



The Instruments providing Macro-Financial Support to EU Member States

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Abstract

Following the financial crisis, the EU put in place a number of instruments aimed at providing macro-financial support to EU member states in difficulty, five of which remain in place. At the request of the European Parliament, CEPS carried out an in-depth assessment of the functioning and institutional arrangements of these support programmes with a view to providing a solid basis on which to design a sound architecture that can serve Europe for decades to come. This paper draws a number of important lessons from this assessment and identifies a few crucial issues that still need to be addressed.

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List of Abbreviations

BoG	Board of Governors
BoP	balance-of-payments
ECB	European Central Bank
EFC	Economic and Financial Committee
EFSF	European Financial Stability Facility
EFSM	European Financial Stabilisation Mechanism
EMU	Economic and Monetary Union
ESM	European Stability Mechanism
EWG	Eurogroup Working Group
GLF	Greek Loan Facility
IMF	International Monetary Fund
MFS	macro-financial stability
MoU	Memorandum of Understanding
SGP	Stability and Growth Pact
SRF	Single Resolution Fund

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Executive Summary

Background

The European sovereign debt crisis, which started in 2010 as a contagion effect of the global financial crises, has clearly proven the need to create a financial safety net for euro-area countries and, more generally, to reinforce the EU mandate to safeguard the macro-financial stability of the Union. A number of instruments for financial assistance have been designed to provide support to member states in financial difficulty.

The instruments were set up as a reaction to emergencies, and their architecture and governance need to be revisited and rationalised to ensure they are efficient and operate within a solid European legal framework.

At the present time, the EU has five financial stabilisation mechanisms in place:

- i) Balance-of-payments (BoP) assistance programme, reserved for EU member states outside the euro area
- ii) European Financial Stabilisation Mechanism (EFSM), reserved for euro-area countries
- iii) Greek Loan Facility (GLF) set up specifically for Greece
- iv) European Financial Stability Facility (EFSF)
- v) European Stability Mechanism (ESM)

The first two are an integral part of the European Union's budget structure and use the margins of the budget under the maximum own resources ceiling (1.23% of GNI) of the EU budget as a guarantee to raise funds in the international markets.

The last three instruments are intergovernmental, set up outside the EU budget and are thus outside the Treaty provisions. The multiplicity of instruments is the result of ad-hoc decisions taken in response to pressing needs when one instrument revealed itself to be insufficient and a new one had to be urgently created.

Now is an opportune time to assess the functioning and institutional arrangements of the financial support programmes put in place by the EU in order to start to design a sound architecture that can serve Europe for decades to come. This paper draws a number of important lessons from this assessment and identifies a few crucial issues that still need to be addressed.

The Balance-of-payments (BoP) assistance and European Financial Stabilisation Mechanism (EFSM) mechanisms have a combined lending capacity of €110 billion (€50 billion for BoP and €60 billion for the EFSM). The BoP and EFSM pose a certain risk to the EU budget, which has been addressed by not allowing any repayment obligation of the EU in any specific year to the borrowers to exceed the Own Resources ceiling.

On the present use of the instruments, the BoP has only EUR4.22 billion outstanding in support for Romania and Latvia,¹ but the support for Ireland and Portugal have drained much of the EFSM (€46.8 billion), and the long maturities means that the capacity of the EFSM is very limited.

This paper pinpoints some concern over the Balance-of-payments BoP assistance and European Financial Stabilisation Mechanism (EFSM), namely weaknesses in the transparency and explanations provided on the mechanisms that would be activated in the event of a default. It is taken for granted that existing budgetary procedures would suffice to cover any amounts, but the EU budget resources structure raises some controversial questions for which the background research has not found convincing answers. For example, in case of a default: Would corrections apply to the amount that member states are required to cover? Would the defaulting member state contribute to its own default and how would the contribution be treated? The political realities on financing the budget and the potential institutional challenges are not completely benign. The UK's questioning of its obligations to support eurozone member states when a bridge loan for Greece was given through the EFSM, are a demonstration of the political sensitivities behind the technical budgetary set-up.

The Greek Loan Facility (GLF), the European Financial Stabilisation Mechanism (EFSM), the European Financial Stability Facility (EFSF) and European Stability Mechanism (ESM), which are designed to support member states of the euro area, have combined outstanding loans to Cyprus, Greece, Ireland, Portugal and Spain worth €359 billion. With the exception of the EFSM, these instruments fall outside the scrutiny of the European Parliament and are intergovernmental in nature.

Three of the existing facilities – the GLF, EFSF and EFSM – seem to be headed towards a slow winding-down process, and their tasks are progressively being taken aboard by the European Stability Mechanism (ESM). Moreover, given that in the long term all EU Member States will adopt the euro as their currency, the Balance-of-payments (BoP) assistance is also destined to disappear. This implies that, in the long term, the European Stability Mechanism (ESM) would remain the only macro-financial stability (MFS) instrument.

The ESM will, therefore, at some point, have to be integrated into the EU legal framework, but there has been no thinking yet about how this will be done, and about its linkages, if any, with the EU budget. Nor has much thought been given to how to ensure democratic control of its

¹ As of 1 December 2016: Latvia EURO.7 bn and Romania EUR3.5 bn.

operations and the possible prejudice played by budgetary sovereignty of national Parliaments in this process.

These are complex questions that require more in-depth analysis than can be carried out in the present exercise. At this stage, this paper presents two extreme options that can be considered as a starting point.

ESM Reform – Option One. A first option would be to integrate the European Stability Mechanism (ESM) into the EU's legal framework by adding it to the EU budget. Such a politically sensitive move would require a very large increase in the ceiling of the EU budget. It would also raise a large number of institutional questions. Macro-financial assistance is very different from the normal operations of the EU budget. Already some of the issues regarding the suitability of the EU budget mechanisms (such as the way in which resources are raised), make the EU budget set-up not ideal. Mimicking the structure of the existing European Financial Stabilisation Mechanism (EFSM) would mean a radical transformation of the current ESM and most likely a radical overhaul of the way in which the EU budget operates at least for the assistance guaranteed in its margins. We also raise a warning note here concerning the proposal to create a eurozone budget: it would not offer a good solution, as a eurozone budget would serve the function of providing macroeconomic stabilisation, while the European Stability Mechanism (ESM) offers macro-financial stability. These functions also do not fit well together in terms of their respective governance requirements.

ESM Reform – Option Two. We propose a second option, namely that the European Stability Mechanism (ESM) would continue to be a new stand-alone and independent EU institution, with its own staff and democratic accountability mechanism, but it would be accountable to the European Parliament for the overall functioning of the mechanism. This would imply that ESM is not only in charge of providing financial assistance but it is also responsible for the design, negotiation and monitoring of the adjustment programme, which defines the conditionality, for the disbursement.

For the 'transition' period during which the ESM would become the only MFS instrument will be a long one. We recommend retaining the European Financial Stabilisation Mechanism (EFSM) in the meantime, but also re-establishing its lending capacity by transferring its existing outstanding loans to the European Stability Mechanism (ESM). The risk assumed under EFSM lending should only fall on euro area member states. The EFSM could be used to help smaller member of the eurozone. Given that there are over 15 member states with a GDP below €300 billion, the EFSM offers a credible financial backing for those, it cannot be excluded that at some point in the future only a limited amount might be needed. Seen from this perspective, the European Financial Stabilisation Mechanism (EFSM) could then turn out to be an important instrument to be used under the normal Community decisions mechanisms and under the scrutiny of the European Parliament.

1. Introduction

The sovereign debt crisis, which started in 2010 as a contagion effect of the Global Financial crises caused by the subprime mortgage market crash in the United States, has clearly proven the need to create a financial safety net for euro area countries and, more generally, to reinforce the EU mandate to safeguard the macro-financial stability of the Union.

