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The European Stability Mechanism

Evaluation and future scenarios of the fireguard of the European Monetary Union

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GLOSSARY

BICC Budgetary Instrument for Competitiveness and Convergence
BoA Board of Auditors
BoD Board of Directors
BoG Board of Governors
BoP Balance of Payments
CAC Collective Active Clause
CDU Christian Democrats Party
ECB European Central Bank
EDP Excessive Deficit Procedure
EEC European Economic Community
EFSF European Financial Stability Facility
EFSI European Fund for Strategic Investments
EFSM European Financial Stability Mechanism
EIB European Investment Bank
EMU Economic and Monetary Union
ESM European Stability Mechanism
EU European Union
GDP Gross Domestic Product
GLF Greek Loan Facility
HFSF Hellenic Financial Stability Fund
IMF International Monetary Fund
MFF Multiannual Financial Framework
MoU Memorandum of Understanding
OMT Outright Monetary Transactions
RFA Regional Financing Arrangements
SPV Special Purpose Vehicle
TEU Treaty on European Union
TFEU Treaty on the Functioning of the European Union
TSCG Treaty on Stability, Coordination and Governance in the Economic and Monetary Union

ABSTRACT

After more than 10 years since the failure of the investment bank Lehman Brothers and the burst of the housing bubble in the US, the time is ripe to evaluate how the European Union (EU) economic framework has been influenced by the greatest financial disaster since the Great Depression of 1929. Indeed, the 2008 financial crisis represents the first major shock that the EU has faced since the signing of the Maastricht Treaty and the official establishment of the European Monetary Union (EMU). The scrutiny of how EU institutional representatives and national authorities managed to operate within the boundaries of the EMU economic governance in a period of crisis may be thought as an easy read: indeed, the inaction which characterised the EU after the Lehman Brothers surely represents one of the causes of the eruption of the sovereign debt crisis in 2010, a double-dip crisis peculiar of the European region, and in particular the European currency area.

However, the background in which the sovereign debt crisis developed, which coincides with the context of this dissertation, is far more complex: 28 very differentiated states cooperating in several institutions which have to cope with enormous amounts of legislative acts and topics. Furthermore, 19 of those countries opted to share a single currency (the euro) in a monetary union which is not complete yet, since economic and fiscal policies are still nationally conducted. The period of economic growth which distinguished the euro area after the introduction of the new currency hidden the increasing macroeconomic imbalances within the Eurozone and the inappropriate policies undertaken by almost every EA19 countries since 2002, which enlarged the gap between debtor and creditor countries in the region, exacerbating the effects of the financial disruption started in the US. The absence of a crisis management tool in the EMU economic framework made the rest: hence, the crisis management instrument developed during the crisis represents the topic of this dissertation. The European Stability Mechanism (ESM) is the European financial institution whose aim is the maintenance of the economic soundness of the Eurozone by providing a backstop for EA19 countries which face economic difficulties and whose default may destabilize the euro area. It is the permanent body which substituted the European Financial Stability Facility (EFSF), a temporary entity which operated from 2010 and 2012, in one of the most chaotic periods in EU history.

The focus of the dissertation relies in the analysis of the evolutionary path of the first crisis management tool in the economic benchmark of the EMU. Starting from the first Greek bailout programme and the creation of the EFSF, the dissertation discusses how the ESM was not only developed and structured, but especially how it was implemented and how this instrument operated in the member states which officially requested the ESM intervention. Furthermore, the scope of the research is also the scrutiny of the relationships which developed between the new entity and both its international counterpart (the IMF), and its regional partners, namely the other institutions which constitute the EU organizational setting, in which the ESM was embedded, not without obstacles.

Having dealt with the diverse economies of the EMU member states and their difficulties, and having cooperated closely with the Commission, the Council, the ECB and the IMF, the ESM succeeded in acquiring an important status in the European economic governance, in particular due to the results obtained by the stability mechanism in the 5 economic adjustment programmes which the new entity administered in as many countries. One of the main objectives which the dissertation tries to fulfil is whether the outcomes of the ESM rescue packages and the conditionality attached to them can be considered a success for the EMU governance, or instead the attempts made by European leaders conclusively resulted in a mismanagement of the consequences of the Great Recession and the sovereign debt crisis. Furthermore, the dissertation attempts to evaluate whether the operational workings of the ESM actually understood the financial needs and the social requirements of the beneficiary states, and formulated programmes in which the requested structural reforms and economic requests were adequate for the situation of the Member State, or whether the main focus of the ESM was the stability of the currency at any cost, with the bailout programmes as the mean to correct economic policies of certain EMU member states, which by undermining their own budgetary situation, were weakening the entire monetary union.

The questions the dissertation would seek to answer does not regard only the relationship between the ESM and the Member States, but also its partnership with communitarian institutions and its principles. Indeed, the ESM was established through an intergovernmental agreement outside the Treaties: hence, its intergovernmental nature and its increasing influence in the EMU economic management during the crisis further developed power relations with the Commission and the ECB (namely, the two supranational economic institutions of the EU), a lack of democratic accountability questioned by the European Parliament and a tumultuous relationship with the IMF.

After the experience accumulated by the ESM in managing financial uncertainty in the Eurozone, the EMU economic governance cannot preclude itself of its bailout fund, but rather a revision of the instrument is needed in order to establish the path forward for the ESM in the process of deepening of the EMU, and in clarifying the role and the competences of the EMU bailout fund in the framework of the Eurozone. Hence, the final chapter of this paper discusses the possible future scenarios which the ESM could undertake in its evolutionary path, focusing particularly on 2 proposals: the ESM reform officially proposed in the Euro Summit held in December 2018, and the plan of creating a proper European Monetary Fund (EMF), motioned by the Commission through a Council Regulation proposal. Both ideas have similarities and discrepancies which make an important difference regarding the political support of those projects. Political will is intrinsic in the analysis of the future scenarios of the ESM; political will had shaped and will continue to influence the effectiveness of the stability mechanism, and whose analysis and evaluation will be taken in consideration during the paper.

The ESM, as the entire European Monetary Union, is part of the European Union, which is a unique political, social and economic experiment which constantly witnesses developments in its political direction. Hence, this dissertation, built on previous work, would serve as a comprehensive instrument for the assessment of the next steps which the European economic governance will undertake regarding crisis management and prevention, starting from an historical analysis of the results of the ESM, evaluating the strengths and flaws of the stability mechanism, and proposing a new understanding on the validity of the reform proposals of the bailout fund of the EMU through a critical perspective. The literature used for this final paper is mainly composed by official documents such as the MoUs signed on behalf of the ESM by the Commission with the beneficiary member state, the reviews and the ex-post evaluation of the economic adjustment programmes launched by the ESM, and further documents from the Commission, the European Central Bank, the European Parliament and the IMF. Furthermore, in order to analyze the impact of ESM bailout programmes within the boundaries of the member states, official reports of national central banks and legislation drafted by national governments have been consulted during the research. This dissertation inserts itself in an academic field in which, despite important economists such as Daniel Gros, Thomas Mayer, Charles Wyplosz and many others have already discussed thoroughly (also directly delegated by the EU institutions) the organization and development of the crisis management sector in EMU governance, literature still has to be drafted on the latest updates regarding the ESM, such as on the 2018 Euro Summit proposal. By adding new empirical data on the financial and social impact of ESM operations, this research represents an expanded and adjourned study on the achievements of the ESM and delivers an exhaustive scrutiny on the reform proposals of the most important crisis management tool in Europe.

During the preparation of the thesis, I also visited the offices of the ESM in Luxembourg in April 2019, where I was helped to wade through the substantial amount of information made available to the public by the institution. This field trip enabled me to have a direct impression of one of the youngest European public institutions and appreciate its inner workings and how such a key player on the European financial stability was created.

1. The European sovereign debt crisis and the first crisis management tools

1.1 The 2008 financial shock

More than 10 years have passed from 15th of September 2008, when the American bank Lehman Brothers declared bankruptcy, becoming the largest bankruptcy filing in the US history and starting the most disruptive financial crisis since the Great Depression in 1929. Even though several signals were already alarming the financial markets, especially in the housing and subprime mortgage markets, central banks worldwide appeared stunned by the consequences of Lehman Brother's bankruptcy. Furthermore, due to the high level of interconnection characterizing financial instruments in 2008, what could have been restricted as a local bankruptcy rapidly became a global recession, affecting not only the global financial market, but also influencing real economic variables all over the world, with almost every developed country experiencing sharp decreases in employment and trade levels.

The 2008 Great Depression has with no doubts changed the landscape of the global financial market and the banking sector, with bank recapitalization cut from $8 to $4 trillions[1]. However, there is one region of the world where the consequences of the financial plunge caused by the failure of Lehman Brothers had disastrous effects and led to a further crisis and to an important reform of the economic governance of the area: the European Union. The sluggish reaction by the European institutions, together with the high level of financial interrelationship between the US financial actors and the European banking sector exacerbated the initial consequences of the recession in the European Union (EU), where the real GDP fall by 4.4% just in 2009[2]. The 2009 slump aimed off the optimism which permeated the European economic governance since the final formation of the European Monetary Union in 2002. The perception of having created a European optimal currency area, as defined by Robert Mundell[3], started in 1956 with European Economic Community (EEC), continued through the end of the Bretton Woods system and the will to minimize the variability of exchange rates in Europe, pursued through the creation of the European Monetary System in 1979, and finally formalized in 1992, when 12 member states of the newly born European Union accepted to create a common currency managed by a single central bank, the European Central Bank, was crushed not just by the 2008 financial crisis, but mostly by the subsequent sovereign debt crisis.

[1] D. Salvatore, *The Global Financial Crisis: Predictions, Causes, Effects, Policies, Reforms and Prospects*, Fordham University, The Journal of Economic Asymmetries, 2010, 1–20.
[2] Data extracted from Eurostat (2018), *National accounts and GDP*, [Online] Available at Eurostat, https://ec.europa.eu/eurostat/statistics-explained/index.php/National_accounts_and_GDP [May 2019]
[3] R. Mundell, *A Theory of Optimum Currency Areas*, Nashville, The American Economic Review, Vol. 51, No. 4 (Sep., 1961), 1961, 657-665

After a relatively calm period, where the focus of the ECB was on the stability of the national banking sectors and on avoiding the contagion effect of possible bankruptcies of European banks, in 2009 the European sovereign debt crisis started emerging. The value of sovereign bonds witnessed negative impacts based on various factors such as prospected losses of the European banking sector of and the fall in tax revenues of the national states, especially those sectors affected by the burst of the housing bubble. These economic patterns resulted in a general increase in deficit-to-GDP ratio, especially in those states externally reliant on international short-term debt market (Ireland), or where the construction sector was growing sharply (Spain)[4]. Overall, the states suffering the most at the beginning of the financial crisis were the ones who enjoyed current account deficit and external imbalances that exposed states such as Spain, Ireland and Portugal to important macroeconomic risks[5].

1.2 The Greek crisis and the sovereign debt crisis 2010-2012

A new phase of the European sovereign debt crisis was initiated by the 2009 Greek elections and the formation of the new government. As a matter of fact, the European Commission opened an Excessive Deficit Procedure (EDP) against Greece in April 2009, when the deficit to GDP rose to 4% and the debt-to-GDP ratio increased to 97%, according to the Bank of Greece.[6] However, the tone over these economic estimates given by Greek institutions were optimistic, and the financial crisis investing the globe was considered irrelevant for Greek economy. The situation evolved dramatically in October 2009, when the new government chaired by Prime Minister George Papandreou revealed not only the 2009 government deficit, but also the 2008 government deficit were in reality double the expectations, further enhancing the deterioration of the confidence within the Greek economy, which was already in recession by the beginning of 2009. The scandal over the misreporting of economic data from Greek institutions to the economic governance of the EMU, with the Eurostat experiencing serious difficulties in establishing the real deficit-to-GDP rate for Greece, which in the end was revised at 15.4%, a percentage extremely higher than the European fiscal impositions, exacerbated the lack of confidence by the investors towards the country, finally uncovering the structural problems of the Greek economy, which comprehended[7]:

- Greece based its economic growth between 2001 and 2007 on foreign indebtedness, leaving its economy open to market rates volatility

[4] P. R. Lane, *The European Sovereign Debt Crisis*, Journal of Economic Perspectives, Volume 26, Number 3, Summer 2012, 49–68

[5] Ibidem

[6] Bank of Greece, *The Chronicle Of The Great Crisis: The Bank Of Greece 2008-2013*, Athens, Bank of Greece Printing Works, Commercial and Value Document Printing Section, September 2014, 33 – 39

[7] Ibidem

- Greece experienced enormous inflows of foreign direct investments; whose peak was reached in 2008 with $4489.9 millions[8]. These allowed Greek governments to exaggerate public employment, guaranteeing subsidies, increased salaries and early pensions.
- The Greek economy never met the convergence criteria neither its entrance in the euro in 2001, nor afterwards. However, until 2007 the macroeconomic performance of Greece was remarkable, with the lowest unemployment rate registered in 2008 at 7.8%, and the lowest public debt percentage registered at 95% in 2004[9]. The financial crisis, together with the fake economic reports given by Greece dramatically worsened the economic situation of the country, making private investors fleeing towards other objectives.
- Tax revenues by the Greek government decreased at 30.5% in 2009, which in a country characterised by tax evasion and where cash transactions are preferred over bank transactions resulted in a loss of confidence within markets and the downgrading by rating agencies of the Greek debt.

Hence, what has started as a financial shock caused by the failure of an investment bank in the US, transformed in a sovereign debt crisis, whose epicenter was Greece, but rapidly had repercussions on the already weakened European economy, in particular over the sovereign bonds' markets. Between 2009 and 2012, the differential of yields between the sovereign bonds of European countries and the German bond rose exponentially, with Greece leading the chart, immediately followed by Ireland and Portugal, with Spain and Italy showing signs of serious financial instability. The importance of the sovereign bond market and the spread between sovereign bond yields increases when referred to the Eurozone, since the debt of every country in the euro area is denominated in the common currency, and the rise of the differentials is perceived by investors as increasing risks and volatility[10].

Even though the situation was considered critical since mid-2009, the intervention by the European economic governance remained stalled for several months, due especially to the initial opposition for any kind of involvement in economic rescue programmes by any European institution by the German Chancellor Angela Merkel and other European leaders, who claimed that Greece should have solved its problems on its own or through an intervention of the IMF. Despite the initial resistance, the European Commission and the ECB continued their mediation actions by inviting the Greek government to pursue a fiscal and public sector reforms. Prime Minister Papandreou announced a major austerity package, which however led to strikes within the public sector, and most importantly did not stop the rise of the bond yields, with the spread over the 10-year bond touching 755 basis points on April 2010. Finally, Greece asked the European Commission, the ECB

[8] R.I. Raj, R. Panda, *Greek Crisis: A Macreconomic Analysis*, Gadhinajar, Oakbrook business Review, Vol. 1, No. 2, October, 2015, 35 – 42
[9] Ibidem
[10] P. R. Lane, *The European Sovereign Debt Crisis*, Journal of Economic Perspectives, Volume 26, Number 3, Summer 2012, 49–68

and the IMF for a multi-year programme of economic policies supported through financial assistance, which was developed in three years stability programme, unanimously voted by the Eurogroup on the 2nd of May 2010 and which granted 110€ financing package. It is important to underline that the financial support to the bailout programme planned and then requested by Greece was based on the Greek Loan Facility (GLF), bilateral loans from euro area countries according to the ECB capital keys which amounted to 80€ billion (then reduced by 2.7€ because Slovakia, Portugal and Ireland stepped down) and pooled by the Commission. The remaining 30€ billion were granted by the International Monetary Fund (IMF) through a stand-by agreement, its workhorse instrument[11].

The first bailout programme displayed the entrance in the international economic scene of the Troika, composed by the European Commission, the ECB and the IMF. The Troika, in order to grant the financial support to the Greek government, put several conditionality clauses. Most of the measures envisaged in the adjustment programme regarded expenditure cuts for an overall volume of 7% of the GDP, because considered more efficient during a financial consolidation programme of a state[12]. Apart from the increase in the VAT and excises taxes, the focus of the Troika programme was put on the pension system reform and public wage cuts (as shown in the table below); special attention was dedicated to the revisions of pension and wage allowances, such as the Christmas and Easter bonuses which were transformed into flat bonuses but for a restricted category of individuals[13]. Other structural reforms present in the first bail-out programme interested the productive market, in order to stem losses in various sectors (energy, transports etc.) and revitalize both the public and the private business environment. Furthermore, a labor market reform was sponsored by the authorities and agreed by Greek industrialists and unions, which does not comprehend any cuts in private wages (since it could have caused a worsening in the income allocation across the society) and strengthened the wage-setting process[14].

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[11] Directorate-General for Economic and Financial Affairs, *The Economic Adjustment Programme for Greece*, Brussels, European Commission, Occasional Papers No. 61, May 2010

[12] Ibidem

[13] Ibidem

[14] Ibidem

2010	% GDP	2011	% GDP	2012	% GDP	2013	% GDP
Revenue measures	**0.5%**	**Revenue measures**	**2.9%**	**Revenue measures**	**0.7%**	**Revenue measures**	**-0.3%**
Increase in VAT rates	0.3%	Carry-over from previous year	0.4%	Excise non-alcoholic beverages	0.1%	Presumptive taxation	0.0%
Increase in excise tax on fuel	0.1%	Carry-over from previous year	0.1%	Gaming licenses	0.1%	Gaming licenses	-0.3%
Increase in excise tax on cigarettes	0.1%	Carry-over from previous year	0.1%	Gaming royalties	0.2%		
Increase in excise tax on alcohol	0.0%	Carry-over from previous year	0.0%	VAT - broadening base	0.1%		
		Taxation on unauthorised establishments	0.4%	Presumptive taxation	0.0%		
		Luxury goods tax	0.0%	Increase of legal values of real estate	0.1%		
		Book specification of income	0.0%				
		Gaming royalties	0.1%				
		Gaming licenses	0.2%				
		Special levy on profitable firms	0.3%				
		Levies on illegal buildings	0.2%				
		VAT - changes of categories, broader base	0.4%				
		Green tax	0.1%				
		Presumptive taxation	0.2%				
		Increase of legal values of real estate	0.2%				
		Taxation of wage in kind (cars)	0.1%				
Expenditure measures	**1.9%**	**Expenditure measures**	**1.2%**	**Expenditure measures**	**1.7%**	**Expenditure measures**	**2.3%**
Wage bill cut (13th 14th wage, allowances)	0.5%	Carry-over from last year	0.2%	Public investment reduction	0.2%	Reduction of public employment	0.2%
Intermediate consumption	0.3%	Intermediate consumption	0.1%	Reduction of public employment	0.3%	Pension freeze	0.1%
Pension cuts (highest pensions)	0.1%	Introduction of unified public sector wages l	0.0%	Means test unemployment benefit	0.2%	Kalikrates savings	0.2%
Elimination of solidarity allowance	0.2%	Pension freeze	0.0%	Pension freeze	0.1%	Unidentified measures	1.8%
Pensions cut (13th 14th monthly payment)	0.6%	Carry-over from last year	0.2%	Kalikrates savings	0.2%		
Public investment reduction	0.2%	Kalikrates savings	0.2%	Cut transfers to public entities	0.4%		
		Pension cuts (highest pensions)	0.1%	Reduction in operational expenditure	0.4%		
		Public investment reduction	0.2%				
TOTAL ANNUAL IMPACT	**2.5%**		**4.1%**		**2.4%**		**2.0%**

Sources: Greek authorities, Commission services, and IMF staff

Source: Bank of Greece[15]

The conditionality clauses comprehended also the strengthening of the banking supervision mechanism, with a special concern on liquidity problems of the Greek banking system after the increased demand of cash by the population due to the financial instability. The Bank of Greece playing a decisive role in the stress test conducted by the European Banking Authority between 2010 and 2011, fundamental in order to ensure transparency within Greek financial institutions and strengthen the credibility of them towards international investors after the tragic events of the post-2008 crisis period[16].

Finally, the first bailout programme developed by the Troika after the official request by Greece suspended its presence in the international bond market for 18 months, enabling Greece to accumulate primary surplus, decreasing its reliance on international funding and initially displaying the ability by member states of the Euro area to financially help fellow states in economic distress[17].

1.2 The first instruments of crisis management in Europe: the EFSM and the EFSF

Despite the array of conditionality clauses contemplated in the first bailout programme set up by the Troika, the reaction of the markets the week after the announcement in May 2010 was adverse: the policy was considered poorly effective, delayed and sluggish, such that the situation within the financial markets turned

[15] Bank of Greece, *The Chronicle Of The Great Crisis: The Bank Of Greece 2008-2013*, Athens, Bank of Greece Printing Works, Commercial and Value Document Printing Section, September 2014, 33 – 39
[16] Ibidem
[17] Directorate-General for Economic and Financial Affairs, *The Economic Adjustment Programme for Greece*, Brussels, European Commission, Occasional Papers No. 61, May 2010

back to when the 2008 financial shock exploded. Most worryingly though, the contagion effect caused by the Greek crisis was becoming an irreversible reality which the European leaders were obliged to settle by that time. The states which suffered the most by the contagion which resulted from Greek financial instability as Ireland, Portugal and Spain are the ones which were exposed in many instances to the macroeconomic consequences of the failure of Lehman Brothers and the subsequent financial crisis, such as widening of the risk premium on government debt markets, which then resulted in the downgrading by rating agencies of the sovereign debt bonds and a general loss of confidence in the markets. Italy too faced important consequences after the eruption of the financial crisis, managing not to enter in an economic adjustment programme though.

The EU economic governance witnessed a boost in its crisis management in the first two weeks of May 2010, with the economic leaders of the sixteen euro countries arranging within 2 days after the Greek financial support package additional measures to expand the crisis mechanism[18]: indeed, the European Commission brought in a stabilization mechanism for European countries which was then accepted in an extraordinary meeting of the ECOFIN on Sunday, May 9th. The series of meetings which took place between the 9th and the 11th of May 2010 resulted in a euro-area financial safety net package of €750 billion divided as follows:

- Immediate €60 billion EU-backed fund called European Financial Stability Mechanism (EFSM)
- €250 billion granted by the IMF
- The formation of a Special Purpose Vehicle (SPV) called European Financial Stability Facility (EFSF), backed by EA member states, whose aim is to collect €440 billion on the capital market, while its function is to guarantee loans when governments officially ask for them[19][20]. The EFSF was a temporary mechanism set to expire in three years.

The EFSM is considered the immediate tool established by the euro area countries in order to create an emergency line for those member states witnessing financial difficulties caused by elements beyond their control. If a government requires economic assistance under Article 122(2) of the Treaty on the Functioning of the European Union (TFEU), only the European Commission will have the authorization to gather a maximum of €60bn in the financial markets and loan to the country economically distressed. The EU will not pay any debt-servicing costs and the loan will have to be repaid by the beneficiary directly to the European Commission. In case of default of the member state which requested the economic aid, the capital required to repay the interest will be drawn from the EU budget[21]. In order to access the EFSM, the member state should

[18] General Secretariat of the Council, *The European Council in 2010*, Brussels, January 2011, 29
[19] The EFSF officially came into existance on the 7th of June 2010, when it was incorporated as a society under Luxembourish law
[20] S. Dullien, D. Shwarzer, *Dealing with debt crises in the Eurozone: Evaluation and limits of the European Stability Mechanism,* Berlin, German Institute for International and Security Studies, RP 11, October 2011, 14
[21] The Council of the European Union, *Council Regulation (EU) No. 47/2010 on establishing a European Financial Stabilization Mechanism*, Luxembourg, Official Journal of the European Union, L11, 11th May 2010

make an official request to which they must attach an economic adjustment plan with the measures and reforms that must be incorporated in order to improve the financial conditions of the nation. Then, the Commission makes a proposal in which it establishes the amount of the payment and the period of the financial aid, together with additional economic conditions which serve as additional guidelines for the member states requiring the EFSM intervention. This proposal is then voted through qualified majority by the Council. Furthermore, the Commission and the beneficiary member state sign a Memorandum of Understanding in which best practices and rules of conduct for both parties are established in a legally binding document[22].

The EFSF became reality in June 2010, but started working properly in august 2010, when almost all the guarantee commitment by member states was confirmed. The EFSF was formulated on a temporary basis, since it would have lasted for three years until June 2013; after that date, the EFSF would have been liquidated. The credit issues of the EFSF are irrevocable and unconditional by the shareholders, which are the member states of the EMU whose financial support is established according to the capital keys of the ECB (see figure below).

Due to the intergovernmental nature of the contributions, the Board of Directors is composed by 19 representatives, one for each shareholder. Members of the ECB and the European Commission can participate as observers to the meetings of the Board, which decided the outlay of the loan facilities and framed the balance sheet of the EFSF. The daily operations of the EFSF were managed by the CEO of the EFSF, the German Klaus Regling, supported by the EFSF Audit Committee which focused on financial reporting, internal control and risk management[23].

The tools possessed by the EFSF were:

- Loans
- Loans specifically for the re-capitalization of banks, directed to the governments
- Precautionary programs such as newly created credit lines
- Public bond acquisitions in the primary and secondary market[24]

Furthermore, in order to fund the economic aid dedicated to the state in financial difficulties, the EFSF was allowed to issue debt instruments to be inserted in the capital markets. For the sake of obtaining a triple AAA rating from the rating agencies, the bonds issued by the EFSF were endowed with an over-guarantee of 120% of its value. As for the ESFM, the EFSF economic support initiates with an official request by a state, which was then analyzed by the Commission in order to ensure that the EFSF intervention in indispensable and maintains the stability of the Eurozone as a whole. Furthermore, the aid is under strict conditionality proposed

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[22] The Council of the European Union, *Council Regulation (EU) No. 47/2010 on establishing a European Financial Stabilization Mechanism*, Luxembourg, Official Journal of the European Union, L11, 11th May 2010

[23] European Stability Mechanism, *EFSF Governance,* ESM [Online], https://www.esm.europa.eu/efsf-governance [June 2019]

[24] Deutscher Bundestag, *Aktueller Begriff – Europa Das Urteil des Bundesverfassungsgerichts zum „EFSF-Sondergremium" des Deutschen Bundestages*. Berlin, Wissenschaftliche Dienste, Nr. 02/12, May 2012

by the Commission, voted by the Council and accepted by the member state through a Memorandum of Understanding.

The peculiarity of the EFSF resides in its implementation: indeed, as it was conceived under the law code of Luxembourg, the EFSF resides outside the Treaties, neither in the Commission, nor in the Council. Furthermore, the initial limited side of the administration of the EFSF (12 employees apart from the Board of Director) made some of the front office and back office activities of the EFSF to be outsourced to the German Debt Management Office and the European Investment Bank (EIB)[25].
The creation of institutions whose aim was to "to safeguard financial stability in Europe by providing financial assistance to countries of the euro area"[26] was pursued after two years from the 2008 economic crisis, and in just a few weeks after the deterioration of the Greek situation. What prompted such a steady reaction to the European sovereign debt crisis after years of inaction by the economic governance?

Both economic and political reasons played a role in this chain of events: following the ECB capital keys, Germany became the larger contributor of the EFSF (the total of the German contribution amounted to 119.390 million euros). Such position represented in the best way possible the role of Germany as the richest economy within the EMU. However, this position did not come without responsibilities: indeed, Germany and its politicians defined the norms and rules of the new institutions and will set the standards for the new economic governance of the Union, following the principles of German Ordoliberalism based on a set of automatic rules. In addition, as we have seen earlier, the economic power of Germany allowed its institutions to decide the fate of Greek economy, with the public opinion and the German constitutional court ruling against any kind of intervention. On the other hand, German banks were highly exposed to a Greek default: the claims of euro area banks peaked in 2008 at €128 billion, and a default of Greece would have led to a risk of insolvency for several European banks and could have exacerbated the contagion effect. Hence, the bailout programme approved in May 2010 allowed German banks to buy time in order to decrease their claims over Greek bonds and avoid further risks[27] such as the possibility of contagion in the euro area.

The same situation can be applied to France, whose banks were as exposed as the German ones, and whose political elite proposed an enlargement of the role of the ECB and of the EU budget in the crisis management; a proposal blocked by the UK, who claimed that Eurozone countries bailout should be managed by Eurozone countries, not by the EU in general[28]. In the end, some analysts believe that the first bailout programme enabled

[25] L. Gocaj, S. Meunier, *Time Will Tell: The EFSF, the ESM, and the Euro Crisis*, Journal of European Integration, Vol. 35, No. 3, 2013, 239–253
[26] European Stability Mechanism, *EFSF Governance* [Online], https://www.esm.europa.eu/efsf-governance
[27] F. Coppola, *Lessons For The Eurozone From The Greek Debt Crisis* [Online], available at https://www.forbes.com/sites/francescoppola/2018/08/20/lessons-for-the-eurozone-from-the-greek-debt-crisis/#24f57d4255dd [2018, August]
[28] L. Gocaj, S. Meunier, Time Will Tell: The EFSF, the ESM, and the Euro Crisis, Journal of European Integration, Vol. 35, No. 3, 2013, 239–253

German and French banks to be "bailed in" by their own taxpayers through the bilateral loans which helped Greece. Greek and US banks benefitted from this procedure in a smaller proportion. The problem aroused when EU countries had to set up the first crisis management institutions, in particular when solving the balance between the supranational or intergovernmental nature of the institutions: in conclusion, the EFSM, directly controlled by the Commission, is considered more supranational than the EFSF, but it is endowed with a smaller portion of the safety net (just €60bn, compared to the €440bn facility of the EFSF)[29].

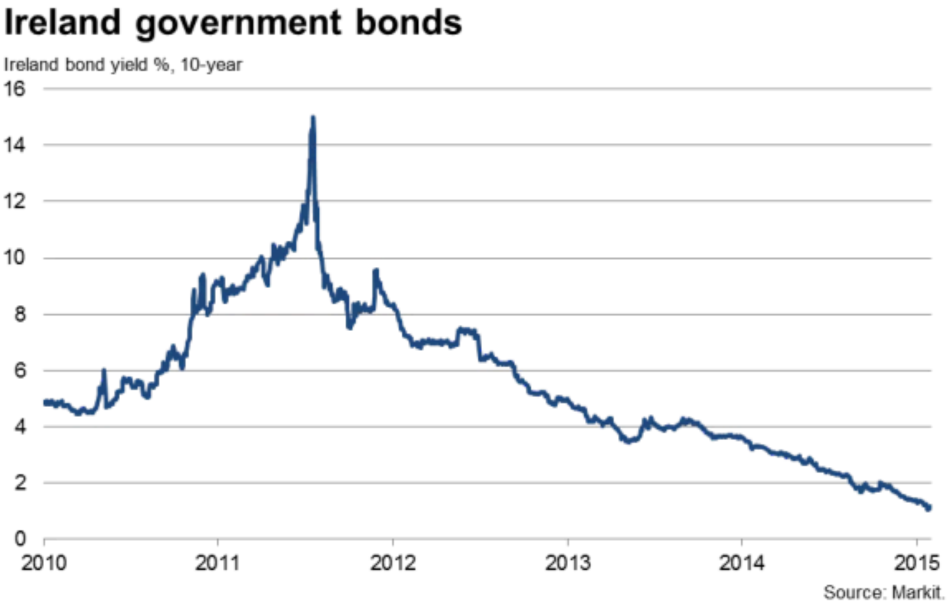
In the end, the pressure exercised by the political authorities of the member states of the Eurozone whose economy was stable outmatched the need by the European Monetary Union of an effective crisis management apparatus. Indeed, the way in which the interest rates over the loans lent by the EFSF suggested the fact that Germany wanted the rates to be higher in order to establishing the EFSF as the last resort instrument for countries experiencing financial difficulties. The reaction of relief by the markets after the formation of the EFSF was dissuaded by such characteristic of the new facility of the EMU, which worsened the financial chaos in several EMU countries and exacerbated the dramatic situation in Greece.

1.3 The Irish Economic Adjustment Programme 2010-2013

The first country which benefited from the new crisis management instruments was Ireland, whose financial institutions faced several problems of insolvency after the 2008 Great Recession due to the great expansion of the property market until 2007 and the imbalances of Irish banks balance sheets. The Irish government reacted by developing several recapitalization schemes for the six main Irish institutions through the creation of the National Asset Management Agency (NAMA), envisioned in the Credit Institutions (Financial Support) Act 2008. The Irish government through NAMA injected €46 billions in domestic banks, in particular the Bank of Ireland, the Allied Irish Bank and the Anglo-Irish Bank[30]. However, after the expiration of the 2008 state aid programme, the enormous costs of nationalizing the banking sector for the Irish government, and the revelation of numerous misconducts by the governance of Irish financial and political institutions (such as the "Golden Circle scandal over the Allied Irish Bank), led to a sharp increase of Irish bonds yields (as displayed by the figure below), the rise of Ireland's deficit in 2010 to 16.7 billion euros, and finally to the request from the Irish government for an Economic Adjustment programme to the EU in November 2010.

[29] ibidem

[30] Directorate-General for Economic and Financial Affairs, *The Economic Adjustment Programme for Ireland*, Brussels, European Commission, Occasional Papers No. 76, February 2011, 13



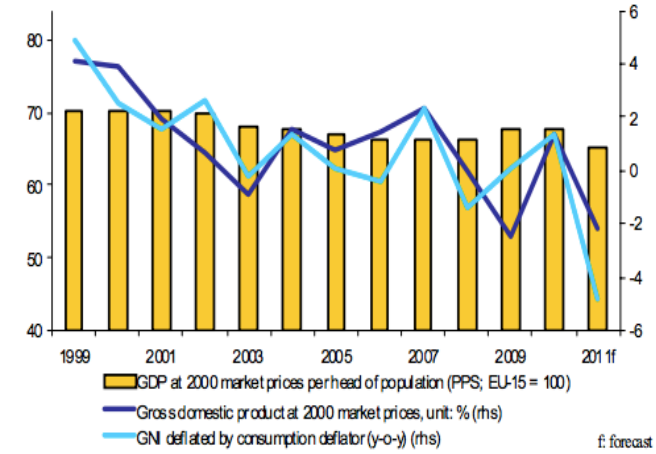
The bailout programme for Ireland consisted in contributions from the EFSM and EFSF for 45bn euros and from the IMF for 22.5bn euros: those contributions should be drawn in parallel. The key elements of the Memorandum of Economic and Financial Policies, agreed between Ireland, the EU and the IMF included the reorganization of the banking sector, fiscal consolidation based on a national plan to reduce expenditures and enlarge the narrow tax base, measures to boost employment and increase Irish competitiveness, a labor market revision regarding principles such as the minimum wage. Such proceedings would have brought back financial stability to the country, whose growth would have been led by the export sector, according to the Commission Service macroeconomic scenarios[31].

1.4 The Portuguese bailout programme 2011-2014

Despite the initial euphoria regarding the possibility to avoid contagion through the new tools in the hand of the EMU economic governance, in April 2011 Portugal requested a financial intervention by the Troika. Portugal's position was much more similar to the one of Greece rather than to Ireland: indeed, Portuguese banks were not disrupted by the 2008 market crash because their exposition to toxic assets was inferior to the one of the Irish banks. However, Portugal has been experiencing low economic performances for a decade until 2011, especially regarding the productivity sector, which increased the external indebtedness of the country and harmed its competitiveness in the international markets (as shown in the figure below[32]). As for Greece, the upward trend of the public debt exacerbated the effects of the recession on the Portuguese fiscal sector; for example, the deficit-to-GDP ratio in Portugal rose to 9.1% in 2010. Such economic drought was intensified by the bad management of state-owned enterprises and the public-private partnerships in the transport sector whose burdens did not allow the government to make efficient fiscal policies in the medium term.

