RECENT DEVELOPMENTS IN EU FINANCIAL STABILITY ARRANGEMENTS

The financial crisis has led to the progressive reinforcement of the framework for provision of financial assistance to EU and euro area countries experiencing economic and financial difficulties. This box provides an overview of the EU financial stability arrangements and reports on the latest developments.

Non-euro area EU Member States suffering balance of payments difficulties can obtain assistance from the EU under the Medium-Term Financial Assistance (MTFA) facility. In the context of the financial crisis, the financing capacity of the MTFA facility was increased from €12 billion to €25 billion in December 2008 and to €50 billion in May 2009. A total of €14.6 billion has been committed to Latvia, Hungary and Romania under the MTFA since the start of the crisis. Prior to the crisis, no comparable facility existed for euro area countries, in view of the fact that belonging to a monetary union alters the balance of payments financing constraint.

In early 2010 a marked rise in Greek sovereign bond yields made it difficult for the Greek government to cover its short-term financing needs in the market, which threatened to endanger financial stability in the euro area. In response, on 2 May euro area countries agreed to activate,
together with the IMF, a three-year financial support programme for Greece. The programme consisted of €80 billion of bilateral loans from euro area countries and an IMF Stand-By Arrangement for up to €30 billion. Disbursement of the funds was made conditional on the Greek authorities implementing the economic and financial adjustment programme negotiated by the European Commission and the IMF, in liaison with the ECB.

However, tensions continued to mount in euro area financial markets in the first week of May 2010. On 9 May EU Member States agreed to establish two financial stability arrangements to provide financial support to EU and euro area countries experiencing severe economic or financial disturbances.

First, the ECOFIN Council adopted a Regulation (No 407/2010) setting up the European Financial Stabilisation Mechanism (EFSM), which allows the European Commission to raise up to €60 billion on behalf of the EU for lending to Member States faced with exceptional circumstances beyond their control. No increase in the overall EU budget ceiling was required for this purpose. The functioning of the EFSM is to be reviewed every six months.

Second, the euro area countries, on an intergovernmental basis, established the European Financial Stability Facility (EFSF). The EFSF is set up as a limited liability company authorised to issue debt securities, guaranteed up to a total of €440 billion by euro area countries on a pro rata basis, to finance lending to euro area countries in financial difficulties. The debt securities to be issued by the EFSF are expected to be awarded the highest (AAA) rating by all three major rating agencies. The EFSF is a temporary facility for the period until June 2013.

Any loans from the EFSM and EFSF are subject to strong policy conditionality and made in the context of joint programmes with the IMF, which is expected to provide financing amounting to up to 50% of the EU/euro area contribution to each programme.

In response to renewed disturbances in financial markets, which threatened financial stability in the EU and euro area as a whole, Eurogroup and ECOFIN ministers unanimously decided on 28 November 2010 to grant financial assistance to Ireland, following a request by the Irish authorities on 21 November. The financial package will cover financing needs of up to €50 billion for the budget and €35 billion for the banking system, with the EFSM providing €22.5 billion, the EFSF €17.7 billion and the IMF €22.5 billion. The EU contribution will also include bilateral loans from Denmark, Sweden and the United Kingdom amounting to €4.8 billion; the financing ratio between the EU and the IMF will thus be 2:1. Half the banking support measures (€17.5 billion) will be financed by the Irish authorities. Financial assistance is provided on the basis of an adjustment programme negotiated by the European Commission and the IMF, in liaison with the ECB, which aims to strengthen and overhaul the Irish banking system, restore fiscal sustainability and introduce growth-enhancing structural reforms.

Also on 28 November 2010 euro area countries decided to put in place a permanent European Stability Mechanism (ESM) to safeguard financial stability in the euro area when the existing EFSF expires in June 2013. This follows the agreement by the EU Heads of State or Government on 28-29 October on the need to establish such a mechanism, which will complement the new framework of reinforced economic governance and substantially reduce the probability

1 Slovakia decided not to participate in the programme.
2 See Box 6, entitled “The Greek economic and financial adjustment programme”, in the May 2010 issue of the Monthly Bulletin.
of crises arising in the future. The ESM will be based on the EFSF and will be capable of providing financial assistance packages to euro area countries under strict conditionality and with preferred creditor status, junior only to the IMF. Rules will be adapted to provide for a case-by-case participation of private sector creditors, fully consistent with IMF policies. Eurogroup ministers will take a unanimous decision on providing assistance on the basis of a rigorous debt sustainability analysis conducted at the outset by the European Commission and the IMF, in liaison with the ECB. For countries assessed to be solvent, the private sector would be encouraged to maintain exposures according to international rules and fully in line with IMF practices. In the unexpected event that a country would appear to be insolvent, it would be required to negotiate a comprehensive restructuring plan with its private creditors, in line with IMF practices, with a view to restoring debt sustainability. This process will be facilitated by the introduction of standardised and identical collective action clauses (CACs) in the terms and conditions of all new euro area government bonds starting in June 2013. The overall effectiveness of this framework will be evaluated in 2016 by the Commission, in liaison with the ECB. The President of the European Council, Herman van Rompuy, will present a proposal for a limited Treaty change reflecting this decision to the European Council in December of this year.