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The European sovereign debt crisis – does the European Stability Mechanism (ESM) serve as a consistent long-term solution?

An attempt to outline and discuss pros and cons.

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Plagiarism Statement

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German Abstract

Seit über drei Jahren ist die europäische Staatschuldenkrise omnipräsent in Medien, politischen Debatten und nationalen Wahlkämpfe. Ihre immensen Kosten werden vielseitig befürchtet, beschworen und politisch instrumentalisiert - und sind bis zum heutigen Tage nicht berechenbar. Ihr Ursprung und Verlauf ist Gegenstand heftiger Debatten mit diametralen Ansichten: Wo griechische Zeitungen der deutschen Kanzlerin plakativ die nationalsozialistische Uniform überstreifen (Focus, 2012a), sieht der Spiegel insbesondere den deutschen Steuerzahler in der „Opferrolle“ (Kaiser, 2012). Der Charakter der Krise ist schwer eingrenzbar: „Lässt sie sich genau charakterisieren? Schulden-, Euro-, Europakrise?“ (Mussler, 2011a). Und während auf politischer Ebene noch um Erklärungs- und Lösungsansätze gerungen wird, wächst in Spanien eine „Generation Zero“ (Kaiser, 2012) heran, gehen in Griechenland die Menschen auf die Straße und in Deutschland erfahren konservative „Alternativen“[1] für den Euro mehr und mehr Zustimmung. Jagt ein Krisengipfel noch den nächsten, entfaltet die Eurokrise schon eine für Europa zerstörerische Wirkung: Das integrative Moment, das die ökonomische Verflechtung seit der Europäischen Gemeinschaft für Kohle und Stahl für eine politische und kulturelle europäische Gemeinschaft hatte, geht verloren. Kein Europäer stützt gerne einen anderen Europäer, sondern ein Deutscher sieht sein Eigentum durch einen Griechen gefährdet. Kulturelle Unterschiede brechen hervor und seit jeher bestehende Vorurteile erfahren neue Prominenz. „Ein Gespenst geht um in Europa“[2], das nicht nur großen Schwachstellen am Gerüst der Währungsunion (EWU) aufdeckt und lebenden und künftigen Generationen einen unzumutbaren Schuldenberg aufbürdet, sondern *Europa* über die ökonomischen und politischen Grenzen hinaus bedroht.

Der Ursprung der Eurokrise liegt in der US amerikanischen Immobilienkrise (2007) und der darauf folgenden globalen Wirtschaftskrise seit 2008. Obwohl sich 2010 die Situation auf den internationalen Märkten kurzzeitig stabilisierte, verkündete der Chef der Eurogruppe, der luxemburgische Premierminister Jean-Claude Juncker, am 19. Oktober 2009, dass Griechenlands Staatsdefizit mehr als doppelt so hoch ausfallen werde wie veranschlagt (Mussler, 2011a). Infolgedessen wurde Griechenland von den Ratingagenturen herabgestuft, der vormals „sichere Hafen“ (SVR, 2011, S.93) europäischer Staatsanleihen wankte und Risikoaufschläge für griechische Anleihen stiegen rasant. Das Misstrauen gegenüber den Ländern der Eurozone war geweckt und so gerieten schnell auch Portugal und Irland in den Fokus der Ratingagenturen. Die betroffenen Staaten sahen sich bald einer Vertrauenskrise

[1] Vgl.: “Alternative für Deutschland”; Internetpräsenz: https://www.alternativefuer.de/de/
[2] Vgl.: „Das Manifest der kommunistischen Partei“ (Engels/ Marx). In: http://gutenberg.spiegel.de/buch/4975/1

gegenüber, in deren Folge die Zinslast für Staatsanleihen der hoch verschuldeten Länder wuchs und sich die wachsende Zurückhaltung der Investoren auf weitere Länder ausbreitete[3]. Aus einer Banken- und Staatsschuldenkrise wurde eine Währungs- und Vertrauenskrise mit erheblichem Ansteckungspotenzial für vormals stabile Mitgliedsstaaten. Sollten große europäische Volkswirtschaften wie Frankreich oder Italien von diesem „Teufelskreis" (SVR, 2012, S.63) erfasst werden, droht der Zerfall der gemeinsamen Währung.

Die beschriebenen Dynamiken stellen dabei konkrete Auslöser und Verlauf der enormen Schuldenkrise dar, der sich die Europäische Union aktuell gegenüber sieht. Die Ursachen liegen jedoch tiefer, in der Architektur der EWU. Eines der institutionell und organisatorisch prägendsten Merkmale der EWU ist die strikte Trennung von Geld- und Fiskalpolitik. Während sich die Wirtschafts- und Fiskalpolitik intergouvernemental organisiert im Kompetenzbereich der Mitgliedsstaaten befindet, ist die Geldpolitik supranational gelenkt und untersteht dem Europäischen System der Zentralbanken mit der EZB an der Spitze. Dieses institutionelle Konstrukt konstituiert eine "Original Sin" (SVR, 2011, p.94): die Mitgliedsstaaten der EWU verschulden sich in einer Währung, die sie nicht selber herstellen können, konventionelle Instrumente zur Krisenbekämpfung wie Abwertung oder Geldschöpfung bleiben ihnen dadurch verwehrt. In diesem institutionellen Umfeld löste die Einführung einer gemeinsamen Währung einen „ökonomischen Schock" (Brunetti, 2011, S.79) aus. Plötzlich konnten sich die Länder der Euro-Zone, trotz aller bestehenden ökonomischen Ungleichgewichte, zu den gleichen niedrigen Zinssätzen refinanzieren. Diese Entwicklung hatte in den GIPS[4] Ländern zwei Folgen: Zum einen stiegen die Preise in den Ländern der südlichen Peripherie stark an, sodass schnell ein Verlust der Wettbewerbsfähigkeit gegenüber den anderen Ländern der Eurozone verzeichnet werden musste. Infolgedessen wurden Importe wirtschaftlich attraktiver als Exporte, wodurch sich betroffene Länder mit steigenden Leistungsbilanzdefiziten konfrontiert sahen. Um diesem entgegenzuwirken, verschuldeten sich die Staaten nun mehr und mehr im Ausland. Zum anderen wurden die mit dem Boom einhergehenden höheren Steuereinnahmen umgehend für staatliche Ausgaben verwendet, anstatt sie in den Schuldenabbau zu investieren. Vertraglich verankerte Regulierungsmechanismen wie der Stabilitäts- und Wachstumspakt und die Defizitregel wurden aufgrund fehlender automatischer Sanktionsmechanismen problemlos gebrochen. So standen die Mitgliedsstaaten in diesem besonderen institutionellen Rahmens der EWU bald einem Schuldenberg gegenüber, ohne über konventionelle volkswirtschaftliche Instrumente verfügen zu können, um die Zinslast zu

[3] auf Spanien, Italien, Zypern

[4] Die GIPS Länder umfassten ursprünglich Griechenland, Irland, Portugal und Spanien. Im Verlauf der Euro-Krise können aber auch Italien und Zypern dazu gezählt werden

senken und eine Rezession zu verhindern. Die potentielle Zahlungsunfähigkeit eines Staates, die damit in den Bereich des Möglichen rückt, hat im Verlauf der Euro-Krise die Angst und das Misstrauen der Anleger geschürt und ebnete den Weg hin zu einer Vertrauenskrise. Die Folge ist die Verschuldung ganzer Volkswirtschaften, eine sich kontinuierlich vertiefende Vertrauenskrise im Euroraum, die erhebliches Ansteckungsrisiko birgt, und eine ratlose Öffentlichkeit, die um Lösungen ringt.

Seit Beginn der Euro-Krise einigten sich Staats- und Regierungschefs der Eurozone daher immer wieder auf ambitionierte Rettungsmaßnahmen, um die Währung zu stabilisieren und Ansteckungseffekte zu verhindern. Im Zuge dessen einigte man sich sowohl auf politische Maßnahmen (u.a. Euro-Plus-Pakt (EEP), Sixpack und den sogenannten Fiskalpakt (TSCG)) als auch auf finanzielle Rettungspakete (u.a. bilaterale Griechenlandhilfe, Outright Monetary Transactions, Europäische Finanzstabilisierungsfazilität), die die Lage zwar kurzfristig zu stabilisieren wussten, deren langfristiger Erfolg jedoch mehr als zweifelhaft ist. Zudem verstoßen diese Maßnahmen eklatant gegen die europäischen Verträge. So zum Beispiel gegen die No-bail-out Klausel (Art.125 (1) AEUV), durch die die Staaten eigentlich dem Druck der Märkte ausgesetzt und zu einer soliden und nachhaltigen Fiskalpolitik gezwungen werden sollen; oder gegen Art. 123 AEUV, der den Ankauf von Staatsanleihen durch die EZB verbietet und damit die ökonomische Unabhängigkeit der Zentralbank garantieren soll. Durch den Bruch insbesondere dieser beiden Klauseln „wurde faktisch eine Haftungsgemeinschaft geschaffen“ (Jeck, Van Roosebeke & Voßwinkel, 2010, S.5), in der finanzielle Verantwortlichkeit und Haftung der Mitgliedsstaaten auseinanderfällt. Dieser *Moral Hazard* - Effekt stellt eine der größten Herausforderungen auf der Suche nach einer konsistenten Lösung für die Staatschuldenkrise im Euroraum dar.

Der erst kürzlich in Kraft getretene Europäische Stabilitätsmechanismus (ESM) ist dabei die erste permanent agierende Rettungsmaßnahme. Hauptziel des ESM ist es, hochverschuldeten Mitgliedsstaaten, die sich aufgrund des Misstrauens der Anleger nicht mehr zu adäquaten Zinsen am Kapitalmarkt refinanzieren können, finanzielle Unterstützung zu moderaten Konditionen zu gewährleisten. Dazu nimmt er selbst durch die Begebung von Anleihen Mittel am Kapitalmarkt auf. Im Gegenzug verpflichten sich begünstigte Mitgliedsstaaten zur Umsetzung fiskalpolitischer Auflagen. Während die Bundesregierung den ESM als „Europäischer Währungsfonds“ (Bundesfinanzministerium 2013) feiert, der „institutionelle Lücken in der Architektur der gemeinsamen Wirtschafts- und Währungsunion“ (Bundesfinanzministerium, 2013) schließt, merkt das Centrum für europäische Politik an, dass der ESM „die Ursachen der Euro-Krise […] nicht lösen“ (CEP, 2012a) kann. Diese lägen insbesondere in der Verschuldung ganzer Volkswirtschaften und dem damit einhergehenden Verlust der Wettbewerbsfähigkeit. Während eine solche Entwicklung

traditionell zur Erhöhung der Kreditzinsen am Markt führt, die von den betroffenen Staaten als Signal für die Notwendigkeit realwirtschaftlicher Reformen gewertet werden, wirkt der ESM diesen Dynamiken durch die Bereitstellung günstiger Kredite entgegen. Dadurch führt er zwar kurzfristig zu einer Beruhigung der Märkte, kann jedoch die Vertrauenskrise nicht grundsätzlich lösen und vertieft sie sogar, da für grundlegende fiskalpolitische Reformen Anreize und Sanktionsmechanismen fehlen. Essentiell notwendige Veränderungen an der Struktur der EWU werden daher nicht vorgenommen. Außerdem sind, trotz des teilweise eingezahlten Stammkapitals des ESM, die weiterführenden Kosten für einzelne Länder bisher nicht absehbar. Befürworter unterstreichen dagegen, dass durch finanzielle Stabilität und Instrumente des ESM das „Vertrauen der Märkte" (Bundesfinanzministerium, 2013) gewonnen werde. Der ESM sei eine „nachhaltige Lösung der Staatsschuldenkrise" (Bundesfinanzministerium, 2013), da er mit politischen Rettungsmaßnahmen (u.a. EPP, Sixpack, TSCG) einhergehe und die Schwachstellen der EWU behebe.

Insgesamt bildet vor allem die Architektur der EWU den Nährboden für die Euro-Krise. Der ESM ändert an diesem Konstrukt zu wenig, um eine konsistente Lösung darzustellen und verstetigt die Krise sogar schlimmstenfalls. Die Euro-Krise ist jedoch nicht mehr nur die Krise einzelner Staaten, sie ist eine „Krise der Europäischen Union" (Enderlein, 2010). Will man das Auseinanderbrechen dieser Union verhindern, kann die Antwort nur ein Mehr an politischer Integration lauten. Bis zum jetzigen Zeitpunkt hat die Krise allerdings schonungslos offenbart, dass weder die Staats- und Regierungschefs noch die europäische Bevölkerung zu einem solchen Schritt bereit sind.

Die vorliegende Bachelorarbeit beschäftigt sich mit der Frage, ob der europäische Stabilitätsmechanismus (ESM) eine konsistente Lösung für die Euro-Krise darstellt. Um diese Frage zu beantworten, werden zunächst grundlegende Charakteristika der Struktur der EWU sowie der Verlauf und die Dynamiken der Eurokrise dargelegt (Kapitel II). Anschließend werden sowohl politische als auch finanzielle Rettungsmaßnahmen erläutert und diskutiert (Kapitel IV). Schwerpunkt der Arbeit liegt auf der Darstellung und Analyse des (ESM), im Zuge derer sowohl *pros* und *cons* diskutiert werden als auch die Effizienz des Mechanismus vor dem Hintergrund der besonderen Anforderungen der EWU und des *Moral Hazard* - Problems (Kapitel III) analysiert wird.