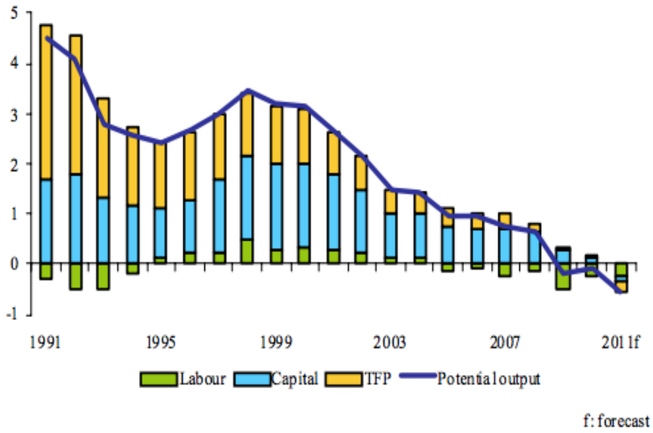
[31] Ibidem, 83 – 87
[32] Ibidem, 5

Graph 1: GDP per capita (EU15=100), real GDP and GNI growth



Source: Commission services

Graph 2: Potential output growth



Source: Commission services

The financing part of the Economic Adjustment Programme for Portugal foresaw an EU-share of 52bn euros to be equally shared by the EFSM and the EFSF, with the remaining 27.5bn euros to be provided by the IMF. The interest rate on the loans by the EFSM was at 5.5%, while on the loan from the EFSF was on 6.1%. In contrast to the Irish bailout programme, the Memorandum of Economic and Financial Policies and the MoU signed by the Troika and Portugal, instead of focusing on the restructuring of the banking sector, required the national authorities to concentrate their effort on

- **Fiscal consolidation**, by prompting the downgrading of the debt-to-GDP ratio through an extensive revision of expenditures, improving bureaucratic efficiency and implementing new frameworks for monitoring the government budget.
- **Structural reforms,** which required the revision of the labor market, the boosting of competitiveness and productivity, in order to achieve an increase in potential growth and strengthen the external balance of Portugal.

The reduction of the debt-to-GDP ratio is complemented with a deleveraging of the national banking sector, taking in consideration the stimulus for economic growth and the social impact of such intervention. In addition, reforms of the productivity sector and the labor market required Portugal to implement, such as the liberalization of the energy sector, the revision of unemployment insurance and wage setting to reduce the time people stay unemployed and to create new job places. Furthermore, the Troika addressed the Portuguese health care system, reviewing the financing framework and the reimbursement of pharmaceuticals, requiring a centralized administrative system for the acquisition of the equipment for the national healthcare system and a series of cuts for the hospital operations according to rational criteria[33].

[33] Directorate-General for Economic and Financial Affairs, *The Economic Adjustment Programme for Portugal*, Brussels, European Commission, Occasional Papers No. 79, June 2011,

1.5 The Greek second bailout 2012-1014

Greece first package was supplemented by a second rescue aid, agreed initially by the Council on the 21st of July 2011, then revised on the 20th of February 2012, and finally signed on the 1st of March 2012. The reason for the second intervention by the Troika rely on several economic variables which signaled unexpected drops in 2011, in particular GDP and internal demands components. Furthermore, the inflation remained high since the first adjustment programme (HICP averaged 3.1%), while the current account deficit stayed at unsustainable levels. In addition, the political cost of accepting the first economic aid by the Troika led to social instability and strikes, which led Greece not to comply to the purpose of reforms requested in the first MoU. Despite these alarming data, numerous advances from the first bailout package were also registered, in particular regarding the government deficit-to-GDP ratio (from 16% in 2009 to 9% in 2011) and the deleveraging process within Greek banks. However, it was not enough[34].

The new intervention comprehended €130bn of financial aid: 100bn euros were given directly to the Greek government in order to restructure the economic situation of the state, while 30bn euros were dedicated to protecting Greek government obligations, encouraging investments form the private sector. Indeed, the private sector played a major role in the Greek second bailout programme, since the bailout of 2012 comprised a debt restructuring through the Private Sector Involvement (PSI). The PSI emerged after days of negotiations at the beginning of 2012, and became the the "world's biggest debt restructuring deal"[35], which involved government bonds for a value of over $205 billion. The government managed to make an agreement with more than 80% of the bondholders, which reduced in a 50% cut of the debt-to GDP ratio through the so-called Collective Active Measure (CAC), for a total of 107 billion euros[36].

The second bailout programme requested by Greece to the Troika envisaged tougher terms that the first bailout programme: it considered the reform of the judiciary, the reform of the health care system apart from a more stringent revision of the pension system and of the about market. More importantly, due to the partial non-compliance by Greece regarding the first rescue package conditionality, the European institutions and the IMF set up a monitoring team to control the progress of Greek economic adjustment path to stay permanently in Athens. The Greek government also agreed to put the repayment of it's as a top constitutional priority, but to

[34] Directorate-General for Economic and Financial Affairs, *The Second Economic Adjustment Programme for Greece*, Brussels, European Commission, Occasional Papers No. 94, March 2012, 23
[35] L. Baker, S. Sassard, *Insight: How the Greek debt puzzle was solved* [Online] vailable at https://www.reuters.com/article/us-europe-greece/insight-how-the-greek-debt-puzzle-was-solved-idUSTRE81S0NP20120229 [February, 2012]
[36] European Commission, Directorate-General for Economic and Financial Affairs, *The Second Economic Adjustment Programme for Greece*, Brussels, Occasional Papers No. 94, March 2012, 47

ensure such claim the parties involved in the bailout constituted an escrow account in which Greece would have ensured to hold three-months-worth debt payments.[37]

2. The permanent crisis management instrument of the EMU: The European Stability Mechanism (ESM)

2.1 The Creation of the ESM

As stated earlier, both the EFSM and the EFSF were just a temporary instrument devised by the European economic governance to stop the financial drain witnessed during the European sovereign debt crisis. However, such instruments, despite effectively helping several countries and institutions facing instability and insolvency, did not manage to remove the public debt issue of some EMU countries, but in particular they were not able to calm down the fear of the contagion effect within the monetary union, which was then reflected by the rising trend of bond yields and the lack of confidence from the financial markets.

On the 21 of July 2011, the 17 finance ministers of the euro area countries (the number of countries which accepted the euro as their currency until 2011 was 17, while nowadays the EMU is composed by 19 states) signed the Treaty for the establishment of the European Stability Mechanism (TESM), which derived from the decision taken by the European Council taken in March 2011. A consolidated version following the accession into the ESM by Lithuania was signed on the 2nd of the February 2012. The consolidated version of the Treaty establishing the ESM explicated the purpose of such economic tool:

> *"The purpose of the ESM shall be to mobilize funding and provide stability support under strict conditionality, appropriate to the financial assistance instrument chosen, to the benefit of ESM Members which are experiencing, or are threatened by, severe financing problems, if indispensable to safeguard the financial stability of the euro area as a whole and of its Member States. For this purpose, the ESM shall be entitled to raise funds by issuing financial instruments or by entering into financial or other agreements or arrangements with ESM Members, financial institutions or other third parties".*[38]

Despite the original plan for the ESM was to start operating by 2013 after the end of the EFSF, the European Council held on the 9th of December 2011 decided for a boost towards a stronger economic and monetary union within euro area countries, by strengthening the coordination in the EMU through the introduction of

[37] P. Spiegel, A. Barker (2012) *Eurozone agrees second Greek bail-out* [Online] Available at https://www.ft.com/content/a3445f64-5c4c-11e1-911f-00144feabdc0 [June 2019]
[38] Treaty Establishing The European Stability Mechanism, T/ESM 2012-LT/en 2, signed on the 2nd of February 2012, T/ESM 2012-LT/

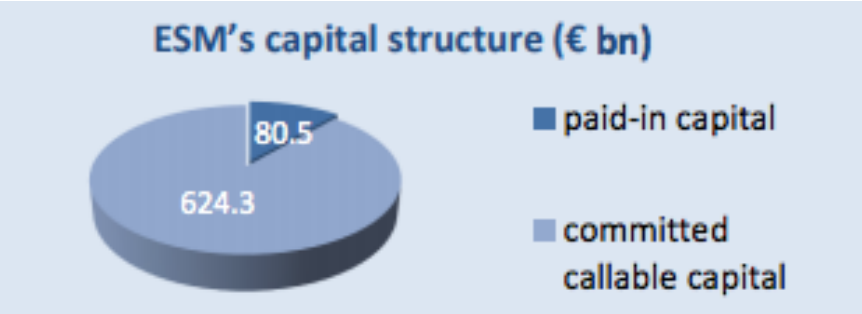
an international agreement called Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (TSCG), widely known as the "Fiscal Compact", and by anticipating the entry into force of the ESM from mid-2013 to July 2012. However, the effective implementation of the new instrument for crisis management in the EMU did not started until October 2012, when finally the German Constitutional Court revealed its decision over the constitutionality of both the TESM and the TSCG. In particular, as regards the TESM, the Constitutional Court was asked to decide whether the structure of the ESM and the principle of "automatized guarantees and transfers" alters the autonomy enjoyed by the German parliament on budgetary legislation. However, the government and subsequently the final decision of the Court overruled such argument by stating that the parliament will be represented in the Board of Governors of the ESM, and that Germany enjoyed a substantial veto power within the ESM due to the voting procedures of it (as we will see later on).[39]

2.2 The structure and funding of the ESM

The Treaty establishing the European Stability Mechanism is an international agreement signed outside the Treaties of European union which establishes the formation of a permanent institution with an intergovernmental nature whose objective is to aid those Member States facing financial difficulties and who are posing threats to the general stability of the monetary union. The ESM has been established outside the EU legal framework since the conditions for member states to build and control an institution set in international law are less restrictive and onerous in comparison with the same circumstances in EU legal system.[40]

The total capital authorized for the ESM amounts to €700 billions, with 80bn euros of paid-in capital (contribution to the institutions by investors who buy stocks in the primary market), and 620bn euros of committed callable capital provided by the Member States when the ESM paid-in capital is used to absorb losses (as shown in the figure below)[41]. The ESM has the possibility to fund itself through the issuance of debt securities. This funding structure which comprehend paid.in capital as collateral was determined to ensure a AAA rating to ESM credit tools by rating agencies.

[39] S. Gather, *Decision of the Federal Constitutional Court of Germany regarding the ESM Treaty*, [Online] Available at https://www.ceje.ch/fr/actualites/questions-institutionnelles/2012/09/decision-federal-constitutional-court-germany-regarding-esm-treaty/ [2012, September]
[40] G. Lo Schiavo, *Evolving Europe: Voices of the Future*, Loughborough, The academic association for contemporary European Studies (UACES), July 2013
[41] European Stability Mechanism (2015), *ESM factsheet*, [Online] Available at https://www.esm.europa.eu/sites/default/files/2015-12-16esmfactsheet.pdf [June 2019]



Source: European Stability Mechanism[42]

The ESM shareholder key reflects the capital keys established by the ECB. In contrast with the EFSF, there is no stepping-out guarantor clause which allows countries facing financial difficulties not to pay their contribution to the ESM funding scheme. euro area states which do not contribute to the ESM funding are sanctioned by removing their right to vote within the ESM[43]. The maximum lending capacity for the ESM will never exceed €500 billions, which represents the summed lending capacity of both the EFSF and the EFSM. Within the funding structure of the ESM, another important difference with EFSF emerges: as stated by the Committee on Monetary, Financial and Balance of Payments Statistics (CMFB), when a beneficiary country asked for a financial aid programme, the EFSF did not guarantee a direct loan to that country, but instead it loaned the established amount to the guarantor countries which then loaned to the beneficiary one. Such process is abolished in the ESM: as an international organization, the ESM works as the IMF. Hence the economic aids are considered direct loans from a permanent international organization to a state. Such loans will not result in the government debt of the euro area member states. This means that in the balance accounts of the Eurozone states beneficiating from loans of the ESM, the debt will not be calculated as due to the Euro area member states, but to the ESM [44].
The ESM has at its disposal 6 types of lending instruments:

1. Loans within a macroeconomic adjustment programme, whose aim is to aid countries out of the market for lack of confidence by investors or for high financing costs of their public debts.
2. Primary market purchases: the ESM may buy bonds and other debt securities in the primary market to sustain countries in rebuilding their relationship with the financial markets.
3. Secondary market purchases: in this case, when threats of market illiquidity in the government debt markets influences the financial soundness of the country in need.
4. Precautionary credit lines: preventive ESM measures to ensure to ESM Member States with sound economies to retain their access to markets and enhance their macroeconomic performances.

[42] Ibidem
[43] Treaty Establishing The European Stability Mechanism, T/ESM 2012-LT/en 2, signed on the 2nd of February 2012, T/ESM 2012-LT/
[44] Eurostat, *Decision of Eurostat on deficit and debt: Statistical classification of the European Stability Mechanism*, Luxembourg, 2013, January

5. Loans for indirect bank recapitalization: ESM tool to address situation in which the economic instability in the country is caused mostly by the financial sector.
6. Direct recapitalization of institutions: the direct intervention by the ESM by flowing capitals in institutions (especially banks) to avoid contagion effect towards the state. Such instrument is limited to €60bn funding.[45]

The instruments already used by euro area member states up to now are the loans within a macroeconomic adjustment programme and the Loans for indirect bank recapitalization. As for the EFSF, every instrument in the lending kit of the ESM is linked to conditionality, which can refer to fiscal consolidation (i.e. Cut of public expenditures), structural reforms (to enhance economic growth and employment rates) and financial sector reforms (especially when recapitalization measures are requested)[46].

The rate of interest attached to the ESM loans is not unique. Indeed, other than passing the cost of issuing bonds and bills to the beneficiary state, the ESM adds a margin (according to art. 20 of the TESM) which depends on the type of lending instrument (for precautionary credit lines and primary market intervention the margin is higher in respect with the other instruments), and it adds also operational costs. In general, the cost of borrowing from the ESM is determined at every tranche of the financial aid programme, together with the maturity of the lending instruments involved in the assistance programme.[47]

The legal construction of the ESM is based on the reform of art. 136 of the TFEU and the relaxation of the "no bail-out clause". This clause is specified in art. 125 of the TFEU, which establishes the impossibility for both the European Union and the EU member states to be accountable for the commitments of other member states. Art. 125 of the TFEU has been a cornerstone of the EMU before the 2008 crisis and in the verge of the sovereign debt crisis. The Commission and EU leaders changed their views and decided that Member States could have been granted financial aids through a communitarian institution provided that conditionality is attached to the financial assistance in order to stabilize their budgetary situation. The subsequent paragraph was added to art. 136 TFEU:

> *"The Member States whose currency is the euro may establish a stability mechanism to be activated if indispensable to safeguard the stability of the euro area as a whole. The granting of any required financial assistance under the mechanism will be made subject to strict conditionality."*

The organizational structure of the ESM is led by the Board of Governors, in which the finance minister of the member states of the ESM are reunited together with the European Commissioner for Economic and

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[45] European Stability Mechanism, *Lending toolkit,* [Online] Available at https://www.esm.europa.eu/assistance/lending-toolkit
[46] Ibidem
[47] European Stability Mechanism (2015), *ESM factsheet*, [Online] Available at https://www.esm.europa.eu/sites/default/files/2015-12-16esmfactsheet.pdf [June 2019]

Monetary Affairs and the President of the ECB, who are not endowed with the right to vote and have the status as observers. The mission of the Board of Governors is expressed in Art. 5 of the TESM and is to make all the primary decisions regarding the operations of the ESM according to 2 main decision-making systems:

- Mutual agreement, which is a decision taken unanimously only by those countries participating in the vote. Abstentions are not taken in consideration
- Other decisions are taken by qualified majority, which for the ESM is established as the 80% of the weighted vote.

The mutual agreement procedure involves decisions taken on 4 aspects of the operations of the ESM: the granting, terms and conditions of financial assistance; the lending capacity of the ESM; and changes to the array of instruments used by the ESM.

The second main organizational body of the ESM is the Board of Directors, which will hold responsibilities officially delegated by the Board of Governors. This body is composed by one Director and one alternate director selected by each Governor of the single member states of the ESM. These personalities must be highly appreciated for their records in economic and financial fields. The main objective for the Board of Directors is to assure that every operation of the ESM is projected following the diktats of the Treaties and the laws under which the organization has been created.

The current Managing Director of the ESM is Klaus Regling, who is in chief of regulating the ordinary businesses of the ESM together with the management board, composed by other 6 figures, and supported by more than 15 figures, each one of them responsible for specific aspects of the current actions of the ESM: from risk management, to investment and economic analysis, from investor relations to corporate governance: At this day, the ESM can count approximately 200 employees.

Non-members of the EMU can participate to part of the meetings of the ESM (an option requested after the Ireland bailout programme developed and implemented by the EFSF). Also, the ECB participates to the organizational structure, not only through the observer role played by its President in the Board of Governors of the ESM, but also by monitoring the ESM actions, by providing technical expertise and documents when adjustment programmes are developed. Furthermore, the ESM will always try to strictly cooperate with the IMF, both in the technical and the financial frameworks[48].

Until 2019, the interventions by the ESM have been requested by 3 countries: Spain, Cyprus and once again Greece. The programmes developed by the new mechanism introduced in the EMU after the EFSF and the EFSM

[48] European Central Bank, *The European Stability Mechanism*, Monthly Bulletin , July 2011, 71 - 84

2.3 The financial sector adjustment programme of Spain 2012-2013

On June the 9th 2012, the Spanish government accepted to request an official aid from the euro area countries to stop the capital drought witnessed within its financial institutions. Mariano Rajoy justified this decision, which derived from concrete pressure coming from the EU and the USA, as a way to demonstrate "the credibility of the European project, the future of the euro, the solidity of our financial system and the possibility that credit will flow again."[49] Such request was officially delivered to the Commission on the 25th of June 2012. The way of proceeding undertaken by the Spanish PM, with the public demonstration of trust towards the Emu and its institutions, represents the first difference between the Spanish experience of Spain with the ESM in comparison with the Greek example.

The economic crush witnessed by the fourth largest economy of the euro area followed the same path of the other states which had requested financial rescue packages: the burst of the housing bubble in 2008. Spin witnessed double digits growth in the construction sectors after its entrance in the monetary union, also due to the expansionary monetary police which the euro has brought into the country. The housing prices in Spain were the highest within EU countries and one of the highest in the Western world. However, by the end of 2008 the value of existing houses dropped by almost 37% until 2012. As happened for numerous other nations, the housing bubble was exacerbated by the easiness under which it was possible to receive loans and start mortgages. Hence, investors flowed their capital in the construction sector, with the share of investment in construction reached 22% of GDP in 2006-2007, compared with 15% in 1995. When the prices fell, Spanish families were not able to repay the mortgage, enhancing the losses of the Spanish banks and "cajas", which held 56% of the total mortgages in 2009. In a country in which the banking system is extremely dense, the mortgage debt crisis rapidly evolved in a real economy emergency, with Spain entering in recession in 2009 and later on in 2011, and experiencing an economic shrank of 10 GDP percentage points between 2008 and 2011[50]. In this period, Spain preferred to bail out financial institutions rather than nationalizing them as Ireland did. Indeed, through the creation of the "Fondo de restructuración ordenada bancaria" (FROB), the Spanish government had restructured Spain's savings banks which filed for bankruptcy for nearly €41.8 billion, more than half of the total cost of the restructuration programme until 2015[51]. However, during the 2011 recession, Spanish public deficit rose to double digits (11%), and the difficulty for the government to borrow money in the market was becoming increasingly frustrating.

The ESM intervention in Spain is one of a kind: indeed, it was the first time the loans for indirect bank recapitalization tool was used by any institution of the EMU. In the MoU signed between the Spanish

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[49] R.Minder, N. Kulish, P. Geitner (2012), Spain to Accept Rescue From Europe for Its Ailing Banks [Online] Available at https://www.nytimes.com/2012/06/10/business/global/spain-moves-closer-to-bailout-of-banks.html [May 2019]
[50] R. Orihuela, Gualtieri T., Sills B. (2018), *How Spain Got Its Swagger Back*, [Online] Available at https://www.bloomberg.com/news/articles/2018-06-19/how-spain-got-its-swagger-back [May 2019]
[51] I. De Barron (2017), Spanish bank bailout cost taxpayers €41.8 billion, Audit Court finds [Online] Available at https://elpais.com/elpais/2017/01/11/inenglish/1484125815_626310.html [May 2019]

government and the European Commission, the totality of the funds requested for the capital recapitalization of the Spanish banking sector amounted to 100 billion euros to be provided entirely by the ESM for the recapitalization in particular of Bankia, Novagalicia, CatalunyaCaixa, Banco de Valencia, with the IMF acting only as a technical support, while the ECB as a monitoring partner together with the Commission.

The programme had to follow a specific timeline, which started in July 2012 with the first tranche of the financial aid (€30bn): the following step consisted in a series of stress testes in order to evaluate the capabilities of each bank to recapitalize against their shortfalls. According to the results gathered by an external consultant, the financial institutions evaluated will be assigned to 3 groups:
Group 1 composed by those banks already aided by the FROB, Group 2 which comprised those which were not able to meet their capital shortfalls privately, while Group 3 consisted in those Spanish banks with losses but capable of developing a recapitalization plan on their own. For Group 1 and 2, recapitalization plans must be set up by Spanish authorities and finally approved by the Commission by November 2012. Until the approval of the restructuring plans, no financial assistance will be given to the institutions. The theoretical basis of the recapitalization plans for the Spanish banking sector is based on sustainability for the State and its taxpayers, the notions of viability, burden allocation and promotion of financial stability through the avoidance of competition distortions. Junk assets present in the banks' balance sheet will be transferred to an Asset Management Company (AMC), which will be controlled by the Spanish authorities together with the Troika, and whose objective is to obtain the real economic value of the acquired assets in the long term[52].
Despite being a totally different scenario than the ones seen with the EFSF, the ESM intervention on the recapitalization of the Spanish banking sector came with a series of conditionality from the Troika towards the Spanish government. Indeed, the conditionality followed the request already made by the Commission to Spain for the extension of the Excessive Deficit Procedure which had saw Spain involved since 2009. Apart from the demand to reduce the deficit from 11% in 2011 to 2.8% in 2014, Spanish authorities should pursue effective structural reforms regarding the fiscal system, but in particular the labor market (with Spain unemployment rate peaking at 26% in early 2013[53]) and the bureaucratic system, which put several obstacles for the creation of a business[54].

Of the 100 billion euros envisaged in the MoU between the Spanish authorities and the Commission, by the exit of Spain from the programme in December 2013, the government just needed €41.3bn in two tranches; the first one in December 2012 and the second in February 2013.

[52] European Commission, Spain, *Memorandum Of Understanding On Financial-Sector Policy Conditionality*, 20th July 2012
[53] Statista, *Unemployment rate in Spain*, [Online] Available at https://www.statista.com/statistics/453410/unemployment-rate-in-spain/ [May 2019]
[54] European Commission, Spain, *Memorandum Of Understanding On Financial-Sector Policy Conditionality*, 20th July 2012

The Spanish government introduced several reforms to respect the MoU and the European Semester: as regards the labor market, it enhanced internal flexibility, with employers able to change wages and time-conditions of the contracts. Furthermore, the government facilitated the creation of new contracts for small firms, focusing on part-time conditions, while also relaxing the tax wedge on employers hiring young workers and on start-up businesses. In addition, in 2012, The Spanish PM Mariano Rajoy, together with businesses and union leaders, devised the "Strategy For Entrepreneurship And Youth Employment 2013 – 2016", which comprised 100 measures for the improvement of "the employability of young people as well as the quality and stability of employment, to promote equal opportunities for access to the labor market and to foster entrepreneurship"[55]. Such measures comprehended special VAT regimes, subsidies from R&D taxes and deductions for investment in start-ups[56].

As regards the public administration, the Spanish government formed the Commission on the Reform of the Spanish Public Administration (CORA), whose objective is to reform the Spanish administrative apparatus on four fronts:

1. Removal of overlapping between central and local administrations
2. Elimination of administrative burdens for companies and businesses
3. Improvement of the structure of the administrative apparatus through mergers and elimination of redundant public bodies
4. Internal reorganization of the administrations for the purpose of pursuing economies of scope and scale[57].

The CORA was complemented by a monitoring body: The Office for the implementation of the reform in the public administration (OPERA). The results affirm that the vast majority of the reform set up by the CORA have been implemented and 44 of such initiatives have been completed.

Other important structural reforms have been implemented in the education system, where the rate of students dropping out from school earlier has been reduced evidently. The fiscal consolidation reforms brought forward by the Spanish authorities regarding the pension system and the cuts in public expenditures have lowered the deficit from 11% in 2011 to 7.1% in 2013. These array of initiatives by the government have changed the economic path of Spain: GDP growth turned back to positive rates already in Q3 of 2013, while in 2014 Spain registered a 1.2% growth in GDP, more than the euro area median (0.8%) and just behind the European locomotive Germany (1.3%). Most importantly, the reform of the banking system is "well underway"[58]

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[55] Gobierno de Espana, Ministero de Empleo y Seguridad Social, *Strategy For Entrepreneurship And Youth Employment 2013/2016,* Madrid, March 2013, 56 – 90

[56] Ibidem, 87

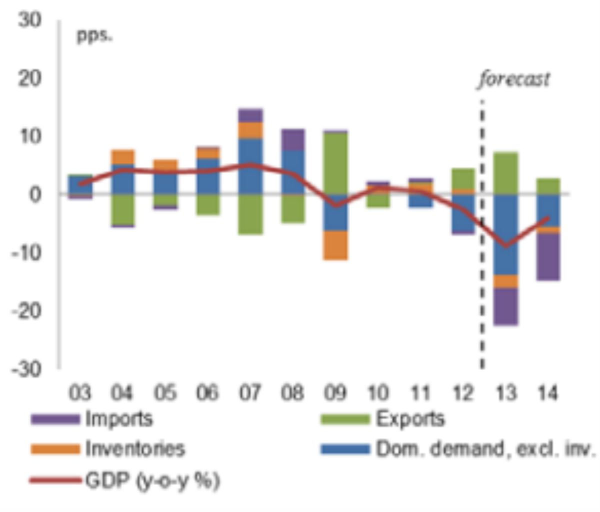
[57] Ibidem, 84

[58] European Stability Mechanism (2013), *Conclusion of ESM financial assistance programme for Spain: an overview*, [Online] Available at https://www.esm.europa.eu/sites/default/files/spanish_exit.pdf [May 2019]

Many analysts consider Spain's early exit by the recapitalization programme of the ESM on the 23rd of January 2013 as a success story[59].

2.4 The economic adjustment programme of Cyprus 2013-2016

In the first decade of the millennium, Cyprus enjoyed an extraordinary economic growth, with positive rates in almost every variable of the real economy. Such economic expansion was paired with high rates of increasing demographics. The average GDP growth established at 3% witnessed by Cyprus (well above the EU average) was boosted mainly by the domestic demand, with high levels of private consumptions and investments, in their turn enhanced by the reforms and the private confidence generated by the 2004 EU accession and the subsequent will to enter the EMU, which finally culminated in 2008. The service sector witnessed a great period of diversification and growth between 2003 and 2010 in Cyprus, which made the island a convenient place to create business.



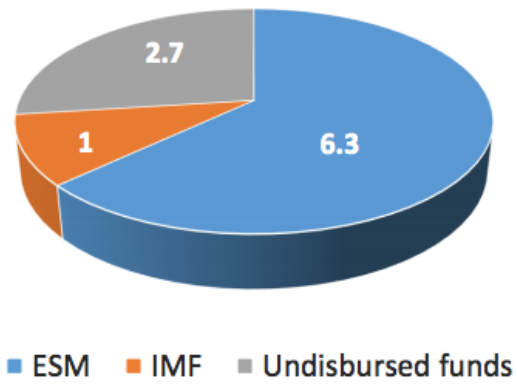
Source: European Stability Mechanism[60]

However, together with the gathering of important rates confirming Cyprus' impressive economic performances, the Mediterranean country was also accumulating important economic flows: the current account balance of Cyprus registered constant negative rates, hampering the competitiveness of the state in the financial markets. External and Internal imbalances were exacerbated also by the enormous amount of liquidity flowed into Cyprus' banking sector due mainly to foreign deposits, especially form Russia. The situation was also worsened by the expansionary credit policies followed by the banks, stimulated by the important data on domestic demand and by the entrance in the monetary union[61]. The boost witnessed by Cyprus' banking sector was not backed-up by appropriate reforms of the financial sector or by counter-cyclical

[59] European Commission, *Post-Programme Surveillance Report – Spain – Autumn 2018*, Brussels, Institutional Paper 091, November 2018, 6-9
[60] Directorate-General for Economic and Financial Affairs, *The Economic Adjustment Programme for Cyprus*, Brussels, European Commission, Occasional Papers No. 149, May 2013, 9
[61] Ibidem, 20

policies to prevent the crash caused by the burst of the housing bubble in 2008. Indeed, the effects of the Great recession were majorly felt in the island due to the great exposition of Cypriot banks towards foreign economies (Cyprus exposition towards Greek economy amounted to 111% of the GDP).
The external exposure, complemented by other structural problems such as the increase of the unit labor cost after the annexation to the euro, the continuous trade deficit and the issues witnessed by Cyprus in financing its public deficit due to the decrease in foreign deposits, led to a sharp rise of the gross public debt of Cyprus, from 60% in 2008 to 65.5% in 2012. The economic difficulties formed during the Great recession led the Cypriot government to ask for 2.5bn of bilateral loans to Russia, with 4.5% of interest rate on them. However, on June 2012 Cyprus requested financial aid to the Troika: an agreement of the economic adjustment programme was reached almost one year later in April 2013, while the first tranche of financial aid was delivered in May 2013.

The programme funding consisted in a total of 10 billion euros, financed through contributions from the ESM (€9 billion) and the IMF through Extended Fund Facility (€1 billion). By the end of the programme though, the disbursement of the funds of the programme have been calculated as shown in the graph below:



Source: European Stability Mechanism[62]

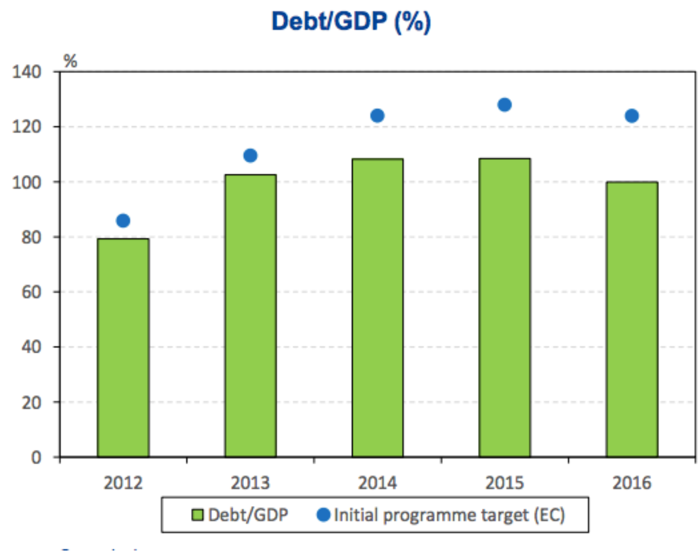
The objectives of the conditionality imposed on Cyprus in the MoU which accompanied the economic adjustment programme focused on the restructuring of the financial sector and the introduction of several structural reforms.
First of all, in order to renew the banking sector, a massive operation of deleveraging was required, especially involving the Bank of Cyprus and the Cyprus Popular Bank. The Greek assets owned by those two banks were sold to the Piraeus Bank, in an operation which deleveraged the balance sheets of the Cypriot banks of 120% GDP points. The external exposition of Cyprus banking sector imposed threats of liquidity outflow; this was stopped through bank holiday which were prolonged several times in March 2013, and which ended with the imposition of capital controls by the government. Then, the focus on the financial sector reform was moved

[62] European Stability Mechanism, *Conclusion of ESM financial assistance programme for Cyprus: an overview*, ESM, 2016 [Online] Available at https://www.esm.europa.eu/sites/default/files/2016_03_31_cyprus_exit_presentation.pdf [May 2019]

on strengthening supervision, provide sufficient capital buffers and restructuring Cyprus' commercial banks and other credit institutions.

On the other side, the fiscal reforms requested by the Troika and accepted by the authorities envisaged fiscal consolidation policies such as a revision for the compensations regarding employees of the public sector, with the government willing to make efforts in the reduction of pubic wages by 3% of the GDP by 2014, and a pension scheme reform regarding public servants.
Structural reforms were directed towards the restoration of sustainability of the Cypriot economy and the competitiveness in the financial market. Initially, a revision of Cyprus' Cost of living adjustment (COLA) was accepted by the authorities both for the public and the private sector. In addition, a reform of the public administration of the service sector was agreed, together with the will by the authorities and the ECB/Commission/IMF to focus the economic efforts by Cyprus on tourism, with the possibility of renewing The Tourism Strategy for 2011-2015 and facilitating investment in the sector through the promotion of condo hotel projects.

The results of the programme are shown by the macroeconomic data recorded by Cyprus in 2015: deficit-to-GDP ratio reduced to 1%, declining government debt and unemployment rate; Cyprus regained a competitive position in the financial market, with a sound banking sector and cash buffers which amount to €1 billion.



Source: European Stability Mechanism[63]

[63] European Stability Mechanism (2013), *Conclusion of ESM financial assistance programme for Spain: an overview*, [Online] Available at https://www.esm.europa.eu/sites/default/files/spanish_exit.pdf [May 2019]

2.5 The Greek third bailout programme 2015 – 2018

The path towards the third rescue package by the euro area countries for Greece, and the first intervention by the newly born ESM displays the tumultuous relation between economics and politics.

After the decision by the Eurogroup, and the signing of the agreement in March 2012, the second economic adjustment programme for Greece entered into force, not without skepticism expressed directly by the parties involved in the accord: indeed, the head of the Eurogroup himself Jean-Claude Juncker was not able to eliminate the possibility of a third intervention by the EMU in Greece, just two days after the decision taken by the commission he was chairing. In fact, the implementation and the effects of its conditionality were hampered by the political turmoil within the Greek borders. The situation deteriorated two months after the initiation of the second bailout programme, when the possibility of an exit by Greece form the Union started going around European institutions, with the word Grexit becoming a trending factor in 2012[64]. Between May and June 2012, the political situation in Greece snowballed: a new political fringe emerged, composed by the conservatives of New Democracy, the socialists of PASOK and democratic socialists of DIMAR. After months of negotiations, finally Antonis Samaras managed to form a majority coalition. Samaras, acknowledging the fact that numerous clauses and expectations agreed in the second MoU were not going to be respected by Greek authorities, asked for a relaxation of the temporal terms, in particular a two-year extension to the 2014 deadline for the Government to cut its budget deficit to 2.1% of GDP, from 9.3% in 2011. Such request was denied by German authorities, together with other Northern European countries, which instead waited the review of the results from the Troika regarding the concession of another tranche of financial aid. The report published during the fall of 2012 maintained that the political uncertainty had amplified the economic recession of Greece, with a further contraction of output by 6% in 2012, an expected contraction for 2013, and with the fiscal targets established for 2013-16 to be revised. However, the most dramatic situation regarded the continuous fragility of the Greek banking sector, and the privatization processes which have been delusional. The Troika established that further tranches of economic aid will be conditional to more stringent evaluation of progresses. Indeed, on the 27th of November 2012, the Eurogroup revised the bailout programme, lowering interest rates and maturities for Greece on the loans received, and reviewing the expectation regarding debt-to-GDP ratio reduction for 2020.

In order to follow the path established in the revised MoU, Samaras' government introduced ulterior austerity measures, including the dismission of 25.000 public servants, a tax reform and other initiatives for fiscal consolidation. Such provisions generated some confidence on a slow but sustainable economic recovery of Greece, with privatization processes and labor market reforms effectively implemented along 2013 and 2014. After the new access into the financial markets by Greece in 2014, and the early exit from the EFSF bailout programme, Greece financial situation was far from being solved: unemployment was at 26.4%, but most

[64] R. Atkins (2012), *A year in a word: Grexit*, Financial Times [Online] Available at https://www.ft.com/content/9e59bcfc-4b74-11e2-88b5-00144feab49a [May 2019]

dramatically a third of the population was on the threshold of poverty and 17.5 per cent lives in households with no income.

The austerity measures imposed important political costs on the Samaras' government, in particular the provisions present in the IMF programme which was still ongoing after the end of the EMU adjustment programme. The resentment toward Greek authorities was sized by Alexis Tsipras, which rapidly gained consensus through a campaign based on the criticism towards the interference of international organization in Greece internal affairs. In January 2015, new elections were held, and Tsipras won the majority of the parliament and formed a new government: his political agenda was dominated by the Thessaloniki Program, which denoted an anti-austerity vision (public investment should have been excluded by the Stability and Growth Pact), the will to dismantle the MoU with the IMF and the request for a «European New Deal» financed by the European Investment Bank.[65] In order to abolish the fiscal consolidation measures imposed by the Troika, Tsipras and his party not only requested the cancellation of the debt (which was in the hands of IMF, EMU member states and ESM for almost 80%), but also the re-introduction of the Christmas bonus for over 1 million pensioners and the increase of the minimum wage to €751, for a financial cost of 13 billion euros. The position by Tsipras set up the conditions for the clash with Greece international partners: clash which peaked on the 30th of June 2015, when Greece misses a repayment for 1.6 billion euros of the IMF programme, which makes the Hellenic state the first developed state to default in front of the IMF.

