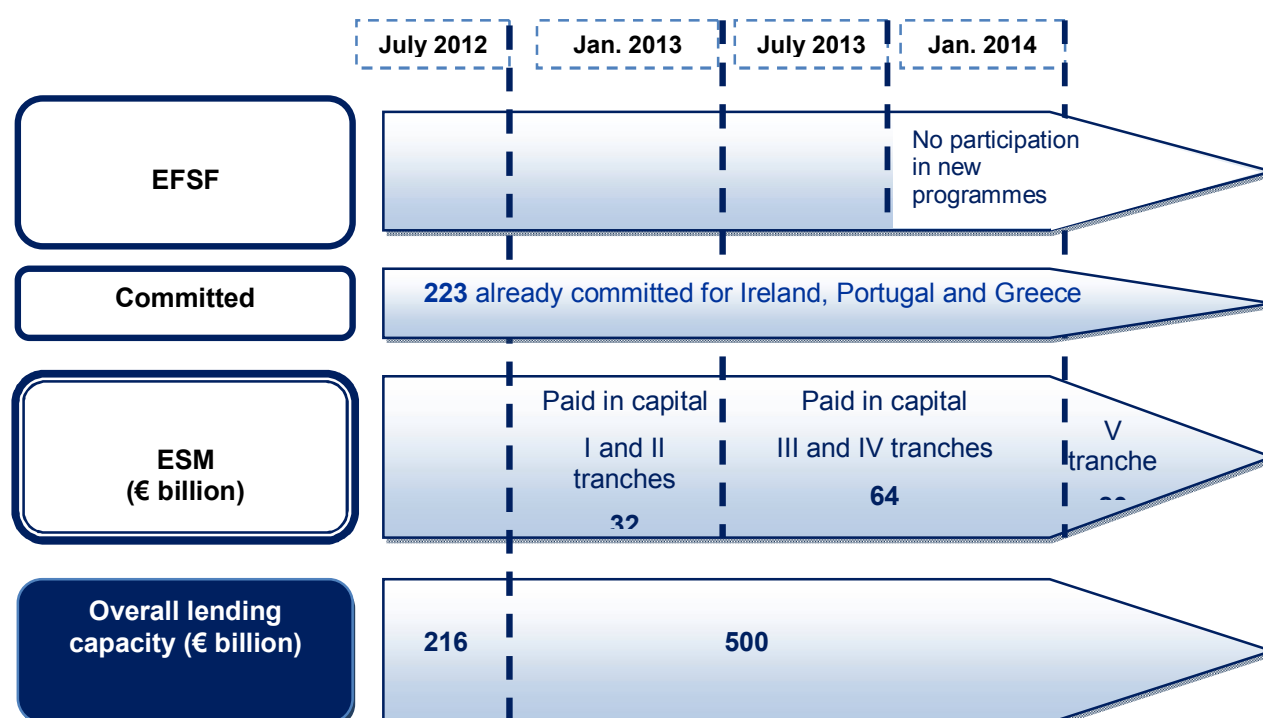
The paid-in capital shares of the ESM have been planned to be made available more quickly than initially foreseen in the first ESM Treaty: two tranches of capital are expected to be paid in 2012, a first one in July, a second one by October. Another two tranches are planned to be paid in 2013 and a final tranche in the first half of 2014. In line with the ESM Treaty, the payment of the capital could be further accelerated during the transitory phase from 2013 to 2014 if needed to maintain a 15% ratio between the paid-in capital and the outstanding amount of ESM issuances activated to assist member states. Furthermore, if an ESM member fails to provide the required payment following a capital call by the ESM, the missing capital should be covered by all other ESM members; thus, this system ensures that the ESM receives the total amount of paid-in capital needed. Finally, the euro area member states have decided to attribute to the ESM, as part of its paid-in capital, the financial sanctions applicable under the Stability and Growth Pact and the macroeconomic imbalance procedure.

Even if a rating agency has already judged the ESM, it is intended to obtain and maintain the highest credit rating, owing its specific capital structure. Unlike the EFSF, the presence of the paid-in capital (in addition to the callable capital and guarantees) should ensure the AAA rating per se, without the presence of the credit enhancement schemes in the EFSF (over-guarantee, cash buffer and cash reserve).

While the EFSF (like the EFSM and the BoP facility) has the same credit right as any other sovereign claim, the ESM – owing to its nature as an intergovernmental organisation – is designed to have preferred creditor status in a similar way as the IMF, even if it accepts the preferred creditor status of the IMF over the ESM.

*Current level of utilisation.* The ESM is designed to consolidate all the new assistance programmes in favour of euro area member states from July 2012 (see Figure 8). Yet since the €500 billion lending capacity is planned to be reached only in 2014 (or even from mid-2013 in the case of an accelerated procedure), because of the delayed capital payments by member states, during the transition phase the EFSF may be engaged in new programmes to ensure an overall lending capacity of €500 billion. For this reason the overall ceiling for ESM/EFSF lending, as defined in the first version of the ESM Treaty, has been raised to €700 billion, such that the ESM and the EFSF will be able to operate jointly from mid-2013. After this date, the EFSF is expected to remain operational only in managing the already activated financing programmes, thus exercising a purely administrative function until it has received full payment of its loans and it has repaid its liabilities.

Figure 8. Timeline for transition to the ESM



Source: authors' elaboration on EFSF information.

## 2. Financial ImplicationS of the use of existing EU MFS instruments for the EU budget

### Key Findings

#### BoP and EFSM

- For the BoP and EFSM, the EU budget sets aside part of the EU budget's margin between payment appropriations and the EU budget ceiling under a 'token entry'.
- The design of the two FMS mechanisms ensures that the risks are greatly minimised, so that the EU budget is exposed to a clearly 'ring-fenced' risk.
- In case of a default of an assisted country, the Commission would initially draw on its cash reserves to service the debt provisionally and amend the yearly budget to incorporate the refinancing need. In this way, the budget lines created ad hoc for MFS

instruments can be financed if called upon by the margin of the EU budget, between the payment appropriations and the own resources ceiling of EU budget.

- Owing to the increasing activity, in the coming years the exposure from a default risk is expected to increase for the EU budget, even if not in a constant way. The spread of the maturity dates ensures that the yearly exposure of the budget remains limited, but in some years maturity dates have accumulated.
- Potential risk is inherently linked to the future evolution of the MFF, since most of the repayments fall beyond the present MFF and even beyond the next one.

#### **MFA**

- The amounts of the financial assistance provided in grants under the MFA must be consistent with the budget appropriations established in the MFF. In addition, each year, the budgetary authority has to authorise the yearly appropriations.
- The risks linked to MFA assistance are similar to those under the BoP facility and the EFSM; however, the risks of a non-repayment of the MFA provided in the form of loans appear higher under this MFS instrument, because the assisted countries are not EU member states.
- To address the possible adverse implications of non-repayment of the loan, the MFA uses as a guarantee for its loan operations the Guarantee Fund for external actions, which provides guarantees to external loans by the EIB, Euratom and MFA.

#### **National Budgets**

- The borrowings undertaken under the three EU MFS instruments are direct and unconditional obligations of the EU but are guaranteed by the 27 EU member states, which are legally obliged by the TFEU to provide funds to meet all of the EU's obligations. Thus in the case of a default of an assisted country, the EU member states have to step in and cover all the possible losses not already covered by the EU internal mechanisms.
- In case of combined default on their outstanding official debts of the countries currently assisted by the euro area MFS instruments, the resources involved would seriously endanger the public finances of euro area member states.

The spread of EU financial assistance mechanisms and the introduction MFS instruments backed by the EU budget give rise to financial and governance concerns. The EU budget is a small financial instrument in relative terms, with inflexible rules and very narrow margins

There are two kinds of operations from which there may be financial repercussions for the EU budget: i) operations for which a predetermined budget line is set aside to guarantee the risk; and ii) assistance that does not have a predetermined budget allocation in the financial framework, thus requiring the budget, in the event of a default, to raise additional funds to cover sums.

In the latter category we find the BoP facility and the EFSM, while the other instrument, the MFA, has a special budget allocation (the Guarantee Fund for external actions), which is expressly designed to prevent the budget from being liable beyond the funding allocated for this purpose.

The first category of MFS instrument (i.e. the BoP facility and the EFSM) is particularly important, as its potential impact on budget stability is not fully understandable from budget analysis. Moreover, the guarantees offered by the budget are relevant: the BoP facility can offer loans fully guaranteed by the budget to the level of €50 billion and the EFSM up to €60 billion. In the recent public hearing of the Committee on Budgetary Control on 24 April 2012,<sup>21</sup> the European Parliament indicated its concern about the risks and liabilities linked to these two instruments. For this reason, this section intends to offer a clearer picture of the issue.

## 2.1 How the MFS instruments are recorded in the budget

For the BoP and EFSM, the EU budget sets aside part of the EU budget's margin between payment appropriations and the EU budget ceiling under a 'token entry' or *pour memoria*. The budget lines for the BoP, EFSM and MFA loans are listed under heading 01 04 01 ("European Community Guarantees for lending operations and for EIB lending operations"):

- 01 04 01 01 – European Union guarantee for Union borrowings for Balance-of-Payments support;
- 01 04 01 03 – European Union guarantee for Union borrowings for financial assistance under the European Financial Stabilisation Mechanism; and
- 01 04 01 04 – European Union guarantee for Union borrowings for Macro-Financial Assistance to third countries.