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Abbreviations

BoD	Board of Directors
BoG	Board of Governors
CAC	Collective Action Clause
EC	European Council
ECB	European Central Bank
ECJ	European Court of Justice
ECOFIN	Economic and Financial Affairs Council
EEC	European Economic Community
EFSM	European Financial Stability Mechanism
EFSF	European Financial Stability Facility
EMI	European Monetary Institute
EMU	Economic and Monetary Union
EPP	European Plus Pact
ES	European Semester
ESCB	European System of Central Banks
ESM	European Stability Mechanism
GIPS	Greece Italy Portugal Spain
MS	Member States
MoU	Memorandum of Understanding
OMC	Open Method of Coordination
OMT	Outright Monetary Transactions
SGP	Stability and Growth Pact
TEU	Treaty on European Union
TEC	Treaty establishing the European Community
TESM	Treaty establishing the European Stability Mechanism
TFEU	Treaty on the Functioning of the European Union
TSCG	Treaty on Stability Coordination and Governance

I. Introduction

Since the global financial crisis triggered the European sovereign debt crisis in 2010, the discussion about its reasons, dynamics and solution approaches is led vehemently. What started with a negative assessment of public finances in Greece, Portugal and Ireland in 2010, rapidly developed into a Euro crisis, which again can be divided into a public debt crisis, a macroeconomic crisis and a banking crisis (Sachverständigenrat für Wirtschaft[5] (SVR), 2012). Hereby, the public debt crisis mainly refers to the indebtedness of several euro area member states (MS), mainly the so-called GIPS countries[6], which consequently face increasing interest rates on their state bonds and, thus, are unable to re-finance on the capital market. The macroeconomic crisis describes their recessive economic development, high unemployment rates and loss of competiveness. Together with the crisis of system relevant banks throughout the euro zone, these crises finally resulted in a crisis of confidence (SVR, 2011). In order to burst this "vicious cycle" (SVR, 2012, p.63) and rebuild confidence, several rescue programs were launched. However, until now they failed to ease the markets, but already forced euro area MS into radical financial obligations, basically provided by guarantees. As most of this callable capital has not been invoked yet, the financial effect the Euro crisis takes on the MS' budgets can hardly be estimated by now. Nevertheless, already now the increasing unemployment rates and the decline of economic performance throughout the GIPS countries give an impression of the effect a Euro crash would have on each MS; an enormous debt mountain accumulates, which is shifted upon the taxpayers of current and prospective generations.

The most important solution approach is the permanent European Stability Mechanism (ESM), which was inaugurated in 2012. The Bachelor thesis at hand with the title: "The European sovereign debt crisis – does the ESM serve as a consistent long-term solution? An attempt to outline and discuss pros and cons" will focus on the legal and organizational patterns of the permanent stability mechanism and its funding. Mainly by analyzing the Treaty establishing the European Stability Mechanism (TESM), this thesis will assess the ESM's capacity to solve the Euro crisis and to pave the way for a sound Economic and Monetary Union (EMU). Consequently, the following question serves as research question and constitutes the common thread of the thesis:

[5] The German Council of Economic Experts (SVR) consists of five economists, which analyze relevant economic policy issues in an annual report and advise the German government and parliament on economic topics

[6] The GIPS-countries initially comprised Greece, Ireland, Portugal and Spain. In the course of the European debt crisis, Italy and Cyprus can be added to this umbrella term

Against the background of the ongoing European sovereign debt crisis and the architecture of the EMU, does the permanent European Stability mechanism (ESM) serve as a consistent long term solution?

In order to analyze the origins of the European debt crisis, the present thesis will firstly provide a preliminary analysis, introducing the structure of the EMU and important dynamics of the ongoing debt crisis. After this descriptive section, the theoretical and methodological approach of *moral hazard* is depicted. The main part of the thesis has to be seen against the background of the legal and organizational architecture of the EMU. Firstly, the movement towards the ESM is outlined by describing and discussing previous rescue measures. Secondly, the pros and cons of the legal structure of the ESM are analyzed and discussed, applying the *moral hazard* theory. Finally, the thesis at hand brings it to a conclusion and provides an outlook.

II. Preliminary analysis

Political authorities, economic scientists and the public find manifold explanatory approaches in order to define the dynamics of the European debt crisis. One of the most common causal analyses accuses certain euro area MS of not complying with the euro convergence criteria outlined in the Stability and Growth Pact (SGP)[7]. Contrarily, Enderlein (2010, p.7) blames the "architecture of the Economic and Monetary Union" as the main cause for the ongoing European financial crisis. In the context of these heterogeneous explanations, the Bachelor thesis will follow an explanatory approach and focus on organizational patterns of the EMU. Thus, the organizational structure and policy of the EMU will be represented in the following section. Subsequently, the causes and course of the European financial crisis will be depicted.

1. European Economic and Monetary Union (EMU)

1.1. History and realization

In general, the overall aim of a single market is the prevention of macroeconomic imbalances. The pursuit of this ambitious goal comprises striving for price stability as well as the ability to deleverage (Zapka, 2012). As a consequence, the ongoing European economic integration since the Treaty of Rome (1957) was accompanied by the idea of a common monetary approach and a single currency throughout the MS of the European cooperative

[7] The SGP is primarily based on article 121 and 126 TFEU

from the very beginning.[8] After several fruitless attempts, the European Council (EC) charged a committee led by the former president of the European Commission, Jaques Delors, with a draft for the introduction of a European economic and monetary cooperative in 1988. The Delors report (1989) set out a three-stages-plan to implement the economic and monetary union, an approach derived from the Werner plan of 1970 (ECB, 2013).

According to the Delors report, the implementation of the first stage (1990-1994) mainly aimed at converging monetary and budgetary stability of the MS of the European Economic Community (EEC) and was based on three pillars: Firstly, the principle of free movement of capital, which was provided by abolishing all former restrictions on it (nowadays *art. 63 (1) TFEU*). Secondly, the EC launched the coordination action of *multilateral surveillance*. Thirdly, the monetary cooperation was reformed by transferring further responsibilities to the Committee of Governors of the central banks of the MS in order to promote price stability (ECB, 2013). Additionally to the implementation of the first stage, further steps were taken in order to successfully implement stage two and three. Initially, the need for a more complex institutional structure asked for a revision of the TEEC[9], which subsequently led to the constitution of the Treaty on the European Union (Maastricht treaty) in 1992: "The Maastricht treaty affirmed the basic principles behind the Delors plan" (McCormick, 2011, p.164) and finally established the EMU. Furthermore, it provided several convergence criteria, the so-called Maastricht criteria, MS striving for admittance to the single currency have to comply with (cf. *art. 140 (1) & art.126 TFEU*, 2009)[10]. These convergence criteria order MS to generate a balanced annual government budget deficit[11] as well as a balanced debt-to-GDP ratio[12], price stability and currency stability[13] as well as stable exchange- and interest rates. In spite of these clauses, the treaty provided a "fudge clause" (McCormick, 2011, p.164), which was later adapted to *art. 126 (2) TFEU*: according to *art.104c (1) TEC* (1992), the MS have to prevent "excessive government deficits", "unless the ratio is sufficiently diminishing and approaching the reference value at a satisfactory pace" (*art.104c (2b) TEC*, 1992).

The introduction of the European Monetary Institute (EMI) formed the entrance and the main feature of the second stage (1994-1999). Besides the advancement of the monetary policy coordination, the main task of the EMI was preparing the European System of Central Banks (ESCB). The ECSB forms the main pillar of stage three and was charged with the tasks of conducting the single monetary policy as well as creating a single currency. Furthermore, the

[8] cf. *art.2 & art.4 of the Treaty of Rome (TEC)*
[9] Treaty establishing the European Economic Community, later amended to the Treaty establishing the European Community (Maastricht treaty). Again, among others, the Maastricht treaty later turned into the Treaty on the European Union (TEU) and the Treaty on the Functioning of the European Union (TFEU)
[10] Ex *art.121 (1) TEC*
[11] ratio of annual government deficits must not exceed 3% in relation to GDP at the end of the financial year
[12] ratio of government debt must not exceed 60% in relation to GDP
[13] inflation rate of a MS must be lower than 1½ percentage points that of the three best-performing MS concerning to price stability during the year preceding the examination of the situation in the concerned MS

second stage marked the adoption of the SGP in June 1997 as well as the establishment of the European Central Bank (ECB) on 1 June 1998 (ECB, 2013).
Finally, the third stage (since 1999) formed the completion of the EMU. The exchange rates of the first eleven currencies of MS fulfilling the euro convergence criteria and, thus, participating in the EMU, were fixed and the newly established ECB gained responsibility for the single monetary policy. In 2002, the new currency came into force (ECB, 2013).
Since then, one decade has passed and the EMU extended to seventeen MS in total, but its "results have been mixed" (McCormick, 2011, p.149). On the one hand, the euro area forms "the world's wealthiest market place" (McCormick, 2011, p.149), on the other hand "troubles in the euro zone in 2009-11 emphasized the many remaining challenges to developing a workable set of economic policies for the EU" (McCormick, 2011, p.149). In order to understand this criticism, one has to deeply analyze the structure and current policy conducted by the EMU.

1.2. Organizational structure and policy of the EMU

1.2.1. Separation of monetary and fiscal policy

Analyzing the policy of the EMU, the spotlight must be directed towards an unique feature of the European single market, which determines the organizational structure of the EMU exceedingly and forms "a critical structural problem" (McCormick, 2011, p.170): According to McCormick (2011, p.170), "the ECB had a high degree of control over Eurozone monetary policy", but at the same time, MS refuse to transfer any responsibilities concerning fiscal policy to EU institutions. These policy fields have been explicitly constituted under *title VIII* of the TFEU, particularly in *chapter one* (*art.120-126 TFEU*) and *two* (*art.127–133 TFEU*).

Indeed, according to *art.121 TFEU* (2009), fiscal policy is coordinated through the Open Method of Coordination (OMC)[14]; de facto, European institutions are only assigned to advisory support. This means in effect that competences concerning fiscal policy are exclusively hold by MS and its organization is of intergovernmental character. In this context, criticism is raised due to the fact that "there is a strong need for coordination between economic and monetary policy, while the economic policy remains under the direction of the MS." (Hillebrand, 2011, p.396) This need accrues from the fact that the budgetary discipline of MS, jurisdiction of the decentralized economic policy, is a necessary pre-condition for price stability, which belongs to the supranational monetary policy.

[14] The OMC has been merged into the European Semester (ES) in 2010. The ES will be detailed in *chapter IV*

In contrast, *art. 127 (2) TFEU* constitutes the ECB to be responsible for monetary policy, which mainly aims at advancing the core principle of price stability[15] by "controlling the money supply and the setting of interest rates" (McCormick, 2011, p.170); "In other words, its monetary policy strategy aims to ensure that short-term volatility in inflation rates does not lead to volatility in long-term inflation expectations." (Stark, 2009) This objective of maintaining price stability is superior to any other aim. Thus, the ECSB only supports "the general economic policies in the Union […]" (*art. 127 (1) TFEU*, 2009) as long as price stability is guaranteed. According to Andersen and Woyke (2003), regional segmentation of monetary policy is impossible "in the nature of things", therefore, its decision making processes must be organized centrally. In further consequence, the responsibilities for this jurisdiction were transferred from the national stage of MS to the supranational stage of the ESCB, headed by the independent ECB. The supranational character of the ESCB is manifested in its double-stage structure consisting of national central banks of the MS and the ECB. On the one hand, the national central banks keep legal personality and contribute the seed capital to the ECB, on the other hand, the ECB, modeled on the example of the German Bundesbank, forms the completely independent head of the ECSB (*art. 130 TFEU*, 2009). Therefore, in relation to national central banks, the ECB is authorized to issue directives, while MS lose their influence on their central banks (Andersen & Woyke, 2003).

The separation of these two jurisdictions entails two important economic features.
Firstly, the supranational character of the ECB implies that monetary policy cannot be dedicated to the needs of a particular MS, but interest rates are adjusted to the average of the euro zone instead (Puetter, 2009). In consequence, monetary policy is not suitable for any MS differing from this economic average and "the ECB conducts the right policy for a country, which does not exist." (Enderlein, 2010, p.8) In result, during the first years of the common currency, this extraordinary structure had the effect of contained inflation with high real interest rates, low growth rates and minor employment rates in one part of the euro area (e.g. Germany) and, simultaneously, high inflation with low or even negative real interest rates, high growth rates and high employment rates in other parts (e.g. Spain, Italy). Secondly, a certain danger of "free riding" (Puetter, 2009, p.105) arising from a common currency remains. The term describes a situation when MS benefit from low interest rates while conducting a highly expansive budgetary policy without suffering immediate disadvantages (Puetter, 2009). In other words, the common currency neutralizes economic adjustment mechanisms of the free market as concerned MS would not suffer negative impacts of high debts as long as the other MS of the euro zone would maintain a stable

[15] cf. *art.127 (1) TFEU* (2009): "The primary objective of the European System of Central Banks […] shall be to maintain price stability."

budgetary policy. These economic features play an important role in the context of the European financial crises, depicted in the second section of *chapter II*.

1.2.2. Economic coordination procedures

The previously depicted separation of the European economic and monetary policy results in a fundamental conflict, which influences the legal and organizational framework of coordination procedures crucially (Böttcher, 2011).

Multilateral surveillance

In order to guard against the above depicted conflict, coordination procedures for fiscal policy (*art.126 TFEU*) as well as for economic policy are available in the treaties (*art.121 TFEU*). The latter designs a closely interlocked coordination procedure in order to harmonize the economic performance of MS. That way, commonly agreed results referring to growth, inflation and employment shall be gained (Böttcher, 2011). The coordination of economic policy is in the hands of the EC and the ECOFIN[16]. The coordinating rules entrust the EC to formulate a draft for general guidelines concerning the economic policy of MS as well as of the EU, based "on a recommendation from the Commission […]" (*art.121 (2) TFEU*, 2009). Subsequently, the Commission assures that MS perform their budgetary policy align with the principles of the community. "On the basis of information provided by the Member States and assessments carried out by the Commission and the Economic and Financial Committee […]" (*Regulation (EU) No 1175/2011, 2011*), the EC monitors the implementation of guidelines and, in the case of an infringement, has the right to impose sanctions. Since the constitution of the Treaty of Lisbon (2009), the right for sanctioning measures has been enhanced (*art. 121 (4) TFEU*, 2009). The sanctions mainly contain of the early warning mechanism, based on reports and recommendations of the Commission (*art.124 TFEU*, 2009). However, these sanctions lack assertiveness in general (Böttcher, 2011).