The need for a new bailout programme became an urgency: despite this, Tsipras decided to make the Greek people decide whether to accept or not the new provisions proposed by Greece international creditors through a referendum, which saw the EU programme refused. However, the emergency caused by the severe default risk and by the pressure deriving from the creditors convinced Tsipras to push for the approval of the new austerity measures by the parliament, which comprehended the introduction of capital controls in order to tamper capital outflows and the dismantling of the national banking system.
Finally, in August 2015 the third bailout programme for Greece is signed and approved by the national parliament.

The funding of the last economic adjustment programme amount to 86 billion euros to be distributed in three years by the ESM through "Aggregate Financial Assistance Amount"[66]. The IMF refused to intervene in this programme until the European creditors provide Greece of a significant debt relief. By August 2018, the ESM disbursed a total of €61.8bn[67].

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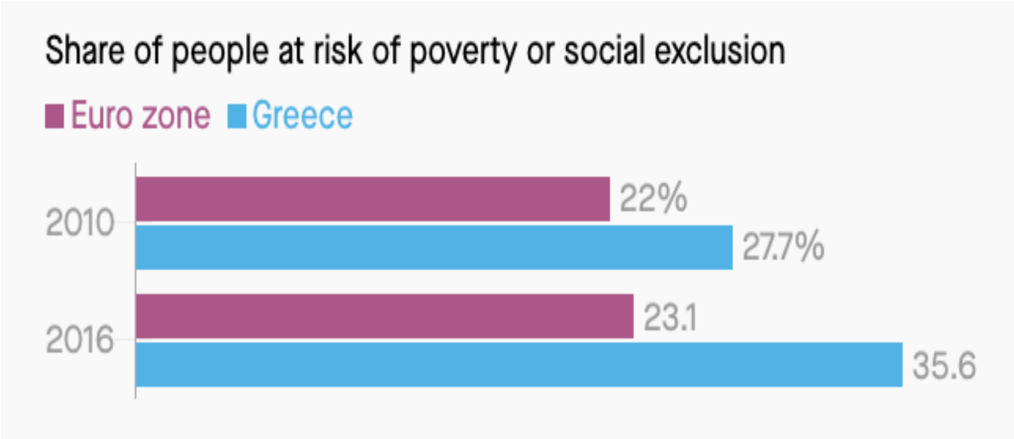
[65] Syriza (2014), *The Thessaloniki Programme*, Syriza, [Online] Available at https://www.syriza.gr/article/SYRIZA---THE-THESSALONIKI-PROGRAMME.html [May 2019]
[66] European Stability Mechanism, Bank Of Greece, Hellenic Republic, Hellenic Financial Stability Fund, *Financial Assistance Facility Agreement*, signed on the 19th of August 2015
[67]European Stability Mechanism (2018), *Conclusion of ESM financial assistance programme for Greece: an overview*, ESM [Online] Available at https://www.esm.europa.eu/sites/default/files/spanish_exit.pdf [May 2019]

The clauses comprised in the MoU referred to the third bailout programme between the Hellenic Republic and the Commission on behalf of the ESM are considered more stringent than the other two rescue packages due to the partial failures of the previous attempts, and worsened by the political clash between Greek government and its creditors envisaged during the negotiation phase.



Source: Eurostat

The new conditionality for the ESM bailout loans envisaged:

- Primary surplus at 3.5% of the GDP in the medium term to restore fiscal sustainability through the Medium-Term Fiscal Strategy (adopted by Greek authorities in October 2015). In order to do so, the implementation of a fiscal reform reviewing VAT system (especially the special status of the islands), income taxes (making it more progressive) and pension framework, by progressively increasing retirement age to 67 without possibility of early exit. Furthermore, Greek authorities agreed on making efforts to reinforce tax compliance and fight tax evasion were required.
- Bank recapitalization in order to eliminate Non-Profitable Loans (NPLs), by strengthening the management of the Hellenic Financial Stability Fund (HFSF) and national banks.
- Further reform of the labor market and productivity sector to bring Greece closer to EU acquis, through the technical support of the OECD, the ILO and other international organizations, in order to create 50.000 new job places and addressing particularly long-term unemployment.
- Public administration reform, enhancing the independency of the institutions (such as the ELSTAT) against corruption. In addition, Greek authorities will benefit from the technical support of the Commission to reform the public sector based on the principles of rationality, optimality, transparency

and accountability, for example by aligning non-wage benefits with best practices in the EU, and by recruiting new public managers through merits and not political decisions[68].

It is important to underline that such measures consider "the need for social justice and fairness, both across and within generations", [69] for example by targeting access to health care for insured and uninsured, by devising a social safety net through the Guaranteed Minimum Income (GMI).
Greece exit the ESM macroeconomic adjustment programme on the 20th of August 2018, registering a positive rate referred to GDP growth since 2017, with unprecedented positive results regarding budget deficit (from 15.1% deficit in 2009 to 0.9% surplus in 2017) and current account deficit, which fell from 15.8% in 2008 to 0.9% in 2017. Beyond, several structural reforms were successfully implemented, which brought to the reduction of the public sector of 25% and improvement of the system of collective bargaining in the labor market.

However, Greece still faces important challenges, in particular regarding the banking sector and the ratio of NPLs over the total amount of granted credits. The NPL ratio trend started decreasing in the fourth quarter of 2017, however the stock of NPLs present in the Greek financial sector remains the highest within EMU member states, and its recovery path towards a sound NPL rate is the lowest in the region[70].

The fragility of the banking sector is accompanied by the concerns regarding the debt sustainability of Greece. Studies of the IMF and the EU Commission have discussed the effects of debt relief initiatives in the short-term and in the long-term. Even though both agree on the need of measures to boost primary budget surplus in the short-term, the IMF argues that in the long-term the maintenance of important primary budget balance targets may have high social costs, especially on public investments and tax wedge.[71]

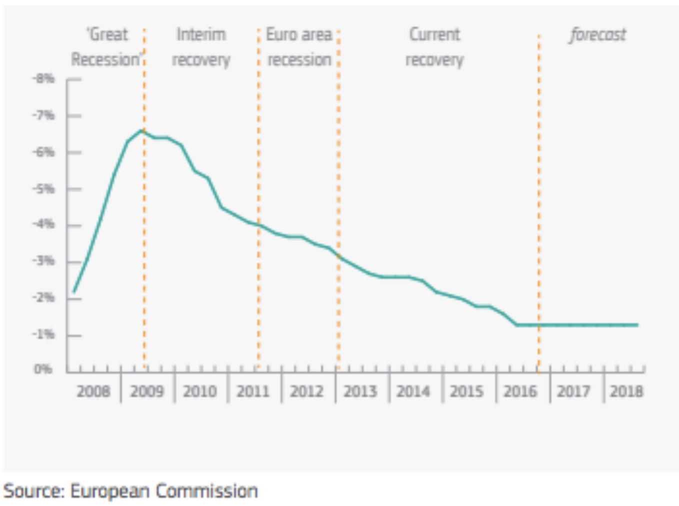
[68] European Commission on behalf of the ESM, Hellenic Republic, Bank of Greece, *Memorandum of Understanding for a three-year ESM programme,* signed on the 19th of August 2015, 8 – 32
[69] Ibidem, 4
[70] A. Lehman (2019), *After the ESM programme: Options for Greek bank restructuring*, Bruegel [Online] Available at: http://bruegel.org/2019/01/after-the-esm-programme-options-for-greek-bank-restructuring/ [June 2019]
[71] E. Maurice, D. Bacci (2018), *Greece exits bailouts, but difficult path ahead,* EU Observer, [Online] Available at https://euobserver.com/economic/142517 [May 2019]

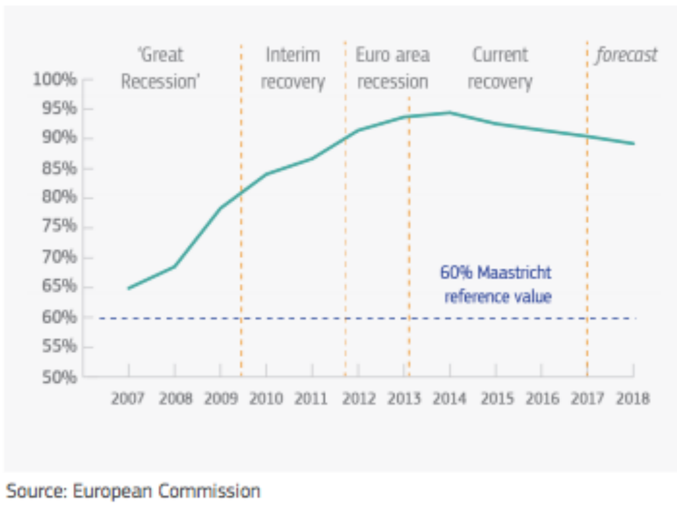
3. Evaluation and criticism of the European Stability Mechanism

3.1 Evaluation of ESM interventions

After 10 years from the most dramatic financial crisis in the post-war era, European institutions are starting to evaluate the results of the crisis management tools introduced in the economic governance of the monetary union, and also acknowledging which could be the perfect continuation of the evolutionary path of the EU economy. The numbers provided by the member states to the Commission confirm positive trends in several economic variables which have been focal points of the policies set up by the EU economic governance since the start of the crisis:

- Both the debt-to-GDP and the deficit-to-GDP ratio, which have been highly affected by the Great Recession and the subsequent sovereign debt crisis, are now experiencing a decreasing trend, even though the public debt of the Eurozone is still higher than the 60% Maastricht criteria.



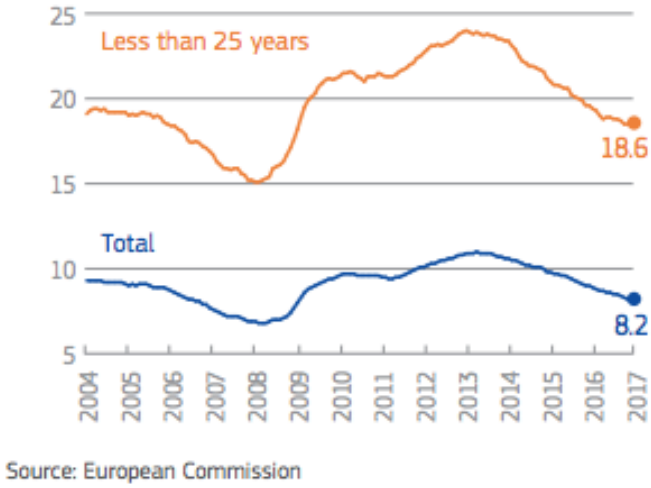


Source: European Commission[72]

- The productivity in the EU has dropped heavily by the 2008 financial shock, but has witnessed a positive trend since 2013, accompanied by an increase in the level of investments boosted by EU actions such as the Juncker plan, which has prompted €225 billions of investments up to July 2017 thanks to the role played by the European Investment Bank (EIB and the European Fund for Strategic Investment (EFSI)[73].

[72] European Commission (2018), *"10 years since the start of the crisis: back to recovery thanks to decisive EU action"*, Brussels, Factsheet – In Numbers.
[73] European Commission (2018), *"10 years since the start of the crisis: back to recovery thanks to decisive EU action"*, Press Release, [Online] Available at http://europa.eu/rapid/press-release_IP-17-2401_en.htm [May 2019]

- The EU unemployment rate has registered a lowering trend, decreasing towards pre-crisis level, establishing at 8.2% in 2017[74]. However, the number of jobless people within the Union still represents an important concern for the EU economic governance, since it is not comparable with the unemployment rate of the most important competitor in the international scenario, the United States of America, which have registered an unemployment rate half the percentage of the EU[75]. Furthermore, youth unemployment still registered concerning levels, leading the President of the Commission Jean Claude Juncker to state that the next generations of European citizens could be the first one less wealthy then the previous one since WW2[76].



Source: European Commission[77]

In this scenario of economic recovery of the European Union, the ending of the third Greek bailout programme, which terminated officially in August 2018, represented the perfect timing for an evaluation of the development and implementation of the EFSF first, and then the ESM, which represent two milestones of the economic reform undertaken by the EU (but in particular the European Monetary Union) after the 2008 recession.

3.1.1 The mission of the EFSF and ESM

In order to evaluate the role played by the EFSF and the ESM since their establishment, understanding the mission of those institution is fundamental; the EFSF and the ESM were arranged in order to provide a financial backstop to the Eurozone menaced by an economic contagion after the inability to answer to the bubble burst started in the US. In addition, the Eurozone was characterised by the impossibility to enact any kind of crisis management policy due to premises such as the no-bailout clause and the non-existence of a tool

[74] European Commission, *White Paper On The Future Of Europe: Reflections and scenarios for the EU27 by 2025,* Brussels, European Commission COM(2017)2025, March 2017, 8 – 15
[75] P. S. Goodman (2016), *Europe's Economy, After 8-Year Detour, Is Fitfully Back on Track*, The New York Times [Online] Available at https://www.nytimes.com/2016/04/30/business/international/eurozone-economy-q1.html [May 2019]
[76] Jean Claude Juncker, *State of the Union Address 2016: Towards a better Europe - a Europe that protects, empowers and defends,* European Commission – Speech, Strasbourg, 14 September 2016
[77] European Commission, White Paper On The Future Of Europe: Reflections and scenarios for the EU27 by 2025, Brussels, European Commission COM(2017)2025, March 2017, 9

to allow debt restructuring. Before the institutionalization of the EFSF and the ESM, euro area countries in financial distress would have referred their needs to the IMF, which through had history of financial aid programmes only for countries not even comparable with euro area states economically speaking. Furthermore, the structure and rules of the IMF, for example regarding the voting system, made almost impossible for the institution to manage the financial difficulties of the Eurozone on its own.

The efforts made by the leaders of the Eurozone member states and the members of the European institutions to deliver crisis management instruments resulted in the formation of a permanent mechanism, whose funding (€700 billion) and structure is able to single handedly develop economic adjustment programmes (Spain's banks recapitalization), lead financial aid plans (as in the case of Greece's several bailouts), and compete with the IMF. Indeed, not only the financial capabilities of the EFSF and ESM, which allowed them to help five eurozone countries, but also the longer maturity and the convenient interest rates of the loans delivered by such mechanisms made them preferable than the programmes arranged by the IMF.

3.1.2 EFSF/ESM programme outcomes

As highlighted in the previous chapters, several member states undertook inappropriate economic policies, in particular due to the relevant optimism observed during the first years after the implementation of the euro. Following the mission of the European leaders who believed and then concretized the monetary union, the Eurozone seemed a solid, irreversible and progressive currency area until the Great Recession. Furthermore, the effects of the crisis were exacerbated by the lack of economic surveillance, especially regarding the macroeconomic imbalance and banking sector supervision; a circumstance defined by the economist Peter Temin as the Eurozone which "talked the talk, but didn't also walk the walk".[78] The consequences of inadequate anti-cyclical economic policies and the inability by the European institutions to check over the financial activities of the member states resulted in increased vulnerability of several sovereign states, in particular between 2008 and 2012. The ESM devised a vulnerability score according to 50 vulnerability indicators based on six dimensions, which covered from the government debt structure to its fiscal position, from the health of the banking sector to the private leverage, from the economic strength of the state to its institutional parameters. The increased national economic vulnerability witnessed in certain areas of the Eurozone spotted by several international agencies was not followed back by sufficient national policies counteracting the deterioration of the financial framework, which finally led increasing borrowing costs, the degradation of confidence, and finally the exit from the international financial markets. At that point, official financial assistance was the only viable option for national authorities.

[78] B. Eichengreen, P. Temin, *Fetters Of Gold And Paper,* Cambridge (MA), National Bureau Of Economic Research Paper Series, July 2010., 19

Such economic aid was not conceived in the European economic governance until the formation of the EFSF first, and then the ESM. 5 countries were aided from 2010 to 2018: Greece, Ireland, Portugal, Cyprus and Spain. Each state was affected by the financial crisis in different ways (Spain, Ireland and Cyprus saw their banking sectors heavily harmed, while Portugal and Greece payed their macroeconomic and external imbalances), but all of them had to deal with fragile fiscal systems and structural issue regarding pension systems and the labor market. The table below, based on ESM calculations of the six dimensions of the vulnerability score, shows that the vast majority of the variables have witnessed an increase thanks to the ESM adjustment programmes, which demonstrates that the pre-intervention analysis made by the Troika authorities on the economic situation of the beneficiary states were predominantly correct, and resulted in adequate conditionalities for the national authorities to be implemented in order to improve the internal financial situation.

Sources of sovereign vulnerabilities

	Last pre-intervention year					Latest available data					Rest of euro area
	IE	PT	EL	ES	CY	IE	PT	EL	ES	CY	
	2010	2010	2011	2012	2012	2016					2016
Overall vulnerability score	2.0	1.9	1.6	1.9	1.8	2.7	2.0	1.8	2.1	2.1	2.7
1 Government borrowing needs, conditions and debt structure	1.6	2.2	1.9	1.9	2.2	2.9	1.7	1.5	2.1	2.0	2.7
2 Economic strength	2.7	1.9	1.6	2.0	1.8	3.3	2.3	2.0	2.5	2.0	2.6
3 Fiscal position	1.8	1.1	1.2	1.7	1.3	3.1	2.1	2.4	1.8	2.6	2.8
4 Financial sector and other contingent liabilities	1.3	2.0	1.7	1.7	1.3	2.2	2.0	1.8	2.3	2.3	2.9
5 Institutional parameters	3.1	2.0	1.0	2.3	2.2	3.5	2.4	1.3	2.2	2.2	2.7
6 Private leverage, credit & real estate	1.5	2.1	2.1	1.7	1.5	1.2	2.1	2.1	1.9	2.1	2.3

Score	1.0 to 2.0	2.0 to 2.5	2.5 to 3.0	3.0 to 4.0
Vulnerability	High	Elevated	Moderate	Low

Source. European Stability Mechanism[79]

Despite the accomplishments achieved by the EFSF/ESM interventions, as shown by the previous table, national authorities must continue the path established by the programmes, since every beneficiary country still display high rate of vulnerability. In addition to the data collected, the programmes were conceived by the ESM not just as short-term crisis management tools, but rather as long-term policies, which envisaged continuous efforts to re-establish the soundness of the economy of the beneficiary countries by the national authorities.

[79] European Stability Mechanism, *EFSF/ESM Financial Assistance Evaluation Report,* Luxembourg, Publications Office of the European Union, 2017, doi:10.2852/187211, 22

Such assessment has not been fully pursued by governments, and not fully understood by the public opinion, which considered the Troika intervention as a menace towards the sovereignty of the state in the name of international investors, interest rates and public debt[80].

Despite the criticism moves towards the intervention by the EFSF and the ESM with other official partners, many accomplishments have been recorded regarding the financial aid programmes: indeed, the median rate of economic growth of the countries involved in EFSF/ESM adjustment programmes has exceeded the median rate of the rest of the euro area, peaking 1.4% of differential in GDP growth in 2016. The fiscal deficits position of all the five countries involved in ESM programmes has been significantly improved, jointly with the debt-to-GDP ratio. Unemployment rates have been moving downwards steadily since 2014, but the ratio is still considerably high[81].

Specifically speaking, Spain, Ireland, Cyprus are widely considered the relevant examples of success of EFSF/ESM intervention.

- The Spanish programme consisted in the recapitalization of the banking sector, and the results over the restricting of the Spanish financial institutions are clear: the Spanish banking sector is increasingly dense (60% of total assets at the end of 2014 are detained by four major institutions), the lending activities have started an upward trend since 2014 (due also to decreasing interest rates and the OMT scheme set up by the ECB), and the ratio of non-profitable loans (NPL) witnessed a significant drop in 2014 (47%), which slowed down in 2015 and 2016. In addition, the funding of Spanish banks started a diversification path, slowing down the reliance on central banks support and increasing the loan-to deposit ratio and the access of Spanish banks in the market at the same time[82].
- As regards Ireland, which faced an economic drought mostly caused by the 2008 financial crisis and the external exposition of its banking sector, the adjustment programme boosted the deleveraging of the public and private sector, the restructuring of financial institutions and the fiscal consolidation of the state. The growth registered during the period of activity of the EFSF rescue package was initially checkered (Ireland re-entered in recession 2011) but recorded a positive trend ultimately. After the end of the programme in 2013, Ireland experienced high levels of economic growth, demonstrated by increase in GDP of 4.8% registered in 2014[83]. Early after the termination of the financial aid by the ESM, the growth was bolstered by the benign conditions of the international market, due to the high levels of FDI in Ireland's economy and the income produced by net exports. Indeed, the current account

[80] J. Clifton, D. Diaz Fuentes, A, Lara Gomez, *The Crisis As Opportunity? On The Role Of The Troika In Constructing The European Consolidation State,* Cantabria, The Jean Monnet Working Paper 1/18, August 2018
[81] European Stability Mechanism, *EFSF/ESM Financial Assistance Evaluation Report,* Luxembourg, Publications Office of the European Union, 2017, doi:10.2852/187211
[82] European Commission, *Evaluation of the Financial Sector Assistance Programme – Spain 2012 – 2014*, Luxembourg, Publications Office of the European Union, 2016, doi:10.2765/119310, 21 – 56
[83] European Commission, *Ex post Evaluation of the Economic Adjustment Programme Ireland, 2010-2013*, Luxembourg, Publications Office of the European Union, 2015, doi:10.2765/520289

balance registered constant surpluses from 2010 to 2016[84]. Eventually, the positive effects of external trade resulted in increasing employment and wage rates, boosting domestic demand, which faced a relevant slump between 2008 and 2010, to become the main driver of the GDP growth.

Despite the important results obtained by the Irish economy during the programme and afterwards, serious challenges impose the continuation of the efforts by the government, in particular regarding the deleveraging of the public sector, which, in contrast with the private sector, has witnessed a rise in the public debt from 91% in 2010 to 120% in 2013[85]. Furthermore, Ireland remains highly exposed to external factors, in particular economic slumps of close economic partners (namely EA19 and the UK).

- Cyprus entered the ESM programme in 2013 in a dramatic situation of macroeconomic imbalances, external exposition and oversizing of the banking sector. The conditionality imposed by the Troika (see section 2.2.2) focused on the restructuring of the financial sector and structural reforms of the labor market. Cyprus followed the requested revisions and from since 2015 its economy has been growing at higher rates in comparison with the other euro area countries. Cypriot authorities made important efforts regarding fiscal consolidation, which resulted in the transformation of a fiscal deficit of 6% in 2013 into a surplus of 1.8% in 2017, leading the debt-to GDP ratio to drop below 100% in the same year.

Spain, Ireland, Cyprus represent successful examples of how a financial backstop tool devised by the Eurozone has actually helped several countries to overcome their economic difficulties and re-establish themselves on a sound path towards economic growth and fiscal consolidation. However, ESM managers argue that efforts should be continued after the end of the programmes and the presence of the Mechanism in the countries, especially regarding the advancement of structural reforms, which is usually very slow. Indeed, the example of Portugal represents the epitome of how slowing down reforms can partially prejudicated the outcomes of the programme

- Portugal faced a situation similar to the one witnessed in Greece when it entered the programme, with low GDP growth rates and low productivity. Furthermore, Portugal resulted highly exposed due to its external indebtedness. Unsound public finances and a banking sector which was cut out form international financial markets made government authorities to request a financial aid programme to the EFSF (together with the IMF and the EFSM) which lasted from 2011 to 2014. In this period, Portuguese authorities managed to introduce important fiscal reforms, which allowed the state to make significant improvements in fiscal consolidation, but focusing mainly on the revenues side of the structural balance sheet, while expenditure remained almost untouched. Such attitude reflects the general difficulties by national authorities in introducing evenly the structural reforms requested in the

[84] Data extracted from Trading Economics [Online] available at https://tradingeconomics.com/ireland/current-account-balance-percent-of-gdp-wb-data.html

[85] European Commission, *Ex post Evaluation of the Economic Adjustment Programme Ireland, 2010-2013*, Luxembourg, Publications Office of the European Union, 2015, doi:10.2765/520289

MoU by international partners. Labor market reform was adequately introduced, but the same cannot be said for the product market reform. Such deficiencies, together with the incautious early exit from the financial aid programme, have led the Portuguese public debt to reach its peak in 2014[86]. However, the Portuguese economy recorded important improvements since 2015, accelerating by 1.6% in 2015, 1,8% in 2016 and 2.7% in 2017. Portuguese public debt started decreasing in 2017, and it is expected to continue this downward spiral in 2018. This improvements are reflected by the upgrading experienced by Portuguese government bonds in the last 2 years from rating agencies, and by the fact that bond yields are recording low levels towards their German counterparts (152 basis points in 2017) and went into negative territory for the first time since the start of the crisis in comparison with Italian BTP[87]. Despite the positive trend undertaken by the Portuguese economy, the Commission and the ESM highlight the importance of increasing the efforts regarding structural reforms, in particular regarding investments and the productivity sector, in order to avoid external factors undermining the economic performances of Portugal.

3.2. Criticisms towards the ESM

The economic performances registered by the states which benefited from the financial aid received from the ESM suggest that the toolkit devised by the European economic governance as a backstop against important financial crisis is efficient and effective. However, all that glitters are not gold: indeed, several criticisms have been moved towards the ESM, most of them related to the intervention in Greece. Last but not least, the President of the Commission Jean Claude Juncker made a remark sustaining that no other state in the euro area should ever be treated as Greece during its sovereign debt crisis and that the EU shown an unacceptable lack of solidarity[88]. Nonetheless, the ESM cannot be considered the only responsible (maybe not even the main responsible) for the economic disaster and the consequent social turmoil happened in Greece; but the Greek example can be taken as a fundamental benchmark in order to analyze the flaws present in the most important crisis management instrument in Europe.

3.2.1 The austerity measures

The question regarding the effectiveness of the new economic policy based on austerity measures undertaken by the European Union, and in particular by the Eurozone, after the 2008 crisis is still a topic of debate within academics and the public opinion.

[86] European Commission, *Ex Post Evaluation of the Economic Adjustment Programme Portugal, 2011-2014,* Luxembourg, Publications Office of the European Union, 2016, doi:10.2765/257396
[87] European Stability Mechanism, *2017 Annual Report,* Luxembourg, Publications Office of the European Union, 2018, doi:10.2852/890540
[88] Jean Claude Juncker, *Discours par le Président Juncker en plénière du Parlement européen à l'occasion de la séance solennelle pour célébrer le 20e anniversaire de l'euro,* Strasbourg, 15th of January 2019

Austerity can be defined as a combination of policies set up by governments in order to control their public sector debt, which is approaching, or it has already experienced serious risks of default and insolvency. Such measures alter the social conditions of the population affected by austerity policies, with increases in unemployment and taxes which reduce the general level of consumption, as seen earlier with regard to the criticism on the protection of human rights within the MoU of the economic adjustment programmes of the ESM. However, the financial crisis and the subsequent sovereign debt crisis witnessed within the EU has represented the perfect window of opportunity both for national authorities to pursue policies which in times of economic growth would be met with opposition[89], and for EU policymakers to increase EU integration, with EU institutions more and more involved in domestic affairs, particularly when referring to national budgetary situations[90]. The changes witnessed from the eruption of the crisis in the EU economic governance and in the process of economic and fiscal integration within the Eurozone countries is in the public eye: the reform of the Stability and Growth Pack, with the 2011 Six Pack and the 2013 Two Pack and Fiscal Compact have increased the degree of fiscal consolidation within the euro area, with several countries introducing in their constitutional documents the "balanced budget principle", which is strictly connected with the possibility to produce austerity measures.

The crisis led the EU to introduce new institutions to avoid and prevent future crisis: the ESM, being the permanent stability mechanism of the Eurozone, is the institution in charge of financially help countries in economic difficulties. As seen earlier, in doing so, the ESM, delegating the negotiation procedure to the Commission and the technicalities to the ECB, requires conditionality to be respected in order to receive the tranches of the loans: the policies which beneficiary states are required to implement procyclical policies (spending cuts or tax increases in periods of recession), which in periods of recession means measures in order to prevent the reappearance of the economic bust, but which do not boost the economy in the short term[91]. The ESM appeared immediately very keen on the strict adherence to rules-based fiscal consolidation as a way for beneficiary states to match once again the preferences of sovereign bond market. What has been analyzed also in the previous chapters is that the ESM managed to restore the confidence in the international financial markets over a state in 4 out of 5 interventions, with the exception (for the moment) of the Greek case. Indeed, the president of the ECB himself Mario Draghi has stated that "Austerity worked in Portugal, Ireland, Spain. Even Cyprus is showing clear signs of recovery". The data seems to sustain Draghi's point of view: as shown in the table below, the debt-to GDP-ratio in the countries which have benefitted from the ESM have remained on a stable trend, helping the European Union to witness a period of recovery in the last 4 years.

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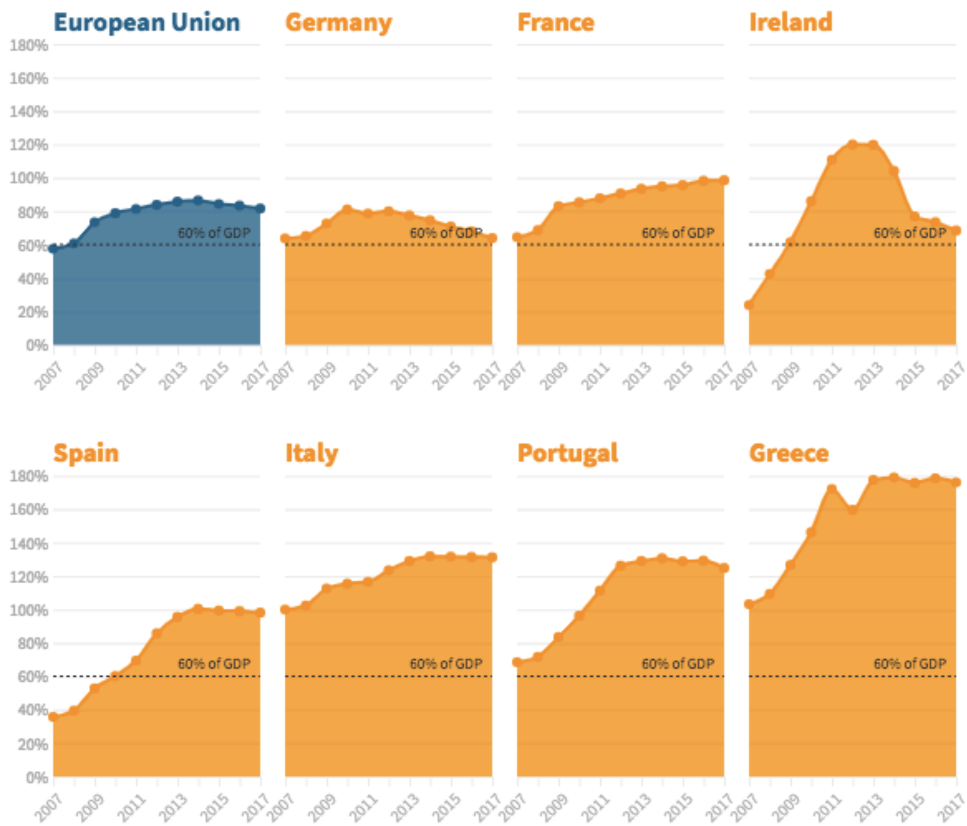
[89] C. Moury, A. Freire, *Austerity Policies and Politics: The Case of Portugal,* Montpellier, Pôle Sud: Revue de science politique de l'Europe méridionale, 2013/2 (n° 39), 2013, 35 – 56
[90] E. Heins, C. de la Porte. *The sovereign debt crisis, the EU and welfare state reform*, Comparative European Politics 13.1 (2015): 1-7. DOI: 10.1057/cep.2014.38
[91] C. Ban, *Austerity Europe, Keynesian Europe: The Politics of Debt and Growth in the European Union*, Boston, The Frederick S. Pardee for Global Studies Boston University



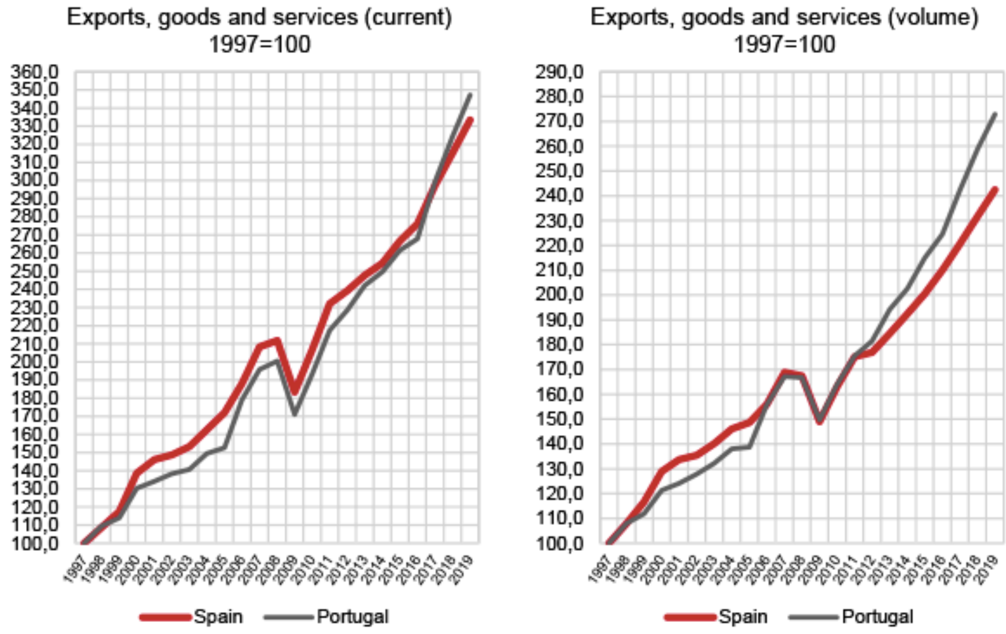
Source: CNBC[92]

Furthermore, as noted by the economist Daniel Gros, European peripheral countries which have undertaken a path of fiscal consolidation (with or without the intervention of the ESM) and have proven their capacity for adjustment, by reducing their fiscal deficits, expanding exports, and moving to current-account surpluses, thereby negating the need for further financing.[93] Exports in particular can be attached to the successful examples of the recovery of Spain and Portugal, which have suffered the consequences of the financial crisis, and after introducing harmful austerity measures, finally they have succeeded in re-establishing appositive trend in their economy, with a constant increase in the levels of exports as an important contributor in the GDP growth of the two Iberian countries[94].

[92] A. Tzortzinis (2018), *Are we witnessing the end of austerity — and what does that mean for Europe?*, CNBC [Online] Available at https://www.cnbc.com/2018/12/05/austerity-over-in-europe-greece-what-does-that-mean-for-the-region.html [May 2019]

[93] D. Gros, *The Greek Austerity Myth,* Brussels, Centre for European Policy Studies, February 2015

[94] D. Gros (2015), *Why Greece is different,* Project Syndicate [Online] Available at https://www.project-syndicate.org/commentary/greece-export-problem-by-daniel-gros-2015-05?barrier=accesspaylog [may 2019]



Source: Real Instituto El Cano[95]

However, austerity measures introduced through ESM economic adjustment programmes have provoked numerous criticisms, not only over the actual effectiveness, but also on the timing and the persistence of such policies. Indeed, despite the reasonably positive results achieved by the countries which received financial aid from the ESM referring to the debt-to-GDP ratio, the same cannot be said when analyzing the unemployment rate, which remains extremely high (especially youth unemployment, prompting the attention of the Commission, as stated by the President Juncker in the "White paper on the future of Europe".[96] Hence, no experience guided by the ESM can be taken as a model to be transposed in other scenarios. In addition, the fiscal multiplier has been evaluated to be much higher during the economic downturns than in normal times, which means that austerity exacerbate the fiscal effects of recession rather than alleviating them[97].

