Crisis Financing in the EU

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The European financial architecture in an environment of liberalized capital markets, and the European monetary union with the euro and an effective Eurosystem on the one hand and a less developed economic union on the other hand have needed to undergo reform to build resilience to crisis. As the Stability and Growth Pact (SGP) had failed to adequately ensure the budgetary surveillance required under the EU treaties, it was revised and reinforced again in 2010 and 2011, and in addition supplemented by a new procedure designed to prevent macroeconomic imbalances. Moreover, a number of "financial assistance facilities" were created or expanded for EU or euro area countries to support them in managing crises that might result in contagion effects. The emerging difficulties of Greece created a need to ensure previously nonexistent crisis financing for euro area countries. In March 2009, the funding capacity of the EU's balance of payments facility was raised to EUR 50 billion. Measures taken since May 2010 include the extension of bilateral loans to Greece and the creation of further financing mechanisms: the European Financial Stability Facility (EFSF: EUR 440 billion), the European Financial Stabilisation Mechanism (EFSM: EUR 60 billion) and the European Stability Mechanism (ESM: EUR 500 billion). With these mechanisms, the EU has built a framework for providing regional financial support alongside funding provided by the IMF at the global level.

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The recent experiences of European countries – Iceland in 2008, Central, Eastern and Southeastern European (CESEE) countries in 2008 and 2009, Greece in 2010, Ireland and Portugal in 2011 – have shown that financial crisis does not stop at the borders of developed economies.

Europe is characterized by liberalized financial markets and a relatively weak common financial infrastructure. The resulting international capital flows – first high inflows, then a sudden stop or even outflows – played an important role in the current crises in Europe. Amid the global financial and economic crisis and the ensuing sharp rise of general government debt ratios of many EU Member States, the economic policy framework of the EU and of the euro area in particular had come under critical scrutiny toward or in 2010. Hence, policymakers committed themselves to reinforce the coordination of budget policies through a reformed Stability and Growth Pact (SGP) and to prevent or, if necessary, correct emerging excessive macroeconomic imbalances through a newly implemented surveillance mechanism.

Moreover, the EU treaties foresee a facility to provide medium-term financial assistance for Member States' balances of payments (BOP). The ceiling of the EU's BOP facility has since been raised twice, most recently in March 2009. This facility had been designed to offer non-euro area EU Member States financial support in times of crisis and was previously without a counterpart for comparable assistance to members of the euro area. However, occasioned by the case of Greece, financial support mechanisms supplementing the assistance facilities of the IMF at the regional level have since been established for euro area countries as well. Following the phasing out of tem-

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porary solutions, the European Stability Mechanism (ESM) is to constitute a permanent crisis mechanism complementing the institutional framework of the euro area.

1 European Financial Architecture and Financial Crises

Since the Bretton Woods System collapsed in 1971, the number of financial crises has again risen worldwide and in Europe alike. According to the IMF (Laeven and Valencia, 2008), there were 208 currency crises, 124 banking crises and 63 sovereign debt crises from 1970 to 2007.

From the early 1970s to the establishment of the euro area in 1999, the EU, too, experienced currency crises and exchange rate volatilities again and again, e.g. the crisis of the European Monetary System in the first half of the 1990s. By creating a monetary union, the EU aimed at preventing such crises – resulting in high costs to the national economies – in the European internal market.

The global financial and economic crisis and the debt crisis of EU Member States that followed, however, also revealed shortcomings and deficiencies in the existing financial architecture and governance framework of the euro area as well as in the coordination of budget and economic policies at the EU level. For example, supervisory authorities had not been institutionalized at the EU level to prevent crises at banks and insurance companies or in the capital markets – they had to be created in response to the crisis. To provide for early warning of systemic risks that may be building up, the European Systemic Risk Board (ESRB) was set up, and financial market regulation was tightened. Furthermore, there was a lack of adequate financial assistance mechanisms to help Member States with liquidity difficulties – both at the EU level and in the euro area.

In addition to the instruments for BOP assistance which were already available under the EU treaties and within the framework of IMF assistance, a number of new mechanisms have been agreed since early 2009, driven by the acute financial and sovereign debt crisis in Greece and its impact on the euro area as a whole, in order to close existing gaps in the institutional infrastructure. These instruments have since been used to support the distressed economies of Greece, Ireland and Portugal as well as, since early 2010, to intensify economic governance in order to address problems arising from misaligned budgetary policies and emerging macroeconomic imbalances at the root.