Stability and Growth Pact (SGP)

In order to advance their budgetary discipline by restraining the government budget deficit to less than 3% of the GDP and their national debt-to-GDP ratio to less that 60%, MS voluntarily imposed the SGP in 1997, which forms a specification of the convergence criteria. Whilst all MS of the EU are engaged in the procedure of multilateral surveillance, MS of the euro zone are subject to the stricter rules of the SGP beyond that, which was established on regulations of both, the EC and the ECOFIN. Consequently, it can be subject to changes (Puetter, 2009). The SGP primarily serves as an instrument of implementation and a

[16] The Economic and Financial Affairs Council; is part of the Council of Ministers and comprises the Ministers of Finances of the 27 MS. In the scope of budgetary issues, Budget Ministers are consulted.

procedure record and, overall, contains of two procedural elements: on the one hand, the preventive element, which aims to prevent poor budgetary discipline, on the other hand, the corrective element, which intends to deleverage exceeding debt and, thereby, re-establish a balanced budget (European Parliament, n.d.). In the scope of the preventive element, MS are constrained to develop a stability program and forward it to the Commission. The ECOFIN examines this program in terms of practicability and a balanced budget (European Parliament, n.d.).

Deficit rule

In the scope of the corrective element, the so called deficit rule provides the most important mechanism of the SGP and is the only instrument bindingly constituted in the TFEU (*art.126 TFEU*, 2009). It applies to the case of exceeding the limits of indebtedness laid down in the Maastricht criteria. In case of violation, the Commission forwards a statement to the EC recommending the opening of the deficit procedure. Afterwards, the EC evaluates the extent of the infringement and might warn the MS to deleverage (Puetter, 2009). Although the deficit rule is applicable for all MS, the EC and Commission only can impose sanctions on MS of the euro area. Emanating from the OMC inherent idea of *naming and shaming*, the EC might publish its recommendation; additionally, the EC has the right to impose monetary sanctions. Nevertheless, until today, the deficit procedure never entailed a penalty payment (Puetter, 2009).

To sum up, the "EMU is a monetary union without a fully-fledged political union." (ECB, 2011, p.71) and, thus, unique. A single monetary policy under supranational jurisdiction is confronted with a fiscal policy of decentralized organization. In order to ensure a sound functioning of the EMU, MS would have to comply with coordination procedures generating an adjusted level of competiveness and stability throughout the euro area MS. Nevertheless, "failure to meet one or more of these conditions over a sustained period of time reduces the net benefits of the EMU and poses the risk of adverse cross-country spillovers." (ECB, 2011, p.71)

2. The European debt crisis – Origin and dynamics

In many journals, the 15th of September 2008, the day the US investment bank Lehman Brothers crashed, is cited as the real beginning of the global financial crisis. Indeed, as illustrated in *table 2* (cf. annex) the European debt crisis since 2010 constitutes "act three of the global financial crisis" (SVR, 2010, p.68), following the US housing crisis in 2007 and the already addressed global banking crisis. Consequently, according to Brunetti (2011), there exists a sequence of interwoven, but diverse crises, which affect different sectors. By

implication, there are "multilateral views about the focal reasons for the European debt crisis" (Kraemer, 2010, p.1), which are characterized by diverse parallel running dynamics: "Firstly, the reasons for this development [of the European financial crisis] can be seen in the architecture of the EMU established in the Maastricht treaty of 1993, secondly, as a consequence of the world financial and economic crisis and, thirdly, in the political failure to react since the acute outbreak of the European crisis." (Busch, Hermann, Hinrichs & Schulten, 2012, p.3). The first aspect listed above has already been depicted in the first section of *chapter II*; in the following segment, the origin and dynamics of the European debt crisis shall be outlined. Afterwards, rescue measures are to be discussed (*chapter IV*).

2.1. Origin and dynamics

In 2010, when the world economic and bank crisis seemed to be nearly overcome, another crisis erupted with vehemence throughout the economies of the GIPS countries. The formerly "safe port" (SVR, 2011, p.93) of state bonds became fragile and conventional mechanisms of market discipline failed at urging concerned economies to a sound and sustainable fiscal policy. Beyond doubt, the risk appetite of banks and their resulting indebtedness are important contributory factors; however, the roots of the European debt crisis lay deeper, in the structure of the EMU, which caused "huge macroeconomic imbalances" (Brunetti, 2011, p.79) throughout the MS of the euro zone.

The abolition of national currencies on the one hand and the launch of the Euro on the other, entailed an "economic shock" (Brunetti, 2011, p.79) throughout the GIPS countries caused by extremely declining interest rates and accompanied with an economic boom. In other words, after the establishment of the EMU, the risk of exchange rate adaption disappeared and "investors assumed that the risk of government bonds belonging to GIPS-countries were equal to German government bonds." (Brunetti, 2011, p.80) This fatally wrong assumption led to declining interest rates in the beginning, was then followed by increasing demand and investment in the concerned MS and finally resulted in diverging development of growth and inflation. This diverging development caused imbalances on two stages: Firstly, the reduction of competiveness and, secondly, the enhancement of government expenditures throughout the GIPS countries (Enderlein, 2010).

The extreme reduction of competiveness among the GIPS countries during an early stage of the EMU can be attributed to a diversification between supply and demand. Due to decreasing interest rates, demand proportionately raised, whilst, simultaneously, production could not be adjusted. In consequence, wages and prices increased significantly. All in all, this led to a rising inflation in the GIPS countries. This situation was disproportionate to the

inflation rate of other euro area countries, a fact, which in turn led to the loss of competiveness in the GIPS countries. Due to the economic boom combined with the reduction of competiveness, imports became way more attractive than exports (Brunetti, 2011). This development resulted in a current account deficit, which forced concerned MS to import capital from abroad, mainly from other European countries. Hereby, the external debt increased (Kraemer, 2010). In consequence, public credits amounted to 8.5% of the European commercial banks' assets in 2010; state bonds equivalent to € 608 billion hedged bonds issued on the money market (SVR, 2010). This fact contributed the amplification of the European crisis of confidence.

At the same time, the above described boom caused the growth of the nominal GDP and, proportionately, higher fiscal taxes, which were turned into extra government expenditures. According to Brunetti (2011), these extra governmental investments form one of the central points during the emergence of the crisis as fiscal revenues were considered to be sustainable, whilst in reality, the boom was not accompanied by an enhancement of efficiency. The effect was the rise of structural deficits.

The basic origin of the European debt crisis is thus not only the indebtedness of the GIPS states, but the external debt of whole national economies. Moreover, according to Kraemer (2010, p.380), the "increasing external debt of the GIPS countries is rooted in the organizational structure of the EMU."

2.2. Specific characteristics of the EMU

Examining the organizational structure of the EMU depicted in the first section of this chapter, three specific features can be defined, all enhancing the effect of indebtedness and the dynamics of the ongoing debt crisis outlined in the preceding paragraph.

Firstly, "the membership of the EMU goes along with a fundamental exception" (SVR, 2011, p.93), the so-called "Original Sin" (SVR, 2011, p.94). The special framework condition of the EMU does not enable its MS to print the money they need to fulfill their obligations or service their redemptions. In other words, their indebtedness is denominated in a currency they cannot produce themselves. In effect, this leads to the fatal risk of illiquidity and inhibits devaluation (SVR, 2011). For example, comparing the development of interest rates of GIPS countries and heavily indebted G7 countries like e.g. Japan, the negative impact of this specific feature becomes evident: Although GIPS countries outpace Japan regarding consolidation effort as well as succeeding in deleveraging (cf. *Figure 1*), countries like Japan or the USA are able to re-finance themselves on the capital market with interest rates comparable to German conditions. This diametrical development of interest rates is caused

by the fact that these countries are nearly unable to default due to their ability of conducting *quantitative easing*[17] or printing money. By contrast, the possibility of illiquidity of GIPS countries leads to mistrusting their creditworthiness. This again entails the surge of interest rates and is a further step onto the race to the bottom of the crisis and its development towards a crisis of confidence (SVR, 2011).

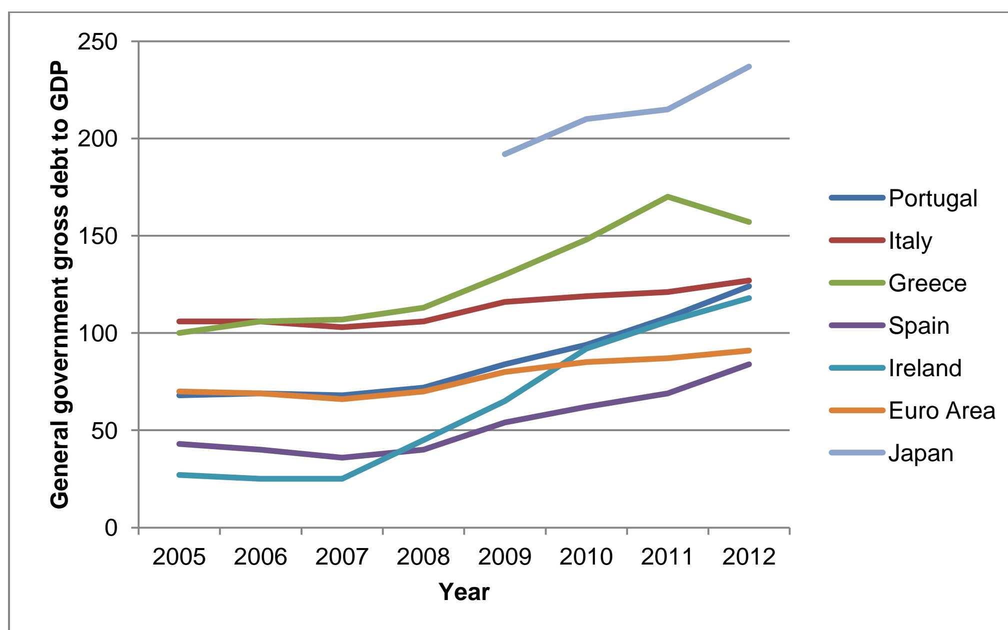

Figure 1: *government gross debt to GDP ratio of GIPS countries and the euro area as a whole compared to the government gross debt to GDP ratio of Japan (own chart, data source: Eurostat, 2013 & IMF, 2012)*

Secondly, aiming to force MS into a sound fiscal policy in order to prevent illiquidity, the Maastricht treaty, respectively the SGP, specifies the stability rules introduced above. However, the Maastricht criteria do not involve automatic sanction measures. Beyond, the penalty payments the deficit rule includes would in fact entail an additional indebtedness of concerned MS. Hence, already in 2009, all euro area countries (apart from Finland and Luxembourg) had violated these criteria several times without suffering negative consequences (European Parliament, n.d.). Apart from that, the convergence criteria solely refer to the indebtedness of the public sector, but ignore private households and enterprises, although, in fact, the external debt is mainly accumulated in the private sectors of GIPS countries. In sum, neither a sound public nor a stable private financial system could be established by the SGP (public system) or the responsible national institutions (private system) (SVR, 2011).

[17] A central bank buys financial assets and state bonds from private institutions (e.g. commercial banks) in order to increase the monetary base (SVR, 2010)

At last, against the background of the rescue measures, crucial fundamental principles of the EMU have been overridden, which will be discussed subsequently. In fact, this mainly concerns the so-called No-bail-out clause (*art.125 (1) TFEU*, 2009) as well as *art.123 (1) TFEU* (2009)[18]. The No-bail-out clause was introduced in order to expose MS to the disciplining pressure of financial markets and stipulates that each MS is accountable for its own fiscal policy and rate of indebtedness. Consequently, financial support of other MS has to be denied. Nevertheless, both clauses are challenged due to the *too big to fail*-questionability. The term is mainly used in the context of system-relevant banks and describes stakeholders, “who play such an important role that their insolvency cannot be taken for granted. Usually, an imminent insolvency is turned away by a governmental intervention (the so-called Bail-out).” (CEP, 2010, p.4) If these stakeholders are aware of their system-relevant character and the incidental bail-out, they have an incentive to take higher risks than they can vouch for. This entails the *moral hazard* problem (cf. *chapter III*) (CEP, 2010). The unsound Greek fiscal policy conducted for years proves that financial markets probably always factored a high possibility of bail-out into their strategies (SVR, 2010). *Art. 122 (2) TFEU* (2009) constitutes the only exception from the imperative of No-bail-out. Accordingly, financial assistance can be granted in the case of exceptional occurrences beyond the control of MS.

2.3. The current situation of the European debt crisis

Finally, the dynamics described above led to constantly declining ratings and assessments of the soundness and solvency of GIPS countries’ state bonds. The evolving mistrust spread to European banks, which were mainly engaged in state bonds of GIPS countries and whose creditworthiness was doubted increasingly. Additionally to these dynamics, austerity measures entailed the recession of economies throughout the euro zone, which again had an impact on the assessment of creditworthiness of states and banks. All in all and according to the Sachverständigenrat (2011, p.89), the above described dynamics already raised to a “crisis of confidence”, mainly characterized by “contagion effects” (SVR, 2011, p.90).

In sum, due to the architecture of the EMU, the MS have to face diverging economic cycles by nature. Thus, cyclical instability will always be omnipresent throughout the EMU (Enderlein, 2010). Against this background, “the financial crisis has revealed major

[18] *Art. 123 (1) TFEU* (2009): “Overdraft facilities or any other type of credit facility with the European Central Bank or with the central banks of the Member States (hereinafter referred to as ‘national central banks’) in favor of Union institutions, bodies, offices or agencies, central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of Member States shall be prohibited, as shall the purchase directly from them by the European Central Bank or national central banks of debt instruments.”

weaknesses and gaps in the existing governance framework" (ECB, 2011, p.72). Consequently, rescue measures aiming at the restoration of confidence of investors and, for that, raise funds in order to prevent the illiquidity of GIPS countries, might be short-sighted. Moreover, reforms should address the whole economic construction of the EMU in order to counteract the crisis of confidence.

