

Response to the Debt Crisis: From Fiscal Compact to Fiscal Union

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Overview

- 11 Mar 2011 - Pact for the Euro
- 20 Apr 2011 - Euro Plus Pact
- 26 Oct 2011 - Debt break
- 23 Nov 2011 - Six Pack
- 31 Jan 2012 - Fiscal Compact (Treaty on Stability, Coordination and Governance in the EMU)
- ??? - Fiscal Union (euro area common bond)

Pact for the Euro

- Basis: EU 2020, European Semester, Integrated Guidelines, Stability and Growth Pact and new macroeconomic surveillance framework
- New commitments - National Reform and Stability Programmes (each year, each Member State)

- Foster competitiveness (unit labour cost to match productivity – peer comparison in euro area and with trading partners; open sheltered sectors; education, R&D and innovation; less red tape for SME & employment),

- contribute further to the sustainability of public finances (align the real retirement age with life expectancy, limit early retirement schemes, debt break in Constitution), reinforce financial stability (reform of the EU framework for financial sector supervision and regulation, fight against fraud and tax evasion, common corporate tax base)

Eurosystem

- Suspension of rating requirement (GR, IE, PT) normally down to A- and BBB- (different haircuts)
- 2x 3 year LTRO (approx 1 trillion)
- Enlargement of the universe of collateral (asset backed securities – RMBS and SME loans; credit claims) Decision of the ECB of 14 December 2011 on additional temporary measures relating to Eurosystem refinancing operations and eligibility of collateral (ECB/2011/25)

Six Pack

- Regulation (EU) No 1173/2011 of the European Parliament and of the Council of 16 November 2011 on the effective enforcement of budgetary surveillance in the euro area
- Regulation (EU) No 1174/2011 of the European Parliament and of the Council of 16 November 2011 on enforcement measures to correct excessive macroeconomic imbalances in the euro area

- Regulation (EU) No 1175/2011 of the European Parliament and of the Council of 16 November 2011 amending Council Regulation (EC) No 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies
- Regulation (EU) No 1176/2011 of the European Parliament and of the Council of 16 November 2011 on the prevention and correction of macroeconomic imbalances (detection of imbalances, corrective action plan)

- Council Regulation (EU) No 1177/2011 of 8 November 2011 amending Regulation (EC) No 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure
- Council Directive 2011/85/EU of 8 November 2011 on requirements for budgetary frameworks of the MS

Fiscal Compact

- Strengthening of the economic pillar of the Economic and Monetary Union by adopting a set of rules intended to foster budgetary discipline through a fiscal compact
- Applicable to euro area MS – others if they wish so immediately or as from the day they introduce the euro
- shall be applied in conformity with the Treaties (how ?)

Legal basis

- Enhanced cooperation – Art 20 TEU and Art 326-334 TFEU in the light of Art 136 TFEU (budgetary and economic coordination applicable only to the euro area MS)
- However, intergov agreement, not EU law – will Court of Justice accept to act?

Goals

- The budgetary position of the general government shall be balanced or in surplus
- Ok even if: annual structural balance of the general government is at its country-specific medium-term objective as defined in the revised Stability and Growth Pact with a lower limit of a structural deficit of 0.5 % of the GDP at market prices (1 % if debt is well below 60 % of annual GDP)

- What means cyclically-adjusted balance net of one-off and temporary measures, expenses related to servicing of the debt, etc.
- Exceptions: exceptional circumstances - unusual event outside the control of the Contracting Party concerned which has a major impact on the financial position of the general government or to periods of severe economic downturn as defined in the revised Stability and Growth Pact

- If debt of 60 % of annual GDP → reduction average rate of one twentieth per year as a benchmark
- MS subject to an excessive deficit procedure → structural reforms
- Debt issuance plans are to be communicated to Council & Commission (coordination should permit cheaper rolling of the debt) – SK (ARDAL), DE DFA, etc.

Treaty applicable over the course of 2013

- Consolidation programme proposed by the Commission can be blocked in Council (qualified majority) – Council in driver's seat
- Court of Justice decides already on implementation (the latter occurs at national, pref constitutional level) – MS can sue even if Commission concludes otherwise

- Fines paid to ESM (euro area MS) or EU budget (other MS)
- all major economic policy reforms – discussed ex ante & coordinated
- **Implementation of fiscal compact is a condition of access to ESM financing**

Sanctions

- Amendment of EU by intergov agreement – automatisisation of sanctions
- Reference to Art 126 TFEU
- a) Publish additional information specified by the Council before issuing bonds or securities
- b) invite EIB to reconsider lending policy towards that MS

- c) require MS to make non-interest bearing deposit of appropriate size until deficit is corrected
- d) impose fines of appropriate size (currently we are talking about up to 0,1% of the annual GDP!)