The present paper discusses the establishment of financial assistance facilities for both euro area and non-euro area EU countries: the EU BOP facility with a ceiling of EUR 50 billion, bilateral loans for Greece, the European Financial Stability Facility (EFSF) with a capacity of EUR 440 billion, the European Financial Stabilisation Mechanism (EFSM) with a volume of EUR 60 billion and the European Stability Mechanism (ESM) with EUR 500 billion. These facilities will enable the crisis-ridden countries to finance an orderly adjustment process, while the Eurosystem's liquidity-providing measures will enable the banks of the crisis countries to compensate net capital outflows (ECB, 2011).

2 EU Balance of Payments Facility

When Lehman Brothers became insolvent in September 2008 and Iceland was hit by a severe financial crisis shortly afterwards, contagion effects arose in

Table 1

Crisis Financing in Europe since 2008[1] (as per November 11, 2011)

Country	Total loans	IMF loan	IMF facility	% of IMF quota	Amount disbursed by the IMF	Amount disbursed by the EU/euro area	Further commitments and payments
	EUR billion				*EUR billion*		
Ireland	84.93	**22.43**	EFF	232,600	8.90	20.50	**EFSM:** 22.5 (disbursed: 13.9); **EFSF:** 17.7 (disbursed 6.6); IE: 17.5; UK: 3.8; SE: 0.6; DK: 0.4
Greece	110.40	**30.40**	SBA	3,212	17.96	47.10	**Bilateral loans[2]: 80 (disbursed:** 47.1)
Portugal	79.30	**27.30**	EFF	2,300	10.44	20.00	**EFSM:** 26 (disbursed: 14.1); **EFSF:** 26 (disbursed: 5.9)
Hungary	19.62	**12.12**	SBA[3]	1,015	8.79	5.50	**EU BOP facility:** 6.5; World Bank: 1
Latvia	7.65	**1.75**	SBA	1,223	1.13	2.90	**EU BOP facility:** 3.1; World Bank: 0.4, EBRD: 0.1; SW, DK, NO, FI: 1.9; CZ: 0.2, PL: 0.1, EE: 0.1
Poland	25.89	**22.05**	FCL	1,400	0.00		World Bank: 3.84
Romania	22.71	**15.71**	SBA[4]	1,326	12.16	5.00	**EU BOP facility:** 5; World Bank: 1; EBRD, EIB and IFC: 1
Iceland	3.92	**1.61**	SBA[5]	1,190	1.61		Scandinavia, NL and UK: 2.31
Bosnia and Herzegovina	1.43	**1.17**	SBA	600	0.39		**MFA:** 0.1; World Bank: 0.16
Serbia	3.36	**2.66**	SBA[6]	560	1.58		**MFA:** 0.2; World Bank: 0.5
Ukraine	20.16	**19.55**	SBA[7]	1,239	10.64		**MFA:** 0.61
Total	379.37	**156.75**			73.60	101.00	

Source: IMF; table prepared by OeNB. Exchange rates of Nov. 11, 2011: 1 SDR = 1.15 EUR; 1 SDR = 1.57 USD; 1 EUR = 1.37 USD. (The figures may differ from those shown in previous tables because of exchange rate fluctuations).

[1] The table is to illustrate all crisis programs offered in Europe since fall 2008, i.e. it also covers programs that have since expired, provided that funds were disbursed. For the sake of clarity, the overview only includes countries receiving more than EUR 1 billion under IMF programs.

[2] Loans granted to Greece by other euro area countries.

[3] Hungary's IMF program ended on October 5, 2010.

[4] One IMF program for Romania that disbursed EUR 12.26 billion ended on March 30, 2011. The current program totaling EUR 3.59 billion will end on March 30, 2013.

[5] Iceland's IMF program ended on August 31, 2011.

[6] One IMF program of Serbia that disbursed EUR 1.58 billion ended on April 15, 2011. The current program totaling EUR 1.08 billion will end on March 28, 2013.

[7] One IMF program of Ukraine that disbursed EUR 8.12 billion ended on July 27, 2010. The current program totaling EUR 11.6 billion will end on December 27, 2012.

