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- Bachelor Thesis -

Is the ESM able to manage the challenges of the euro area as a non-optimum currency area currently being in a heavy crisis?

Double diploma Bachelor programme Public Administration/ European Studies

School of Management and Governance (UT) - Institute of Political Science (WWU Münster)

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Abbreviations (thematically arranged)

OCA	Optimum currency area
GDP	Gross domestic product
SGP	Stability and Growth Pact
EC	European Communities
EU	European Union
EMU	European Economic and Monetary Union
ECB	European Central Bank
ESCB	European System of Central Banks
EFSM	European Financial Stability Mechanism
EFSF	European Financial Stability Facility
ESM	European Stability Mechanism
IMF	International Monetary Found
ECOFIN	Economic and Financial Affairs [Council]
TFEU	Treaty on the Functioning of the European Union
TESM	Treaty Establishing the European Stability Mechanism
TSCG	Treaty on Stability, Coordination and Governance in the Economic and Monetary Union
SMP	Securities Markets Programme
OMT	Outright Monetary Transactions
MoU	Memorandum of Understanding
CAC	Collective Action Clause

1 Introduction

As a consequence of disregarding the fiscal rules laid down in the Stability and Growth Pact for years in combination with the increasing macroeconomic imbalances within the euro area and set of by the global financial and economic crisis since 2007 the European sovereign debt crisis has escalated to an existential crisis of the euro. To overcome this crisis several measures like the temporary euro bailout funds EFSM and EFSF haven been taken, but without a convincing effect. Besides Greece, Ireland, Portugal and Cyprus as well as big euro member countries like Italy and Spain have increasingly come into trouble. The Eurozone threatened to break up with incalculable consequences and dangers for the global economy and financial system.

Only since the decision to install an permanent euro bailout fund called ‘European Stability Mechanism‘ (ESM) and extensive interventions by the ECB in 2011-12 the situation of the euro area could have been stabilised and fairly calmed down. However neither the crisis is over yet nor the reasons for the crisis and the structural problems of the euro area are solved up to the present day. The future of the euro area and the economic welfare of its member countries now depends on the implementation and the outcome of the measures that have been taken.

Against this background the present thesis deals with the ESM. The research question and the aim of the work is to investigate if or how far the ESM is able to manage the challenges of the euro area as a non-optimum currency area currently being in a heavy crisis. In the centre of the thesis are two leading questions. The first question applies to the way how it actually could have come to the escalation of the crisis and how the foundation for the ESM came about. This is done by descriptive historical-generic methodology. The second question treats the ESM and its possibilities to fulfil its tasks to compensate the deficits of the euro area to solve the current crisis. This is done by empirical-analytic methodology. The research design of the thesis is about descriptive research.

Initially the thesis treats with the theories of optimum currency areas (OCA) *(chapter 2)*. First the separate criteria of the OCA-theories are presented *(2.1)*. After that it is investigated how far the euro area applies to these criteria by giving an overview of the present research *(2.2)*. The following chapter examines the current European sovereign crisis and the way to the foundation of the ESM *(chapter 3)*. The description of the crisis of the euro is divided into several prior warnings *(3.1)*, the reasons for the crisis *(3.2)*, the course of the crisis and previous measures *(3.3),* the interventions by the ECB *(3.4)* and the criticism of these measures *(3.5)*. The next part deals with the European Stability Mechanism *(chapter 4)*. It contains the conception of the ESM *(4.1)* and its possibilities of task fulfilment *(4.2)*. The financial capacity *(4.2.1)* and instrumental possibilities *(4.2.2)* are especially explored. Furthermore numerous different ways of criticism of the ESM are explained and reviewed *(4.5)*. At the end of the thesis the conclusion contains an analysis of the strengths, weaknesses and limits of the ESM and tries to give an answer of the research question by summarising the findings of the work *(chapter 5)*.

2 Theories of optimum currency areas (OCA)

The theories of optimum currency areas (OCA) are the standard approach to evaluate and compare the benefits and costs of a monetary integration (Bundesbank, 2012, p. 21). They describe the optimal size and characteristics and provide important insights which preconditions shall be fulfilled in case of a merger of currencies or a creation of a new common currency. Moreover they can be used to find out which challenges a monetary union has to overcome if national differences and wrong developments become more important. Together with the current experiences of the crisis the theories might even be able to provide targeted reform measures (GCEE, 2010, p. 71).

There are several advantages of founding or joining a monetary union. These are the loss of the transaction costs and exchange rate uncertainty, the reduction of currency crisis risks, positive credibility effects and therefore benefits for trade, inventions and growth (Peters, 2006, p. 2). Moreover a monetary union leads to a higher level of integration and an intensified competition within the union (Heinemann, 1998, p. 2). The benefits of a common currency usually increase with geographic size of the area. But it should be noted that monetary areas are also able to become too heterogenous and thus again causes costs (Peters, 2006, p. 3).

Costs of monetary unions mainly arise due to the lack of exchange rate instruments to overcome asymmetric spread shocks. Problems especially arise in the case of affected countries in a different extent (Bundesbank, 2012, p. 21). Therefore the key element of the OCA-theories is the question how far alternative adjustment mechanisms are available to replace flexible exchange rates, reducing the costs and effects of short-term asymmetric shocks and bringing long-term competitiveness into line (Kronberger, 2010, p. 183).

2.1 Criteria of the OCA-theories

To evaluate the costs and benefits of monetary unions usually various criteria are applied to investigate the availability of alternative adjustment mechanisms depending on the structural characteristics of the participating economies (Bundesbank, 2012, p. 21).

According to Robert A. Mundell ("A theory of optimum currency areas", 1961) the exchange rate is dispensable if a high factor mobility of labour and capital and a high flexibility loans and prices are available to compensate economic disparities and establishing a balance of trade (Kronberger, 2010, p. 184). The more these adjustment mechanisms are given to overcome asymmetric shocks the more countries are suitable to form a monetary union. Besides the costs decrease (Peters, 2006, p. 6-7)

Ronald I. McKinnon ("Optimum currency areas", 1963) takes the degree of openness and integration of the national economies into consideration. The more an economy is open and integrated in international trade the more the costs decrease. For this reason forming a monetary union is beneficial (Peters, 2006, p. 7-8).

Peter Kenen ("The Theory of Optimum Currency Areas", 1969) added the criteria of diversification and structure of an economy and the availability of fiscal transfers. Therefore highly diversified economies with high adaptability are rather suitable to form a monetary union with again decreasing costs (Peters, 2006, p. 8-9). Furthermore fiscal transfers are able to cushion the consequences of temporary asymmetric shocks. Likewise permanent transfers are able to compensate long-term regional differences. However both of them require a high degree of fiscal integration and sustainable public finances (Kronberger, 2010, p. 184-185).

Beside the above mentioned so-called ‘old criteria‘ one can also take into consideration the mainly macroeconomic, monetary and global economy focussed ‘modern criteria‘ since the 1990s. These comprise the degree of capital mobility, the alignment of the business cycles, price stability, fiscal integration and political integration (Peters, 2006, p. 10-13). The sufficient availability and fulfilment of these criteria also increase the benefits of forming a monetary union. In contrast to the old criteria the fulfilment of the modern (endogenous) criteria is not sufficiently needed in advance, they might rather only develop in the course of the monetary union (Kronberger, 2010, p. 183).

2.2 Overview of the present research: How far does the euro area correspond to the criteria of the OCA-theories?

Already before its foundation and especially against the background of the current crisis it is again called into question if the euro area corresponds to the conceptions of the OCA-theories (Bundesbank, 2012, p. 23). Many critics of the euro right form the beginning since the breakout of the crisis in 2009-10 have been confirmed in so far as the euro area is not to be about an OCA (GCEE, 2010, p. 71). To examine this question in the following part the euro area is investigated with regard to the separate criteria.

Owing to the free movement of workers and the right of establishment in the context of the European Single Market the labour mobility is legally completely realised. But due to social, cultural and linguistic barriers within the euro area a complete mobility is neither given nor soon expected (Peters, 2006, p. 14). Despite the broaden recession and partially significantly different unemployment rates within the euro area (chart 1) the actual migration readiness is comparatively lower than in the U.S. Federal States (Plickert, 2012).

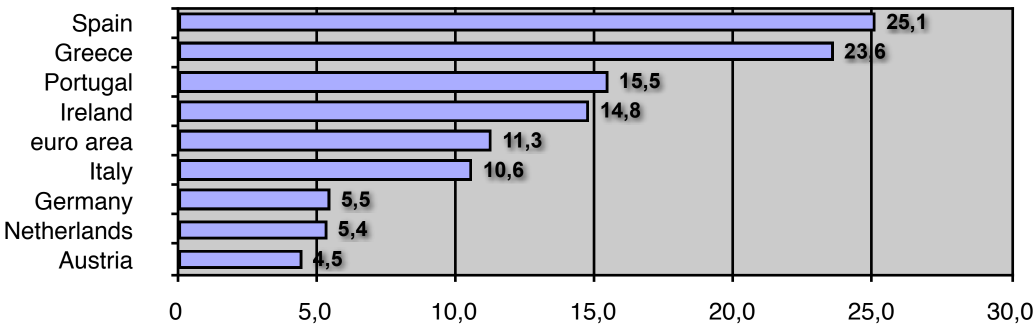

chart 1: unemployment rates in % of selected countries of the euro area in 2012
(own chart, data: Eurostat, 2013)

Generally the EU is marked by a higher inner mobility within the member states than an outer mobility to other member states (Heinemann, 1998, p. 6). In so far the Eurozone does not correspond to the conceptions of an OCA according to this criteria (Peters, 2006, p. 15/ Plickert, 2012). However since the escalation of the crisis the immigration from the affected countries to presently comparatively prosperous countries like Germany actually raises. For instance the number of immigrants to Germany from 2011 to 2012 sharply increased especially from Greece (+78%), Spain (+53%) and Portugal (+53%) (Statistisches Bundesamt, 2012).

Since the foundation in 1999 within the euro area significant differences concerning the development of loans and prices have been noticed. Especially the formally booming and currently troubled countries Greece, Ireland, Portugal, Spain and Italy list raising unit labour costs up to 23% from 2000 up to 2010 in contrast to just 7% in Germany (chart 2) .

