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A FINANCIAL FIREWALL FOR THE EUROZONE –

THE COMBINATION OF ESM AND EFSF AS AN APPROACH TO RESCUE THE EURO?

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List of used abbreviations

Bn	billion
CAC	Collective Action Clause
DSA	Debt Sustainability Analysis
ECB	European Central Bank
EFSF	European Financial Stability Facility
EFSM	European Financial Stability Mechanism
EMU	European Monetary Union
ESM	European Stability Mechanism
EU	European Union
GDP	Gross Domestic Product
IMF	International Monetary Fund
MoU	Memorandum of Understanding
MS	Member State
TFEU	Treaty on the Functioning of the European Union

"We have to stop the bush fires turning

into a Europe-wide forest fire"

(Olli Rehn in December 2010)[1]

1. Introduction

During the past three years, the economic and financial stability of the euro-zone was put into jeopardy several times and the continuity of its common currency *the euro* was highly questioned even leading to speculations of its reaching the brink of existence.

The euro crisis might have started in Greece, but taking into consideration the architecture of the European Monetary Union as it exists today, the problems did not remain a solely Greek problem for a long time. The close conjunction of the European countries and their economies facilitated a fast overlapping of the Greek problems to other European peripheral countries, and the image of a fire inferno that seizes one country after the other quickly became a popular saying not only for EU government officials to describe the unprecedented crisis of the euro-zone. In the meantime emergency measures to provisionally contain the skipping of the flames were introduced and proposals were put forward comprising possible future approaches to deal with the new type of European crisis. In this context the demand for a European *financial firewall* that would safeguard the euro area from contagion and provide stability was quickly established. On October 29th 2010 the EU leaders agreed to establish a permanent crisis resolution mechanism – the European Stability Mechanism – that should be equipped to demonstrate a sufficient *firewall* as a protection shield for the euro area Member States.

Until 2009, for the most people it was simply unimaginable that the European Union would find itself in such a despairing condition. When just a few years after the Second World War the European Community was established and thenceforth the European Community and its responsibilities did steadily grown (AUEB.2006), not only in size through the accession of new Member States, but also in political and economic power in response to new developments and challenges. Ten years ago in 2002, when the euro was introduced as a currency for the European Monetary Union, the main intention was not to just replace the national currencies in 12 of the 15 countries which were members of the EU at that time, but also to guarantee the further concrescence of the European Community. A single currency was supposed to promote the European unity. And even in the beginning

[1] Olli Rehn cited in "the economist" (2010, December 9th)

of 2008, just a few months after the beginning of the financial market crisis in the United States, the German Minister of Finance Peer Steinbrück said about the euro: *"my feeling about the euro's success is close to euphoric. It is one of the greatest success stories in the history of the European Community" (van Overtveldt.2011. p.77)*. And this was only one example of the celebrations of the "*success-story euro*" up to that time. Since its introduction in 1999 as a cashless currency and its going into circulation in January 2002, the euro had been a great success for the members of the euro-zone. Joining the euro provided its member countries with a number of advantages: Among them being enhanced currency stability in- and outside of the euro area, low inflation and interest rates as well as enhanced credibility which made the currency more stable against speculation on the international capital market. At the time of its introduction the euro seemed like the next important step in the creation of the EU single market (EU Commission.2012) and a deeper European economic integration.

The situation changed when in late 2008 the worldwide recession also hit the euro-zone and got even worse in 2009 and since then, the euro-zone has had to deal with a sovereign debt crisis that not only poses a threat to the economic stability of the Member States of the euro area but reaches far beyond the borders of the European Community. The situation in Greece and its possible effects on other euro area Member States drew attention to a new type of crisis for the European Union: the threat of insolvency faced by one of the euro area Member State. Not long after, the euro area leaders agreed on different potential rescue measures that would not only stabilize the Greek economy but would also be available to other Member States if needed. However soon reality sat in and it had to be realized, that the available temporary measures did not reach far enough and it became obvious, that the euro-zone was not equipped to deal with this new kind of crisis.

1.1 Thesis Objective

The sovereign debt crisis in the euro-zone represents not only a new type of crisis for the EU but it also requires a new way of approaching and dealing with this kind of situation. Following the Greek bailout packages and the introduction of temporary rescue mechanisms over the past two years a number of different concepts have been discussed including alternative approaches reaching from the strengthening of the economic governance in the EU towards the establishment of a crisis resolution mechanism for the euro-zone. Consequently a number of proposals have been made including the idea of a European Monetary Fund, or the issue of a common euro area bond. So far these

proposals have not been taken forward yet. In late 2010, the European Council proposed the establishment of a permanent rescue mechanism (Zandstra.2011. p.299) that would be authorized to grant financial assistance to MS in need. The European Stability Mechanism is not supposed to be a simple continuation of the existing temporary emergency measures but a strict and permanent emergency mechanism to be activated only if inevitable for the stability of the euro area.

In the following, the present Bachelor thesis aims to give further insight into the circumstances of the establishment of the ESM and its possible consequences for the further development of the European approach in dealing with a financial crisis that not only affects one MS but puts the whole euro area at risk. Against this background, the main research question of the present thesis reads as follows:

To what extent may the European Stability Mechanism contribute to the rescue of the euro?

The research question has the objective to guide the analysis of the thesis. The aim is to preliminary evaluate the potential contribution of the ESM also in combination with the European Financial Stability Facility as the European *financial firewall* for the rescue of the euro. For the reason that the topic has a high degree of sensitivity towards day-to-day transformations a final and irrevocable evaluation at this point in time is simply not possible. Nonetheless the topic is of high relevance considering that the euro-zone reached a defining crossroad that will influence the future of the *euro* as a common currency and will affect the further development and integration of the European Union.

1.2 Methodical Proceeding

Taking into account the high actuality of the topic, the Bachelor thesis follows a normative approach and is therefore based on literature reading, and the study of relevant scientific studies. To analyze and evaluate the development of the ESM and its implications, contributions of different international authors to the existing literature are studied and if possible compared.

In order to assess the implications of the establishment of the ESM, the first objective is to consider the beginning of the euro crisis, by exploring its commencing in Greece in 2009. Subsequently after outlining the origination of the Greek almost insolvency in 2009 the main European responses towards the crisis in Greece have to be considered. Therefore an overview of the European bailout packages to Greece is given and the temporary

support measures by the EU are presented. The following part comprises an extended overview of the ESM, by presenting its legal and architectural construction as well as its available instruments for granting financial assistance. Preceding this, the discussed options for building a financial firewall with the ESM in combination with the EFSF are portrayed and the question is posed whether the options allow for a *firewall* that is *high* enough to perform the tasks given. This directly afferents to the preliminary assessment of the ESM and EFSF supported by a *SWOT analysis* following the example of Sony Kapoor in his *study "Improving and Expanding the EFSF"* published in Re-Define in 2011. The thesis will then conclude with a short review of the ESM.

2. The Greek Crisis and Major European Policy Responses and Measures

The unfolding of the crisis started in 2009 with the report of the then newly-elected Greek government, that the Greek budget deficit had been underreported for years and that Greece was threatened by insolvency. On October 19th 2009 after the meeting of the *Eurogroup,* Jean-Claude Juncker announced that the Greek public deficit for the year 2009 would be twice the amount as the expected 6 percent of the GDP reaching 12 to 13 percent of the GDP. It was revised up to 12.7percent and later even to 13.6percent of the GDP (D&B.2012. p.2). This statement not only lead to the degradation of Greece by the international credit rating agencies but also drew attention to a new type of crisis for the European Union: the threat of insolvency faced by one of the euro area MS.

