THE EURO ZONE AND SOVEREIGN DEBT[*]

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Europe has to face the triple challenge of sovereign solvency, liquidity problems and the repercussions of the banking crisis. The Euro zone is pressurised into taking more decisive action on the institutional deficiencies of the European Monetary Union. This paper reviews the European trajectory from makeshift to more comprehensive strategies with resecue mechanisms for countries in distress, including an assessment of the role of the European Central Bank and the conflicting interests of the Member States. A section on the Spanish Recapitalisation Schemes of 2012 and the EU's policies on recapitalising banks demonstrates the interface between the sovereign debt and banking crises.

I. A MULTIPLE CRISIS

A. THE CHALLENGE

If the Executive Board of the European Central Bank ('ECB') is to be believed the Euro as a *currency* is not in crisis:[1] "The objectives of the single currency remain as relevant as they were when the single currency was agreed: to spread price stability and sustainable growth to all European citizens".[2] From an institutional perspective, a critical vacuum exists between the ECB's centralised monetary policies and the decentralised fiscal and supply-side economies that Member States have pursued with little inclination to coordinate. Moreover, there is competitive gap between the Northern and Southern members of the Euro zone.[3] With varying degrees of intensity, the

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[1] J. Asmussen, Executive Board Member, Zwischenbericht auf dem Weg in eine stabilere Wirtschafts- und Währungsunion, Speech, (August 27, 2012), availableat http.//www.ecb.int/press/key/date/2012/html/sp120827.de.html (Last visited on October 7, 2012).

[2] President M. Draghi, *The future of the euro: stability through change*, DIE ZEIT (Germany) August 29, 2012, English version available at http.//www.ecb.int/press/key/date/2012/html/sp120829.en.html (Last visited on October 7, 2012).

[3] International Monetary Fund, Euro Area Policies – 2012 Article IV Consultation (IMF Country Report No. 12/181 (July 2012)); for a detailed economic analysis *see also* J. Y. Lin, V. Treichel, *The Crisis in the Euro Zone – Did the Euro Contribute to the Evolution of the Crisis?*, (World Bank Policy Research Working Paper 6127, 2012); *see also* Part II of the Communication from the Commission to the European Parliament, European Council, the European Central

Euro zone and its members are suffering from a 'syndrome of multiple interdependent crises' provoked by sovereign insolvency, sovereign illiquidity and bank undercapitalisation.[4]

With respect to the Euro zone, the IMF diagnoses an "adverse bank-sovereign feedback", which has intensified in the peripheral countries of the European Union ('EU').[5] The Euro Area Summit Statement of June 29, 2012 pledges to "break the vicious circle between banks and sovereigns".[6] This is a reference to the EU rules on State aid to banks, which were introduced when Member States started saving their domestic banks of systemic importance.[7] Under the terms of the most recent bailout of ailing Spanish banks, the EU conditions its approval of the national aid scheme on restructuring plans for credit institutions.[8] The June 2012 statement also adds a new policy element as it announces a risk assessment of banking practices during the sovereign debt crisis[9] with a view to speed up recapitalisation.[10] Moreover, the EU insists on replacing bailout strategiesby a bail-in approach.[11]

B. OUTLINE

This paper first identifies the economic and legal challenges of the sovereign debt crisis. The anti-crisis policy of the EU and its Member States is assessed in the light of the EU Treaty and the guarantee measures that have been taken to assuage the markets and to end moral hazard by national

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Bank, the Economic and Social Committee and the Committee of the Regions, *Reinforcing economic policy coordination*, Brussels, May 12, 2010, COM (2010) 250 final.

4 UK House of Lords European Union Committee, The Euro Area Crisis (25th Report of Session 2010-2012), ¶11.

5 International Monetary Fund, Euro Area Policies (2012).

6 Euro Area Summit Statement, June 29, 2012, available at http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/131359.pdf (Last visited on October 7, 2012).

7 For a survey of national measures by the Member States of the EU, *see* A. Petrovic & R. Tutsch, *National Rescue Measures in Response to the Current Financial Crisis* (European Central Bank Legal Working Paper Series No. 8, July 2009).

8 Press Release, European Commission, *State aid: Commission approves Spanish recapitalisation scheme for credit institutions* (July 25, 2012).

