EU Regulation

MEASURES FOR FINANCIALLY UNSTABLE EURO COUNTRIES

cep Centrum für Europäische Politik

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MAIN ISSUES

Objective of the Regulation: The Commission would like to see euro countries that might in future need financial assistance subjected to enhanced surveillance and the conditions attached to receiving financial assistance enshrined in EU law.

Parties affected: All euro countries.

Pros: Euro countries threatened with financial difficulties can effectively be forced to seek financial assistance. This reduces the volume of the rescue package.

Cons: (1) The Commission fails to define any criteria as to when exactly a euro country should be subjected to enhanced surveillance.

(2) The euro countries granting financial assistance have no influence on the introduction of enhanced surveillance, although they have to bear the additional costs in the case of it not being introduced.

CONTENT

Title

Proposal COM(2011) 819 of 23 November 2011 for a **Regulation** of the European Parliament and of the Council **on the strengthening of economic and budgetary surveillance** of Member States experiencing or threatened with serious difficulties with respect to their financial stability in the euro area

Brief Summary

- **Background and objective**
  - Over the last months, Member States of the euro area have agreed on numerous measures for granting assistance to euro countries experiencing serious financial difficulties. This includes the contracts on financial assistance to Greece, the European Financial Stability Facility (EFSF) and the European Stability Mechanism (ESM); these contracts are not concluded under EU legislation but at intergovernmental level.
  - On the one hand, the Commission proposes supplementing these contracts. It wishes, in particular, to:
    - conduct "enhanced surveillance" of euro countries, which can lead to the Council recommending that a euro country requests financial assistance (Art. 2 and 3); and
    - continue monitoring Euro countries which have received financial assistance, even after they have met the accompanying requirements for reform (Art. 11).
  - On the other hand, the Commission wishes to see the tasks assigned by the EFSF contract and the ESM contract draft enshrined in secondary EU legislation. To this end, it proposes
    - reviewing the sustainability of the debts when a euro country applies for financial assistance (Art. 5);
    - negotiating a draft version of a macro-economic adjustment programme with the euro country concerned (Art. 6); and
    - monitoring the implementation of the macro-economic adjustment programme (Art. 6).

- **"Enhanced surveillance" of economic policy and the financial situation**
  - The Commission can intensify the surveillance of the economic policy and financial situation of a euro country ("enhanced surveillance") if it (Art. 2):
    - experiences "severe difficulties" in maintaining its financial stability; or
    - receives "financial assistance on a precautionary basis" from the EFSF, the ESM or any international financial institution such as the International Monetary Fund (IMF) or by other states; this rule does not apply where the state is not structurally jeopardized, so that the financial assistance is not related to policy actions, and neither where such assistance has not yet been sought. "Financial assistance on a precautionary basis" takes the form of credit lines, which can be requested when needed ("credit limit"). They are to address speculations against a euro country in advance; credits that have actually been granted are not included.
  - A euro country under enhanced surveillance must (Art. 3):
    - in consultation and cooperation with the Commission adopt measures to address its difficulties;
    - if requested by the Commission (Art. 3 (3)):
      - communicate to the Commission, the European Central Bank (ECB) and the European Banking Authority (EBA) disaggregated information regarding the financial situation of the financial institutions which are under the surveillance of national supervisors;
      - carry out stress tests or "sensitivity analyses" in order to assess the resilience of the banking sector to macro-economic and "financial shocks";

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- allow for expert assessments of the quality of national banking supervision; and
- communicate any information needed for the monitoring of macro-economic imbalances. Macro-economic imbalances are mainly characterised by differences in the competitiveness of euro countries, bubbles on capital investment markets and high public or private indebtedness in individual euro countries.

– On the request of the Commission, a euro country under enhanced surveillance is moreover obliged (Art. 3 (2)) to
  - report regularly on the implementation of the current budget [cf. Regulation Proposal COM(2011) 821 on the monitoring and assessment of the draft budgetary plans and the approval of correction of excessive deficits, Art. 7 (2) and (3)] and
  - have the budget figures comprehensively reviewed by an independent institution, which it must then report [cf. COM(2011) 821, Art. 7 (6)].
– The Commission assesses regularly the progress made as a result of the enhanced surveillance and the necessity of further measures (Art. 3 (4) and (5)). If the Commission concludes that
  - further measures are necessary and
  - that the financial situation of the euro countries has an adverse effect on the financial stability of the euro zone,

  then the Council may follow the advice of the Commission and "recommend" (Art. 3 (5)) that financial assistance be sought and a macro-economic adjustment programme drawn up.
– The Council may publish such a recommendation.

► **Assessment of the sustainability of debts**

– A euro country that wishes to seek financial assistance from other states, the EFSF, ESM, IMF or any other institution from outside the EU, must first inform the Council, the Commission and the ECB (Art. 4). This rule applies irrespective of whether or not the euro country is subject to enhanced surveillance.
– Where financial assistance is sought from the EFSF or the ESM, the Commission analyses together with the ECB and "wherever possible, the IMF" (Art. 5):
  - the sustainability of government debts and
  - the Member State's ability to pay back the financial assistance.