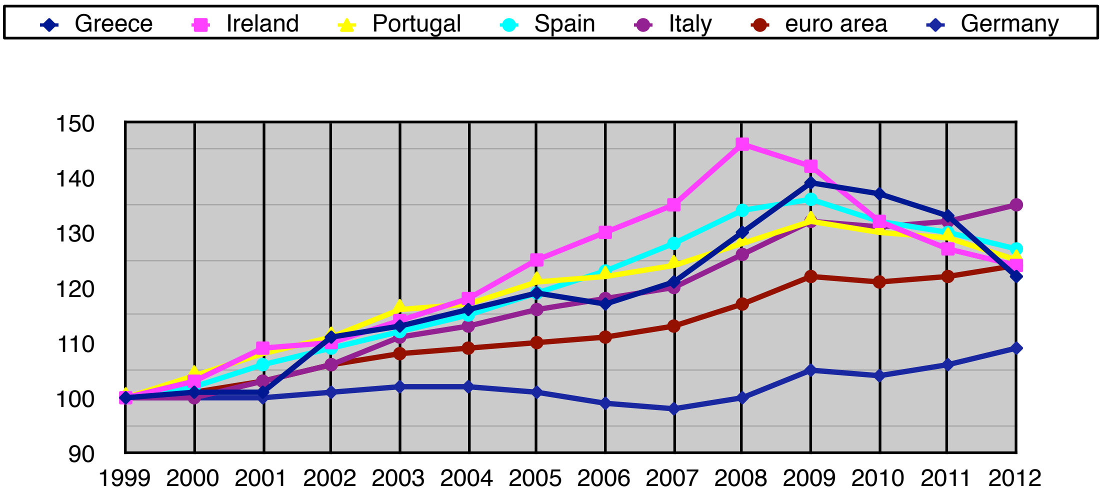

chart 2: development of unit labor costs in % (basis of 100% in 1999) of selected countries of the euro area in 1999-2012 (own chart, data: GCEE, 2013)

The money wages and prices also raised. As a consequence the affected countries gradually lost their productivity and competitiveness. Hence according to this criteria the euro area does not confirm to an OCA (GCEE, 2010, p. 86/ Bundesbank, 2012, p. 23/ 26).

The degree of openness describes the integration of the economies in international trade usually marked by the rates of exports and imports of the GDP and the foreign trade balance. As seen in chart 3 there are considerable differences within the euro area. The product export rate extends from just 8% of the GPD in Cyprus up to 87,6% in Slovakia in 2012.

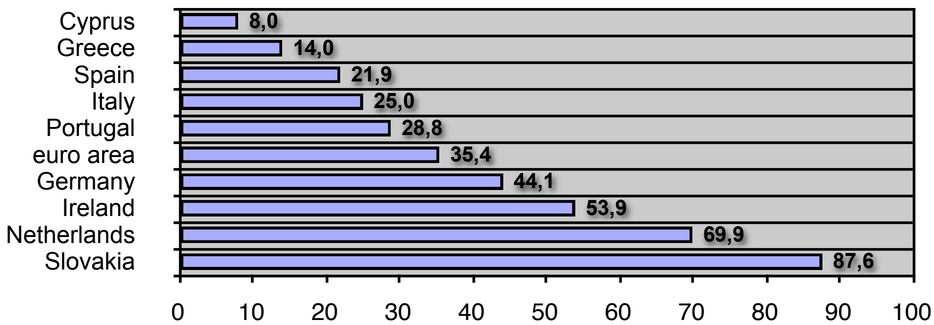

chart 3: product export rate in % of the GPD of selected countries of the euro area in 2012 (own chart, data: Eurostat, 2013)

Likewise the foreign trade balance varies considerably. It extends from Cyprus (-21,9% of the GDP) up to Ireland (+23,8%) in 2012 (chart 4).

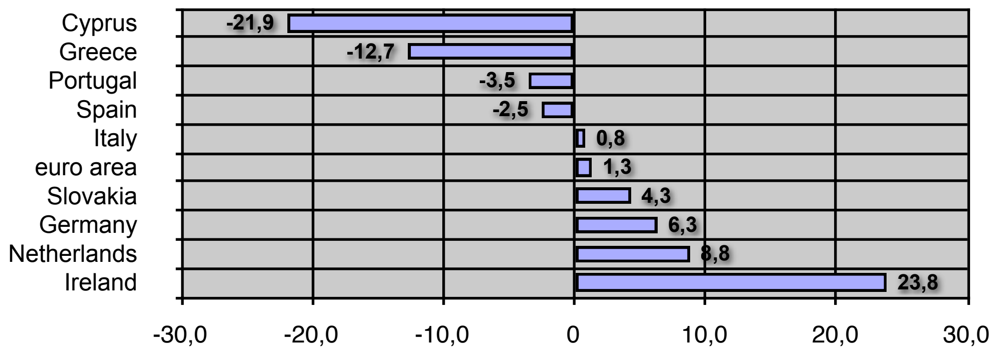

chart 4: foreign trade balance in % of the GPDof selected countries of the euro area in 2012 (own chart, data: Eurostat, 2013)

In this context the euro area can be divided into two groups. Export-orientated countries like Germany, the Netherlands, Slovakia and even Ireland[1] are marked by high product exports rates and trade balance surpluses. Whereas countries like Cyprus, Greece, Portugal, Spain and Italy are marked by low import rates and trade balance deficits. This again mainly results from the decreasing competitiveness in the course of the prior wage increases (chart 2). In principle the euro area is marked not only since the introduction of the common currency by a high degree of openness usually benefiting all member states. In regard to this the euro area complies with the criteria of the OCA. But especially the high accumulated current accounts deficits of the crisis countries significantly caused the structural problems and macroeconomic imbalances within the euro area. These are one of the central reasons for the current crisis (GCEE, 2010, p. 71-71/ 2012, p. 91).

Regarding the diversification of the economy there are no significant differences obvious concerning the production structure and the shares of the agricultural, industrial and service sector within the euro area to fulfil this criteria (Peters, 2006, p. 17-18).

Until the outbreak of the European sovereign debt crisis and the decision of the extensive bailout funds EFSM, EFSF and especially ESM financial transfers within the Eurozone were just conducted in a minor extent.[2] The whole budget of the EU just comprises about 1% of the Gross National Income of the EU-27 (European Commission, 2013). However it is to note that financial transfer generally should operate temporarily only to overcome short-term asymmetric shocks and to avoid permanent dependences of the affected countries.[3] With the just recent decision of the permanent existing ESM an adequate fulfilment of this criteria remains to be seen.
According to the so-called ‘new criteria‘ of OCA-theories a high capital mobility is able to cushion the consequences of short-term asymmetric shocks (Heinemann, 1998, p. 7). In the context of the European Single Market the mobility is completely legally given. It has further increased since the foundation of the euro. Moreover the euro area is basically marked by an high degree of financial integration which benefits all members in normal times (ECB, 2011, p. 72). However during the crisis a reversal and a growing

[1] In contrast to the other troubled countries Ireland is noticeably marked by an high degree of openness. Hence the main reasons for the Irish crisis are caused by a sharply raised indebtedness due to an extensive financial crisis as a consequence of the bursted house bubble.

[2] e.g. the European Regional Development Fund (ERDF) to compensate regional differences.

[3] e.g. the structural dependencies of former East Germany and Southern Italy (‘Mezzogiorno‘) (Heinemann, 1998, p. 9).

fragmentation of the credit relationships has occurred. Owing to the broaden lack of mutual trust and as an expression of a profound crisis of confidence the banks withdraw to their domestic markets (GCEE, 2012, p. 152-53). Further the crisis countries were affected by an extensive flight of capital reinforcing the payment difficulties of both troubled banks and countries (GCEE, 2011, p. 99). Although this criteria is generally sufficiently fulfilled within the euro the high capital mobility leads to reinforcing negative effects area during the crisis.

Regarding the alignment of business cycles within the euro area noticeable differences become apparent (chart 5).

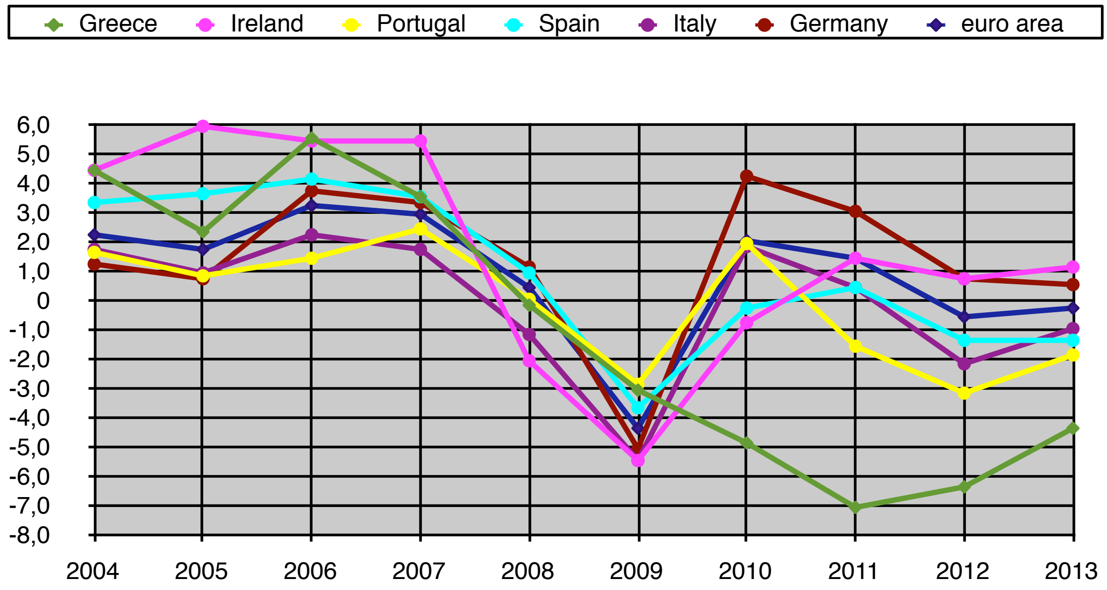

chart 5: changes in real GDP in % of the GPD over the previous year of selected countries of the euro area in 2004-12 (own chart, data: Eurostat, 2013)

Even until the beginning of the crisis in 2008 the euro area was marked by differently growing economies. In contrast to the formally booming and presently troubled countries Germany was marked by low economic growth. From 2008 to 2009 nearly all euro area economies were almost equally affected by the shock of the global financial crisis. However after that the development again considerably diverged. Whereas especially in 2010 and 2011 Germany could quickly recover there is still a large recession in the crisis countries. With that a uniform monetary policy by the ECB equally benefiting all member states is nearly impossible. Generally there is no explicit confirmation that a currency area leads to a higher convergence of the business cycles (Kronberger, 2010, p. 190). Therefore the criteria is at best partly fulfilled.