9 *See* G. Adler, *Intertwined Sovereign and Bank Solvencies in a Model of Self-Fulfilling Crisis* (IMF Working Paper WP/12/178, July 2012); Min Zhu, Deputy Managing Director, IMF, Opening Remarks at the 12th IMF Forum on Managing Sovereign Risk and Bank Solvencies: *Managing Sovereign Debt: A Seismic Shift in Demand and Supply Dynamics* (June 28, 2012), available at http://www.imf.org/external/np/speeches/2012/062812.htm (Last visited on October 7, 2012).

10 *See infra* Part III.B.

11 *See* EU Commission Proposal for Directive of the European Parliament and of the Council establishing a framework for the recovery and resolution and investment firms, COM(2012) 280/3, Brussels, June 6, 2012 (SWD(2012) 166/SWD(2012) 167), 3, available at http://ec.europa.eu/internal_market/bank/docs/crisis-management/2012_eu_framework/COM_2012_280_en.pdf (Last visited on October 7, 2012). *See generally* J. Zhou, V. Rutledge, W. Bossu, M. Dobler, N. Jassaud, M. Moore, *From Bail-out to Bail-in: Mandatory Debt Restructuring of Systemic Financial Institutions*, IMF Staff Discussion Note, SDN/12/03 (April 24, 2012).

governments. This is very much an account of law-in-the-making as the Euro zone slowly edges towards more comprehensive fiscal and economic policies, addressing competitive imbalances among its members. The focus is on the legal framework of the stabilisation funds and on the role of the ECB with respect to the fiscal policies of the Member States.[12] The analysis then concentrates on the Spanish Recapitalisation Schemes of 2012 and the EU's recapitalisation requirements for the banking sector.

II. THE EU AND SOVEREIGN DEBT – FROM MAKESHIFT TO A COMPREHENSIVE POLICY APPROACH?

A. MONETARY UNION AND THE CRISIS – BASICS[13]

The introduction of European Monetary Union ('EMU') was designed as a three-step process. In 1990, stage-I ushered complete freedom for capital transactions based on increased cooperation between central banks and pledges to improve the economic performance of the future members of the Euro zone. The predecessor of the ECB, the European Monetary Institute, assumed its functions in 1994. From then on, central banks were prohibited from extending credit to the public sector and the Euro zone members were required to ensure the independence of their respective national banks. In 1999, monetary union was launched without Euro banknotes and coins: fixed conversion rates between the Euro zone countries were introduced and the European System of Central Banks was charged with developing a single monetary policy. The Member States of the Euro zone, however, continued to enjoy remarkable freedom to pursue their own domestic economic and fiscal policies, inefficiently bound by the stipulations of the Stability and Growth Pact.[14] Banknotes, the most visible sign of monetary union, came in 2002.

The freezing of conversion rates produced remarkable effects on the markets for sovereign bonds of European countries. Sovereign bond yields converged so that South European countries had to spend less on public borrowing, thereby diminishing the incentives to reduce credit finance in the public sector. The financial crisis has reversed this trend. In fact, as early as August 2007 markets began to change their attitude towards the economies of the EMU Member States: international risk factors and individual macro-fundamentals

12 *See also* A. Schaechter, T. Kinda, N. Budina, A. Weber, *Fiscal Rules to the Crisis – Toward the Next-Generation Rules: A New Dataset* (IMF Working Paper WP/12/18, July 2012); S. Claessens, A. Mody, S. Vallée, *Paths to Eurobonds* (IMF Working Paper/12/172, July 2012).

13 For a detailed analysis,*see*D. Marsh, The Euro – The Battle for the New Global Currency 185 et seq. (2011).

14 *See infra*, Part II.B.1.

(including competitiveness) came to be priced on a country-by-country basis.[15] The yield spreads on sovereign bond markets for Euro zone bonds are considerable.[16] Greece, Spain and Italy have come to be perceived as countries where the credibility of their commitments under the Stability and Growth Pact is problematic.[17]

B. THE LEGAL FRAMEWORK

1. Monetary Union according to the Treaty on the Functioning of the European Union[18]

The pre-crisis legal foundations for the EMU are the result of a problematic compromise between France and Germany.[19] The Treaty Functioning of the European Union ('TFEU') in its current version 'unifies' monetary policy for the Euro zone by entrusting the ECB with policy design and enforcement. But during the negotiations for the organisational framework no agreement could be reached on harmonised macroeconomic policies of the Member States. Title VIII of TFEU enacts a complicated liaison between economic and monetary policies, which are to be developed concurrently by the Member States and the ECB. Art. 119(1) TFEU envisages the adoption of an economic policy which is based on "close coordination of Member States' economic policies, on the internal market … and conducted in accordance with the principle of an open market economy".[20] Arts. 119(2) and (3) of the TFEU make

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15 *C.f.* M. G. Arghyrou, A. Kontonikas, *The EMU's sovereign debt crisis: Fundamentals, expectations and contagion, European Commission* (European Economic Paper 436, February 2011), 2 et seq.; N. Gaillard, A Century of Sovereign Ratings 173 (2012).