In each line, the references to the basic act, the volumes of the operation and the duration are to be included. Moreover, budget line 01 04 01 14 shows the sum of the "Provisioning of the Guarantee Fund" for all Union and Euratom borrowing operations and for EIB lending operations.

For the MFA, the risk exposure is recorded as part of the EU budget expenditures in the Guarantee Fund for external actions (as a safety net), which is also used to guarantee loans by the EIB to third countries. The amounts of the financial assistance provided in grants under the MFA must be consistent with the budget appropriations established in the multi-annual financial framework (MFF), in accordance with Council Regulation (EC, Euratom) 480/2009 of 25 May 2009 on the Guarantee Fund for external actions<sup>22</sup>. In addition, each year, the budgetary authority has to authorise the yearly appropriations, in order to be consistent with the ceilings established for the relevant budget appropriations in the multiannual financial framework. Table 8 shows the estimated impact on expenditure foreseen by the Commission for MFA grants, summarised in the budget line 01 03 02.

Table 8. Commitments in macroeconomic assistance grants

2011	2012	2013
104,869	104,900	137,436

Note: Operational commitment appropriations (grants)

Source: European Commission.

<sup>21</sup> Public Hearing, Committee on Budgetary Control, Tuesday 24.4.2012, Budgetary control of the EFSF/EFSM/ESM, Chairman Michael Theurer, rapporteur Iliana Ivanova.

<sup>22</sup> Council Regulation (EC, Euratom) 480/2009 of 25 May 2009 establishing the Guarantee Fund for external actions, OJ L 145/10, 10.06.2009.

Finally, budget lines 800 for BoP and 802 for ESFM have been created on the revenue side to account for any potential reimbursements after an initial default or for any other revenue arising in connection with the guarantee provided by the EU budget.

## 2.2 Risks to which the EU budget is exposed by the EFSM and BoP facilities

The exposure to risk of the EU budget by the guarantees it extends in different forms, including MFS assistance, is presented by the European Commission's Working Document on guarantees covered by the EU budget (European Commission, 2011c). More generally, the risks that the lending and borrowing operations can pose are market or currency risks, interest rate risks, credit risk and liquidity risk (summarised in Table 9 at the end of this section). The design of the EFSM and BoP mechanisms ensures that the risks are greatly minimised, so that the EU budget is exposed to a clearly 'ring-fenced' risk.

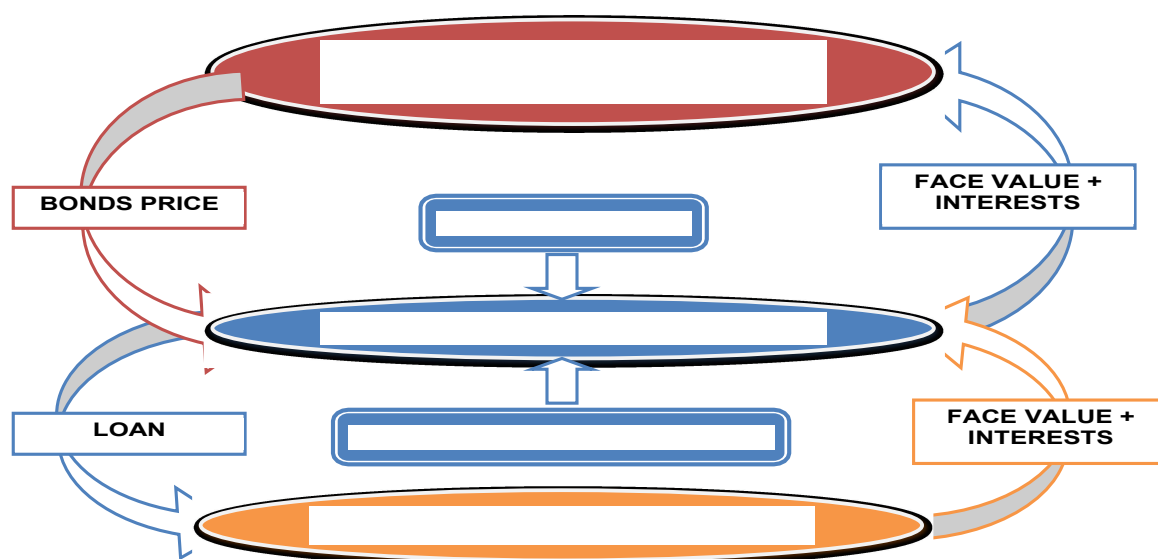
*Market risk.* Under the BoP facility and the EFSM, assistance is provided in euros and thus cannot be affected by exchange rate fluctuations, leaving the market risk to be borne in full by the country benefitting from the assistance. This element concerns in particular the BoP facility, which assists EU countries that are not part of the euro area, but it could also concern the EFSM, since a euro area member state could be forced to leave the monetary union while the provision of financial assistance is still active.

*Interest rate risk.* Under these two MFS instruments, the terms of repayment for the beneficiary country are determined back-to-back, mirroring the requirements of the bonds issued or any form of loan raised, including any management costs or interest. These will be designed to cover the exact same terms on which the ESFM or BoP instruments have raised the funding from the capital markets through the bond issuances, thus limiting the interest rate risk. Under these two instruments the EU has significant interest-bearing assets and liabilities, but once the Commission has disbursed the assistance, the exact potential liability and time of the potential risk occurring can be estimated (the final interest rates may vary). The back-to back operation is described in Figure 9. In this way the EU budget thus, in principle, never de facto has to be called upon to cover unforeseen events in addition to an actual default of the member states in its commitments.

*Credit risk.* This represents the most important risk, and a risk that the EU budget has to bear under the budget ceiling of 1.23% of GNI. Theoretically, if the repayment commitment is large enough, there is a risk that the margin between payment appropriations and the EU budget ceiling will become too small. Given the large margin in the budget until 2013 and the expected large margins from 2014 to 2020, the probability of the margin being too limited appears practically inexistent. Of course, a fall in EU GNI combined with unexpected increases in payment appropriations could in theory have an effect, given that the margin is just a fraction of 1% of GNI. The credit risk from 2020 onwards is hard to estimate, as at present the budget size in future MFFs cannot be foreseen.



Figure 9. A back-to-back loan operation



Source: Authors' elaboration.

**Liquidity risk.** In addition to the general back-to-back structure of the loans and the subsequent schedule of the liquidity management, the regulations for both MFS instruments ensure that beneficiaries are expected to repay their loan 14 days in advance of the date the European Commission has to pay the sums to creditors, thus securing the liquidity management.

According to Council Regulation No. 1150/2000 of 22 May 2000<sup>23</sup> on the system of the European Communities own resources, in case of a default of an assisted country, the Commission would initially draw on its cash reserves to service the debt provisionally and amend the yearly budget to incorporate the refinancing need. In this way, these budget lines can be financed if called upon by the margin of the EU budget, between the payment appropriations and the own resources ceiling of EU budget. This ensures a de facto commitment by all member states to cover this amount in the event of a default by the assisted country, as the member states are obliged by the TFEU to provide the funds necessary to meet all of the EU's obligations (Arts. 310 and 323 TFEU).

<sup>23</sup> Council Regulation No. 1150/2000 of 22 May 2000 on the system of the European Communities own resources, OJ L 130, 31.5.2000.

Table 9. Summary of risks for the EU budget under the EFSM and the BoP facility

Type of risk	Description of the risk	EU budget implications under the BOP and the EFSM	Description of the implications	Level of risk
Market risk	Exchange rate fluctuations	No	Borne by the beneficiary as loans are determined in euros	Absent
Interest rate risk	Change in the value due to the variability of interest rates	Yes	Eliminated thanks to the back-to-back lending system	Absent
Credit risk	Losses arising from a borrower that does not make payments as promised	Yes	Given the large margin in the coming years, the EU budget could deal with potential losses	Low
Liquidity risk	Mismatch between the repayment of the borrower and repayments to bondholders	Yes	Beneficiaries have to repay their loans 14 days in advance of the date the European Commission has to pay the sums to creditors	Low

Source: Authors' elaboration.

### 2.3 Assessing the annual risk exposure of the budget from the BoP and EFSM

Transparency and oversight of the operations conducted under the BoP facility and the EFSM is guaranteed under very similar procedures and are presented in the section 3.1. More difficult is understanding how the budget is actually expected to cover outstanding liabilities in the coming years. Under these two MFS instruments, the Commission contracts borrowings in the financial markets on behalf of the European Union and the amounts borrowed and the interest create de facto a financial risk for the EU budget. Given the small size of the budget, the potential total borrowing capacity of the instruments of €110 billion is far from negligible. It is thus crucial to assess the evolution of the risks entailed in the operations for the EU budget, gather a full picture of the financial liabilities of the EU budget and discuss the consequences of the potential defaults of large liabilities.

The evolution of risks under the BoP facility and the EFSM is expected to correspond to the annual repayment schedule under the financial instruments guaranteed by the budget (including interest on loans). This risk is designed to be covered by the EU budget's available margin under the EU budget ceiling of 1.23% of GNI.