With regard to the criteria of price stability despite of certain differences one can say that the inflation rates within the euro area are most extensively moving into line corresponding to the OCA-theories (chart 6). Further the long-term average rate of the euro area from 2000 to 2005 (2,2%) and from 2005 to 2010 (1,9%) is quite close to the objective of the ECB with an targeted inflation rate of 2% (Eurostat, 2012).

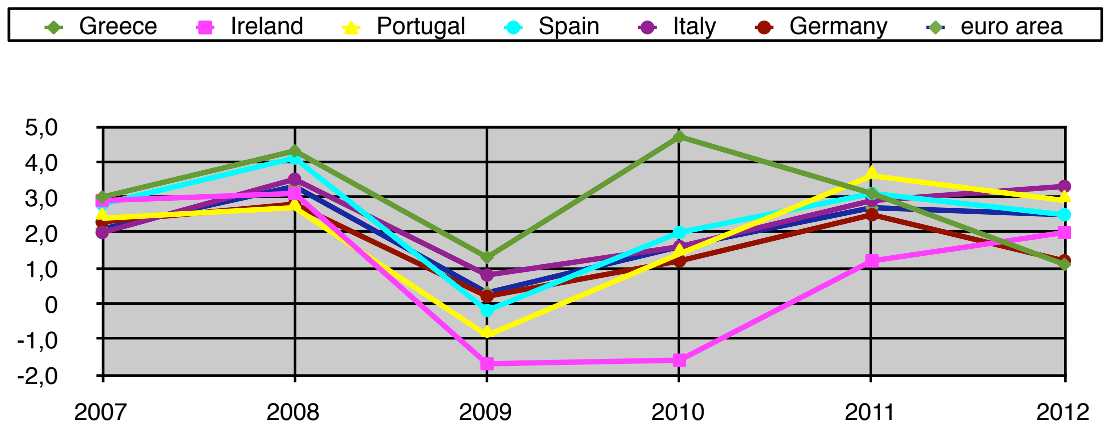

chart 6: annual change of the consumer prices in % of selected countries of the euro area in 2007-12 (own chart, data: Eurostat, 2012)

To ensure a sufficient fiscal integration and sustainable public finances the Stability and Growth Pact (SGP) was decided. But already before the crisis the annual budgetary deficits of Portugal, Italy and especially Greece have been over the maximum limit of 3% (chart 7). Ireland and Spain even lists budgetary surpluses due to their formally booming economies but without considering their already high level of private debt (see chart 13, part 3.2 of the thesis). Since the outbreak of the crisis nearly all countries considerably violated the limit of 3%.[4]

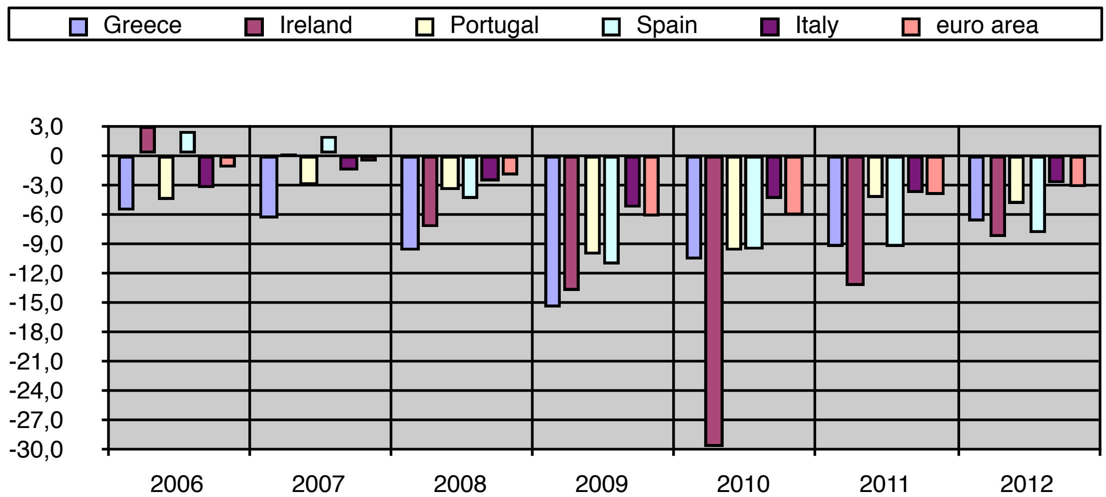

chart 7: annual budgetary deficit in % of the GPD of selected countries of the euro area in 2006-12 (own chart, data: Eurostat, 2013)

Already before the crisis the level of debt especially of Greece and Italy and even of the average of the euro area have been over the maximum limit of 60% of the GDP. Since the outbreak of the crisis especially the level of Greece, Ireland, Portugal and Spain sharply increased (chart 8).

[4] The enormous Irish deficit of almost 30% in 2010 is explained by extensive measures to rescue troubled banks.

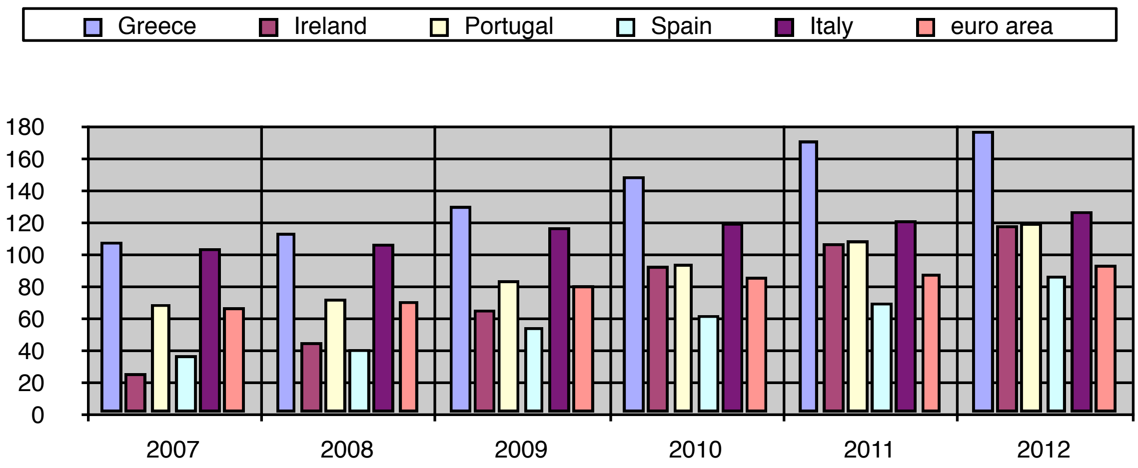

chart 8: level of debt in % of the GPD of selected countries of the euro area in 2007-11
(own chart, data: Eurostat, 2013)

The sustainability of the public finances of these countries has been increasingly called into question and a payment default has been feared. But not only since the outbreak of the crisis the SGP was often disregarded, which has considerably led to the current crisis. These high deficits and debt levels substantially result from the consequences of the crisis, the broaden recession and the prior mentioned current account deficits due to the lost competitiveness of the crisis countries. With that a sufficient fiscal integration within the euro area and sustainable public finances are not given. Therefore this criteria is not fulfilled.

In conclusion after applying the several criteria to the euro area with an investigated period of the last years one can say that the initially expressed assumption is mainly confirmed. The euro area in its present condition only inadequately and at best partially corresponds to the OCA-theories. Due to its economical heterogeneity an optimal quality of the euro area as an currency area is not sufficiently given (Kronberger, 2010, p. 187/91). In this context just a few criteria are applicable (e.g degree of openness and diversification of the economies) whereas other important do not apply (e.g. flexibility of prices and loans, integration of the labour markets, alignment of the business cycles). However owing to the advanced process of integration and the mutual dependences within the euro area another monetary system can at present not be preferred (Bundesbank, 2012, p. 26/ GCEE 2011, p. 96-98). In principle many experts consider the euro area to be successful, however not without some major flaws. Essentially these are periods of substantial tensions as the current crisis owing to the misalignment of the national business cycles and conflicts about the enforcement of fiscal constraints laid down in the SGP (Beetsma/Guiliodori, 2010, p. 603-04). In the corresponding literature there is a broad consensus of the need to strengthen the coordination of the fiscal and macroeconomic policy (Kronberger, 2010, p. 183). Therefore the decided measures and especially the ESM should be investigated with regard to the ability to compensate the current deficits of the euro area ensuring really effective solutions for the crisis.

3 The crisis of the euro and the way to the foundation of the ESM

3.1 Prior warnings

In contrast to other (e.g. the global financial crisis since 2007) the European sovereign debt crisis was forecasted by several economists. For example the nobel laureate Milton Friedman predicted that it would be impossible to create a common currency for such a heterogeneous area as the euro area (Plickert, 2012). Likewise other well-known economists warned of the consequences of a common currency.[5] Already after the Treaty of Maastricht in June 1992 60 German professors published the statement "The EC monetary union leads to a real test". A central point was that a functional currency union needs an approximation of relevant economic structures of the member countries proven over several years away (Plickert, 2012). In September 1998 155 German professors published the appeal "The euro comes to early". The statement accentuated the importance of the European integration. But owing to excessive deficits, no sufficient fulfilment of the convergence criteria, structural difficulties, none automatic sanctions laid down in the Stability and Growth Pact and an unsuitable economic situation the introduction of the Euro was regarded as too early. Otherwise a loss of trust and a difficult start of the euro would threaten (Kösters/ Neumann/ Ohr/ Vaubel 1998). In this context lots of warnings apply to the condition of the euro area not sufficiently corresponding to an OCA (see prior part 2.2 of the thesis). Despite the success of the euro in the first decade unfortunately much of this has come true since the outbreak of crisis (Sinn, 2012, p. 33).

3.2 Reasons for the crisis

The European sovereign debt crisis is concerned as the third act of the global financial and economic crisis[6], resulting of the first U.S. real estate crisis and the following great recession (GECC, 2010, p. 68).