In just a few recent years, the architecture of the economic governance within the EU has evolved substantially: there are more shared rules, commitments and coordination, thanks to the Euro Plus Pact, the Six and the Two Packs reforming the Stability and Growth Pact (SGP) and, overall, the introduction and development of the European Semester.

It was evident, however, that to ensure the macro-financial stability across the EU, and especially within the euro area, common rules alone were not sufficient, and new instruments for financial assistance have been designed to provide support to member states in financial difficulty.

On the eve of its 60th anniversary, it is worth recalling that the Treaty of Rome already countenanced the possibility of the Council granting ‘mutual assistance’ to member states facing a balance-of-payments crisis.² At that time, however, the first pre-condition of making such assistance available was “a concerted approach to or within an international organization”.³ In fact, when the ‘Common Market’ was formed 60 years ago, monetary policy was assumed to be a national competence and exchange rates were fixed under the Bretton Woods system of the dollar-gold standard. But when the Bretton Woods system collapsed in the 1970s, exchange rate movements became an important issue for the functioning of the EU. International financial issues, however, such as exchange rates, were still coordinated mainly through global institutions such as the International Monetary Fund (IMF). With the establishment of EMU (Economic and Monetary Union), the evolving role of the European Central Bank (ECB) and the involvement of the EU institutions in the management of the crisis in the EU periphery, the role played by the Union in the financial stability of European economies was significantly strengthened.

Nevertheless, the economic governance framework at EU level and the coordination of economic and budgetary policies among member states have proven to be ineffective in addressing the impact of shocks and the risks of financial contagion. Additional instruments to support macro-financial stability have been created out of the common EU governance and law framework. The urgency brought on by the sovereign debt crisis has certainly made it more difficult to find the political support necessary to produce a more integrated and institutional response.

Through bonds issued on international capital markets, the European Commission runs three loan programmes that provide financial assistance to member states experiencing financial

² Art.108 of the Treaty of Rome, paragraph 1.

³ Art.108 of the Treaty of Rome, paragraph 2.

distress. Two of these are of relevance for this paper: i) the balance-of-payments (BoP) assistance programme, reserved for EU member states outside the euro area and ii) the European Financial Stabilisation Mechanism (EFSM), reserved for euro-area countries. By 2014, the EFSM had supported Ireland (€22.5 billion) and Portugal (€24.3 billion).

The maximum commitment under the two mechanisms, which operate under the guarantee of the EU common budget, is €110 billion (€50 billion for the BoP assistance and €60 billion for the EFSM), i.e. roughly over two-thirds of the total annual value of the EU budget. Although the likelihood that none of the lending is repaid is small, such a sum may represent a significant risk for the budget. However, since the lender is the EU, the default of a member state on any repayment does not mean that the EU (which acts as the guarantor) is defaulting, which allows the EU to 'annualise' the risk, i.e. to record only the payment due on the particular budgetary year as the risk to the budget.

To date, the EU has issued some €53 billion in outstanding bonds maturing until 2042. As a matter of fact, it is necessary to monitor the credit risks borne by the EU budget that result from guarantees and lending operations managed by the European Commission and maximise the potential of EU's own resources as collateral.

The sovereign debt crisis affecting euro area members showed the limited capacity of the EU budget alone to meet the financing needs of member states in financial distress and to prevent the contagion effects that could potentially put the stability of the euro area at risk. In response, **a range of MFS mechanisms has been created out of the EU budget**. The **Greek Loan Facility (GLF) in 2010** and the more structured **European Financial Stability Facility (EFSF) in 2011** emerged as **temporary instruments** to respond to the increasing tension brought about by the sovereign debt crisis. **Only in 2013**, thanks to a minor amendment to the Treaty,⁴ the creation of a **permanent instrument, the European Stability Mechanism (ESM)**, was allowed.

As will be illustrated in detail below, the transitory nature of both the EFSM and EFSF, and the assumption that all EU member states will eventually adopt the euro, make the European Stability Mechanism (ESM) the only instrument for macro-financial stability in the EU. At the same time, it is also (together with its predecessor, the EFSF) the result of an interinstitutional agreement and as such is subject to very small, if any, parliamentary control and democratic accountability.

According to the roadmap proposed in the Five Presidents' Report on "Completing Europe's Economic and Monetary Union" (Juncker et al., 2015), in the medium term, i.e. between 2017 and 2025, the European Stability Mechanism (ESM) should become an integral part of EU law.

⁴ The new Art. 136 of the TFEU states: "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."

The main objective of this paper, however, is not to explore avenues for reform, but rather to offer a succinct account of the recent MFS mechanisms used in Europe and to point out some critical aspects that should be addressed in future reforms.

Therefore, in Section 2 below, we present an outline of the current facilities for financial assistance, both at the level of the Union and at the intergovernmental level. Section 3 describes the different MFS instruments, the basic ways in which they function and the activities undertaken so far. Section 4 looks at the implications of the different financing methods for MFS instruments, which either rely on the guarantee of the EU budget or on guarantees generated by member states' contributions. We conclude by highlighting some critical points and presenting some recommendations with the aim of: i) increasing the democratic control and accountability of support programmes, ii) identifying specific solutions for the euro area and iii) reforming the ESM.

2. An Overview of the instruments For Financial Support

This section offers an overview of the existing instruments for financial support to member states distinguishing between those operating within the EU budget framework and those outside. The latter, which were created after 2010, are reserved for euro area countries and are endowed with much larger resources than the instruments that preceded them.

Table 1 provides a summary of their main features. The development process of each instrument will then be presented in more detail in the rest of this section.

Table 1. Summary of the instruments providing financial support to EU Member States

	EU common MFS instruments			EA member states' MFS instruments		
	Balance-of-payments (BoP) Facility	European Financial Stabilisation Mechanism (EFSM)	Macro-Financial Assistance (MFA)*	Greek Loan Facility (GLF)	European Financial Stability Facility (EFSF)	European Stability Mechanism (ESM)
Eligible countries	Non-euro area EU Member States	EU (mainly euro area) Member States	EU neighbour countries	Exclusively Greece	Euro area Member States	Euro area Member States
Validity	Permanent instrument	Temporary instrument	Permanent instrument	Temporary instrument	Temporary instrument	Permanent instrument
Legal basis	Council Regulation n° 332/2002	Council Regulation n° 407/2010	Art. 212 TFEU	MoU 3 May 2010	EFSF (Amended) Framework Agreement	Treaty establishing the ESM
Decision-making body	ECOFIN Council	ECOFIN Council and Eurogroup	Council	Eurogroup	Eurogroup and EFSF BoD**	Eurogroup and ESM BoD**
Assistance modality	Loans or credit lines	Loans or credit lines	Loans or grants	Loan to Greek government	- Loans - Intervention in primary and secondary bond markets	- Loans - Intervention in primary & secondary bond market

					- Precautionary programmes - Banks recapitalisation	-Precautionary Programmes - Banks recapitalisation
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* Since it provides financial assistance to non-EU countries, the Macro-Financial Assistance (MFA) programme run by the Commission falls outside the scope of this Briefing paper.

** BoD stands for Board of Directors.

Source: Casale et al. (2012).

Table 2 provides an overview of the total outstanding loans under the different instruments by country. The case of Greece stands out as exceptional.

Table 2. Overview of disbursed funds outstanding by receiver and programme (€ billion)

Lender	Latvia	Romania	Cyprus	Greece	Ireland	Portugal	Spain
Bilateral	-	-	-	53	4.8	-	-
European Financial Stability Facility (EFSF)	-	-	-	131	17.7	26	-
European Stability Mechanism (ESM)	-	-	6.3	32	-	-	41.3
European Financial Stabilisation Mechanism (EFSM)	-	-	-	-	22.5	24.3	-
Balance-of-payments (BoP) facility	0.7	3.5	-	-	-	-	-
Total	0.7	3.5	6.3	216	45	50.3	41.3

Source: Authors' computations.