16 European Commission, Directorate-General Economic and Financial Affairs, *European Sovereign Debt Markets – Recent Developments and Policy Options*, Note for the attention of the European Parliament's Special Committee on the Financial, Economic and Social Crisis (CRIS), Brussels, 14 January 2011 (ECFIN/E/E1), 2 available at http://www.europarl.europa.eu/meetdocs/2009_2014/documents/cris/dv/bond_markets_20_1_2011/bond_markets_20_1_2011en.pdf (Last visited on October 7, 2012).

17 *See* the deficit statistics in Eurostat News Release, *Euroindicators First quarter 2012 compared with fourth quarter 2011*, July 23, 2012, available at http://epp.eurostat.ec.europa.eu/cache/ITY_PUBLIC/2-23072012-AP/EN/2-23072012-AP-EN.PDF (Last visited on October 7, 2012).

18 *See* the survey by D. Adamski, *National Power and Structural Failures in the European Macroeconomic Governance*, 49 Common Mkt. L. Rev. 1319 (2012).

19 For a detailed account, *see* D. Marsh, *supra* note 13, 202 et seq., 212 et seq.; *c.f.* T. G. Ash, *The Crisis of Europe – How the Union Came Together and Why It's Falling Apart*, 91(5) Foreign Affairs (2012).

20 *See* Treaty on the Functioning of the European Union, Art. 119:

(1) For the purposes set out in Article 3 of the Treaty on the European Union, the activities of the Member States and the Union shall include, as provided in the Treaties, the adoption of an economic policy which is based on the close of Member States' economic policies, on the internal market and on the definition of common objectives, and conducted in accordance with the principle of an open market economy with free competition.

(2) Concurrently with the foregoing, and as provided in the Treaties and in accordance with the procedures set out therein, these activities shall include a single currency, the euro,

a somewhat desultory attempt to combine the economic policies of the Member States with the single currency and exchange rate policy: "The activities of the Member States and the Union shall entail compliance with … stable prices, sound public finances and monetary conditions and a sustainable balance of payments". The treaty enshrines an imbalance between hortatory invitations to develop a common economic policy for the Union and credible mechanisms to enforce a common approach.[21] Nonetheless, the language of the treaty would allow for greater coordination of national policies if there were a political will to do so.

Art. 122 et seq. of the TFEU lay down ground rules for situations of economic stress: A Member State which is in difficulties or seriously threatened with severe difficulties caused by natural disasters or exceptional circumstances beyond its control may receive under certain conditions Union financial assistance.[22] Art. 123 of the TFEU,[23] however, introduces severe restrictions on

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and the definition and conduct of a single monetary policy and exchange-rate policy the primary objective of both of which shall be to maintain price stability and, without prejudice to this objective, to support the general economic policies in the Union, in accordance with the principle of an open market economy with free competition.

(3) These activities of the Member States and the Union shall entail compliance with the following guiding principles: stable prices, sound public finances and monetary conditions and a sustainable balance of payments.

21 *C.f.* D. Adamski, *National Power and Structural Failures in the European Macroeconomic Governance,* 49 Common Mkt. L. Rev. 1319, 1322 et seq (2012).

22 *See supra* note 20, Art. 122:

(1) Without prejudice to any other procedures provided for in the Treaties, the Council, on a proposal from the Commission, may decide, in a spirit of solidarity between the Member States, upon the measures appropriate to the economic situation, in particular if severe difficulties arise in the supply of certain products, notably in the area of energy.

(2) Where a Member State is in difficulties or is seriously threatened with severe difficulties caused by natural disaster or exceptional circumstances beyond its control, the Council, on a proposal from the Commission may grant.

23 *See id.*, Art. 123:

(1) Member States shall avoid excessive government risks.