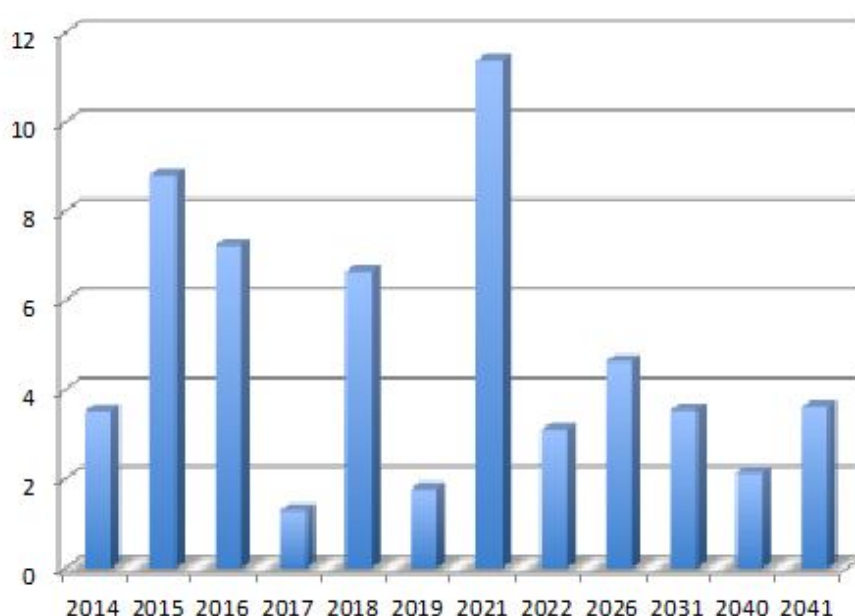
Before turning to assess the yearly exposure of the EU budget over the coming years, two points are important to better understanding the evolution of the risk exposure:

- despite the fact that the lending activity has increased in recent years (see section 1.1), yearly risk exposure is in any case limited due to the spread of the reimbursement commitments; and

- the EFSM is approaching the limit of funding it is allowed to commit in giving assistance to euro area member states. With the activation of the ESM, it is highly improbable that this MFS instrument will be used for new assistance programmes. The same conclusion could not be drawn for the BoP assistance.

Figure 10 shows the risk exposure calculated based on the outstanding loan amounts per year including the interest costs (nominal amounts with estimated interest costs based on initial terms). It does not incorporate, however, those amounts that have already been committed, but not yet disbursed (around €10 billion, see section 1.1). It appears that owing to the increasing activity of the two MFS instruments, in the coming years the exposure from a default risk is expected to increase for the EU budget, even if not in a constant way during the period considered (2014-41).

Figure 10. Risk exposure of the budget based on bond maturity date and interest rate



Note: € billion

Source: Authors' elaboration based on European Commission and information by DG ECFIN.

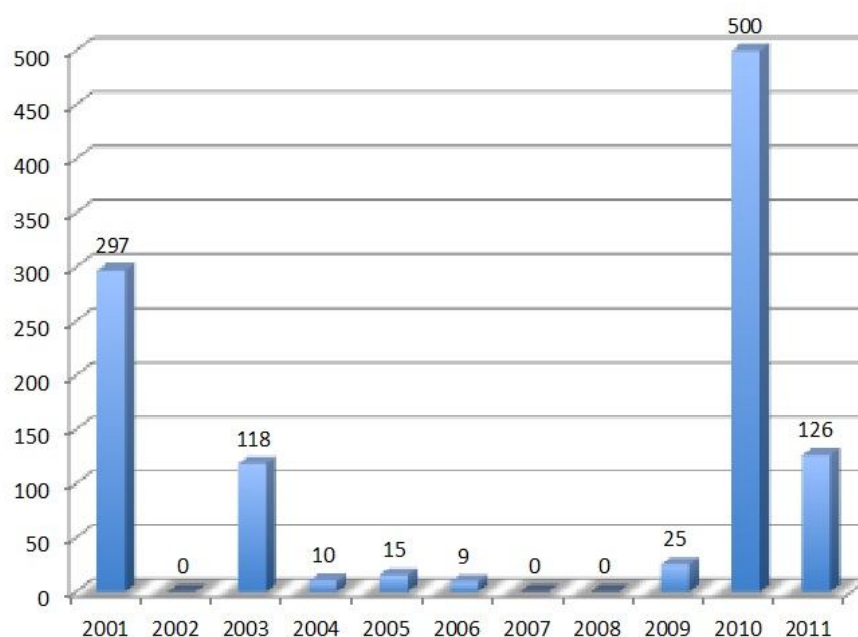
The spread of the maturity dates ensures that the yearly exposure of the budget remains limited, but in some years maturity dates have accumulated, in particular for 2015 and 2021. Even if the exposure may seem particularly high, this does not necessarily mean that these amounts represent a serious and severe risk for the EU budget. Indeed, the potential risk (i.e. the possibility for the EU budget to be unable to cover potential losses with the margin) is inherently linked to the future evolution of the multiannual financial framework, since most of the repayments fall beyond the present MFF and even beyond the next one. Still, at the moment there is no way to say what the needs will be in the future MFFs. For the 2014-20 MFF, the margins available between the payment appropriations and the own resources ceiling are estimated to be over 0.2% of GNI for most years, except for 2015 with 0.18% (based on the European Commission's MFF proposal; European Commission 2011g). At current prices, in 2015 this would amount to a margin of approximately €30 billion, well above the risk of €9 billion. Based on these estimations, it appears that there is no significant risk to the budget over the next MFF in terms of an over-restrictive margin.

Nevertheless, care should be taken to avoid accumulating bond maturities for the same years. In 2021, for example, there is again a spike of commitments, at nearly €11.5 billion. For that period there is no MFF programme to estimate the available margins, but imagining a situation in which the EU faces particularly important challenges and where an agreement for a new MFF allowed a substantial increase in payment appropriations, such a token budget entry could be limiting in practice unless the ceiling of own resources is also increased. It is too early to speculate on a post-2020 MFF, but history has not been kind to the EU budget ceilings.

## 2.4 Assessing the risk exposure from the MFA facility

The MFA offers two types of support – grants in the form direct assistance to the country requesting assistance and loans. The granting of MFA assistance has fluctuated over the years and it peaked in 2010: between 2001 and 2011 the loan component of the MFA disbursed reached €1.1 billion, while MFA grants disbursed amounted to €2.1 billion (see Figure 11). To assess the risk exposure resulting from the use of this MFS instrument, we find it better to concentrate only on the loans, as they create future liabilities and risks for the EU budget.

Figure 11. MFA amounts authorised by year during 2001-11



Note: € million

Source: Authors' elaboration based on European Commission (2011b) and information by DG ECFIN.

The risks linked to MFA assistance are similar to those under the BoP facility and the EFSM described in the previous section; however, the risks of a non-repayment of the MFA provided in the form of loans appear higher under this MFS instrument, because the assisted countries are not EU member states. Although the macroeconomic adjustment and reform programme agreed in the MoU and the oversight also provided by the IMF are expected to mitigate these risks, the prospects of a default by the beneficiaries appear more likely under this instrument.

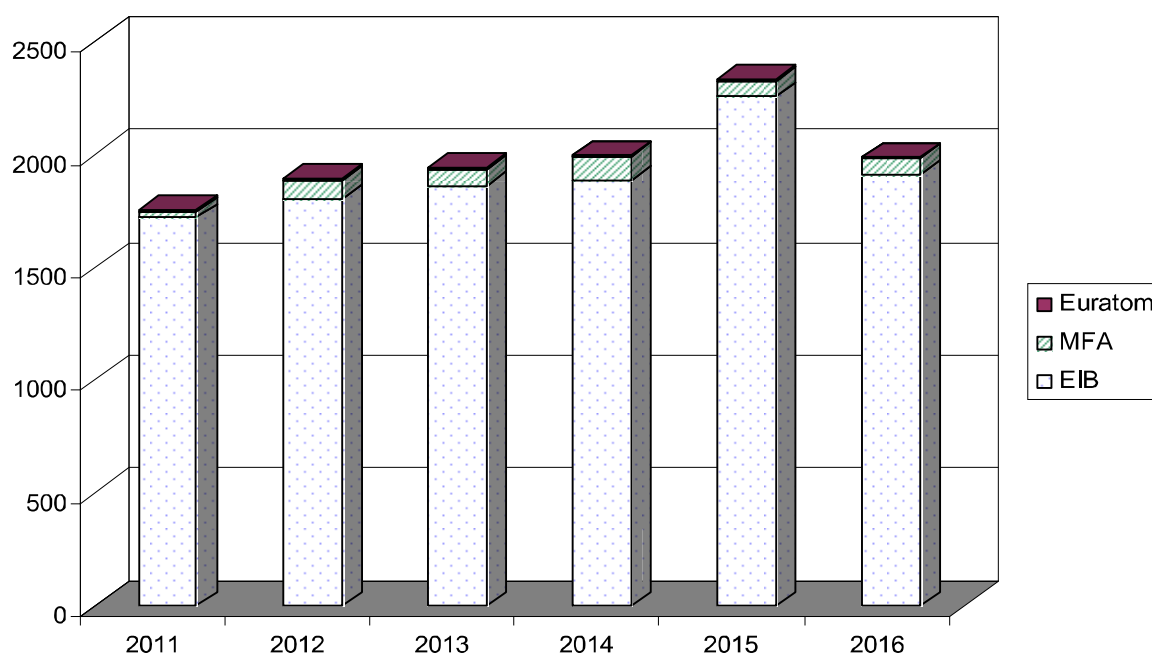
To address the possible adverse implications of non-repayment of the loan, the MFA uses as a guarantee for its loan operations the Guarantee Fund for external actions, which provides

guarantees to external loans by the EIB, Euratom and MFA. This is summarised in budget line 01 04 01 14, and is provisioned at a rate of 9% of the outstanding amount.

The guarantees are designed to cover due repayment and interest, based on a back-to-back agreement with the beneficiary countries that mirrors the commitments of the EU towards its borrowings. The overall costs and risks of the MFA are low compared with the other MFS instruments, as the amount of assistance is much lower.