Furthermore, the effects of austerity measures are still debated within the academics, and a universal approach is still far from being developed. In particular, economists agree that adjustment programmes based on expenditure cuts are less harmful than the ones based on increasing taxes. In addition, if economic adjustment programmes are accompanied by spending-based policies the negative effects of austerity measures are alleviated or even eliminated. However, the effectiveness of austerity measures is represented also by the diversification of austerity programmes according to the analysis of the economic variables of each state: if recession is caused by high levels of private debt, or by the mismanagement of public finances, or by a crisis in the balance sheet of a country, the design of the reaction policies must be diversified. Usually, a gradual fiscal consolidation is preferred, since it undermines the negative effects in the short-term and exacerbates the

[95]S. Puig, A. Sanchez (2018), *Portugal versus Spain: an Iberian economic saga,* Real Instituto El Cano [Online] Available at http://www.realinstitutoelcano.org/wps/portal/rielcano_en/contenido?WCM_GLOBAL_CONTEXT=/elcano/elcano_in/zonas_in/ari96-2018-puig-sanchez-portugal-versus-spain-iberian-economic-saga [May 2019]

[96] European Commission, White Paper On The Future Of Europe: Reflections and scenarios for the EU27 by 2025, Brussels, European Commission COM(2017)2025, March 2017, 8 – 15

[97] J. Van Reenen, *Fiscal consolidation: Too much of a good thing?*, cited in G. Corsetti, *Austerity: Too Much of a Good Thing? A VoxEU.org eCollection of views by leading economists*, London, Centre for Economic Policy Research, 2012, 55 – 65

positive externalities in the long-term. However, when the public debt and deficit reaches extremely dangerous levels (as in the case of Greece), rapid and strong interventions are almost obliged in order to avoid defaults and the total exclusion from the financial markets[98].

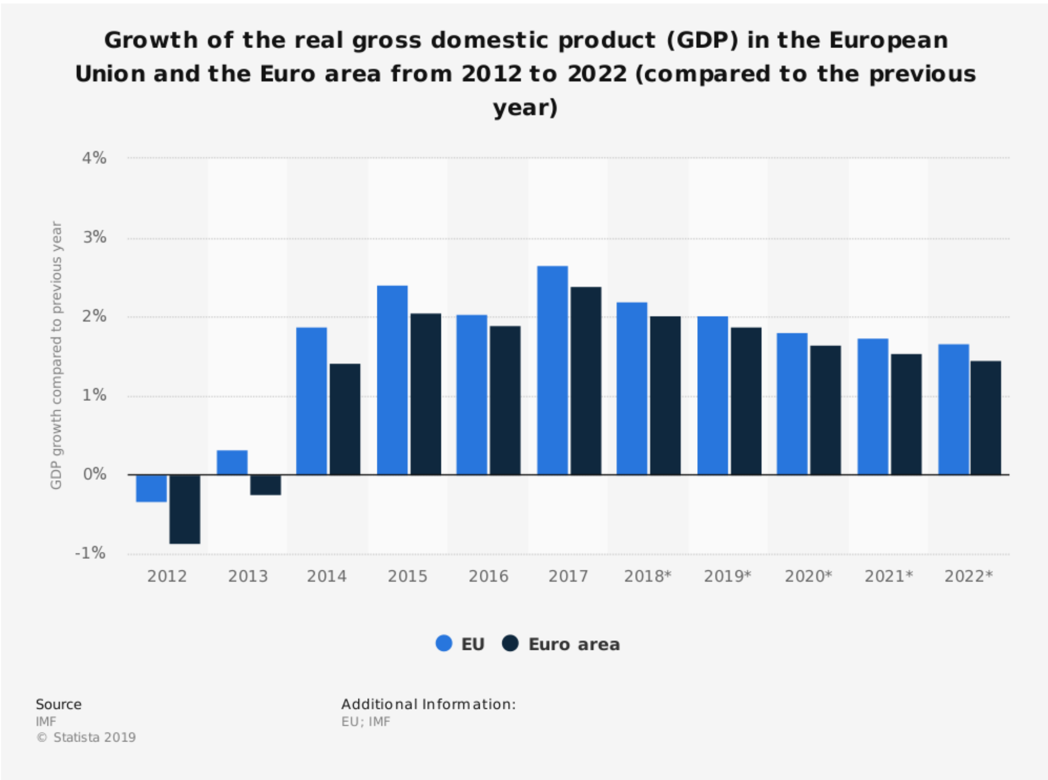
These assumptions can be hardly found within the EU fiscal framework: indeed, the Union leaders decided to commit towards a "'one-size-fits-all' fiscal-consolidation model, making extremely difficult to diversify the modus operandi of the ESM and the Commission when formulating the economic adjustment programmes of the countries requesting financial help. The different attitude by the Troika in Greece, where the inadequate implementation of the austerity measures by national authorities was followed by harsher demands in more limited span of times, in comparison with Ireland, where the Troika was more condescend probably because of the similarities of the Irish economic models with the ones of the European creditor countries (Germany, Netherlands, Belgium).[99] The automatic rules which constitute the EU fiscal framework must be acceptable and easily applicable to every state, and despite allowing a degree of flexibility for every state in relation to fiscal consolidation, the principles behind the EU fiscal framework developed during the crisis seems to halt the possibilities for countries with unsound finances to improve their economic performances.[100]

From 2011, questions regarding the effectiveness of austerity measures in Europe concentrated also on the possibility of contractionary policies being "self-defeating". Austerity implies an increase in taxes and cuts in public spending in order to reduce the budget deficit and the debt-to-GDP ratio. However, some economists maintain that the negative impact of the austerity policies may be so harmful that the actual effect on the public debt would be the opposite of the expected one. The reason for this assumption relies on the fact that during economic downturns, unemployment is high and job security low, leading households and firms are to have liquidity problems. The effects of fiscal consolidation in Europe are exacerbated by the high degree of trade relations within states; hence, a trend towards austerity reduces national outputs, causing a spillover effect in the EU[101]. In order to avoid the self-defeating effects of the austerity measures, it should be evaluated whether it is possible to boost the demand in other ways. However, in Europe such possibilities are limited: indeed, the change in the monetary policy through the cut of the interest rate could not be pursued due to the already negative level of interest rate. Furthermore, the devaluation of the currency for EU member states is not an option, while export-led growth has not been possible in all countries, as the Greek example shows[102]. Despite the criticism towards the self-defeating nature of austerity programs, it should be underlined that, as stated by

[98] M. Buti, L. R. Pench, *Fiscal austerity and policy credibility*, cited in G. Corsetti, *Austerity: Too Much of a Good Thing? A VoxEu e Collection of views by leading economists*, London, Centre for Economic Policy Research, 2012, 45 – 55
[99] J. Clifton, D. Diaz Fuentes, A, Lara Gomez, The Crisis As Opportunity? On The Role Of The Troika In Constructing The European Consolidation State, Cantabria, The Jean Monnet Working Paper 1/18, August 2018
[100] M. Buti, L. R. Pench, *Fiscal austerity and policy credibility*, cited in G. Corsetti, *Austerity: Too Much of a Good Thing?*, London, Centre for Economic Policy Research, 2012, 45 – 55
[101] D. Holland, J. Portes (2012), *Self-defeating austerity?*, Centre for Economic Policy Research [Online] Available at: https://voxeu.org/article/self-defeating-austerity [May 2019]
[102] J. Portes (2012), *Is austerity self-defeating? Of course it is*, Centre for Economic Policy Research [Online] Available at: https://voxeu.org/debates/commentaries/austerity-self-defeating-course-it [May 2019]

Daniel Gros, the possibility of a rise in the debt-to-GDP ratio is plausible in the short term due to the multiplier effect of some contractionary measures, which causes a myopic reaction of risk premia on the part of financial markets. However, such increase in the debt ratio would be followed by an opposite movement, with the multiplier effect which fades away and the effects of the austerity measures contained in the adjustment programmes which improve the situation of the primary balance[103].

Another problem is whether the excessive length of austerity problems can be considered as one of the causes of the slower growth witnessed in eurozone countries, in comparison with not only other regions of the world, but also with the EU in general, as shown in the table below.



Source: IMF[104]

The process of fiscal consolidation envisioned in the EU since the 2008 financial crisis has been continuous for 10 years, and several economists and political leaders required EU policymakers to slowdown such consolidation procedures in order to allow governments to undertake expansionary measures and boost economic growth. Some academics argue that the gap between potential output and actual output in the Eurozone which cannot be matched by monetary policies devised by the ECB. Such gap is caused by negative rates in demand and by the negative shock on supply witnessed after the crisis and which has caused a drop in

[103] D. Gros (2011), *Can austerity be self-defeating?,* Centre for Economic Policy Research, [Online] Available at: https://voxeu.org/article/can-austerity-be-self-defeating [May 2019]
[104] International Monetary Fund (2019), Real GDP growth, IMF [Online] Available at: https://www.imf.org/external/datamapper/NGDP_RPCH@WEO/OEMDC/ADVEC/WEOWORLD [June 2019]

the productivity of several Eurozone countries witnessed between 2011 and 2013, namely the period where most of the reforms towards fiscal consolidation were introduced.[105]

Despite having being challenged by political leaders, economists and the public opinion, the data signaled that austerity measures have reached the aim to reduce the public debt and deficits of the countries which have implemented them efficiently, but most importantly have brought those structural reforms which have revised the unsound management of finances envisioned form the introduction of the euro until the 2008 financial crisis in those states which have requested the help of the ESM.

3.2.2 The role of the IMF

However, the inquiries over whether the austerity has "gone too far" in the euro area have reached also the IMF, which in 2016 publicly criticized the ESM regarding the new austerity measures to be introduced in Greece, because it would hold back the signs of recovery displayed by the Hellenic Republic.[106] The IMF started considering the possibility of a debt restructuring in Greece rather than the hardening of the fiscal consolidation process[107]. Furthermore, the International Monetary Fund has raised the question whether austerity actually does more harm than good: indeed, they challenge the fact that while fiscal consolidation may produce a boost in the economy and the stabilization of public debt and deficit in the long term, that results are counterbalanced by the costs of deepening inequalities and increasing unemployment rates[108].
When analyzing the relationship between the European Stability Mechanism and the IMF, it must be taken in consideration the nature of the ESM, which is namely a Regional Financing Agreement (RFA), defined in the ESM discussion paper *IMF–RFA collaboration: motives state of play, and way forward* as "a crisis prevention or resolution mechanism for a defined region or a group of countries sharing similar economic characteristics and mandated to provide emergency liquidity to its member countries".[109] Various RFAs had been already set up when the ESM came into place in the euro area, as for example the Arab Monetary Fund (AMF) and established cooperation mechanisms with the IMF, which is largely considered as the global lender of last resort. However, the formation of RFAs peaked after the 2008 financial crisis, not only with the development of the ESM; but also, with the creation of the ASEAN+3 Macroeconomic Research Office (AMRO), the BRICS Contingent Reserve Arrangement (BRICS CRA) and many others. All these crisis

[105] J. Van Reenen, *Fiscal consolidation: Too much of a good thing*?, cited in G. Corsetti, Austerity: Too Much of a Good Thing? A VoxEU.org eCollection of views by leading economists, London, Centre for Economic Policy Research, 2012, 55 – 65
[106] M. Obstfeld, P. M. Thomsen (2016), *The IMF is Not Asking Greece for More Austerity*, International Monetary Fund [Online] Available at: https://blogs.imf.org/2016/12/12/the-imf-is-not-asking-greece-for-more-austerity/#more-1584 [May 2019]
[107] C. Ban, *Austerity Europe, Keynesian Europe: The Politics of Debt and Growth in the European Union*, Boston, The Frederick S. Pardee for Global Studies Boston University
[108] L. Elliott (2016), *Austerity policies do more harm than good, IMF study concludes*, The Guardian [Online] Available at: https://www.theguardian.com/business/2016/may/27/austerity-policies-do-more-harm-than-good-imf-study-concludes [May 2019]
[109] G. Cheng, D. Mernik, Y. Barnieh, B. Han, I. M. Sari, F. Q. Pang, T. Kostanyan, A. Efimov, M. Houdart, A. de Carvalho, C. Giraldo, V. Monroy, *IMF–RFA collaboration: motives, state of play, and way forward: A joint RFA staff proposal,* Luxembourg, European Stability Mechanism, ESM Discussion Paper Series, 4 – Special Issue, October 2018, 5

management instruments, while being different due to the heterogeneity of the regions in which they operate, share similar visions and procedures regarding crisis prevention modalities and financing.[110]
As stated earlier, the ESM represents the first permanent instruments for crisis management introduced in the Eurozone economic governance. However, similar instruments were already present in the EU economic framework: the EU Balance of Payment assistance, which offers financial aid to Eu countries threatened by economic difficulties, and the EU Macro-Financial Assistance (MFA) to non-EU partner countries, which instead extends the possibility to take advantage of financial rescue packages also to non-EU countries which are partner of the Union and face a balance of payments crisis. Both instruments are managed by the European Commission and have been implemented several times; beneficiary states of the EU BoP assistance are Romania, Hungary and Latvia[111], while the MFA was requested by the Armenia, Jordan, Tunisia, Ukraine and others[112].

After the eruption of the European sovereign debt crisis though, the EFSF initially, and then the ESM became the most relevant crisis management tools in the EU, but in particular in the euro area, and the IMF immediately turned into the most influential international partner of both mechanisms in the economic adjustment programmes which took place from 2010 until now. The collaboration between the IMF and the EFSF/ESM does not stop to financing economic aid programmes, but encompasses also joint training programmes, capacity building projects with member states countries in order to improve their management of sectors such as debt sustainability and public finances. Due to the total inexperience of the euro area economic governance regarding the management of economic droughts such as the one exploded after the failure of Lehman Brothers, the IMF brought important technical advice to the newly born European institution[113].

Most importantly, the relation between the EFSF/ESM and the IMF represent a unique case when focusing on the in-crisis collaboration. Indeed, no other RFA has such an institutionalized form of in-crisis collaboration as the IMF and the ESM have, which is codified in the ESM Treaty. The connection between IMF and ESM ranges from financing cooperation to the negotiation of the conditionality and the monitoring of the compliance, jointly with the Commission and the ECB: such expansive linkage led to the common definition of the joint economic intervention of the IMF, the EC and the ECB is famously defined as the "Troika"[114].

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[110] *Ibidem*
[111] The Council of the European Union, *COUNCIL REGULATION (EC) No 332/2002 establishing a facility providing medium-term financial assistance for Member States' balances of payments,* Brussels, Official Journal of the European Communities, L/53/1, 18 February 2002
[112] European Commission, *Report from The Commission to The European Parliament and The Council on the Implementation of Macro-Financial Assistance to third countries in 2017*, Brussels, COM(2018) 511 final, 29th of June 2018
[113] G. Cheng, D. Mernik, Y. Barnieh, B. Han, I. M. Sari, F. Q. Pang, T. Kostanyan, A. Efimov, M. Houdart, A. de Carvalho, C. Giraldo, V. Monroy, IMF–RFA collaboration: motives, state of play, and way forward: A joint RFA staff proposal, Luxembourg, European S Stability Mechanism, ESM Discussion Paper Series, 4 – Special Issue, October 2018, 21
[114] *Ibidem, 15*

However, the relationship between the two institutions has been deteriorating since the transformation of the provisional EFSF into the permanent crisis management tool the ESM. As maintained in the ESM Discussion Paper, the EFSF had limited operational functions and it was deemed as a mere “cash machine, raising money and disbursing loans”.[115] On the contrary, the ESM, due to its permanent nature and the taking advantage from the experience collected from working side to side with the IMF, started being involved in more operative tasks, such as the negotiation of the third economic adjustment programme in Greece. Indeed, Klaus Regling, the managing Director of the ESM, was added to the Troika composed by the ECB governor Mario Draghi, the EC President Jean-Claude Juncker, and the IMF President Christine Lagarde, forming the so-called “Quadriga” [116], which did not enhance the cooperation between these institutions though.

The detachment within the ESM and the IMF has caused several issues in the relations within two institutions which are now considered the two most important lender of last resorts for nation states. The dispute over the debt restructuring of Greece, sponsored by the IMF, and the development of the third economic adjustment programme, wanted by the ESM, was explained by the Managing Director of the ESM Klaus Regling with the different timing of repay the two institutions have imposed on the Hellenic Republic and the preferred creditor status enjoyed by the IMF: indeed, the maturity of the IMF loans is 10 years, while the one of the ESM loans is 32 years. Such long maturity, according to Regling, represents an indirect debt restructuring which the ESM have conceded to Greece, without actually reducing the nominal value of the debt-to-GDP ratio[117]. The different attitude noticed in the development of the Greek economic adjustment programme denoted the difference not only in the economic, but also in the philosophical approach of the two institutions: the ESM demonstrated to be stick to the economic rules of the Eurozone, which foster fiscal consolidation, while the IMF finally resorted to the sovereign bond market solution, which instead was not considered by the European counterpart.

[115]G. Cheng, D. Mernik, Y. Barnieh, B. Han, I. M. Sari, F. Q. Pang, T. Kostanyan, A. Efimov, M. Houdart, A. de Carvalho, C. Giraldo, V. Monroy, IMF–RFA collaboration: motives, state of play, and way forward: A joint RFA staff proposal, Luxembourg, European S Stability Mechanism, ESM Discussion Paper Series, 4 – Special Issue, October 2018, 16

[116] Klaus Regling, *Strengthen stability: further development of the ESM in a deepened monetary union*, speech at the Parliamentary evening of the association of German savings banks (DSGV), Brussels, 17th October 2018, [Online] Available at: https://www.esm.europa.eu/speeches-and-presentations/strengthen-stability-further-development-esm-deepened-monetary-union [May 2019]

[117]C. Ban, L. Seabrooke, *From Crisis to Stability: how to make the European Stability Mechanism Transaparent and Accountable*, Brussels,Transparency International EU, 2017

3.2.3 The mismanagement of the Greek crisis

Greece is generally considered the main protagonist of the European sovereign debt crisis; so important that the fear of the contagion effect resulted from the Hellenic debt crisis led European leaders to finally endorse the development of a crisis management tool within the Eurozone and conceive the temporary EFSF, and finally the permanent ESM[118]. The ESM economic adjustment programmes in Greece are widely considered as the most complex and comprehensive interventions within the EFSF/ESM activities in euro area countries: for example, the first economic adjustment programme document drafted by the European Commission in 2010 and which comprehended the request made towards Greek national authorities was 1,800 pages long. The same document for the economic adjustment programme in Ireland was just 900 pages long. Obviously, the length of the documents is not the focal point of the criticism: however, the demands made by the ESM through the Commission towards the beneficiary states are all very similar (fiscal consolidation, debt relief, structural reforms) and did not take in consideration the different economic framework in which these demands should have been implemented. The requests made to Ireland were very similar to measures which have been already undertaken by the national authorities before the EFSF intervention. On the other hand, the implementation of the EFSF/ESM programmes in Greece was far more complicated due to the enormous differences between the point of view of the European lenders and the economy on the ground in Greece.

The main criticism regarding the management of the Greek economic adjustment programme regards the privatization process required by the Commission, the EFSF/ESM and the IMF: as inquired into the three Economic Adjustment Programmes, Memoranda of Understanding and Specific Economic Policy Conditionality Reports related to Greece, the international authorities have been giving increasing prominence to privatization policy, by expanding the revenues from 7 billion from the EFSF programme between 2011-2013 to 50 billion euros in the ESM programme from 2015[119]. Such focus on privatization by the Troika derived on the will to cut the dimensions of the Greek public administration, which experienced high growth rates since the restoration of democracy in 1974, which emerged as the economic locomotive for the entire state but which played the main role in the data scandal regarding the budget deficit in 2009[120]. International lenders listed a series of assets which the Greek authorities should have sold in a specific span of time, which however was not respected. For this reason, the Troika initially ordered the set up Hellenic Republic Asset Development Fund (HRADF) in 2011, and then, after the slow continuation of the privatization process, asked to merge the HRADF with the Public Properties Company (ETAD) into a Holding Company able to work independently from the government.

The privatization policy became immediately deeply unpopular, especially when the assets to sell required by the Troika where made public with timeline and prices; a gesture which was considered a humiliation by the

[118]E. Jones, S. Meunier, D. R. Kelemen, *Failing Forward? The Euro Crisis and the Incomplete Nature of European Integration*, SAGE Journals, Comparative Politics Studies, 2016, Vol. 49(7), 2016

[119] J. Clifton, D. Diaz Fuentes, A, Lara Gomez, The Crisis As Opportunity? On The Role Of The Troika In Constructing The European Consolidation State, Cantabria, The Jean Monnet Working Paper 1/18, August 2018

[120] T. Mavrikadis, D. Dovas, S. Bravou (2018), *Failure Factors of the Economic Adjustment Programme for Greece,* [Online] Available at: https://link.springer.com/content/pdf/10.1007%2F978-3-319-70377-0_10.pdf [May 2019]

public opinion, leading political leaders and people to claim that the programme was more concerned about the interests of the international creditors rather than the ones of the Hellenic Republic and its taxpayers. Furthermore, the implementation of the privatization programme remained elusive and complicated, taking in consideration the dimensions of the private sector in Greece, based on an array of small and medium enterprises, in which 35% of added value is produced by micro-enterprises (businesses with less than 10 employees)[121]. Such composition of the Greek private sector (as displayed by the table below) did not stop the Troika to pursue privatization objectives, with the real estate market being conquered by international investors (Germany invested in the Port of Thessaloniki, China in the Piraeus), while not considering the possibility to modernize the Greek public sector, which produced important results for the country before the eruption of the crisis.[122]

Composition of SMEs in Greece—2008 (in brackets: average for the EU27)

Enterprise category	**Number of enterprises (% of the total)**	**Number of employees (% of the total)**	**Added value (% of the total)**
Micro (1–9 employees)	96.49 (89.8)	58 (28.1)	35 (19.8)
Small (10–49 employees)	3.04 (8.5)	17 (20.5)	20 (18.3)
Medium-sized (50–249 employees)	0.42 (1.5)	12 (18.3)	18 (20.0)
Total SME's	99.95 (99.8)	87 (66.9)	73 (58.1)

Source: Annual report on EU SMEs EIM/European commission/observatory of European SMEs

Source: Springer Proceedings in Business and Economics[123]

The Greek bailout finally managed to undertake the sustainable path with the third the economic adjustment programme, but the social costs for Greece remain extremely relevant: the conditionality imposed by the Troika required high levels of public expenditure cuts, which involved the working situation of more than 1 employee out of 3 in the public administration and in the social services. These initiatives, while bringing the deficit back to surplus in 2017 for the first time since 2009, and restoring an adequate level of competitiveness

[121] T. Mavrikadis, D. Dovas, S. Bravou (2018), *Failure Factors of the Economic Adjustment Programme for Greece*, [Online] Available at: https://link.springer.com/content/pdf/10.1007%2F978-3-319-70377-0_10.pdf [May 2019]
[122] J. Clifton, D. Diaz Fuentes, A, Lara Gomez, *The Crisis As Opportunity? On The Role Of The Troika In Constructing The European Consolidation State*, Cantabria, The Jean Monnet Working Paper 1/18, August 2018
[123] T. Mavrikadis, D. Dovas, S. Bravou (2018), *Failure Factors of the Economic Adjustment Programme for Greece*, [Online] Available at: https://link.springer.com/content/pdf/10.1007%2F978-3-319-70377-0_10.pdf [May 2019]

in the international markets, did not reach all the goals: Greek GDP stopped at levels below 1999 in 2017, while unemployment recorded a negative path but it remains critically high at 19% in 2018 (with youth unemployment at 50%). Furthermore, emigration sharply rose during the post-crisis period, with almost half a million Greek youngsters in between their 20s emigrating to find better working opportunities, most of them having graduated in Greek universities first, causing a "brain drain" which represented an obstacle for the recovery ambitions of the Southern European country[124]. This phenomenon was so influential which defined the third wave of emigration witnessed by Greece, after the ones at the beginning of the 20th century and during the 60s.[125] Those people who decided to remain in Greece, the difficult economic situation made ordinary life difficult for numerous Greek families leading to increasing rates of suicides linked to the economic crisis: suicide rates which climaxed after the eruption of the financial crisis in 2008 and stayed worryingly constant during the EFSF/ESM programmes.

Increasing unemployment, emigration, high costs for the society are factors which can be found in every country which benefitted from the financial aid of the ESM, and can be linked to the devastation caused by the 2008 Great recession and the subsequent European sovereign debt crisis. Indeed, the default situation experienced by Greece has been mostly built domestic structural deficiencies and an extensive mismanagement by the national authorities of the public administration of every sector of the societies (from banking supervision to health and energy), in a way not comparable to the other Member States which entered into an ESM programme. However, as recognized by President Juncker recently, the price paid by Greece has been disproportionate in comparison with the fellow beneficiary states. While the ESM cannot be blamed entirely for the Greek situation, what happened in the Hellenic Republic has been considered an example of the attempt by the Troika to please international investors and establish states which respect harsh fiscal rules rather than effectively help the economy and the population; and the ESM has been organized as a tool in order to pursue these objectives, with its governance structure and its transparency problems.

3.2.4 Accountability and transparency

The criticisms towards the in-field operations by the ESM are often matched by a negative analysis regarding the structure of the instrument used by the Eurozone to overcome the worst financial crisis since the 30s. As observed earlier, after the eruption of the 2008 crisis, EU institutions observed the consequences of the financial shock caused by Lehman Brothers for almost two years before actively develop and implement crisis management tools; such inaction has exacerbated the effects of the crisis. On the other hand, as observed earlier, European leaders had to rush in order to formulate an effective solution for the contagion effect which was prospected after the altered data scandal in Greece and the discovery of the disastrous budgetary situation

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[124] K. Hope (2018), *Greece brain drain hampers recovery from economic crisis,* Financial Times [Online] Available at: https://www.ft.com/content/24866436-9f9f-11e8-85da-eeb7a9ce36e4 [May 2019]
[125] P. Chrysopoulos (2016), *Economic Crisis Marks 3rd Emigration Wave of Greeks,* Greek Reporter [Online] Available at: https://greece.greekreporter.com/2016/07/02/economic-crisis-marks-3rd-emigration-wave-of-greeks/ [May 2019]

of the Hellenic Republic. However, they found an obstacle within the founding treaties of the EU: the "no bail-out clause". According to art. 125 of the TFEU, the member states are not accountable for the losses of member states which are not able to honor their payments. Such clause was introduced in order to avoid moral hazard problems and make taxpayers of Eurozone countries having sound economics to pay for irresponsible states.

In order to overcome such limitation, the leaders of the Eurozone countries created the European Financial Stability facility through an intergovernmental agreement which formed a public company under the law of Luxembourg. The EFSF was a temporary instrument and it was replaced in 2012 b the European Stability Mechanism (ESM), a permanent institution set up through a treaty under international law, which involves just euro area countries, and which is officially outside the legal framework of the European Union. The only provision taken through which the European Union recognizes the possibility for the Eurozone to develop a mechanism for the stabilization of the currency was he amendment of Art. 136 of TFEU, as stated earlier. Such modification was passed through the simplified revision procedure envisaged in the Treaty of Lisbon. The same treaty in which the European Union made important steps towards transparency and democratic accountability; the documents of the Commission, the Parliament and the Council should be accessible to all citizens of the Union, while the decision-making participation should be as open as possible following article 1 of the TEU.[126]

However, the way in which the ESM was constructed does not seem fully respectful of what the European leaders agreed in the Lisbon Treaty, but rather euro area countries not only preferred to overcome the EU institutional setting by signing agreements outside the EU legal framework, but also decided to do so under closed doors. As opposed to what happens for the other EU organs, the ESM Treaty lacks any particular transparency obligations, but instead envisages rules over the confidentiality of certain documents. Furthermore, in order to protect the members of the Board of Governors, the Board of Directors and other functionaries "shall be immune from legal proceedings with respect to acts performed by them in their official capacity and shall enjoy inviolability in respect of their official papers and documents", according to Art. 35 of the ESM Treaty. As regards the inviolability of the information collected by the ESM and its archives, Art. 34 and 32(5) establish that the abovementioned organs, together with individuals who works in connection with the ESM (consultants are also included) cannot disclose any material connected to the stability mechanism[127].

[126] J. Mendes (2011), *Participation and the Role of Law After Lisbon: A Legal View on Article 11 TEU*, Luxembourg, Common Market Law Review, Vol. 48, No. 6, September 2011, 1849-1878

[127] M. De Nes, (2015), *The ESM and the Principle of Transparency,* Turin, Centro Studi Sul Federalismo, Perspectives on Federalism, Vol. 7, issue 3, 2015, 128 – 138

The questions regarding the transparency regime within the ESM treaty has been broadly analyzed by the NGO "Transparency International EU", which is part of Transparency International, a global anti-corruption movement which is working in over 100 countries all over the world. The report published by the NGO in November 2016 regarding the analysis of the ESM suggested that the theoretical principles under which the stability mechanism was created did not represent a good example of a transparent organization. However, thanks to the so-called Transparency Initiative sponsored by the President of the Eurogroup in 2016, the Dutch Jeroen Dijsselbloem, who practically changed the vision over confidentiality of documents drafted by the ESM and its international partners.[128]

Nowadays, the majority of ESM documents, from the MoU to the reviews of the economic adjustment programmes of the EFSF and the ESM are published as "Legal Documents" in the ESM website and visible to everyone. However, ESM managers maintained some room of discretion regarding exceptional cases in which documents shall not be made public: the risk of sovereign bonds acquisition (in order not to alter the markets) and actions which may undermine ESM interests; a definition purposely vague.

Despite the improvements brought about by the ESM transparency initiative, Transparency International EU suggest ulterior reforms which may improve the situation;

- The confidentiality regarding documents including economic models and assumptions which determine the policy disposed for the beneficiary countries should be less restrictive in order to allow further discussions within academics and in the public opinion
- The meetings of the Board of Governors and of the Board of Directors are secreted, and verbatim minutes are not even taken, which makes internal workings and operations based just on executive summaries and official files. Such provision is possible within the ESM and the Eurogroup, which is the informal institution in which the Ministers of Finances of the Eurozone countries meet to establish the economic policy of the euro area, because their establishments are outside the EU treaties and their provisions over transparency. Despite this, the meetings of the institutions within the ESM should be made public, with a reasonable delay in order not to influence international markets in a negative way, as already done by the IMF.

Transparency issues of an institution are strictly linked with criticisms regarding its democratic accountability and the governance. The opacity of the ESM, is in contrast with its mission, which is the avoidance of future financial disasters that could strongly affect the stability of Eurozone members.[129]

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[128] C. Ban, L. Seabrooke, *From Crisis to Stability: how to make the European Stability Mechanism Transaparent and Accountable*, Brussels,Transparency International EU, 2017

[129] M. De Nes, *The ESM and the Principle of Transparency,* Turin, Centro Studi Sul Federalismo, Perspectives on Federalism, Vol. 7, issue 3, 2015, 128 – 138

When pursuing an analysis of the degree of accountability of the ESM, various factors should be taken in consideration. First of all, the timing of the formation of the stability mechanism embedded in the EU institutional framework: as explained earlier, the "no bail-out clause) included in EU Treaties literally tied the hands of European institutions and its leaders during the financial crisis and the worsening of the economic situation of the euro area. In order to overcome such obstacle, together with the veto power wielded by the UK Prime Minister regarding financial revisions of the Treaties in order to facilitate the bailout proposal for euro area countries[130], Eurozone leaders acted outside the Treaties and formulated an intergovernmental institution which is difficult to place within the institutional framework of the European Union, complicating its relationship with the other structures which compose the EU. In particular, the ESM is legally not accountable to the European Parliament, Commission and the Court of Auditors. In addition, the ESM is not accountable towards the European Anti-Fraud Office and the European Ombudsman, to which however it outsources some of its practices. Furthermore, the ESM documents are not under the judicial review of the European Court of Justice, with the exception of disputes between ESM member states; single European citizens cannot challenge the decisions of the ESM.[131] Another criticism moved towards the ESM organizational structure, in particular by the EU Parliament, regards the fact that the financial assistance pursued by the institutions should be made more accountable to the citizens of the Union, due to the fact that the contributions of the states are taxpayers money which would then be converged by the ESM into the economic adjustment programmes. Despite the fact that just 80bn euros out of the €500bn lending capacity of the stability mechanism is composed by paid-in capital, it should be underlined that the democratic accountability requested by the European Parliament over the ESM must take in consideration the principle of "no taxation without representation", according to which the ones who contribute are the entities which in the end should have a voice in the decisions-making process. This assessment, together with the political will by several EMU member states not include in a limited way the most democratic institution of the EU in crisis management, and the increasing relevance of the ECB and the Commission over matters of European economic governance, hampers the process of enhanced role of the Parliament in the EU institutional setting of the Union started after the ratification of the Lisbon Treaty.[132]

In contrast with this low level of accountability towards the other EU institutions, the degree of independence enjoyed by the ESM and its members towards the nation states which ratified the ESM Treaty is relatively low, in particular if compared with the international counterpart, namely the IMF. The organization of the Board of Governors, composed by the Finance Ministers of the euro area states, makes such institutions accountable towards national parliaments: the emblematic case is the one of the Dutch Governor who, in order

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[130] N. Watt (2011), *Britain may seek EU veto precedent to protect City*, The Guardian, [Online] Available at: https://www.theguardian.com/world/2011/oct/28/britain-veto-precedent-eurozone-bailout [May 2019]
[131] Ibidem, 10
[132] B. Rittberger , *Integration Without Representation? The European Parliament and the Reform of Economic Governance in the EU*, JCMS: Journal of Common Market Studies, Vol. 52, Issue 6, November 2014, 1175.

to vote for a tranche of the Greek rescue package, requested an extraordinary session and vote of his Parliament during the holidays. In addition to this, fundamental decision by the BoG are taken through unanimity, hence endowing every state with a generalized veto power, making the decision-making process of crisis management solutions more sluggish.

What has been proposed by the NGO Transparency International EU in order to improve the question regarding the democratic accountability of the ESM is the improvement of its institutional relationship with the most democratic body in the EU organizational structure: The European Parliament. Despite not legally obliged, the Managing Director faces the EU Parliament whenever is asked and according to his event schedule, while EU MPs have access to the ESM Annual Report and other document from the Board of Auditors and the BoG. Furthermore, the ESM frequently interfaces with the Economic and Monetary Affairs Committee of the European Parliament (ECON). For this reason, in the moment in which the ESM has not been included within the Eu Treaties yet, the European Parliament demands a formal accountability mechanism between the two institutions.

The relationship between the ESM and the Commission is probably even more complicated and opened to criticism. Indeed, Article 5(6) of the ESM Treaty establishes that the Commission id delegated by the ESM to negotiate with the beneficiary state of the financial assistance the conditionality attached in order to receive the money tranches, together with the ECB (and the IMF when planned). As seen for the Greek example, the economic adjustment programmes do not come without social costs for the communities, caused by public expenditures cuts which affected millions of European citizens working in the public administrations of countries entered within the financial aid programmes of the stability mechanism. However, since the ESM is regulated outside the EU legal framework, the mechanism and the member States which take part in it is not obliged to follow the provisions of fundamental EU documents, in particular the EU Charter of Fundamental Rights. While for the Member States the possibility of not following the provisions of the Charter is envisaged within Art. 51(2) of the charter itself (the Charter does not extend the field of application of Union law beyond the powers of the Union or establish any new powers or tasks for the Union or modify powers and tasks as defined in the Treaties). The same cannot be applied for the Commission and the ECB, which as EU official bodies are bound to Treaties and the Charter provisions[133]. Here, a problematic contradiction arises: as the Commission and the ECB have the duty of negotiating economic conditionality with the recipient states of the ESM financial aid, the member States are "borrowing" EU bodies to pursue this task on behalf of the ESM. Such legal limbo under which the ESM has been constructed represents the most critical issue regarding the accountability of the stability mechanism, which will be maybe solved only through the incorporation of the ESM in the EU Treaties.

[133] E. M. Salomon (2015), *Of Austerity, Human Rights and International Institutions*, London, London School of Economics and Political Science Law Department, LSE Law, Society and Economy Working Papers 2/2015, 2015, 8

3.2.5 Human rights protection in the decision-making process

It remains complicated how the Commission and the ECB should act within this limbo of legal framework, in particular regarding the respect of human rights of the population affected by the effects of the provisions inserted in the Memorandum of Understanding of the economic adjustment programmes[134]. What has been evaluated by Transparency EU is that the public opinion targeted the EU Commission and the ECB were the main responsible for the social disasters envisaged in moments of the sovereign debt crisis. In particular, the two institutions, together with the other members of the Troika, were blamed for not respecting provision of the Charter, in particular regarding social assistance, fair labor conditions and health care, as reported by the United Nations Human Rights Office of the high Commissioner. Such report focused on the situation of Greece, in which the austerity measures proposed by the Troika in the economic adjustment programme were too harsh for a country in which the social safety net was heavily damaged by the 2008 financial crisis and could not bear the social costs deriving from public expenditures cuts, salary revision and tax increase.
Despite being outside the EU legal framework, the ESM is an international organization whose member states have signed international covenants in order to protect socio-economic rights. Transparency EU refers directly to the International Covenant for Social, Economic and Cultural Rights adopted in 1966. In such covenant, it is underlined not only the fact that states should respect all human rights in their territories, but also the fact that decisions taken by external actors which may influence the internal workings of a state must take in consideration the social, economic and cultural rights of the recipient states. Hence, even though European leaders may have managed to set up an institution which can work outside the Treaties and the EU Fundamental Charters of Human Rights, the provisions of the International Covenant for Social, Economic and Cultural Rights must be taken in consideration in the decision-making process which leads to the redaction of the Memorandum of Understanding[135].