In comparison to other big currency areas as the U.S., the UK or Japan concerning the budgetary deficits and the level of debt the euro area appears comparatively positive (chart 9-10). However the escalation of the sovereign debt crisis mainly arose in euro area, whereas the other big current areas have not been affected in these dimensions. Among others this results from the specific framework of the euro area (GCEE, 2010, p. 71). The euro member states do not have independent national central banks of their own like the Federal Reserve, Bank of England or Bank of Japan. These are able to provide money and buy government bonds at any extent on their own risks (programs of 'Quantitative Easing') and therefore serving as 'lender of last resort'. Investors of these countries just have to fear rising inflation rates instead of eventually possible payment defaults (GCEE, 2010, p. 69/ 2011, p. 93). Nevertheless during the crisis the ECB has considerably intervened as well (see part 3.2.4 of the thesis).

[5] e.g. Hans Tietmeyer (former president of the German Central Bank), Martin Feldstein, Rudolf Richter, Manfred Neumann, Joachim Starbatty and Ralf Dahrendorf (Sinn, 2012, p. 31).

[6] Began in June 2007 as a subprime-crisis in the U.S. and expanded worldwide in the following. Concerned as the worst world economy crisis since the Great Depression in the 1930s (GCEE, 2011, p. 68.)

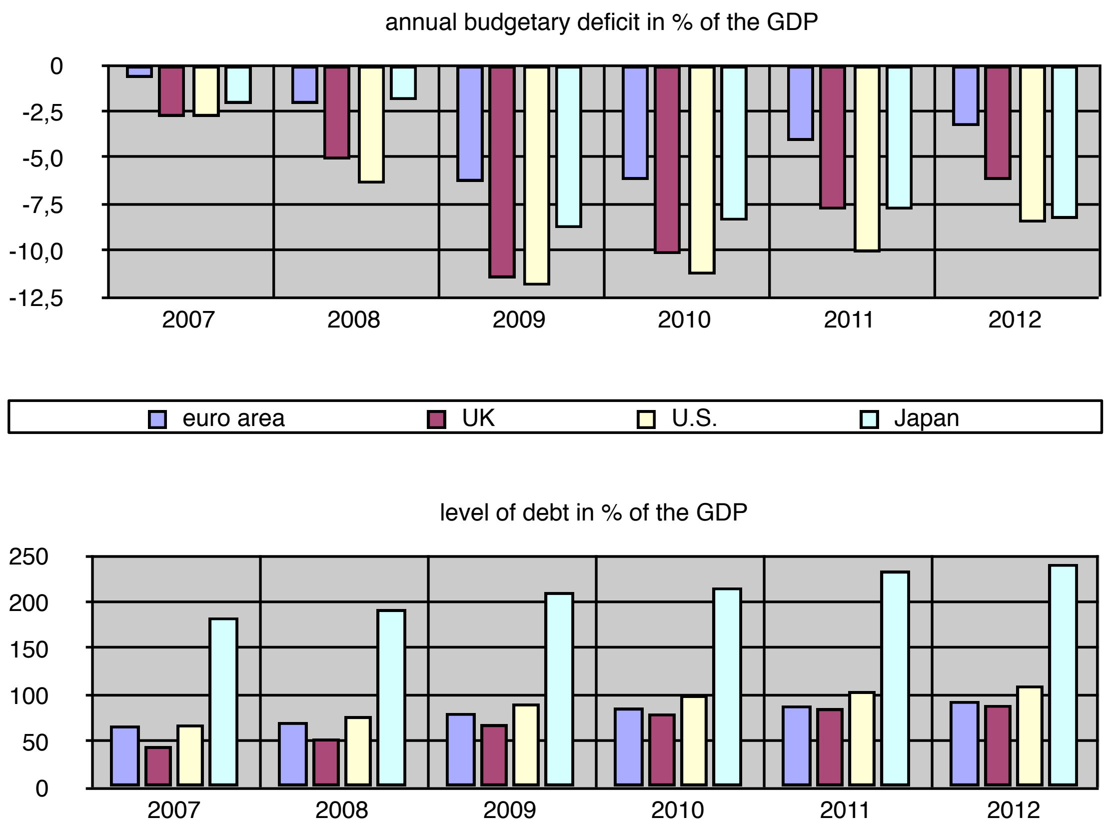

chart 9-10: annual budgetary deficit and level of dept in % of the GDP
of selected currency areas in 2007-12 (own depiction, data: Eurostat/ OECD, 2013)

The institutional framework of the European Economic and Monetary Union (EMU) is unique in the world. It is about an economic union with a single market, whereas the euro area is to higher degree a monetary union with supranational single monetary policy, however without a completed political union.[7] Consequently the member states are still responsible for their own national economic and financial policy (ECB, 2011, p. 71). This leads to an asymmetry of political responsibility and might lead to tensions regarding the financial policy. As seen in the current crisis a fiscal misconduct of one member state can lead to dangers for the stability of other states or even the whole currency area. Therefore all states of the common currency have to bear the resulting consequences (problem of 'moral-hazard') (Bundesbank, 2008, p. 30).

The euro area is characterised by a high degree of economic and financial integration which normally benefits all members. But in crisis unsuitable developments and extern negative effects can easily spread over from one to another country. In order to ensure the functionality of the currency area, the stability of the euro and the independence of the ECB despite this contradiction two required central regulations are of particular importance. These are the 'no-bailout' clause (article 125 TFEU) and the monetary financing prohibition of the ECB (article 123 TFEU) to exclude a transfer and the monetarisation of public debts in case of financial difficulties (ECB, 2011, p. 71-72).

[7] The whole EMU comprises all 27 EU memeber states, wheras the euro area comprises the 17 EU member states having already adopted the euro.

The crisis of the euro comprises three main trouble spots reinforcing each other. In detail these are the sovereign debt crisis (marked by rising debt rates and risk premiums of the countries being in trouble), the macroeconomic crisis (characterised by a broaden recession and rising unemployment rates in the euro area, based on long-term problems in international competitiveness and excessive labor costs) and the banking crisis (predominantly in the crisis countries due to low trust by the investors and re-nationalised credit relations) (GCEE, 2012, p. 64).

The crisis resulted from a number of different factors whose relative weighting is controversial. Central reasons are substantially the unreasonable implementation of the fiscal rules (GDP) neither before nor during the crisis, in the Greek case with that inadequate and wrong statistical facts about the public finances (chart 12), the underestimation of fundamental structural deficits of several national economies, and since foundation of the EMU too optimistic assessments of the national budgets by the investors (Bundesbank, 2011, p. 66). Furthermore there is the specific constellation of the euro area with the not seriously taken assumption of the 'no-bail-out' clause by the financial markets and the unique interest rate policy. Latter only enabled the economic overheating in the euro periphery countries (GCEE, 2010, p. 68-69). Moreover there was the faith of the ECB as 'lender of last resort' and the unimaginable case of a state insolvency in the euro area (Sinn, 2012, p. 128).

According to the regulations of 'Basel II' for banks on government bonds no collateral deposits are necessary. With that the banks are able to buy these bonds in an almost unlimited extent to finance the deficits of the euro periphery countries (Sinn, 2012, p. 126-27). But since the crisis it has become apparent that national bonds from industrial countries are no longer risk-free assets (Bundesbank, 2012, p. 18).

A central reason for the crisis is the failure of the Stability and Growth Pact (SGP). Even before the foundation of the euro the convergence criteria[8] to join the euro area have been disregarded. In the examination year 1997 only five countries were under the maximum limit of a dept level of 60%. Nearly all of the pre-accession countries including Germany had problems regarding their compliance, especially Belgium and Italy (chart 11). Nevertheless owing to political reasons all of them were allowed to take part of the euro introduction. Consequently in 1999 the euro started after having disregarded its own rules (Sinn, 2012, 44-45).

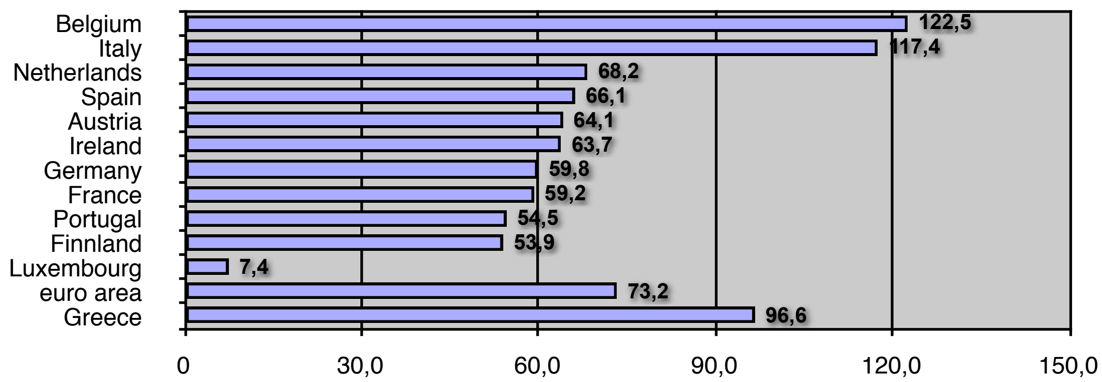

chart 11: level of debt in % of the GDP of the 11 pre-accession countries for the euro area in 1997 (own chart, data: Eurostat, 2012)

[8] Comprise three monetary criteria (price stability, convergence of the interest rates, exchange stability) and two fiscal criteria (limits of 3% budgetary deficit and 60% debt ratio of the GDP).

Furthermore in 2005 the SGP was reformed by Germany and France. With that the pact was crucially weakened and numerous exceptions regarding the 3%-rule were introduced enabling to circumvent the sanctions (Bundesbank, 2008, p. 37-38). All in all a transgression occurred in over 120 cases. Only 37 of them were allowed duo to recessions. In fact in 83 cases sanctions should have been pronounced, even 96 due to the rules before the change in 2005. But actually in no case sanctions were decided (Sinn, 2012, p. 84). The responsibility is caused by the ECOFIN Council. But due to the fact that a decision of sanctions requires a majority and the enormous number of violations in principal all judges were also (potential) sinners to judge about other sinners.

Regarding Greece there is a particular situation. Despite not fulfilling any of the criteria Greece nevertheless absolutely wanted to join the euro area. To fulfil the criteria the statistical figures were faked for years (chart 12).[9] Further the Greek bureaucracy was concerned as underdeveloped and inefficient. Before 1997 no electronic devices were used and everything was written by hand. No controls by Eurostat (statistical office of the EU) and the European Commission were taken or even possible. As a consequence Greece managed to cheat into the Eurozone in 2001. To fulfil the criteria of the GDP in the following the fake of the statistical figures continued.[10] Eurostat again did not know anything. At first in 2004 due to a Greek government change there were beginning doubts about the Greek numbers. The deception became gradually clear and a retroactive inflation of the deficit was necessary. The figures were not only faked but also even arbitrary inserted for years (Wech, 2012).