Lastly, Table 3 provides an overview of the outstanding commitments by euro area country under the different mechanisms for financial stability. Each mechanism has a different character, not all imply monetary disbursements, and the liability they entail are all pro-rata. Neither the GLF, the EFSF or the ESM entails joint and several liabilities.

Table 3. Out of EU budget commitments by (euro area) country (€ billion)

Member state	Greek Loan Facility (GLF) disbursed* bilateral loans	European Financial Stability Facility (EFS) guarantee commitments**	European Stability Mechanism (ESM) capital subscriptions
Austria	1.6	21.6	19.5
Belgium	1.9	27.0	24.3
Cyprus	0.1	1.5	1.4
Estonia	-	2.0	1.3
Finland	1.0	14.0	12.6
France	11.4	158.5	142.7
Germany	15.2	211.0	190.0
Greece	-	-	19.7
Ireland	0.3	-	11.1
Italy	10.0	139.3	125.4
Latvia	-	-	1.9

Lithuania	-	-	2.9
Lux.	0.1	1.9	1.8
Malta	0.1	0.7	0.5
Netherlands	3.2	44.4	40.0
Portugal	1.1	-	17.6
Slovakia	-	7.7	5.8
Slovenia	0.2	3.7	3.0
Spain	6.7	92.5	83.3
Total	52.9	726.0	704.8

* Disbursed under the GLF, remainder of the initially committed EUR80 billion were used within the EFSF.

**Commitments post enlargement of the fund.

Source: European Commission.

2.1 The Balance-of-Payments (BOP) facility

As mentioned earlier, the Balance-of-payments (BoP) facility is directly managed by the Commission which, backed by EU own resources, borrows on the financial markets and lends to member states outside the common currency area. It is designed to provide financial assistance to those non-euro countries that are encountering problems with their balance of payments, as specified in Art. 143 TFEU.

The Balance-of-payments (BoP) assistance provides medium/long-term financial resources to ease a country's external financing constraints and allow it to return promptly to borrow directly in the financial markets. Technically, the BoP assistance provides loans solely by the EU, but recently the Commission has granted support in co-operation with the European Investment Bank (EIB), the IMF and other international institutions.

In institutional terms, the first evaluation on granting financial assistance to a country that makes such a request falls in the hands of the Economic and Financial Committee (EFC).⁵ Following a formal request of the Commission, the Council must approve it by a qualified majority.

BoP assistance is granted if the recipient member state presents a sound economic and financial adjustment programme. The Commission, in consultation with the European Central Bank (ECB), coordinates with the potential beneficiary to identify the necessary measures that should be part of the adjustment programme to speed up the country's return to international financial markets and correct imbalances in its balance of payments. Casale et al. (2012) further point out that in order for the EU assistance programme to be fully established, the Commission, in collaboration with the IMF (or other programme partners) and the EFC agrees upon a Memorandum of Understanding (MoU) with the member state that benefits from the BoP facility. The MoU contains the details of the economic policies outlined in the adjustment

⁵ Currently chaired by Thomas Wieser. For more information, see http://europa.eu/efc/welcome-economic-and-financial-committee-efc-website_en.

programme endorsed by the Council. According to Casale et al. (2012), conditions are usually related to: i) fiscal consolidation, e.g. reduction of the government deficit; ii) structural reforms (e.g. labour market reform, liberalisation of the economy); iii) reforming the public administration; and iv) measures to safeguard against fraud. Every six months a progress review is conducted, which clarifies whether modifications are in order.

The BoP lending capacity has been progressively increased over time, but it remains rather limited. In 2002 the total outstanding amount of loans to be allocated to member states out of the common currency area was of €12 billion.⁶ This amount was then increased to €25 billion in 2008,⁷ and today has reached the current total lending capacity of €50 billion.⁸

In terms of type of financial assistance, the BoP facility can hand out loans or lines of credit. Funds are collected by the Commission at the lowest possible cost, obtained so far by issuing debt securities on the market.

Table 4. Overview of recent balance-of-payments assistance programmes

Country	Total international financial assistance / of which EU financial assistance	Disbursements made by the EU	Disbursement period covered by EU assistance	Status of the programme (as of Jan. 2012)
Hungary	€20.0 bn / €6.5 bn	€55 bn	Until November 2010	Post-programme surveillance; availability of the unclaimed EU financial assistance (€1 bn) expired in November 2010
Latvia	€7.5 bn / €3.1 bn	€2.9 bn	Until January 2012	Post-programme surveillance; Disbursements completed Part of bilateral funding will be treated as credit lines
Romania I	€20.0 bn / €5.0 bn	€5.0 bn	Until June 2011	Post-programme surveillance; Disbursements completed
Romania II	€5.0 bn / €1.4 bn		Until March 2013	Precautionary (not activated)
Romania III	€4.0 bn / €2.0 bn		Until September 2015	Precautionary (not activated)

Source: European Commission, January 2017

(http://ec.europa.eu/economy_finance/eu_borrower/balance_of_payments/index_en.htm).

Table 4 and Box 1 provide an account of the utilisation of the BoP assistance, which has been mainly used in the framework of bigger international financial programmes. After the reintroduction of the BoP programme in 2002, the first assistance programme was granted to Hungary in 2008. Aside from Hungary, only Latvia and Romania benefitted from the programme. The latter remains under the post-programme surveillance), as €3.5 billion are

⁶ Council Regulation No.332/2002.

⁷ Regulation No 1360/2008.

⁸ Regulation No 431/2009.

currently outstanding⁹. Under the post-programme surveillance period, the member state that has to repay the loan is required to discuss new major policy reforms and intentions with the Commission.¹⁰ Furthermore, in the context of the European Semester, the Commission maintains close cooperation with the BoP beneficiary to uphold a sound fiscal and macroeconomic framework.

Box 1. Recap of BoP interventions, by country

Hungary
<ul style="list-style-type: none"> • In 2008, to relieve the pressure on the country's financial markets, the Balance-of-payments (BoP) facility provided €6.5 billion as part of an international financial programme which amounted to €20 billion (Council Decision 14953/2/08). • Out of the €6.5 billion, only €5.5 billion were actually disbursed and the availability of unclaimed financial assistance expired in 2010, when the programme ended. • In 2011, Hungary requested new assistance under the BoP facility; the request was not approved by the Council, which also adopted a decision suspending €495 million in scheduled commitments under the EU's cohesion fund, due to insufficient measures taken by the country to correct its budget deficit. • The post-programme surveillance (PPS) was discontinued in January 2015, as Hungary has repaid more than 70% of the loan.
Latvia
<ul style="list-style-type: none"> • Motivated by concerns over the health of the domestic banking sector, the Latvian government requested financial assistance in late 2008 from the EU, IMF and regional neighbours. • The EU agreed to contribute with a €3.1 billion three-year lending programme as part of a multilateral financial assistance amounting to €7.5 billion. • The repayments started in 2014, including the principal and interests of approximately 3.2%. • In January 2012, Latvia officially completed the assistance programme, and the PPS also expired in 2015, as over 75% of the EU loan had been repaid.
Romania
<ul style="list-style-type: none"> • Currently under the precautionary programme activated up to €1.4 billion. • Council agreed on May 2011 to support the re-launch of growth with a focus on structural reforms and fiscal sustainability (Council Decision 2011/288/EU). • This latter programme follows the first assistance programme worth €20 billion provided for the 2009-2011 period: €5 billion BoP, €13 billion IMF, and the remaining €2 billion by WB, EIB and EBRD (Council Decision 2009/459/EC). • The repayment of the 2009 loan started in 2015 and includes the principal and the interest of approximately 3%. • The ongoing PPS foresees a regular exchange of information between the Romanian authorities and the Commission, which visits biannually and assesses the country's financial situation. • At this time, €3.5 billion are outstanding, and the PPS may end in mid-2018, when 70% of the loan under the first programme is expected to be repaid.

Source: Casale et al. (2012) and authors' own research.