III. Theoretical and methodological approach

Analyzing financial rescue measures in the following chapter, the breach of *art.125 (1) TFEU* is more or less ubiquitous. The so-called No-bail-out clause stipulates that "*the Union shall not be liable for or assume the commitments of central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of any Member State, without prejudice to mutual financial guarantees for the joint execution of a specific project. A Member State shall not be liable for or assume the commitments of central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of another Member State, without prejudice to mutual financial guarantees for the joint execution of a specific project.*" (*art.125 (1) TFEU*, 2009) Similarly to the Maastricht criteria of the SGP and *art.123 TFEU*, the No-bail-out clause forms a fundamental pillar of the EMU and shall force the MS into a consistent and sustainable budgetary policy. However, more importantly, it shall inhibit the emergence of a liability union (CEP, 2010), which creates a situation where "MS are not responsible for their own budgetary planning anymore" (CEP, 2010, p.4). Consequently, a liability union would lead to a breakup of liability and control, a situation, which makes the occurrence of the *moral hazard* phenomenon to be very likely. In the course of the ongoing European debt crisis, the efficiency of launched reforms was mainly determined by their ability of merging control and liability. Thus, the *moral hazard*[19] approach will be introduced in the following in order to finally assess the ESM in *chapter IV*.

[19] Beside the *moral hazard* approach, there could be further theoretical approaches being applied, which are linked to the EU. For example, the "Original Sin hypothesis" (Eichengreen, Hausmann & Panizza, 2002). As outlined in the previous chapter, *original sin* refers to a situation, when "countries cannot borrow abroad in their own currencies" (Eichengreen et al., 2002, p.2). This situation challenges the financial and macroeconomic stability of a country, because external debts accumulated by this country are denominated in foreign currency. Therefore, "under these conditions, if a country accumulates a net debt (as a developing country is expected to do) there will be an aggregate currency mismatch on its balance sheet. This mismatch is associated with greater output and capital flow volatility, lower credit ratings, and more rigid monetary policies." (Eichengreen et al., 2002, p.2). However, this theoretical approach mainly can serve as an explanation for the instability of the EMU and, thus, for the reasons of the European debt crisis. It, hence, does not exactly describe the effect, the ESM deploys. Another approach could be the "Optimum currency area (OCA)" (Mundell). Accordingly, an OCA is only successful, if comparable economies with high mobility of workforces merge. By introducing a single currency, the countries of the OCA would maximize their economic efficiency. However, this approach

Basically, the approaches of Adam Smith (e.g. "The invisible hand") and further models of competition underline that "as a general rule, open markets lead to the highest possible economic welfare" (Donges & Freytag, 2009, p.169). However, if the criterions of competition[20] are not fulfilled to a certain degree, the efficiency of markets is restricted. In this case, governmental interference can serve as a consistent solution in order to counteract market failure. *Moral hazard* is a form of market failure and can be assigned to the Principal-Agent-Theory. According to this theory, the inefficiency of the markets is attributed to an asymmetrical distribution of information among market participants, in this case, the principal and the agent. The principal is characterized as the proprietor, who transfers the control over his property to the agent, his deputy. The agent again has higher expertise than the principal. This leads not only to a disparity of information, but also to a differentiation between property, in other words, liability, and control (Donges & Freytag, 2009). This special relationship is influenced by the rational behavior of both stakeholders, which is based on the rational choice imperative of maximizing its own benefit. Due to these characteristics, it is understood that the principal and the agent face conflicting interests (Dehling & Schubert, 2011). Therefore, the agent has an incentive of abusing his information to his own benefit without considering the principal's interest.
The problem of asymmetrical information among market participants might arise pre-contractually (the principal lacks of information before contracting) as well as post-contractually (the agent's behavior derogates from the contract agreements). In both cases, the principal would have to draw from resources (e.g. money, energy) in order to inhibit his welfare loss, hence, he refuses to do so (Donges & Freytag, 2009). The *moral hazard* problem can be assigned to the latter and is defined by "opportunistic behavior and the unverifiable violation of contract through one market participant." (Donges & Freytag, 2009, p.209) Therefore, "a country, which is insured against balance of payment difficulties, might succumb to the temptation to make fewer efforts to prevent them." (SVR, 2011, p.141) In other words, as the principal is unable to monitor the agent's behavior after contracting, the agent is led by the disincentive to breach his duty of care and causes a welfare loss (Donges & Freytag, 2009). Finally, guarantee or liability obligations under governmental constrain constitute a common method to counteract this kind of market failure (Donges & Freytag, 2009).

Methodologically, the approach of the present Bachelor thesis factors the topicality of the focal point, the ESM. Consequently, a review and qualitative analysis of primary and

rather addresses the organizational structure of the EMU itself, but does not serve as a consistent theoretical approach to discuss the effect of the ESM (Kunz, 2012).

[20] according to Mankiw and Taylor (2008), these criterions comprise, among others, the equality of goods, unrestricted access to information as well as a large number of suppliers and demanders

secondary sources is applied. The most important primary source, beside further treaties and regulations, is the Treaty establishing the European Stability Mechanism (TESM). Secondary sources mostly comprise paper of economists, e.g. the annual report of the Sachverständigenrat or analysis by the Centrum für europäische Politik (CEP)[21]. Beyond, further journals and assessments are taken into account in order to analyze and examine the TESM. Systematically, the sources were summarized and concentrated to the topical focus of the ESM. Subsequently, crucial articles of the TESM are analyzed against the background of the secondary sources. Ultimately, the results will be presented in a topical overview.

IV. The European Stability Mechanism (ESM)

In 2010, the smoldering economic crisis erupted and hit the financially beleaguered GIPS countries vehemently. Due to negative assessments of public finances, investors questioned the liquidity of GIPS countries. Therefore, the European financial crisis constitutes a crisis of confidence by its nature (Winkler, 2012). This lack of confidence was reflected in increasing risk surcharges, respectively higher interest rates and the imminent downgrade through rating agencies. Notably the interest rates for Greek state bonds rose up to 8% (Brunetti, 2011). Consequently, a consistent rescue measure would, firstly, have to stabilize severe market situations in short-term and, secondly, stimulate fundamental policy reforms in long-term. These rough objectives could be gained e.g. by financial incentives and sanctions. Instead, fearing a contagion effect for the whole EMU, the MS rapidly negotiated rescue measures. These rescue measures are structured bilaterally with political measures on the one hand and financial measures (aggregated in the so-called *euro rescue package*) on the other and have to be assessed against the background of the EMU and the previously mentioned requirements. *Table 1* (cf. annex) provides a detailed overview over financial measures. The financial rescue measures mainly contain of the EFSF and the ESM. Considering the topical overlap of the EFSF and its successor ESM, which forms the emphasis of the Bachelor thesis at hand, these two main features of the rescue package will be discussed separated from other financial measures.

1. Initially applied rescue measures

1.1. Political rescue measures

In the course of the European debt crisis, it became evident that "initial instruments of European economic governance, which should have contributed to the avoidance of

[21] The Centrum für europäische Politik (CEP) is a German think tank, which analyzes economic undertakings of the EU and develops own strategies and solutions for European issues.

excessive public debt as well as to the coordination of the national economic policy, failed." (SVR, 2012a, p.117) Consequently, several programs were launched during the last two years in order to improve political instruments. Three of these measures will be depicted in the following: the so-called Sixpack, the Euro Plus Pact (EPP) and the European Fiscal Compact[22] (TSCG).

1.1.1. Sixpack

The Sixpack aims to strengthen the fiscal and economic supervision of MS. Transposing this purpose into law, six draft proposals[23] were initiated, which mainly deal with the reform of the SGP and the inauguration of a new procedure facing macroeconomic imbalances. Additionally, the European Semester (ES) was introduced, which aims to coordinate economic governance instruments substantially and temporally (European Parliament, n.d.).

Assessment

The Sixpack forms stricter regulations of sanctions based on the Maastricht criteria. Indeed, the percentage thresholds and sanction procedures already existed before, however, the SGP's structure lacked effective applications to counteracting MS. Particularly the requirement of a two-third majority of the EC to access the excessive deficit procedure prevented a successful implementation of sanction measures until now, creating a situation where "sinners passed judgment on sinners" (SVR, 2012a, p.122). In the scope of the Sixpack, the exception of the debt criterion (c.f. "fudge clause") is sufficiently defined[24] and sanction measures can be adopted earlier. Nevertheless, the lack of automatic sanction procedures was not corrected satisfactorily: The initiation of sanction procedures still requires a two-third majority. Thus, a minority of MS is still able to inhibit the adoption of sanctions.

[22] Treaty on Stability, Coordination and Governance in the Economic and Monetary Union

[23] The Sixpack contains of:
1. Amendment of Regulation (EC) No 1466/97 on the strengthening of budgetary surveillance and coordination of economic policies (fiscal policy)
2. Amendment of Regulation (EC) No 1467/97 regarding speeding up and clarifying the implementation of the excessive deficit (fiscal policy)
3. Directive on the effective enforcement of budgetary surveillance in the euro area (fiscal policy)
4. Directive on the requirements for the fiscal framework of the Member States (fiscal policy)
5. Regulation on the prevention and correction of macroeconomic imbalances
6. Regulation on enforcement action to correct excessive macroeconomic imbalances in the euro area (European Parliament, n.d.)

[24] The provision of Art.104c of the Maastricht treaty (nowadays Art. 126 TFEU) stipulates, that the MS have to prevent "excessive government deficits" (Art.104c (1)), "unless the ratio is sufficiently diminishing and approaching the reference value at a satisfactory pace" (Art.104c (2b)). This "fude clause" had not been sufficiently defined yet, but the provisions of the Sixpack caught up on that: the obligations are accomplished, if the distance between the debt-to-GDP ratio and the reference value of 60% of the GDP has been diminished by one-twentieth in between the last three years or the Commission deems this reduction to be likely in between the prospective three years (SVR, 2012a, p.6)

Furthermore, the Sixpack stipulates that a payment penalty in the amount of 0.2% of the GDP is imposed on MS, which fail to eliminate excessive deficits although a deficit procedure was opened against them. In the case of a MS reporting false data, a payment penalty might be imposed as well (SVR, 2012a). However, imposing further financial burdens on debt-ridden MS has already been criticized referring to the previous version of the SGP.

In the scope of the Europe 2020–strategy (EU2020)[25], the ES[26] was developed in 2010. The ES serves as a coordination framework and forms a six-month cycle, which advances the coordination of economic governance throughout MS in order to improve the implementation of structural economic reforms. Thus, it synchronizes coordination patterns of the SGP, e.g. processes of fiscal surveillance, and the Europe 2020 strategy. This way, "the coordination and supervision of European economic governance receives an ex ante dimension" (Bundesfinanzministerium, 2012) and, therefore, can be better synchronized than before.

1.1.2. Euro Plus Pact (EPP)

Similarly to the Sixpack, the EPP was introduced to advance the coordination of economic governance. Beyond, it aims at enhancing competitiveness and, thereby, supports growth and convergence throughout the euro zone. Therefore, the reform faces issues[27] belonging to economic policy, a policy area mainly dedicated to national jurisdiction (Bundesfinanzministerium, 2012a).

Assessment

The heads of state and government of the MS sign voluntary agreements, which have to be implemented on a yearly base. The implementation is assessed by the Commission, the EC and the Eurogroup in the scope of the ES (Bundesfinanzministerium, 2012a). However, according to the Sachverständigenrat (2012), the EPP was not established by European law, thus, no sanction measure is available to induce the MS to implement the measures.

[25] The Europe 2020 – strategy is the successor of the Lisbon Strategy (LS) (2000), which aimed to make the EU "the most competitive and dynamic knowledge based economy in the world" in 2010 (Armstrong, 2010, p.286). However, after it has become clear that the LS was unlike to meet its goals, Europe 2020 was launched in 2010. It is affected by stronger need for improvement of political coordination processes and for "'smart', 'sustainable' and 'inclusive'" (Armstrong, 2010, p.288) economic growth.
[26] The ES forms the main organizational pattern of Europe 2020, contrarily to the LS, which was organized through the Open Method of Coordination (OMC). The OMC merged into the ES in 2010 (European Parliament, n.d.).
[27] Promotion of competiveness, promotion of employment, promotion of sustainability of public finances, strengthening of financial stability

1.1.3. European Fiscal Compact (TSCG)

The European Fiscal Compact (TSCG) forms a contract under international law, ratified in March 2012 and came into force in January 2013. The attempt to ground the TSCG in the European treaties in order to enforce its position failed due to the resistance of Great Britain and the Czech Republic. However, according to *art.16 TSCG* (2013), the contract shall be transferred to European law in between the next five years. Nevertheless, this procedure requires the approval of all MS, whilst the aforementioned still refuse to ratify it (SVR, 2012a). Similarly to other political measures, the TSCG aims at the advancement of budgetary and fiscal discipline as well as economic coordination throughout the EU (CEP, 2012). In order to reach its goals, the TSCG mainly stipulates the establishment of balanced budget amendments into national law. The standard values of the national balanced budget amendments are stated by the TSCG as well as its structure (*art.3 TSCG*, 2013). Hence, if the thresholds of the structural deficit (0,5% of the GDP in case of a debt-to-GDP ratio higher than 60%; 1% of the GDP in case of a debt-to-GDP ratio lower than 60%) is exceeded, an automatic correction mechanism will be triggered (*Art.3 (1) lit. e TSCG*, 2013). Furthermore, the TSCG repeats the criterion stated in the SGP, which defines the rate at which debt levels above the limit of 60% of GDP shall decrease. If a MS fails to incorporate a balanced budget amendment into its national law, it is sued in front of the European Court of Justice (ECJ) in between three months (*Art.8 (1) TSCG*, 2013). Further obligations of the TSCG refer to budget discipline and coordination.