  Excluded are euro countries seeking precautionary financial assistance or credits to recapitalise financial institutions (Art. 13).

► **Negotiating a macro-economic adjustment programme**

– A euro country seeking financial assistance must, together with the Commission, draw up a macro-economic adjustment programme (Art. 6 (1)). Excluded are euro countries seeking precautionary financial assistance or credits to recapitalise financial institutions (Art. 13).
– The adjustment programme is to (Art. 6 (1)):
  - ensure the re-establishment of a sound and sustainable economic and financial situation; and
  - lead to the euro country concerned restoring its capacity to finance itself fully on the financial markets.
– The Council approves the adjustment programme proposed by the Commission with a qualified majority (Art. 6 (2)).
– An adjustment programme agreed upon within the framework of the Stability and Growth Pact is to be suspended for the duration of the macro-economic adjustment programme (Art. 7 and 8).

► **Monitoring of the implementation of the macro-economic adjustment programme**

– The Commission (Art. 6 (3) to (5))
  - monitors, together with the ECB, the implementation of the adjustment programme;
  - may require that the same measures be adhered to as with enhanced surveillance;
  - proposes to the Council amendments to the adjustment programme and
  - can recommend that the Council declares non-compliance with the adjustment programme.
  - Non-compliance with the adjustment programme can entail the suspension of payments to the euro country concerned (Recital 7): European Regional Development Fund (ERDF), the European Social Fund (ESF), the Cohesion Fund (CF), the European Agricultural Fund for Rural Development (EAFRD) and the European Maritime and Fisheries Fund (EMFF).

► **Post-programme surveillance**

– Surveillance also continues after the adjustment programme has been completed and until the euro country has paid back at least 75% of the obtained financial assistance (Art. 11). The duration of surveillance can be extended beyond this.
– As long as surveillance lasts, the Commission may:
  - require that the same measures be adhered to as with enhanced surveillance (Art. 3 (3));
  - carry out regular review missions to assess the economic policy and the financial situation of a euro country; if as a result it turns out that corrective measures are necessary, the Council may follow the proposal of the Commission to recommend such measures.

Statement on Subsidiarity by the Commission

The Commission does not address the question of subsidiarity.

Policy Context

The Regulation Proposal forms part of the Commission's legislation package for more growth, economic policy steering and stability in the euro area. Apart from the present Regulation Proposal, the Commission has submitted a further Regulation Proposal on the monitoring and assessing of draft budgetary plans [COM(2011) 821], the Annual Growth Survey 2012 [COM(2011) 815] and a Green Paper on Eurobonds [COM(2011) 818; s. CEP Policy Brief]. The two Regulation Proposals ("Two-Pack") build on the "Six-Pack" [Regulations (EU) No. 1173/2011, 1174/2011, 1175/2011, 1176/2011, 1177/2011; Directive 2011/85/EU] on the Reform of the Stability and Growth Pact (s. CEP Policy Brief).
The Commission's Proposal regarding the analysis of the sustainability of public indebtedness is already provided for by the ESM Contract and thus only constitutes a secondary legislative establishment of the ESM Contract. The same applies to the negotiating and surveillance of the adjustment programme (cf. Recital 17 and/or Art. 13 (3) ESM Draft Contract).

Legislative Procedure

23 November 2011	Adoption by the Commission
24 January 2012	Debate in the Council
11 June 2012	1. Reading in the European Parliament

Options for Influencing the Political Process

Leading Directorate General:	DG Economic and Financial Affairs
Committees of the European Parliament:	Economic and monetary affairs (in charge), rapporteur: Jean-Paul Gauzès (EVP, FR)
Committees of the German Bundestag:	Budgetary committee (in charge), Committee for affairs of the EU, Committee for economy and technology, Finance Committee
Decision mode in the Council:	Qualified majority (only euro countries may vote, Art. 136 (2) TFEU)

Formalities

Legal competence:	Art. 136 in conjunction with Art. 121 (6) TFEU (budgetary discipline and coordination of economic policy)
Form of legislative competence::	Coordination of economic policy (Art. 5 (1) TFEU)
Legislative procedure:	Art. 294 TFEU (ordinary legislative procedure)