Unfortunately, with the available information released by the Commission it is very difficult to gather figures on the yearly risk the MFA poses for the budget. But considering that the MFA represents just a fraction of the Guarantee Fund for external actions (in budget line 01 04 01 14), some conclusions could be drawn. Figure 12 shows the level of the risk borne by the MFA compared with the whole guarantee line. The figures do not take into account new commitments since 2010, as it has not been possible to obtain data on the repayment schedules from the Commission. Still, the results show that the risks posed for the EU budget by the MFA instruments are rather small in the coming years.

Figure 12. Total annual risk borne by the budget related to third countries for the period 2011-16



Note: € million

Source: European Commission (2011c).

While it is expected that the EFSM will be used less often as an MFS instrument in the coming years, the same conclusion cannot be drawn for the MFA. The number and scale of operations conducted under this mechanism are determined by the frequency and severity of economic and financial crises outside the EU, and the global economic conditions at present do not appear so bright. The Commission has nonetheless estimated that the MFA is expected to remain consistent with the current financial perspectives covering the period 2007-13 and the budgetary appropriations foreseen therein (European Commission, 2010).

## 2.5 The political issue of financing defaults at EU level

The analysis contained in the previous sections shows there is little risk that the stability of the budget is threatened by the operations owing to their present maximum size and



repayment schedules. It is clear, however, that in particular for the EFSM, the EU budget perhaps does not represent the most appropriate instrument to operate as a guarantee for large assistance programmes to member states. The inability of the EU budget to raise funding autonomously to finance itself and to establish 100% risk coverage for all operations limits the budget's capacity to play a larger role in offering effective MFS instruments to EU member states, especially for the greater economies of the euro area.

But there are other considerations that formally do not exist, which in practice are very important in defining the role of the EU budget in MFS assistance. What the rules and official documents do not mention are the distortions in the financing of a potential default through the budget's own resources system and the potential political cost of any default for the EU in terms of EU budget governance and operations. Theoretically there is an available margin and theoretically the member states have an obligation to cover any default by increasing their contributions to the budget based on their share of contributions to the budget. In practice, however, this is not so frictionless or uncontroversial.

In the case of a default by a member state under the EFSM or BoP, the member states are expected to contribute to the financing of the liability. It is important to note that the Own Resources Decision does not exclude the EFSM or BoP from the UK's correction mechanism. The UK House of Commons estimates that the UK's contribution to an eventual default would be require a contribution from the UK equivalent to its share of the EU budget contribution (Thompson, 2011). The regulations for the EFSM and BoP stipulate that the Commission will disclose the amounts for which the Commission has drawn from its own resources and request an increase if the cash reserves are not sufficient. This means *de facto* that the UK rebate applies, and also the reduced contributions to the rebate by Austria, Germany, Sweden and the Netherlands, as agreed in the Own Resources Decision of 2007 (Council Decision (2007/438/EC) of 2007.<sup>24</sup> Consequently, poorer member states, as well as the defaulting member states, would have to contribute a share of the cost that would be higher than their share based on GNI. Yet, the defaulting country may still be held liable to eventually repay the guarantee through the own resources budget lines 800 or 802. If the country reimburses the funds the problem with the UK rebate would be neutralised. Nevertheless, the controversy on how the funds are raised at the time of the default and the political impact on the size of the annual budget would remain.

This problem does not arise in the case of the MFA, as external expenditure of the Union is not accounted for in the rebate. The MFA, in fact, is covered by the external action budget line, which is not allocated expenditure in the terms of the Own Resources Decision and is thus not eligible for the UK rebate.

## 2.6 Implications of existing MFS programmes for national budgets

In addition to the risks directly connected to the EU budget (resulting from the EFSM, the BoP facility and the MFA, and analysed in the previous sections), another element has to be taken in account to depict how the EU budget could be affected by the current MFS assistance programmes: their impact on the member states' public finances. Given that the EU budget cannot incur a deficit, the borrowings undertaken under the three EU MFS instruments are direct and unconditional obligations of the EU but are guaranteed by the 27 EU member states, which are legally obliged by the TFEU to provide funds to meet all of the EU's obligations, according to Arts. 310 and 323. Thus in the case of a default of an assisted

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<sup>24</sup> See Council Decision 2007/436/EC, Euratom of 7 June 2007 on the system of the European Communities' own resources, OJ L 163/17, 23.6.2007.

country, the EU member states have to step in and cover all the possible losses not already covered by the EU internal mechanisms.

Consequently, fundamental to understanding the effect on the EU budget is assessing the potential impact on the national budgets of the member states of possible defaults of the euro area countries currently assisted by the euro area MFS instruments (the GLF and EFSF). Indeed, a devastating result for the public finances of the member states would not leave enough resources to fully bail out the EU budget.

So far, euro area member states have already disbursed €178 billion in official direct assistance to Greece, Ireland and Portugal, through the GLF (€53 billion) and the EFSF (a total so far of €125 billion). In relation to the losses under the EFSF assistance programme to Greece, neither Ireland nor Portugal have to provide official guarantees due to their 'step-out creditor' position, so all the EFSF potential losses in this programme would be split solely among the remaining member states (the mechanism is valid also for Ireland under the assistance programme to Portugal).

*Table 10. Exposure of euro area member states resulting from EFSF and GLF loans*

Country	Guarantees provided	As % of total euro area assistance	As a % of GDP
Germany	79,870	28.9%	3.1%
France	59,980	21.7%	3.0%
Italy	52,706	19.0%	3.3%
Spain	35,023	12.7%	3.3%
Netherlands	16,821	6.1%	2.8%
Belgium	10,230	3.7%	2.8%
Austria	8,189	3.0%	2.7%
Finland	5,288	1.9%	2.8%
Slovakia	2,925	1.1%	4.2%
Portugal	1,832	0.7%	1.1%
Slovenia	1,387	0.5%	3.9%
Ireland	868	0.3%	0.6%
Luxembourg	737	0.3%	1.7%
Cyprus	577	0.2%	3.3%
Malta	267	0.1%	4.2%
Greece	/	/	/
<b>Total</b>	<b>276,700</b>	<b>As euro area GDP</b>	<b>3%</b>

*Notes:* As of May 2011. € million.

*Sources:* Authors' calculations based on European Commission and EFSF data.

Tables 10 clearly shows how the potential losses due to the transformation of the guarantees provided by euro area member states under the GLF and the EFSF in actual expenses, could heavily impact on their public finances: this serious implication for euro area member states would materialize only in case of default of assisted countries, since the back-to-back mechanism applied under the EFSF and GLF assistance prevents other types of losses. Even without considering the possible bailout of the banking system, the potential losses for the official sector under the three assistance programmes would amount to €277 billion, around 3% of euro area GDP, posing serious threats to the guarantees offered by the member states to the EU budget, especially for those countries who already face difficulties in financing their expenditures. Although this section deals only with euro area MFS instruments, it is important to underline that also the United Kingdom, Denmark and Sweden could be subjected to potential losses due their bilateral loans provided under the international assistance programme to Ireland: their bilateral loans, however, amount only to €4.8 billion, thus the impact for national public finances would be minimal.

A final remark on the analysis of the effects of potential defaults is needed: at the moment the member states would be the first official actors incurring losses in the event of restructuring/default on the official assistance given to member states through the different MFS instruments. In fact, according to the current institutional framework, seniority is accorded only to the IMF, which would thus be the first institution to be repaid. Then, the Greek experience of debt restructuring has shown that the Eurosystem is actually treated as senior *de facto*, since all the Greek debt held by the NCBs of the euro area has been fully exchanged into safe EFSF bonds. Considering instead the degree of seniority of the different EU MFS instruments, the only instrument defined as senior is the ESM, while the EFSF, the EFSM and the BoP facility do not have any preferential creditor status. Thus in the case of the loans to Ireland and Portugal, there is not any agreed seniority of the EFSF against the EFSM or vice versa, and the legal effects of possible defaults on the countries' official assistance debt is uncertain, since the only declared senior in that instance would be the IMF.

### 3. Democratic control of the EP in the decision to use MFS instruments

#### Key Findings

##### BoP and EFSM

- The BoP assistance and the EFSM are EU funding programmes that are subject to the general EU legal framework, in which the European Commission is accountable to the European Parliament. Therefore, given that these two instruments are subject to the EU framework, there is a relatively adequate degree of public audit and parliamentary scrutiny of them.
- The Commission and the beneficiary member state conclude an MoU detailing the general, economic policy conditions laid down by the Council. Furthermore, the Commission provides regular reports to the Parliament and the Council on the borrowing and lending activities of the EU.
- Even though the European Parliament does not have the power to grant assistance under these programmes, as the loans are backed by the EU budget (budget lines have been created for the guarantees provided by the EU), the European Parliament can scrutinise the European Commission's actions with regard to these instruments.

**EFSF and ESM**

- The EFSF and ESM are independent entities established by agreement or international treaty among the euro area member states and are thus outside the framework of the EU treaties.
- This means that democratic control of the actions of the member states with regard to the EFSF and ESM would mostly be exercised by the national parliaments. Yet this would only partially ensure democratic control at EU level, as the national parliaments tend to focus on the position of their country and not on the functioning of the programme as a whole.
- The constituting documents of the EFSF and the ESM give the Commission the important roles of negotiating the policy conditionality attached to financial assistance and of monitoring compliance with it. Thus, even though the European Parliament is not directly involved in the ESM, it can exercise a degree of democratic scrutiny regarding the Commission's use of EU resources for its work in the ESM framework. This role falls under the regular powers of the EP established by the treaties and provides certain checks of the work by the Commission.