Assessment

The CEP (2012, p.4) assesses the TSCG to be a step in the right direction, however, predicts a disappointment: “The TSCG ensures neither the establishment of a balanced budget amendment into national law, nor its correct implementation”. Firstly, the sanction measures of the treaty have been widely welcomed. On the one hand, the TSCG provides sanction measures in monetary form (0.1% of the GDP) in case one MS refuses to establish the national balanced budget amendment. On the other hand, the prohibition of access to the ESM forms a further sanction (SVR, 2012a). Secondly, mainly the compliance with the national balanced budget amendment was criticized to be questionable: Particularly the MS are not entitled to mutual monitoring referring to the implementation of each other’s national balanced budget amendments; monitoring is only conducted by national institutions and, thus, its efficiency remains doubtful (CEP, 2012). Furthermore, the national balanced budget amendment must not obligatorily obtain constitutional status, consequently, its compliance depends only on political authorities. Indeed, the ECJ has the right to sue MS infringing their

obligations; nevertheless, if MS keep refusing the implementation, the ECJ lacks further enforcement mechanisms, e.g. further payment penalties (CEP, 2012). Further criticism has been engendered about the permitted public debt ratio of less than 60% in general, which is originally based on the SGP and only repeated in the TSCG. However, this ratio is frequently criticized to be arbitrary and economically baseless (Hans-Böckler-Stiftung, 2012). Instead, the implementation of the TSCG would deny the MS's access to incurring of debts, even "if they would have to react to a persistent crisis with lower tax receipts and cyclical higher government expenditures […]." (Hans-Böckler-Stiftung, 2012, p.5) The consequently following budget cutbacks would tighten the ongoing crisis of confidence.
To sum up, most of the provisions fixed in the TSCG already existed in the established EU law. The treaty stresses these provisions and forms a further stride towards a prospective fiscal union. Nevertheless, it does not provide effective instruments for the current crisis.

1.2. Financial rescue measures

1.2.1. Bilateral rescue package

The initial financial rescue measure was rather bilateral and situated under international law and not under EU law (Rohleder, Sinn & Zehnpfund, 2010). After Greece requested financial assistance in May 2010, support with a total capacity of € 110 billion was granted by the MS and the International Monetary Fund (IMF)[28]. These bilateral loans are provided on a three-yearly base and consist of € 80 billion supplied by the MS of the Eurogroup[29] and further € 30 billion provided by the IMF (SVR, 2011). In return, Greece agreed to the implementation of strict economic reforms.

Assessment

According to Jeck, van Roosebeke and Voßwinkel (2010, p.4), already this first rescue measure forms a "bail-out loan" and, thus, a "breach of law". This criticism refers to the prohibition of art. *125 (1) TFEU* (2009) and entails the fear of negative signal effects and *moral hazard*. Contrarily, the German Bundestag denies these arguments. According to the parliament, the measure is solely of bilateral character, hence "is not based on […] a parent act of the fundamental European treaties." (Rohleder et al., 2010, p.7). However, even if a

[28] "The International Monetary Fund (IMF) is an organization of 188 countries, working to foster global monetary cooperation, secure financial stability, facilitate international trade, promote high employment and sustainable economic growth, and reduce poverty around the world." (IMF, n.d.)
[29] The Eurogroup consists of the finance ministers of euro zone MS. The meetings usually take place one day before ECOFIN meetings.

breach of *art.125 (1) TFEU* remains questionable due to bilateralism, the measure's signal effect creates the impression that the realization of a liability union is possible.

1.2.2. Purchase of state bonds through the ECB

During its launch in May 2010, the volume of the EFSF was not available to the fullest on short call. Consequently, the ECB purchased state bonds of endangered countries in order to "appease the panic of the state bond markets and prevent the panic from spreading to the banking system." (Brunetti, 2011, p.115).The ECB repeated this procedure in 2011, aiming to prevent interest rates of Spanish and Italian state bonds from rising increasingly (SVR, 2011). In the course of 2012, the European debt crisis compounded and "only eased when the ECB declared to, if necessary, unlimitedly purchase state bonds in the scope of the Outright Monetary Transactions (OMT)." (SVR, 2012, p.63) The launch of the OMT in September 2012 forms a "strategic reframing" (SVR, 2012, p.85) as it constitutes the first engagement of the ECB in a rescue measure of this extend. In the scope of the OMT, the ECB is empowered to purchase state bonds at the secondary market without a quantitative ex ante limit; consequently, the purchase can practically be made unlimitedly. In contrast to the previous programs conducted by the ECB, the OMT requires concerned MS to implement strict reform programs linked with the EFSF, respectively the ESM. In the case of an infringement through beneficiary MS, the OMT is abandoned immediately (SVR, 2012).

Assessment

Diverse criticism is raised about the approaches adopted by the ECB. Most of all, the purchase of state bonds constitutes an infringement of *art.123 (1) TFEU* (2009). Consequently, the independency of the ECB becomes questionable, which is potentially dangerous (Jeck et al., 2010). Stark (2012) fears the political exploitation of the ECB and, in effect, its inability to fulfill "its core task, the guarantee of price stability". Against this background, he criticizes the politico-economic character of the ECB's rescue measures, which would lead to a critical interlocking of monetary and fiscal policy. He furthermore assesses this development as a move towards a transfer union and stresses that the ECB lacks democratic legitimation to conduct these transfers (Stark, 2012). In contrast, some experts adopt a positive attitude on rescue measures implemented by the ECB. The Sachverständigenrat (2012, p.86) examines the measures to be "successful" as "they led to an instant easing of the markets without the need for the ECB to become virtually active at the bond market." However, high inflation rates forms a further point of criticism. According to Stark (2012), the EMU will face high inflation rates following the ECB's announcement, "not today, not tomorrow, but in medium- and long-term." Contrarily, the ECB states "the complete withdrawal of liquidities created by monetary policy measures" (Focus, 2012) after the

stabilization of the markets and, thereby, overrules the fears of increasing inflation. Nevertheless, the long-term prevention depends on further structural improvements throughout the EMU (SVR, 2012). In 2013, a suit was filed against the OMT in front of the German Bundesverfassungsgericht, accusing the ECB of transgression of competences and undemocratic behavior. Economists criticized that "according to the Maastricht treaty, the ECB is allowed to independently make decisions concerning the maintenance of price stability throughout the euro zone. However, government financing does not belong to its competences." (Bleiker, 2013) A ruling has not yet been issued.
In the scope of the OMT, the ECB refrains from its superior creditor rank. Thus, haircuts of debt-ridden MS would have the same impact on the ECB as on any other creditor. On the one hand, this leads to the ECB competing equally with private investors on the bond market; on the other hand, taxpayers are liable in the case of haircuts (Focus, 2012).

To put it all in a nutshell, the pure announcement of the ECB to unlimitedly purchase state bonds provoked an easing of the markets on short notice. Nevertheless, the resulting transfer union could lead to higher inflation rates on the long-term. Moreover, a transfer union would diminish the pressure markets put onto the concerned MS and, therefore, inhibit the imperative of fiscal and economic reforms. Finally, these insecurities are played out at the expense of taxpayers.

2. The European Financial Stability Facility (EFSF) – the ESM's predecessor

On May 9, 2010, after the bilateral rescue measure had failed to ease Greece's financial situation, further European programs were launched in order to financially support concerned MS on a middle- and long-term base. The temporary "rescue umbrella" (SVR, 2010, p.85) comprises mainly the European Financial Stability Facility (EFSF), which provides credit facilities of € 440 billion. In addition, further € 60 billion are provided through a rescue program by the Commission, the European Financial Stabilization Mechanism (EFSM) as well as € 250 billion through the IMF (Brunetti, 2011). These programs are based on *art.122 (2) TFEU* (2009), thus, financial assistance can be granted by the Union, "where a Member State is in difficulties or is seriously threatened with severe difficulties caused by natural disasters or exceptional occurrences beyond its control". The two main features of this second rescue package, EFSM and EFSF, will be explicitly outlined below.

Firstly, the introduction of European act No. 407/2010[30] paved the way for the EFSM, a Community instrument hedged by the EU's budget (SVR, 2010). In the case that a euro area

[30] Regulation (EU) No 407/2010 establishing a European financial stabilization mechanism

MS "is experiencing, or is seriously threatened with, a severe economic or financial disturbance caused by exceptional occurrences beyond its control […]" (*art. 1 European act No. 407/2010, 2010*), the EFSM grants financial support to a predetermined limit of € 60 billion. More precisely, the Commission is stipulated to raise funds on behalf of the EU (*art. 2 of EU act No. 407/2010*) and, according to *art.3 of the European act No. 407/2010* (2010), the EC grants the support on a proposal by the Commission (CEP, 2011). In sum, the EFSM forms an "emergency funds" (SVR, 2010, p.85).

Secondly, in order to boost the financial scope of the EFSM, the EFSF was established on June 7, 2010. The EFSF forms a single-purpose company by Luxembourgian law and aims to provide lower interest rates to debt-ridden MS, which would otherwise be exposed to unacceptably high rates at the capital market. Therefore, the EFSF raises funds at the capital market using proportionate guarantees of MS as collateral. As illustrated in *figure 2*, these funds are forwarded to concerned countries, which have to refund them in between fifteen years (Tagesschau, 2013). In the scope of this procedure, the EFSF is working on its own account and initially comprised a total capacity of € 440 billion; the proportionate guarantees of MS depend on their relative stake in the ECB (CEP, 2011). However, further additional costs for the single country could e.g. arise in the case of a *Stepping-out Guarantor*[31] (e.g. a loss of Greece, Spain, Portugal). Simultaneously, aiming at an AAA-rating, an overcollateralization was necessary and the lending capacities had to be exceeded by liabilities 20% higher than each MS's stake (SVR, 2011). Consequently, in the course of the ongoing crisis, the guaranteed sum was reformed in 2011 in order to boost the real lending capacity of the facility. Considering assumed obligations of € 190 billion[32], the EFSF's real lending capacity solely comprised € 250 billion from the very beginning. Striving for the full lending capacity of € 440 billion while maintaining AAA-rating, a leverage of the EFSF was negotiated and finally inaugurated in October 2011. This leverage is mainly based on the idea that the EFSF does not purchase state bonds itself. Instead, the default risk of state bonds, purchased by (private) investors, is covered by the EFSF. Hence, in the case of illiquidity of one MS, the investor's drops would partly be refunded by the EFSF, but the EFSF would not have to pay for 100% of the value. Hereby, the clout of the EFSF would be enhanced many times over and comprises guarantees amounting to € 780 billion (cf. *Figure 2*) (SVR, 2011). Nevertheless, after its launch, the leverage has been highly criticized for failing to significantly enhance the clout of the EFSF. Concretely, the leverage missed the target of boosting its lending capacity up to € 1 trillion and was only likely to realize € 750

[31] A Stepping-out Guarantor is a country, which formerly hold a share in the EFSF, but has to make use of the loans itself due to increasing indebtedness (SVR, 2010)

[32] At this time, around € 100 billion should contribute to the second Greek rescue package. Further obligations of the fund comprised € 44 billion (Ireland, Portugal) and € 40 billion for the recapitalization of banking systems (Mussler, 2011)

billion (Mussler, 2011). A further measure of leverage is the Co-Investment-Funds, a sub company of the EFSF with the involvement of private investors, entrusted with the task of purchasing state bonds of crisis-ridden countries (Tagesschau, 2013).

In the scope of the reform in 2011, the EFSF gained further competences beside the above outlined capacity (*Art. 2 Abs. 1 lit. b. of the EFSF Framework Agreement*, 2010). They comprise the purchase of state bonds at both, the primary and secondary market as well as the indirect support of the banking sectors of concerned MS. Furthermore, the EFSF is able to grant preventive loans (Tagesschau, 2013). Nowadays, the scope of the EFSF is enhanced to an amount of € 780 billion with a lending capacity € 440 billion. According to *art.5 (3) of the EFSF Framework Agreement* (2010), the MS can adopt a credit enhancement "in order to enhance or to maintain the creditworthiness". General premise for intervention is "the mandatory provision of the measure requested by the concerned MS in order to protect the overall stability of the EMU" (CEP, 2011, p.2). However, financial support is only granted associated with sanction measures (e.g. payment penalties in case of an infringement) and reform programs.

In January 2011, the EFSF placed its first bond on the market for an amount of € 5 billion in order to raise financial facilities for Ireland. The borrowing costs for EFSF amounted to 2.89 %. Beside Ireland and Portugal, which already accessed the rescue package in 2010 and 2011, Cyprus and Slovenia announced to rely on support before long. Additionally, the Spanish banking sector is restructured with EFSF capital amounting to € 1 billion (Brunetti, 2011).

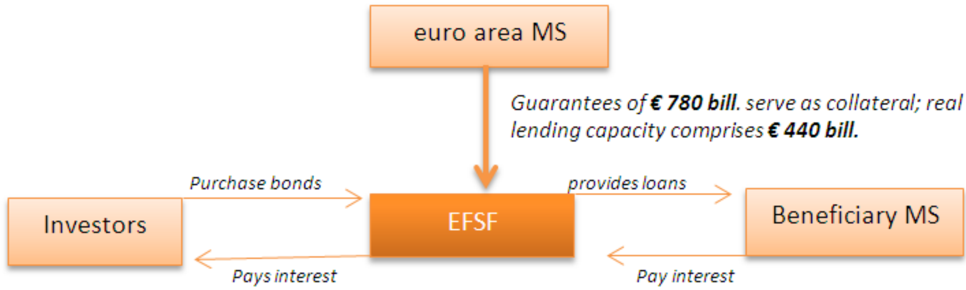

Figure 2: *Functioning of the EFSF (after its leverage in 2011) (own graph, data source: Tagesschau, 2013)*

Assessment

Similarly to the bilateral measure as well as the EFSM, the crucial tenor of the criticism to the EFSF is the breach of *art.125 TFEU* as well as the interpretation of *art.122 (2) TFEU* (2009). Accordingly, financial assistance can only be granted, if a crisis situation was "caused by natural disasters or exceptional occurrences beyond its control". However, it remains more than questionable, if the indebtedness of MS is a matter beyond their control. Thus, the rescue umbrella can be seen as a further step towards a liability union. But, considering the

topical overlap of the EFSF and its successor ESM, which forms the emphasis of the Bachelor thesis at hand, the pros and cons of the rescue package will be discussed at the bottom of this work in the scope of the ESM.