(2) The Commission shall monitor the development of the budgetary situation and of the stock of government debt in the Member Stats with a view to identifying gross errors. In particular it shall examine compliance with budgetary discipline on the basis of the following two criteria:

(a) whether the ration of the planned or actual government deficit to gross domestic product exceeds a reference value, unless:
– either the ratio has declined substantially and continuously and reached a level that comes close to the reference value,
– or, alternatively, the excess over the reference value is only exceptional and temporary and the ratio remains close to the reference value;

(b) whether the ratio of government debt to gross domestic product exceeds a reference value, unless the ration is sufficiently diminishing and approaching the reference value at a satisfactory pace.
The reference values are specified in the Protocol on the excessive deficit procedure annexed to the Treaties.

(3) If a Member State does not fulfil the requirements under one or both of these criteria, the Commission shall prepare a report. The report of the Commission shall also take into

direct aid from a Member State to any other Member State. Overdraft facilities or any other type of credit facility with the ECB or a Member State's central bank in favour of a public institution of another Member State are expressly prohibited. Moreover, the treaty introduces a ban on the ECB or any national central bank directly purchasing debt instruments. Under Art. 125(1) of the TFEU, the Union or any Member State shall not be liable to or assume the liabilities of public institutions of any Member State. Mutual financial guarantees for the execution of a joint specific project are, however, acceptable.

According to Art. 126 of the TFEU, Member States are admonished to avoid excessive deficits. But closer inspection of the enforcement mechanisms suggests that the barriers to excessive national spending are not insurmountable. It shall be the duty of the Commission to monitor the budgetary situation and the stock of government debt in the Member States. Compliance with budgetary discipline – subject to certain exceptions – shall be examined on the basis of the ratio of planned or actual government deficit to the gross national product. Moreover the totality of government debt to gross domestic product should not exceed a certain reference point. The Protocol on the Excessive Deficit Procedure specifies that the ratio of the planned or actual government deficit to gross domestic product shall be 3%. The ratio of government debt to gross domestic product at domestic prices has been set at 60%.[24]

If a Member State does not observe these criteria, the Commission is charged with commencing an excessive deficit procedure. It should be noted that this procedure would apply irrespective of whether the Member State is a member of the Euro zone or not. If the Council of Ministers of the Member States, upon proposal from the Commission, finds that an excessive deficit exists it may address recommendations to the Member State.[25] If the Member State fails to implement the recommendation, the Council may put the State on notice, requiring measures to take action within a specified time limit.[26] It is obvious that the excessive deficit procedure in its current form is very far from traditional law enforcement mechanisms. Instead, the procedure relies on reputation mechanisms and peer pressure to encourage Member States to reduce their deficits.[27] If, however, larger Member States agree to disregard the excessive deficit procedure and its findings,[28] the Commission is left without

account all other relevant factors, including the medium-term economic and budgetary position of the Member State.

The Commission may also prepare a report if, notwithstanding the fulfilment of the requirements under the criteria, it is of the opinion that there is a risk of an excessive deficit in a Member State.

24 Protocol (No. 12) on the Excessive Deficit Procedure, O. J. C 115/279 of May 9, 2008, Art. 1.

25 Treaty on the Functioning of the European Union, Art. 126(7).

26 *Id.,* Art. 126(9).

27 *C.f.* Presidency Conclusions on Improving Governance of the Council of the European Union, Brussels, March 23,2005 (Council of the European Union, 7619/1/05 REV1 – CONCL1).

28 S. Collignon, *The End of the Stability and Growth Pact?*, LSE Paper (2003/2004), available at http://web1.sssup.it/pubblicazioni/ugov_files/102165_Stability%20and%20Growth%20Pact.

any viable policy instrument to improve budget discipline, maintain price stability and incentivise Member States to meet the competitive challenges of globalisation. The Euro zone resembles a federal state with a federal currency without federal enforcement mechanisms and a sovereign firewall.[29] The drafters of the treaty on EMU cannot be accused of ignoring the lacunae of this approach.[30] In fact, the language of the treaty suggests that they were fully aware of the interface between monetary and economic policy, but had to leave it to the negotiating game between the Member States to find a solution. In an age of globalization, the Euro zone has become vulnerable to external shocks, financial institutions which legitimately exploit the fallacies of the contractual network of sovereign debt and inertia of politicians who have to win elections at a national level.[31]

2. The Role of the ECB

The institutional deficiencies of the Euro zone have put the ECB into the limelight. It is the only centralised EU institution, which is responsible for surveying the interface between economic and monetary policy. It has the funds to protect the currency and it has to establish its independence against politicians who are tempted to use the bank as a scapegoat for national shortcomings. In accordance with Art. 282(1) of the TFEU, the ECB and the central national banks shall constitute the European System of Central Banks.[32] This

pdf (Last visited on October 7, 2012).