Given the important amount of funds involved under the MFS instruments, it is extremely important to have in place systems for ensuring the democratic control of their use. This issue can be separated between the MFS instruments that are subject to the EU framework (BoP and the EFSM) and those that are outside of it (EFSF and ESM). This section does not deal specifically with the MFA, following the entry into force of the Lisbon Treaty, MFA decisions are no longer taken by the Council alone, but in accordance with the ordinary legislative procedure (co-decision between the European Parliament and the Council), which ensure a full democratic control of the European Parliament in the definition of assistance activities to third countries.

**3.1 BoP assistance programmes and the EFSM**

The BoP assistance and the EFSM are EU funding programmes that are subject to the general EU legal framework, in which the European Commission is accountable to the European Parliament. Therefore, given that these two instruments are subject to the EU framework, there is a relatively adequate degree of public audit and parliamentary scrutiny of them.

Even though the European Parliament does not have the power to grant assistance under these programmes, as the loans are backed by the EU budget (budget lines have been created for the guarantees provided by the EU), the European Parliament can scrutinise the European Commission's actions with regard to these instruments.

Under the BoP and the EFSM, the Commission and the beneficiary member state conclude an MoU detailing the general, economic policy conditions laid down by the Council. The Commission transmits these MoUs to the European Parliament and to the Council (Council Regulation No. 407/2010 of 11 May 2010). For each member state receiving a loan under the BoP or the EFSM, the Commission carries out a quarterly assessment on compliance with the agreed macroeconomic and structural objectives of the programme before a further instalment is disbursed and these reports are then made public.

Furthermore, the Commission provides regular reports to the Parliament and the Council on the borrowing and lending activities of the EU. Under the BoP and EFSM, the loans are also

accounted for in the annual financial statements of the EU and thus subject to political accountability by the Parliament (the BUDG and CONT Committees in particular) by means of the budgetary adoption and discharge procedures.

In both the case of the BoP and the EFSM, the European Court of Auditors (ECA) has full audit rights and can perform financial and performance audits of all the borrowing and lending activities of the Commission.

### 3.2 EFSF and ESM

The EFSF and ESM are independent entities established by agreement (EFSF, 2011b) or international treaty (ESM, 2012) among the euro area member states and are thus outside the framework of the EU treaties. Thus, as intergovernmental, non-EU entities, the EFSF and the ESM do not fall under the direct supervision of EU institutions and cannot be directly held accountable in the EU's institutional framework. The European Parliament, the ECA and the Court of Justice of the EU have rather limited roles in relation to these instruments: the ECA does not have a separate audit right of its own and the Court of Justice can only deal with disputes that are brought to it by an ESM member.

This means that democratic control of the actions of the member states with regard to the EFSF and ESM would mostly be exercised by the national parliaments. Yet this would only partially ensure democratic control at EU level, as the national parliaments tend to focus on the position of their country and not on the functioning of the programme as a whole.

The European Parliament indicated in its Resolution of 23 March 2011<sup>25</sup> that the creation of the ESM outside the EU's institutional framework could create problems for its democratic control. More recently, other concerns have been expressed by some of the supreme audit institutions (SAIs) at the national level (Kees, 2012), specifically that the Treaty lacks sufficient provisions for ensuring an effective audit and that the arrangements existing in the ESM Treaty for transparency and accountability are weak.

Still, the constituting documents of the EFSF and the ESM give the Commission the important roles of negotiating the policy conditionality attached to financial assistance and of monitoring compliance with it. Thus, even though the European Parliament is not directly involved in the ESM, it can exercise a degree of democratic scrutiny regarding the Commission's use of EU resources for its work in the ESM framework. This role falls under the regular powers of the EP established by the treaties and provides certain checks of the work by the Commission.

Like the BoP or EFSM, each member state that receives assistance from the EFSF or the ESM is subject to regular assessments of the fulfilment of the policy conditionality. The MoU signed with these countries in relation to the EFSF are transmitted to the European Parliament and this practice will continue under the ESM. The Commission has also proposed a new regulation (European Commission, 2011f) that aims at ensuring consistency between the processes established under the EFSF Framework Agreement and the ESM Treaty, as well as the EU's multilateral surveillance framework (Buti, 2012).

Concerning an audit of the EFSF, its Framework Agreement does not include audit rights for the SAIs. But as a company registered in Luxembourg, it is subject to the Luxembourgish

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<sup>25</sup> European Parliament resolution of 23 March 2011 on the draft European Council decision amending Article 136 of the Treaty on the Functioning of the European Union with regard to a stability mechanism for Member States whose currency is the euro (P7\_TA(2011)0103).



legal requirements on auditing. Its articles of incorporation also provide for independent external auditors, adding to the existing, internal auditing process.

According to Art. 29 of the latest version of the ESM Treaty, the external public audit of the mechanism is to be carried out by a Board of Auditors, consisting of five members appointed by the ESM Board of Governors. One of these is to come from the European Court of Auditors, with two others (appointed on a rotational basis) to come from the supreme audit institutions of the ESM member states. The Board of Auditors will be able to undertake independent audits and will have full access to all the ESM documents.

The annual audit report of the Board of Auditors will be submitted to the Board of Governors of the ESM, which will then send it to the national parliaments and the SAIs of the ESM member states. The European Parliament is not mentioned in the ESM Treaty as being included in this process. As the by-laws of the ESM are currently being drafted, these provisions could potentially be extended to include the European Parliament in the list of institutions receiving the annual audit report by the Board of Auditors as well as an expansion in the audit tasks of the latter.

#### 4. Potential future developments of EU MFS assistance

##### Key Findings

- To solve the systemic flaws of the euro area, different solutions have been proposed, requiring the need for a broader mandate for the ECB, a reform of the banking system and the creation of a fiscal union. The latter would imply the move from the current system, in which each country is responsible for its own debt, to a system of joint and several guarantee, in which all countries are jointly responsible for the common debt issued as Eurobonds.
- The gains from the eurobonds of increased liquidity and lower borrowing costs could be of minor relevance. The real benefit of the mutualisation of national sovereign debts would come from restoring confidence in the euro area, reassuring markets on the solvency of member states.
- Most of the schemes proposed in the recent period, entail a joint and several guarantee limited to a certain amount of the national debt; few have a joint and several guarantee on the whole national debt and only one takes into consideration a pro-rata liability. However, none of them is based mainly on the use of guarantees offered by the EU Budget, therefore resulting in almost no impact on the resources of the Union.

The financial crisis in Europe has highlighted not only the lack of enforcement of existing fiscal rules but also persistent, large, current payment imbalances within the Union and the euro area, reflecting substantial competitive imbalances.

In their attempts to reduce competitive imbalances, peripheral countries of the euro area have embarked on a large widening of public sector deficits, provoking a loss of confidence by the markets in the capacity of the countries to honour their sovereign debts. Indeed the loss of confidence, if profound, may lead to a liquidity crisis, i.e. the countries would be unable to finance their debt rollover at reasonable interest rates. With increasing interest rates the liquidity crisis may then turn into a solvency crisis (De Grauwe, 2011). Amid the crisis, the private financing from the surplus countries has halted and the financing burden

of external deficits has mostly fallen on official channels and the ECB, along with official assistance programmes (EFSM and EFSF). Restoring private capital flows from the centre to the periphery largely depends on restoring confidence in the payment imbalances and the sustainability of sovereign debts. Euro area member states appear more vulnerable to liquidity crises than non-euro member states with similar levels of deficit and public debt. This is a consequence of inherent flaws in the European financial system.

First, the monetary union suffers from a “foreign currency” syndrome as defined by De Grauwe (2011), whereby member states have lost the economic policy instruments of interest rates or exchange rates and need the permission of an independent institution, which they do not control, to increase liquidity. In addition, the ECB and NCBs are not allowed to provide monetary financing to member states, or notably, to purchase sovereign bonds in the primary market. The euro is therefore like a foreign currency, since euro area member states cannot print it. Moreover, there is only one monetary policy that must fit all regardless of divergent prices and wages, productivity, market structure, public spending and taxation (Micossi, 2011b).

Second, there is a strong interdependence between banking systems and sovereign debts. On one side, member states are responsible for rescuing national banks, and therefore they are highly vulnerable to the costs of the banking crisis (Pisani-Ferry, 2012). On the other side, euro area sovereign debts are largely held by national banks, with bias for the bonds of the member state of the bank’s headquarters but also with significant exposures to other countries’ sovereign debts. This is partly due to banking regulation and regulatory capital requirements, which provide for zero-risk weighting for euro area sovereign bonds and their acceptance by the ECB as collateral in its liquidity policies. This interconnection implies that doubts about the sustainability of sovereign obligations are transformed into doubts about the banking system (Micossi, 2011b).

According to Schoenmaker and Gros (2012), a European-level banking system would break this vicious circle and help to stabilise the euro area. Yet “the European sharing of banking-sector risk is only feasible if (national) fiscal weaknesses do not threaten banking stability”. In this regard, according to the authors banks should diversify their sovereign risk (e.g. applying large exposure limits to sovereign debt) and national fiscal positions should be sufficiently sound to not seek financing from local banks. To this end the authors propose the establishment of a European Deposit Insurance scheme and a resolution authority to stabilise the retail deposit base and resolve troubled cross-border banks.