In addition, some other major problems of the euro-zone including major imbalances and a fragile banking sector became obvious. There was also the strong probability that problems faced by Greece could also spread to other euro-zone members as for instance Ireland and Portugal, and concerns about the future of the other heavily indebted countries in Europe were raised. The governments and people were confronted with a *"make it or break it"* situation not only for single Member States but for the euro-zone and Europe as a whole. The crisis was not only about the money alone anymore, it was also about the European idea and the future of Europe.

In the subsequent years the European leaders as well as the European Union as a whole undertook a number of steps and implemented unprecedented policy measures to try to tackle, or at least try to contain the effects of the world-wide financial crisis, both in the European Union as such and especially within the euro area of the European Union. (EU

Summit Statement. 2011. p.1) Some of the key response measures taken by the European Community included the design of a revised strategy with the main objectives being to ensure fiscal consolidation, to support countries in difficulty, and the strengthening of the euro area governance structures. (EU Summit Statement. 2011. p.1)

2.1 The European Emergency Measures

On May 2nd 2010, the first Greek bailout package was passed by the European Council. Together with the IMF the European Union provided a total of 110bn euros of bailout loans to Greece to help the government pay its creditors. This first rescue package included 80bn euros from the Member States of the euro-zone (by reference to their proportion of paid-up capital at the European Central Bank) as well as additional 30bn euros from the IMF in the form of bilateral contributions conditional on the implementation of austerity measures. The EU and IMF loans are supposed to run for three years until 2013 which should allow Greece to avoid large-scale borrowing and financing on the private and public capital markets until 2012. (Dullen/Schwarzer.2011. p.15) The financial rescue package was subject to a strict macro-economic adjustment program including "*quarterly quantitative fiscal targets as well as phased fiscal and structural reforms" (Zandstra.2011. p.286)*. As a consequence, the Greek government was subject to implement various austerity measures including cuts in public spending and tax rises, a reform of the pension system as well as other structural policies.

Shortly after the first rescue package for Greece was passed, the situation on the financial markets deteriorated with a sharp fall of trading in Greek bonds and a strong rise in the cost of insuring loans to the problem states against default. As a reaction to these developments and the risk of contagion from one euro area Member State to another, on May 9th 2010 the EU leaders created a 750bn euros safety net of loans to be able to expand assistance to cover all euro-zone states. (Dullen/ Schwarzer.2011. p.14) This so-called safety net was build-up of three possible sources for emergency loans and credit guarantees (Zandstra.2011. p.287):

I. 60bn euros from a European Financial Stability Mechanism (EFSM)
II. 440bn euros from the European Financial Stability Facility (EFSF)
III. 250bn euros made available by the International Monetary Fund

In addition to the safety net, the ECB announced the establishment of its *Securities Market Program* which would allow the ECB to intervene in the secondary market for euro area government bonds (Zandstra.2011. p.287). The objective here was that through the

purchase of Member State's bonds the bond notation and hence the interest rates of the specific MS would stabilize. (Dullen/ Schwarzer.2011. p.14)

2.2 The European Financial Stability Mechanism (EFSM)

The European Financial Stability Mechanism as a first line of emergency fund was set up to support the defence of contagion of the sovereign debt crisis. It was established by the Council Regulation (EU) N°407/2010 of 11th May 2010 with regard to Article 122(2) of the Treaty on the Functioning of the European Union (TFEU) and constitutes an important pillar of the European framework for addressing the current exceptional circumstances on the financial markets. It facilitates the support of euro area MS by providing financial support to Member States with financing problems with a maximum amount of 60bn euros.

The emergency measure is funded by the own capital resources and guaranteed by the EU budget. In case the EFSM should be activated the European Commission on behalf of the European Union would be authorized to borrow a maximum amount of 60bn euros on the financial markets. The loan is then further processed to the MS in need. Through these lending conditions the EU does not have to pay any debt-servicing cost (EU Commission.2012b), the interest rates as well as the loan itself has to be paid back by the beneficiary MS via the European Commission. The repayment is guaranteed by the EU budget and consequently in the case that a beneficiary MS of the fund should default, the debt service would be drawn from the EU's budget.

According to Article 122(2) TFEU the general scope of the mechanism includes assistance to those euro area Member States that are threatened by, or experiencing severe financial disturbances due to exceptional occurrences beyond their control. Difficulties under the scope of the Article 122(2) TFEU may be caused by a serious deterioration in the international economic and financial environment. (Council Regulation (EU) No 407/2010) In the case of these events, the EFSM may grant a loan or credit line to the Member State in need.

The first time the EFSM was activated was in the case of Ireland in November 2010. Out of the total amount of 62.7bn euros of the Irish rescue package the EFSM provided 22.5bn euros. (FAZ.2011) The EFSM has also been activated for Portugal in May 2011, for a total amount of up to 26bn euros over a total disbursing time of three years.

In order for the EFSM to become activated for a state, a request for financial assistance has to be made by the concerned MS. Financial assistance under the scope of the EFSM

is subject to strict conditionality incorporating a macroeconomic adjustment program that has to be agreed on by the ECB and the Commission.

The granting of financial assistance follows a specific procedure: the first step is the request for financial assistance by a Member State. A request has to include the assessment of the financial needs of the MS as well as the draft of an economic and financial adjustment program that comprises the measures and reform plans of the Member State that would have to be taken to restore its financial stability.

Based on a proposal by the Commission, the Council makes a decision whether financial assistance will be granted to the applicant. Decisions by the Council are made by qualified majority and have to include the detailed terms and conditions for the financial assistance. This includes firstly the economic and financial adjustment program drafted by the Member State itself, as well as the general procedures for the financial assistance. Besides, the details about the amount, the number of payments and the period of time the financial assistance will become available. The Commission additionally sets general economic policy conditions for the financial assistance with the main objective to serve as an additional guideline for the MS in distress to re-establish a sound economic situation with the goal that it will be able to finance itself on the capital markets again (EU Commission.2012c) and thereby contribute to its economic recovery.

In addition, the financial assistance measures respectively the general economic policy conditions are subject to a Memorandum of Understanding. This additional legal document between the MS and the Commission outlines further requirements and responsibilities for each signatory (Investopedia.2012) and establishes a code of practice between the parties. On a regular basis the compliance of the Member State with the outlined conditions and practices is then examined by the commission and the ECB. (EU Commisssion.2012c)

The EFSM is only one part of the wider safety net for the euro-zone. Next to the European Financial Stabilization Mechanism, the European Financial Stability Facility (EFSF) was founded by the euro area Member States.

2.3 The European Financial Stability Facility (EFSF)

The EFSF is the second rescue fund that was established by the euro area Member States. In contrast to the first rescue fund, the EFSF was established as a company incorporated under Luxembourgish law on June 7th 2010 and consequently is more

substantial than the EFSM. The reason for the ad hoc establishment of the EFSF by the European Finance Ministers of the euro-zone can be seen in the recent events during the first week of May 2010 on the financial markets that preceded the decision. In order to prevent the eruption of a *systemic crisis* similar to the financial crisis in 2008 and to protect the euro area MS from the threat of contagion, the European Heads of State and Government decided to take the necessary steps to protect the stability and integrity of the euro and the euro-zone as a whole. (Bundesministerium der Finanzen.2011) In addition they decided to take the necessary measures to consolidate the budgets of the states.