⁹ As Latvia already repaid over 75% of the EU loan under BoP, it is no longer under post-programme surveillance. As reported in table 2, €0.7 bn remain outstanding.

¹⁰ The EFC can also be involved if the Commission has concerns about a potential worsening of the Member State's ability to repay the financial assistance.

2.2 The European Financial Stabilisation Mechanism (EFSM)

Created in May 2010, the EFSM was one of the first responses to the sovereign debt crisis affecting euro area countries. It basically mirrors the functioning of the BoP facility, but the facility is designed only for euro area member states. The scope of the EFSM, however, is wider than that of the BoP facility; in fact, it is more designed to provide assistance to euro area countries that are experiencing financial problems in general, and not necessarily a balance-of-payments crisis.

As per the BoP assistance, EFSM assistance is linked to an adjustment programme and a Memorandum of Understanding (MoU) with the Council and the Commission. Institutionally speaking, the relevant difference is that the EFC is involved only in the euro area configuration: the Eurogroup Working Group (EWG). Furthermore, the ECB acts for this facility as a sort of fiscal agent, which administers the loans between the European Commission and the beneficiary's central bank.

An additional difference from the BoP pertains to the possibility to borrow from international capital markets more funds than those actually needed according to the disbursement schedule. This allows the Commission, when operations so require, to keep borrowed funds in a dedicated cash or security account,¹¹ with the objective of borrowing at the lowest feasible cost.

The monitoring is strengthened: i) the Commission runs quarterly checks on the developments of the adjustment programme; ii) every six months the Commission reports to the Council and the Economic and Financial Committee (EFC) on the developments of the imbalances that justified the EU support and iii) the Court of Auditors has the right to carry out audits and financial controls (Casale et al., 2012).

The total lending capacity is fixed at €60 billion, just above that of the BoP. As with other macro-financial stability (MFS) instruments, the Commission often provides European Financial Stabilisation Mechanism (EFSM) support in the framework of wider and multilateral international assistance programmes, in partnership with the IMF and other financial institutions. For instance, the first time the EFSM was activated,¹² the €22.5 billion of EFSM support to Ireland represented approximately one-third of a bigger international bailout package, which also involved the IMF, the EFSF and bilateral loans from Sweden, Denmark and the UK. Also in the case of Portugal,¹³ the €26 billion assistance via EFSM amounted to just one-third of the total bailout package, where also the IMF and the EFSF were involved.

¹¹ Which is operated under the rules applying to off-budget operations. Such funds can only be employed to provide financial support via the EFSM and all the costs incurred by EU institutions in implementing the financial assistance falls on the beneficiary.

¹² Council Decision 17211/10 of 7 December 2010.

¹³ Council Decision 10231/11 of 17 May 2011.

In total, the EFSM has disbursed **€46.8 billion over the period 2011-14**; Table 5 provides a list of the different operations and their agreed maturity.

Table 5. Overview of recent European Financial Stabilisation Mechanism (EFSM) programmes

Date raised	Amount (€ billion)	Maturity	Beneficiary	Date of disbursement
5 Jan. 2011	5.00	7	Ireland	12 Jan. 2011
17 Mar. 2011	3.40	10	Ireland	24 Mar. 2011
24 May 2011	4.75	5	€3 billion for Ireland; €1.75 billion for Portugal	31 May 2011
25 May 2011	4.75	10	Portugal	1 Jun. 2011
14 Sept. 2011	5.00	15	Portugal	21 Sept. 2011
22 Sept. 2011	4.00	7	€2 billion for Ireland; €2 billion for Portugal	29 Sept. 2011
29 Sept. 2011	1.10	30	€0.5 billion for Ireland; €0.6 billion for Portugal	6 Oct. 2011
9 Jan. 2012	3.00	20	€1.5 billion for Ireland; €1.5 billion for Portugal	16 Jan. 2012
27 Feb. 2012	3.00	26	Ireland	5 Mar. 2012
17 Apr. 2012	1.80	10	Portugal	24 Apr. 2012
26 Apr. 2012	2.70	15	Portugal	4 May 2012
26 Jun. 2012	2.30	15	Ireland	3 July 2012
23 Oct. 2012	3.00	10	€1 billion Ireland; €2 billion Portugal	30 Oct. 2012
18 Mar. 2014	2.60	15	€0.8 billion Ireland; €1.8 billion Portugal	25 Mar. 2014
5 Nov. 2014	0.40	15	Portugal	12 Nov. 2014
–	7.16	7	Greece	20 June 2015

Source: European Commission, DG ECFIN website.

In July 2013, the Council adopted the decision to extend the maturities of the loans to Ireland and Portugal both under the European Financial Stabilisation Mechanism (EFSM) and European Financial Stability Facility (EFSF). This implied increasing the average maturity by seven years, from 12.5 years to 19.5 years, in order to smoothen the countries' debt redemption profiles and lower their refinancing needs in the period subsequent to their economic adjustment programmes.

In 2015, Ireland requested to lengthen the first EFSM loan of €5 billion disbursed in 2011, which was due in December 2015. The loan was refinanced in three transactions with maturities in 2023 (€2 billion), 2029 (€1 billion) and 2035 (€2 billion). In January 2016, the Portuguese government also requested a lengthening of the second EFSM loan of €4.75 billion disbursed in 2011 and due in June 2016. Refinancing has been scheduled in three transactions maturing in 2023 (€1.5 billion), 2031 (€2.25 billion) and 2036 (€1 billion).

Recently, the European Financial Stabilisation Mechanism (EFSM) has also been employed for bridge loans. In July 2015, it provided short-term assistance of €7.16 billion to Greece. The loan was fully repaid one month later in August 2015.

Aside from these limited activities covering the lengthening of the maturities of outstanding loans and the disbursement of bridge loans, the EFSM is no longer the reference macro-financial stability (MFS) instrument for euro area countries. As will be explained below, since 2013, EU member states in the euro area that experience severe financial distress can turn to the European Stability Mechanism (ESM). Already in December 2010, the Council conclusions singled out the ESM as the programme intended to “replace the European Financial Stability Facility (EFSF) and the European Financial Stabilisation Mechanism (EFSM), which will remain in force until June 2013.”¹⁴

2.3 The Greek Loan Facility

As is clear from its name, the Greek Loan Facility (GLF) is an *ad hoc* macro-financial stability (MFS) instrument, which turned out to be needed, as Greece was not eligible for Balance-of-payments (BoP) assistance and up to 2010, no other assistance programme was in place at European level. The dramatic situation affecting Greece made clear that euro area member states actually needed access to financial assistance and that more resources were required to safeguard stability. As a matter of fact, the GLF allocated loans worth €77.3 billion to Greece, an amount that exceeded the sum that was available at the time for the stability of the whole collection of non-euro member states via the BoP facility.

As the resources available were insufficient to cope with the sovereign debt crisis and were not targeted to euro area countries, other instruments had to be found to preserve the stability of European economies. While the political consensus was emerging to design a specific MFS instrument for the euro area, the urgency brought about the financial distress of Greece led to the creation of the Greek Loan Facility (GLF), before the EFSM and EFSF were constituted.

The solution that was found rests on bilateral loans from other EU member states. In this case, the Commission does not act as a borrower, but rather is entrusted with the tasks of coordinating and administering the pooled bilateral loans, in liaison with the ECB. Such an intergovernmental system “clearly represented an interim solution before the establishment of a more structured (EFSF) or permanent (ESM) mechanisms”.¹⁵

Following a formal request of the Greek government for international financial assistance, in May 2010, EU governments agreed on a financial assistance programme in partnership with the IMF. Out of the total €110 billion provided in the framework of the three-year adjustment programme, 16 euro area countries, through pooled bilateral loans, agreed to provide about

¹⁴ See European Council (2011), EUCO 30/1/10 Conclusions, Rev1, Brussels, 25 January 2011.