Lastly, the ‘no bailout’ clause provided in Art. 125 TFEU excludes any possibility of direct fiscal transfers from the EU or one member state to another, in order to help a member state meet its debt obligations, as well as the assumption of guarantees for those liabilities. As a consequence any direct purchases of sovereign debt in the primary market seems banned, as this could entail a direct assumption of the commitments of a member state.

Art. 125 TFEU states that neither the Union nor a member state “shall be liable for or assume the commitments of” any public body or entity of any member state, “without prejudice to mutual financial guarantees for the joint execution of a specific project”. Thus Art. 125 allows guarantees for a ‘joint project’, which may well include financial assistance to a member state, provided that a) financial assistance is for the purpose of preserving collective financial stability, i.e. to avoid unwanted systemic fallout from a local crisis; and b) financial assistance does not result in a fiscal transfer to a member state.

The Treaty leaves broad room to grant financial assistance to the member states of the Union and the euro area in order to preserve systemic stability. Acts of financial assistance that would be qualified as permissible could be extending a loan to roll over sovereign debt, as

has been done, but also intervening in distressed markets to restore normal conditions, or exchanging eurobonds for sovereign debt held by the private sector, provided these operations are undertaken at market prices.

#### **4.1 Existing proposals for new EU MFS instruments and their implications for the EU budget**

To solve the systemic flaws of the euro area, different solutions have been proposed. In particular, Pisani-Ferry (2012) emphasises the need for a broader mandate for the ECB, a reform of the banking system and the creation of a fiscal union. The latter would imply the move from the current system, in which each country is responsible for its own debt, to a system of joint and several guarantee, in which all countries are jointly responsible for the common debt issued as eurobonds. It is widely recognised that taking collective responsibility for the sovereign debts of member states is essential to reassure financial markets.

The idea of substituting national sovereign debts with the common issuance of eurobonds is an old one, but the reasons and expected benefits have changed over time. When the idea was first explored in the Giovannini report (2000), the aim was to enhance liquidity and market efficiency in the euro area. The crisis has accelerated the debate on common bonds, which are now considered an instrument to solve the liquidity crisis in the short term and to ensure financial stability in the long run. Eurobond proponents argue that in the short term, the common issuance, which usually implies a joint and several guarantee, would make these assets super-safe, decrease borrowing costs and make the debt of certain member states more sustainable. In the long term, better-rated bonds would make the euro area more stable. Also, the large-scale conversion of national bonds into eurobonds would reduce the risk that a confidence crisis in relation to weak countries would spread all over the euro area.

Eurobonds would also increase the size of the corresponding market, thus protecting member states that have lost control over their currency from a liquidity crisis (De Grauwe 2011). As a highly liquid asset, eurobonds would be able to compete with US Treasury bonds, helping the euro to be the second global reserve currency. In addition, eurobonds would have a positive impact on the banking system, since banks would be exposed to the same safe assets.

Nevertheless, there are also several concerns arising from the mutualisation of debts. First of all, the joint and several liability would seem to violate the no bailout clause of the Treaty (Art. 125); therefore in some cases its revision would be necessary. Furthermore, the mutual guarantee would weaken market discipline and enhance moral hazard. Indeed, as member states would be jointly accountable for the eurobond, some countries could rely on this guarantee and behave irresponsibly.

To counter moral hazard and make eurobonds more acceptable to public opinion in more disciplined countries, member states should accept some elements of a 'fiscal union'. This implies that freedom to issue bonds would be lost or reduced, and member states would have to accept an ex-ante approval or strict monitoring of their national budgets (or even sanctions) from an EU institution or an independent body. This would likely interfere with national constitutional rules on the approval of the budget and powers of national parliaments.

Still, according to Gros (2011b) even the best-designed institutional framework could not suffice to maintain incentives for some member states to pursue fiscal solidity and good economic performance. This is because there are extreme differences in the member states' political systems and administrations. Moreover, peer oversight in the Council has never

worked and sanctions are not effective because they are not time consistent: when a country is in trouble, it is not punished but receives help. The author concludes that a political union is essential for eurobonds but even then this scheme could only work if there were low levels of debt, because if debt levels were high the market would consider eurobonds a large transfer of risk and expect that future accumulations of debt would be treated in the same way.

In addition, the expected advantages of eurobonds would be unfairly spread. While the lowly rated sovereigns would benefit from a reduction in borrowing costs, the highly rated issuers would in all likelihood lose on this score. In any case, as Gros (2011b) pointed out, given the yield differentials between large and small AAA-rated countries (in the order of 30-50 basis points) the liquidity gains would be minor.

In sum, the gains from the eurobonds of increased liquidity and lower borrowing costs could be of minor relevance. The real benefit of the mutualisation of national sovereign debts would come from restoring confidence in the euro area, reassuring markets on the solvency of member states.

In this regard, a number of schemes for the common issuance of eurobonds have been proposed and are analysed in the subsections below (summarised in Table 13 at the end of this section). As a general observation, most of the schemes described below propose a joint and several guarantee limited to a certain amount of the national debt; few have a joint and several guarantee on the whole national debt and only one takes into consideration a pro-rata liability. However, none of them is based mainly on the use of guarantees offered by the EU Budget, therefore resulting in almost no impact on the resources of the Union.

#### 4.1.1 *Blue bonds and red bonds*

According to Delpla and Weizsäcker (2012), the joint and several guarantee would cover the national debt only up to 60% of GDP.<sup>26</sup> This part of the debt would be pooled to issue a common bond, the 'blue bond', benefitting from the joint and several guarantee of participating members. The debt exceeding 60% of GDP would remain national and on this part each member state would issue a 'red bond', for which it would be uniquely responsible. A blue bond would benefit from seniority status, and would therefore be repaid before any other public debt (except IMF debt). It is likely that the seniority status, the liquidity gains and the joint and several guarantee of participating members would always warrant the triple-A rating for the blue bond.

An independent body (a Stability Council) would propose the annual allocation of the blue bonds, which would be approved by national parliaments. Any member state could decide neither to issue the blue bond nor to provide its guarantee for a given year. The 'opt-out' of a major participant would undermine the confidence in the entire scheme; this threat would be an incentive for the fiscal discipline of other countries. The Stability Council and the possible opt-out would also work as a safeguard to avoid any attempt by countries to increase the 60% of GDP threshold for borrowing in the blue bond. To counter the moral hazard, participation in the scheme would not be automatic but subordinated to enhanced fiscal credibility, and the blue bond would be allocated according to the principles of the Stability and Growth Pact and notion of general fiscal sustainability.

The red bond, issued by national treasuries, would be 'junior' to the blue one and hence it would be repaid only when the latter has been fully honoured. The bailout of red bonds by

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<sup>26</sup> The 60% ratio makes reference to the Maastricht criterion; it is generally considered an easily sustainable debt.

any EU mechanism (EFSM, EFSF or ESM) would not be permitted. Therefore, these instruments would be smaller in size, because they would finance only primary deficits. As a default of red bonds would not affect the blue tranche, it would be less disruptive and hence more likely. To allow for an 'orderly default', red bonds should be kept out of the banking system; they would not be eligible for ECB refinancing operations and banks holding this debt would be subject to higher capital requirements.

It is likely that the 'junior' status, the reduced liquidity and the risk of default would increase the borrowing costs of the red bonds. Critics fear that "low-rated sovereign borrowers would be confronted [by] prohibitive costs on red national bond[s] and be immediately forced into debt restructuring as they could no longer find buyers for the part only guaranteed nationally" (Gros, 2011b). Delpla and von Weizsäcker reply that in order to reduce borrowing costs for red bonds, weaker countries would be forced to pursue fiscal discipline, thus acquiring fiscal credibility. This would have the effect of reducing the overall debt, and the borrowing costs for red bonds would become 'quite reasonable'.

Moreover, critics have called into question the real gains in terms of total borrowing costs, highlighting that the increase of red bond costs would offset the decrease in the yield on blue bonds, leaving the average constant. But Pisani-Ferry has pointed out that member states would in any case have the advantage of maintaining access to issuance, at least for the amount corresponding to the redemption of maturing blue debt (Pisani-Ferry, 2012). For the authors, the blue and red bond scheme could even be compatible with Art. 125 TFEU. On the basis of the Maastricht Treaty, a debt of 60% of GDP is deemed to be sustainable; therefore, the joint and several guarantee would apply only in the case of exceptional situations, such as a natural disaster, and in such a case, a bailout is allowed as foreseen in Art. 122 TFEU (Delpla and von Weizsäcker, 2010).

#### 4.1.2 Eurobills

Hellwing and Philippon (2011) propose the issuance of 'eurobills': short-maturity securities (of less than a year) jointly guaranteed for a debt of up to 10% of GDP. Member states would finance the rest of their needs through longer-dated bonds (two years or more). Member states would no longer be allowed to issue short-term national bonds. According to the authors, the main aim of this proposal is to prevent a liquidity crisis that eventually could turn into a solvency crisis. The short maturity would make eurobills effectively and credibly senior to other debts. The authors point out that "it is difficult to make long-term claims effectively senior because borrowers can engage in side contracts, hidden pledge[s] of assets, risk shifting and maturity shortening. These issues only become more relevant when we move from corporate to sovereign borrowing."

The credible seniority and the limited amount of issuance would probably make the joint and several guarantee acceptable to strong countries, whose participation in the programme is important also to prevent their short-term papers from competing with eurobills. To counter the moral hazard effect of mutualisation, participation in the issuance would be conditional on fiscal discipline and the country may be asked to pay a penalty interest rate if it does not meet the related criteria. Moreover, exit procedures are envisaged, representing a transparent, predictable and costly incentive for countries to stay in the scheme as well as a feature to enable the scheme to perform well. Strong countries would provide the bulk of the initial guarantee and weaker countries could be asked to pay a small premium over the eurobill rate (maybe related to their fiscal and debt situation). This premium could go into a fund for insurance (or be used temporarily) to offset the higher costs for others.