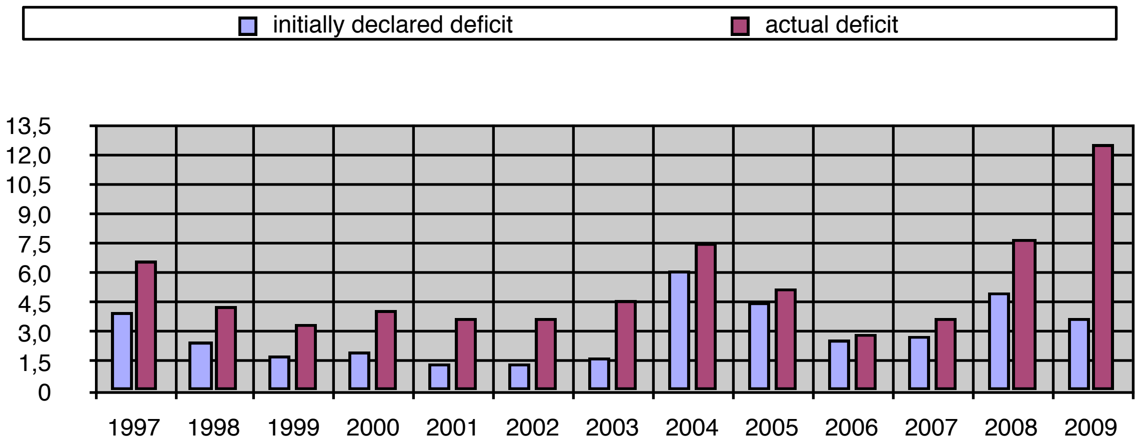

chart 12 : initially declared and actual annual budgetary deficit of Greece in % of the GDP in 1997-2009 (own chart, data: Eurostat, 2013)

Since the decision of the euro introduction on the European Council in Madrid in 1995 the interest rates of bonds of the member states adopted (chart 12). Owing to the saved interest-spendings since 1995 a self-fulfilling compliance of the budgetary criteria to join in 1999 was made possible (Sinn, 2012, p. 83). But in the euro-periphery

[9] e.g. by shifting the military spendings (highest per-head in Europe) to the future (Wech, 2012).

[10] e.g. in 2000 Greece made an advance booking of the revenues of Athens airport and concluded a secret foreign-currency swap with the investment bank Goldman Sachs to hide € 2,8 billion. Although at that time the deal was legal but morally questionable. Later this very risky daring interest bet failed with high losses for Greece (Wech, 2012).

countries the savings due to the exceptionally lower interests on debt were mostly spent for expenditures and wage increases instead of debt-depleting (Sinn, 2012, p. 85-88).

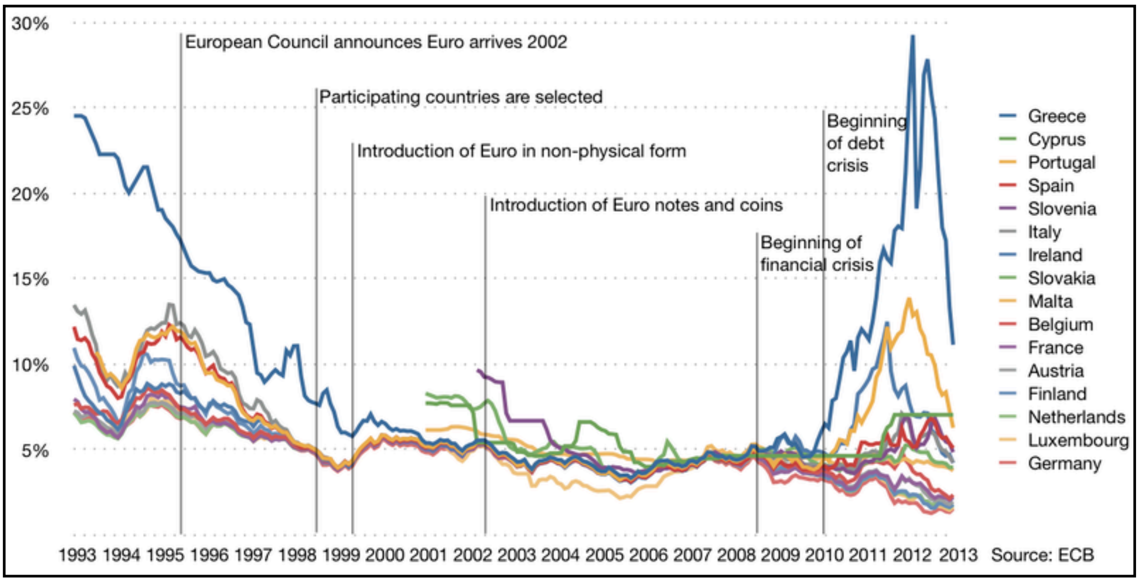

chart 12: long-term interest rates of euro area countries in 1993-2013 (Source: ECB, 2013)

At a consequence it was possible for the euro periphery countries to favourably finance the extensive current account and budgetary deficits. A credit financed, inflationary consumption and property boom began, mostly financed by the capital market and especially by northern European banks. The consequences were an economic growth and decreasing unemployment. But there were also an increasing temptation of debt, decreasing competitiveness and increasing good and labour prices (see chapter 2.2 of the thesis) (Sinn, 2012, p. 102). Especially in Ireland and Spain an extensive property boom like in the U.S. and the UK arose. But the reverse of the boom meant high foreign liabilities and private debts (chart 13). However in Greece and Portugal the boom was mostly based on growing public expenditures and thereby on growing debts but with the the same effects (Sinn, 2012, p. 96-99).

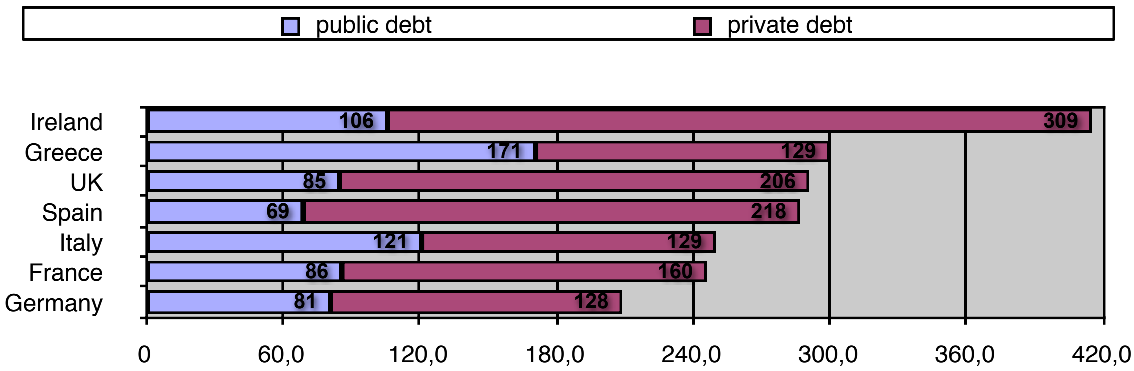

chart 13: debt of private persons and companies and public debt in % of the GDP of selected European countries in 2011 (own chart, data: Eurostat, 2013)

Just as the financial crisis in the U.S. the European sovereign debt crisis was again proceeded by an extensive credit growth, setting of a credit financed boom but resulting in a broaden recession.

3.3 The course of the crisis and previous measures

The European sovereign debt crisis first occurred in October 2009 caused by the dramatic situation of the Greek public finances. The Greek budgetary deficit for 2009 must have been corrected from 5% up to 13% by the new elected government. Further a raising debt ratio up to 140% of the GDP in 2010 was predicted and the ECOFIN Council initiated an Excessive Deficit Procedure (EDP). Thereafter the Greek government bonds were devaluated by the rating agencies in turn causing trouble on the financial markets. As a consequence the situation escalated and a bankruptcy of Greece threatened. Therefore the European Council decided a first financial assistance program for Greece about € 80 billion of bilateral loans on 2 May 2010 (for details see table 1).

But nevertheless the situation did not calm down, shortly thereafter a spread-over to Ireland and Portugal threatened. Thus a comprehensive package of measures consisting of the two bailout funds European Financial Stabilisation Mechanism (EFSM) and the European Financial Stability Facility (ESFS) was decided by the ECOFIN Council on 9 May 2010 (table 1) (GCEE, 2011, p. 86).

In the second half of 2011 the crisis spread over to the big euro member states Italy and Spain. With that the crisis of the euro came to a head and became a systemic crisis. Therefore further measures were decided on the European Council at 21 July 2011: The extension of the assistance for Greece until 2014 (€ 109 billion) inclusive a hair cut concerning the private creditors and the extension of the credits for Ireland and Portugal from 15 up to 30 years in combination with lower rates. To raise the way of working an extension of the deposit volume of the EFSF up to € 780 billion to effectively lend up to € 440 billion was decided. Likewise new instruments to capitalise banks being in trouble and government bond purchases both on the primary and secondary market were enabled (GCEE, 2011, p. 87). In March 2012 the Greek haircut about € 107 billon by private creditors took place, private investors went without 53,5% of the nominal active debts. It was considered to be the biggest hair cut of all time (Sinn, 2012, p. 289).

In July 2012 an aid program for the Spanish banks which got into difficulties up to € 100 billion by the EFSF was decided. Actually about € 39 billion were applied up to the present (European Commission, 2012). In summer 2012 Cyprus also applied financial assistance. Due to its close connection to the Greek financial sector the Cypriot banks also came into trouble and therefore need about € 17 billion (FAZ, 2012). But no assistance was decided up to the present.

To strengthen the budgetary discipline of the member countries the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (TSCG, so-called 'fiscal pact') was decided at the EU summit on 2 March 2012. It was signed by all EU members states except the UK and the Czech Republic. Therefore the TSCG is an intergovernmental treaty but no a part of the EU-law. According to the TSCG the member states must have balanced budgets. Only an annual deficit of max. 0,5% of the GDP is allowed. But an adjustment is possible in case of economic cyclical and one-off effects. The maximum dept ratio is about 60% of the GDP. In the case of an higher level an annual reduction of 0,05% is envisaged. If a member state violates against the regulations, the pact comprises automatic sanctions. Furthermore the member states have to implement national debt breaks. The implementation is controlled by the European Court of Justice (GCEE, 2012, p. 96-97).