3. The European Stability Mechanism (ESM)

3.1. Legal patterns and organizational structure

Whilst the Sachverständigenrat (2011, p.86) notes that the ongoing "spiral of insecurity" stresses the ineffectiveness of the temporary rescue package, the German government underlines the efficiency of the temporal mechanism as a "signal of confidence" (Bundesfinanzministerium, 2013). Indeed, the situation eased temporarily after its inauguration. However, as the insufficient impact of the temporary crisis management in medium- and long-term perspective was predictable even for the heads of government, the establishment of a permanent rescue measure, aiming "to safeguard financial stability in the euro area as a whole" (ECB, 2011, p.74), was already agreed to in October 2010. The ESM was designed to completely replace its predecessors in 2013, however, it became applicable already in September 2012 (*cf. Figure 3*). Beyond, as presented in *figure 3*, the EFSF remains active in programs that started before the ESM was inaugurated and, additionally, will engage in new programs during a transitional period in 2013. Thereby, the full lending capacity of the ESM can be provided. Thus, although the ESM forms the main instrument of financial assistance, the EFSF is in force until all its remaining obligations have been repaid (ESM, 2012).

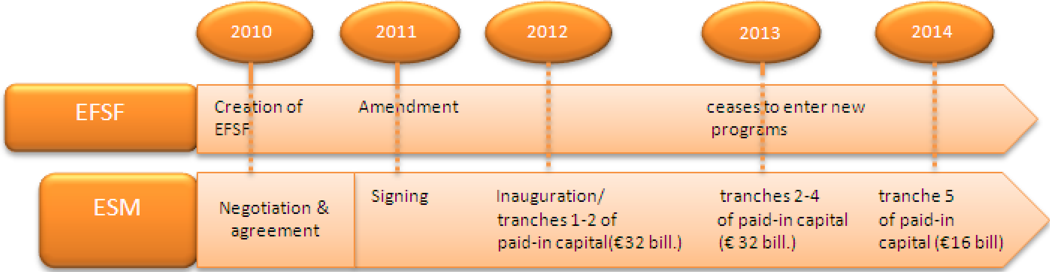

Figure 3: *Parallelism and relationship of the EFSF and the ESM over the years (own graph)*

The overall objective of the ESM is to provide financial assistance at moderate interest rates to ESM members, which have become unable to access market financing due to distrust of lenders. In order to fulfill this objective and thereby contribute to the financial stability of the whole EMU, the ESM funding structure is built on certain principles. Firstly, the ESM shall be more than just a temporal stability mechanism. Hence, it must be able to react short-ranged and flexible, but simultaneously, save up "liquidity buffers" (ESM, 2012, p.9) for periods of severe market conditions. Secondly, it has to "achieve the aim of establishing itself as a

reliable issuer in a difficult market environment" (ESM, 2012, p.9). Therefore, consistent, but simply structured instruments must be introduced.

According to the German Bundesregierung, crucial gaps of the EMU have been filled by the inauguration of the ESM. It states that the ESM is designed as an overall package, which is embedded in policy solutions like the EEP or TSCG and provides more than single solutions for the ongoing crisis (Bundesfinanzministerium, 2013). However, this statement has to be examined in the following. Primarily, the structure and instruments of the ESM are detailed in the upcoming section. Afterwards, the pros and cons of the ESM will be discussed, guided by the central question: Does the ESM constitute a consistent and sustainable solution for the European sovereign debt crisis?

3.1.1. Legal base

The ESM does not vary significantly from the EFSF, nevertheless, there are some fundamental changes. Most of all, there is a remarkable renewal concerning the legal base. Unlike the ESM, previous rescue measures were based on *art.122 (2) TFEU*. As the interpretations of *art.122 (2) TFEU* remained more than questionable, the ESM needed to be built on a consistent legal pillar, which is designed two-staged: Firstly, *art. 136 TFEU* was revised and supplemented by a further paragraph. According to new *art.136 (3) TFEU* (2011), the establishment of an European stability mechanism is lawful under the condition that the measure is "indispensable to safeguard the stability of the euro area as a whole". Secondly, the ESM is based on this paragraph, designed as an "intergovernmental institution established under public international law by a treaty[33] signed by the euro area countries […]" (ECB, 2011, p.74). Hence, established as International Financing Institution (*Art.1 TESM*), it differs from the EFSF, a private company under Luxembourgish law. Although harsh criticism has been raised about the legal compatibility of the ESM with EU treaties, the ECJ as well as the German Bundesverfassungsgericht ruled it to be inoffensive. Accordingly, the TEU as well as the TFEU "do not preclude the conclusion and ratification of the ESM Treaty" (ECJ, 2012, p.2).

3.1.2. Governance of the ESM

According to *art.4 (1) TESM* (2012), the ESM is composed of three agencies.

Firstly, the Board of Governors (BoG) (*art.5 TESM*) constitutes the most important decision making body within the institutional patterns of the ESM. In registry with the Eurogroup, it consists of the euro zone finance minister (*art.5 (1) TESM*). Organizationally, most of its

[33] Treaty Establishing the European Stability Mechanism (TESM)

decisions are taken unanimously by mutual agreement[34] (*art. 4 (3) TESM*); it competences mainly comprise "to provide stability support by the ESM" (*art.5 (6) lit. f TESM*, 2012), "to establish […] the financial terms and conditions" (*art.5 (6) lit. f TESM*, 2012), "to change the authorized capital stock and adapt the maximum lending volume of the ESM" (*art. 5 (6) lit. d TESM*, 2012) and "to change the list of financial assistance instruments that may be used by the ESM" (*art.5 (6) lit. i TESM*, 2012). Contrarily to the latter, the EFSF's framework agreement had to be changed in order to expanse its instruments. Beyond, further decisions are taken by qualified majority[35] or simple majority[36].

Secondly, the Board of Directors (BoD) (*art. 6 TESM*) is dependent on the BoG and manages the operational business (*art.5 (6) lit. m TESM*). *Art.6 (1) TESM* (2012) stipulates rules relating to its structure; accordingly, "each Governor shall appoint one Director and one alternate Director from among people of high competence in economic and financial matters. Such appointments shall be revocable at any time." Its decisions are taken by qualified majority, however, they are taken conforming with and for the purpose of the BoG.

Thirdly, matters of daily business are transferred to a Managing Director (*art.7 (1), (4), (5) TESM*), who remains in office for a minimum of five years. Thus, the Managing Director is appointed by the BoG and instructed by the BoD.

3.1.3. Funding and implementation of the financial assistance

Financial assistance can only be granted to ESM members, more precisely, the seventeen euro area MS. As portrayed in *figure 3* and *4*, the ESM's funding is organized double-staged: On the one hand, paid-in capital is deposited by euro area MS in five annual installments measured against each MS's share in the ECB's capital key[37]; it amounts to € 80 billion in total. On the other hand, the callable capital comprises € 620 billion and is contributed by MS guarantees, depending on the national share in the ECB's capital key as well. In sum, the ESM provides stock capital of € 700 billion in total, thereby insures a real lending capacity of € 500 billion[38] as well as AAA-credit ratings for the ESM (CEP, 2012a). In March 2012, the

[34] BoG as well as BoD have a quorum if 2/3 of the members with voting rights representing at least 2/3 of the share capital are present. (*Art. 4 (2), (7)*)

[35] Qualified majority (*Art.4 (5) TESM*) is usually defined as 80% of the voted cast. Votes will be weighted equal to the countries' number of shares in the ESM capital. Areas concerned are e.g. the appointment of the Managing Director the approval of the ESM's annual accounts and the accessions of new MS to the EMS. However, there is a further qualified majority concerning the emergency voting procedure. In the case of an emergency call for financial assistance, decisions can be made by 85% of the votes cast (*Art. 4 (4) TESM*)

[36] Simple majority (*Art.4 (6) TESM*) requires a majority of the votes cast

[37] The ECB's capital key "gives equal weight to the country's shares in the total population and total GDP, respectively, of the EU" (ECB, 2011, p. 83)

[38] Identically equal to the EFSF, the ESM is over-collateralized by € 200 billion in order to gain AAA-ratings and thereby ensure financial support with low interest rates. Thus, the total capital comprises € 700 billion, whereas the real lending capacity amounts to € 500 billion.

continuation of existing financial assistance, granted by the EFSF to Portugal, Greece and Ireland, was decided. Consequently, the lending capacity of EFSF/ESM combined amounts to around € 700 billion[39] in total (ECB, 2011). These organizational patterns form a renewal compared to the EFSF, which was not equipped with paid-in capital and has to rely on over-collateralization instead. In order to finance its instruments and similarly to the EFSF, the ESM is entitled to issue bills and bonds at the capital market (*art. 21 TESM*). That way and backed by securities of the previously described funding structure, the ESM is able to provide financial assistance to concerned MS under market conditions (cf. *Figure 4*). Additionally, the ESM holds a reserve fund, which is generated from MS sanction payments in the scope of TFEU procedures as well as surplus funds emanating from ESM operations. Losses arising from ESM operations are firstly rescued by this fund. Referring to the financial assistance, the ESM grants loans to fixed as well as variable interest rates, which cover the refinancing costs, and demands risk surcharge (ESM, 2012).
Comparable to its successor, the ESM has five financial assistance instruments at its disposal in order to support MS facing extensive financial difficulties. Financial assistance can be granted through credit lines[40] (*art.14 TESM*), “loans to an ESM Member for the specific purpose of re-capitalizing the financial institutions of that ESM Member” (*art.15 TESM*, 2012), loans (*art.16 TESM*) and “purchase of bonds of an ESM Member on the primary market […]” (*art.17 TESM*, 2012) as well as on the secondary market (*art.18 TESM*). Loans in the form of the ESM Stability Support (ESS) constitute the mechanism’s core instrument and are granted accompanied compulsively with macroeconomic adjustment programs, which have to be implemented by the supported MS in return (*art.16 (2) TESM*).

As illustrated in *figure 5* (cf. *annex*), financial assistance through ESM instruments is initiated only by an ESM member’s request after it made full use of all other possibilities before. The request triggers the assessment of the situation as “a risk to the financial stability of the euro area as a whole […]” (*art.13 (1) lit. a TESM*, 2012). The assessment as well as the sustainability evaluation of the requesting country’s national indebtedness situation are conducted mainly by the Commission, “in liaison with the ECB […]” (*art.13 (1) TESM*, 2012) and the IMF, the so-called *Troika*. Finding “that a macroeconomic adjustment program can realistically restore the public debt to a sustainable path” (ECB, 2011, p.76), the previously named institutions are charged by the BoG with the development of a Memorandum of

[39] This amount is cited under reserve and only refers to the combined EFSF/ESM. Considering e.g. further € 49 billion from the EFSM and € 53 billion already disbursed in the scope of the bilateral rescue measure for Greece, the real amount of the rescue package is hard to define and subject to variation. (Tagesschau, 2013)
[40] Credit lines provide solutions for short-termed financial difficulties. Thus, they serve as preventative measures for crises of confidence and contagion effects. Their drawdown is linked to the implementation of reforms (Bundesfinanzministerium, 2012a)

Understanding (MoU), more precisely, an adjustment program including measures aiming at restoring financial stability (*art. 13 (3), (4) TESM*). The MoU is signed by the Commission on behalf of the ESM. Beyond the policy conditionality laid down in the MoU, a further condition for entering the ESM is the signature of the TSCG from March 2013 on.

Although the Managing Director forwards a proposal about terms and conditionality of financial assistance, the BoG finally decides about its granting and accompanying conditions (*art.13 (5) TESM*). Afterwards, the BoD has to approve and outline technical details referring to the granting of financial assistance. During the further procedure, the implementation of the macroeconomic adjustment program is monitored by the Troika (*art.13 (7) TESM*). If a beneficiary MS fails to comply with policy conditions, the BoG decides about abandoning the payment of tranches. Beyond, post-program monitoring can be launched by the EC until a certain amount of the loans is repaid (ECB, 2011). Furthermore, private sector involvement is considered on a case-by-case base and only in "cases where stability support is provided accompanied by conditionality in the form of a macro-economic adjustment program." (*TESM preamble (12)*, 2012) However, against the background of private sector involvement, *art.12 (3) TESM* (2012) stipulates that "Collective action clauses shall be included […] in all new euro area government securities". Collective Action Clauses (CAC) legally aggregate debt securities and inhibit the blocking of payment negotiations by few individuals. Thus, in a case of a MS' illiquidity, creditors can decide about changing the terms of payment (e.g. haircut) with a qualified majority (ECB, 2011).

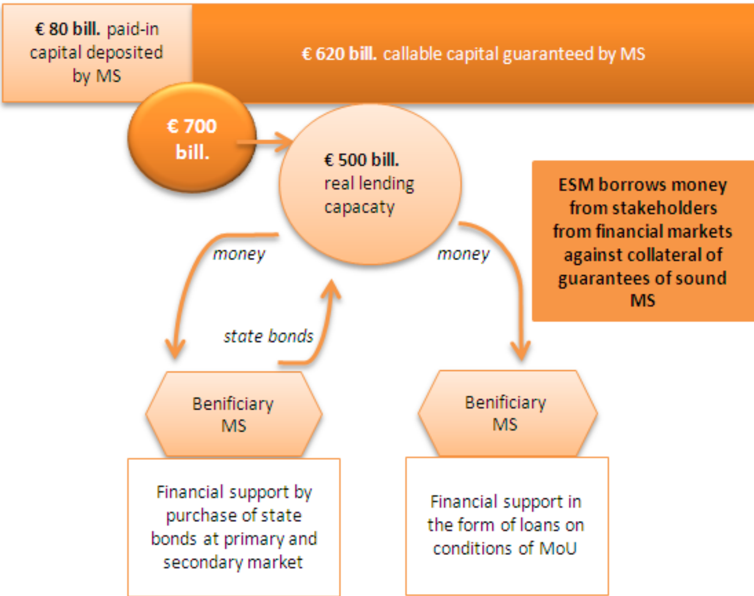

Figure 4: *Functioning of the European Stability Mechanism (ESM) (own chart)*

3.2. Discussion and Assessment

The discussion about the ESM is led zealously, but can hardly draw on valid data. In fact, neither there has been an economic and political construction comparable to the EMU (cf. *chapter II*), nor have the large part of liabilities of the ESM been paid yet. Thus, solid facts and figures about future financial burdens potentially imposed on single MS or the whole EMU are nearly impossible to define, whilst currently available figures are mostly subjects to exploitation and political calculation. Consequently, the arguments urged in the following in order to examine the ESM are not built upon these data. Instead, the ESM's organizational structure (cf. *Figure 4 & 5 (annex)*) is assessed against the background of the previously outlined reasons for the European debt crisis. Ideally, "an efficient official financing framework must be designed in a way that minimizes *moral hazard* and reinforces incentives to undertake fiscal and macroeconomic adjustment and to seek market financing as soon as feasible" (ECB, 2011, p.74) in order to answer to the needs derived from the organizational patterns of the EMU and the dynamics of the European debt crisis; theoretically, "this can be achieved through strict conditionality and fair but non-concessional loan pricing provisions" (ECB, 2011, p.74). It is questionable, if the ESM contributes to these needs and thereby constitutes a valid solution for the European debt crisis.