Common euro area bond (Art 125 (1) TFE)

The Union shall not be liable for or assume the commitments of central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of any MS, without prejudice to mutual financial guarantees for the joint execution of a specific project. A MS shall not be liable for or assume the commitments of central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of another MS, without prejudice to mutual financial guarantees for the joint execution of a specific project.

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Common euro area bond

- How to avoid moral hazard (free riding)? Tragedy of the commons
- Merger of AAA rated countries first – idea by BCL governor – following downgrade, the given state would need to back from the structure (reimburse the entire share in the volume of common emission)
- Was before AT and FR downgrade

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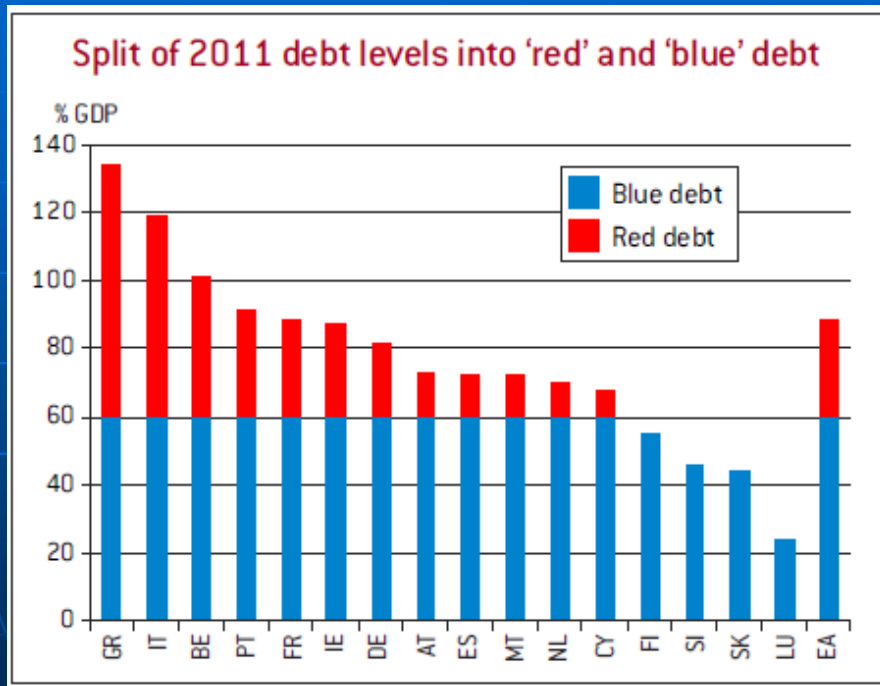
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Blue bond

- idea by Bruegel – 6 May 2010 (Jakob von Weizsacker, Jacques Delpla)
- More sophisticated approach than mere coordination of debt issuance (Fiscal Compact)
- Blue bond – if as liquid as US treasuries might promote euro as reserve currency

- Independent Stability Council would decide on access to Blue bond
- Could be interconnected with fiscal compact - no constitutional debt break, no access to Blue bond (under FC – no access to ESM)
- Non-complying state would be gradually squeezed out from the scheme (no new Blue bond issuance)