For this reason, in order to avoid the possibility of being held responsible for violation of socio-economic rights of a population, but most importantly to better address the real impacts of the conditionality measures present in the economic adjustment programmes, Transparency EU suggests that the Commission should be delegated by the ESM to develop routinely social impact assessment, based not only on International covenants provisions, but also on the clauses of the Charter[136]. It should be maintained though that it is generally accepted that the conditions negotiated by the Commission should be consistent with the fundamental rights protected within the EU legal framework; in order to confirm this practice, the Court of Justice of the European Union

[134] Ibidem, 13
[135] E. M. Salomon, *Of Austerity, Human Rights and International Institutions*, London London School of Economics and Political Science Law Department, LSE Law, Society and Economy Working Papers 2/2015, 2015, 21
[136] C. Ban, L. Seabrooke, From Crisis to Stability: how to make the European Stability Mechanism Transaparent and Accountable, Brussels,Transparency International EU, 2017, 7

established in the *Ledra Advertising Case* in 2016 that the Commission has the obligation to develop and sign MoU which are in accordance with EU law, and should "refrain from signing a memorandum […] whose consistency with EU law [and with the Charter] it doubts »[137]. However, the social consequences faced by the countries undermined by the financial crisis are in the public eye, and while the international lenders blamed the inappropriate economic behavior of the national authorities in the years after the entry into force of the euro, while national authorities harshly criticized the conditionality purposes of the international lenders.

3.2.6 ESM independency and the relationship with the Eurogroup

As seen earlier, the ESM has managed to create and maintain a certain degree of independence from the other institutions of the Union. However, the intergovernmental approach undertaken by the European leaders made the member states to exercise a high level of control over the mechanism, a higher degree than the control exercised over the Commission. Hence, the Member States exercise important influence over the decision-making process and the exercise of financial assistance by the ESM. In particular, the unanimity voting process, which protects member states (which are also shareholders) against the risk of financial losses which can occur if the beneficiary state defaults. However, unanimity in the Board of Governors not only could slow down the intervention timing of the mechanism, but also implies the influence of national parliaments in the decision-making process.

The unanimity requirement can be overcome by the ESM Emergency Procedure, which enters into force when a financial drought in a state of the euro area could provoke a contagion which could affect the stability of the European Monetary Union. The emergency procedure foresees that in order to pass a financial rescue package in the BoG, 85% of votes in favour are required. However, the division of voting shares within the ESM causes two peculiarities:

- Germany, France and Italy can use the veto power by themselves, since they hold more than 15% of the shares.
- The six largest Eurozone states can decide whether to pass financial assistance towards a beneficiary state or not, without calculating the votes of the other eleven states[138].

Such voting procedure is not even comparable with the qualified majority voting system used for example in the Council of the European Union, and it does not follow what established in the EU legal framework. In addition, the 27% of voting shares possessed by Germany allows such state to play a pivotal role in deciding whether to provide or not financial assistance, as seen by the role played by the Bundestag in the Greek crisis.

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[137] Judgment of the Court (Grand Chamber) of 20 September 2016,
Ledra Advertising Ltd and Others v European Commission and European Central Bank (ECB)
[138] C. Ban, L. Seabrooke, From Crisis to Stability: how to make the European Stability Mechanism Transaparent and Accountable, Brussels,Transparency International EU, 2017, 11

Such voting method, together with the general intergovernmental nature of the ESM, has increased the gap between creditors and debtor countries within the Eurozone.

Another criticism often moved to the European Stability Mechanism involves the relationship with the Eurogroup, in particular the structure and membership of the ESM Board of Governors which is identical to the one of the Eurogroup, a term which refers to the meetings between the finance ministers of the states of the eurozone. Such meetings are held periodically and in an informal way. The aim of the Eurogroup is to influence the monetary policy of the eurozone, through the instruments and the institutions provided by the Treaties such as the ECB. Despite being an informal institution (consensus building organ as defined by EU law), not governed by the Treaties, with no headquarters or staff members, as the ESM Director Klaus Regling once said: “The Eurogroup already works as a government of sorts.” In particular, the Eurogroup can practically take important legal decisions by changing its name in ESM Board of Governors, since it has the same representatives within its organization. Furthermore, as seen earlier in the chapter, the ESM BoG does not have to follow the same accountability and transparency requirements of other EU institutions, further deepening the democratic deficit envisioned un the European Union as a whole.

The situation was worsened by the 2008 crisis, when the risk of contagion tightened the controls by the European economic governance over the budgetary situations of the single states. New directives, new regulations and new institutions were promulgated, and the role of the Eurogroup vis-à-vis such novelties increased exponentially. Indeed, due to the identical membership of the ESM BoG and the Eurogroup, and due to the fact that the ESM BoG delegates the Commission for the formulation and negotiation of the adjustment programmes, the Eurogroup heavily influences the workings of the Troika, without being officially a member of it[139]. Despite the statements of the ESM functionaries which underlined the different legal nature of the ESM BoG and the Eurogroup, the fact that the meetings of the ESM BoG and of the Eurogroup usually take place in the same day and in the same room, and the fact that the Chairman of the ESM’s BoG Jeroen Dijsselbloem once maintained that the governing bodies of the ESM reunite after the Eurogroup has managed to formulate a general political line regarding the Eurozone, exacerbate the doubts regarding the independence of the ESM versus the Eurogroup.[140] Such uncertainty become smore evident when comparing the ESM governing bodies to the ones of its international counterpart: indeed, the IMF Board of Governors is composed by all the ministers of finance, who are not part of any informal body that comes to the table with a ready-made decision. On the other hand, the decisions taken by the Eurogroup and the ESM BoG are usually pre-prepared by a group of functionaries selected by the national treasuries of the euro area member states, who

[139] B. Braun, M. Hubner, *Vanishing Act*: *The Eurogroup’s accountability*, Brussels,Transparency International EU, 2019, 14
[140] C. Ban, L. Seabrooke, From Crisis to Stability: how to make the European Stability Mechanism Transaparent and Accountable, Brussels,Transparency International EU, 2017, 8

convene in the Euro-area Working Group (EWG). The EWG does not have any formal operational procedure, nor it has the obligation to publish an of the documentation it drafts.[141]

The accountability and transparency problems of the Eurogroup were envisioned by the European leaders in order to allow the informal organ to actually take decisions and establish the economic horizon of the Eurozone. However, the issues arise when the Eurogroup affects the independency of the governing bodies of the ESM, which is not just a consensus-building organ, but a financial institution whose decisions affects the lives and rights of millions of people. The solution proposed by the NGO Transparency EU to solve the problems of independency of the ESM BoG is to allow national parliaments to elect the governor who will represent the interests of the state in the ESM, different and not subordinated to the national finance minister.

4. Future scenarios for the European Stability Mechanism: the 2018 reform proposal vs. the creations of a European Monetary Fund

4.1 Why is it important to understand the future path of the ESM?

After the exit of Greece from the third economic adjustment programme officially announced on the 20th of August 2018, the ESM is no longer involved in any financial aid programme with any member state of the Eurozone. [142] this is a first time for this institution: indeed, since its formation after the transformation of the EFSF in permanent stability mechanism, the European Stability Mechanism has always been involved in economic adjustment programmes, whether they were directly formulated by the new institution or they were legacy of the previous crisis management tool. After 10 years since the breakdown of the financial markets after Lehman Brothers bankruptcy, it is possible to assume that the euro area has overcome the worst period of its brief but already important history: as the Managing Director of the ESM Klaus Regling maintained in a speech to the Representation of the State of North Rhine-Westphalia to the EU on the 29th of January 2019: "Today, the euro area is better positioned than it was 10 years ago. The reason for this is a broad package of measures which were successful because of their combination".[143]

By understanding the differences between the euro area 10 years ago and the nowadays Eurozone, it is possible to address the question regarding the future steps of the ESM: when the euro area was constitutionalized through the Maastricht Treaty in 1992, the European leaders wanted the monetary union to appear "solid,

[141] B. Smith-Meyer, R. Heath (2017), *Eurogroup confronts own deficit: governance*, POLITICO [Online] Available at: https://www.politico.eu/article/eurogroup-urged-to-tackle-its-own-deficit-governance/ [May 2019]
[142] European Stability Mechanism, *Greece successfully concludes ESM programme*, Press Release published on the 20th of August 2018 [Online] Available at https://www.esm.europa.eu/press-releases/greece-successfully-concludes-esm-programme [May 2019]
[143] Klaus Regling, *What comes after the Euro Summit? The role of the ESM in a deepened monetary union* ,Speech at the Representation of the State of North Rhine-Westphalia to the EU, , Brussels, 29th of January 2019.

progressive and irreversible"[144]. And so it was: it seemed so impossible to even think that a Eurozone member state could fall into financial difficulties due its public debt situation that the no bail-out clause was introduced, and until the relaxation of art. 136 of the TFEU in 2012, it remained unaltered.
However, the crisis revealed that also euro area countries can experience loss of access in the international market, and the EU discovered to be highly exposed to the inefficiencies of the financial markets, not having any financial instrument to help sovereign in difficulty, and an entity technically able to arrange programmes as the IMF did in the global scene.[145]

The EFSF/ESM crisis management tools were set up in an urgency situation in order to patch a flawed economic framework unable to cope with a sovereign debt crisis, inserted in a monetary union which limited and eliminated several monetary instruments which could have been useful to counteract the previous financial crisis, such as the possibility of currency devaluation for the member states. In the end, the ESM came to be considered a "cornerstone" within the European Monetary Union, not only because of its lending capability, but also because of its increasing influence within the EU institutional structure, especially in its relationship with the Commission and the ECB when Eurozone countries face liquidity crisis[146]. Klaus Regling underlined the pivotal role played by the ESM during the financial drought by stating that "Without the creation of rescue funds, former programme countries such as Greece, Ireland and Portugal would probably have had to leave the monetary union. Europe would look different today."[147]

In addition, the ESM will fulfill a determinant position in the process of deepening of the EMU, envisaged in the 2015 "Five Presidents' Report", in which the presidents of the European Commission, the European Parliament, the ECB, The Eurogroup and the European Council established the step forward which the European Union should undertake in order to complete and efficient Economic and Monetary Union. They envisage the ESM as a credible player in the process of formation of a financial union, with the objective of creating a macroeconomic stabilization function in the euro area, in which the ESM could be fundamental in sectors such as financing and economic evaluation[148].

Hence, the answer to the question posed in the title of this paragraph does not rely just on the explicit mission of the European Stability Mechanism expressed in its founding treaty, namely the financial aid of Eurozone

[144] B. Eichengreen, P. Temin, *Fetters Of Gold And Paper,* Cambridge (MA), National Bureau Of Economic Research Paper Series, July 2010, 17
[145] D. Gros (2017), *An evolutionary path towards a European Monetary Fund*, European Parliament provided at the request of the Economic and Monetary Affairs Committee, [Online] Available at http://www.europarl.europa.eu/RegData/etudes/IDAN/2017/602075/IPOL_IDA(2017)602075_EN.pdf [May 2019]
[146] G. Claeys, A. M. Collin (2018), *Does the Eurogroup's reform of the ESM toolkit represent real progress?*, Bruegel [Online] Avaialble at: http://bruegel.org/2018/12/does-the-eurogroups-reform-of-the-esm-toolkit-represent-real-progress/ [May 2019]
[147] Klaus Regling, *What comes after the Euro Summit? The role of the ESM in a deepened monetary union* ,Speech at the Representation of the State of North Rhine-Westphalia to the EU, , Brussels, 29th of January 2019.
[148] J. Juncker, *5 President Report: Completing Europe's Economic and Monetary Union,* Brussels, European Commission, 22nd of June 2015

member states threatened by economic issues, and so the importance of a stability mechanism in relation to the nation states which could benefit from it. The answer should picture also the increasing importance of one of the newest EU entity within the European institutional organization, in particular with respect to the process of formation of a European Economic and Monetary Union, a project started more than 20 years ago which has become the emblem of the he European integration process, which has been seriously damaged in its core aims of maintaining prosperity and stability for the European citizens by the financial crisis, and which should remain open to other EU member states which should understand the advantages of entering the euro area. In this sense, the EMU project still misses several developments for its completion, summarized by the Five Presidents' Report in: impossibility to bridge the social and economic divergences in the Eurozone, the inability to alleviate the political price of certain economic decision, and the fact that the EMU is still not completely unexposed to external shocks[149]. The analysis of the possible future scenarios of the ESM should be inserted in this scenario of rethinking the establishment of the EMU.

4.2 The 2018 ESM reform proposal

The will by EU institutional leaders and their nation states counterparts to deepen the monetary union through a series of reform has witnessed a decisive acceleration in December 2018. Through a mandate given by the Euro Summit in June 2018, the Eurogroup took a crucial decision on the 4th of December, with the aim of proposing technical advancements of the euro area architecture to improve its resilience to financial disasters.[150] On the 14th of December, in the statement notified as EURO 503/18, the Euro Summit agreed on the terms of the reform of the ESM, recalling the desire of the Commission to increase the international relevance of the euro, encouraging all parties to take all the necessary steps to strengthen the EMU.

In order to do so, the Euro Summit reform proposal of the ESM Treaty focuses especially on its role in the project of a European Banking Union, the accessibility and efficiency of its financial tools, and its relationship with the other actors EU institutional organization, in particular the linkage with the Commission.

4.2.1 ESM as the common backstop of the Single Resolution Fund of the European Banking Union

After the 2008 financial crisis, the European Union discovered the issues of managing a banking sector in which the capillary linkages between financial institutions of several countries and public sector finances are extremely high. In order to avoid the contagion effect of a bank failing (as witnessed in the US), the ECB and

[149] European Commission, *Reflection Paper On The Deepening Of The Economic And Monetary Union*, Brussels, COM(2017) 291, May 2017, 9
[150] G. Claeys, A. M. Collin (2018), Does the Eurogroup's reform of the ESM toolkit represent real progress?, Bruegel [Online] Avaialble at: http://bruegel.org/2018/12/does-the-eurogroups-reform-of-the-esm-toolkit-represent-real-progress/ [May 2019]

the Commission stressed the importance of creating a banking union which could re-build trust in the European banking system, and provide:

- more transparency through an array of standardized criteria and rules to effectively administrate the supervision, recovery and resolution of European banks
- Safety through preventive interventions in order to prevent financial institutions to fail
- Unity, through the standardization of cross-border banking activities.[151]

The project of a European banking union is based on two pillars: The Single Supervisory Mechanism (SSM) and the Single Resolution Mechanism (SRM).
The SSM comprises the ECB and national supervisory authorities of the banking systems and ensures the soundness of the banking system through operations such as conduct supervisory reviews, inspections and investigations, allocation of banking licenses, compliance with EU banking criteria, assessment of acquisition of banks and establishment of capital requirements to avoid financial risks.
The ECB has jurisdiction over all the SSM functions, which do not involve all the financial entities present in the Eurozone: indeed, the ECB exercises its supervision on 119 significant banks, which hold 82% of banking assets in the euro area. The remaining part is supervised by the national authority for banking supervision, in collaboration with the ECB. The significance is based on fixed criteria such as size, economic importance, cross-border activities and public financial assistance, as established in Regulation (Eu) No 468/2014 of the European Central Bank.[152]

Complementary to the SSM, the Single Resolution Mechanism (SRM) is applied to the 119 significant banks which, if they notify their failure, will be managed by the SRM through the Single Resolution Board (SRB) and the Single Resolution Fund. The SRB, being the central authority within the SRM, is an independent agency with a centralized decision-making system which allows the rapid and effective implementation of resolution decisions across the banking system. The SRM is completed by the Single Resolution Fund (SRF), which is funded by bank contributions. This construction allows the SRM to protect the European taxpayers from paying for the mismanagement of financial institutions, and to effectively stabiles the banking sector when shocks and contagion risks.[153]

[151] European Central Bank (ECB), (2018*), "SSM Supervisory Manual. European banking supervision: functioning of the SSM and supervisory approach*", Frankfurt, doi:10.2866/891872
[152] European Central Bank, Regulation (Eu) No 468/2014 "*establishing the framework for cooperation within the Single Supervisory Mechanism between the European Central Bank and national competent authorities and with national designated authorities (SSM Framework Regulation)",* 16th April 2014,
[153] European Parliament, Council of the European Union, Regulation (Eu) No 806/2014 *"establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) No 1093/2010",* 15 July 2014

As regards the Single Resolution Fund, the Euro Summit has agreed to designation of the European Stability Mechanism as the common backstop for the Single Resolution Fund. It means that, if the SRF does not have the financial capacity to cover the failure of a bank, the ESM will intervene by lending to the SRF the required amount of liquidity. Furthermore, the backstopping by the ESM of the SRF will substitutes the direct recapitalization tool. The Euro Summit has set the timeline for the introduction of this new feature of the ESM: in 2024, the common backstop must be operative. However, if banks manage to reduce the percentage of non-productive loans to 5% (which represents their exposure to risks), the backstop function of the ESM can be anticipated (such possibility will be evaluated in 2020). The decision-making process regulating the disbursement of loans to the SRF will be managed by the Board of Directors. The SRF will have to repay the ESM in three years, with the possibility of one further extension of two years, in order to be a fiscal neutral policy in the medium term.[154]

The decision by the Euro Summit to formalize the role of the ESM as the common backstop of the Single Resolution Fund represents the natural progression of the path indicated by the Five President's Report as regards the deepening of the EMU through the creation of a Capital markets Union (which is not envisioned in the 2018 Euro Summit statement), and the completion of the banking union, in particular when referring to the resolution of financial institutions. The ESM becomes more and more pivotal in the completion of a common European banking scheme, since the "lender-of-last-resort" role which the ESM will undertake provides high degree of credibility to the project; credibility which reassures also the other protagonists of the banking union, in particular the ECB.[155] The European Parliament has already stressed the importance of clearly established conditions for the disbursement of the emergency loans by the ESM to the SRF, in order to ensure "responsibility, accountability and the principle of moral hazard prevention as well as safeguarding the principle that taxpayers are not liable for banking risks".[156]

4.2.2 The revision of ESM precautionary credit lines

Within the ESM toolkit, precautionary credit lines are instruments to help member states to maintain important macroeconomic performances also in periods of economic stability, toughening the credibility in the international markets. According to Art. 1 of the Guideline on Precautionary Financial Assistance by the ESM, "precautionary financial assistance is to support sound policies and prevent crisis situations by allowing ESM Members to secure the possibility to access ESM assistance before they face major difficulties raising funds

[154] Council of the European Union, *Terms of reference of the common backstop to the Single Resolution Fund,* published on the 8th of December 2018
[155] J. Brunsden, M. Khan (2018), *Eurozone reform deal: what was agreed and what was put on hold,* Financial times [Online] Available at: https://www.ft.com/content/826a4986-f7ac-11e8-af46-2022a0b02a6c [May 2019]
[156] European Parliament, *Resolution of 16 January 2019 on Banking Union – annual report 2018*, Strasbourg, European Parliament, (2018/2100(INI))

in the capital markets".[157] In practice, this tool consists in credit lines operationalized through loans or primary market purchases: these credit lines re directed to a member state who officially requested the activation of such ESM tool to the Chairperson of the ESM Board of Governors, which will entrust the Commission and the ECB of the evaluation of risks of the financial stability of the state, its debt sustainability and need of financial aid of the beneficiary state. After the evaluation phase, as for the typical ESM economic adjustment programme, the Commission (on behalf of the ESM) negotiates the conditionality in a Memorandum of Understanding attached to the precautionary credit line with the Member State.[158]

In order to gain access to the ESM precautionary credit line, member states must respect certain criteria which are the main subject of the 2018 reform of the ESM. The criteria are listed as follows:

- Compliance with the fiscal rules established in the Stability and Growth Pact, even if a country is subject to an Excessive Deficit Procedure, as long as the country follows the Council's decisions and recommendations
- The government debt of the beneficiary country must be sustainable
- Compliance with the requirements of the Excessive Imbalance Procedure, even if a country is subject to an Excessive Imbalances Procedure
- A track record of access to capital markets on reasonable terms
- A sustainable external position
- No systemically relevant bank solvency problems.[159]

Precautionary credit lines are not an invention of the European Stability Mechanism, but the crisis management tool of the Eurozone drew inspiration from the International Monetary Fund, in particular its lending tool known as Precautionary and Liquidity Line (PLL). Apart from the duration of the loans, which is similar to the one of the ESM precautionary credit lines, the mission resembles the aim of the European counterpart: indeed, after the 2008 crisis, the IMF decided to shift its attention to the crisis prevention, and not only the crisis management. The PLL comes with qualifications requirements for the state which would like to be beneficiary of this IMF lending tool: on the IMF website, the core eligibility criteria which are assessed by the institution are mentioned as:

- Has sound economic fundamentals and institutional policy frameworks
- Is currently implementing—and has a track record of implementing—sound policies
- Remains committed to maintaining sound policies in the future.[160]

[157] European Stability Mechanism, *Guideline on Precautionary Financial Assistance*, ESM [Online] Available at: https://www.esm.europa.eu/sites/default/files/esm_guideline_on_precautionary_financial_assistance.pdf [May 2019], 1
[158] Ibidem, 3
[159] Ibidem, 1
[160] International Monetary Fund (2019), *IMF Precautionary and Liquidity Line (PLL),* IMF Factsheet published on the 27th of February 2019 [online] Avaialble at: https://www.imf.org/en/About/Factsheets/Sheets/2016/08/01/20/45/Precautionary-and-Liquidity-Line [May 2019]

As for the ESM, also the precautionary credit lines of the IMF not only comes with ex-ante requirements, but also with ex-post conditionality, "aimed at addressing the remaining moderate vulnerabilities identified during the assessment of qualification".[161] Until 2019, Morocco and Former Yugoslav Republic of Macedonia have requested and benefitted from PLL from the IMF. In December 2018, the IMF Executive Board approved two-year programme under PLL for Morocco, for a total financing of 2.97 billion dollars: the agreement between the beneficiary state and the international institution comprises fiscal consolidation maneuvers[162] to reduce the debt-to-GDP ratio and structural reforms regarding education and labor market.

The PLL programme for Macedonia goes back to 2011, and according to IMF review of it, the crisis prevention instrument managed to stabilize its financial position, with a sound banking sector and with levels of fiscal deficits which meet the targets established by the IMF[163].

Going back to the ESM precautionary financial assistance instruments, as established in article 14 of the ESM Treaty, the European financial institution provides two options for its member states:

- Precautionary Conditioned Credit Line (PCCL), which requires commitments towards the SGP, the Excessive Imbalance Procedure and debt sustainability.
- Enhanced Conditions Credit Line (ECCL), which is dedicated to those states which do not qualify for receiving PCCL: in this case, the states agree to implement reforms and programmes in order to address the flaws found during the evaluation process and to avoid the impossibility to access financing markets in the future.

In contrast with their IMF counterpart, neither one of the two precautionary financial assistance instruments has been officially requested by any ESM member states: This is one of the reasons why the Euro Summit meeting in December 2018 revised precautionary credit lines, together with the fact that preventive disbursement of smaller loans to member states can prevent smaller crisis to develop into greater financial droughts and recessions, destabilizing not only the local economy, but also the functioning of the entire euro area system, as witnessed after the 2008 Great Recession.

The 2018 ESM reform proposal focuses on ensuring that ex-ante eligibility criteria of the PCCL become more "transparent and predictable".[164] In this sense, member states who want to benefit from the PCCL instrument have to meet the general EU fiscal rules, in particular the ones established in the SGP and which are becoming well-renowned in the European context: indeed, member states have to 3% deficit-to-GDP benchmark and the 60% debt-to-GDP benchmark (or the reduction of it of 1/20 in the following year). Together with these

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[161] Ibidem
[162] International Monetary Fund, *Morocco Request For An Arrangement Under The Precautionary And Liquidity Line"*, Washington, IMF Country Report No. 19/24, 17th of December 2018
[163] IMF (2014), *"Former Yugoslav Republic Of Macedonia Second Post-Program Monitoring Discussions"*, Washington, IMF Country Report No. 11/280, 13th January 2014
[164] European Stability Mechanism, "*Term sheet on the European Stability Mechanism reform*", 4th December 2018 [Online] Available at https://www.consilium.europa.eu/media/37267/esm-term-sheet-041218_final_clean.pdf [May 2019]

quantitative criteria, candidates must meet qualitative criteria as not being involved in Excessive Deficit Procedures or Excessive Imbalance Procedures. States which meet these requirements will have to sign a Letter of Intent in which it agrees to continue meeting these qualifications.[165]
While for the PCCL the Memorandum is substituted by a Letter of Intent, the same is not applied to the Enhanced Conditions Credit Line, in which the state will sign a MoU in which establishes its commitment not only to comply with the eligibility criteria, but agrees to introduced the requested reforms by the Commission in liaison with the ECB and the ESM. Both for the PCCL and the ECCL, beneficiary states will undergo into an enhanced surveillance program under the EU legal framework. (as in the case of other ESM economic adjustment programmes)[166].

The reform proposal of the Euro Summit aims at making crisis prevention instruments not only more effective, but also more fascinating and easily accessible for states to actually used them, taking as an inspiration the successful examples of the IMF. The importance of precautionary credit lines within the Eurozone is still underrated: crisis prevention seems to be a topic on which the ESM is going to devote more resources (e.g. Vulnerability Index as example). The possibility that, after the end of the last economic adjustment programme in Greece in August 2018, the ESM will experience a period in which it will shift its operations towards precautionary credit lines instead of full financial aid programmes is high, due to the smaller size of the interventions and the possibility to make evaluations without being pressures by an economic situation which is already close to a full-blown sovereign crisis.

4.2.3 Debt sustainability and single limb collective action clauses (CACs)

After the 2008 financial crisis which resulted in the Eurozone sovereign debt crisis, debt sustainability became a major priority for the economic governance of the euro area and has been inserted in many European documents, directives and decisions: debt sustainability is at the basis of the reforms of the Stability and Growth Pact, can be found in all the economic adjustment programmes MoUs of the ESM and, as seen in the previous paragraph, is one of the ex-ante conditionality in order to accede to precautionary credit lines.

When discussing debt sustainability in the paradigm of international funds or regional financing agreements, the question on how to make a public debt sustainable through an effective instrument (and not a series of conditional clauses) pops up often. Debt restructuring is often considered the only way in which the international community can help countries with unsound finances, and at the same time repay private investors. However, many criticisms are moved towards such instrument, in particular regarding the risks which a debt restructuring programme can enhance: moral hazard and deadweight losses.

[165] Ibidem
[166] Ibidem

The problem of moral hazard in this case refers to the investors which, knowing that the IMF or any RFA may intervene giving a loan to a country in order to pay its maturing credits, may become more risk takers and invest in sovereign bonds of that country, since they can exit their investment without losses. However, the beneficiary state will have to repay the institutions which lend the money, and in order to do so it will have to implement measures such as austerity policies and structural reforms, with enormous social costs for the population[167].

On the same side of the medal there is the deadweight losses criticism moved towards the debt restructuring possibility. Deadweight losses are efficiency losses which comes out from information and coordination issues which reduce the economic situation of a country. According to Eichengreen, the restructuration of sovereign debt by an international institution imply losses for both lenders and borrowers for problems of coordination and information. In this scenario, no universal way of thinking regarding a more efficient mechanism for debt restructuring, which could dissolve any doubts on the transparency of the arrangements behind the process of debt workout of a country.[168] The provision which has been mostly used by policymakers to rationalize the sovereign debt restructuration are the collective action clauses (CACs), clauses which allow investors to change the rules and conditions through rules of majority voting. This contractual provision eliminates the problem of "holdouts", which could allow a minority of shareholders delay the debt restructuration by not accepting the new terms.

CACs have been present in the sovereign bond market for years, and in contrast with the precautionary credit lines, they have played a role in the sovereign bond crisis: indeed, in 2012, when the Greek debt was restructured, part of this debt was revised following majority voting procedure within the bondholders[169]. In addition, the ESM has recognized the effectiveness of introducing CACs when bonds are issued that has introduced an obligation for member states to include CACs from the 1st of January 2013 in article 12 of the ESM treaty[170].

The 2018 reform of the ESM would introduce single-limb Collective Action Clauses, that will substitute the two-limb CAC in which the decision to pursue a debt restructuring option required two supermajority votes. The single-limb CACs which will allow the application of the same conditions approved by the majority of bondholders to all the bonds with one majoritarian vote. The single limb CACs will be introduced by 2022. According to the Managing Director of the ESM Klaus Regling, this revision "the debt sustainability analysis

[167] B. Eichengreen, "*Restructuring Sovereign Debt*", Nashville, Journal of Economic Perspectives—Volume 17, Number 4, 2003, 75-98
[168] Ibidem
[169] P. S. Kenadjian et al., "Collective Action Clauses and the Restructuring of Sovereign Debt", Berlin, Deutsche Nationalbibliothek, 2013
[170] Treaty Establishing The European Stability Mechanism, signed on the 2nd of February 2012, T/ESM 2012-LT/

(DSA) will be done in a transparent and predictable way, while allowing for some judgement". Furthermore, the Euro Summit has agreed on enhancing the role which the ESM will play in debt restructuring arrangement, thanks to the experience it has accumulated in the European sovereign bond market. Indeed, the ESM will have the possibility to operate as a moderator between member states and investors, in an informal way and after an official request.[171]

4.2.4 The relationship between the ESM and the Commission

As maintained earlier (see 3.2.4), the insertion of the ESM within the institutional structure of the European Union has created visible loopholes, mostly due to the rushed formation of this new institutions when the sovereign debt crisis was pressuring European leaders to take important stances in order to solve the issue which was undermining the stability of the entire euro area. Initially, the EFSF was considered just a lending machine to beneficiary member states, involved in the collection of capitals and in the disbursement, while all the operational working, comprising the evaluation, the negotiation and the surveillance phases were mostly guided by the Commission in liaison with the ECB.

However, the experience accumulated by the stability mechanism through its interventions in several euro area countries, the technical expertise accumulated through the close relationship with the IMF, and the expansion of the lending capacity obtained through the signing of the ESM Treaty has increased the relevance of the ESM within the EU economic governance. The rise of the ESM went hand in hand with an expansion of its powers and influence over sectors which were competence of the Commission. Hence, a problem of overlapping of jurisdiction arose, with the legal limbo of the ESM and the Commission being regulated by two different legal frameworks: the ESM Treaty (signed under Luxembourg law) and the EU Treaties.

In order to solve this problem, and to better explain the cooperation which the Commission and the ESM must pursue to the common objectives they have to achieve to maintain the financial stability of the Eurozone, the EC and the ESM signed a "Memorandum of Understanding on the working relations between the Commission and the European Stability Mechanism" in April 2018, which was further deepened by the "Joint position on future cooperation between the European Commission and the ESM" published on the 19th of November 2018 as a preparatory document for the Euro Summit which was held in December 2018.
In both documents, the two institutions define the roles they will play and the methodology they will apply not only during all the phases of an economy adjustment programme, but also regarding scenarios outside sovereign bailouts such as precautionary credit lines, staff training and information exchange. In all cases,

[171] ESM, "*Term sheet on the European Stability Mechanism reform*", 4th December 2018 2018 [Online] Available at https://www.consilium.europa.eu/media/37267/esm-term-sheet-041218_final_clean.pdf [May 2019]

both the Commission and the ESM will respect their obligation both under EU law and the ESM Treaty. Furthermore, the Commission should continue to work constantly as guarantor of the EU law.[172]

As regard economic adjustment programmes, the ESM and the EC divide this case scenario in 4 phases:

1. **Preparation of financial assistance:** firstly, both institutions will work jointly to draft the debt sustainability assessment of the beneficiary state. The Commission will base its decisions on its economic forecasts and estimated, adding the situation of the member state regarding the compliance with the SGP requirements. The ESM will focus on the beneficiary state debt cost and its position in the sovereign bond market, considering its interest rate developments and its capacity of refinancing. Then, the attention will shift on the financing needs of the member state, with the commission drafting projections for the financial and fiscal plans (debt reduction and privatization proceedings), while the ESM will focus on medium and long term debt repayment and short-term liquidity buffers to foster the market access of the state. Finally, the computation of the financial risks of the member state will be assessed by the Commission together with the ECB, but the ESM will give major contribution in the analysis of the risks in the sovereign bond markets.[173]
2. **Negotiation of conditionality:** as established by the ESM Treaty, the Commission signs the Memorandum of Understanding on behalf of the ESM. The Commission, in liaison with the ECB, negotiate the terms of the conditionality with the national authorities. However, the ESM will collaborate closely with all the parts in the organizational aspects on how the state will repay its debt and will restore its financial situation. Furthermore, the ESM will work jointly with the Commission in establishing the goals and impact related to the financing needs of the beneficiary state of the proposed reforms (but the design of the reform remains under the jurisdiction of the Commission).
3. **Compliance monitoring:** both the ESM and the Commission will monitor the implementation of the reforms prescribed under the conditionality of the MoU, with the monitoring tasks divided as in the negotiation of conditionality phase.
4. **Post-programme monitoring:** in this phase, the two institution follow two different pieces of legislation: The Commission shall follow article 14 of Regulation (EU) 472/2013, while the ESM shall comply with article 13 of the ESM treaty, establishing the principles of the Early Warning System which shall last from the first tranche until the debt is fully repaid. The post-programme surveillance shall be pursued jointly in order not to burden in an unnecessary way the member state[174].

[172] European Stability Mechanism, European Commission, *Memorandum of Understanding on the working relations between the Commission and the European Stability Mechanism*, signed on the 27th of April 2018
[173] European Stability Mechanism (2018), *Joint position on future cooperation between the European Commission and the ESM*, Press release [Online] Available at: https://www.esm.europa.eu/press-releases/joint-position-future-cooperation-between-european-commission-and-esm [May 2019]
[174] Ibidem

When referring to cooperation outside economic adjustment programmes, The Commission and the ESM will share data, analysis and other information which result useful to fulfil their objectives, respecting their respective rules of confidentiality.[175] Furthermore, the two institutions will prepare joint training programmes for their functionaries. ESM members will be invited by the Commission to intervene and participate to economic policy coordination missions.
The comprehension by the Commission (and in general by the EU) of the pivotal role which the ESM has gained during the crisis is represented in these documents which, despite not changing the rules established under the EU treaties, prepare the floor for an increasing influence of the ESM on the economic governance of the Eurozone.

4.3 Perplexities about the 2018 ESM reform proposal

Even though the efforts made by the European leaders to deepen the monetary union envisaged in the previous paragraph represent important step forwards which were unthinkable just a few years ago, the decisions taken within the documents signed in the Euro Summit held in December came short to determine a clear path towards a comprehensive economic a monetary union, more resilient to external shocks and more integrated. Furthermore, several instruments which could have been useful for the completion of the EMU, and in which the ESM could have played a major role in the financing sector, have not been introduced in the discussion, leading some economists to deem the December 2018Euro Summit proposal a "mini reform".[176]

In this paragraph, the analysis will focus firstly on the main criticism regarding the decisions taken regarding the European Stability Mechanism by the European finance ministers in the Euro Summit. Then, the attention will shift on the missing proposals which could have made the ESM reform of 2018 a fundamental piece of legislation in the history of the euro area.