The seniority and the cap on the amount of the issuance would minimise the moral hazard. First, as at least every year eurobills would have to be rolled over, the country asking for the



short-term financing would be subject to an assessment of its market discipline. Second, the 10% limit on issuance would prevent eurobills from bailing out insolvent countries, as this amount would probably cover only a small part of the country's refinancing needs in a given year. Therefore the eurobills would not violate the no bailout clause and an international treaty may suffice. To avoid the negative feedback between a sovereign and a banking crisis, eurobills would also receive special prudential treatment to become the favoured asset for banks to satisfy Basel III liquidity ratios. The joint and several guarantee of member states would be relatively well defined and limited. Thus the objections of the German Constitutional Court may be overcome. The German Court stated that the Bundestag cannot assume "liability for other States' voluntary decisions, especially if they have consequences whose impact is difficult to calculate" (Philippon, 2012).

#### 4.1.3 *European redemption fund*

The German Council of Economic Experts (GCEE 2011) proposes a separation of national debt accumulated so far into a part below the 60% of GDP that – in contrast to the blue bond scheme – remains national and a part exceeding it, which would be transferred to a European redemption fund (ERF). The ERF would benefit from a joint and several guarantee of member states, thus providing affordable refinancing costs for highly indebted countries. All euro area members would be able to participate in the ERF but those under a structural adjustment programme could join the ERF only after the successful conclusion of the programme. From the start, the debt assumed by the ERF would be limited in time and volume. The transfer would be made for a fixed amount contractually agreed in advance, which could not be subsequently increased. The limitation in time and the fixed amount would enable the scheme to respond to objections by the German Constitutional Court. During the 'roll-in' phase, (whose length depends on the maturity profile of outstanding national debt over three to five years), the ERF would issue bonds up to the fixed amount to cover the refinancing needs of participating countries.

In return, each country would be obliged to repay its own transferred debt over a period of 20-25 years. At that time, the ERF would be fully redeemed and would then expire. Unlike other schemes, these eurobonds would be temporary and limited in volume, and their main objective would be achieving the full redemption of the excessive debt rather than financing the joint debt. To counter the moral hazard, participation would be subject to strict conditionality for member states:

- i) devoting a portion of tax revenues (VAT or income tax or both) directly to the ERF for fulfilling the payment obligations;
- ii) guaranteeing national debts in the ERF through a 20% deposit in the form of foreign currency or gold reserves. This collateral would not be pooled;
- iii) defining a medium-term consolidation and growth strategy;
- iv) committing not to raise the national debt above 60% of GDP. To this end, debt brakes would be introduced into national constitutions; and
- v) agreeing a burden-sharing of risk among the solvent participating countries.

If countries failed to meet these commitments during the roll-in phase, it would be immediately interrupted, while if the failure happens afterwards, countries would forfeit collaterals. According to the authors, the ERF could be based on an international treaty, thus changes in the EU Treaty would not be necessary. At this stage this scheme has received positive comments. In particular, Verhofstadt (2012) considers the "ERF a cheaper and more effective option than anything else currently being considered". Moreover, the ERF "would

be enough to act as a firewall for the likes of Italy or Spain, for whom the current EFSF and permanent ESM bail-out funds combined...would be insufficient”.

A scheme similar to the European redemption fund has been proposed by Vincenzo Visco (2011b). The author proposes to transfer to a jointly guaranteed fund the national debt exceeding 60% of GDP, thus re-establishing a level playing field among countries. The fund would issue bonds at 25-30 years. As the EU does not have the fiscal power to grant this debt, however, the market could view it as ‘junk bonds’. Thus Visco proposes the application of a financial transaction tax to finance the transfer. An earmarking of taxes from weaker countries is envisaged to compensate the increase of costs for stronger member states. The burden of compensation would be shared among weaker countries, according to the benefit they receive from the creation of the new European debt. Highly indebted countries should commit to fiscal discipline and structural reforms.

#### 4.1.4 *Euro-Fund*

Christophe Chamley (2012) also highlights the need to devote a tax to the common debt. He proposes the establishment of a Euro-Fund, an independent institution in charge of purchasing 50% of the national public debt by issuing eurobonds. The participating countries, by treaty, would transfer to the Euro-Fund a specific tax with priority on any other expenses. Each member state would have a separate balance in the Euro-Fund. Any excess or deficit of the tax revenues would determine a modification of the debt of the member state in the Euro-Fund, which in any case would not exceed 60% of its GDP.

Tax funding would ensure the credibility of the eurobonds and solve problems related to the fiscal transfer. Countries would maintain a sovereign debt that would be priced in the market. The interest rate on these sovereign bonds would obviously be higher than that on eurobonds and would depend on a country's commitment to fiscal stability.

#### 4.1.5 *E-bonds*

Monti (2010) proposes the institution of a European Debt Agency (EDA) in charge of borrowing on a large scale through the issuance of E-bonds, and then of on-lending to member states. The lending to member states should not exceed 40% of a country's GDP. Governments would continue issuing their national debt, for which they would remain individually responsible, to cover their finance needs exceeding the 40% of GDP threshold. This mechanism would provide cheaper funding for member states. The EDA would be considered a preferred creditor, compared with holders of their debt floating on the market, theoretically increasing the possibility of a default only on the latter. In turn, this should increase market pressure and yields on the floating debt, triggering a stronger incentive for member states to quickly reduce such debt through sound fiscal policies. To make the proposal immediately attractive, it should be made clear that fiscally responsible countries would not be forced to bail out less disciplined member states. Therefore more effective multilateral oversight, tackling moral hazard, could be envisaged through an increase in the sensitivity of markets to national budgetary developments, and by making the possibility of a default on national debt more manageable by other EU countries, hence more likely and easier to price by the markets.

In line with Monti's proposal, Juncker and Tremonti (2010) envisage that the EDA would gradually issue bonds up to 40% of euro area GDP and that of each member state. Moreover, it would finance national issuance (up to 50% or 100%) and offer a switch between E-bonds and national bonds at a discount option. Thus E-bonds would decrease market pressure and avoid moral hazard; disruption on the primary market would be precluded and, because of the switch, bank losses would be more transparent. Finally, the EDA would reap a profit

from the purchase of the national debt securities of the member states at a discounted rate, thereby reducing the cost of borrowing.

#### 4.1.6 *Eurobonds for triple-A countries*

Georg Erber (2012) proposes that the EDA pools the debt of AAA-rated countries. Countries losing their triple-A rating would start to issue their own government bonds again or turn to the EFSF. Hence, member states would be under constant pressure to maintain fiscal discipline under the control of rating agencies and financial markets.

In our view, this proposal fails to offer a solution to the current crisis. In addition, it gives rise to some concerns about the attribution to the credit rating agencies of such power to decide on entry and exit in the eurobond scheme.

#### 4.1.7 *European safe bonds*

The Euro-nomics Group (Brunnermeier et al. 2011) proposes that the EDA buy on the secondary market sovereign bonds from members of the euro area up to 60% of euro area GDP. The weight of each national debt in the EDA portfolio would be fixed as a share of the GDP of the issuing country. Countries under a financial assistance programme would not be able to participate in the scheme, at least in the initial phase.

The EDA would issue two kinds of securities: European safe bonds (ESBies) and European junior bonds (EJBs). The first kind would be 'senior' and would receive principal repayment. ESBies would be a safe asset with a triple-A rating and a yield similar to German Bunds. The second kind would be 'junior' and would be the first to be hit in the event of one or more sovereign defaults. Nevertheless, the EJBs could be attractive for institutional investors because EJBs would provide a high return. To create further liquidity for EJBs, the EFSF could act as the market-maker ready to buy and sell EJBs.

The EFSF should be well capitalised, and a credit line with the ECB collateralised by EJBs could be envisaged. If the EFSF could not repay its credit line from the ECB, member states – according to the Treaty – would automatically recapitalise the ECB. The authors affirm that this scheme has all the advantages of eurobonds without their political constraints: it creates a pool of safe assets redirecting capital flows from across national borders to across tranches; it stabilises financial markets by providing liquidity; as a pure re-packaging of existing debt, it does not require further funding from participating members; and it does not involve a joint and several liability, and hence there is no need to change the Treaty.

Capital regulation and ECB policy should be modified to incentivise banks to hold mainly ESBies rather than national bonds and to make them acceptable as collateral by the ECB. As a consequence, the perverse link between banking and sovereign credit risk would be rescinded and demand for ESBies boosted. Some critics argue that "the suspicion about the potential fragility of a securitization of these assets cannot be dismissed.... Therefore this solution faces a credibility gap." Moreover, the scheme does not appear to address the moral hazard problem, insofar as no conditionality is explicitly required (Erber, 2012).

#### 4.1.8 *Stability bonds*

The European Commission, in its Green paper (2011a) proposes three options for "Stability bonds" jointly issued by member states, requiring strengthened fiscal oversight.

The first option implies a full substitution of the national debt with stability bonds issued by the EDA with joint and several liability of all the participating members. This approach would create a large market for these bonds, thus enhancing liquidity and breaking the sovereign-banking system link. To reduce the high risk of moral hazard, budgetary

discipline and commitment to structural reforms would be required. This framework would call for further economic, financial and political integration, and most likely treaty amendments.