3.2.1. Pros

Funding

Compared to the EFSF, the ESM is equipped with paid-in capital, which is widely welcomed. Indeed, the lending capacity of the EFSF is only secured by MS' guarantees, a funding structure entailing the problem of overcollateralization[41]. In contrast, the paid-in capital stock of the ESM ensures creditworthiness and confidentiality by reducing the potential "migration risk"[42] (ECB, 2011, p.82). In other words, downgrades through rating agencies do not pressurize the remaining sound countries to enhance their guarantees. Furthermore, the paid-in tranches immediately show up in the contributing MS' budgets. Consequently, the financial effect of bail-out becomes apparent and this might reduce the incentive to steadily guarantee further financial assistance (ECB, 2011). Additionally, the reserve fund serves as a "buffer" (Bundesfinanzministerium, 2013) in order to inhibit the utilization of paid-in capital. That way, the liabilities of the MS are likely to be reduced as well.

[41] Guarantees must exceed the real lending capacity by far, because rating agencies only take guarantees of AAA-rated MS into account (Bundesfinanzministerium, 2013)

[42] "the risk emanating from potential downgrades of the credit ratings of individual euro area countries" (ECB, 2011, p.82)

Procedures

As detailed in the previous section, most of the decisions concerning the adoption of financial assistance are taken by mutual agreement, more precisely "unanimously by those countries participating in the vote." (ECB, 2011, p.76) Consequently, one single MS cannot impede a decision through abstention (cf. *policy of the empty chair*[43]). In effect, this principle enhances the efficiency and flexibility of the ESM. However, crucial decisions influencing national budgets often require the approval of national parliaments (c.f. *art.19 TESM*). Thus, democratic decision making processes are partly taken into account (CEP, 2012).

Instruments

As roughly introduced in the previous section, the ESM comprises five instruments of financial assistance. Beside the main instrument, loans (*art.16 TESM*), which financially support debt-ridden MS directly, other instruments also support MS in a predominantly sound fiscal situation or after the implementation of adjustment programs. That way, they try to prevent upcoming crises or facilitate the re-integration into markets. The first instrument of this type, loans supporting the recapitalization of financial institutions (*art.15 TESM*), serves as prevention measure, which reduces contagion effects and enhances the financial stability of single MS and the euro zone as a whole by reacting to crises "primarily located in the financial sector and not directly related to fiscal or structural policies" (ESM, 2012, p.12). The second instrument, the provision of credit lines (*art.14 TESM*), partly punctuates the *ultima ratio* principle of financial assistance as it is granted to MS in sound economic condition (ESM, 2012). In order to attain its objectives, two types of credit lines are available: one of them to MS with a sound economic and financial background (precautionary conditioned credit line, PCCL), the other to MS in a sound economic and financial situation, but without complying with the eligibility criteria[44] required for PCCL (enhanced conditions credit line, ECCL). Hereby, according to the ESM (2012), economic and financial crisis situations are inhibited preventively. Furthermore, the grant of credit lines entails extended surveillance of the country's financial situation through the Commission (e.g. reports, stress tests). The final financial assistance instrument is the purchase of bonds, on both, the primary and the secondary market (*art.17 & art.18 TESM*). These instruments are intended to be applied at

[43] In 1965 and 1966, France opposed proposals of the Commission concerning agricultural policy. In order to inhibit the proposals, French members stopped attending Community meetings and, thereby, blocked decision-making in the EC.
[44] sustainable public debt, respect of commitments under excessive deficit procedure (EIP), track record of access to capital markets on reasonable terms, sustainable external position, and the absence of bank solvency problems that would pose systemic threats to the stability of the euro area banking system (ESM, 2012,p. 14)

the end of an adjustment program. Especially the purchase of bonds on the secondary market aims to motivate investors to keep participating in the financing of ESM MS (ESM, 2012). Thus, they enable a MS's comeback to the market.

Adjustment programs and sanctions

The overall imperative of the ESM is "solidarity for solidarity" (Bundesfinanzministerium, 2013). In other words, financial assistance is only granted, if concerned MS declare their agreement with adjustment programs and the refund of facilities. The German Bundesfinanzministerium (2013) examines this fact as the final prove that the apprehension of an evolving transfer union is inappropriate. The abandonment of financial assistance constitutes the most important sanction the BoD can impose on MS, which do not adhere to their obligations. With certainty, this sanction serves as incentive for beneficiary MS to implement adjustment programs. Beyond, "the country would also lose the catalytic role that the existence and proper implementation of an adjustment program would play in convincing the private sector to maintain its exposure." (ECB, 2011, p.78) The ECB (2011) concedes that the short-term effect of adjustment programs might be limited; however, it characterizes ESM instruments as "liquidity bridge" (ECB, 2011, p.73), which contributes to financial recovery in medium term.

3.2.2. Cons

Funding

Opposed to the rather positively assessed paid-in capital, other aspects of the ESM's funding are highly criticized: The paid-in capital of € 80 billion contrasts with callable guarantees 7.75 times higher, numerical € 620 billion; as outlined above, the ESM amounts to € 700 billion and comprises a real lending capacity of € 500 billion in total (cf. *Figure 4*). Thus, although the paid-in capital immediately shows up in the MS' budget and, therefore, is calculable, callable guarantees are still likely to have devastating effects on the national budgets in the case of a total recourse.[45] In effect, "the potential claim of the full lending capacity would lead to the meltdown of the national budgets of euro area countries." (Gerken & Kullas, 2011, p.6) Furthermore, *art.8 (5) TESM* (2012) stipulates: "The liability of each ESM member shall be limited, in all circumstances, to its portion of the authorized capital stock at its issue price." However, the credit line of € 500 billion, respectively the capital of € 700 billion, is not strictly limited. To the contrary, on March 24, 2011, it was negotiated that the BoG examines the

[45] Exemplarily, Germany deposits paid-in capital amounting to €22 billion and warrants a sum of €168 billion; in total, this amounts to 62% of the German budget of 2011 (SVR, 2011)

efficiency of the credit lines constantly and, in the case that the current capital is estimated to be insufficient, enhances the credit line (Tagesschau, 2013a). Beyond, only "the authorized capital stock at its issue price [...]" (*art.8 (5) TESM*, 2012) is limited; logically, the capital stock at its nominal value is unlimited (Homburg, 2012). *Art.8 (2) TESM* (2012) stipulates "that shares shall be issued at par, unless the BoG decides to issue them in special circumstances on other terms"; thus, the issue price can exceed the nominal value. Hence, credit lines can be enhanced further (Homburg, 2012). Additionally, prospective losses of the ESM could lead to the demand of ESM capital and guarantees. As e.g. GIPS countries will not be able to account for these payments, a redistribution of the default risks to financially sound MS will be the consequence (*art.25 (2) TESM*).
The borrowing operations of the ESM became contractual in *art.21 TESM*. According to Homburg (2012), this article de facto constitutes the introduction of Eurobonds as it enables the ESM to borrow at the capital market by issuing bonds with joint liability.

To sum up, potential costs imposed on the MS are not calculable by now (Gerken & Kullas, 2011). As a side effect, the chance of an unlimited enhancement of the credit lines also reduces the incentives for a sound fiscal and economic behavior of MS, therefore promotes *moral hazard* and the development towards a liability union. Furthermore, whilst the reserve fund was positively characterized as a "buffer" (Bundesfinanzministerium, 2013) on the one hand, criticism is raised about this feature as well on the other hand. Presumably, the amount of the reserve fund will be rather small, in view of the fact that payment penalties mostly came to nothing in past and that still an automatic sanction mechanism is inexistent (CEP, 2012a).

Procedures

According to *art.12 (1) TESM* (2012), financial assistance is only granted on condition that it is "indispensable to safeguard the financial stability of the euro area as a whole [...]". Nevertheless, the example of Greece proved that even rather small MS can provoke a banking crisis throughout the whole EMU and endanger its stability. Therefore, the interpretation of "indispensable" is to be seen against the background of *too big to fail*, in turn, entailing *moral hazard*. Because, the problem of system relevant banks is not solved by the ESM, the financial stability of the EMU is at risk even if rather small MS become illiquid. Consequently, each MS and bank will be rescued (Gerken & Kullas, 2011). The fact that private sector involvement is not obligatory will even reinforce the *moral hazard* effect. Because of the ESM, liability and responsibility disintegrate, especially referring to private creditors. In other words: private creditors do not have to be liable for their financial

engagement in state bonds, but receive risk premiums for lost state bonds. Therefore, the risk of the private creditor is carried by the taxpayer. Consequently, "interest rates charged by private creditors do not reflect the need to reform and, thus, reform pressure is diminished" (Gerken & Kullas, 2011, p.8). According to Weidmann (2011), the CACs are not sufficient to solve this problem.

Instruments

Among others, the ECB (2011) and ESM (2012) underline the positive features of instruments, which are designed to cover a wide range of severe situations MS of the euro area could be susceptible to. Nevertheless, these positive arguments are disproved by critical arguments.

First of all, *art.19 TESM* (2012) stipulates that "the Board of Governors may review the list of financial assistance instruments provided for in *articles 14 to 18* and decide to make changes to it." Thus, the unlimited enhancement of instruments is possible without a change of treaty. Indeed, decisions about instruments deploying further financial burdens on national budgets require the involvement of national parliaments in several MS; in the case of a refusal to adopt the amendment, the MS' representative would have to vote against the new instrument and its adoption would be questioned (ESM, 2012). However, these regulations are not defined in the ESM treaty[46], thus are non-binding under international law. Consequently, decisions of the BoG are binding, even if the national parliament votes against an amendment (Homburg, 2012). Certainly, the BoG consists of the MS' ministers of finance, which are bound to the will of national parliaments; however, it can be doubted that national parliaments truly have the opportunity to influence proceedings independently: Firstly, based on experiences with previous rescue measures, the BoG will not negotiate too long before adapting a rescue package due to the *too big to fail*- difficulty and potential contagion effects. This proceed is facilitate by the "emergency voting procedure"[47] (*art.4 (4) TESM*, 2012). In this case, the national parliament will be asked for approval after the adaption of a decision. However, the disapproval of the parliament at this point is unlikely as it would risk its credibility without changing the decision itself (Homburg, 2012). Secondly, the minister of finance enjoys penal immunity (*art.34 & 35 TESM*). Thus, his decision has no consequences on him, even if it counteracts to the national democratic decision-making process (Homburg, 2012).

[46] These rules are incorporated in national accompanying acts, for example the German ESM-Ratifizierungsgesetz, which rules the involvement of the Bundestag in Art. 2 Abs. 2 ESM-Ratifizierungsgesetz
[47] Art. 4 (4) TESM: "[…] an emergency voting procedure shall be used where the Commission and the ECB both conclude that a failure to urgently adopt a decision to grant or implement financial assistance […] would threaten the economic and financial sustainability of the euro area."

The second criticism concerns instruments, but also constitutes the fundamental argument against the ESM as a whole: The instruments of the ESM are unable to solve the reasons of the European debt crisis. These reasons can be found in the architecture of the EMU as described in *chapter II*, on the one hand; on the other hand, "the problems of the faltering euro area MS are not only based on the indebtedness of the state, but on the indebtedness of the whole national economy." (CEP, 2012a, p.3) As outlined in *chapter II*, the declining interest rates after the introduction of the new currency led to the reduction of competiveness and increasing current account deficits. Consequently, not only the public, but also the private sector declared higher needs for credits. However, the ESM aims to grant financial assistance only to MS, which are not able to re-finance themselves at the capital market with affordable interest rates. In other words, the ESM is geared to financial problems of the public sector without approaching problems of the private sector, namely the problem of external debts, loss of competiveness and the ongoing flight of capital.

Usually, ongoing indebtedness would entail increasing interest rates and force the debt-ridden countries into political, fiscal and real economic reforms. Instead, the ESM increases the incentive of demanding credits by providing low-interest credits. Thus, the incentive to conduct indispensable fiscal and economic reforms is diminished, whereas the disincentive to *moral hazard* increases, because MS "can socialize a failure's financial losses" (Gerken & Kullas, 2011, p.6); therefore, the ESM reinforces the debt crisis. Surely, the grant of financial assistance is accompanied by reform programs laid down in MoU. However, due to the imperative of *ultima ratio* (cf. *art.12 (1) TESM*), financial assistance is only granted, when a beneficiary MS is already unable to re-finance itself at the capital market. Hence, adjustment programs can be launched when it is already too late. Furthermore, according to *art.16 (2) TESM* (2012), conditionality is only attached to ESM loans, not to further financial assistance instruments.