¹⁵ Casale et al. (2012, p. 36).

€80 billion. Finally, the Greek Loan Facility (GLF) consisted of €53 billion of bilateral loans, as Slovakia opted out and Ireland and Portugal revised their contribution since they were also under a financial assistance programme. For the rest, the contributions to the GLF were fixed on the basis of the ECB capital key.¹⁶

Greece and the Commission agreed on a Memorandum of Understanding (MoU) outlining a programme to redress internal and external imbalances. The disbursement of the loan over the three-year term was provided in five tranches and was based on the assessment of the performance on a set of criteria defined by the Commission.

When it was clear that the first Greek financial assistance programme would not have been sufficient, the Eurogroup approved the financing of a second adjustment programme worth €130 billion, of which €102 billion came under the European Financial Stability Facility (EFSF).¹⁷ The shift from the first to the second assistance programme entailed a switch from the ad-hoc Greek Loan Facility (GLF) to the more structured EFSF, which actually disbursed the last tranche of the loan available under GLF. With the exception of the repayments of the debt by Greece, the activities of the GLF ended in 2011.

2.4 The European Financial Stability Facility (EFSF)

Following up on the Greek crisis, which showed the inadequacy of the European Financial Stabilisation Mechanism (EFSM) resources guaranteed by the EU budget to deal with such a large crisis and the need to resort to bilateral loans, the euro area member states decided in 2010 to set up an additional pool of funds to **support euro area countries in financial distress**, called the **European Financial Stability Facility (EFSF)**. Its main aim was to safeguard the financial stability of the euro area by providing financial assistance to countries at times when markets rates would be unsustainably high and before market access is lost. In 2011, the EFSF's scope of activity was enlarged to allow for precautionary programmes, recapitalisation of financial institutions and interventions in the secondary sovereign security markets (EFSF, 2011).

The EFSF was created as a **temporary mechanism** to deal with the sovereign debt crisis that started with Greece and it has provided financial assistance to Ireland, Portugal and Greece through the issuance of EFSF bonds and other debt instruments on capital markets. Since 2013 the EFSF does not provide any more financial assistance, as this task is now performed solely by the ESM (see next paragraph). Nevertheless, the EFSF continues to operate to receive loan repayments from beneficiary countries, make interest and principal payments to holders of EFSF bonds and roll over outstanding EFSF bonds, as the maturity of loans provided to Ireland, Portugal and Greece is longer than the maturity of bonds issued by the EFSF.

¹⁶ Table 2 reports the details of contributions by country.

¹⁷ More details are presented in section 3.2. The IMF contributed €28 billion.

Formally the EFSF is a private company incorporated under Luxembourg law, owned by member states of the euro area and structured as a temporary credit-enhanced special purpose vehicle, with minimal capitalisation and guarantees given by the 17 euro area member states to raise funds from the capital markets on its investment grade rating.¹⁸ Initially the EFSF was set up with €440 billion of guarantees, which was increased in 2011 to €780 billion to allow an effective lending capacity of €440 billion (the over-collateralisation was the requirement to keep the AAA rating on the issuances). The key percentage of the guarantees given by each member state is defined in accordance with its share in the paid-up capital of the ECB.

One key feature of the European Financial Stability Facility (EFSF) was that the financial assistance can be released following an official request made by a euro area member state and the commitment of the country to undertake a macroeconomic, IMF-style adjustment programme. The Commission, in liaison with the ECB and the IMF, together called the Troika, is in charge of conducting an analysis of the sustainability of the public debt of the concerned country and assessing its financing needs. On these bases, the programme is negotiated and included in the Memorandum of Understanding (MoU). During the assistance programme, the Commission (together with the IMF and the ECB) is responsible for the monitoring activity, reporting directly to the Council and the EFSF Board of Governors (BoG), which decide on the disbursement of the new tranches of the loan.

The EFSF was activated for the ad-hoc assistance programmes to Ireland (€17.7 billion) and Portugal (€26 billion). Moreover, when the second adjustment programme for Greece was agreed, it was also decided to use the EFSF as a vehicle for a €180 billion loan. In this framework, the EFSF managed the undisbursed tranches of the GLF, provided additional funds for Greek banking sector recapitalisation process and also performed additional tasks linked to the debt restructuring of 2012 (see Casale et al., 2012, for details).

Table 6. European Financial Stability Facility (EFSF) assistance programmes (€billion)

Country	Agreed amount	Disbursed	Period covered	Other partners
Ireland	17.7	12.0	2010-2013	IMF, EFSM and bilateral loans UK, DN SW
Portugal	26.0	9.6	2011-2014	IMF and EFSM
Greece II	179.6	103.7	2011-2015	IMF

* As of May 2012.

Source: EFSF (www.esm.europa.eu/efsf-overview).

2.5 The European Stability Mechanism

Soon after the EFSF was set up, it became clear that a crisis-resolution mechanism should not only be large in size but also permanent. In this vein, the EFSF became *de facto* permanent in the form of the European Stability Mechanism (ESM).

¹⁸ For a detail description of the institutional framework and its functioning, see Casale et al. (2012).

The treaty establishing the ESM was signed in June 2011 by the finance ministers of the 17 euro area countries. The treaty builds on an amendment of Art. 136 of the Treaty on the Functioning of the European Union (TFEU).¹⁹ The ESM is designed as an intergovernmental organisation under public international law, with a planned lending capacity amounting to €500 billion. Operational since July 2012, the ESM was expected to take over the tasks of EFSF and EFSM, using the same instruments as under the EFSF, as summarised below.

Figure 1. European Stability Mechanism instruments

Loans to MSs	<ul style="list-style-type: none"> • When access to market financing is impaired or at risk of being impaired • Objective: to safeguard the stability of the euro area
Precautionary programme	<ul style="list-style-type: none"> • No programme • Preferential credit lines to overcome temporary shocks • Objective: to prevent crisis
Debt market interventions	<ul style="list-style-type: none"> • Primary and secondary markets purchases (limits in the MoU) • Objectives: to maintain market access and increase liquidity
Bank recapitalisation	<ul style="list-style-type: none"> • Loans go to member state governments not to financial institutions • Outside standard assistance programme • Objective: to limit contagion through banking sector

Source: Authors' elaboration, based on Casale et al. (2012) and ESM website.

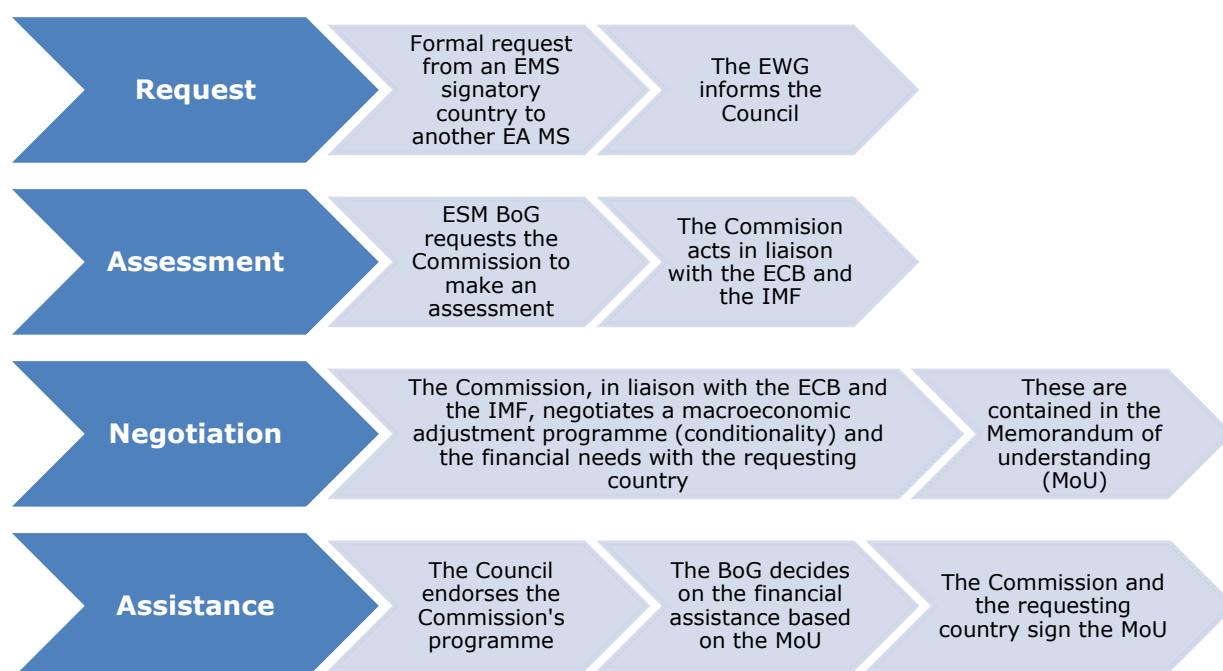
Since its creation the ESM has provided loans to Greece and Cyprus. Spain also received a loan to support banks' recapitalisation.²⁰ (See Annex for amounts disbursed.)