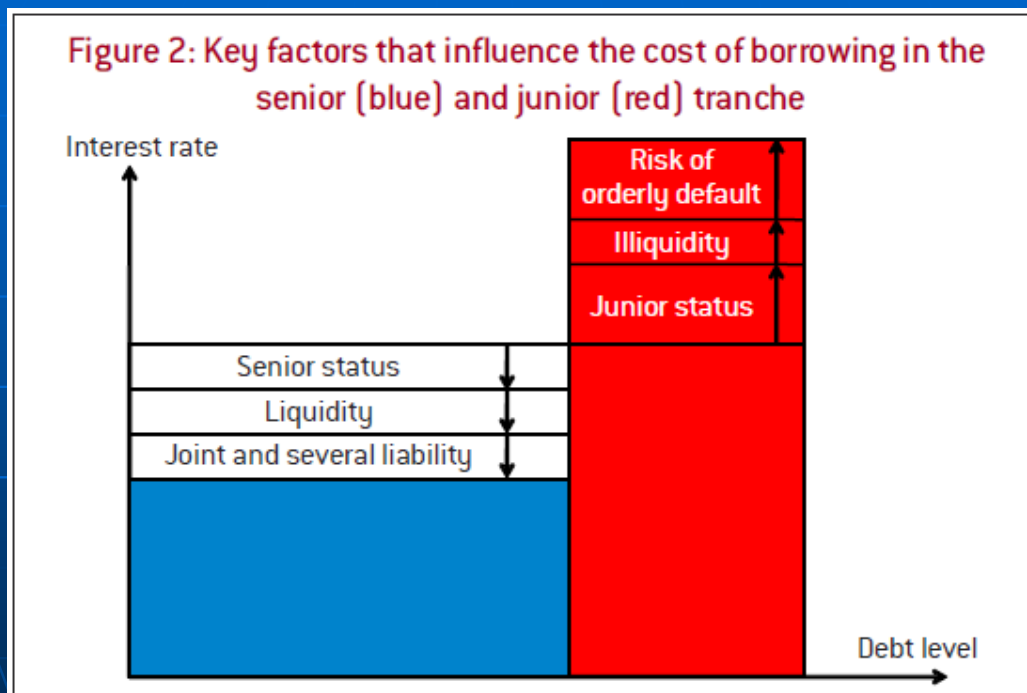
Background



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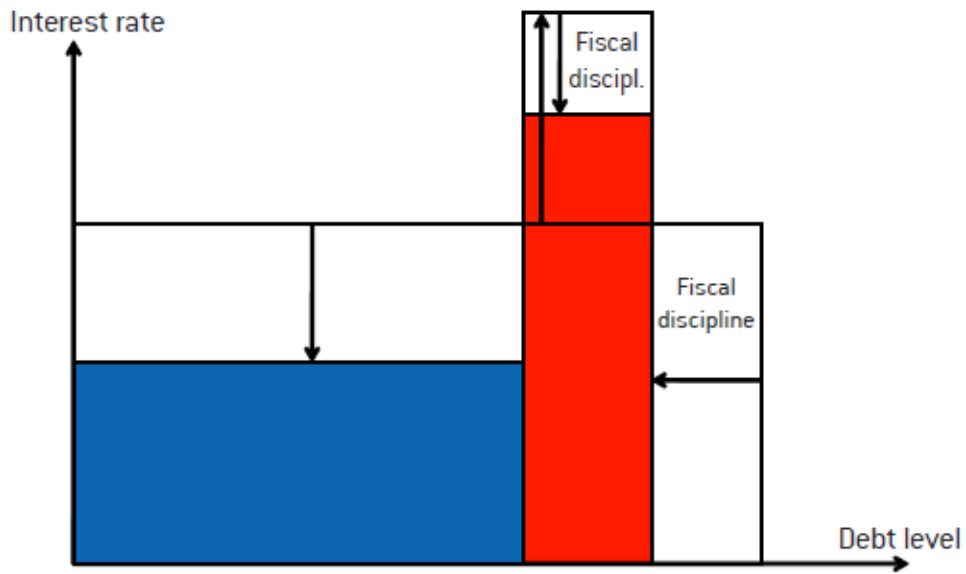


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Figure 3: Improved fiscal discipline due to the increased marginal cost of debt

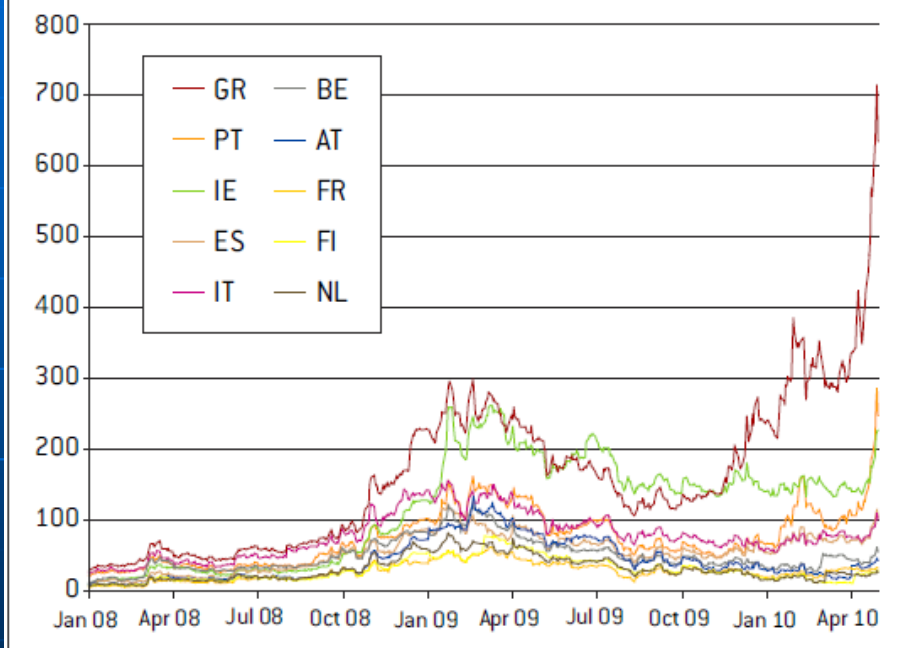


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Figure 5: Sovereign bond spreads over the German Bund in the euro area (January 2008 to April 2010)