ASSESSMENT

Economic Impact Assessment

Ordoliberal Assessment

Ultimately, the aim of enhanced surveillance is to force euro countries to seek financial assistance. Although the Council may only make a recommendation, as soon as such a recommendation becomes public, the markets will demand such high risk premiums that the euro country will have no option than to seek financial assistance.
Euro countries whose financial stability is jeopardised and euro countries providing financial assistance have differing views about when to submit an application for financial assistance. The latter favour an early application so as to keep the financial assistance and the accompanying reforms to a minimum. By contrast, those Euro countries whose financial stability is jeopardised wish to avoid seeking financial assistance for as long as possible, as this goes hand-in-hand with a stigmatisation of the state. Moreover, the state concerned must undertake to carry out an adjustment programme which essentially entails surrendering a part of its national sovereignty. **Both Portugal and Ireland procrastinated for a long time before seeking financial assistance, thereby making the amount higher than it need have been** and jeopardising the stability of the European banking system unnecessarily. **The enhanced surveillance** of states threatened by insolvency creates a balance between the different interests of the euro countries and **can** thus **help avoid cost-increasing delays in a financial assistance application**.
If euro countries are forced to seek financial assistance in order to recapitalise banks the ECB can also be relieved. For many euro countries grant state guarantees for bank bonds enabling the banks to borrow money from the ECB by pledging such bonds. Thus large risks are transferred to the ECB. It is estimated that in this way the Greek, Portuguese and Irish banks obtained credits amounting to 90 billion Euros.
In addition, along with the monitoring conducted within the framework of the Stability and Growth Pact [Regulations (EU) Nos. 1466/97, 1467/97 and 1176/2011; s. CEP Analysis], enhanced surveillance creates a further option to oblige euro countries at an early stage to carry out reforms.

However, the proposed **procedure presents two difficulties. Firstly, it contains no criteria that define when a euro country is under enhanced surveillance**. This means that neither national governments nor investors can develop sufficiently substantiated expectations. **The uncertainty resulting from this can make the refinancing of individual euro countries more difficult**. While it is true that it is hardly possible to define exactly such criteria, as there can be many different reasons why a euro country is threatened with financial instability, there should be at least a rough definition of criteria, as this would enable governments and investors to take corrective measures in time. **Secondly, it is problematic that only the Commission has an influence on the initiation of proceedings while euro countries granting financial assistance and the ECB do not.** It should be possible to initiate enhanced surveillance if a qualified majority of euro countries or the ECB deem such a procedure necessary. Moreover, it should be possible to prevent such a procedure if the ECB and a qualified majority of euro countries veto it.

The obligation to provide information, as required by enhanced surveillance, is indispensable for the assessment of the stability of the financial sector and the evaluation of the fiscal stability in euro countries. As information on the financial sector also provides important information for the identification of macro-economic imbalances, it would also be necessary to extend such an obligation to provide information to the macro-economic surveillance under the scope of the Stability and Growth Pact [Regulations (EU) Nos. 1466/97, 1467/97 and 1176/2011; s. CEP Policy Brief].

The possibility to continue the monitoring of a euro country even after the adjustment programme has expired reduces the risk of relapsing into old policy patterns.

Legal Assessment

Competency

Unproblematic: The EU may adopt measures to reinforce the coordination and surveillance of the budgetary discipline of euro countries (Art. 136 TFEU). It may also coordinate, monitor and assess the economic policy of all Member States and issue warnings and country-specific recommendations (Art. 121 TFEU).

Subsidiarity

A subsidiarity check may only be carried out in cases of non-exclusive EU competencies. Regarding the present legal basis, either an exclusive (Art. 3 (1)c TFEU) or coordinating EU competency (Art. 5 (1) TFEU) could apply. The wording of Art. 121 and 136 TFEU already serves the purpose of coordination. The fact that special rules apply to euro countries pursuant to Art. 5 (1) sentence 3 TFEU further emphasises the effect of the special rules in Art. 136 TFEU being subject to the coordinating competency. The exclusive EU competency, however, applies only to special rules of monetary policy (Art. 127-133 TFEU). As a coordinating competency is at hand, the subsidiarity requirements must be complied with. This is the case:

As a state in financial difficulties can meanwhile be sure to be rescued financially, a sloppy approach to economic and finance policy might make sense from their point of view, but from a European standpoint it is harmful. A surveillance of euro countries at EU level is therefore necessary. The intended strong influence of the Commission is also appropriate: basically, surveillance should not be left to any bodies in which other euro countries that might also be in financial difficulties have a direct interest of their own in less strict controls.

Proportionality

EU measures for surveillance and coordination are necessary. For in order to ensure the proper "functioning of economic and monetary union" (Art. 136 TFEU), difficulties with the financial stability of euro countries must be quickly identified and addressed.

Compatibility with EU Law

Unproblematic.

Compatibility with German Law

The German Federal Financial Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht, BaFin*) may not convey disaggregated information on the financial situation of national financial institutions (Art. 3 (3)) directly to the European Banking Authority (EBA) (§ 7b KWG in conjunction with Art. 35 Regulation (EU) No. 1093/2010). The KWG would have to be adjusted upon the adoption of the Regulation.

Conclusion

Ultimately, enhanced surveillance aims to force euro countries to seek financial assistance. Thus cost-increasing delays in requesting financial assistance can be avoided in future. This would relieve those euro countries acting as grantors for financial assistance. However, at least a set of rough criteria as to when enhanced surveillance should take effect would need to be defined. Otherwise, an uncertainty would be created among governments and investors which would make the refinancing of euro countries more difficult. Moreover, it should be made possible to initiate enhanced surveillance if a qualified majority of euro countries deem such a procedure necessary.