Note: SDR = Special Drawing Right; SBA = Stand-By Arrangement; FCL = Flexible Credit Line; EFF = Extended Fund Facility; EFSM = European Financial Stabilisation Mechanism; EFSF = European Financial Stability Facility; MFA = Macrofinancial Assistance provided by the EU; EIB: European Investment Bank; IFC: International Finance Corporation

the CESEE economies. Hungary was affected directly after Iceland in October 2008 and had to be rescued by joint actions of the IMF, EU and other international financial institutions. As a result, the CESEE countries[2] faced speculative attacks in spring 2009. Austria, too, came under pressure because of the comparatively high exposure of its banks to this region.

In view of the financing problems of these countries, the European Council decided in March 2009 to increase the funding capacity of the "facility providing medium-term financial assistance for Member States' balances of payments" (EU Regulation (EC) No 332/2002; EU BOP facility) from EUR 25 billion to EUR 50 billion (following an initial increase from EUR 12 billion to EUR 25 billion). Additionally, the EU Member States agreed to contribute up to EUR 75 billion (approximately USD 100 billion) to support the IMF's lending capacity. Also Japan and the U.S.A. committed up to USD 100 billion each to increase the IMF's financial resources. Thus, the G-20 representatives were able to pledge tripling the IMF's lending capacity from USD

[2] *Apart from Latvia and Lithuania, in particular Hungary, Poland, the Czech Republic, Romania, Croatia and Serbia.*

Box 1

IMF Funding

The IMF is funded by its member countries – in the case of Austria through the Oesterreichische Nationalbank (OeNB). In 2009 and 2010, the OeNB's actual contributions (lending to the IMF) amounted to slightly more than SDR 440 million as a whole. In those years, the SDR interest rate stood at approximately 0.25%, thus being clearly below the main refinancing rate for Eurosystem monetary policy operations (1%) so that the OeNB suffered an annual loss of interest of roughly 0.75%, i.e. almost EUR 4 million in 2009 and 2010 each.

In the coming years, the OeNB's contributions will significantly rise because additional funds totaling up to SDR 3.6 billion will have to be provided to the IMF under the expanded New Arrangements to Borrow (NAB). However, the loss of interest could also turn into interest gains for the OeNB if the SDR interest rate should exceed the euro interest rate.

On December 9, 2011, the euro area Heads of State or Government agreed that the euro area countries and other EU Member States would consider, and confirm by December 19, the provision of additional resources for the IMF of up to EUR 200 billion, in the form of bilateral loans, to ensure that the IMF had sufficient resources for coping with the crisis. They added that they also looked forward to parallel contributions from the international community. On December 19, 2011, the EU finance ministers agreed that the euro area countries would provide EUR 150 billion to the IMF; the OeNB's share in this respect was slightly more than EUR 6 billion.

250 billion to USD 750 billion when meeting in London in early April 2009. To boost global liquidity, the IMF furthermore allocated special drawing rights (SDRs) equivalent to USD 250 billion to its member countries. Later on, the EU Member States agreed to raise their contributions to the IMF to EUR 125 billion, mainly by committing more funds under the New Arrangements to Borrow (NAB). Following the onset of the debt crisis in Greece in spring 2010, the IMF expressed its willingness to contribute up to EUR 250 billion to crisis financing in Europe.

The Vienna Initiative was successful in "bailing in" private sector creditors. Banks committed to maintaining their exposure to the CESEE region and, thus, to continuing to finance these countries. As a consequence, both credit default swap (CDS) spreads and risk premiums on government bonds decreased. Thanks to the joint financial support provided by the IMF and EU to individual Eastern European countries such as Hungary, Romania and Latvia, the situation in Eastern Europe stabilized (see overview in table 1). Austria also benefited from the stabilization of the CESEE economies since the risk premiums on domestic government bonds – which had strongly risen in comparison with Germany – declined again subsequently (see also Nauschnigg, 2011).

3 Greece

A number of new financing instruments were created for EU and euro area countries specifically in response to the budgetary imbalances that emerged above all in Greece. While in April 2009 the Ecofin Council had moved to launch an excessive deficit procedure for Greece, it did so under the (now inconceivable) assumption that, according to European Commission's forecasts, the general government deficit would reach 4.4% of GDP in 2009 and 4.2% of GDP in 2010 subject to a "no policy change" assumption. As a consequence, Greece was requested to take effective action within six months in order to bring the budget deficit below 3% of GDP already in 2010. After the six-month period, however, the new Greek government reported considerable revisions of the deficit data (2008: 7.7% instead of 5% of GDP; 2009: 12.7% instead of 3.7% of GDP) in October 2009. These data were not validated by Eurostat, due to uncertainties over the figures notified by the Greek authorities, and subsequently had to be revised several times.