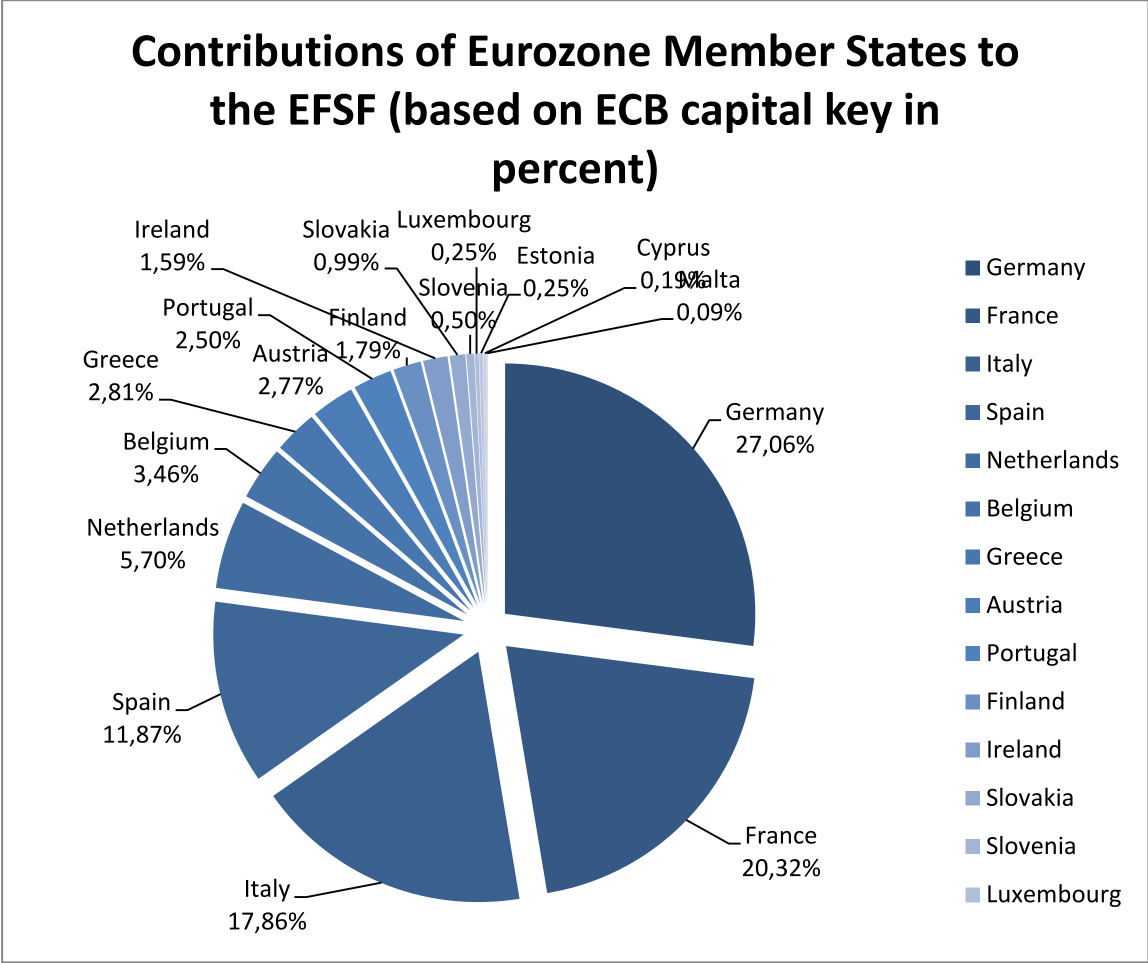
The fund was intended to help those euro area Member States that had lost access to the financial markets to cover their financing needs. The main objective of the EFSF is to preserve the financial stability of the EMU as a whole by providing temporary financial assistance to euro area MS if needed. The EFSF was set up with a temporary operation period of three years until June 2013. (EFSF.2012b) It is explicitly stated that the EFSF can only finance loans prior to June 30th 2013 and that after all funding has been repaid, respectively if there are no outstanding loans anymore, the EFSF will be liquidated. (Zandstra.2011. p.289)

Shareholders of the fund are the euro area Member States therefore the board of the intergovernmental body is comprised of one representative of the 17 euro area MS each. Additionally there are observers from the European Commission and the ECB present on the board.

Since the 4th of August 2010 the EFSF is fully operational with the possibility to issue credit guarantees for the MS of the euro area up to 440bn euros. (Christova.2011. p.50) The issues are backed by irrevocable and unconditional guarantees by the shareholders in compliance with their share of paid-up capital of the ECB. In order to ensure its *AAA* rating by the rating agencies *Standard& Poor's* and *Fitch* and an *Aaa* rating by *Moody's* it includes an over-guarantee of the amount borrowed by 120 percent. Therefore its lending capacity does not correspond to its funding volume.

On June 24th 2011 it was agreed by the EU Heads of State and Government to increase the funds scope of activities, and to raise the effective lending capacity of the EFSF to 440bn euros (guaranteed commitments were raised from prior 440bn euros to 780bn euros). Following all necessary national procedures on the 18th of October 2011, the amendments to the EFSF framework could come into force. (EFSF.2012a.)

Figure 1: Contributions to the EFSF by the euro area Member States



Source: own representation based on *Bundesministerium der Finanzen*

After the amendments to the framework in October 2011, the EFSF is constituted of the following key features:

The fund is authorized to make use of the following financial assistance instruments: 1) loans, 2) loans specifically for the re-capitalization of banks through loans to governments also including non-program countries, 3) the provision of precautionary programs as for instance credit lines that can be made available if needed, 4) government bond purchases on the primary market, and 5) government bond purchases on the secondary market. (Deutscher Bundestag.2012)

The EFSF may issue bonds or other debt instruments on the market to raise the funds needed to provide loans to countries in financial difficulties. All financial assistance to euro area MS is linked to appropriate conditionality. Consequently in order for the supporting measures of the EFSF to become activated the concerned Member State has to fulfill specific requirements. All of the five mentioned financial assistance instruments presume

that the measures are i*ndispensable* and necessary to *ensure the stability of the euro-zone as a whole.* In addition there is the further requirement that the measures would *prevent contagion from one euro area Member State to another* that has to be fulfilled in order to profit from the following measures: loans for the recapitalization of banks, the precautionary programs and the intervention in the debt secondary markets. Furthermore in order to purchase government bonds on the secondary market the ECB has to state that there are exceptional circumstances on the financial markets prevailing that put the financial stability at risk. (Sauer/ van Roosebeke.2011. p.2)

Both ESFM and EFSF were set up in May 2010 in an ad-hoc manner as a temporary rescue measure for Greek and other European countries. Their main objective then was to send a positive signal to the international financial market to restore their trust in the affected countries and to shield them against further speculations which would have put additional pressure and their financial situation. However since both instruments were established on a temporary basis, there was no time to give them a necessary legal foundation by including them into the European legal system specifically by adapting the relevant articles in the TFEU.