ESM loans are always tied to strict conditionality. This usually involves an agreed path of fiscal consolidation, governance measures as well as financial-sector stabilisation and structural reform measures to improve the business environment and support growth. Figure 2 illustrates the formal procedure, which is similar to that of the EFSF.

¹⁹ 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."

²⁰ See www.esm.europa.eu for details.

Figure 2. European Stability Mechanism procedure for financial assistance



Source: Authors' elaboration, based on Casale et al. (2012). Notes: EA MS: Euro area member state, EWG: Eurogroup Working Group, BoG: Board of Governors.

The usual assumption of the various assistance programmes drafted by the Troika of international lenders (Commission, IMF and ECB) was that the requesting country faced a temporary liquidity crisis. Under this hypothesis, a relatively short and sharp macroeconomic adjustment effort is expected to be sufficient to resolve problems, which usually arise from external fiscal and external deficits. The financial assistance combined with the promise of adjustment make it possible to regain access to international capital markets.

Ex-post it seems that for Ireland and Portugal the assumption has proven correct; in the case of Greece it turned out to be wrong. Since 2010, Greece has undergone three adjustment programmes, a debt restructuring through the PSI (private sector involvement) and a further restructuring through maturity extensions. Yet no consensus has been reached on its debt sustainability.

With reference to the financial assistance function, there are two main differences between the European Financial Stability Facility (EFSF) and European Stability Mechanism (ESM). First, of the €700 billion of ESM-subscribed capital, €80 billion are paid-in capital shares, and €620 billion are callable shares.²¹ In principle, this division ensures the AAA rating even in the absence of credit-enhancement schemes (the EFSF had an over-guarantee, cash buffer and reserves).

²¹ These amounts are split among euro area member states according to their capital contribution key in the ECB (see Table 3 above).

Second, while the European Financial Stability Facility (like the EFSM and the BoP facility) has the same credit right as any other sovereign claim, the “ESM loans [will] enjoy preferred creditor status in a similar fashion to those of the IMF, while accepting preferred creditor status of the IMF over the ESM”.²²

As result of an international treaty outside the TFEU, the functioning of the European Stability Mechanism does not entail any direct involvement of the EU institutions.

3. Financing the Balance-of-Payment (BOP) facility and the European Financial Stabilisation Mechanism (EFSM) in the EU budget

The macro-financial stability (MFS) programmes managed by the Commission rely on the EU budget as a guarantee. The **EU cannot borrow to finance a budget deficit**, but borrowing can be conducted for MFS instruments with the involvement of direct and unconditional obligations of the EU. Such obligations, however, are implicitly guaranteed by EU member states, given that they are legally obliged to provide funds to meet all of the EU’s obligations²³ (Casale et al., 2012).

It is necessary to monitor the credit risks borne by the EU budget resulting from the guarantees given and the lending operations implemented directly by the European Union or indirectly through the guarantee granted for EIB financing projects outside the Union. Presently the EU has about €53 billion in outstanding bonds from the BoP facility and EFSM, which will mature up until 2042.

For both the BoP facility and the EFSM, the risk is directly covered by the EU budget. As reported in European Commission (2016), the BoP facility has an outstanding capital of €42 billion and approximately €100 million of accrued interest. The EFSM instead represents 56.4% of all outstanding amounts covered by the EU budget (including other guarantees, such as EIB operations), as it has an outstanding capital of €46.8 billion and accrued interest of €709 million (European Commission (2016)).

No debt-servicing cost is foreseen for the Union as the interest payments and loan principal is repaid by the beneficiary member state via the Commission.

The 2015 amendment to the Regulation of the EFSM²⁴ has *de facto* broken with the ‘joint and several’ commitment of all Member States for the EU budget, and thus to some extent the unity of the budget. *De jure*, the obligation of all Member States remains unchanged, but in practice, a sub-group of member states, e.g. the euro area, becomes jointly liable, therefore setting preliminary steps towards an own budget.

²² See Treaty establishing the ESM, p. 7.

²³ See Arts 310 and 323 of the TFEU.

²⁴ Council Regulation 2015/1360 of August 2015 amending Regulation (EU) No 407/2010 establishing a European financial stabilisation mechanism.

One observation has to be made concerning equal treatment in risk-sharing between euro area and non-euro area member states. It seems rather inconsistent to operate two macro-financial stability instruments targeted at a subset of member states, in one of which the risk is jointly held at sub-group level (the EFSM²⁵), whereas for the other subgroup, the risk is borne by all member states equally (the BoP facility). One might be tempted to argue that only non-euro MSs should be involved in the latter.

In their study for the EP, Casale et al. (2012) are critical of the notion of using the core architecture of the EU budget to safeguard macro-financial stability. They argue that its relatively small size and inflexible rules make it unfit to deploy macroeconomic financial stability instruments, when needed. In fact, the recent development of macro-financial stability instruments occurred outside the guarantee of the European common resources. But the reason cannot be imputed solely to the limited EU budget. At the political level, there was a preference for developments in an intergovernmental setting where member states, through the Eurogroup, can more stringently monitor and influence adjustment programmes and their progress.

3.1 Some considerations on the general principles of the budget

One of the questions arising from the existence of instruments for macro-financial stability is to what extent are they in line with the general principles of the EU budget, in particular the principle of unity.

The principle of unity stipulates in Art. 7 of the Financial Regulation (European Commission, 2014) that the EU budget shall comprise all revenues and institutional and operational expenditures occasioned by the provisions of the TEU and the European Atomic Energy Community. It also requires (Art. 7 §2) the recording of the “*guarantees for borrowing and lending operations entered into by the Union, including the European Financial Stability Mechanism and Balance of Payment Facility operations, in accordance with point (d) of Article 49(1)*”.

Thus the EFSM and the BoP facility are formally in line with the unity principle of the financial regulation, but, as mentioned above, in practice the EFSM is a budget for a subset of member states (eurozone members) and agreements have been reached to reduce or exclude any liability on the part of non-euro member states towards it.

The European Stability Mechanism, being outside the TEU, is a separate financial instrument, outside the EU budget remit and with its own governance structure. As such, it is *de jure* not affecting the unity of the EU budget. However, if the ESM is brought into the Treaty, the question of how it will be financed and the role of the institutions, including democratic control by the EP, will have to be addressed.

²⁵ With the amendment introduced in 2015. See footnote 22.