To sum up, the instruments of the ESM address only a small part of the reasons for European debt crisis. Thus, they may serve as a bridge for short-term financial problems of MS. However, they do not address fundamental problems through fiscal and economic reforms and the involvement of the private sector and, thus, are unable to stabilize the EMU on a long-term basis; moreover, they stabilize and continue the European debt crisis.

Adjustment Programs and sanctions

As already mentioned above, adjustment programs are only attached to loans and only launched, if the concerned MS already faces severe economic problems (c.f. *ultima ratio*). Hence, already existing political, economic and fiscal problems, mainly emanating from the architecture of the EMU, are not addressed.

According to the ESM (2012, p.11), the financial assistance can be abandoned, “if monitoring processes highlight significant deviations from the macroeconomic adjustment program”. Nevertheless, as the “financial stability of the euro area as a whole” (*art.12 (1) TESM*, 2012) is the crucial objective of the ESM, the *too big to fail*- problem will keep granting MS from abandoning tranches: in order to attain this aim, they have to financially support each debt-ridden MS, regardless of whether it complies with the adjustment program or not. This effect is associated with the fact that the ESM still lacks adequate surveillance mechanisms and automatic sanctions. Tranches are paid off “after having received a report […]” (*art.14 (5) TESM*, 2012) about the monitoring results; however, “there is no talk of attached conditionality.” (CEP, 2012a, p.3)

In sum, this situation created by the ESM is likely to lead to a behavior comparable with the breach of the convergence criteria without consequences: “The more MS make use of financial assistance and the bigger these MS, the more yielding the sanctions.” (Gerken & Kullas, 2011, p.3) Again, the lack of enforceable political and economic restrictions and automatic sanction measures reinforces the *moral hazard* effect additionally.

3.2.3. Assessment of the theoretical background – *moral hazard*

It has already been remarked that institutional patterns of the ESM are likely to tempt to *moral hazard*: “The prospect of official financial assistance being available under certain conditions can, of course, alter incentives related to the conduct of national economic policies and thus introduce *moral hazard*.” (ECB, 2011, p.78) However, consistent quantitative or qualitative indicators quantifying the degree of *moral hazard* are impossible to define. Hence, only analyzing the legal and institutional design of a rescue measure, as done in the previous part of this chapter, can indicate whether a *moral hazard* behavior is likely to appear. Legally, the amendment of *art.136 (3) TFEU* serves as the main pillar for the permanent rescue measure; de facto, it disables the No-bail-out clause of *art.125 (1) TFEU*. Whilst *art.125 (1) TFEU* (2012) stipulates that the EU or a MS shall not be liable to any financial commitments by other MS, *art.136 (3) TFEU* (2012) allows kinds of financial assistance and stability mechanisms where it is “indispensable to safeguard the stability of the EU […]”. Thus, it paves the way for an unlimited bail-out in the form of the ESM. Hereby, the ESM rather reinforces the European debt crisis by further undermining the liability of creditors through holding out the prospect of bail-out (CEP, 2012a). However, Boysen-Hogrefe (2011) and Winkler (2012) deny a *moral hazard* effect of great moment. Accordingly, if a *moral hazard* behavior emanated from the ESM, interest rates would have decreased significantly after its launch, which is not the case. Furthermore, they characterize the European debt crisis as a “crisis of suspense” (Boysen-Hogrefe, 2011, p.6) due to asymmetrical distribution of information: as financial assistance is attached to the

implementation of adjustment programs, investors would fear its abandonment in the case the beneficiary MS does not comply with political and economic reforms. Thus, correspondent to Boysen-Hogrefe (2011) and Winkler (2012), MS would not rely on the ESM and call for financial assistance in order to inhibit this crisis of suspend. However, the reverse is true. Interest rates do not decrease despite of the ESM, because the ESM is not able to assert fiscal, political and economic reforms. Therefore, it is neither able counteract *moral hazard* by merging liability and control, nor it addresses the fundamental problems of the European debt crisis. Thus, investors do not reclaim confidence that the European debt crisis will withdraw and MS will be able to service their debts in long-term perspective even after the ESM was inaugurated. Beyond, they have to fear the worsening of the crisis. To sum up, the ESM reinforces the *moral hazard* behavior of the MS and is unable to rebuild the investors' confidence. Hence, it does not constitute a consistent instrument to counteract the crisis of confidence.

V. Conclusion

Taken as a whole, the European debt crisis since 2010 cannot be attributed only to the misguided policy of certain MS, but rather to the architecture of the EMU as a whole. Particularly, the establishment of a single currency without a joint coordination of fiscal policy and enforceable stability mechanisms (e.g. the SGP), paved the way for cyclic divergences, external debt and the loss of competitiveness. Finally, this instable overall structure led to the ongoing indebtedness not only of the state, but of whole economies and erupted in a deep crisis of confidence. In other words, the EMU provided the breeding ground for the current crisis. Consequently, in order to provide consistent solutions for the European debt crisis, the organizational and institutional patterns of the EMU have to be addressed. However, the already implemented problem-solving approaches, notably the ESM, do not take these special requirements into account. To the contrary, the rescue measures do not imply incentives to conduct a sound fiscal and economic policy, but tempt to *moral hazard*.

According to the German Bundesbank (Weidmann, 2011), a consistent rescue mechanism would have to contribute to three aspects: prevention, acute crisis management mechanisms and consistent implementation. Firstly, the core aspect of prevention would have to be the anticipatory avoidance of excessive public debts and the coordination of the national economic policy (Weidmann, 2011). Nevertheless, the *ultima ratio* imperative of the ESM entails that crucial structural reforms are only scheduled when the concerned MS is already heavily in debt. Additionally, *ultima ratio* can be subject to vague interpretations and, as a result, the "application of the fund can always be justified in any way." (Homburg, 2011)

Furthermore, intergovernmental political measures like the Sixpack, the EPP or the TSCG are under jurisdiction of the MS, making their enforceability questionable. Secondly, acute crisis management should provide both, financial assistance and simultaneously incentives to a sound fiscal policy. These incentives could e.g. consist of economic and fiscal restrictions, adequate interest rates and private sector involvement in case of illiquidity (Weidmann, 2011). As outlined in the previous chapter, the ESM contributes to none of these requirements, moreover, provides disincentives by e.g. comparably low interest rates and the insufficient CACs. Thirdly, the consistent implementation is dependent on surveillance instruments and, in case of doubt, sanctions (Weidmann, 2011). Again, as depicted in the previous section, the ESM lacks appropriate instruments, e.g. automatic sanction measures. To sum up, the ESM does not constitute a consistent mechanism to solve the European debt crisis. Beyond, by de facto leveraging the No-bail-out clause and disintegrating liability and control, it expedites the movement towards a liability union and, thereby, reduces the incentive for a sound fiscal and economic policy. In effect, it stabilizes the crisis. Summarizing, the ESM provides a short-term "liquidity bridge" (ECB, 2011, p.73) to ease the markets and inhibit contagion effects, but does not serve as a consistent long-term solution for the crisis of confidence and even protracts and compounds the fundamental problems.

In the end, "the Euro crisis is a crisis of the European Union" (Enderlein, 2010, p.12). Thus, the response to it has to be that a single currency must be associated with a strong economic-political integration in future.

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Figures

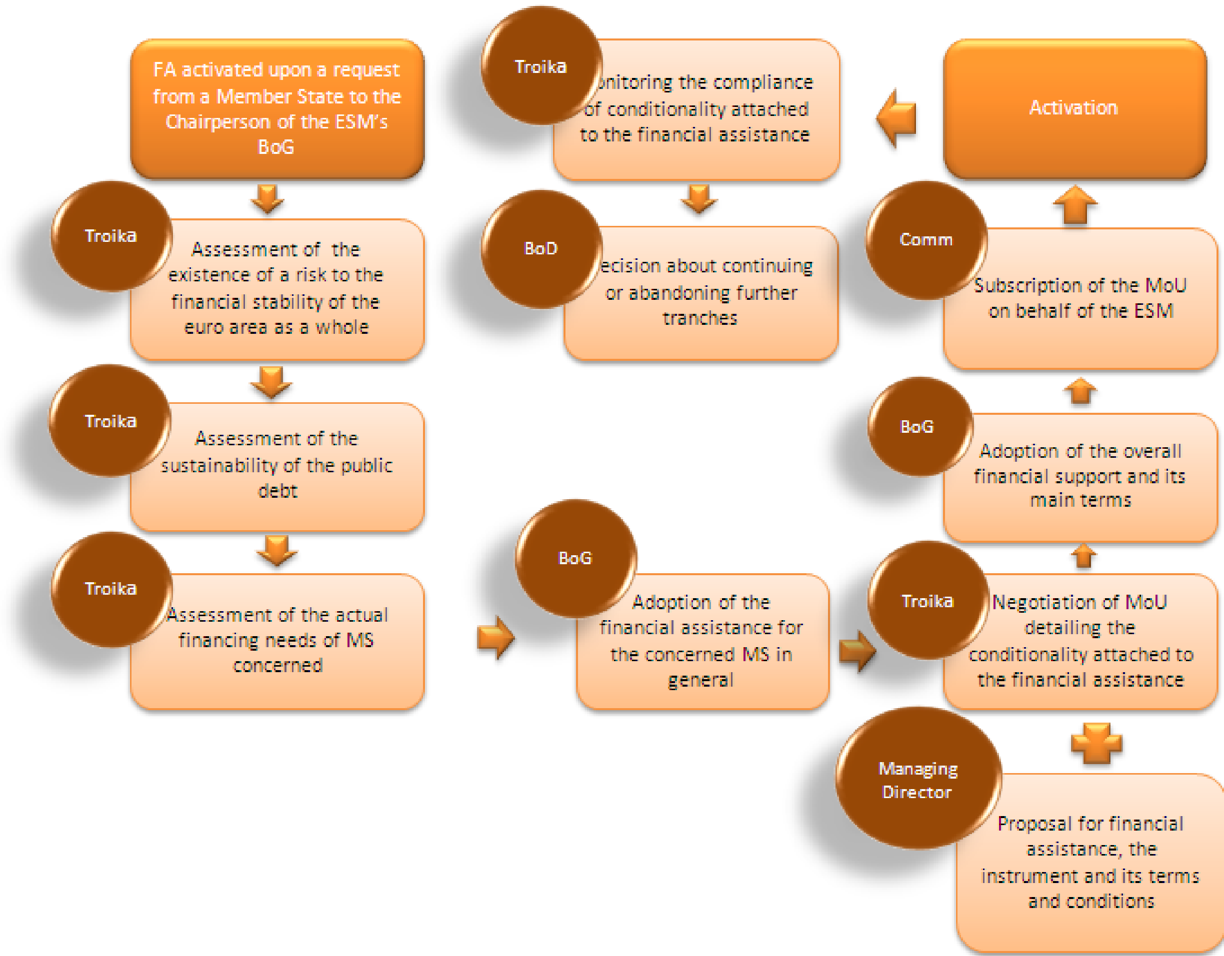

Figure 5: *procedure and activation of financial assistance in the scope of the ESM (own chart, data source: ESM, 2012, p.3)*

Tables

***Table 1:** Overview over the financial assistance facilities for euro area countries (own chart, data source: ECB, 2011, p.75)*

	intergovernmental loans to Greece	***EFSM***	***EFSF***	***ESM***
Legal/ institutional form	Intergovernmental agreement	EU mechanism	Private company owned by euro area countries	Intergovernmental organization
Capital structure	Bilateral loans pooled by Commission	Guaranteed by euro budget (= all EU MS)	Guarantees and over-guarantees from euro area MS	€80 billion paid-in capital and €620 billion callable capital (payment of initial shares by euro area countries to be made in five annual instalments of 20% of the total amount)
Lending capacity **EU/euro area limit**	€80 billion	€60 billion	€440 billion	€500 billion
Instruments	Loans	Loans, credit lines	Loans, bond purchases on the primary & secondary market, credit lines, recapitalization facilities	Loans, bond purchase on the primary & secondary market, credit lines, recapitalization facilities
Duration	Loans to be repaid seven and a half years after disbursement date in 22 equal quarterly payments	Until the end of June 2013	Until the end of June 2013. Will also remain operational thereafter until all outstanding liabilities are repaid	Permanent mechanism from September 2012 onwards
Main decision making bodies	Eurogroup	ECOFIN Council, acting by qualified majority voting on proposal from European Commission	Eurogroup/EFSF Board of Directors	Eurogroup/ESM Board of Governors and ESM Board of Directors
Legal basis	Intergovernmental decision and Treaty Article 136	Treaty Article 122 (a Member State facing "exceptional occurrences beyond its control")	Intergovernmental decision	Intergovernmental treaty linked to amended Treaty Article 136

Table 2: *Origin and development of the European debt crisis*

2006-2007	**House prices radically decrease after years of allocation of risky mortgage loans (subprime); securities, derived from the pooling of these mortgages fall in value; these securities are hold by global banks**
August 2007	**Banking crisis** - banks distrust each other due to the allocation of risky mortgage loans; the interbank market collapses; central banks support banks with credits
September 2008 - 2009	Lehman Brothers crashes - banks refuse to grant each other loans; big financial institutions become critically endangered and central bans support them with short-term credits
2008-2010	**World economic crisis** – declining economic situation across the globe; central banks and government of most countries try to counteract crisis with expansive monetary and fiscal policy; public debts increase; end of 2010: situation improves
2009-2010	**European debt crisis** - high indebtedness throughout GIPS countries due to massive budget deficits and recession; interest rates for state bonds of GIPS countries increase significantly
May 2010	Imminent national bankruptcy of Greece, contagion effect on European national banks; **bilateral rescue measure** (€ 110 bill.)
May 2010	Fear of a loss of confidence; MS of the euro zone and IMF launch a rescue fund of € 750 bill.
November 2010	Ireland is supported by the rescue fund (€ 85 bill.)
March 2011	Decision about a permanent European stability mechanism (ESM) amounting to € 700 bill.
April 2011	Portugal is supported by the rescue fund (€ 78 bill.)
2012	Spain and Cyprus ask for help; beyond, the Spanish banking sector is supported with € 100 bill.
September 2012	Inauguration of the ESM