4.3.1 PCCL criteria becoming tighter and the relationship with the OMT programme

The operational instruments in the hands of the European Stability Mechanism will undergo into an amendment procedure for the years to come. As stated earlier in the chapter, the revision of the ESM toolkit represents the attempt by the leaders of the European economic governance to enhance the potential of an institution whose importance has increased constantly ever since its creation. However, according to some analysts, the degree of powers granted to the ESM still puts uncertainty on whether the ESM can solve liquidity

[175] European Stability Mechanism, European Commission, *Memorandum of Understanding on the working relations between the Commission and the European Stability Mechanism*, signed on the 27th of April 2018

[176] M. Karnitschnig (2019), *The Eurozone's counterreformation*, POLITICO [Online] Available at: https://www.politico.eu/article/eurozone-reform-macron-merkel-counter-reformation-euro/ [May 2019]

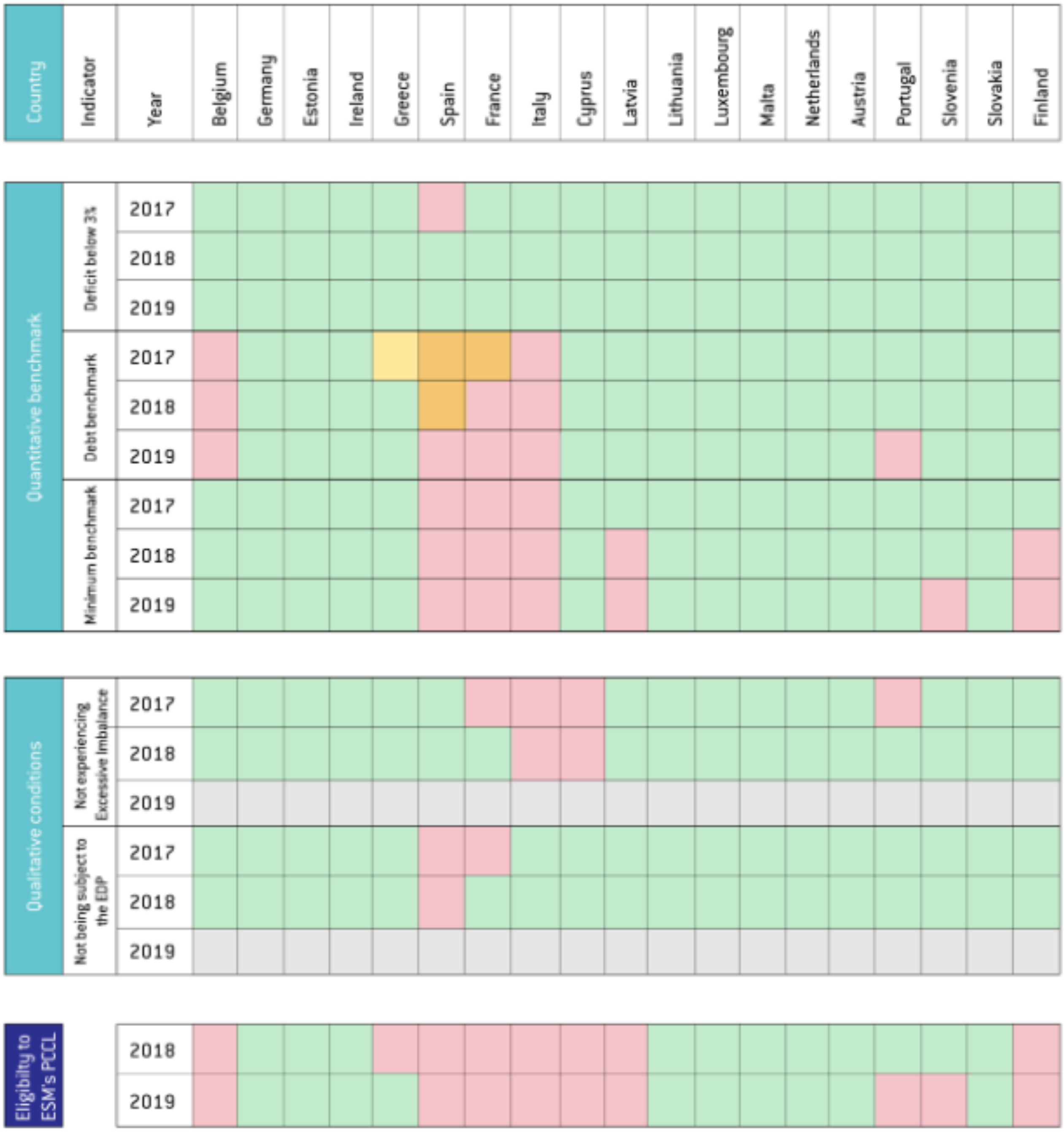
crisis on their own, or even allow the institution to prevent further crisis and maintain the stability of the euro area.

In an article published by Bruegel's, some questions over the reform of the precautionary financial assistance revision of the ESM are asked: in particular, the authors aim the attention at the new requisites necessary to request Precautionary Conditioned Credit Line (PCCL) in order to prevent the eruption of future crises. The aim of the Euro Summit was to facilitate the access to preventive crisis instruments by changing the eligibility criteria in order to eliminate the signing of a Memorandum of Understanding and avoid discussions about loss of sovereignty towards the European Union by countries willing to receive loans from the ESM.

However, in including the SGP criteria of the 60% debt-to-GDP ratio and the 3% deficit-to-GDP ratio in the qualifications for receiving PCCL, together with the fact that beneficiary states must not be involved in any Excessive Deficit Procedure or Excessive Imbalance Procedure, the audience of member states who can apply for PCCL is considerably small. That is because, the new criteria set in the Euro Summit are more precise than the ones present before the reform, especially regarding the fiscal sector. However, more precise coincides with tighter and more difficult to meet for euro area member states, especially for the ones which are still recovering from the financial crisis, and which would benefit the most from a precautionary intervention of the ESM. At the moment, more than half of EA19 countries cannot be eligible for receiving PCCL: not only countries such as Spain and Italy, whose economic situation is sketchy, cannot benefit from this ESM instrument, but also more sound economies such as France and Finland are cut out from PCCL by the new eligibility qualifications, as displayed in the table below.[177]

[177] G. Claeys, A. M. Collin (2018), *Does the Eurogroup's reform of the ESM toolkit represent real progress?,* Blog Post, Bruegel, [Online] Available at: http://bruegel.org/2018/12/does-the-eurogroups-reform-of-the-esm-toolkit-represent-real-progress/ [May 2019]

Table 1: Which countries would be eligible to the revamped PCCL?



Source: Bruegel

Furthermore, the structural deficit estimation is difficultly observable, with the risk of exposing the PCCL decision-making process to endless discussions between the parts involved, namely the Commission, the ESM and the member states.

Another important flaw which has been underlined in the Bruegel's article regards the role of the ECB, and in particular the possibility for PCCL beneficiary states to enter into an Outright Monetary Transaction (OMT) program provided by the European Central Bank. The OMT is the "Eurosystem's outright transactions in secondary sovereign bond markets that aim at safeguarding an appropriate monetary policy transmission and the singleness of the monetary policy"[178], and it is one of the instruments created by the ECB during the sovereign debt crisis to avoid liquidity issues in a specific member state. As for the interventions of the ESM, OMT programs come with a conditionality, and one of the features a state must have in order to ask for the activation of the OMT is the current implementation of an ESM tool in the country. Such conditionality rests upon any ESM programme which "can take the form of a full EFSF/ESM macroeconomic adjustment programme or a precautionary programme (Enhanced Conditions Credit Line), provided that they include the possibility of EFSF/ESM primary market purchases".[179] It is unclear whether PCCL are comprised in this conditional clause for ECB's OMT programs, and it becomes fundamental to allay the vagueness over this conditionality since it is not proved that PCCL instruments can solve a liquidity crisis on their own, without the aid of the ECB.

4.3.2 Is the introduction of single-limb CACs an opening to debt restructuring by the ESM?

The introduction of single-limb CAC in sovereign bonds after the ESM reform refers to the attempt by the European economic governance to address the possibility of insolvency for a state. This new feature, which replaces the two-limb CACs in sovereign bonds introduced from 2013, makes the process of debt restructuring more fluid in the Eurozone, avoiding the possibility for minority creditors to block the entire process. The single-limb CAC has been criticized widely because disadvantages small creditors. However, this flaw has been corrected through an international provision in which all bondholders are equally treated. However, it is unclear whether this reform admits an opening of the EA19 to the circumstance of debt restructuring, after its total refusal of proceeding through debt reestablishment before the third Greek economic adjustments programme. The ESM has always deemed its financial aid, provided at very cheap rates and with long maturities, as an indirect way to revise the debt situation of a sovereign state, and economic adjustment programmes are preferable to debt restructuring. Single-limb CACs have been introduced not only to provide more option for the ESM in the case of an insolvency problem in a state, but also to make clearer and easier the euro sovereign bond market.

4.3.3 The incomplete determination of the backstopping nature of the ESM

Another article by Bruegel deems European Banking Union project after the development of the new role of the ESM as the common backstop of the Single Resolution Fund (SRF) as "still incomplete" and that could

[178] European Central Bank (2012), *Technical features of Outright Monetary Transactions*, Press Release, [Online] Avaialable at https://www.ecb.europa.eu/press/pr/date/2012/html/pr120906_1.en.html [May 2019]
[179] Ibidem

probably represent a step back from the completion of the EMU[180]. In particular, the concerns of the article refer to the liquidity provision to banks after the initiation of resolution scheme, arguing that:

- The way in which support which the ESM would provide to SRF will then be transferred to the financial institutions in collapse is not mentioned, despite being fundamental to understand the process. The authors suggest that the credit line could be provided through the same guarantee used as a collateral to access the Emergency Liquidity Assistance (ELA), a tool already utilized by the ECB which gives permission to national central banks to provide liquidity or any kind of financial assistance to banks in crisis. However, as maintained in the article, "the scope of the SRB, even with a credit line from the ESM would be limited to guarantees of 120bn – too small to deal with a bigger crisis". An alternative could be the issuance of bonds by the SRF, which however will not have good ratings due to the ESM preferred-creditor status as a backstop. This preferred-creditor status create some perplexities regarding the general possibilities of actually witnessing the Single Resolution Board asking for a loan to the ESM for the SRF.
- The intergovernmental nature of the ESM does not comply with bank resolution mechanisms, which must be effective and rapid at the same time. The unanimity decision-making process within the Boards which constitutes the ESM could create obstacles for the transfer of liquidity for financial resolution purposes from the ESM to the SRF, despite the general will expressed in the Euro Summit to make this process smoother.
- The substitution of the direct recapitalization tool of the ESM with the new common backstop role means that bank resolution procedure will not be financed through any taxpayer money, but only through the bank contributions to the SRF (plus the loans of the ESM when requested). Even though this could be seen as a positive fact, the authors argue that it represents a backing down on the fiscal side of the banking union, since bank contribution could not bear a crisis eruption in one of the EU major banks. This last argument does not stand on solid basis; indeed, the ESM has just 80bn of paid-in capital, while the majority of its financing is obtained through issuance of debt securities and operations in the markets.

All the concerns displayed in the Bruegel's article can be the starting point of further discussions regarding the new backstopping feature of the ESM in the banking union. However, as written in Eurogroup report published on the 4th of December of 2018 and endorsed subsequently by the ESM, the Eurogroup will amend the ESM Treaty in order to pursue the reform of the institution by June 2019. Hence, there is still time to improve what can be seen an important step forward towards the formation of a European banking union[181].

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[180] M.Demertzis, G. B. Wolff, (2018), "*Providing funding in resolution: Unfinished business even after Eurogroup agreement on EMU reform",*Bruegel, Blog Post, [Online] Available at: http://bruegel.org/2018/12/providing-funding-in-resolution-unfinished-business-even-after-eurogroup-agreement-on-emu-reform/ [May 2019]

[181] Eurogroup (2018), "*Eurogroup report to Leaders on EMU deepening*", Press Release, [Online] Available at: https://www.consilium.europa.eu/en/press/press-releases/2018/12/04/eurogroup-report-to-leaders-on-emu-deepening/ [May 2019]

4.4 The European Monetary Fund (EMF)

The ESM reform proposed in 2018 is the first formal attempt by European leaders, in collaboration with some EU institutions, to enhance the powers of the stability mechanism, asserting its future crucial role in the European Monetary Union. However, this is not the only option which has entered into the EU institutional framework on how to fortify the monetary union and prevent external shocks to disrupt the system.

4.4.1 The History of the EMF proposal and the current position of EU protagonists on the project

In 2010, immediately after the Greek crisis and the outbreak of the sovereign debt crisis, the economists Daniel Gros and David Mayer published an article proposing the formation of the European Monetary Fund, with the aim of restoring "market discipline by making failure possible" in the EMU[182]. Gros and Mayer vision of a European Monetary Fund envisioned the settlement of such institution within the EU Treaties through the notion of enhanced cooperation, completely opposite from the way in which the European Stability Mechanism was thought and implemented. The financing of Mayer and Gros's EMF proposal had to be constituted just by the contribution of such countries which are not respecting the Maastricht criteria, so to minimize the risk of moral hazard of debtor countries, while removing the possibility of the intervention by creditor countries to help EMU countries facing financial difficulties through public finances. The first EMF proposal in 2010 already envisioned the conditionality to be attached to rescue packages, with the new institution managing the entire process (there is no reference to the role of the Commission). Mayer and Gros argue that having a specific rescue fund for EMU sovereign states represent a better option than asking for the IMF intervention. The initial EMF proposal entailed the default of the sovereign state in an orderly way, with the exchange of bad debt with safer obligations backed by the EMF, which will take in its balance sheets all the claims against the defaulted country. In this way, there is no possibility for states experiencing a financial drought to refuse the adjustment, leaving the exit from the EU through article 50 as the only viable option to reject any intervention by European institutions[183].

As witnessed during the sovereign debt crisis, the leaders of the euro area countries decided to opt for a crisis management instrument built outside the EU treaties, whose paid-in capital is composed by all the countries of the Eurozone according to the ECB capital keys, and whose adjustment programmes envision not only a partnership with IMF, but also the delegation of the negotiation phase and the formulation of the MoUs to the Commission in liaison with the ECB. Despite the EFSF initially, and the ESM later on are far from being resembling to the Mayer and Gros' proposal for a European Monetary Fund, the idea of creating an organization within the EU Treaties, similar to the IMF but with the exclusive purpose of ensuring the financial

[182] D. Gros, T. Mayer (2010), *Towards a Euro(pean) Monetary Fund,* Centre for European Policy Studies (CEPS), Policy Brief No. 202. [Online] Available at SSRN: https://ssrn.com/abstract=1615478 [May 2019], 2
[183] Ibidem, 4

stability of the Eurozone, has never been abandoned, but rather it has found the support of some European institutions, EU representatives, and lastly some euro area countries leaders.

The EU institution which mostly endorsed the project of a European Monetary Fund between 2010 and 2019 was the European Commission, in particular when Jean Claude Juncker started chairing the executive body of the European Union. According to the point of view of the European Commission, the EMF should constitute the natural evolution of the ESM, when the stability mechanism will be integrated in the EU legal framework according to art. 352 of the TFEU. The development of a European Monetary Fund will provide more financial autonomy from other international institutions, while being accompanied by euro area treasury able to surveille the economic and fiscal situations of the member states, provide macroeconomic stabilization and a budget for the Eurozone, while issuing Euro assets. Furthermore, the inclusion of the ESM in the EU legal framework through the formation of the EMF would accelerate the decision-making process (slowed down by the intergovernmental nature of the ESM), strengthening the efficiency of the EA19 crisis management apparatus and the EMU in general. The ultimate step was taken In December 2017, when the Commission took the executive initiative for a Council Regulation on the establishment of the European Monetary Fund.[184] The proposal of the Commission on the creation of the EMF encompasses the so-called "EMF statute" suggestions over the governance, the capital and lending capacity, the financial support to member states, the decision-making process and many other characteristics. Also, the current Managing Director of the ESM Klaus Regling has demonstrated its favourable vision on the enhancement of powers for the institution he chairs, even though he believes that the development in the EMF is just a formal evolution, and not substantial. In a speech held at the Euro 50 Groups conference in Brussels on the 8th of April 2018, Regling stated that the inclusion of ESM in the EU Treaties should follow the example of the EIB, which is connected to the EU legal framework, but maintaining its independence through "its own protocol, its own capital and accountability to its shareholders"[185]; according to Regling, this model could preserve the efficiency of the ESM within the various layers of the EU institutional setting. Not only Jean Claude Juncker and his Commission backed the EMF proposal, but also the Dutch Finance Minister and Chairman of the Eurogroup Jeroen Dijsselbloem displayed its support for a "European IMF" in the long term period, in order to break up the Troika after acquiring the technical expertise from the international counterpart in crises management.[186]

Another EU institution which put pressure on European leaders for the integration within the EU legal framework of the ESM through the EMF establishment is the European Parliament. The EP claims for the

[184] A. Gasparotti, M. A. Minkina., A. Zoppè, (2018), *The ESM and the proposed EMF: a tabular comparison*, Directorate-General For Internal Policies of The Union Economic Governance Support Unit, European Parliament, [Online] Available at: http://www.europarl.europa.eu/RegData/etudes/STUD/2018/614499/IPOL_STU(2018)614499_EN.pdf [May 2019]
[185] Klaus Regling, "A European Monetary Fund: for what purpose?", speech at the Euro 50 Group conference, Brussels, 10th April 2018 [Online] Available at: https://www.esm.europa.eu/speeches-and-presentations/european-monetary-fund-what-purpose-speech-klaus-regling [May 2019]
[186] M. Martin, P. Carrel. (2017), *Euro zone's Dijsselbloem wants bailout fund turned into a European IMF,* Reuters [Online] Available at: https://www.reuters.com/article/us-eurozone-esm-idUSKBN16Q0SL [May 2019]

introduction of the Communitarian law of the ESM trace back to 2013, but it has been updated in 2017 after the Five Presidents' Report on the finalization of the EMU. The main pattern constituting the support of the EP about the formation of European Monetary Fund is the absence of democratic accountability which characterizes the ESM and its operations workings, which could be solved through a well-structure incorporation of the ESM Treaty in the acquis communitaire.[187] The EP further maintains that the inclusion of the ESM in the Treaties would improve the lending capacity of the ESM, improving its capacity of shock absorption through operating more closely with the Commission in the economic analysis phase and acting more rapidly and effectively. Furthermore, the entrance of the stability mechanism in the EU legal framework would foster the introduction of further EU financial proposals, such as the Euro budget and Eurobonds. The European Parliament requests for more democratic accountability for the ESM has been recently backed by the European Economic and Financial Affairs Commissioner Pierre Moscovici, who maintained that the intergovernmental nature of the stability mechanism should be substituted by a structure which entails the control of the EP.[188]

After the 2008 financial shock and the subsequent European sovereign debt crisis, numerous EU member states leaders have expressed their position over the proposal of a European Monetary Fund, with ever-changing views according to the ever-shifting majority in sovereign governments. However, the establishment of a roadmap for the deepening of the EMU by the Commission in December 2017 has led to the dissipation of the fog which surrounded the single positions of member states over the proposal of a European IMF. In particular, the three countries which actually have substantial veto power in the decision-making apparatus of the current ESM (namely France, Germany and Italy) dissent more than a little over the evolutionary path the EMU should follow regarding its bailout fund, as explained in the following paragraphs.

The European personality who most fervently pushed for the adoption of the EMF is the French President Emmanuel Macron, who set as a fundamental pillar of his vision of a Eurozone reform, together with the composition of the Eurozone budget and the creation of a Eurozone Finance Minister, demanding more risk-sharing within the euro area. Macron's vision of a European Monetary Fund consisted in a lending institution for countries which risk financial default. Furthermore, the EMF should be endowed with crisis prevention tools too. While the ESM already has the possibility to pursue crisis prevention and crisis management programmes, Macron is open to the EMF playing a bigger role in bail-outs than the current ESM, especially because the French president harshly criticized the operations of the IMF within the Troika system, stating

[187] European Parliament, *Improving the functioning of the European Union building on the potential of the Lisbon Treaty*, Strasbourg, Resolution of 16 February 2017, (2014/2249(INI))
[188] J. Strupczewski (2017), *Deeper euro zone integration must unite EU – Commission*, Reuters, [Online] Available at: https://af.reuters.com/article/worldNews/idAFKBN1DY20T [May 2019]

that there is “no room” for the IMF in European economic affairs, finding the support of both Greek and German authorities[189].

Macron’s proposal on the creation of the EMF resulted in the return of the debate regarding the future of the EMF, which slightly faded after the Gros and Mayer’s article and the establishment of the ESM. German authorities answered to the document on the reform of the euro suggested by Macron: despite both France and Germany being favourable to the integration within the EU legal framework of the ESM for democratic accountability reasons, their opinions structure and organization of the future European Monetary Fund are far from being similar. One of the most prominent figure in the German political scenario, former German Finance Minister Wolfgang Schäuble, came out with a counterproposal for the evolution of the ESM: he suggested that the ESM should become the paladin of fiscal discipline and fiscal responsibility in the EMU, with more powers endowed on matters such as monitoring compliance to the SGP criteria and debt restructuring. Despite suggesting that the ESM should continue to cooperate with other institution, the expansion of powers suggested by Schäuble’s proposal suggest the formation of a more independent institution, more administrative and more entitled to take important political decisions on its own. Such proposal was questioned by French authorities. The concern within French representatives regard the possibility of a new EMF keener on controlling national budgets which could easily become the new tool of Germany to impose its austerity and Ordoliberalism in the Eurozone[190]. Furthermore, as maintained by several experts, Schauble’s vision of the sovereign bail-out fund exclusive of the euro area imply the ability of it to cope with major external shocks, hence its entanglement with central bank financing; an option which in Berlin and in the ECB is not welcomed[191]. Angela Merkel’s official position on Macron’s vision about the future of the euro is difficult to be decoded, due to the weakness of its majority after the 2018 German elections: within its party, The Christian Democrats Party (CDU), many representatives have expressed their opposition towards the French proposal and their concerns regarding the risks of German liabilities if the size of the fiscal backstop within the EMU is enlarged due to the new configuration of the EMF.[192] On the other side of the government coalition, the Social Democratic Party mostly shares the view expressed by Macron’s project, creating an important impasse within the German political scenario which has halted the process of reform of the Eurozone until December 2018, and which temporarily blocked the introduction of the EMF in the EU institutional setting[193].

[189] M. Khan (2017), *Emmanuel Macron offers vision for Europe and lobs thunderbolt at IMF*, Financial Times [Online] Available at: https://www.ft.com/content/9cf31be8-947f-11e7-a9e6-11d2f0ebb7f0 [May 2019

[190] C. Grant (2018), *Macron’s plans for the euro*, Centre for European Reform (CER), [Online] Available at: https://www.cer.eu/sites/default/files/insight_CG_23.2.18_fin_0.pdf [May 2019]

[191] P. Briançon (2017), *A political fog on eurozone reform — courtesy of Paris and Berlin*, POLITICO, [Online] Available at: https://www.politico.eu/article/a-political-fog-on-eurozone-reform-courtesy-of-paris-and-berlin/ [May 2019]

[192] M. Dawson (2018), *No bailout fund without representation*, POLITICO, [Online] Available at: https://www.politico.eu/article/opinion-europe-bailout-fund-without-representation/ [May 2019]

[193] *Ibidem*

More transparent and decisive is the stance over the European Monetary Fund of Northern European countries, led by the Netherlands. Eight countries signed a joint statement in which, apart for claiming that the discussions over an EMU reform should not be an exclusive project of France and Germany, maintain the necessity to create an EMF which should enjoy enhanced powers in monitoring the budgetary situations of member states in developing financial assistance programmes. Northern European countries believe in the intergovernmental nature of the decision-making system of the ESM, which should be replicated in the future EMF.[194]

Last but not least, the new Italian government expressed its position over the proposed reform of the EMU through a note of the Office of the Relations with the European Union of the Chambers of Deputies, sustaining the incorporation of the ESM within the EU Treaties through the formation of an European Monetary Fund under certain conditions:

- First of all, no macroeconomic stability monitoring tasks should be assigned to the EMF, since it would represent a duplication of the functions of the Commission;
- The discussions over the institution of the EMF should be delayed after the 2019 European elections;
- The EMF structure should be almost identical to the one of the ESM, with the addition of an explicit refence clause to the Charter of Fundamental rights of the European Union;
- The relationship between the EMF and the other European institutions, in particular the European Parliament, should be strengthened;[195]

The discordant visions not only between EU institutions and member states, but also within the sovereigns, led to the 2018 ESM reform, which do not include the formation of an official EMF. However, in a subtle way, EA 19 countries and EU institutions consider the inclusion of the ESM within the EU legal framework as a necessary step for the deepening of the EMU and the financial stabilization of the euro area. The next paragraph will analyze the Commission's idea of a European Monetary Fund, recommended in the "Council Regulation for the establishment of the European Monetary Fund" and in its annex comprising the EMF statute.

4.4.2 The 2017 EMF Commission proposal and the EMF statute

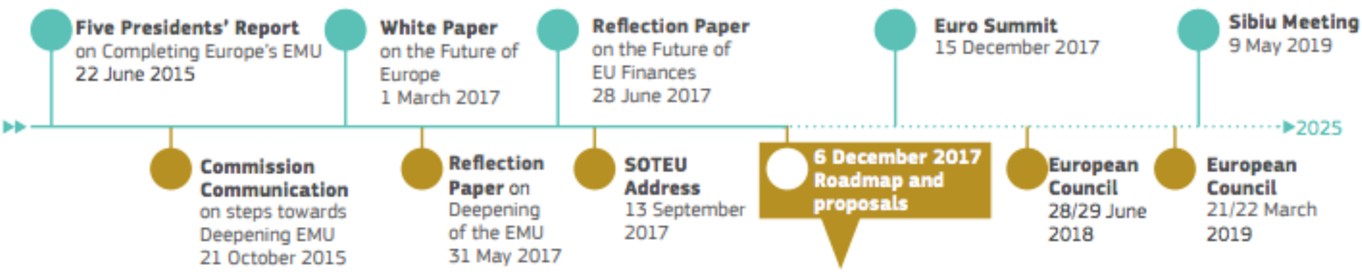
The Council Regulation of the European Commission which describes the establishment of the European Monetary Fund draw inspiration from numerous documents and statements made by EU representatives: from the 2015 Five Presidents Report to the Commission's White Paper on the Future of Europe, the main source

[194] *Finance ministers from Denmark, Estonia, Finland, Ireland, Latvia, Lithuania, the Netherlands and Sweden underline their shared views and values in the discussion on the architecture of the EMU*, Joint Statement published on the 6th of March 2018

[195] Camera dei Deputati (2019), "*La riforma dell'Unione economica e monetaria*", Rome, Ufficio Rapporti con l'Unione Europea XVIII Legislatura, published on the 2nd of April 2019.

is represented by the State of the Union address on 13 September 2017, delivered by President Juncker, in which he delineated the principles for a stronger European Union. Juncker emphasizes the need for a deeper EMU based on greater unity, with non-Euro area countries which are committed to enter the monetary union, greater efficiency, with all intergovernmental agreements to be integrated in the EU legal framework, and greater democratic accountability, based on more transparency and responsibility within EU institutions.

The Council Regulation outlines the transformation of the ESM into the EMF, with its inclusion in the EU legal basis through Art.352 of the TFEU and the use of the special legislative procedure requiring the unanimity vote in the Council and the consent of the European Parliament. The Commission established a timeline for the formation of the EMF, with the Sibiu Meeting on the 9th of May as the final prospected stage for the official entrance of the ESM in the EU Treaties.



Source: European Commission[196]

The Regulation outlines the new accountability provisions of the EMF; a more structured and enhanced relationship with the EP is established, with the EMF which has to provide annual adjournments on the completion of its objectives, with the possibility for MEPs and specific parliamentary committees to question the EMF. Furthermore, the EP will play a greater role in the appointment procedure of the EMF managing Director: as established in Art. 7 of the EMF statute, the Managing Director will come up from a shortlist of candidates drawn by the Board of Governors. Then, the Council will appoint the Managing Director after having consulted the European Parliament, enhancing the political responsibility of the Managing Director, and of the EMF in general. Furthermore, the Regulation affirms the need for national parliament to be equipped to exercise an oversight function over the operations of the EMF.[197]

As regards the governance of the European Monetary Fund, the Council Regulation proposed by the Commission suggest the strengthening of the current governance of the ESM, which reflects the reaction of European leaders to an unprecedented crisis for the EMU. The intergovernmental nature of the ESM, according to the Commission, could halt the efficiency of the institutions due to the required involvement of the national parliaments and the difficulties in reconciling the position of 19 countries. The Commission suggests the inclusion of the ESM in the EU treaties as a way to speed up the decision-making process thanks

[196] European Commission (2017), *Completing Europe's Economic And Monetary Union: The Commission's Contribution to the Leaders' Agenda,* European Commission, [Online] Available at: https://ec.europa.eu/commission/sites/beta-political/files/further-steps-completing-emu_en.pdf [May 2019]

[197] European Commission (2017), *Proposal for a Council Regulation on the establishment of the European Monetary Fund*, Brussels, 6th of December 2017, COM(2017) 827 final, Annex

to the numerous practices present in the EU legal framework for making the conversion of official acts more fluid. In this way, the EMF could benefit from the formation of synergies with the other EU institutions, reinforcing the procedures of the bailout fund of the EMU.[198]

The major revision of the EMF governance proposed by the Commission in Council Regulation, and present also in the annexed EMF statute, regards the decision-making procedure for the approval of the use of financial tools under different situations. While maintaining the same organizational structure, the mutual agreement procedure of the current ESM disappears from the text of the EMF statute. In art. 4 of the EMF statute proposed by the Commission, the BoG and the BoD will take decisions through "unanimity, reinforced qualified majority, qualified majority or simple majority", according to specific situations. The unanimity procedure is maintained for impactful financial measures such as capital calls or modification of the EMF lending capacity. The reinforced qualified majority, which resembles the emergency procedure of the Board of the Directors already present in the ESM Treaty, requires the 85% of the votes cast, and it is applied to measures such as granting and disbursement of financial packages to the member states of the European Monetary Fund. Furthermore, the reinforced majority decision-making process will regulate the disposal of the backstop function of the EMF for the Single Resolution Fund. According to the Commission, the introduction of the reinforced majority for urgent financial disposition significantly streamlines the decision-making process, while preserving the intergovernmental method and the member states representation in the fund. Furthermore, the EMF establishment tries to streamline the decision-making process through the decreasing of the role played by the Eurogroup and the Council by using best practices, following the example of the IMF.[199]

In relation to the evolution of the relationship between the EMF and the IMF, the proposed EMF statute does not mention in any of its articles the International Monetary Fund: this means that the IMF functionaries will not participate to the meetings of the Board of Governors anymore, and the IMF will not be involved in the determination of the conditionality attached to the financial support provided by the EMF, actually excluding the most important international bailout fund from the legal document establishing the European Monetary Fund, enshrining the downward spiral of a partnership which happened in several occasions during the sovereign debt crisis, but which was harshly criticized by European leaders. However, the Council Regulation suggested by the Commission envisions structured relations for the EMF with third states and other international organization.

Another important reform present in the EMF Statute refers to the relationship with the Commission itself, in particular about the negotiation phase of the financial assistance provided to member states. As regards the

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[198] European Commission (2017), "*Proposal for a Council Regulation on the establishment of the European Monetary Fund*", Brussels, 6th of December 2017, COM(2017) 827, 3
[199] C. Wyplosz (2017), "*A European Monetary Fund?*", European Parliament provided at the request of the Economic and Monetary Affairs Committee, [Online] Available at: http://www.europarl.europa.eu/RegData/etudes/IDAN/2017/602076/IPOL_IDA(2017)602076_EN.pdf [May 2019]

MoU for the granting of financial support to a country in financial difficulties, while in the ESM treaty it was established that the Commission "shall sign the MoU on behalf of the ESM" (art. 13), the EMF statute maintains that the EMF will sign the MoU together with the Commission, sanctioning the maturity that the ESM has achieved after years and years of crisis management and following the prospected more comprehensive liaison between EMF and Commission suggested by Klaus Regling on financial programme design, negotiation and compliance monitoring[200]. Furthermore, EMF and Commission will cooperate (together with the ECB) in the negotiation phase in order to delineate the policy conditionality to be attached in the MoU. The assessment phase regarding the risks for the euro area, the debt sustainability and the financial needs of the member state which officially requested financial support to the EMF BoG still remains in the hands of the Commission and of the ECB.

The Council Regulation proposed by the European Commission for the implementation of an European Monetary Fund establishes that the ESM toolkit will be maintained also for the EMF, together with its initial capital stock and lending capability; however, it envisions the possibility for the new institution to develop new financial instruments to fulfill its mission of financial stability maintenance of the euro area. The possible new tool suggested by the Commission refers to policies fostering a macroeconomic stabilization function of a Eurozone country. According to the Commission, the EMF, by giving loans to member states without conditionality, could automatically mobilize countercyclical policies in the country. In order to activate this instrument:

- The sovereign state should rely first on their national stabilizers and their fiscal policies, and consider the EMF intervention as the extrema ratio[201];
- The stabilization function can be activated only if eligibility criteria are met; the assessment would be managed by the Commission, while the EMF would support the member state in the financing organization[202].

It must be emphasized that the EMF statute envisions a substantial transformation in the general principles of the most important crisis management institutions in the EMU: indeed, the Commission proposes the modification of art. 12 of the ESM statute, establishing that the EMF should provide financial support "If indispensable to safeguard the financial stability of the euro area or of its Member States" The use of the conjunction "or" rather than "and" as in the ESM Treaty suggests the fact that the European Monetary Fund can intervene even if there is no clear contagion risks for the financial stability of the euro area. Furthermore,

[200] Klaus Regling, *"A European Monetary Fund: for what purpose?"*, speech at the Euro 50 Group conference, Brussels, 10th April 2018 [Online] Available at: https://www.esm.europa.eu/speeches-and-presentations/european-monetary-fund-what-purpose-speech-klaus-regling [May 2019]
[201] A. Zoppè, C. Dias (2019), "*The European Stability Mechanism: Main Features, Instruments and Accountability*", Economic Governance Support Unit (EGOV), European Parliament, [Online] Available at: http://www.europarl.europa.eu/RegData/etudes/BRIE/2014/497755/IPOL-ECON_NT(2014)497755_EN.pdf [May 2019]
[202] European Commission (2017), "*Proposal for a Council Regulation on the establishment of the European Monetary Fund"*, Brussels, 6th of December 2017, , COM(2017) 827, 11

this transition regarding the mission of the EMF more towards the difficulties of the single member states rather than the Eurozone in general is confirmed also by the fact that Art. 12 of the Statute eliminates the phrase “as a whole” after the words “euro area”, which instead is present in Art. 12 of the ESM Treaty. Art 12 plays a pivotal role in the EMF Statute because in its comma 2 it includes the compliance obligations for the EMF towards the Charter of the Fundamental Rights of the European Union, in particular art. 28 on the right of collective bargaining and action, in relation to the will by the Commission to abandon the introduction of CACs in Eurozone sovereign bonds. In addition to this, the explicit reference to the European Charter of Fundamental Rights in the EMF Statute, together with the mentions made in the Council Regulation proposal, exacerbates the protection of personal data and the increase of transparency for the EMF compared to the ESM. This novelty is not only due to the foreseen introduction of the ESM in the EU legal framework, but it is also the reduction of the pressure exercised by the other EU institutions such as the European Parliament, and NGOs such as Transparency EU, as explained earlier (see 3.2.5)[203].

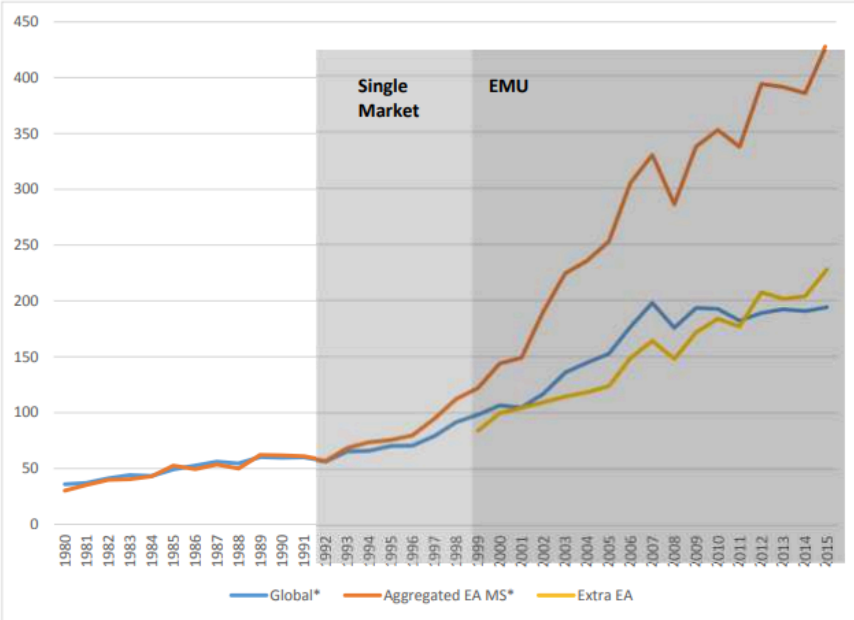
4.5 Objections on the formalization of the EMF

While the EMF has not been formally established yet, its structure, its mission and its operationalization have sparked the debate within the EU institutions, the European leaders and the academics, not only regarding the possible flaws of a “European IMF.