Against the backdrop of dramatically rising risk premiums on Greek government bonds and the increasing awareness that Greece would not be able to keep refinancing its debt at sustainable interest rates, or not at all, on the capital markets, the Heads of State or Government of the EU Member States already stated on February 11, 2010, that they "will take determined and coordinated action, if needed, to safeguard financial stability in the euro area as a whole." At the end of April, Greece requested financial assistance whereupon the finance ministers of the euro area countries approved a support package at a special meeting held on May 2, 2010. This package provided funds totaling up to EUR 110 billion for a three-year joint adjustment program of the (then 16) euro area countries (up to EUR 80 billion) and the IMF (up to EUR 30 billion).

The mandate of the Heads of State or Government marked the start of a nearly two-year series of negotiations that had not ended by November 2011. Under the impression of persistent volatility in the financial markets, several summits were convened both at the level of finance ministers and Heads of State or Government of the euro area countries. Based on the solution tailored to Greece (bilateral loans pooled by the euro area countries), the decision was taken more or less in parallel to set up a temporary financial assistance mechanism until mid-2013: the EFSF, a guarantee-backed facility that had a considerably higher lending capacity of EUR 440 billion. Following a decision taken in October 2010, the EFSF will be replaced by the Permanent Stability Mechanism (ESM), which has been modeled on existing international financial institutions. In all cases, the disbursement of funds was linked to policy conditionality.[3]

Not surprisingly, the developments in Greece triggered critical debates on a series of fundamental economic and legal issues regarding the euro area which had never been resolved. At heart, these issues relate to the consequences of lacking budgetary discipline in individual euro area countries, the potential impact of such deficiencies on other euro area countries and the willingness or unwillingness to provide support in such cases. Specifically, this is reflected by the intensive discussions on the role of the "no bailout" clause enshrined in the Maastricht Treaty in 1992 (now Article 125 of the Treaty on the Functioning of the European Union – TFEU), the enforcement of the SGP as well as the role of the ECB. The views on these issues are highly varied, not only with regard to loan support to Greece, but also with regard to the establishment of the EFSF and the ESM, which have been identified as a necessary expansion of the institutional framework of the euro area as well as an inadequate treatment of symptoms raising the problem of negative incen-

[3] *Conditionality will not be discussed in this paper. It should be noted, however, that any conditionalities must comply with the existing rules of budgetary surveillance laid down in primary EU legislation and that the European Commission plays an important role in assessing the progress of the programs, in cooperation with the ECB.*

tives and continuing to undermine budgetary discipline. As the contagion risk for other euro area countries rises, the discussion becomes increasingly fundamental in nature and challenges the design of the euro area per se, having recourse to the argument that it lacks the characteristics of an optimal currency area. Therefore, concepts such as a European ministry of finance, a European monetary fund, a European debt agency or eurobonds frequently crop up in the political debate.

These fundamental issues that reemerged with the debate about Greece are more important than the design of the bilateral loans pooled by the euro area countries, which are an interim solution, pending the creation of permanent institutions in the long run. Thus, the functioning of these loans need not be described in detail. What is important is that – unlike subsequent mechanisms – the first assistance package was based on bilateral loans pooled by euro area countries, with almost 80% of the monies provided by four countries: Germany (up to EUR 22.3 billion), France (up to EUR 16.7 billion), Italy (up to EUR 14.7 billion) and Spain (up to EUR 9.8 billion).

4 Temporary Financial Assistance Mechanisms: EFSF and EFSM

Immediately after the adoption of the first assistance package for Greece, the Ecofin Council announced more sweeping changes involving much higher amounts in a special meeting on May 9, 2010, which led to the creation of two new instruments: the European Financial Stability Facility (EFSF) and the European Financial Stabilisation Mechanism (EFSM). Together with the IMF contribution, the financial stability package adopted by the Ecofin Council totaled EUR 750 billion – on top of the bilateral support to Greece. This was to demonstrate the political determination to combat the contagion risk for other Member States.