As the situation and conditions of the market for the European peripheral countries deteriorated very quickly, it became obvious that Europe and especially the euro-zone were in need for a permanent solution to deal with the Greek crisis and similar situations that might arise in the near future. Consequently instead of renewing the temporary rescue measures, the EU leaders decided to establish a permanent rescue mechanism for the euro area to protect the stability and integrity of the EMU. In October 2010 the Council decided to draw up a new treaty that would create the new permanent mechanism. On December 16th 2010 the European Council agreed on changing the Treaty of Lisbon in order to be able to establish the European Stability Mechanism.

2.4 The Second Greek Rescue Package

On July 21st 2011 the Greek rescue package was topped up with a second rescue package with a total volume of 130bn euros. Euro-zone leaders agreed to offer the second bailout loan for Greece on the condition of the implementation of another set of austerity measures. This time the package also included the agreement of private creditors to contribute to the restructure of the Greek debt. The MS of the euro area

agreed to contribute 100bn euros in the form of loans to the Greek government until 2014. (Tagesschau.de.2012)

In contrast to the first rescue package from May 2010, the financial assistance of the second bailout package is provided by the funds of the EFSF. While in 2010 the Member States of the euro area had to grant bilateral loans directly to the Greek government, that is not the case for the second rescue package anymore. Through the financial assistance by the EFSF the governments of the euro-zone only give guarantees for the measures. Only in the case of a Greek default the euro area countries would have to stand in for their given guarantees.

The loans in the amount of 100bn euros to favorable conditions by the EFSF are supposed to assist the Greek government to cover its financial needs in the following years. Additional 30bn euros are supposed to cover the protection of Greek government bonds as an incentive for private investors. (Tagesschau.de.2012)

3. The Permanent European Stability Mechanism

The development in Greece illustrates, that the temporary rescue measures were not sufficient enough to safeguard the economic and financial stability of the euro area, but they had to be combined with further policy measures in order to reinforce the economic governance framework of the euro-zone. The European Stability Mechanism will complement this new framework of reinforced economic governance that aims at a more effective economic surveillance in the euro-zone and focuses on prevention.

3.1 The European Stability Mechanism – an Introduction

The European Stability Mechanism is the permanent crisis management framework that was specifically designed for the euro-zone. The mechanism, an international financial organization under public private law, is based in Luxembourg. It was initially set up to safeguard the financial stability in the euro area, and to prevent the risk of financial contagion mainly by providing financial assistance to euro area MS in times of need.

The ESM is part of the measure packages – the so-called *"rescue parachutes"* and will mainly build on the features of the existing European Financial Stability Facility and therefore will to a great extent assume similar tasks. Following the decision of the

European Council of 25th March 2011, the 17 Finance Ministers of the euro area signed the Treaty establishing the ESM on July 11th 2011 and a second version with changes on February 2nd 2012 to make the ESM more effective. After ratification by the euro-zone MS the ESM was due to be launched mid-2013 as a successor of the temporary EFSF. Against the background of recent developments it was then decided in December 2011, that the ESM should be introduced earlier and already become operational in mid-2012 after the successful ratification by the national parliaments of the Member States. It was projected, that beginning in July 2012 the ESM would be in effect to secure the financial solvency of the states of the euro-zone members.

3.2 Legal Construction of the ESM

In order to implement the ESM, two important steps had to be taken: The first step involved a change of the existing Treaty of the Lisbon[2]. The European Council agreed that in contrast to the emergency rescue packages, the ESM should not be based on the Article 122(2) of the TFEU anymore which caused discussions about the bailout problematic of the euro area Member States under the temporary rescue mechanisms. In consequence the MS decided to relax the existing "no-bail-out clause" in the EU treaties by amending the Article 136 of the TFEU through a simplified revision procedure as it is set out in Article 48(6) of the Lisbon Treaty. The following paragraph was added to Art.136 TFEU:

> "*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."*

Thereby the members of the euro-zone constructed the legal basis to allow financial assistance to MS if this is "*indispensable to safeguard the stability of the euro*". Emphasis is put on the aspect that the financial assistance should be seen as an *"ultima ratio*" only to be used as a last resort.

The second step of the introduction of the ESM is its establishment through an international treaty, the so-called ESM Treaty. On February 2nd 2012 the second version of the treaty was signed by the 17 euro area MS. In order to come into force the ESM Treaty has to go through the national ratification process of the euro area Member States.

[2] Treaty of the Functioning of the European Union

To become operational, the ESM Treaty has to be ratified by its Member States that together provide at least 90% in value (capital stock payable to the ESM Institution) respectively voting power of the euro-zone Member States. As of July 20th 2012, the ratification process of the ESM was completed in nine Member States[3] and approved at parliamentary stage in seven[4] Member States. But with Germany and Italy as two of the biggest MS of the euro area missing among the countries that completed the ratification process, the ESM could not enter into force yet. As long as decisions are still pending, the EFSF is the mechanism in place that can grant financial assistance to euro-zone countries in need.

3.3 Main Organs of the ESM

According to Article 4(1) of the ESM Treaty, the ESM will have the following three main bodies: the Board of Governors, the Board of Directors and the Managing Director.

I. The Board of Governors

The Board of Governors will consist of the 17 European Ministers of Finance of the Eurozone members. Each ESM Member State will appoint one Governor and one alternate Governor from its government who has responsibility for finance. The Board of Governors is the body that will assume the responsibility of making all the primary decisions as for instance deciding on the granting of financial assistance to a country in need (Art. 5(6) ESM Treaty).

The decision making process of the Board of Governors is based on mutual agreement. An exception can be made in cases of emergency that are very time sensitive. Here the modified treaty provides for a procedure that allows for a decision to grant financial assistance to be taken by qualified majority of 85% of votes cast. In order to decide by mutual agreement, the Commission and the European Central Bank both have to conclude that there is no viable alternative to an adoption of a decision in order safeguard the economic and financial sustainability of the euro area. (Factsheet.2012.p.2)

II. The Board of Directors

The Board of Directors will assume tasks of the operational business of the ESM including the tasks delegated by the Board of Governors. Each of the Governors will appoint one Director as well as one alternate Director "*from among people of high competence in*

[3] CY, EL, FI, FR, IE, LU, PT, SI, SK
[4] AT, BE, DE, ES, IT, MT, NL

economic and financial matters" (Art. 6(1) ESM Treaty) to the committee. Their main responsibility will be to ensure that the ESM is run in accordance with the Treaty and the by-laws of the ESM (Art. 6(6) ESM Treaty). Decisions by the Board of Directors will be taken by qualified majority.

III. The Managing Director

In addition according to Article 7 of the ESM Treaty, the Board of Governors will appoint a Managing Director as the third body of the ESM. The Director will be the legal representative of the ESM and shall act upon instructions of the Board of Directors and conduct the current business of the ESM. In order to be appointed Managing Director a potential candidate is required to have the nationality of one of the ESM Member States, the relevant international experience needed for this responsibility and a high level of competence in economic and financial matters.

3.4 Capital of the ESM

The ESM will encompass an authorized capital stock of 700 billion euro. Out of the total subscribed capital, 80 billion will be provided by paid-in capital of the 17 euro-zone MS with additional callable capital and guarantees in the amount of 620 billion euros to achieve the highest AAA rating from the credit rating agencies and thus to ensure a low interest rate on the capital market. The authorized capital stock is divided into seven million shares with a nominal value of 100.000 euros for each share. The initial shares as well as the other shares will be issued at par unless the Board of Governors decides to issue them under different terms and conditions.[5] According to Article 8(3) of the ESM Treaty shares are not transferable and cannot be encumbered or pledged in any manner.