4.5.1 Cross-border debt

The questions over the establishment the EMF have been raised once again not only because of the political initiative by the French President by Emmanuel Macron, or by the technical proposal of the Commission, but also because of the worrying increasing trend involving the cross-border debt. As shown in the figure below, extrapolated from the a paper requested by the European Parliament titled “An evolutionary path towards an European Monetary Fund”, the level of cross-border financial exchange of assets and liabilities of the euro area has experienced an exponential increase after the formation of the EMU, which has been exacerbated by the crisis. Alongside the rise of intra euro-are financial flows, intra euro-area debt has witnessed a sheer increment. Initially the vast majority of this EMU intra-debt was constituted by private debt; however, percentage of the total cross-border public debt involving the EMU member states has escalated from 5% to 20%[204].

[203] A. Gasparotti, M. A. Minkina., A. Zoppè, (2018), *The ESM and the proposed EMF: a tabular comparison*, Directorate-General For Internal Policies of The Union Economic Governance Support Unit, European Parliament, [Online] Available at: http://www.europarl.europa.eu/RegData/etudes/STUD/2018/614499/IPOL_STU(2018)614499_EN.pdf [May 2019], 4
[204] D. Gros (2017), *An evolutionary path towards a European Monetary Fund*, European Parliament provided at the request of the Economic and Monetary Affairs Committee, [Online] Available at http://www.europarl.europa.eu/RegData/etudes/IDAN/2017/602075/IPOL_IDA(2017)602075_EN.pdf [May 2019], 15



* For each year all available IIP data from the country group relative to the respective aggregated GDP.
Data source: IMF, World Economic Outlook database.

Source: European Parliament[205]

The rising level of EMU cross-border debt will provoke a meaningful impact on the operations of the EMF, since future economic adjustment programmes could have greater magnitude than the ones which have been already completed by the ESM. This hypothesis poses serious doubts on the entire structuration of the EMF: from the funding, to the governance, passing through the risks for the lender and the borrowers and the independency from the IMF. At the same time, the possibility of an exclusive bailout fund for the Eurozone opens up numerous opportunities for the further development of the EMU, since in order to avoid future crises, and to expand and make more effective the crisis prevention policies of the EMF, several developments in the structure of the euro area are required.

4.4.3.2 Moral Hazard

One criticism moved towards the transformation of the ESM into an European Monetary Fund is the absence of any reference or tool to avoid to the problem of moral hazard; indeed, despite the trend is always to blame the borrower, the possibility for the lender to disburse excessive amounts of capital to a country compared to its debt is real. Indeed, the temptation for the international lender is to grant any volume of loans, and not just the sufficient amount of capital because the burden of the costs in the case if failure of the programme will be beard by the private sector and the fiscal system of the beneficiary country. Hence, also regional funds should equip themselves with instruments to eliminate such circumstance, as the IMF did with the "excessive access procedure"[206]. On the contrary, the EMF Statute proposed by the Commission eliminates the only instrument in the hands of the ESM to control the moral hazard tendency, which is the introduction of CAC in all euro

[205] Ibidem, 15
[206] C. Wyplosz (2017), "*A European Monetary Fund?*", European Parliament Provided at the request of the Economic and Monetary Affairs Committee, [Online] Available at: http://www.europarl.europa.eu/RegData/etudes/IDAN/2017/602076/IPOL_IDA(2017)602076_EN.pdf [May 2019], 5

area bonds: While the existing CACs still give the opportunity to minority shareholders to block possibilities of debt reduction, the decision of the Commission to delegate negotiation procedure regarding the these clauses to national legal systems makes the moral hazard solution path more uncertain. Furthermore, the EMF establishment proposal does not envision an ex-post evaluation of the loans given to a beneficiary country, which could establish the well-design of the adjustment programme, or the risks of excessive lending and the analysis of a possible debt restructuring.[207] Such task should be outsourced to an independent body, whose designation is complicated; within the EU institutional setting the bodies endowed with the technical expertise in order to finalize this ex-post analysis are the ECB and the Commission. However, due to their involvement in the development of financial aid programmes, and the influence that national interests can indirectly exercise on such institutions, their independency is debatable[208]. Arguably, the European Investment Bank (EIB) could represent another valid option for the conduction of an evaluation of EMF, due to its similarities with the current ESM on matters of lending procedure and governance, and its technical experience in developing project appraisals on its own.

However, the total opposition within the EIB and the ESM/EMF on the mission they must pursue (the ESM/EMF aims at the financial stability of the euro area, while the EIB aims at the development of the internal market through public and private investments) makes this partnership more complex. Since the IMF is progressively being excluded from the talks over the future EMF, the only option available is to delegate the ex-post analysis of EMF loans to private independent agencies, whose involvement could increase the political costs for the beneficiary country, which could translate in more social instability and a reputational shock for the EMF.

One of the most controversial aspects of the EMF proposal regards its governance and how it should work: the Council Regulation proposed by the Commission and the EMF Statute attached to it still envisions unanimity decision-making process, beside the reinforced majority system to decide over the most influential policies in the hands of the EMF. On the other hand, the IMF takes its most important decisions such as modifications of the quota system or the deployment of Special Drawing Right (SDR), which aid the official reserves of a sovereign member state through simple majority. Arguably, IMF's decision-making system appears smoother and more efficient, and while the Commission's intent is to bring closer the ESM to the international bailout fund, the reform proposed does not represent a decisive step forward towards that direction

[207] Ibidem, 23
[208] Ibidem, 6

4.5.2 The relationship with the EU institutional setting

The relationship with the other European institutions represents an extra shortcoming of the proposal of a European Monetary Fund by the Commission. The institution of the EMF could be considered the crucial step for the long-term project of integration of the ESM within the EU legal framework, which is an assessment addressed and supported by all the protagonist of the EU political scenario. Nonetheless, the entrance of the European bailout fund in the EU institutional setting, and especially the evolution of the latter after this major reform have been discussed vaguely by the Council Regulation and the EMF Statute. Moreover, the introduction of the ESM through its transformation in the EMF in a multilayered institutional framework as the one characterizing the European Union, where numerous interest conflict horizontally (within EU institutions) and vertically (within EU entities and nations states), could alter the efficiency of the fund's decision-making process, and the effectiveness of its programmes. Indeed, as seen earlier, the ESM has enjoyed a great level of independency in relation to the other institution on several aspects (respect of the Treaty provisions, selection of the personnel etc.) thanks to its establishment through an intergovernmental agreement under Luxembourg law. In particular, the Commission has not specified exhaustively the relation between the new EMF and the Commission itself. Indeed, the risk of overlapping competences between the two European institutions on matters such as financial evaluation, negotiation and formulation of the economic adjustment programmes is concrete. The financial supervisory coordination between EMF and Commission envisioned in the Council Regulation could lead to flawed transfer of information between the two institutions, due to reasons of confidentiality and hierarchy, and conflicts due to blame game in moments of crisis. In order to solve this conundrum, Daniel Gros and Charles Wyplosz suggested in papers requested by the European Parliament the division of responsibility for the maintenance of the financial stability of the Eurozone between the EMF and the Commission: the Commission should remain responsible for the general economic surveillance of the EU, focusing on enhancing the influence of the clauses established in the Stability and Growth Pact, while the EMF should perform a surveillance role on patterns which constitute a concrete danger for the stability of the euro area[209]. According to Gros, fields of coordination between EMF and EC should exist, such as in Macroeconomic Imbalance Procedures (MIP), in which the EMF should provide the technical expertise in collaboration with the omission in order to draft reports to be presented to the Council which would then decide whether to start an excessive imbalance procedure[210].

[209] Gros D. (2017), "An evolutionary path towards the European Monetary Fund", European Parliament Provided at the request of the Economic and Monetary Affairs Committee [Online] Available at: http://www.europarl.europa.eu/RegData/etudes/IDAN/2017/602075/IPOL_IDA(2017)602075_EN.pdf [May 2019]
[210] Ibidem, 21

4.5.1 The question on the EMF technical staff

The evolution of the ESM in a complete European bailout fund envisions the enhancement of its powers on not only matters of crisis management, but also of crisis prevention, in line with the objectives of its international counterpart; the IMF. Despite being just a regional fund, the ESM has a similar capital to the total quotas of the IMF (€700 billion for the ESM, $1 trillion for the IMF, but in reality is nearly $700 billion) and also similar lending capacity (€500 billion for the ESM, $750 billion for the IMF). In proportion though, the IMF interventions have a much lower impact than the ones of the ESM on the GDP of its member states.[211] With the possibility an increase in the size of economic bailout programmes in the euro area, and with new tasks given by the EMF statute, there is no room for making mistakes by the European Monetary Fund. Hence, the EMF should equip itself with high-skilled staff to perform all its new functions perfectly. At the moment, the ESM employs just 200 workers divided in sectorial teams (risk management, policy, investment etc.), extremely less than the 2,700 employees of the IMF.[212] However, an augmentation of the number of staffers in the EMF poses some objections:

- The number of candidates for entering in an economic adjustment programme of the EMF is much less than the ones of the IMF, with the risk for EMF employees to sit back and not being involved in any economic operations for years. At the moment, no programme is still ongoing and the main operations of the ESM consists in examining and monitoring the repayment of the loans by the beneficiary states[213].
- In order to keep the EMF staffers constantly active, the focus of the bailout fund should shift to crisis prevention, implying also a degree of economic surveillance. This circumstance, if not managed correctly, could lead to a duplication of activities with reference to the competences of the Commission and the Economic and Financial Affairs Committee. In order to avoid this correspondence of objectives between the two institutions, a formal distribution of competences should be established. However, the actual situation remains vague.

[211] D. Gros (2017), *An evolutionary path towards a European Monetary Fund*, European Parliament provided at the request of the Economic and Monetary Affairs Committee, [Online] Available at http://www.europarl.europa.eu/RegData/etudes/IDAN/2017/602075/IPOL_IDA [May 2019], 12

[212] A. Zoppè, A. Gasparotti (2018), *The ESM and the IMF: comparison of the main features*, Economic Governance Support Unit, European Parliament [Online] Available at: http://www.europarl.europa.eu/RegData/etudes/IDAN/2017/614485/IPOL_IDA(2017)614485_EN.pdf [May 2019], 4

[213] D. Gros (2017), *An evolutionary path towards a European Monetary Fund*, European Parliament provided at the request of the Economic and Monetary Affairs Committee, [Online] Available at http://www.europarl.europa.eu/RegData/etudes/IDAN/2017/602075/IPOL_IDA[May 2019], 21

4.6 The establishment of the EMF as a source of opportunity for a deeper integration of the EMU

As stated earlier, the establishment of a European Monetary Fund is long-term project which entail in the first place the introduction of the ESM in the EU Treaties. With this major change, the EU economic governance would witness a yet another fundamental reform. However, in contrast to the 2010 – 2012 when the introduction of crisis management tools was rushed, European leaders, both in the member states and in the communitarian institution, may take advantages of this period of relatively stable economic situation of the Eurozone after the end of the Greek bailout programme not only to formally create the EMF, but also to pursue several project which could not only better harmonize the monetary union, but also to strengthen the validity and the effectiveness of the EMF.

4.6.1 The Euro Budget

In fact, Emmanuel Macron's proposal for the reform of the Emu already envisioned several novelties which could be introduced in the European economic governance together with the EMF or as a corollary of the inclusion of the Eurozone bailout fund in the EU institutional setting. One suggestion which has been present in the discussion over the structuration of the Emu for years, and which witnessed an important push thanks to Macron's political initiative is the option for the EA19 to access to their own financial budget parallel to the already existing EU budget. French vision of an euro area budget is strictly connected with the eventuality of an European IMF, since the former would represent an investment budget in which every member state contribute and benefit from it, while the EMF will be structured as a lending instrument for countries needing financial aid to prevent or avoid default. The proposal by the French President and his advisory seem utopist taking in consideration the different point of views on how to use and manage public investments between EA19 countries. Furthermore, the proposal for a eurozone budget suggested by France was rejected by various Northern European countries led by the Netherlands, and it was tempered by German authorities, which have never been keen on deepening the EMU enhancing financial risk sharing and fiscal transfer union.[214] Nonetheless, France and Germany finally found a synthesis of their ideas regarding the eurozone budget in June 2018 when they jointly signed the Meseberg Declaration for "Renewing Europe's promises of security and prosperity"[215]. In this document, both French and German authorities agree on forming a euro area budget within the EU Treaties with the mission of promoting "competitiveness, convergence and stabilization in the euro area"[216]. The eurozone budget should become operative in 2021, while the funding and the size of such instrument should be decided during the Multiannual Financial Framework (MFF) 2021-2027 negotiations.

[214] C. Grant (2018), *Macron's plans for the euro*, Centre for European Reform (CER), [Online] Available at: https://www.cer.eu/sites/default/files/insight_CG_23.2.18_fin_0.pdf [May 2019]

[215] France and Germany, *Meseberg Declaration: Renewing Europe's promises of security and prosperity,* signed in Meseberg on the 19th of June 2018. [Online] Available at: https://archiv.bundesregierung.de/archiv-de/meta/startseite/meseberg-declaration-1140806 [May 2019]

[216] Ibidem

The Meseberg Declaration represented a crucial step forward for the political initiative needed in order to develop an important economic project for the Eurozone

Indeed, the Euro Summit held in December 2018 asked to the Eurogroup to define the specifics for the "a budgetary instrument for convergence and competitiveness for the euro area, and ERM II Member States on a voluntary basis."[217] Such details consist in the size, the financing, the governance, accessibility and the definition of the objectives of the Eurozone budget.

As regards the size and the financing of the new proposed instrument, the Eurozone budget should be incorporated in the EU budget. This assessment provokes two important reservations on the proposal:

- In the MFF 2014-2020, the EU structural funds taken form the EU budget and transferred to EA19 countries pile altogether to 27bn per year. The size of the Eurozone budget, according to the ideas of Macron, should be composed by several percentage points of the eurozone total GDP, which would overcome the total amount of structural funds dedicated to euro area countries by far. Such difference could create important obstacles in the negotiation of the MFF 2021-2027, apart from the specific discussions on the euro budget.[218]
- Furthermore, EA19 countries would face the opposition of non-euro countries, which in order to complete the formation of the Eurozone budget, could see the disbursement of structural funds diminish.[219]

In order to solve the size issue, the resources for the Eurozone budget, as maintained in the Meseberg Declaration, should come from "both national contributions, allocation of tax revenues and European resources"[220]. As regard the allocation of tax revenues, no specifics are expressed neither in the Declaration, not in the Statement of the Euro Summit. A possibility could be the introduction of a corporate common tax (to be summed to already existing VAT tax percentage which flow in the EU budget), which have to meet a predetermined amount of capital, taking in consideration the business cycles of the participating countries[221]. In this way, countries facing a downward economic spiral would pay less than the ones with stable finances, while at the same time creating a degree of economic cycle convergence in the euro area. However, this proposal presents an institutional and an economic flaw:

- Institutionally speaking, a Eurozone common corporate tax is not easily feasible in the context of the EU Treaties. Furthermore, the political willingness to undergo to such initiative (which could possibly

[217] Euro Summit, *Statement of the Euro Summit*, Brussels, 14th of December 2018, EURO 503/18
[218] O. Funke, L. Guttenberg, J. Hemker, S. Tordoinr (2019), *Finding common ground: A pragmatic budgetary instrument for the euro area*, Berlin, Bertelsmann Stiftung and the Jacques Delors Institute Berlin, Policy Paper, February 2019, 9
[219] Ibidem, 9
[220] France and Germany, *Meseberg Declaration: Renewing Europe's promises of security and prosperity,* signed in Meseberg on the 19th of June 2018. [Online] Available at: https://archiv.bundesregierung.de/archiv-de/meta/startseite/meseberg-declaration-1140806 [May 2019]
[221] C. Grant (2018), *Macron's plans for the euro*, Centre for European Reform (CER), [Online] Available at: https://www.cer.eu/sites/default/files/insight_CG_23.2.18_fin_0.pdf [May 2019]

shake completely how the Union collect revenues) is not so firm and could extend he time for the EMU reform.

- Economically speaking, if Eurozone countries face a period of low economic growth, the possibility for the euro budget to collect the necessary contribution will face enormous obstacles, possibly leading to cut expenditures and increasing deficit for the instrument, increasing the difficulties in investment planning. Hence, a common corporate tax must be preceded by a sufficient degree of convergence of the business cycles of the EA19. [222]
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As regard the governance of the euro budget, the Euro Summit statement envisions the euro budget more as a political body rather than a technical instrument. In a paper published jointly by the Bertelsmann Stiftung and the Jacques Delors Institute Berlin, the authors suggest that the Eurogroup and the Euro Summit would play a major role in the decision-making process for the disbursement of capitals by the euro budget. The presence of the Eurozone budget in the EU Treaties imply the scrutiny of the European Parliament in order to ensure a certain level of democratic accountability to the instrument, while the Commission should play administrative role and ensure the implementation of the decisions taken by the euro budget

In relation to the mission of the Eurozone budget, the euro budget, which could be named "Budgetary Instrument for Competitiveness and Convergence" (BICC), as stated by Moscovici,[223]will concentrate on:

1. **Competitiveness**: the definition of competitiveness for a monetary union is not confined to unit labor cost and price competitiveness, but also productivity growth, as Paul Krugman stated in a famous *Foreign Affairs* publication.[224] Hence, the euro budget should target production boost, enhancing even more its objectives
2. **Convergence**: in this case, the term convergence does not refer just to income convergence between EA19 countries, but most importantly business cycles convergence. Indeed, the sovereign debt crisis has been exacerbated by the enormous macroeconomic imbalances within the euro area[225]. Some tools have already been introduced in the European economic governance to boost convergence (SGP criteria and MIP), but the euro budget could differentiate itself by the other instruments by providing countercyclical measures, not following the austerity example which characterized the euro area governance since 2010.

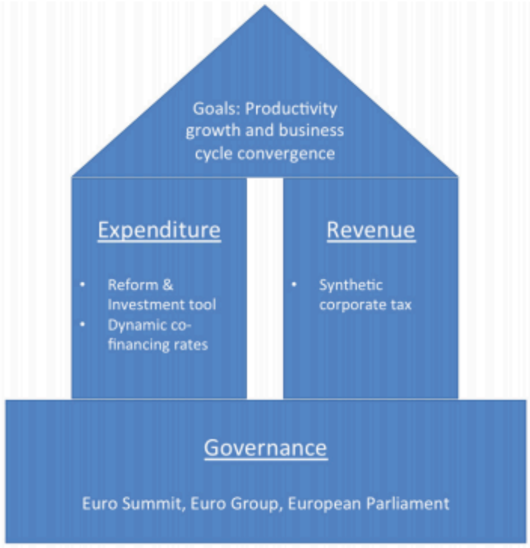
[222] O. Funke, L. Guttenberg, J. Hemker, S. Tordoir (2019), *Finding common ground: A pragmatic budgetary instrument for the euro area*, Berlin, Bertelsmann Stiftung and the Jacques Delors Institute Berlin, Policy Paper, February 2019, 7

[223] P. Moscovici (2019), *Commissioner Moscovici's introductory remarks at the Eurogroup press conference*, European Commission Press Release, [Online] Available at http://europa.eu/rapid/press-release_SPEECH-19-2592_en.htm [May 2019]

[224] , P. Krugman (1994), *Competitiveness: A Dangerous Obsession*, Foreign Affairs, March/April 1994 issue.

[225] O. Funke, L. Guttenberg, J. Hemker, S. Tordoinr (2019), Finding common ground: A pragmatic budgetary instrument for the euro area, Berlin, Bertelsmann Stiftung and the Jacques Delors Institute Berlin, Policy Paper, February 2019,

In the end, the structure of the Eurozone budget should follow the design shown in the graph below.



Source: Bertelsmann Stiftung and the Jacques Delors Institute Berlin

However, the mission statement has changed since the Meseberg Declaration, since the stabilization objective initially envisioned has disappeared in the Euro Summit Declaration. Here is where the EMF comes into the discussion: indeed, the creation of an euro budget should be paired with the transformation of the ESM into the EMF, since the latter would perform the stabilization of the euro area function. By proposing the two instruments together, or in a very strict period of time, the European economic governance could alleviate the criticism moved towards the ESM/EMF, especially on the conditionality and the introduction of austerity measures in exchange for financial aids. While the EMF could continue lending signing MoU in which it requires structural reforms to restore the financial stability of a country, on the other side of the medal, the euro budget could provide funds in order to finance public investments and structural reforms, following the objectives of convergence and competitiveness. However, it will be crucial in the establishment of both instruments to avoid the overlapping of duties (for example, EMF precautionary credit lines could resemble the operations of the euro budget), and the formulation of severe criteria to access the tools of the euro budget. For example, if the SGP criteria are taken as benchmark, just a few countries could benefit from the euro budget, with the risk of making it an instrument just for sound countries, enlarging the already increasing gap between EA19 creditor and debt countries. The alternative could be to grant access to countries which maintain their compliance to the requests of the Commission and the Council on how to re-enter within the communitarian limits.

4.6.2 The European Capital Market Union

European leaders could seize the opportunity of the finalization of the European Monetary Fund project by completing the Capital Markets Union (CMU), an initiative proposed by the Commission in 2015 and constituted one of the pillars of the investment programme envisioned by Jean Claude Juncker and the other Commissioners. Indeed, the aftermath of the 2008 financial recession and the consequent sovereign debt crisis in Europe exposed the over reliance of EU companies and investors on bank loans rather than financial instruments. Hence, the Commission believed that, in parallel with the development of the banking Union, the EMU should provide itself with a Capital Market Union allow more investment diversification at a lower price and making the European financial market more resilient to internal and external shocks by creating a single capital market. To pursue this objective, the Commission drafted an action plan to be terminated in 2019 in which it established the direction the EU should follow in order to establish a coherent CMU: the process targeted not only the heavy dependence on the banking system in EU by complementing it with capital market instruments, but also the capacity of the European financial market to boost growth through financing start-ups, innovation and non-listed companies, the facilitation of long-term sustainable investment, institutional investments and international investments, the elimination of cross-border barriers for financing complemented with an enhanced financial supervision and convergence in the EU.[226]

The CMU Action Plan encompassed a mid-term review in 2017 where the Commission analyzed the state of progress of the capital market union in Europe through seven indicators, whose definitions and data are listed in the graph below:

[226] European Commission (2015), *"Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions: Action Plan on Building a Capital Markets Union"*, Brussels European Commission, 30th of September 2015, COM(2015) 468 final.

Index	What this index measures	EU 2012-16 average	EU 2017	National Findings
Market Finance NFC equity and bond issuance as % of total NFC annual financing	Capacity for NFCs to raise finance on public markets	13%	14%	**UK and Ireland** lead the EU countries with over 25% of total NFC new funding raised from markets. **Slovenia, Slovakia, Malta, Cyprus, and Bulgaria** had no NFC bond or equity issuance in 2017.
Household Market Investment Household financial assets saved in financial instruments (excluding cash, deposits and unlisted equity) as % GDP	Availability of pools of capital	114%	118%	**Denmark** has improved the most among EU countries over the last 5 years in the accumulation of household savings in capital markets instruments, due to greater pension coverage and higher savings rates.
Loan Transfer Securitisation, covered bond issuance and loan portfolio transactions as % of outstanding bank loans	Capacity to transform bank loans into capital markets instruments (securitisation, covered bonds and loan transactions)	5.6%	5.2%	**Spain, Italy, Ireland, Greece, and Portugal** (countries with high levels of non-performing loans) are in the top seven EU nations in the loan transfer index in 2017, suggesting an encouraging trend to use market instruments to dispose of distressed assets.
Sustainable Finance Bond issuance labelled as sustainable as % of total bond issuance	Labelling of sustainable bond markets	0.4%	2.1%	**Netherlands, France and Sweden** are the leading EU nations, all with over 3% of bonds issued in 2017 classified as sustainable. **Lithuania** had the highest indicator value in 2017 of almost 10%, but this reflects a single bond.
Pre-IPO Risk Capital Annual investment through equity crowdfunding, business angels, and private equity growth funds and venture capital funds as % of loan and risk capital investment to SMEs	Finance for non-listed companies	1.4%	2.5%	**Estonia, Denmark and the UK** lead by availability of risk capital for SMEs. Estonia has a prominent participation of business angel investment, while **Denmark and the UK** have more diversified sources of risk capital from private equity and venture capital.
Cross-border Finance Composite indicator of cross-border M&A transactions, equity & bond issuance, Private Equity, and portfolio holdings. Range 0-1	Capital markets integration within the EU	0.23	0.25	**Luxembourg, the UK, and Belgium** rank as the most interconnected capital markets with the rest of the EU. **Luxembourg's** lead is due to its fund and bond issues held within the EU, and a prominent share of their total private equity activity invested in companies in other EU countries.
	Capital markets integration with the rest of the world	0.40	0.36	**UK and Luxembourg** are the most globally interconnected European capital markets. The UK prominently participates at intermediating global flows of FX and derivatives trading, cross-border holdings of equity shares, and facilitating public equity raising by non-EU companies.
Market Depth Composite indicator of primary markets issuance, institutional capacity and availability of pools of capital. Range 0-1	Development of CEE markets	0.11	0.13	**The Czech Republic** is the deepest capital market in CEE. In 2017, the Czech Republic was the second-most active primary market for equity and bonds in CEE after Poland; had the highest recovery rate for business insolvency; and was among the top 3 CEE countries with the largest accumulation of savings in market instruments (as % GDP).

Source: Association for Financial Markets in Europe (AFME)

The indicators have shown important improvements in several factors: in particular, European citizens are starting to put their savings into capital market assets rather than in bank deposits or cash, which implies a greater array of financial instruments and more diversification of investment. Furthermore, the amount of capital invested through private equity, venture capital and other instruments by the small and medium enterprises has more than doubled: from €10.6bn in 2013 to €22.7bn in 2017[227]. However, the indicators still

[227] Association for Financial Markets in Europe (2018), *Capital Markets Union: Measuring progress and planning for success*, Report, [Online] Available at: https://www.afme.eu/globalassets/downloads/publications/afme-cmu-kpi-report-3.pdf [May 2019], 5

display shortcomings in the reliance by EU companies on the banking system, with just 14% of their external funding based on bonds or equities. Furthermore, the ability to transform bank loans into other market debt instruments such as covered bonds or securitizations in the EU has dropped since 2013, probably due to the financial crisis which lasted longer than in the rest of the world, and to the heavy regulations which burden the European financial sector compared to the US. In addition, the capital market integration within the EU has just slightly increased, while the rate of integration of the financial markets in Europe calculated through cross-border finance has decreased once again.[228]

The Loan Transfer and the Cross-Border Finance are linked to the proposal of the establishment of the EMF. As seen earlier, the level of cross-border has steadily increased since the creation of the EMU, and after the sovereign debt crisis the trend has been rising constantly. The increase in cross-border debt corresponds to the growth in the size of economic adjustment programmes by the European bailout fund for aiding countries in risk of default. Furthermore, the insistence of investors on loans from banks maintains the dimension of the European banking systems at high rates. With the absence of a totally integrated banking union, in the possibility of another financial crisis, the banking sector in Europe could be once again harmed, and the amount liquidity required to stabilize the situation would skyrocket in comparison with what happened between 2010 and 2014. According to data collected by the Commission, in the event of an economic adjustment programme involving Italy, in order for the EMF to efficiently restore sound finances in the country, the required economic disbursement would amount to almost 250bn euros per year. Therefore, the lending capacity currently in the hands of the ESM will not allow the bailout fund to pursue a three-year economic adjustment programme as for the other 5 cases in which its intervention was asked. Hence, the circumstance of larger bailout interventions should be taken in consideration when discussing the formation of the EMF; though, both in the Council Regulation proposed by the Commission and the EMF Statute, the financing part for the European Monetary Fund remained the same of the current ESM. Despite not being used in its entirety, the ESM would have difficulties in managing programmes with higher disbursements than the ones in which it has been involved; such complications could be exacerbated by the entry of the ESM Treaty in the EU legal framework through its transformation in the EMF, since it would be introduced in a multilayered system which can halt the decision-making process and which could stop the enlargement of capital destined to the institution. Hence, the completion of an European CMU, by creating conditions for investors to rely more on capital market instrument, would lead the downgrading of national banking systems, and would unburden the EMF of enormous recapitalization programmes, whose results are uncertain.[229]

[228] Ibidem, 7
[229] D. Gros (2017), *An evolutionary path towards a European Monetary Fund*, European Parliament provided at the request of the Economic and Monetary Affairs Committee, [Online] Available at http://www.europarl.europa.eu/RegData/etudes/IDAN/2017/602075/IPOL_IDA [May 2019], 16

4.6.3 The Eurobonds

The exhaustive arrangement of the European Capital Market Union, paired with the enhancement of powers of the European bailout fund envisioned in the EMF purpose could revamp the initiative of creating Eurobonds. Eurobonds, or "Stability Bonds", trace back to the Barroso Commission, in particular to the publication of the
"Green Paper on the feasibility of introducing Stability Bonds" in 2011. The Green paper suggests "the introduction of commonly issued Stability Bonds would mean a pooling of sovereign issuance among the Member States and the sharing of associated revenue flows and debt-servicing costs".[230] The Commission further discussed three option for the formulation of these European debt market instruments:

- The creation of Stability Bonds with "joint and several guarantees", which should totally replace sovereign bonds of the nation states
- The issuance of Stability Bonds with "joint and several guarantees", which should partially replace sovereign bonds of the nation states. Member states will continue to issue national bonds at lower levels
- The issuance of Stability bonds with "several but not joint guarantees", which should partially substitute national bonds of the member states. This option is the most feasible one, since it does not require legal changes of the Treaties. However, the effects for the financial stability of the EMU is low.[231]

The advantage of Bonds with joint guarantees by Member States rely not only on the improvement of the resilience of the euro area to further financial shocks due to their increased robustness of the collateral for financial institutions, but would also improve the integration of the EMU capital market thanks to the increased level of issuance the joint guarantees could provoke, also enhancing the role of the euro in the global financial market. Furthermore, the issuance of Eurobonds would render the monetary policy of the ECB more easily implementable and more effective.

Most controversially, the Eurobonds would alleviate the sufferance provoked by the sovereign debt crisis, in particular in the bond market. As maintained by the Commission, the issuance under joint guarantees would allow high-yield Member States to "benefit from the stronger creditworthiness of the low-yield Member States",[232] tampering the spread instability in the euro area. However, the main doubts are raised by the fact that the benefits provided by low-yields countries to financially weaker member states could turn into higher degrees of moral hazard. Under such assessment, Northern countries, led by German Chancellor Angela

[230] European Commission (2011), *Green Paper on the feasibility of introducing Stability Bonds*, Brussels, 23rd of November 2011, MEMO/11/820
[231] Ibidem
[232] Ibidem

Merkel, harshly criticized the Eurobond proposal[233], despite the reassurances of the Commission for an enhanced fiscal monitoring and coordination of economic policies within the EMU.[234]

The Eurobond project faded away even after the taming of Angela Merkel's position on the initiative, when she declared the Eurobond should represent the "final step towards a long-term debt union".[235] Another reason for the disappearance of the Eurobond option from the economic agenda of the EU is the timing when it was brought forward: the issuance of Stability Bonds with joint guarantees would have required a reform of the EU Treaties, which would have kept European institutions busy indefinitely ,while the sovereign debt crisis was culminating. Hence, more rapid and effective solutions were found, in particular with the establishment of the EFSF and the ESM. Nonetheless, the further reform of the ESM, with its inclusion in the Treaties and the establishment of the EMF could represent the right window of opportunity for reforming the EU legal framework in order to regulate joint guarantees and allow the issuance of Eurobond guaranteed by all the member states EMF. An option to avoid the criticisms of some member states could be that the EMF issues Eurobonds with fixed interest rates, always exchangeable for liquidity, but not tradable. In this way, the EMF could fund itself in order to restore the public finances of countries in difficulties, following the best practices of conditionality; however, it would also stabilize the interest rate in the euro area, playing a major role in the deepening of the monetary union.[236] It must be underlined that the ESM already issue bonds with a maturity which can arrive to 45 years to fund itself[237]. However, it must be reminded that the ESM operates outside the Treaties, enjoying less restrictions than the entities within the EU institutional setting.

[233] S. Ping Chan (2012), *"Angela Merkel rules out eurobonds for 'as long as I live'",* The Telegraph [Online] Available at: https://www.telegraph.co.uk/finance/financialcrisis/9357592/Angela-Merkel-rules-out-eurobonds-for-as-long-as-I-live.html [May 2019]
[234] European Commission (2011), *Green Paper on the feasibility of introducing Stability Bonds,* Brussels, 23rd of November 2011, MEMO/11/820
[235] A. Evan Pitchard (2011), *Germany's Angela Merkel faces eurobond mutiny,* The Telegraph [Online] Available at: https://www.telegraph.co.uk/finance/financialcrisis/8703147/Germanys-Angela-Merkel-faces-eurobond-mutiny.html [June 2019]
[236] S. Schulmeister, *The European Monetary Fund: A systemic problem needs a systemic solution*, Paris, Observatoire français des conjonctures économiques (OFCE), vol. N° 127, issue 1, 2013, 389-424
[237] European Stability Mechanism (2015), "*ESM factsheet*", ESM, [Online] Available at: https://www.esm.europa.eu/sites/default/files/2015-12-16esmfactsheet.pdf [May 2019]

FINAL REMARKS

By studying the reaction of the EMU management to the 2008 crisis and the subsequent sovereign debt crisis, the structuration of the first crisis management tools devised by the European economic governance which culminated with the definition of the ESM as a permanent instrument to preserve the stability of the Eurozone, and the first on-the-field operations of the stability mechanism, this research delivers a comprehensive evaluation of the performance of the ESM since its establishment, with a precise focus on the positive and negative aspects of the bailout programmes for the EMU member states, but without neglecting the debates generated by the introduction of the ESM within the EU institutional apparatus.

Despite having being created in a boisterous period for the Eurozone, with EU leaders being put under pressure by international markets due to inappropriate economic policies in certain states, which lasted too long altering in an almost irreversible way the finances of those countries and the stability of the Eurozone as a whole, the ESM managed to drive the euro area out of the eye of the storm of the financial crisis, with all 5 beneficiary member states being able to exit the programmes, and with at least 3 of those member states already displaying important improvements regarding their public debt and their national budgetary situation. Even though the ESM (together with the members of the Troika) have been harshly criticized on the social and political downsizes of the economic adjustment programmes, the conditionality imposed on the beneficiary states proved not only to be necessary to overturn the financial drought in which some EMU member states were directed, but also to be effective, since the structural reforms managed to positively review sectors such as productivity and the labor market. Indeed, all 5 countries which entered in the ESM bailout programmes display a GDP growth percentage which is over the median of the EU-28, and all of them enjoyed decreasing unemployment trend since the intervention of the stability mechanism.

However, the ESM could be considered still a work in progress: indeed, the conditionality attached to the loans of the stability mechanism presented restrictive measures which provoked visible social costs for the citizens of the beneficiary member states, in particular for civil servants who were the category most involved in the public spending cuts required by the Troika. Hence, the ESM started being depicted as the intermediary through which the EMU (in particular creditor countries) could impose their austerity policies in order to accommodate international markets rather than taking care of the peoples. Although certain MoU may have been unnecessarily too austere (in particular for Greece), this research affirms that the ESM cannot be blamed for having intervened in states on the brink of default due to years and years of irresponsible policies, but rather it has revealed as a concrete communitarian solution for resolving financial crisis, by bearing in mind both the different characteristics of the economics composing the EMU, and the principles at the basis of the Eurozone as a whole, with the aim of restoring the financial stability of the region.

The ESM pivotal role played during the sovereign debt crisis stimulated the debate over how the European economic governance should be shaped after the establishment of the stability mechanism as a permanent irreversible instrument which the EMU can spare anymore. In this discussion over the future scenarios of the ESM, this dissertation does not just propose a comparative study over the most prominent projects of reform of the stability mechanism, but also evaluates the critical points of both ideas about their organization, their governance, their funding and their financial assistance procedures. It would be bold to declare which proposal between the 2018 ESM reform and the EMF establishment fits the most the project of deepening of the monetary union, also because they could be complementary. Indeed, the ESM reform, by maintaining the ESM an intergovernmental institution outside the EU legal framework, is more feasible in the short-term and would respect the will of the EMU member states leaders to maintain control over the instrument according to the principle of "no taxation without representation". However, it falls short on the aspects of democratic accountability, transparency and full-development of the toolkit. On the other hand, the formation of a proper European Monetary Fund would represent a crucial step forward in the integration process of the EMU, since the inclusion of the fund in the treaties would not only mean an important political effort, but also the possibility for the instrument to form new synergies with the other EU institutions in order to preserve the stability of the single currency. However, the establishment of the EMF would be an financial project to be formed through a political agreement, which in the EMU represents an important obstacle due to the heterogeneity of visions over economic and fiscal policies present in the monetary union. Furthermore, the efficiency of the crisis management tool within a multilayered institutional setting as the one of the EU could be harmed, and the way in which the ESM would be introduced in the EU legal is still debated.