	Programs for Greece	European Financial Stabilisation Mechanism (EFSM)	European Financial Stability Facility (EFSF)	European Stability Mechanism (ESM)
legal and institutional form	intergovernmental agreement	EU mechanism	private company owned by euro area countries	intergovernmental organisation
capital structure	None, bilateral loans pooled by the European Commission	Guaranteed by EU budget (i.e. all EU euro area States)	Guarantees from euro area countries about € 780 billion	€ 80 billion paid-in and € 620 billion callable capital (possibility of extension)
lending capacity	€ 80 billion (plus € 30 billion by the IMF)	€ 60 billion	€ 440 billion (possibility of leveraging, plus up to € 250 billion by the IMF)	€ 500 billion (possibility of extension)
taken commitments	€ 80 billion	€ 22.5 billion for Ireland, € 26 billion for Portugal	€ 17.7 billion for Ireland, € 26 billion for Portugal, € 144,6 billion for Greece	€ 39.5 billion for Spanish banks
instruments	loans	loans, credit lines	loans, recapitalization of financial institutions, bond purchases on the primary and secondary market	loans, recapitalization of financial institutions, bond purchases on the primary and secondary market, possibility of extension
duration	Loans to be repaid seven and a half years after disbursement date	Until the end of June 2013	Until the end of June 2013	Permanent mechanism since September 2012
main decision making bodies	Euro Group	ECOFIN Council	Euro Group/EFSF Board of Directors	Euro Group/ESM Board of Governors
legal basis financing	Intergovernmental decision and article 136 TFEU	article 122 TFEU (a Member State facing “exceptional occurrences beyond its control”)	Intergovernmental decision	Intergovernmental treaty linked article 136 (3) TFEU
legal basis conditionally	articles 126 and 136 TFEU	EU Council Decision on basis of EFSM Regulation	EFSF Framework Agreement by cross-reference with MoU and EU Council Decision	ESM Framework Agreement by cross-reference with MoU and ESM Board of Governors Decision

table 1: financial assistance facilities for euro area countries
(Sources: ECB, 2011, p. 75/ EFSF, 2013/ ESM, 2013)

3.4 Interventions by the ECB

During to the escalating crisis the ECB moved into an increasingly difficult situation. Owing to the fact that the decided bailout funds are still too small developed to save Italy or Spain the ECB executed an unconventional monetary policy and had often to serve as a ‘lender of last resort‘ (GCEE, 2012, p. 81). On 9 May 2010 the ECB firstly decided the Securities Markets Program (SMP) to purchase government bonds of the crisis-countries Greece (in amount of € 30,8 billion), Ireland (€ 13,6 billion) and Portugal (€ 21,6 billion) on the secondary market. Later in summer 2011 the ECB also to bought Spanish (€ 43,7 billion) and Italian (€ 99 billion) bonds (in sum € 208,7 billion) (ECB, 2013). After that the SMP was stopped in September 2012.

In July 2012 the ECB President Mario Draghi announced “to do everything necessary to save the euro“ (Martens/ Plickert/ Weiland, 2012). Later on September 2012 this was followed by the statement to buy government bonds if necessary in an unlimited extent as part of the Outright Monetary Transactions (OMT). By that the ECB made a strategic realignment. The OMT superseded the SMP. It comprises as well the purchase of government bonds on the secondary market. In contrast to the unconditional SMP the purchases of the OMT are associated with an approach and conditional program of the EFSF or ESM (GCEE, 2012, p. 85). After this announcement the crisis and the situation of the euro noticeably calmed down. Owing to the announcements and measures of the ECB neither Italy nor Spain so far needed any financial assistance by the bailout funds apart from the program for the Spanish banks (GCEE, 2012, p. 65). Until February 2013 no OMT purchases were taken (Bundesbank, 2013, p. 27).

Moreover the ECB carried out an extensive program called ‘big bazooka‘ on December 2011 and February 2012 providing longer term refinancing transactions for three years about € 1.000 billion to several European banks (GCEE, 2012, p. 88). In the course of the crisis the ECB gradually lowered the security standards for the banks refinancing by the ECB. Disregarding their rating government bonds were always accepted (Sinn, 2012, p. 150-52). With these measures the ECB enables commercial banks still to buy the bonds of the crisis countries to defuse the crisis. However this leads to increasing mutual dependancies of the ECB, the commercial banks and the crisis countries.

Owing to the wide extended balance sheet of the ECB the monetary basis also sharply increased. But regarding the inflation expectations the more important money supply M3 just raised slowly. This can be explained by that fact the new created liquidity is mainly hold by banks and the financial sector and has not transmuted to the real economy yet. In combination with the rising unemployment, the broaden recession and a low lending until now the inflation rate persists constantly and no short-term price increases are expected. However there is a rise of several asset prices as the house prices in Germany since 2009 (GCEE, 2012, p. 91-96). Nonetheless there are still long-term dangers of inflation owing to the taken measures of the ECB (GCEE, 2012, p. 63).

3.5 Criticism of the previous measures

The previous measures and substantially the euro bailout funds and the bond purchases of the ECB have been criticised by many sides. In this context two main directions are recognised based on a different view on the main reasons for the crisis. One opinion is based on the assumption that the sovereign debt and the financial problems of the crisis countries occurred due to irrational skepticism and a lack of trust of the capital markets. Therefore it is necessary to provide much more (cheap) money by the ECB and bailout funds with more ‘firepower‘ to convince the capital markets and ensure the liquidity of the euro area. Therefore the previous measures are assessed as insufficient.[11] According the other argumentation the euro crises however occurred owing to a deep structural and competition crisis of the periphery countries just intensified by the low interest rates and cheap money. To solve the crisis it is necessary to realise structural reforms and extensive spending cuts.[12]

Furthermore the legal basis of the measures regarding the European Treaties was criticised. Hence the euro bailout funds (EFSM, EFSF) violate against the ‘no-bailout clause‘ of article 125 TFEU.[13] Greece is seen as a comparative small country which financial crisis does not justify an emergency case according to article 122 (2) TFEU (Sinn, 2012, p. 30). The extensive government bonds purchases in the aftermath of the SMP and the OMT since February 2010 the ECB were heavily criticised too.[14] The programs violate against the prohibition of monetary state financing according to article 123 TFEU. But the ECB refers only to buy government bonds on the secondary market which is not explicit prohibited.

Especially the Bundesbank voiced serious criticism on the taken measures. This was particularly done in the assessment of the decisions of the euro summit on 21 July 2011. Substantial points of criticism are the reduction of conditions for countries with an assistance programme. This reduces the incentives to conduct fiscal and economic reforms again rapidly enabling to sounder the public finances and return to the capital markets. The insufficient separation between fiscal und monetary policy was also criticised. Therefore the rescue of insolvent institutes is clearly a task of the fiscal instead of the monetary policy. There is no legitimation of the monetary policy to redistribute loads. At any rate important and basic principles of the Eurozone (subsidiarity, fiscal personal responsibility, mutual disclaimer, disciplining function of the capital markets) are significantly weakened. Furthermore the institutional framework of the Eurozone loses consistency. Currently a transmission of loads from the financially weak to the strong countries without significant intervention possibilities of those is going on. Due to the fact that an political union is not foreseeable there is an danger of rising debt addiction and an increasing pressure of a loose monetary policy. However a reaffirmation of the disclaimer and a disciplining of the financial policy is crucial (Bundesbank, 2011, p. 66-69). Moreover present measures are mostly characterised by shifting the risk from the private to the public sector (Bundesbank, 2012, p. 7).

[11] Statement primarily represented by the lobby of the financial markets (which want to save their own investments e.g. George Soros) and economists as Paul Krugman or Paul der Grauwe (Sinn, 2012, p. 12-18). Especially the German Government and Chancellor Angela Merkel are critiqued to block further measures and take further assumptions of liability.

[12] Primarily represented by Kenneth Roof, Martin Feldstein or Hans-Werner Sinn and other German economists (Sinn, 2012, p. 12-18).

[13] e.g. Christine Lagarde (director of the IMF) admitted a deliberate breach of the Treaty of Maastricht and article 125 “to save the Euro“ (Interview in the ‘Süddeutsche Zeitung‘ on 23 December 2010).

[14] especially by the German Bundesbank president Jens Weidmann, the former president Axel Weber and the former chief economist of the ECB Jürgen Stark (Sinn, 2012, p. 42-43).

4 The European Stability Mechanism (ESM)

4.1 The conception of the ESM

Already shortly after the decision of the EFSM and the EFSF the European Council proposed on the summit at 28-29 October 2010 the establishment of an permanent bailout fund ESM to replace the existing temporary rescue funds since June 2013.

The creation of an permanent bailout fund is motivated by three essential considerations. Firstly the appearance of external, exogenous and asymmetrical shocks can not be excluded. Due to the high degree of monetary and financial integration within the Eurozone mutual reinforcing spill-over and feedback effects might lead to potential consequences destabilising the whole euro-area. Further there is the possibility of market failures in the financial sector, especially self-fulfilling trend dynamics in the pricing of sovereign risk. In this case again spill-over effects can lead to increasing consequences as seen in the financial market tensions in autumn 2008. At least there is seen a need for credible and predictable crisis responses. A permanent credible management as the ESM might prevent tensions by providing clear 'rules of the game' to influence the expectations and incentives for both private creditors and public debtors (ECB, 2011, p. 73-74).

At the summit on 16-17 December 2010 the European Council decided to change article 136 TFEU (chapter of specific provisions for the Euro member states) to implement the ESM in the European Treaties. The following new third paragraph is added: "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." With that a ratification by all euro member states was necessary. On the summit at 24-25 march 2011 the European Council decided besides other measures[15] the ESM with an lending volume of € 500 billion (ECB, 2011, p. 71-74). The "Treaty Establishing the European Stability Mechanism" (TESM) was signed on 2 February 2012. With the German ratification by the Federal President Joachim Gauck the ESM came into force on 27 September 2012. With that the necessary condition was fulfilled that 90% of the share capital has to ratify the treaty (article 48 TESM). Meantime all member states ratified the treaty (GCEE, 2012, p. 98).

Previous the German Federal Constitutional Court refused an urgent application against the treaty of the ESM. However it declared that the payment obligations of the share holder countries have to be clearly limited on their capital stock portion. A raising requires a prior approval by the national parliaments. Further it cleared up that despite the regulations concerning the inviolability and obligation to secrecy of the ESM the parliaments have be extensively informed. Therefore treaty was replenished by a corresponding interpretative declaration (GCEE, 2012, p. 98). Furthermore the European Court of Justice approved the ESM after a lawsuit that the ESM violates against the no-bailout clause (FAZ.net, 2012).