National contributions to the capital of the ESM are established with a contribution key laid down in Annex I. and Annex II. of the ESM Treaty. In the case that a new state would join the euro area the contributions would increase automatically. (Dullen/ Schwarzer.2011. p.16) Each ESM Member State has a limited liability to its portion of the authorized capital stock. No MS will be liable for any losses of the ESM besides their contribution to the capital stock. If a Member State is eligible for, or is receiving any form of assistance from the ESM Institution, this will not affect its obligation to pay its contribution to the paid-in capital stock on time (Article 8(5) ESM Treaty).

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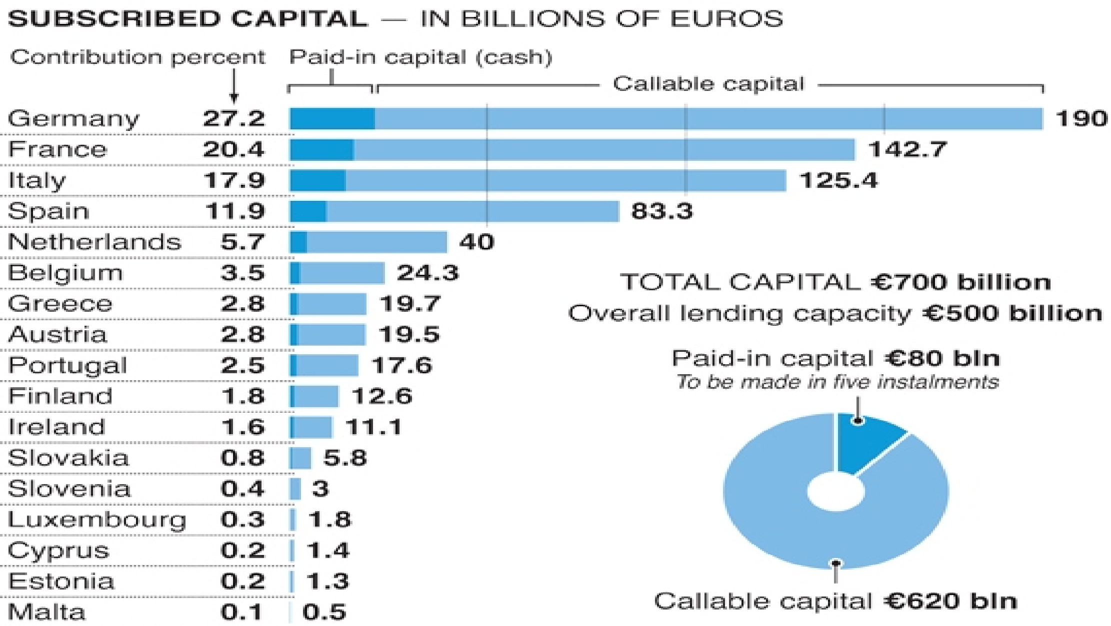
[5] Article 8(2) ESM Treaty

Figure 2: Capital of the ESM



source: Thomson Reuters (June 2012)

It has to be taken into account that the ESM's callable capital will not be ready for use immediately, in contrast to its paid−in capital. Since it is planned to be covered in five equal installments, the ESM will reach its full amount only in June 2014. According to the preliminary payment plan, the first two installments have to be made in July and October 2012, and the next two by mid−2013 and the fifth by mid−2014. (Eurobank EFG.2012. p.3)

For the transitional period between mid-2012 and mid-2013, when the EFSF and the ESM are supposed to run alongside, the total maximum amount of combined lending capacity from both funds for *new* lending programs will be capped at a maximum of 500bn euros (Eurobank EFG.2012. p.3). However according to the ESM Treaty there is the possibility for the Board of Governors to review on a regular basis whether the maximum ESM lending volume is still appropriate[6]. If necessary they might decide to make some adjustments and raise the required amount of capital of the ESM.

Additionally, if a Member of the ESM is not able to make its payments according to Article 9(2), (3) ESM Treaty, the fellow ESM MS will have to increase their share of capital accordingly to assure that the total amount of the paid-in capital is available upon call (Art.

[6] ESM Treaty Article 10(1)

25(2) ESM Treaty). The capital stock of the ESM would also be reduced in case a country does not complete the ratification process and consequently is not becoming an ESM Member State. Then the contribution share of the Member States would have to be recalculated accordingly. (Halbach.2012. p.1)

It has to be noted again, that as long as the ratification process of the ESM Treaty is not completed, the capital stock of the ESM cannot be provided and it cannot become operational. As shown in the graphic above of Thompson Reuters from June 2012, Germany has a contribution share of 27.2 percent and Italy a share of 17.9 percent of the subscribed capital. Taking into account that their contributions each amount to more than 10 percent, in order for the ESM to become active both countries have to complete the ratification process of the ESM Treaty.

3.5 Instruments of the ESM

As it is the case with the reformed EFSF, there are several instruments available for the European Stability Mechanism to grant financial assistance. An important feature of the ESM is that a distinction will be made between liquidity and solvency crises. While a liquidity issue for a country can be defined as a temporary cash flow problem, a solvency crisis is of rather serious nature because it occurs if the debt of a country cannot be met by its assets anymore. (Pettinger.2012) Consequently if a country is illiquid it means that at this specific point in time it is unable to cover current liabilities with the assets that are available. So even if the overall assets of a country are greater than its debts, the illiquid assets might result in the country's inability to comply with its payment requirements. In this case financial assistance in the form of emergency loans can be a viable option for this country. In contrast to that, a country suffering from a solvency crisis is unable to tend to its excess debt because the necessary assets to cover the liabilities are not disposable. There, just to rely on emergency loans is not an option. In the case of insolvency debt restructuring is necessary to bring the country´s finances back in order.

Consequently it is of main importance to be able to distinguish between liquidity and solvency problems of a country in order to choose the necessary instruments. In the case of a decision about the granting of financial assistance, the European Commission and the IMF, in liaison with the ECB will conduct a debt sustainability analysis (Europa.2010) following the standard procedure of the IMF assistance programs. If according to the conducted DSA a MS has a liquidity problem, the financial assistance by the ESM will be

subject to an adjustment program and in addition, the involvement of private creditors will be encouraged. In the event that the debt sustainability analysis reveals the insolvency of a country, this Member State has to draw up a comprehensive plan with private creditors (Europa.2010), and might be eligible for financial assistance through the ESM.

The possible "financial assistance instruments" may according to the ESM Treaty include the following five forms:

I. Credit lines (Article 14)

These are the ESM´s precautionary financial assistance instrument mainly intended for those Member States of the euro-zone that are in need of temporary financial assistance.
Precautionary financial assistance is available in two forms: either as a *precautionary conditioned credit line* or in the form of an *enhanced conditions credit line*. Both forms are granted by the Board of Governors and are suspect to strict conditionality. The main purpose of the credit lines is to support the states of the euro-zone that in general have fundamentally sound data and are only in need of *bridging loans* to mainly strengthen the trust of the financial markets.