The EFSF was designed as a temporary mechanism, to be phased out after three years (mid-2013). To speed up the process, it was established as a public limited liability company in Luxembourg on June 7, 2010, with the shareholders being the euro area countries (Austria: 2.78%). The requirement to keep its structures lean is also reflected by its low capitalization of only around EUR 30 million.

The company purpose is to supply funds to distressed euro area countries, subject to strong conditionality, as was the case with the bilateral support to Greece, to be agreed in a memorandum of understanding with the European Commission. The idea is that the EFSF raises funds at favorable terms and conditions in the capital markets, and onlends these funds. The creditworthiness of the EFSF is ensured by pro-rata guarantees of the euro area countries. To ensure the AAA rating targeted for EFSF bonds given that just six euro area countries currently enjoyed such a rating when the EFSF was set up, various credit enhancements were put in place, including an "over-guarantee" of 120% on each issue; in other words, all Member States other than "program countries" – i.e. states receiving loans from the EFSF as well as Greece – are liable for 120% of their share in the bond issues.[4] Additionally, cash reserves were built up in summer 2010 to compensate for the low capitalization and offer higher security for investors. The

[4] *Irrespective of the over-guarantee for individual bonds, however, the liability of a Member State is limited to its shareholding. Austria's initial liability was around EUR 12.2 billion.*

EFSF made its debut on the capital markets in January 2011 to finance the first loan installment for Ireland through five-year bonds totaling EUR 5 billion.

The organizational structure of the EFSF, its terms and conditions for raising money in the capital markets (financing), the disbursement arrangements as well as the rights and obligations of the guarantors towards the company and among themselves are governed by a framework agreement between the EFSF and the euro area countries. Unlike the pooled bilateral loans for Greece, the EFSF is a guarantee-backed instrument and therefore does not require refinancing by the Member States. As a result, however, the EFSF also faces the risk of rating migrations[5] – which would, however, only materialize if a Member State with an AAA rating were to be downgraded.

The need to create a cash reserve to secure an AAA rating at the same time reduced the actual lending capacity of the EFSF; moreover, interest rate developments further decreased the originally assumed capacity of EUR 440 billion to an actual loan volume of EUR 220 billion to EUR 250 billion.

Therefore, the euro area Heads of State or Government decided on March 11, 2011, to raise the effective lending capacity to EUR 440 billion. In view of the persistent crisis and the perception that the financing instruments available (loans and primary market purchases) were insufficient, a special meeting of the euro area Heads of State or Government resolved to additionally enhance the flexibility of the EFSF on July 21, 2011. Specifically, the EFSF was enabled to use also precautionary instruments (similar to the IMF's flexible credit line and precautionary credit line[6]), to recapitalize financial institutions by means of loans and to buy government bonds on the secondary markets.

These changes were implemented in summer 2011 by adapting the EFSF framework agreement to include an increase of the total guarantee volume to around EUR 780 billion (EUR 726 billion excluding Greece, Ireland and Portugal) and a rise of the over-guarantee to up to 165% on the one hand and to include the new instruments on the other hand.[7] The significance of these changes is reflected by the intensive political debates in the Member States that, in the case of Slovakia, eventually even resulted in the collapse of the coalition government.

On October 26, 2011, the euro area Heads of State or Government took note of the entry into force of the new EFSF agreement and, at the same time, mandated that the resources available be used as efficiently as possible. Two leverage options were indicated: on the one hand the provision of credit enhancements to new debt issued by individual Member States to reduce the funding cost; on the other hand the establishment of one or more special purpose vehicles to combine existing public funds with private sector resources, which would accordingly augment the funds available for extending loans, for bank recapitalization and for buying bonds in the primary and secondary markets. As a result, the funds mobilized by the EFSF should

[5] *This means that a change in the rating of a guarantor may impact the rating of the EFSF.*

[6] *A detailed description of these two IMF instruments that mainly differ by their qualification requirements and conditionality is available at www.imf.org/external/np/exr/facts/eng/list.aspx (as retrieved on December 20, 2011).*

[7] *Hence, the share of Austria now amounts to around EUR 21.6 billion plus interest and cost.*

increase fourfold to fivefold. On November 29, 2011, the Eurogroup approved the terms and conditions of the leveraging options.[8]