The ESM is an intergovernmental organisation under international law located in Luxembourg. The members are the euro-member countries (article 1 TESM), new members are possible in the case of an euro adoption (2). However participating in

[15] Reform of the SGP, 'Euro-Plus-Pact', macroeconomic imbalance procedure (MIP) and 'European Semester' (ECB, 2011, p. 76).

providing financial assistance of non-euro EU members is ad hoc possible.[16] The general purpose of the ESM corresponds to the added paragraph of article 136 (3) TFEU. The ESM shall mobilise funds providing financial support under strict conditions in case of financial difficulties to stabilise member states or the euro area as whole (3).

The ESM basically comprises of the Board of Governance, the Board of Directors and a Managing Director (article 4.1 TESM). The most important decision body is the Board of Governance. It is made up by the finance ministers of the euro area countries and the Managing Director (5.1), presently chaired by the current president of the Euro Group Jeroen Dijsselbloem.[17] The Board of Governance takes the most important decisions (5.6/ 5.7) especially to grant financial assistance (5.6 f), determines the terms and conditions for the financial assistance (5.6 g/h), decides on the lending capacity of the ESM (5.6 d) and changes the menu of instruments (5.6 i).

The decisions of these key issues are taken by mutual agreement (4.3). In this case the decision is taken unanimously by the voters participating in the vote. Abstentions do not prevent the decision from being adopted. With that the decision making efficiency of the ESM should be strengthened. Other decisions are taken by qualified majority requiring 80% of the votes cast (4.5) or simple majority (4.6). Nevertheless in all cases a quorum of 2/3 of the members representing 2/3 of the voting rights must be present (4.2). The needed majority depends on the importance of the decision. If an ESM member does not follow the obligations to pay its voting right becomes temporarily invalid (5.8). In the adopted case that a failure of urgently financial support would threaten the economic and financial sustainability of the euro area the ECB and the Commission are able to carry out an emergency voting. This requires a qualified majority of 85% of the votes casts (4.4).

Each Governor appoints the directors to form the Board of Directors implementing and executing the taken decisions of the Governors (6). The Managing Director is the legal representative of the ESM. He chairs the meetings of the Board of Directors and manages the operating business.[18]

Examined is the ESM by an Board of Auditors elected by the Board of Governors (30). The ESM has got full legal personally and the full legal capacity to execute its tasks (32.1/ 32.2). Moreover the ESM enjoys general immunity, all property of the ESM is inviolable (32.3). All member persons of the ESM are subjected to professional secrecy (34) and all persons of the ESM enjoy immunity (35). Questions about the interpretation of the ESM regulations and all disputes are heard at the European Court of Justice (37).

[16] In this case the concerning EU members are allowed to participate on the meetings in question (preamble 9, article 5.4 TESM). Observers may be the European commissioner for economic and monetary affairs and the presidents of the ECB and the Euro Group (5.3).

[17] The Board is either able vote a chairperson by itself or decides to be chaired by the president of the Euro Group (5.2 TESM).

[18] Currently Klaus Regling, the previous director of the EFSF. The Managing Director is elected by the Board of Governors, the term of office is five years and one re-appointment is possible (7 TESM).

4.2 Possibilities of task fulfilment

4.2.1 Financial capacity

The authorised capital stock of the ESM is about € 700 billion (article 8.1 TESM). It is divided into paid-in shares of € 80 billion and callable shares of € 620 billion (8.2). The initial maximum lending volume is firstly restricted to € 500 billion (preamble 6 TESM). The Euro Group decided to extend the EFSF until June 2013 on the summit at 30 March 2012. Hence together with the EFSF the lending capacity increases up to € 700 billion. Thereof about € 200 billion are already given to Greece, Ireland and Portugal (GCEE, 2012, p. 98). The contribution key of the capital stock corresponds with the key of the ECB (11) (table 3).

Contribution Key of the ESM

ESM Member	ESM key (%)
Kingdom of Belgium	3,4771
Federal Republic of Germany	27,1464
Republic of Estonia	0,1860
Ireland	1,5922
Hellenic Republic	2,8167
Kingdom of Spain	11,9037
French Republic	20,3859
Italian Republic	17,9137
Republic of Cyprus	0,1962
Grand Duchy of Luxembourg	0,2504
Malta	0,0731
Kingdom of the Netherlands	5,7170
Republic of Austria	2,7834
Portuguese Republic	2,5092
Republic of Slovenia	0,4276
Slovak Republic	0,8240
Republic of Finland	1,7974
Total	**100,0**

Subscriptions to the authorised capital stock

ESM Member	Number of shares	Capital subscription (EUR)
Kingdom of Belgium	243 397	24 339 700 000
Federal Republic of Germany	1 900 248	190 024 800 000
Republic of Estonia	13 020	1 302 000 000
Ireland	111 454	11 145 400 000
Hellenic Republic	197 169	19 716 900 000
Kingdom of Spain	833 259	83 325 900 000
French Republic	1 427 013	142 701 300 000
Italian Republic	1 253 959	125 395 900 000
Republic of Cyprus	13 734	1 373 400 000
Grand Duchy of Luxembourg	17 528	1 752 800 000
Malta	5 117	511 700 000
Kingdom of the Netherlands	400 190	40 019 000 000
Republic of Austria	194 838	19 483 800 000
Portuguese Republic	175 644	17 564 400 000
Republic of Slovenia	29 932	2 993 200 000
Slovak Republic	57 680	5 768 000 000
Republic of Finland	125 818	12 581 800 000
Total	**7 000 000**	**700 000 000 000**

table 3: contribution key and subscriptions to the authorised capital stock of the ESM (Source: TESM, Annex I and II, 2012).

The liability of each ESM member is limited in all circumstances to its portion of the authorised capital stock (8.5). However if an ESM member is not able to fulfil its payment obligations all other members has to pay in an revised increased contribution ensuring the ESM to receive payments in total amount (25.2). In case of a new ESM member the share shall be recalculated and therefore changed (5.6 d, 10.3, 11.3 a). The Board of Governors regularly reviews (at least every five years) the amount of the maximum lending volume and the authorised stock capital. Further it is able to change those and the concerning article 8 TESM. However changing the stock capital requires a prior approval of all ESM members according to their national procedure (5.6 d , 10.1). The ESM members oblige irrecoverably and unconditionally to pay in their capital share within seven days (8.4 and 9.3). An adequate and proportionable participation of the private sector is just considered in exceptional cases (preamble 12).

On the summit at 29 July 2012 the European Council decided to enable direct financial assistance to banks by the ESM to break the virus cycle between the troubled banks and indebted states. As prior requirement an European bank supervision called Single Supervisory Mechanism (SSM) has be installed below the ECB at the earliest in 2013 (FAZ.net, 2012). The direct assistance for banks should be limited no to exceed €

80 billion (FAZ.net, 2013). In this context a participation of private creditors to leverage the lending capacity of the ESM was discussed but not decided up to the present day (Mussler, 2012).

4.2.2 Instrumental possibilities

The instruments, procedure and rules of providing financial assistance of the ESM are aware to be alike the present programs of the IMF and the EFSF. Therefore a close cooperation with the IMF is striven (preamble 8 TESM).

Basically five instruments are available: These are precautionary financial assistance (credit lines for countries with structural problems but with otherwise solid macroeconomic figures and sustainable public debts) (article 14 TESM), financial assistance for the direct re-capitalisation of financial institutes of an ESM member (without a microeconomic adjustment program as precondition) (15), ESM loans to support a macroeconomic adjustment program (16), primary market support facilities to enable or maintain the market access for an ESM member (17) and secondary market support facility to avoid contagion effects and reduce risks for the stability of the financial markets (18) (GCEE, 2012, p. 98). All instruments are able to be changed by the Board of Governors (19). To fulfil these tasks the ESM is able to borrow capital on the markets, by banks and other institutions (21).

Generally just ESM members are able to get financial assistance. This can only be applied in case of financial difficulties of the member country or its financial sector and if it is indispensable to safeguard the stability of the member state or the euro area as whole (12). Only in the case of ESM loans a microeconomic adjustment program must be agreed (16.2). Otherwise it just might be included in the conditions. A further general condition to get financial support by the ESM is to sign and ratify the fiscal compact and to implement a national debt brake from 2013 on (preamble 5 TESM). In the case of an application by an ESM member the ECB, the European Commission and the IMF (so-called ‘troika‘) access the risks for the financial stability of the euro area or the member state, wether the public dept is sustainable and the actual financial need (13.1). As a consequence the Board of Governance decides about granting assistance (13.2 in connection with 5.6 f). In the case of an adoption the troika negotiated and signed a so-called Memorandum of Understanding (‘MoU‘) with the concerning member about the associated measures and conditions (13.3/ 13.4). The fulfilment of the MoU is afterwards again supervised by the troika (13.7). The release of funds requires a qualified majority of 85% of the votes. Thus Germany has got de facto a veto-right (GCEE, 2012, p. 98).

On the EU summit on 29 July 2012 especially Italy and Spain demanded and achieved essential changes of the terms of the conditions to get financial support by the ESM. According to this the concerning ESM member just has to fulfil the regulations of the fiscal pact (TSCG) but no specific macroeconomic adjustment programme to achieve financial assistance by the ESM.

Standardised and identical Collective Action Clauses (CAC) are included on all new euro area government bonds since 1 January 2013 (article 12.3 TESM). These enable the legal basis for eventually debt refunding in case of state bankruptcy, already done in Greece in March 2012. In principle the ESM is exempted from any requirement or license as a credit institution or investment service provider (33.9).

4.3 Criticism of the ESM

The ESM is considerably criticised by many sides. Especially in Germany significant criticism has been expressed. This could be seen on the legal action against the ESM heard by the German Federal Constitutional Court with its decision on 12 September 2012.[19] In the opinion of these critics the violation against article 125 TFEU, the principle of democracy, the budgetary autonomy of the Bundestag and the dept brake of the Basic Law were causes of the action.[20]

There are several central aspects of the critics. Firstly there is none existing right of withdrawal to leave the permanent mechanism (Brück, 2012). Indeed the treaty does not have an explicit termination or exit right (BVerG, 2012). According to international law a termination is only able in case of total changing fundamentals.