II. Re- capitalization of financial institutions (Article 15)

The ESM may also grant financial assistance in the form of loans to the members of the euro-zone for the specific purpose of the re-capitalization of the financial institutions in the ESM Member State. However this form of financial assistance is subject to the European state aid law. Since the loan is granted to the ESM Member State, the Member State is responsible for repayment and compliance with the conditionality of the financial assistance for the re-capitalization.

III. ESM loans (Article 16)

The ESM will also be able to grant loans to the ESM Member States that are in need of financial assistance to help with funding difficulties. In return, the country has to commit to an extensive reform plan in the form of a macroeconomic adjustment program which is subject to strict conditionality comparable to the conditionality of the EFSF. The main target of the ESM loan is to assist the MS in need to achieve a sound economic and financial situation and to be able to finance itself on the capital markets again.

IV. Primary market support facility (Article 17)

In accordance with Article 12 ESM Treaty the Board of Governors are authorized to allow the purchase of bonds of an ESM Member State on the primary market. The reasons for a primary market bond purchase by the ESM Institution include the intention of assisting ESM MS to maintain access to the primary market as well as the re-accession of a Member State after the successful completion of an adjustment program.

V. Secondary market support facility (Article 18)

In accordance with Article 12(1) ESM Treaty the ESM might also be operational on the secondary market. However the purchase of government bonds on the secondary market should be regarded as exemption in exceptional circumstances. The secondary market support facility should only become available if according to Article 18(2) ESM Treaty the analysis of the ECB states that there is a risk to the financial stability due to the threat of contagion or the existence of the exceptional circumstances. This measure is subject to strict conditionality and aims at supporting and guaranteeing the availability of sufficient liquidity on the bond markets.

3.6 New Elements in the ESM

Even though the ESM was constructed in a similar way to the EFSF, there are a few innovations that are supposed to be implemented in the permanent crisis mechanism to strengthen it, and to make it more flexible in granting financial assistance.

I. Private Sector Involvement

A crucial element of the granting of financial assistance by the ESM will be the involvement of the private sector. This can include for instance banks or insurances and will follow the established practices of the IMF. According to recital 12 of the ESM Treaty the private sector involvement should only be considered if it contributes to the financial stability of the euro-zone in context with a macro-economic adjustment program under strict conditionality. In reference to that, the involvement of the private sector is not going to be included automatically but should be considered in an adequate and proportionate form (ESM Treaty.2012) on a case-by-case decision. The case-by-case decision will be

based on a debt sustainability analysis according to general IMF practice maintaining the necessary flexibility of the involvement and methods to be used. (IMF.2001) This will allow the spontaneous private capital inflows achieved by the traditional *catalytic role (IMF.2001)* of the IMF. This takes into account that by pursuing own interests, the private sector voluntarily contributes to the resolution of the crisis.

II. Collective Action Clauses

The second important new element of the ESM is the inclusion of debt restructuring clauses, the so-called *Collective Action Clauses*. As of the 1st of June 2013 *Standardized and Identical Collective Action Clauses* will be included for all new euro area government bonds. (EFSF.2011) These clauses will be standardized and identical for all countries and will provide the legal basis for the negotiation process with creditors. (Europa.2010) They will become obligatory for all new government bonds with maturity above one year.[7] The objective of these clauses is the prevention of individual creditors from blocking negotiations concerning specific debt restructuring measures and regulations (Bundesministerium der Finanzen.2012) as well as the reduction of the need for the additional involvement of third-party bailouts.

CACs in general can facilitate the restructuring of debt in cases where the government bonds are spread between many different groups of creditors that are therefore difficult to co-ordinate. Under such circumstances the inclusion of clauses in bond contracts that limit the ability of individual creditors to obstruct or to prevent an agreement of the majority of the creditors might be a benefit. (IMF.2001) Through the inclusion of CACs creditors will be enabled to pass by qualified majority a decision regarding a legally binding change to the terms of payment of the loans. Depending on the specific case of the involved parties the change of the term of payment can take the either the form of a *standstill, an extension of maturity, an interest-rate cut and/or haircut. (Europa.2010)*

There is a multitude of types of CACs available for different regulatory realms. During the Council meeting in March 24th and 25th in 2011 it was concluded to include *Standardized and Identical CACs* in the ESM Treaty. The decision for this type was based on the consideration that they will be the best option for the MS of the euro-zone because they "ensure a level playing field among them". (Christova.2011. p.54) In addition to that emphasis is put on the fact that CAC should be regarded as a tool that facilitates the

[7] ESM Treaty: Article 12(3)

discussion between a debtor and its creditors and does not per se increase the risk of restructuring. (Europa.2010)

3.7 Summit June 2012 – Changes for the ESM

During their meeting on the 28th and 29th of June 2012 the EU leaders agreed upon first changes to the ESM even though to this point the treaty has not been ratified by all MS yet.

The opening statement of the Council of Europe in the Euro Summit statement reads as following *"We affirm that it is imperative to break the vicious circle between banks and sovereigns" (Council.2012)*. In order to achieve this objective they agreed, that once they established a single banking supervisory mechanism, the ESM would be authorized to directly re-capitalize banks, bypassing the respective sovereign borrower. This mechanism is supposed to be subject to strict conditionality and should involve the ECB in compliance with state aid rules that would be formalized in a *MoU (Deutsche Börse.2012)*. This instrument is part of the agreed short term measures that should support MS under market pressure (EU Commission.2012d) and extend the flexibility of the EFSF/ESM to ensure the financial stability of the euro area in order to stabilize markets for MS. (Eurobank EFG.2012)

4. Evaluation of the ESM

It has been undisputed that the EU and specifically the euro area are in need of a permanent crisis resolution mechanism that would be able to address liquidity as well as solvency problems of its Member States, and in case safeguard the economic and financial stability of the euro area and thereby the common currency itself.

In the previous part of the thesis, the main elements of the ESM were presented. By looking at its legal structure as well as the instrumental design including the governance structure an insight was given to the potential of the mechanism for the granting of financial assistance under the specified terms and conditions of the ESM Treaty. In the following, these insights will provide the necessary background to assess and evaluate the ESM regarding its potential contribution to the construction of a protective *liquidity firewall* and the safeguarding of the stability of the euro-zone and the currency.

4.1 Options for the Sovereign Firewall

The combined lending power of the European Stability Mechanism and the European Financial Stability Facility represents the *European firewall* that is supposed to protect the euro area against economic contagion from heavily indebted countries (Giovannini/ Gros.2012. p.1) to other euro-zone MS. The combination of ESM and EFSF was made possible, when the Heads of State and Government agreed that the ESM should enter into force as soon as possible, preferably as early as July 2012, one year earlier than originally intended, while the EFSF would also remain active until mid-2013. This plan followed the logic, that by introducing the ESM earlier than planned and having it run parallel to the temporary rescue measure already in place, the euro area would be equipped with *adequate firewalls* to address current problems and be prepared for possible ones that might arise in the near future.

Here the questions arise what options are available to combine the ESM and the EFSF, and what implications the combination of both funds have for the rescue of the euro. In this context in March 2012 the *Eurogroup* and other euro-zone finance officials proposed three different options (Collins.2012) for *building the sovereign firewall* to make it *high* enough to be able to prevent contagion and support the European economy.