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EFSF (acc to official website)

- Bonds issued by EFSF (AAA, S&P AA+) are eligible collateral for Eurosystem monetary policy purposes
- Liquidity category 2 (agency debt instruments)
- For the time being – AAA stems from AAA rating of certain countries and cash reserve

EFSF

- European Financial Stabilisation Mechanism "EFSM" €60 bn (EU27)
- European Financial Stability Facility "EFSF" €440 bn (in guarantees by EAMS) – increased to approx **780 bn**
- International Monetary Fund €250 bn max
- Total € 750 bn (increased to **1090bn**)
- Estonia entry (0,25 % approx 2 bn)

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New EFSF (440 bn lending cap)



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Shareholders

EFSF shareholder contribution

Member States	Credit rating (S&P/Moodys/Fitch)	New EFSF maximum guarantee Commitments (€m)	New EFSF contribution key (%)	New EFSF maximum guarantee commitments (PT, GR, IE stepped out)	New EFSF contribution key in % (PT, GR, IE stepped out)
Austria	(AA+/Aaa/AAA)	21,639.19	2.78	21,639.19	2.99
Belgium	(AA/Aa3/AA)	27,031.99	3.47	27,031.99	3.72
Cyprus	(BB+/Baa3/BBB-)	1,525.68	0.20	1,525.68	0.21
Estonia	(AA-/A1/A+)	1,994.86	0.26	1,994.86	0.27
Finland	(AAA/Aaa/AAA)	13,974.03	1.79	13,974.03	1.92
France	(AA+/Aaa/AAA)	158,487.53	20.31	158,487.53	21.83
Germany	(AAA/Aaa/AAA)	211,045.90	27.06	211,045.90	29.07
Greece	(CC/Ca/CCC)	21,897.74	2.81	0.00	0.00
Ireland	(BBB+/Ba1/BBB+)	12,378.15	1.59	0.00	0.00
Italy	(BBB+/A2/A-)	139,267.81	17.86	139,267.81	19.18
Luxembourg	(AAA/Aaa/AAA)	1,946.94	0.25	1,946.94	0.27
Malta	(A-/A2/A+)	704.33	0.09	704.33	0.10
Netherlands	(AAA/Aaa/AAA)	44,446.32	5.70	44,446.32	6.12
Portugal	(BB/Ba2/BB+)	19,507.26	2.50	0.00	0.00
Slovakia	(A/A1/A+)	7,727.57	0.99	7,727.57	1.06
Slovenia	(A+/A1/A)	3,664.30	0.47	3,664.30	0.51
Spain	(A/A1/A)	92,543.56	11.87	92,543.56	12.75
Total		779,783.14	100	726,000.01	100

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Guarantees

- Each guarantor issues unconditional and irrevocable guarantees to the amount of –
Contribution Key x 120% x EFSF Obligations
- The contribution key is on a pro rata basis in accordance with EAMS' share in the paid-up capital of the ECB

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Loan request procedure

- Application for aid - EAMS makes formal request to other members
- Support programme - European Commission negotiates stabilization programme – including strong conditionality - in cooperation with the IMF and in liaison with the ECB
- Approval of loan terms - A common MoU of loan terms is established between the EC, the IMF and beneficiary country and approved by Eurogroup and IMF Board
- Loan disbursement - EFSF finalises technical terms of loan: term, redemption, schedule, interest rate. On defined date, EFSF makes loan available to borrower



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Ireland

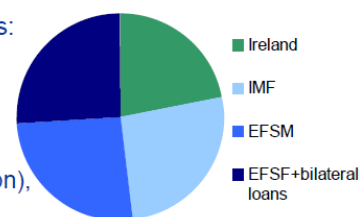
Financial assistance programme for Ireland

Objectives of the programme

- Immediate strengthening and comprehensive overhaul of the banking sector  €35 billion
- Ambitious fiscal adjustment to restore fiscal sustainability, correction of excessive deficit by 2015  €50 billion
- Growth enhancing reforms, in particular on the labour market, to allow a return to a robust and sustainable growth

Financing

- The total €85 billion of the programme will be financed as follows:
 - €17.5 bn contribution from Ireland (Treasury and NPRF*)
 - €67.5 bn external support
 - €22.5bn from IMF
 - €22.5bn from EFSM
 - €17.7bn from EFSF + bilateral loans from the UK (€3.8bn), Denmark (€0.4bn) and Sweden (€0.6bn)



Disbursements will be made over 3 years with an average loan maturity of 7½ years**

*National Pensions Reserve Fund,

** Maturity and lending costs are subject to revision following euro zone summit of 21 July

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