More questionable is the aspect of the compliance with the **principle of transparency**. Are the liabilities of the European Financial Stabilisation Mechanism presented in a sufficiently transparent manner for the member states (or other stakeholders) to be aware of the outstanding risk on future EU budget margins? In the Council Regulation laying down the multiannual financial framework (1311/2013), the potential liabilities of the BoP facility and the EFSM are only mentioned in the preamble: *“If it is necessary to mobilise the guarantees given under the general budget of the Union for the loans provided under the Balance of Payment Facility or the European Financial Stabilisation Mechanism set out in Council Regulation (EC) No 332/2002 and in Council Regulation (EU) No 407/2010, respectively, the necessary amount should be mobilised over and above the ceilings of the commitments and payments appropriations of the MFF, while respecting the own-resources ceiling.”* The actual risks in the margins are not presented in the multiannual financial framework.

Similarly, the Interinstitutional Agreement (2013/C 373/01) mentions in paragraph 16 the requirement for annual reports from the Commission on the guarantees covered by the general budget to fulfil the transparency requirements.

The latest actual report on the guarantees (COM(2016) 576 final) does present an overview of the operations and the budgetary risk on the completed financial year, but some of the finer details of the mechanisms are not presented; nor are all future liabilities, which need to be looked up separately. The procedures to be followed in case of a default are also not presented.

3.2 Lack of procedural clarity in case of defaults

The use of the Balance-of-payments facility and European Financial Stabilisation Mechanism and their size open a number of questions if a default occurs in any particular year. The authors have reached the following tentative conclusions but they emphasise that this topic needs further analysis:

- The defaulting member state would remain liable for the sum that the EU will have to raise to cover the default.
- The EU would use the GNI key contributions to raise the funds needed to cover the annual shortfall.
- The defaulting member state should in principle have to finance its own default based on its GNI share.

Among the questions require further consideration are the following:

- If the member state contributes to its own default by the increased GNI payment to the EU budget to cover the default, will this payment be deducted from the outstanding balance?
- How exactly will the amount be recovered for which the defaulting member state remains liable?
- Are corrections (e.g. the UK rebate) applicable to the extra contribution to the budget to cover the default?

- Will the UK still be liable for the lending risks of the EFSM and the BoP facility after exiting the EU? Based on budgetary rules, the UK would normally be liable for the commitments taken by the budget in the years when it was still a member. This is less clear, however, in the case of the EFSM²⁶ and BoP facility, because the **risk is recorded on an annual basis** in future budgetary margins. And these are not recorded in full in the budget margin when the loan support is transferred to the beneficiary country. Does this mean that the liability in case of default falls only on the member states at the time of the default, and not on those that were members when the funds were transferred to the beneficiary country?

3.3 Some considerations on the Eurozone budget and the European Stability Mechanism

At the present time, discussion is underway concerning the possibility of creating a eurozone fiscal capacity. This has given rise to the misapprehension that this budget would take over the role or the resources of the European Stability Mechanism. It is difficult to know how the governance structure of the euro area will evolve in the medium term, but at this stage but it is important to highlight that the ESM and a eurozone fiscal capacity would respond to two different policy objectives. The eurozone budget would provide resources to perform a **macroeconomic stabilisation function** for the euro area, for instance through a common unemployment benefits scheme (see for instance Beblávy et al., 2015 and CEPS, 2017). Conversely, the ESM is a **macro-financial stability mechanism**, which kicks in in case sovereigns are confronted with serious macro-financial instability and should have a separate set-up. This implies that in the first case the policy objective is that of countering the economic cycle and mitigate the effect of asymmetric shocks; in the second, the policy objective is pertaining more to the overall stability of the euro area through containing the risk of contagion of banking or a sovereign debt crisis. This idea of having distinct functions and instruments is supported by the Five Presidents' report (Juncker et al., 2015), which states that *"It (a macroeconomic stabilisation system) should not be an instrument for crisis management. The European Stability Mechanism (ESM) already performs that function. Instead, its role should be to improve the overall economic resilience of EMU and individual euro area countries. It would thus help to prevent crises and actually make future interventions by the ESM less likely."*

3.4 Accountability and democratic control

The European Financial Stability Facility (EFSF) and the European Stability Mechanism (ESM) are independent entities established by agreement or international treaty among the euro area member states and, as emphasised above, are thus outside the framework of the EU treaties.

²⁶ The 2015 amendment to EFSM regulation should exempt the UK from liabilities incurred at euro area level.

The European Parliament was not involved in any capacity in negotiating the treaty establishing the European Stability Mechanism.²⁷ Its absence was in part determined by the legal basis on which the ESM Treaty was formulated. Indeed, in 2011, the European Parliament approved the amendment to Art. 136 of the TFEU, clearing the way for the ESM Treaty to be adopted. Such approval was negotiated against the promise that the European Commission would play a central role in running the ESM and that the intergovernmental mechanism would be eventually brought within the EU framework. This has not yet happened, but the roadmap for the EMU institutional reforms contained in the Five Presidents report – stage two (i.e. 2017-2025) – calls for the integration of the ESM into the EU law framework in order to strengthen democratic accountability and legitimacy.

As for the current situation, in 2011, the President of the Eurogroup and the Ecfm Commissioner committed on behalf of the Council and the Commission to inform the European Parliament on a regular basis about the establishment and the operations of the ESM. The President of the Eurogroup, as chair of the EMS, can be invited to discuss some aspects of the operation of the ESM,²⁸ which happened for instance in the case of extending financial assistance to Cyprus. In addition, the ESM sends its annual report and audit report to the European Parliament, but there is no formal accountability process.

The ESM Treaty gives the Commission an important role in negotiating the conditionality attached to financial assistance and in monitoring compliance with it.²⁹ This means that the European Parliament can exercise a small degree of democratic scrutiny over the ESM, which is limited to the Commission's use of EU resources for its work in the ESM framework.³⁰ This scrutiny does not cover the use of ESM resources for financial assistance.

In fact, given the ESM structure, **democratic control over the actions of the member states with regard to the ESM is in the hand of national parliaments**. Because of their nature, however, national parliaments tend to focus on the interest, mostly financial, of their country and not on the functioning of the mechanism as a whole.

Among many commentators, there is a widespread feeling that EMU should continue in its process of political integration, which would resolve many of the issues raised above. The

²⁷ The European Parliament participated in the negotiations of the Treaty on the Stability, Coordination and Governance of the EMU and of the Single Resolution Mechanism.

²⁸ See Annex 3 of the European Parliament resolution of 23 March 2011 on the draft European Council decision amending Art. 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 (www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+TA+P7-TA-2011-0103+0+DOC+XML+V0//EN#BKMD-4).

²⁹ As mentioned above, the Commission does not act alone, but in liaison with the ECB and IMF, the so-called Troika. In the past the role and responsibility of each of the three institutions has lacked transparency and raised a lot of questions about democratic accountability. In the future, given the changes in governance, the ECB is likely to play a much more limited role and should elect to leave the Troika (see Gros, 2015).

³⁰ See Alcidi et al. (2014).

proposals to create a parliament for the euro area or to appoint a finance minister,³¹ or form a Treasury are all trying to respond the same question.

4. Conclusions and recommendations

The crisis and its management have set up a steep learning curve. Instruments had to be created rapidly and adapted to new circumstances. Now is an opportune moment to sit back and extract the lessons learned in terms of the functioning and institutional arrangements of the financial support programmes to start designing an architecture that can serve Europe for decades to come. There are a number of lessons learnt and a few crucial issues that still need to be resolved.

The most important lesson was that members of the euro area may need financial assistance to address macro-financial instability, just as non-euro area member states and, potentially, on a much larger scale.

The unpreparedness of the euro area to respond to the crisis led to the creation of many ad hoc macro-financial stability (MFS) instruments, which now need to be rationalised. Three of the existing facilities, the Greek Loan Facility (GLF), the European Financial Stability Facility (EFSF) and the European Financial Stabilisation Mechanism (EFSM), seem to be headed towards a slow winding down process and their tasks are progressively being taken aboard by the European Stability Mechanism (ESM). Moreover, given that in the long term all EU Member States will have adopted the euro as their currency, the Balance-of-payments (BoP) assistance facility is also destined to disappear. These processes imply that, in the long term, the European Stability Mechanism (ESM) will remain the only macro-financial stability (MFS) instrument.