Upon closer examination, it is striking that the EFSF has had to be modified several times already since June 2010: at first to ensure its creditworthiness, then to raise its effective lending capacity and finally to introduce new financial instruments. However, it would be overly simplistic to see the repeated adjustments as an outcome of structural deficiencies. In view of its extremely low capitalization, the strength of the EFSF unquestionably only relies on the quality of the underlying guarantees and therefore is affected by the different ratings of the guarantors and the related migration risk. Other challenges include the need to get investors to subscribe to bonds with different maturities, and the need to do so as a new market player in times of elevated volatility. At the same time, the EFSF must be credited for its ability to create a safety net in a very short time, which has already been used to support Ireland and Portugal in 2011. Within such a short period, it would simply not have been possible to create a more robust instrument that benefits from a higher rate of capitalization, like the ESM.

In contrast to the EFSF, the EFSM is a Community instrument, so that the relevant decisions need to be taken in line with EU-27 Community procedures. The EFSM is based on Article 122(2) TFEU, under which Member States which face difficulties caused by exceptional occurrences beyond their control may be granted financial support. The functioning of the EFSM is governed by a Council Regulation that was adopted at maximum speed and is modeled heavily on the existing instrument of EU BOP assistance.[9] Its funds are raised by the European Commission (on behalf of the EU) on the capital markets, and the guarantees are provided not directly by the Member States, but indirectly through the EU budget within the framework of its own resources ceiling. The lending capacity of the EFSM has been limited to EUR 60 billion. The underlying Regulation provides for a regular review on whether the exceptional circumstances still exist; in other words, the instrument was not designed to be a permanent mechanism. Most probably, the EFSM will have been phased out at the latest when the EFSF expires in mid-2013.

5 Permanent Crisis Mechanism for the Euro Area: ESM

Both the EFSF and the EFSM are to be replaced by the European Stability Mechanism (ESM) in the future. On October 28/29, 2010, the European Council already agreed on establishing a permanent crisis mechanism to safeguard the financial stability of the euro area. On November 28, 2010, the Eurogroup issued a statement defining the general characteristics of the ESM. It is to build on the existing rules and procedures of the EFSF: The ESM will provide financial assistance to euro area countries under strict conditionality. Unlike the EFSF, however, the rules will provide for ad hoc participation of private sector creditors. In order to facilitate the process, the countries of the euro area undertook to include collective action clauses (CACs) in the

[8] *www.efsf.europa.eu/attachments/efsf_terms_of_reference_maximising_the_capacity.pdf (as retrieved on December 20, 2011).*

[9] *Council Regulation (EU) No. 407/2010 of May 11, 2010 establishing a European financial stabilisation mechanism.*

terms and conditions for all new euro area government bonds to be issued after June 2013. Another new aspect is the fact that the ESM will claim a preferred creditor status without prejudice to the status traditionally accorded to the IMF.

The ESM is supported by the euro area countries. EU Member States acceding to the euro area in the future are explicitly expected to join the ESM, too.

Unlike the EFSF, the ESM has been set up as an international organization, i.e. by means of a treaty under international law (in Austria: state treaty under Article 50 paragraph 1 item 1 of the Bundes-Verfassungsgesetz – Federal Constitutional Law); therefore, its capital structure is in line with that of other international financial institutions, such as the International Bank for Reconstruction and Development (World Bank) and regional development banks. The authorized capital stock amounts to EUR 700 billion and, in analogy with other international financial institutions, is divided into paid-in and callable shares.[10] The nominal value of paid-in shares will total EUR 80 billion. Therefore, the ESM will operate in a way fundamentally different from the EFSF, whose low capital level had to be compensated by guarantees for individual bond issues. This mechanism is not required for the ESM; the high AAA credit rating needed is achieved on account of the high capital stock.

As in the case of the EFSF, the key decisions of the ESM (e.g. on the extension of loans) are to be taken by mutual agreement, i.e. unanimously. Access to financial assistance from the ESM is granted subject to strict policy conditionality and, on principle, under a macroeconomic adjustment program; beforehand, the European Commission, together with the IMF and in liaison with the ECB, is to perform a rigorous analysis of government debt sustainability. The beneficiary Member State is required to ensure adequate private sector involvement – taking account of the specific circumstances and fully in line with IMF practice. The ESM will have an effective lending capacity of EUR 500 billion.