As of now, the ESM lending capacity is supposed to become equipped with a maximum amount of 500 billion euros when it enters into force and the existing European Financial Stability Facility has after lending 200billion euros to Ireland, Portugal and Greece, 240 billion euros left of its original available amount. There have been ongoing discussions by the European leaders about "*how high the firewall*" for the euro area needs to be in order to work efficiently and to be sufficient for all the possible economic scenarios that might occur. (Giovannini/ Gros.2012. p.1) Additionally the members of the G20 as well as the IMF and various others called on the leaders of the euro-zone to increase the *financial firewall* to equip it with more power and to protect it against speculation on the international capital market.

In the following, a short overview over three of the possible options for combining the ESM with the EFSF is presented. The options presented are based on the proposal of the European Commission that was discussed during the meeting of the *Eurogroup* in Copenhagen.

Option 1: Combination of the ESM with the used EFSF capacity

This option would combine the full capacity of the ESM with the committed resources of the EFSF (200bn euros). Thereby the total lending volume would increase from 500bn euros to 700bn euros but after subtracting the 200bn euros that are already committed under the EFSF for bailouts, the available lending amount would be 500bn euros (FT.2012) when the ESM enters into force.

Even if the effective lending capacity of the ESM /EFSF would be increased immediately to a total amount of 500bn euros with the entering into force of the ESM, the amount is likely to be insufficient to provide adequate funding for the MS in need of financial assistance.

Option 2: Combination of the ESM and full EFSF capacity

By combining the full volume of the ESM (500bn euros) with the full capacity of the EFSF (440bn euros) the maximum capacity of both funds would raise to 940bn euros. Consequently until the EFSF expires on June 30th 2013, the possible amount for lending under this combination would be increased to 740bn euros. (FT.2012) This would mean that as soon as the ESM would come into force, it could draw from its full amount of 500bn euros, while the EFSF could still provide new loans of about 240bn euros until its expiration date. After the expiration of the EFSF, the permanent *firewall* would then be reduced to 500bn euros including the capital of the ESM. (BBVA.2012. p.1)

So, on a temporary basis the increased effective lending amount of 740bn euros is able to *induce greater market confidence (Collins.2012)* and might cause other partners as for instance the IMF and G20 to unlock more resources and to increase their support for the euro-zone. However problems might arise in the market coordination (FT.2012. p.3) of both funds and competition between them might develop.

Option 3: Transformation of unused EFSF guarantees into ESM capital

The third option would increase the effective lending capacity of ESM and EFSF to 740bn euros. By transforming the EFSF's total guarantees of 440bn euros into the already subscribed capital of the ESM, the total lending ceiling would reach an amount of 940bn euros. Arguments in favor of this option state, that with a permanent effective lending capacity of the ESM of 740bn euros the structure of the *sovereign firewall* in quality as well as in *height* seems more *streamlined and robust (Collins.2012)*. In addition the new effective lending capacity of the fund would encourage other G20 partners (FT.2012.p. 4) as well as the IMF to support the ESM by pledging additional funds which would strengthen the effectiveness of the *financial firewall* even further.

During the meeting of the euro area minister in Copenhagen on March 30th 2012, the three options for a combination of the ESM and the EFSF were discussed and the decision was made to set the effective maximum lending volume of the ESM at 500bn euros as of mid-2013 (Eurogroup.2012). The combined lending ceiling of the ESM and the temporary EFSF was set at maximum of 700bn euros. (Vasarri/ Skoczylas.2012) So in total the finance ministers agreed to a maximum height of the sovereign firewall of more than 800bn euros to safeguard the financial stability of the euro area (Eurozone Portal.2012). This also includes the 49bn euros out of the EFSM and 53bn euros from the bilateral Greek loan facility which have already been paid out. In their statement of March 30th 2012 the *Eurogroup* announced, that as from its entering into force the ESM would assume the role of the main instrument that grants financial assistance (Eurogroup.2012) and the EFSF would focus on the financing programs that have already been set up before the completion of the ESM ratification process.

In their paper from March 30th 2012 Alessandro Giovannini and Daniel Gros from *CEPS*[8] did calculations whether the *financial firewall* of the euro-zone would be *high* enough to secure all euro-zone countries (Giovannini/ Gros.2012. p.1) and if necessary would be able to provide the funding to prevent contagion. Taking into account the experience made with Greece, that financial assistance programs might not work out as originally planned and instead of the return of the country to the capital market a second program of additional funding becomes necessary, the combined lending power of the ESM and the EFSF might still not be efficient enough.

According to the estimates of the IMF the financial assistance needs of Portugal, Ireland and Greece alone reach about 500bn euros. (Giovannini/ Gros.2012. p.1) Taking together the agreed funds of financial assistance by the various mechanisms in place, the total assistance through EFSM, EFSF, IMF funding and bilateral EU loans amount to about 390bn euros. (Giovannini/Gros.2012. p.1) The authors Giovannini and Gros concluded that an effective lending capacity of the ESM with about 500bn euros would hardly be enough to provide funding for Greece, Portugal and Ireland including the fact that there is need for a safety puffer in case the current programs are insufficient.

Consequently the available funding through the ESM would not be enough to cover potential financial assistance needs of other European countries like Italy and Spain.[9] In a

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[8] Centre for European Policy Studies, Brussels

[9] Based on IMF calculations, the financing needs of Italy and Spain together are likely to reach up to 1.800 billion euros.

worst case scenario, taking into consideration, that Greece, Ireland, Portugal, Italy and Spain are not able to contribute their share of the ESM capital, the effective lending capacity of the ESM would be reduced by 35% (Giovannini/ Gros.2012. p.3). Possible consequences would be that the ESM simply would not be equipped to provide the demanded funding and the *firewall* of the euro-zone would not be operational to fulfill its commitment of safeguarding the stability of the euro area.

4.2 Critical Assessment of the EFSF/ESM

Considering the current stage of the ratification process of the ESM, emphasis has to be put on the fact that Germany as the country with the highest share of capital contribution[10] has not yet completed the ratification with the decision of the German Constitutional Court still pending which puts the entry into force of the ESM in jeopardy.

Fact is, that several appeals against the ESM Treaty have been submitted to the German Federal Constitutional Court, which caused not only a delay in the successful ratification process, but the final decision has been postponed and is likely to take several additional months. (Halbach.2012) These recent developments illustrate only one aspect of the high sensitivity of the subject. It is also fact, that the ESM has been criticized by the European and international public as well as by economic and financial experts worldwide for months for various reasons. In the following some of the points of critique put forward by these experts and people are presented to exemplify the ongoing discussion about the European *financial firewall*.

4.2 SWOT Analysis of the ESM and EFSF Combination

In order to achieve a balanced assessment of the advantages and disadvantages not only of the ESM but also in combination with the EFSF, the evaluation of the mechanism will be based on a SWOT analysis based on a study by Sony Kapoor. (Kapoor.2011)

Usually the SWOT analysis is a tool used in business environments that originated in the Stanford Research Institute and dates back to the 1960s (Businessballs.n.d.). It is used by organizations to create a framework for their operations and to facilitate a company's decision-making process. SWOT is an acronym for **S**trengths, **W**eaknesses,

[10] 27.2% which accumulates to a German contribution in the amount of 190bn euros

Opportunities, and **T**hreats. By analyzing these four dimensions it is possible to achieve a more balanced evaluation of the topic beyond advantages and disadvantages.