The Euro area needs a strong and well-functioning financial stabilisation mechanism which caters for the euro area stability and is in line with European objectives. The Euro area and its Member states cannot rely on the International Monetary Fund (IMF) that has the mandate is to safeguard global financial stability. In a future crisis within the euro area the IMF might thus decline to intervene if the global financial system is stable, whatever happens inside the euro area. Any threat to the stability of the euro area merits a common response because (as we have seen) the cost of a financial/banking crisis can be very large and requiring an urgent response to limit the damage.

This eventuality raises fundamental questions about how to construct a coherent 'financial arm' of the EU and where to place the European Stability Mechanism.

As mentioned above, the European Stability Mechanism (ESM) will, at some point, be integrated into the EU law framework, but there has been no thinking yet about how this will be done, about its linkages, if any, with the EU budget and about how to ensure democratic

³¹ See for instance Enderlein & Haas (2015).

control over its operations and the prejudice it will possibly encounter as a result of the budgetary sovereignty exercised by national Parliaments.

These are complex questions requiring in-depth analysis. At this stage, **two extreme options** can be considered as a starting point:

- 1) A first option would be to integrate the European Stability Mechanism (ESM) into the EU law framework, mimicking the structure of the existing European Financial Stabilisation Mechanism (EFSM), with all the implications this entails in terms of EU budget and parliamentary oversight. This would mean a radical transformation of the current ESM.
- 2) A second option is to re-create the European Stability Mechanism (ESM) as a new EU stand-alone, independent institution, with its own staff and democratic accountability mechanism. This would imply that the ESM is not only in charge of providing financial assistance but it is also responsible for the design, the negotiation and the monitoring of the adjustment programme, which defines the conditionality for the disbursement. In performing its tasks, it should be accountable to the European Parliament for the overall functioning of the mechanism.

The latter option is in line with the proposal to create a European Monetary Fund, as suggested by Gros & Mayer (2010), even though such a proposal aimed at establishing a risk-based system to constitute a real ex-ante fund, not unlike the SRF, to finance future operations. The European Stability Mechanism (ESM) financing is different and unlikely to change.

Another issue relates to the **'transition' period**, which is likely to still be long, before the European Stability Mechanism (ESM) becomes the only macro-financial stability instrument, and whether the Balance-of-payments (BoP) assistance should remain separate from the ESM or become an arm of it.

Similar questions hold for the European Financial Stabilisation Mechanism (EFSM). A large part of the lending capacity of the EFSM will not be available until 2042 because it has been used up by very long-term loans to Portugal and Ireland. One way to re-establish the lending capacity of the EFSM would be to transfer its existing outstanding loans to the European Stability Mechanism (ESM).³² Such an operation would also clarify that the risk under EFSM lending falls only on euro area member states. This is the case anyway for new loans under the August 2015 addendum, but only in an indirect way, as the euro area member states promise to indemnify the non-euro area states in case there is a loss from an EFSM operation.

The European Financial Stabilisation Mechanism (EFSM) would, by itself, not constitute an important instrument if a systemic euro crisis were to return. However, if fully available, its €60 billion could make a decisive contribution in the event that only one of the smaller member states had difficulties. In any event, the amounts needed in a future crisis should be more

³² Technically this would work only if the bonds issued by the Commission could be called early and the ESM could refinance the operations at the same rate as used by the Commission.

limited given the Banking Union, which should limit the over-lending at the national level, and the Single Resolution Fund (SRF).³³ For any one country of a GDP below €300 billion, the EFSM could provide up to 20% of GDP and thus constitutes a key element for a rescue package. Given that there are over 15 member states below this size, it cannot be excluded that at some point in the future only a limited amount might be needed. Viewed from this perspective, the EFSM could then turn out to be an important instrument to be used under the normal Community decision-making mechanisms and the scrutiny of the European Parliament.

³³ Also close to €60 billion on its own when fully constituted.

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Annex

Table A1. ESM disbursements to Greece

Date of disbursement	Amount disbursed (€ bn)	Maturity*	Cumulative amount disbursed (€ bn)
20/08/2015	13.0	Amortisation from 2034 to 2059	13.0
24/11/2015	2.0	Amortisation from 2034 to 2059	15.0
1/12/2015	2.7	Interim maturity coinciding with maturity of ESM notes**	17.7
8/12/2015	2.7	Interim maturity coinciding with maturity of ESM notes**	20.4
23/12/2015	1.0	Amortisation from 2034 to 2059	21.4
21/06/2016	7.5	Amortisation from 2034 to 2059	28.9
26/10/2016	2.8	Amortisation from 2034 to 2059	31.7

* Weighted average maturity of loans (excluding cashless disbursements): 31.97 years.

**The final maturity will be in line with the maximum weighted average loan maturity of 32.5 years.

Table A2. ESM disbursements to Cyprus

Date of disbursement	Amount disbursed (€bn)	Maturity*	Cumulative amount disbursed (€bn)
13/05/2013	1.00	13/05/2026	
13/05/2013	1.00	13/05/2027	2.00
26/06/2013	1.00	26/06/2028	3.00
27/09/2013	0.75	27/09/2029	
27/09/2013	0.75	27/09/2030	4.50
19/12/2013	0.10	19/12/2029	4.60
4/4/2014	0.15	4/4/2030	4.75
9/7/2014	0.60	9/7/2031	5.35
15/12/2014	0.35	15/12/2025	5.7
15/07/2015	0.10	15/12/2031	5.8
15/07/2015	0.20	8/10/2029	6.0
8/10/2015	0.30	8/10/2031	6.3

*Weighted average maturity of loans: 14.9 years.

Table A3. EFSF disbursements to Portugal

Date of disbursement	Amount disbursed (€bn)	Maturity	Cumulative amount disbursed (€bn)
22/06/11	3.70	01/07/2036	3.70
29/06/11	2.20	03/12/2025	5.90
20/12/11	1.00	03/12/2025	6.90
12/01/12	1.70	30/01/2035	8.60
19/01/12	1.00	18/07/2027	9.60

30/05/12	3.50	30/05/2032	13.10
30/05/12	1.70	30/05/2035	14.80
17/07/12	1.50	17/07/2038	16.30
17/07/12	1.10	17/07/2040	17.40
03/12/12	0.80	03/12/2028	18.20
07/02/13	0.80	07/02/2026	19.00
27/06/13	1.05	27/06/2033	20.05
27/06/13	1.05	27/06/2034	21.10
22/11/13	3.70	22/11/2033	24.80
28/04/14	1.20	28/04/2038	26.00

Note: Weighted average maturity of loans: 20.8 years.

Table A4. EFSF disbursements to Ireland

Date of disbursement	Amount disbursed (€bn)	Maturity	Cumulative amount disbursed (€bn)
1/2/2011	1.9	1/8/2032	1.9
1/2/2011	1.7	1/8/2033	3.6
10/11/2011	0.9	1/8/2030	4.5
10/11/2011	2.1	25/07/2031	6.6
15/12/2011	1.0	1/8/2030	7.6
12/1/2012	1.2	1/8/2029	8.8
19/01/2012	0.5	1/7/2034	9.3
3/4/2012	2.7	1/8/2031	12.0
2/5/2013	0.8	1/8/2029	12.8
18/06/2013	1.6	18/06/2042	14.4
27/09/2013	1.0	27/09/2034	15.4
4/12/2013	2.3	4/12/2033	17.7

Note: Weighted average maturity: 20.8 years.

Table A5. ESM disbursements to Spain (for banking sector recapitalisation)

Date of disbursement	Amount disbursed (€bn)	Maturity	Cumulative amount disbursed (€bn)
11/12/2012	39.468	11/12/2027	39.468
5/2/2013	1.865	11/12/2022	41.333

Note: Weighted average maturity: 12.5 years.