This dissertation emphasizes the relevance of discussing over the future scenarios of the ESM by providing an extensive vision over the opportunities which the EMU could seize by including the ESM into the EU Treaties and, by foreseeing the new objectives the ESM may aim in the future economic governance of the region. The research contributes to the discourses over the Euro Budget, the Eurobonds and the Capital Market Union of the EMU by underlining the positive externalities which the formation of a proper European Monetary Fund may have in the development of all these initiatives, and suggest more insights on the relation between the ESM reform and the introduction of new instruments in the EMU. By analyzing both ESM reform proposals, this study concludes that the ESM should took advantage of the relatively stable economic period which the EMU is witnessing at the moment to extend its knowledge and capability of crisis prevention, in addition to its focus on crisis management. Such change of perspective must be combined with augmented solidarity between the member states of the Eurozone, in order not to create obstacles to preventive financial assistance tools (which may generally be more complex to device than the crisis management ones, both on the conditionality negotiation and the funding organization), and to avoid further economic adjustment programmes, whose dimension could be possibly unbearable for the stability mechanism of the EMU as conceived nowadays. Extra studies may be pursued in order to improve the knowledge of crisis prevention tools in the EMU and how the ESM/EMF may manage them.

However, limiting the reasons for the possible failure of the project of a greater integration of the monetary union to a question of solidarity (as displayed in several important documents of the EU such as the Five President's Report) would be a shortfall by the EMU governance in the acknowledgment of the mistakes made in the past, and the evaluation of the novelties introduced during the sovereign debt crisis. Indeed, this research further concludes that EU representatives should concentrate their efforts in rebuilding trust towards the institution they preside over: during the crisis, EU institutions such as the ESM have been described as entities whose only scope is to preserve the Union apparatus and competitiveness, to the detriment of European national population. Such pattern resulted in the rise of nationalist and euro-sceptic movements, which cannot be traced back just to the phenomenon of Brexit, but also to the way in which the EMU managed the financial recession. The ESM is like a medication to cure an illness, which in this case was the 2008 crisis and the increasing trend of national public debts. The problem was not the medicine, but the bitterness of it, which made difficult for patients (in this case member states) to accept the treatment which was necessary to overcome the effects of the disease. Without increased solidarity between member states, and without an acceptable degree of trust towards communitarian institutions, any idea of reforming the ESM and deepen the EMU will bump into the wall of the complex decision-making process of the EU. The consequences of an incomplete monetary union may derive in enhanced political uncertainty, which will result in EU institutions not comprehending the economic needs of the states, leading to further financial instability. On the other hand, EU institutions, Member States and all their representatives must come together to complete the EMU because:

> *"A complete EMU is not an end in itself. It is a means to create a better and fairer life for all citizens, to prepare the Union for future global challenges and to enable each of its members to prosper."*[238]

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SUMMARY

The dissertation titled "The European Stability Mechanism: Evaluation and future scenarios of the fireguard of the European Monetary Union" covers the evolutionary path of the crisis management apparatus of the Eurozone after the crash of Lehman Brothers in 2008, the global financial crisis sprung after the crash of the US housing market, and the subsequent sovereign debt crisis in 2011 which afflicted several member states of the European Monetary Union. During the analysis of the progression of what can be defined as a double-dip recession within the EMU, the study includes an evaluation of the development by the European economic governance of the crisis management instruments in reaction to the financial drought experienced in the region, which led to the formation of the European Stability Mechanism, unconceivable in the euro area until the 2008 recession.

Furthermore, the research analyses the economic adjustment programmes conducted by the ESM, which involved 5 countries out of the 19 member states which compose the euro area. The ESM financial intervention, permitted through the funding of the stability mechanism, and managed by the well-known Troika, an abstract entity composed by the European Commission, the European Central Bank and the International Monetary Fund, characterised the economic history of the EMU since the first bailout programme held in Greece in 2010. After the end of the third economic adjustment programme in Greece in August 2018, the study evaluates the effects of the financial aid plans on the economies of the beneficiary member states, examining several economic variables such as the debt-to-GDP and the deficit-to-GDP ratio, but also the unemployment level and the productivity rates.

The examination of the economic adjustment programmes allows the research to discuss the conditionality attached to the loans devolved to the beneficiary states, which originated debates over the adequacy of the financial plans in reference to the social requirements of the beneficiary states in order to answer the questions regarding the perception of ESM interventions in the EMU member states, comparing the economic results with the social impact of the request jointly approved by the national authorities and the representatives of the Troika.

Such discussions led the study to review not just the criticisms moved by European national leaders, namely the mismanagement of the Greek crisis which led to major protest and important political changes, the questions regarding the effectiveness of restrictive economic policies prompted by the Troika, or the questions regarding the respect of human rights within the aid programmes. The research shifts its attention also to the objections over the structuration and the legal basis of the ESM, which create problems of transparency, accountability, independency, and the dualism between the European Stability Mechanism and its international counterpart, the International Monetary Fund.

The pivotal role acquired by the ESM during the sovereign debt crisis raised question over the future scenarios of the institution focusing on two initiatives: the 2018 ESM reform proposal drafter in December by the Euro Summit versus the proposal by the Commission of a Council Regulation for the establishment of a European Monetary Fund. In analyzing both proposals, the dissertation aims to evaluate the strengths and weaknesses of both ideas in the context of the EU political and legal framework

The dissertation would like to function as an exhaustive instrument for the assessment of the next steps which the European economic governance will undertake regarding crisis management and prevention, starting from an historical analysis of the results of the ESM from the point of view of the member states and their perception of the EMU governance, evaluating the strengths and flaws of the stability mechanism, and proposing a new understanding on the validity of the reform proposals of the bailout fund of the EMU through a critical perspective.

The literature used during the research is composed mainly by official documents and reports form the European institutions such as the ESM, the European Commission and its Directorates, the European Parliament and its committees and the ECB. In addition, the author collected information over the various points of view of influential economists over the formation of the crisis management tool of the EMU through publications in important journals or by relevant research centers. In addition, the author had the unique opportunity to directly visit the ESM headquarters in Luxembourg, to meet several functionaries of the institution and ask questions useful for the conduction of the study.

The first chapter initiates with the description of the causes and propagation of the financial shock caused by the failure of Lehman Brothers, which propagated rapidly all over the world due to the high level of interconnection between financial institutions and the deregulation of financial instruments, which resulted in the Great Recession. The consequences of the 2008 financial crisis in Europe were exacerbated by the sluggish reaction of EU institutions, which resulted in a real GDP fall by 4.4% just in 2009, with unemployment rates all over Europe reaching record peaks, and with the stability of the euro posed at risk for the first time.

This instability resulted in a sovereign debt crisis, with bond yields rising sharply due to decreases in national tax revenues and uncertainty over the solidity of the banking sector, and with deficit-to-GDP ratio reaching worrying levels in countries with important external debt and with a rising construction sector.

The first country experiencing the intervention of the Troika was Greece, in particular after that Prime Minister George Papandreou revealed that both the 2009 government deficit and the 2008 government deficit were in reality double the expectations, exacerbating the already unsound situation of the Greek economy. The first bailout programme for Greece met the opposition of some European leaders, led by the German Chancellor Angela Merkel, which initially invoked the intervention of the IMF. In the end, Greece asked the European Commission, the ECB and the IMF for a multi-year programme of economic policies supported through financial assistance, which was developed in a three years stability programme, unanimously voted by the Eurogroup on the 2nd of May 2010 and which granted 110€ financing package, composed for €80bn by bilateral loans from euro area countries according to the ECB capital keys which was named Greek Loan Facility (GLF), while the remaining 30bn were granted by the IMF. The conditionality attached to these loans comprehended enhanced supervision of the banking sector, the establishment of a decreasing path for the public debt and deficit, and structural reforms of several sectors of the state, in particular the public administration, the productivity and the labor market.

After the first Greek bailout programme, EMU governance understood that the Eurozone needed an instrument to avoid the contagion effect 8whose first glances started to be displayed in the Eurozone), and which could provide and maintain stability to the currency area. Hence, the European Commission brought in a stabilization mechanism for European countries, accepted in an extraordinary meeting of the ECOFIN on Sunday, May 9th. The ECOFIN approved a euro-area financial safety net package of €750 billion, together with the establishment of two organs: the EFSM, an emergency line through which the European Commission would have the authorization to gather a maximum of €60bn in the financial markets and loan to the country economically distressed, and the EFSF, a temporary intergovernmental instrument endowed with a more comprehensive financial assistance toolkit, whose shareholders are the member states of the EMU, whose contributions are established through the capital keys of the ECB. In both cases, the financial aid intervention must come after an official request by the member state, followed by a negotiation with the Commission on the amount of the payment and the period of the financial aid, together with economic conditions which serve as guidelines for the member states requiring the EFSM intervention to restructure its economy. The state and the Commission sign then a memorandum of understanding.
Some criticisms aroused after the establishment of the EFSF, in particular regarding its formation outside the treaties and its intergovernmental nature, which allowed Germany and France to be influential in decision-making process, to introduce automatic rules for fiscal consolidation and to recover from their exposition towards countries in economic difficulties.

The relief did not last: Ireland entered into an economic adjustment programme in partnership between the EFSF and the IMF in 2010, due to its financial institutions facing problems of insolvency after the 2008 Great Recession due to the great expansion of the property market until 2007 and the imbalances of Irish banks balance sheets. The MoU signed by the EU, the IMF and Ireland comprehended reforms of the labor market, fiscal consolidation policies and the revision of the entire banking sector, harmed also by several scandals.
In April 2011 Portugal requested a financial intervention by the EFSF. Portugal was involved in a crisis much more similar to the Greek example, with low level of economic growth, mismanagement of the public administration and a weak fiscal sector which led to an increasing trend both for the public debt and deficit. The bailout programme was funded by the EFSF, the EFSM and the IMF for a total of 79.5bn euros, and

comprehended conditionality implying the revision of the productivity sector, the liberalization of the energy market and policies boosting fiscal consolidation.
Greece first package was supplemented by a second rescue aid in 2012, due to unsustainable levels of instability which persisted in several economic variables (inflation, unemployment, current account deficit). The new intervention comprehended €130bn of financial aid, together with a partial debt restructuring via Private Sector Involvement (PSI). The MoU enlarged the spectrum of the conditionality established by the Troika with the national authorities, with more comprehensive reforms in more stringent time span and with higher levels of monitoring by the Troika.

The second chapter of this work deals with the formation and operational working of the European Stability Mechanism. The ESM was established in July 2011 through an international agreement signed outside the Treaties, with the purpose of providing stability support through financial aid to member states in difficulties to preserve the stability of the euro area as a whole. The ESM started operating in 2013 after the liquidation of the EFSF and the decision of the German Constitutional Court. The total capital authorized for the ESM amounts to €700 billions, with 80bn euros of paid-in capital (contribution to the institutions by investors who buy stocks in the primary market), and 620bn euros of committed callable capital. The ESM shares similarities with the EFSF (possibility to issue debt securities) and contrasts (no possibility for countries in economic difficulties not to contribute to the ESM).
The ESM has at its disposal 6 types of lending instruments: loans within a macroeconomic adjustment programme, primary market purchases, secondary market purchases, precautionary credit lines, loans for indirect bank recapitalization, direct recapitalization of institutions. The legal construction of the ESM is based on the reform of art. 136 of the TFEU and the relaxation of the “no bail-out clause”.
The ESM structure is composed by the Board of Governors, composed by the finance ministers of the member states, which takes the primary decisions on financial assistance and loan granting, through mutual agreement and qualifies majority. The Board of Directors, composed by highly prepared representatives nominated by the Governors, makes sure that the decision of the BoG is implemented and comply with the Treaties. The Managing Director conducts the ordinary businesses of the ESM together with the management board, composed by other 6 figures, and supported by more than 15 figures, each one of them responsible for specific aspects of the current actions of the ESM.

In 2012, Spain officially request the intervention of the ESM through the loans for indirect bank recapitalization tool. The totality of the funds requested for the capital recapitalization of the Spanish banking sector amounted to 100 billion euros, whose spending was monitored by the ECB and the Commission. As the first case of indirect recapitalization of financial institutions, the MoU signed by Spanish national authorities established specific timelines for the tranches and specific steps to be followed, form the evaluation of the condition of the national banks through stress tests to the approval of recapitalization plans for the

Spanish banking sector. Also the Spanish recapitalization programme came with a conditionality, constituted by fiscal policies for the reduction of the public deficit (which reached double digits in 2011 after the crash of the national housing market) and several structural reforms of the labor market (with more flexibility and a new governmental strategy for improving youth unemployment levels), the revision of education system and the simplification of the public administration. By implementing the majority of the requested reforms, Spain was able to exit the programme before receiving the entirety of the loan by the ESM.

In June 2012, after a decade of economic expansion (especially through the service sector), Cyprus requested an economic adjustment programme to the Commission through the ESM. The causes of the financial drought witness in the island were the inadequacy of the financial sector referred to the enormous liquidity inflow which Cyprus has experienced since 2000, the external imbalances and the trade deficit which characterized the economy of Cypriot Republic. The programme funding consisted in a total of 10 billion euros, financed through contributions from the ESM (€9 billion) and the IMF through Extended Fund Facility (€1 billion). The conditionality present in the MoU signed by Cyprus focused on the reform of the national financial sector, through a massive operation of deleveraging of the banking system and the enhancement of the financial supervision mechanism. Furthermore, the MoU comprised a revision of the public administration, in particular on the wages of the public employees and managers. In addition, the heterogeneity of the requests by the troika is witnessed by the proposed reform of the tourism sector though a temporary investment strategy by the government.

In the meantime, the Greek second bailout programme was not reaching its objectives due to the shortcoming on the reforms by the Greek national authorities, and the political turmoil sparked in the state which led to the possibility of an exit of Greece form the EMU. The tumultuous political situation led to a new government led by Alexis Tsipras and his party Syriza, which proposed the end of the austerity programme and the re-introduction of several facilitation for public employees. Tsipras held a referendum in order to allow the people to decide on the clauses proposed by the Commission and the ECB regarding a third bailout programme: clauses which were rejected. However, the dramatic situation of Greek economy and the inability to repay IMF loans without the aid of the ESM pressured Tsipras to accept a third bailout programme, whose conditions were more stringent than the previous programmes due to the failures of the national authorities to follow the request of the Troika. The third Greek MoU, in order to diminish the worrying levels of public debt and deficit comprised the further reform of the banking system to reduce the percentage of non-profitable loans in the balance sheets of the banks), a review of the public administration sector, a fiscal reform reviewing VAT system and the revision of the labor market through the technical advice of the ILO in order to create new jobs. The third Greek bailout programme registered the debate between the IMF and the ESM on the sustainability of the Greek debt and how to restructure it: debate which led to the detachment between the two institutions.

The third chapter is an evaluation of the activities of the ESM (in particular the economic adjustment programmes), and on the achievement of the targets sanctioned in the ESM Treaty. The function of the EFSF and the ESM was to endow the EMU of a crisis management tool to answer effectively to possible external financial shocks and provide stability to the euro area, whose legal basis did not provide room for any rescue fund due to the no-bailout clause. The efforts made by the leaders of the Eurozone member states and the members of the European institutions to deliver crisis management instruments resulted in the formation of a permanent mechanism, whose funding (€700 billion) and structure is able to single handedly develop economic adjustment programmes (Spain's banks recapitalization), lead financial aid plans (as in the case of Greece's several bailouts), and compete with the IMF (regarded as the only source of financial assistance before 2010).

As for the programme outcomes evaluation, the ESM proved to be an efficient institution whose programmes managed to reduce the vulnerability of its beneficiary states, and automatically increase the financial stability in the Eurozone, despite some shortcoming in the implementation of clauses by national authorities, and the negative reputation the ESM obtained within the public opinion.
Specifically speaking, Spain banking recapitalization programme increased the density of the banking system, boosted the lending activities of Spanish banks and bolstered the reduction of NPLs in the Spanish financial sector by 4%. Furthermore, the structural reforms proposed by the Troika sparked a decreasing trend in the unemployment rates while the productivity enhanced the economic growth of the country in the last 5 years.
After the end of the programme in 2013, Ireland experienced high levels of economic growth, demonstrated by increase in GDP of 4.8% registered in 2014, which would then be stabilized in recent years. Even though Ireland has been favored by the positive performance of the global economy which enhanced Foreign Direct Investments rate in the country, the fiscal consolidation programme and the revision of the financial sector stimulated by the EFSF intervention helped in fostering the conditions for such benevolent economic conditions for investments.
Cyprus followed the revisions requested by the Troika in the MoU signed in 2013 and since 2015 its economy has been growing at higher rates in comparison with the other euro area countries. Cypriot authorities made important efforts regarding fiscal consolidation, which resulted in the transformation of a fiscal deficit of 6% in 2013 into a surplus of 1.8% in 2017, leading the debt-to GDP ratio to drop below 100% in the same year.

Portugal's programme outcome evaluation has been more chequered: despite having recovered from a situation of unsound finances and external exposition, the reform of the fiscal system concentrated more on tax revenues rather than expenditure cuts, leading to a historical peak of the debt-to-GDP ratio in 2014. Despite not having fully implemented the productivity sector reform, Portugal witnessed important rates of economic growth since 2015, but the Commission and the ESM continue pressuring national authorities to persist in the introduction of the revisions present in the MoU, despite the programme has ended.

The most famous ESM interventions, but also the activities which mostly aroused the discussion over the effectiveness of the stability mechanism, are the three bailout programmes involving Greece. Despite having registered small improvements in specific sectors in every adjustment programme, the Greek bailout finally managed to undertake the sustainable path with the third the economic adjustment programme. The criticism over the social and political costs Greece had to pay refer to the mismanagement of the MoU clauses formulation, in particular the privatization programme, the reform of the public administration and the effectiveness of the austerity measures.

The privatization programmes for Greece had the objectives to restore the sound finances of the country, which were destabilized by inadequate economic policies and investments on publicly managed assets which created important losses for the state. The public opinion harshly criticized the dimension of the privatization programme, considered too harsh and a humiliation for the state and his people. According to the critics, the troika allowed international investors to conquer several sectors of the Greek economy, while not focusing on the development of Greek public sector.

The reform of the public administration implied important expenditure cuts, which resulted in increasing level of poverty, a relevant emigration phenomenon, and high unemployment which started decreasing only in 2018.

Austerity measures, despite decreasing consistently the Greek deficit-to-GDP ratio, did not bring its economy to pre-crisis levels, with Greece still having the highest debt-to-GDP ratio in the EU. The questions over the effectiveness of the austerity measures can be expanded to all the ESM adjustment programmes. The detractors of austere policies, namely restrictive policies in period of crisis in order to restore soundness in public finances, focus their criticism on the success of those measures, which result ineffective in the short-term, which do not show any positive externality for variables such as unemployment rate, and which consider the pressure by the Commission and the ECB on the implementation of those policies as an attempt to introduce general automatic economic rules following the example of the German Ordoliberalism, which they believe cannot be applied to all the countries of the EMU.

Furthermore, no universal approach can be applied for the formulation of austerity programmes, since it all depends on the nature of the financial distress witnessed in the country. In addition, some economists regarded the austerity measures as self-defeating, in the sense that they exacerbate the effects of the crisis, annulling the positive consequences of debt reduction.

Such claims have been partially contrasted by the outcomes of the ESM programmes, which resulted convincing in 4 out of 5 cases, which displayed relevant levels of growth and a positive path towards the stabilization of public finances. Furthermore, Greece exited the bailout programme in 2018, whose effects have still to be evaluated. The ESM does not propose itself as a short-term crisis management fund, but rather as a long-term instrument which envisaged continuous efforts to re-establish the soundness of the economy of the beneficiary countries by the national authorities.

Other criticism moved towards the ESM regard its legal basis and organizational structure. Due to its establishment outside the Treaties, the ESM sparked debates over its lack of accountability and transparency. Euro area countries opted to overcome the EU institutional setting by signing agreements outside the EU legal framework in order to react as fast as possible to the consequences of the financial crisis. In this way though, critics maintain that member states were able to exercise total control over the decision-making process of the ESM, enlarging the democratic gap between EU citizens and Eu institutions, creating another organ which is not under the scrutiny of the European Parliament. Furthermore, the ESM shall not follow the transparency requirements established under the Lisbon Treaty; an assessment which creates resentment due to the impact of ESM decisions on the ordinary life of European people.

Improvements on the transparency issues have been made, with the majority of ESM documents now published on its website, while BoG and BoD meeting still remain secreted. As regard the democratic accountability problem, the situation could be improved with the instruction of the ESM in the Treaties, which represent an important obstacle. In any case, according to the principle of "no taxation without representation", the EU itself should contribute to the funding of the instrument in order to require a greater level of accountability and influence in the decision-making process for the European Parliament. Furthermore, some countries such as Germany and Finland must go through the voting procedure of their national parliaments in order to establish how to vote in the ESM BoG, certifying a certain degree of democratic accountability

Furthermore, criticisms towards the ESM focused also on its level of independency due to the voting procedure used in the decision-making process. The BoG takes decisions through mutual agreement and qualified majority (which is established at 80% of favourable votes), while the voting shares are established according to the ECB capital keys: in this way, Germany, France and Italy enjoy effective veto powers, while Germany alone play a major influential role in the decision-making process through its 27% shares of vote.

Further perplexities regard the relationship of the ESM with the Eurogroup, since the structure and membership of the ESM Board of Governors which is identical to the one of the Eurogroup. Hence, the Eurogroup can practically take important legal decisions by changing its name in ESM Board of Governors, heavily influencing the workings of the Troika, without being officially a member of it, possibly creating more democratic deficit and conflict of interest.

On the other hand, the relationship with IMF deteriorated after the discussion over the debt restructuration of Greece in 2016, and after the ESM became increasingly important in the EMU governance, actually adding itself to the Troika. The discussions between the two institutions did not focus only on the preferred creditor status of the IMF, but also in the different style of intervention of the two bailout funds, with the IMF more keen on debt restructuring programmes, while the ESM on economic adjustment programmes with lower interest rates and longer maturity posed on loans.

The last chapter deals with the future scenarios of the ESM, comparing the 2018 ESM reform proposal by the Euro Summit and the establishment of a EMF by the Commission.
The 2018 ESM reform envisages the ESM as the common backstop for the Single Resolution Fund (SRF) of the European banking union. The banking union is composed by the Single Supervision Mechanism, to monitor the financial condition of 120 significant banks, and the Single Resolution Mechanism, aimed at helping institutions experiencing financial distress. The SRM is completed by the Single Resolution Fund (SRF), which is funded by bank contributions. This construction allows the SRM to protect the European taxpayers from paying for the mismanagement of financial institutions, and to effectively stabiles the banking sector when shocks and contagion risks. In this way, the ESM becomes more and more pivotal in the completion of a common European banking scheme.

Furthermore, the ESM reform of the Euro Summit proposes the reform of precautionary credit line instrument, namely credit lines operationalized through loans or primary market purchases requested by member states to prevent further crisis and stabilize the economy. In the ESM toolkit, two types of precautionary credit lines are present, differentiated by the criteria for accessing to them: Precautionary Conditioned Credit Line (PCCL) and Enhanced Conditions Credit Line (ECCL). ESM precautionary credit lines come with ex-ante requirements, but also with ex-post conditionality, which made the access for countries more difficult. The reform establishes that countries who want to access PCCL have to meet general EU fiscal rules established in the SGP, namely3% deficit-to-GDP benchmark and the 60% debt-to-GDP benchmark and must not be involved in in Excessive Deficit Procedures or Excessive Imbalance Procedures. In this way, the precautionary instruments would become more fascinating and easily accessible for states and would represent a change in the mindset of the ESM in order to become a crisis prevention instrument, together with having crisis management tools.

The 2018 ESM reform envisages a shift in the point of view of the ESM regarding debt restructuring. Indeed, the reform would introduce single-limb Collective Action Clauses, that will substitute the two-limb CAC in which the decision to pursue a debt restructuring option required two supermajority votes. The single-limb CACs which will allow the application of the same conditions approved by the majority of bondholders to all the bonds with one majoritarian vote, making the process of debt restructuring smoother.

In addition, the experience accumulated by the stability mechanism through its interventions in several euro area countries has increased the relevance of the ESM within the EU economic governance. In order to avoid the duplication of task with the Commission, the Euro Summit suggested the formulation of an MoU between the two institution which should determine the roles they will play and the methodology they will apply not only during all the phases of an economy adjustment programme, but also regarding scenarios outside sovereign bailouts such as precautionary credit lines, staff training and information exchange. Furthermore, the role of the Commission as the guarantor of EU law, and its control over the respect of EU Treaties by the ESM, is enhanced.

Several perplexities emerged around the 2018 ESM reform. Some economists maintained that the backstopping nature of the ESM has yet to be completed. In particular, the way in which support which the ESM would provide to SRF will then be transferred to the financial institutions in collapse is not mentioned, while the intergovernmental nature of the ESM does not comply with bank resolution mechanisms, which must be effective and rapid at the same time. In addition, the substitution of the direct recapitalization tool of the ESM with the new common backstop role could alter the effectiveness of the instrument itself since there is uncertainty over the level of bank contribution.

Furthermore, in including the SGP criteria of the 60% debt-to-GDP ratio and the 3% deficit-to-GDP ratio in the qualifications for receiving PCCL, together with the fact that beneficiary states must not be involved in any Excessive Deficit Procedure or Excessive Imbalance Procedure, the ESM 2018 reform has reduced the audience of member states who can apply for PCCL, with more than a half of the EA19 countries excluded. Another unclear aspect regards the fact if the new PCCL can be considered a conditional clause in order to enter in an ECB Outright Monetary Transaction (OMT), in the case of a worsening of the liquidity stance of the beneficiary member state.

Lastly, the other scenario on the evolution of the ESM is the creation of an European Monetary Fund. Such possibility dates back to 2010, in the middle of the Greek crisis, when Daniel Gros and Thomas Mayer proposed the creation of an institution with the aim of restoring “market discipline by making failure possible” in the EMU. Such entity should have been settled within the EU Treaties through the notion of enhanced cooperation. The financing of Mayer and Gros’s EMF proposal had to be constituted just by the contribution of such countries which are not respecting the Maastricht criteria, so to minimize the risk of moral hazard of debtor countries. The EMF would have represented a better option EMU sovereign states than asking for the IMF intervention.

The leaders of the EMU opted for the ESM construction, built outside the EU treaties and with capital funding composed by all contributions coming from all member states. However, the idea of the inclusion of the ESM in the Treaties has been sponsored by several actors of the EU institutional setting, in particular the Juncker Commission. The Commission maintained that an European Monetary Fund will provide more financial autonomy from other international institutions and would accelerate the decision-making process (slowed down by the intergovernmental nature of the ESM). Such project has been sustained also by the Chairman of the Eurogroup Jan Djisselbroem and the Managing Director of the ESM Klaus Regling, which consider the EMF the natural evolution of the ESM.

After his election, the French President Emmanuel Macron made the EMF constitution a pillar of his EMU reform. Macron's vision of an European Monetary Fund consisted in a lending institution for countries which risk financial default. Furthermore, the EMF should be endowed with crisis prevention tools too. Macron is open to the EMF playing a bigger role in bail-outs than the current ESM, especially because the French president harshly criticized the operations of the IMF within the Troika system.
Macron's vision has been challenged by Germany; despite being favourable to the integration within the EU legal framework of the ESM for democratic accountability reasons, their opinions structure and mission of the future European Monetary Fund are different. Germany recommends the EMF as the paladin of fiscal discipline and fiscal responsibility of the EMU. In addition, 8 northern European countries led by the Netherlands contested Macron's more supranational vison of the EMF, while Italy contests to the French position the macroeconomic stability powers endowed to the new EMF.

The legal documents which describe the characteristics of the purposed EMF is the European Commission "Proposal for a Council Regulation on the establishment of the European Monetary Fund", and its annex titled "EMF Statute". The Commission suggests the inclusion of the ESM in the EU legal basis through Art.352 of the TFEU and the use of the special legislative procedure requiring the unanimity vote in the Council and the consent of the European Parliament. The relationship between the EMF and parliament will be more structured and enhanced, with the EP having a role in the appointment of the Managing Director of the EMF.
While maintaining the same organizational structure, one major change is represented by the decision-making process: the mutual agreement procedure of the current ESM disappears from the text of the EMF statute. Unanimity is maintained for certain decisions. The EMF statute introduces the reinforced qualified majority, which consents the approval through gathering 85% of the voting cast in favor. and it is applied to measures such as granting and disbursement of financial packages to the member states of the European Monetary Fund. In this way, the Commission is pursuing the streamlining of the intergovernmental decision-making approach. The EMF statute establishes that the new institutions could intervene even if there is no threat of a financial contagion. In addition, the Commission proposal makes explicit reference to the European Charter of Fundamental Rights in the EMF Statute, together with the mentions made in the Council Regulation proposal, exacerbates the protection of personal data and the increase of transparency for the EMF compared to the ESM. In addition, no reference has been made in the Commission text to the role of the IMF, suggesting an exclusion of the international bailout fund form the operations of the EMF.

As for the 2018 ESM reform, the EMF project presents several flaws. The Commission proposal does not seem to tackle the worrying increasing trend involving the cross-border debt in the Eurozone. This tendency will provoke a meaningful impact on the operations of the EMF, since future economic adjustment programmes could have greater magnitude than the ones which have been already completed by the ESM.

Another criticism is the absence of any reference or tool to avoid to the problem of moral hazard, both for the lender and the borrower. In addition, the only instrument which partially prevented such circumstance, namely CAC in euro bonds, will be eliminated. While the existing CACs still give the opportunity to minority shareholders to block possibilities of debt reduction, the decision of the Commission to delegate negotiation procedure regarding these clauses to national legal systems makes the moral hazard solution path more uncertain.
Furthermore, to avoid the borrower moral hazard, the Commission does not provide the EMF of an an ex-post evaluation of the loans given to a beneficiary country, which could establish the well-design of the adjustment programme, or the risks of excessive lending and the analysis of a possible debt restructuring. The EMF could also outsource such practice to another EU institution (EIB and ECB re valid options) or to independent agencies (increasing the politicization of the EMF).

A further objection regards the governance and the relationship with the EU institutional setting. Indeed, important decisions still envisions unanimity decision-making process, which is not the path followed by the IMF, which takes its most important decisions such as modifications of the quota system or the deployment of Special Drawing Right (SDR), which aid the official reserves of a sovereign member state through simple majority.
A smoother decision-making process is a priority for the EMF, since its entrance in the EU treaties means also the entrance in a multilayered institutional organization, which could alter the efficiency of the bailout fund. In particular, the Commission has not specified exhaustively the relation between the new EMF and the Commission itself. Indeed, the risk of overlapping competences between the two European institutions on matters such as financial evaluation, negotiation and formulation of the economic adjustment programmes is concrete. Hence, a division of responsibility for the maintenance of the financial stability of the Eurozone between the EMF and the Commission should be envisioned: the Commission should remain responsible for the general economic surveillance of the EU while the EMF should perform a surveillance role on patterns which constitute a concrete danger for the stability of the euro area.

Despite being a regional fund, the ESM has a similar funding size in relation to the IMF, and through its transformation in the EMF, it will have similar powers of crisis management and crisis prevention. Hence, the EMF should equip itself with high-skilled staff to perform all its new functions perfectly. At the moment, the ESM employs just 200 workers divided in sectorial teams. AN increase in EMF employees is not mentioned by the Commission, also because there are some objections on such proposal, such as the smaller number of candidate for bailout programmes than the IMF, which would leave new staff members inoperative for most of their working time: In addition, in order to avoid such possibility, the EMF should shift most of its operations to crisis prevention, duplicating the actions of the Commission.

Despite these objections, the introduction of the ESM in the Treaties, and the formation of the EMF are considered sources of opportunity for introducing new instruments and institutions to deepen the EMU and its governance. First of all, the EMF could foster the establishment of a euro budget, an instrument whose mission would be the maintenance of appropriate level of competitiveness and business cycle convergence in the euro area. Both member states (in particular France and Germany) and the EU institutions have expressed their will to cooperate on the establishment of a euro budget, which should be aired with the creation of the EMF. Indeed, While the EMF could continue lending signing MoU in which it requires structural reforms to restore the financial stability of a country, on the other side of the medal, the euro budget could provide funds in order to finance public investments and structural reforms, following the objectives of convergence and competitiveness. However, some perplexities on the size of the euro budget and its governance are still debated.

Another project which could witness an acceleration is the European Capital Market Union (CMU). Europe is characterised by an over reliance of EU companies and investors on bank loans rather than financial instruments compared to the US. While some improvements have been made in the rate of transformation of bank loans into alternative financial instruments, the absence of a capital market union, and the incomplete nature of the bank union represent a risk factor in the possibility of another financial crisis. Such assessment, paired with the high level of cross-border debt, could harm the efficiency of the EMF intervention, since economic adjustment programmes in the future greater in terms of lending and complexity.
The completion of an European CMU, by creating conditions for investors to rely more on capital market instrument, would lead the downgrading of national banking systems, and would unburden the EMF of enormous recapitalization and economic adjustment programmes, whose results are uncertain.

Lined to the CMU is the Eurobond project, which are bonds which should substitute the national ones, jointly guaranteed by EA19 countries, whose revenues and costs are shared by the member states. Such proposal traces back to 2010, and it has been analyzed in a Green paper which has also suggested different types of Eurobonds. However, the initiative has been initially halted by Germany and other Northern European countries due to their unwillingness to go through debt mutualization, and it has faded away due to the need of a reform of the Treaties in order to introduce bonds jointly guaranteed. Such reform would have required time and political effort, unavailable during the sovereign debt crisis. The introduction in the EU institutional setting of the EMF could foster the reform of the Treaties for joint guarantees, but Eurobonds could also represent a new instrument of the toolkit of the EMF. Indeed, an option to avoid the criticisms of some member states could be that the EMF issues Eurobonds with fixed interest rates, always exchangeable for liquidity, but not tradable. In this way, the EMF could fund itself in order to restore the public finances of countries in difficulties, following the best practices of conditionality; however, it would also stabilize the interest rate in the euro area, playing a major role in the deepening of the monetary union.

This work concludes that the ESM managed to drive the euro area out of the eye of the storm of the financial crisis, with all 5 beneficiary member states being able to exit the programmes, and with at least 3 of those member states already displaying important improvements regarding their public debt and their national budgetary situation.
Despite not being perfect, the depiction of the ESM as the intermediary through which the EMU (in particular creditor countries) could impose their austerity policies in order to accommodate international markets rather than taking care of the peoples falls apart when analyzing the trends of productivity and unemployment experienced in all the 5 beneficiary countries of ESM programmes.

The relevant role acquired by the ESM in the EMU governance sparked the discussion over its future. Bothe the 2018 ESM reform and the EMF proposal are valid and should be thoroughly discussed by EU leaders: the former is more feasible in short-term but does not cover the flaws of democratic accountability of the ESM, while the latter represent the natural evolution of the stability mechanism, but if not structured in a proper could alter the efficiency demonstrated by the ESM in the sovereign debt crisis.
The inclusion of the ESM in the Treaties represents a crucial discussion over the future scenarios of the institution, since it could boost the conclusion of several projects which remain unfulfilled, and which could effectively complete and deepen the monetary union.

Generally speaking, this work suggests that the ESM should took advantage of the relatively stable economic period which the EMU is witnessing at the moment to extend its knowledge and capability of crisis prevention, in addition to its focus on crisis management. Such change of perspective must be combined with augmented solidarity between the member states of the Eurozone, in order not to create obstacles to preventive financial assistance tools (which may generally be more complex to device than the crisis management ones, both on the conditionality negotiation and the funding organization), and to avoid further economic adjustment programmes, whose dimension could be possibly unbearable for the stability mechanism of the EMU as conceived nowadays
However, solidarity is not enough. EU representatives should concentrate their efforts in rebuilding trust towards the institution they preside over: during the crisis, EU institutions such as the ESM have been described as entities whose only scope is to preserve the Union apparatus and competitiveness, to the detriment of European national population. Without increased solidarity between member states, and without an acceptable degree of trust towards communitarian institutions, any idea of reforming the ESM and deepen the EMU will bump into the wall of the complex decision-making process of the EU. An incomplete EMU would

exacerbate once again the effects of external financial shocks, fostering political uncertainty, whose costs will be beard by the economies of the member states.