In the case of the ESM, the European Commission and the ECB will again perform major tasks in monitoring program progress and ensuring coherence with EU budgetary surveillance. The expertise of the IMF will also be regularly used whenever possible.

The treaty establishing the ESM was signed on July 11, 2011, but again partly called into question by the decisions taken by the euro area Heads of State or Government on July 21, 2011. In particular, the creation of the new instruments mentioned above applies both to the EFSF and the ESM and, as a result, they also have to be introduced into the ESM treaty – thus, the ratification processes were postponed pending revision of the text.

In the past few months, political discussions especially focused on the question of how to adequately involve the private sector, given that the ESM is the first instrument for which private sector bail-in has been explicitly regulated. Some actors strongly criticize the approach adopted and consider it one of the causes of persistent uncertainty in the financial markets. This question was clarified in a statement of the euro area Heads of State or Government on December 9, 2011: "Concerning the involvement of the private sector, we will

[10] *The Austrian share is 2.7834% or almost EUR 19.5 billion, out of which approximately EUR 2.2 billion have to be paid in within five years of the ESM treaty's entry into force.*

strictly adhere to the well-established IMF principles and practices. This will be unambiguously reflected in the preamble of the treaty. We clearly reaffirm that the decisions taken on 21 July and 26/27 October concerning Greek debt are unique and exceptional."

The statement of December 9, 2011, also results in further changes, especially in the field of voting rules, which will also include an emergency procedure foreseeing decisions by a qualified majority of 85% in case the financial and economic sustainability of the euro area is threatened.

At the same time, an acceleration of the entry into force of the ESM was agreed (objective: July 2012).

Moreover, the issue of the external control of the ESM gains in importance. A key controversy was the fact that provisions are lacking on the involvement of national courts of auditors in addition to external and internal auditing. These requirements may be included in the revised ESM treaty. At any rate, this revision would also take account of the fact that, in view of the high budgetary expenditure, national parliaments should have broader information and control rights. Other controversies related to the relationship of the ESM to the EU treaties. Especially Germany demanded further specifications to be included in the TFEU – in the light of actions pending before the German Federal Constitutional Court. On March 25, 2011, the European Council adopted Decision 2011/199/EU amending Article 136 TFEU, thus added the following paragraph to Article 136: "The Member States whose currency is the euro may establish a stability mechanism to be activated if indispensable to safeguard the stability of the euro area as a whole. The granting of any required financial assistance under the mechanism will be made subject to strict conditionality." According to the opinion of the Council Legal Service, this addition is not to be seen as the actual legal basis for the establishment of the ESM since it only acknowledges the right of the euro area countries to enter into a treaty under international law.

6 Conclusions

The developments outlined above show that, in the course of the debt crisis, a substantial deepening of European integration resulted from new crisis financing mechanisms, especially in the euro area.

Until recently, financial assistance mechanisms for euro area countries did not exist, and the idea of strengthening the European financial architecture was considered utopian, as can be seen from the fact that proposals put forth in 2009 to create a financial assistance facility in the amount of EUR 200 billion for the euro area countries as a lesson learnt from the Icelandic crisis and to prevent contagion effects (Nauschnigg, 2009) was considered unrealistic at that time. Yet the case of Greece put a process in motion in the course of which several mechanisms were established within an extremely short period to provide financial assistance to euro area countries in difficulty. These instruments will ultimately be replaced by a permanent crisis mechanism and a new addition to the institutional framework of the euro area: the ESM.

Financial support to Greece was still granted in the form of bilateral loans pooled by the euro area countries. Yet, these measures must be seen as an interim solution, pending the creation of permanent institutions in the long run. The EFSF that is available until mid-2013 is based on guarantees. Its swift establishment and configuration formed an important safety net that could be used for Ireland and Portugal in 2011. But the guarantee concept involves deficiencies that have required several revisions since June 2010. The ESM will not be affected by this disadvantage because its capital structure is in analogy with that of other international financial institutions and in comparison with them, it has a high share of paid-in capital.

The financial assistance facilities that have been institutionalized permit orderly adjustments, reduce uncertainty among financial market actors and, as a result, reduce the vulnerability of European countries to financial crises. In the past, however, measures were very often taken only in the last moment and subject to domestic policy considerations, which significantly affected the impact of the actions in the financial markets. This gave the impression that policymakers were doing "too little, too late."

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