Another main aspect of the SWOT analysis is its differentiation between internal and external factors that influence the assessment. Accordingly strengths and weaknesses are categorized as internal factors that are inherent, whereas opportunities and threats are external factors that include influences from the external environment.

I. Strengths

There are several advantages or strengths of the ESM as well as of the EFSF that would also benefit the euro-zone when both are combined to work together. Among the advantages, the greatest is, that in principle their general design does not differ a lot. The ESM was mainly build on the existing features of the EFSF and therefore a common basis is given. They correspond on the aspect, that they grant financial assistance to euro area MS in need as a *ultima ratio* to safeguard the financial stability of the euro-zone as a whole. Plus, they follow the same procedure for granting financial assistance that is subject to strict requirements based on an extensive DSA. The common basis is beneficial in two ways: first the ESM can profit from the experiences made with its predecessor mechanism EFSF that allows for making necessary adjustments in the design to avoid similar flaws that could make it subject to inefficiency. The second advantage is that the high degree of relation creates the opportunity to combine both funds during the transitional period until mid-2013 to build a *financial firewall* that has more potential than the ESM or the EFSF alone. And besides all critics, with the ESM the euro area would have a permanent mechanism and consequently a relatively clear and comprehensive body of legislation.

II. Weaknesses

The weaknesses of the ESM and the EFSF have been widely discussed and criticized. Predominantly is the fact that the capital of the ESM might not be enough to have any real impact in times of severe crisis. Even in combination with the remaining funds of the temporary EFSF, the *firewall* would not have the necessary funds to provide financial assistance to any of the larger MS. With the current effective lending capacity the ESM is only able to limited funding of states in distress in the European periphery.

Major internal flaws have been depicted in the governance structure of the ESM and the decision-making process of the main bodies is subject to critics. The highest decision-making body of the ESM is the Board of Governors which is comprised of the Ministers of Finance from the ESM MS. Here the problematic arises, that the ESM decisions will most

likely be subject to bias since the main actors are politicians who will act in the best interests of their country of origin. Consequently the decisions of the ESM will represent national interests rather than European ones. Plus considering, that decisions have to be taken by mutual agreement, the process can develop into a lengthy and difficult procedure that will inhibit the necessary flexibility of the ESM in times of crisis.

Another problem might be the interest rates of the ESM. According to critic, the interest rates are too high. The problem is that if the interest rates on loans are too high, the country might be unable to solve its liquidity problem which will in the end not be able to solve the underlying problem and just postpones a comprehensive solution.

Furthermore one of the major weaknesses that might turn out to be problematic in the future is, that the ESM Treaty is missing the possibility of a sovereign default of a MS. Taking into account the recent developments, a procedure for dealing with a sovereign default might be in demand sooner rather than later. So realizing and recognizing the need is not enough, but instruments and procedures have to be implemented to equip the ESM with the necessary influence to contribute to the resolution of the euro crisis.

III. Opportunities

Besides internal flaws in the architecture of the ESM, there is still capacity in the ESM to improve the euro area fiscal instruments to provide further crisis mitigation for the MS. The greatest achievement of the ESFS/ ESM discussion is probably the emphasis on the need for an integrated European framework that is equipped to deal with the consequences of situations similar to the Greek crisis. Ongoing discussions have led to the recommendation, that the ESM should be embedded in an overall consistent system of European economic governance. In this context a whole set of measures and improvements is under construction to work on the "*birth defects*" of the euro-zone, the ESM has the opportunity to become a first measure of the euro area to implement a permanent crisis resolution mechanism.

IV. Threats

The ESM also faces several severe threats from its external environment. Among these, the threat with the highest potential originates in the MS itself. In contrast to the concept worked out by the *Eurogroup,* the ESM is not operational yet, because the ratification process in MS like Germany has not been successfully completed. The decision of the

German Constitutional Court regarding the appeals against the ESM is still in doubt which puts the whole strategy for building a *financial firewall* for the euro area in peril.

Also considered a threat by political and economic experts is the fact, that ESM as an intergovernmental organization under public international law will have the authority to intervene in the autonomous fiscal policy of a sovereign state. With the ESM Treaty the ESM acquires rights which put the national governments and the EU in situation of a legal limbo. After ratification and becoming operational, the ESM - respectively the main bodies of the ESM may assume tasks[11] that are not necessarily determined by democratic decisions of the national parliaments.

Problematic is also the fact, that the EFSF in combination of the ESM might further encourage Moral Hazard of the countries already afflicted by the crisis. The Moral Hazard problematic is associated with less cautious behavior of a state including extensive borrowing instead of implementing necessary austerity measures because in a worst case scenario the state expects to rely on European assistance and bail-out. Consequently an inherent problematic of the European rescue mechanisms - temporary as well as permanent - stays in place and still has the potential to threaten the financial stability in the future.

The SWOT Analysis illustrated clearly, that besides existing advantages of an ESM and EFSF combination during the transitional period until 2013, the disadvantages and points of critique overweight. Named as a step towards the right direction have to be the inclusion of CACs and private sector involvement into the framework of the permanent rescue mechanism. They represent the first part of a further development process that has to take place within the framework. Hence, there are still some flaws that have to be revised in order to make the CAC and the private sector involvement more precisely. Considering the permanent nature of the ESM, it can be considered as a further coherent development of the temporary rescue mechanisms. The history of the past years has shown, that the EU rescue policy approach is in need of a support mechanism that is as flexible as possible to deal with numerous potential types of problems that might arise. By omitting detailed specifications for procedures, the scope for generous interpretations of the existing rules and regulations is broadened which might turn out to prevent efficient and flexible political decision-making and thereby finding necessary solutions to problems is avoided.

[11] As for instance the authorization of the EU finance minister to demand the unlimited deposition of additional capital in the ESM from its national parliaments

5. Conclusion

The main conclusion that has to be drawn from the preceding analysis is, that neither the ESM alone nor in combination with the temporary EFSF, has the rescue mechanism the capacities to solve the internal and external causes of the euro crisis. Referring back to the main research question, the inquiry to what extend the ESM as part of a European *financial firewall* has the potential to contribute to the rescue of the euro, it has simply to be stated that up to this point there is no viable alternative to the ESM. With the ratification process of the ESM still pending there is only room for speculations regarding the future of the euro-zone and its currency. The developments in the coming weeks and months will have to show to what extent the critics of the ESM are justified. As it is now, the ESM Treaty is without a real solution for the problem of insolvency of an EU MS and unaccounted specifications for concrete procedures leave room for reasonable criticisms. To some of the problems of the euro-zone the ESM provides no convincing solutions and by postponing decisions the situation is made worse.

Nevertheless the attempts by the EU leaders to save the *euro* with the temporary rescue mechanisms EFSM and EFSF, and the establishment of the permanent ESM unmistakably illustrate the political will behind their decisions to deal with the crisis. For two years now the political leaders are trying to master the debt crisis while the situation on the market seems to be getting worse. In order to effectively and efficiently deal with the implications of the financial crisis in the euro-zone, the ESM alone is not enough. Necessary for the euro-zone is a comprehensive economic governance framework that includes the tighter surveillance of the economic and fiscal policies, a surveillance system that focuses on preventive as well as well as on corrective measures. Consequently a *financial firewall* in the form of the ESM in combination with the EFSF can only serve as component of such a framework, but it cannot solely provide the necessary equipment that is crucial for the persistence of the euro area and its common currency *the euro.*

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