Furthermore all activities of the ESM are withdrawn of any administrative, judicial or legislative control (article 32, 34, 35 TESM). The rights of the member states are just represented by the finance minister (ESM Governor) and not by the parliament (Brück, 2012). With that the TESM means a loss of sovereignty of the national parliaments concerning the budgetary law autonomy and eliminates substantial rights of control. The more there is the danger of divided loyalty of the finance ministers between the international law of the ESM and national interests (Homburg, 2012). Thus the German Federal Constitutional Court demands a decision and control right of the Bundestag. But this is only implemented as an national escort law and not a change of the ESM-treaty binding in international law. However all relevant budgetary decisions of the ESM have to be approved by the national parliaments (Sauer/ van Roosebeke, 2012, p. 4).

Moreover there is the obligation to pay further capital in case of a payment default of one member state and with that possibly raising liabilities of the ESM members (25.2 TESM) (Brück, Homburg, 2012). Furthermore the Board of Governors is able do decide that the issued price of the shares may be higher than the nominal value (8.2). The treaty does limit the liability to the issued price instead of the par volume (8.5). Thus more than € 700 billion without a modification of the treaty or capital increases might be possible (Homburg, 2012). According to article 21 TESM the ESM is empowered to borrow capital on the markets to perform its tasks. With that an introduction of Eurobonds[21] through the back door is expected (Homburg, 2012). In contrast to this it is to regard that the liabilities of the ESM members are restricted under all circumstances to their capital share (article 8.5 TESM). But indeed the Treaty does not include a definite nominal liability limit.

According to article 32.9 the ESM is exempted from any requirement to be authorised or licensed as a credit institution. Thus a discussion about a banking license is unnecessary and a monetary state financing is possible (Homburg, 2012). However this depends on the decision of the ECB to acknowledge the ESM as as business

[19] Plaintiffs against the ESM were inter alia the Member of the Bundestag Peter Gauweiler (CSU), the further minister of justice Herta Däubler-Gmelin (SPD) representing the initiative "more democracy" of 12.000 citizens, the parliamentary party of 'die Linke' and a group of professors of economy and law with Wilhelm Hankel, Wilhelm Nölling, Karl Albrecht Schachtschneider and Joachim Starbatty.

[20] Other well-known critics are the Member of the Bundestag Frank Schäffler (FDP), the European and and the German Tax Payers Organisation, the president of the Ifo Institute for Economic Research in Munich Hans-Werner Sinn, the party 'Freie Wähler', the chairman of the Centre for European Policy in Freiburg, Lüder Gerken and the further board member of the Bundesbank Thilo Sarrazin.

[21] Suggested goverment bonds of the euro area jointly by the 17 euro members with common liability.

partner. According to the statues of the ECB this is possible, however the ESM has to adopt the rules of the minimum reserve of the Eurosystem (Sauer/ van Roosebeke, 2012).

Regarding the financing need of the euro member countries just being in financial trouble it is to note that the actual need greatly exceeds the current capacity of € 500 billion. Just the refinancing requirement of Italy and Spain amount until 2014 up to € 1.052 billion. The ESM would just provide a respite. The added capacity of the EFSF and ESM after deducting the assistance for Greece, Ireland, Portugal and the Spanish banks just amounts to € 400 billion. This would just cover the annual funding needs of Italy and Spain (GCEE, 2012, p. 6-7). All in all amounts the finical requirement of the five mentioned crisis countries up to € 1.282 billion in 2013 and up to € 1.306 billion in 2014 (Sinn, 2012, p. 301). In this case of an payment default of Italy and Spain an increase or leverage of the lending volume is definitely necessary. A leverage of the ESM to lend up to € 2.000 billion was already discussed but not implemented yet.

According to article 19 T/ESM the board of governors is able change the list of financial assistance instruments without changing the treaty. With that a direct bank recapitalization is expected. Indeed there is no regulation clearly prohibiting this. In this context is to note that the bank debts of the crisis countries amount to circa € 9.400 billion, more than three times as the national debts about € 3.500 billion. Just a small part of this sum would be enormous in comparison to the current capacity of the ESM of € 500 billion (Hau/ Sinn, 2013). The discussion about a bank license of the ESM and an associated bank union with enormous potential liabilities induced numerous German economists in 2012 to publish a critical and concerned appeal.[22] Further it is to regard that in the case of extensive broaden guaranties by the until now top rated and very creditworthy member states again their rating and creditability would be threaten. A deteriorating credit rating of these countries again would call the credibility of the whole bailout funds into question (GCEE, 2011, p. 103-04).

Also criticised is the only exceptionally participation of private creditors just mentioned in the preamble 12 of the treaty. According to preamble 13 the ESM loans enjoy the status as privileged creditor, only the IMF is priority. But the European Council decided on 28-29 June 2012 to relinquish the privileged status in course of taking over the assistance of the Spanish banks by the ESM to calm the markets. This is again criticised as questionable concerning the regulatory policy (GCEE, 2012, p. 7).

More than the programs for Greece, the EFSM and the EFSF the permanent ESM ensures that the no-bailout clause (article 125 TFEU) has no relevant scope of law (Sauer/ van Roosebeke, 2012, p. 4). With that one of the central regulations of the Eurozone is basically inoperative.

All in all it is to be said that the ESM has been strongly criticised by many sides. Many central critical points are well-founded due to missing, inadequate or difficult-to-interpret regulations. It remains to be seen and depends on the interpretation and implementation of the concerned regulations in the future if the criticism is justified. So many legal doubts are still existing.

[22] Appeal of 172 German economists on 5 August 2012 in the 'Frankfurter Allgemeine Zeitung' in regard with establishing an European Bank Union.

5. Conclusion: Strengths, weaknesses and limits of the ESM

After investigating the euro area with regard to the criteria of the OCA-theories one can say that the euro area just partly confirms with the conceptions of the OCA. Even more besides disregarding the rules of the SGP one of the main reasons for the current crisis are the economical imbalances within the euro area. In my following conclusion I try to give an answer to the given research question by an analysis of the strengths and weaknesses of the ESM.

Initially one can say that the ESM is an useful instrument in an emergency case. Until now there was no permanent mechanism for euro member states being in payment difficulties. With the ESM fixed rules of a procedure for financial assistance are given and no further ad hoc measures seem to be necessary (GCEE, 2012, p. 99). This reduces the risks of infection and in the moment provides a calming down of and some confidence by the markets (Sauer/ van Roosebeke, 2012, p. 4). It is a good idea that the ESM should only serve as an 'ultima ratio' safeguard with financial assistance under strict conditions and only after a positive analysis of the sustainability of the public debts to minimise the danger of 'moral hazard' (ECB, 2011, p. 74). To strengthen the budgetary discipline a ratification and implementation of the fiscal pact (TSCG) is a condition for financial assistance by the ESM. Furthermore the ECB only carries out bond purchases in the course of the OMT program in case of fulfilling the conditions of the ESM. The useful CAC-clauses enable the legal basis for a possible debt refunding in case of state bankruptcy. At last the liability of the ESM members is limited to its share of the stock capital. An increase of the stock capital requires a prior approval process by the separate member states (Sauer/ van Roosebeke, 2012, p. 4).

But in opposite to the strengths of the ESM there are lots of serious weaknesses and deficits to mention. At first the current capacity is too short in case of a Italian or Spanish payment default or even to rescue troubled financial institutes in the course of the currently planed bank union.

The ESM is only able to solve the problems of the euro crisis if the conditions are strictly applied (Sauer/ van Roosebeke, 2012, p. 3). But as it became obvious on the EU summit in June 2012 an eased access to financial assistance by the ESM was made possible. Instead of a specific macroeconomic adjustment program only the fulfilment of the regulations of the fiscal pact (TSCG) is now necessary. But without any strict conditions and only by permanent financial transfers no real compensation of the deficits of a non-optimum currency area is possible. The increasing rates on the markets reveal structural problems of the crisis countries and therefore demand economical reforms to reduce the deficits. However the task of the ESM is to provide cheap credits. Consequently the ESM simplifies the use of financial assistances and weakens the incentives for unpopular economical reforms (Sauer/ van Roosebeke, 2012, p. 3). Owing to the fact that the ESM permanently exists there is an danger of an constant redistribution within the euro area (Bundesbank, 2011, p. 68).

Nevertheless rules for state insolvency and rules for temporary exits out of the euro area are still needed. In case that a member state is only able to recover by temporarily leaving the Eurozone and conducting a nominal devaluation to restore its competitiveness an exit should be possible. Otherwise the Eurozone is exposed to more and more extensive transfers of finances and liabilities.

In addition the ESM just comprises an insufficient participation of the private sector raising the liabilities of the public sector only to pay for the costs of the crisis. The rescue policy so far did not really rescue the states and economies per se but even more the interests of the investors and the financial sector to save their investments.

Moreover all the most important decision making bodies, the Government Council of the ECB, the Board of Governors of the ESM, the Euro Group and the ECOFIN Council are dominated by members of the executive without any direct democratic legitimation. Furthermore the mainly southern crisis countries have a structural majority which enables them to demand and enforce their interests in these vital committees. This could already be seen on the EU summit in June 2012. The more countries have access to ESM assistance and the bigger they are the less the ESM is able to force them to real economic reforms (Gerke, 2012).

However as already seen during the crisis there is the unpredictability of the politicians concerning laid down regulations. Especially in critical and serious situations fundamental principles have been disregarded, changed or interpreted differently (e.g. numerous violations against the SGP, the ‘no-bailout‘ clause, changed conditions for assistance by the ESM). Last but not least the elected governments are considerably responsible for the crisis and consequently have suffered massive losses of confidence (Wech, 2012). For this reason about half a dozen governments have been deselected since the beginning of the crisis.

All in all the ESM can only be a part of long-term new institutional arrangements in Europe. These have to comprise strict rules to ensure fiscal discipline, realisable procedures to harmonise the economies, an improved regulation and a liability participation of the private finance sector to prevent extensive assumptions and redistribution of liabilities. Only under a closely defined framework and under strict conditions a temporarily liquidity support might be useful (GCEE, 2012, p. 99).

Nevertheless there is no easy solution for the current crisis. Each solution is marked by a continuous, distressing and laborious step by step process. According to the announcements of the ECB President Mario Draghi and the extensive measures that have been taken the key for the solution of the crisis seems to be located at the ECB providing more money to calm down the markets.

With regard to the rescue policy that has been made so far especially alarming and worrying are the raised long-term dangers of inflation and the extensive redistributions and assumptions of liability within the euro area as well as from the private to the public sector.

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