The intermediate scheme explicitly recalls the blue/red bond approach and the EU redemption fund proposal.

The third option provides for the partial substitution of national debt with stability bonds underpinning a pro rata guarantee of member states. This approach has limited effects in terms of stability and integration of the financial market but also in terms of the risk of moral hazard. The re-financing cost for some countries would be unchanged or slightly lower since the credit qualities of a stability bond would be, at best, the weighted average of the credit qualities of the member states. To boost the demand for these instruments, member states could provide seniority through changes of secondary legislation and collateral, such as cash, gold reserves and/or the earmarking of specific revenues. These bonds would have some similarities to EFSF bonds, although the latter are meant to help finance member states facing a sovereign debt crisis while the stability bonds would be available to all member states independent of crisis situations.

*Table 11. Implications for national budgets and the EU budget of existing proposals for new EU MFS instruments*

MFS instrument proposal	Implications for national budgets	Implications for the EU budget
Blue/red bonds	<ul style="list-style-type: none"> <li>- Fiscal discipline</li> <li>- Possible increase of general borrowing costs or at least for the red bonds</li> <li>- If 'activation' of a joint and several guarantee on the blue bond</li> </ul>	No implications
Eurobills	<ul style="list-style-type: none"> <li>- Fiscal discipline (and penalty if not met)</li> <li>- Small premium to be paid by weaker countries</li> <li>- If 'activation' of a joint and several guarantee</li> </ul>	No implications
European redemption fund	<ul style="list-style-type: none"> <li>- Devoting a share of tax revenue to the ERF</li> <li>- Putting up collateral for the ERF</li> <li>- If 'activation' of a joint and several guarantee</li> </ul>	No implications
Euro-Fund	<ul style="list-style-type: none"> <li>- A transfer to the Euro-Fund of a specific tax</li> <li>- If 'activation' of a joint and several guarantee</li> </ul>	No implications
E-bonds	<ul style="list-style-type: none"> <li>- Fiscal discipline</li> </ul>	No implications, but the EDA institutional arrangements are unclear
Eurobonds for AAA-rated countries	<ul style="list-style-type: none"> <li>- Fiscal discipline</li> <li>- If 'activation' of a joint and several guarantee</li> </ul>	No implications
ESBies	<ul style="list-style-type: none"> <li>- Recapitalisation of the ECB in the event of an EJB 'default'</li> </ul>	No implications, but the EDA institutional arrangements are unclear
Stability bond	<ul style="list-style-type: none"> <li>- First option: fiscal discipline and if 'activation' of</li> </ul>	No implications, but in the

	a joint and several guarantee - Second option: see blue/red bonds - Third option: 'activation' of a pro rata guarantee	first option the EDA institutional arrangements are unclear
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Source: Authors' elaboration.

## 5. Conclusion

Table 12. Overview of MFS instruments and their implications for the EU budget

	EU common MFS instruments			Euro area MFS instruments		
	BoP Facility	EFSM	MFA	GLF	EFSF	ESM
<i>Lending capacity</i>	50	60	–	70	440	500
<i>Remaining lending capacity</i>	34	11.5	–	–	216	500
<i>EU budget implication</i>	Full guarantee for date of repayment			Indirect, thought their impact on euro area member states public finances		

Note: € billion

Source: Authors' elaboration.

The proliferation of EU instruments for macro-financial stability has been remarkable in recent years (Table 17) and has raised, prior to the concerns at the financial level, questions about their democratic accountability. For the two MFS instruments designed to assist member states and subject to the EU legal framework (the BoP and the EFSM) there is a relatively adequate public audit and parliamentary scrutiny. This is not entirely the case for the two MFS instruments managed by euro area member states, the EFSF and from July 2012 the ESM. As the ESM is supposed to have a permanent character it is even more important that its provisions for democratic control, currently deficient, should be strengthened. More information sharing and public scrutiny are needed for these instruments to enjoy the trust of European citizens. The by-laws of the ESM are still under negotiation and they should be used to fix the shortcomings in democratic accountability. In the case of the ESM, the results of the audits carried out by its Board of Auditors should be made public. Additionally, to improve the political scrutiny of the ESM the European Parliament should be granted a similar level of access to information as the national parliaments. The monitoring activities carried out by the European Commission and the ECB in the framework of the ESM Treaty could also be made subject to an audit by the European Court of Auditors – a measure that would allow for increased scrutiny by the European Parliament.

From the financial point of view, the EFSM and the BoP facility are guaranteed by the margins of the EU budget between payment appropriations and the ceiling of the budget. The analysis provided in the previous sections has shown how the margins are large enough in this and the next MFF to cover programmed defaults by currently assisted member states. However, it emerges how there is a need to clarify how a default will be covered by member states and the participation by the defaulting member state(s). In theory, the UK rebate distortion in case of a BoP or EFSM default should not pose a problem, as the defaulting member state(s) will still be liable to the EU budget and would have to repay the assistance it received: the Own Resources budget lines 800 (for the BoP assistance) and 802 (for the EFSM)



have been created exactly for this purpose. In addition, the first potential default can only take place in the next MFF and the Own Resources decision that will be in force then is still under discussion. However, in practice this matters. The defaulting member state(s) would have had to contribute to the EU budget to cover its share of the amount through the Own Resources mechanism, including an additional amount caused by the rebates. This payment also would not count as a repayment of the loan, the country would be held liable for the full amount. Thus, in the future Own resources decision, macro-financial assistance of any kind should clearly be excluded from any rebate calculations and maybe incorporate special clauses on the own refinancing of the default by the defaulting member state: a possible solution to this conundrum would be to exclude this operations from the UK rebate and not to require the defaulting member states to contribute to Own resources to recover the funds. In case of a repayment, the member states would be reimbursed based on shares of their contribution.

Another issue that needs clarification is the treatment of the fines to countries failing to maintain fiscal discipline and are penalised under the 'six pack' rule (Art. 12 of Council Regulation (EU) No. 1177/2011)<sup>27</sup>. Regarding fines imposed by the Council to EU member states in virtue of Art. 126 of the TFEU, the Regulation provides that such fines shall constitute other revenue, as referred to in Article 311 TFEU, and shall be assigned to the EFSF and in the future to the ESM, thus without constituting a source of revenue for the EU budget. However, the article does not stipulate how the transfer occurs, without defining if the Commission is in charge of collecting the amount and if the funding will pass through the EU budget. If the operations will be done using the EU budget, this will increase the variability of the budget, as the funds paid in and the disbursement are fall different years. A possible solution, would be the creation of a separate fund for the EFSF and later ESM, thus avoiding complexities and potential inconveniences with the EU budget.

The size of the EU budget is an extremely controversial subject. In case of a large default it is not straightforward that the member states will be ready to finance the default without this having a repercussion on the annual budgetary discussions. Today, with the pressure to keep the budget down and to cut it, a default could lead to an ever-stronger reaction.

Concluding, the EU budget does not represent the most adequate tool for MFS operations, in particular for the euro area member states, where providing financial assistance requires large amounts (Giovannini and Gros, 2012). For this reason EFSM is most likely going to be superseded by the ESM and only remain active as a guarantee for existing commitments or/and as an instrument of last resort, without being the instrument of preference. Yet the ESM, despite its characteristic of permanence, cannot represent the definitive answer in terms of an EU instrument for macro-financial stability. Eurobonds, under the different forms proposed, could be a plausible EU facility for macro-financial stability that could be used in a more or less near future: the existing eurobond proposals, however, do not seem to entail any direct implications for the EU budget. It is true that most of these schemes do not yet outline all the technical arrangements, but none of them make explicit reference to the EU budget. Thus, the main future implications for the EU budget could come mostly indirectly, through the effects of MFS assistance programmes on the public finances of euro area member states.

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<sup>27</sup> See 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, OJ L 306/33, 23.11.2011.

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## List of Abbreviations

<b>BoP</b>	Balance of Payments
<b>CIF</b>	Co-investment fund
<b>ECA</b>	European Court of Auditors
<b>ECB</b>	European Central Bank
<b>ECCL</b>	Enhanced Conditions Credit Line
<b>ECOFIN</b>	Economic and Financial Affairs Council
<b>EDA</b>	European Debt Agency
<b>EFC</b>	European Economic and Financial Committee
<b>EFSF</b>	European Financial Stability Facility
<b>EFSM</b>	European Financial Stabilisation Mechanism
<b>EIB</b>	European Investment Bank
<b>EJB</b>	European junior bond
<b>EMTN</b>	Euro Medium-Term Note Programme
<b>EP</b>	European Parliament
<b>ERF</b>	European redemption fund
<b>ESBies</b>	European safe bonds
<b>ESM</b>	European Stability Mechanism
<b>EWG</b>	Eurogroup Working Group
<b>GDP</b>	Gross domestic product
<b>GLF</b>	Greek Loan Facility
<b>GNI</b>	Gross national income
<b>IMF</b>	International Monetary Fund
<b>MFA</b>	Macro-Financial Assistance (facility)
<b>MTF</b>	Multiannual financial framework
<b>MFS</b>	Macro-financial stability
<b>MoU</b>	Memorandum of Understanding
<b>NAMA</b>	National Asset Management Agency (Ireland)
<b>NCB</b>	National Central Bank
<b>PCCL</b>	Precautionary Conditioned Credit Line
<b>SAI</b>	Supreme audit institution
<b>S&amp;P</b>	Standard and Poor's
<b>SGP</b>	Stability and Growth Pact
<b>SMP</b>	Securities Markets Programme
<b>TFEU</b>	Treaty on the Functioning of the European Union





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