

The European Financial Stability Facility

In the trail of negative consequences of the global financial crisis of 2008, the European Union and the euro area in particular, has been shaken by a series of national debt crises, whether it be in Greece, in Ireland or in Portugal. The public deficits of nearly all of the EU Member States have been worsened by this global crisis, placing on these countries, but also on the European Institutions, the duty to intervene to prevent the bankruptcy of some, which could lead to the bankruptcy of all.

I. The sovereign debt crises call for a necessary united EU response

In view of the deteriorating public finances of the Member States that are sometimes grouped under the acronym 'PIIGS' (Portugal, Ireland, Italy, Greece and Spain) and the risk to the financial markets of them defaulting on payment, these countries, which are the most indebted in the euro area have had to face a considerable rise in interest rates on the markets where they borrowed before the crisis, so much so that it has been impossible for them to acquire new financial resources by issuing bonds. Increasing unemployment, falling economic growth, a deepening public deficit and an unprecedented level of debt are conditions that have left them no other choice but to call on the assistance of their euro area partners.

Greece was the first of these Member States to suffer these effects of the financial and budgetary crisis. On 16 October 2009 the Greek Government announced that by the end of the year the budget deficit would reach 14% of its GDP and that the public debt would reach 115% of GDP. For the first time, a rating agency, Fitch, downgraded the rating of an EU Member State to below A, reducing Greece's rating from A- to BBB+. Lending to Greece appeared increasingly risky. Interest rates soared and the resulting budget haemorrhage finally bled the Greek public finances dry.

In return for implementing a policy of budgetary austerity, the Eurogroup granted Greece a 110 billion euro support package on 11 April 2010, part of which came from the IMF. But this assistance was not sufficient to reassure the financial markets and the rating agencies once again lowered the Greek debt rating by a notch. At the same time, they also downgraded the ratings of Portugal and Spain.

II. The creation of the EFSF

On 9 and 10 May 2010 the finance ministers of the euro area reached agreement on the creation of a European financial stabilisation mechanism. The main purpose of the European Financial Stability Fund (EFSF), established on 7 June 2010, is to issue up to 440 billion euros in bonds that can later be lent to the Member States of the monetary union that are in difficulty (in reality, only 250 billion are in a position to be

released). Since these bonds are guaranteed by the Member States, in particular those whose sovereign debt obtains an AAA rating from the rating agencies, the EFSF can borrow on the bond market at an interest rate much lower than that to which Greece was subjected from the end of 2009. That being the case, each euro area Member State that might find itself in a similar situation can henceforth rely on this fund which, through the pooling of risk, guarantees it a more reasonable borrowing rate, linked to an AAA rating. However, the granting of any assistance to these countries in difficulty can only take place under certain conditions, in particular in compliance with the restrictions and budgetary austerity defined by the members of this fund.

In addition to the 440 billion euros of bonds issued on the market, the EFSF is financed to the tune of 60 billion euros by the European Commission, which borrows in its name on the financial markets under the guarantee of the Member States. The IMF is contributing 250 billion euros.

Ireland was the first Member State to benefit from this mechanism. Suffering serious speculative attacks against its borrowing rates on the bond market, the former 'Celtic Tiger' has been forced, in exchange for increased budgetary efforts to stabilise its public finances, to receive the assistance of the EFSF of which the first payment of assistance totalling 85 billion euros was made in January 2011.

While the EFSF was only intended to operate for a fixed term, Germany, gradually followed by France and then the other members of the euro area, proposed to perpetuate the experiment by restructuring this fund to make it permanent. On 29 October 2010 the 27 Member States decided to initiate a limited revision of the Lisbon Treaty in order to organise budgetary orthodoxy and the defence of the euro, in particular through the creation of a new instrument that would supersede the EFSF when the latter expires.

III. The ESM perpetuates the EFSF experiment

So it was that on 21 March 2011 the euro area finance ministers reached an agreement on the creation of a European Stability Mechanism (ESM) as a permanent means of providing assistance to indebted countries. The ESM, due to be set up as of mid-2013, will have 700 billion euros (with an intervention capacity of 500 billion euros), including 80 billion of capital contributed directly by Member States in order to guarantee the AAA rating of the 620 billion euros of bonds to be issued. While the terms and conditions of the loans already made to Greece and Ireland have not been changed, the interest rates on future loans to any Member States in difficulty are even lower than EFSF rates, which were already lower than bond market rates. The financing of the capital of 80 billion euros is shared between the Member States in accordance with their current capital contributions to the ECB. Decisions on granting assistance will be taken unanimously by the finance ministers, with the Member State applying for assistance still being required to undertake economic and fiscal adjustment but also on the basis of a debt sustainability analysis on the country in question carried out jointly by the European Commission, the IMF and the ECB.

IV. ALDE Group positions on this subject

The issues of the reduction of public debt and of budgetary stability have long been core concerns of the ALDE Group even before the financial crisis of 2008. In the European Parliament, group members were the first to call for a partial pooling of the debts of the various euro area Member States.

In January 2011 the Chair of the ALDE Group, Guy Verhofstadt, advocated the creation of Eurobonds which would 'provide an additional incentive for compliance with the Stability and Growth Pact, reduce overall EU debt, add stability to the Euro zone while injecting market confidence but, above all, [...] free resources for boosting EU growth.' The system advocated by Guy Verhofstadt and by ALDE is based on the idea that 'only the first 60% of debt of GDP is pooled, AAA countries will pay less than the average while low rating countries will pay a bit more than the average' but 'every single country will pay less due to higher liquidity and a deeper bond market meaning that the interest rate on the common bond will be lower than the average of national interest rates.'

The Chair of the ALDE Group was also delighted at the formalisation of a financial stabilisation tool in the form of the ESM. However, though he is satisfied with the sum available for release (700 billion euros), the way assistance is to be granted leaves him perplexed as regards the effectiveness of the ESM. 'Every time that money is to be released, every Member State's Parliament will have to give their green light. Notwithstanding the slowness of the procedure, it is very risky and will mean that any bailout for a country will be contingent on the internal politics of another country.' Mindful of strengthening the role of the European Institutions, which are much more able to contribute effective responses to this type of problem than the national selfishness sometimes tempted by vote-catching among its own public as dictated by almost annual elections, Guy Verhofstadt supports the initiative of the European Parliament which is proposing to 're-establish the European Commission's right of initiative, at every stage of the new mechanism's implementation, as well as mandatory consultation of Parliament.'

Further information:

[Press releases from ALDE members on budgetary stabilisation issues](#)

[The European Parliament's Committee on Economic and Monetary Affairs](#)