29 *C.f.* J.C. Piris, The Future of Europe – Towards a Two Speed EU? 41 et seq. (2012); T.G. Ash, 91(5) Foreign Affairs (2012); C. F. Bergsten, *Why the Euro Will Survive – Completing the Continent's Half-Built House*, 91(5) Foreign Affairs (2012).

30 *See* A. Dombret, Member, Executive Board of the German Bundesbank, Speech at the Bank of America Merrill Lynch Global Macro Conference, London: The present state of the euro-area sovereign debt crisis (June 12, 2012), available at http://www.bundesbank.de/Redaktion/EN/Reden/2012/2012_06_12_dombret_euro_area_sovereign_debt_crisis.html (Last visited on October 7, 2012).

31 *See* the analysis by C. Bastasin, Saving Europe – How National Policies Nearly Destroyed the Euro, 73 et seq (Brookings Institution Press, Washington, D.C., 2012). For a more optimistic assessment *C.f.* Bergsten, *supra* note 29.

32 *See* Treaty on the Functioning of the European Union, Art. 282:

(1) The European Central Bank, together national central banks, shall constitute the European System of Central Banks (ESCB). The European Central Bank, together with the national central banks of the Member States whose currency is the euro, which constitute the Eurosystem, shall conduct the monetary policy of the Union.

(2) The ESCB shall be governed by the decision-making bodies of the European Central Bank. The primary objective of the ESCB shall be to maintain price stability. Without prejudice to that objective, it shall support the general economic policies in the Union in order to the achievement of the latter's objectives.

(3) The European Central Bank shall have legal personality. It alone may authorise the issue of the euro. It shall be independent in the exercise of its powers and in the management of its finances. Union institutions, bodies, offices and agencies and the governments of the Member States shall respect that independence.

(4) The European Central Bank shall adopt such measures as are necessary to carry out its task in accordance with Articles 127 to 133, with 138, and with the conditions laid down in the Statute of the ESCB and of the ECB. In accordance with these same Articles, those

includes the central banks of all Member States of the EU. For practical purposes, the Eurosystem and its decision-making bodies determine the monetary policy of the Union. The Eurosystem consists of the ECB and the national banks of the Member States whose currency is the Euro. The Governing Council of the ECB is composed of the Executive Board of the ECB and the governors of the national central banks whose currency is the Euro.[33] The ECB shall ensure price stability as primary objective of its activities is maintained. It is empowered to conduct foreign-exchange operations, to hold and manage the official foreign reserves of the Member States and to promote the smooth operation of payment systems.[34] The ECB authorises the issue of Euro banknotes.[35] The initial capital of the ECB was fixed at €5,000 million and is held by the national central banks in proportion to the population and gross domestic product by the respective Member State.[36]

The Statute of the European System of Central Banks and the ECB confers broad powers on the Governing Council and the Executive Board of the ECB.[37] The ECB and national central banks may open accounts for credit institutions and other market participants and accept assets, including book entry securities, as collateral. Both, the ECB and central banks are entitled to operate in the financial markets by buying and selling outright (spot and forward) or under repurchase agreement and by lending or borrowing claims and marketable instruments. Moreover, the ECB and national central banks may engage in credit operations and other market participants, including lending based on adequate collateral. Art. 21 of the Statute reiterates that the ECB may not grant overdraft facilities to official institutions of the Member State and shall be barred from directly purchasing Member States' debt instruments. The original version of the treaty establishing monetary union and the Statute do not provide for ECB oversight over national credit institutions. Art. 25 of the Statute confines the ECB's role to giving advice on the implementation of Union legislation on prudential supervision and the stability of the financial system.

Member States whose currency is not the euro, and their central banks, shall retain their powers in monetary matters.

(2) Within the areas falling within its responsibilities, the European Central Bank shall be consulted on all proposed Union acts, and all proposals for regulation at national level, and may give an opinion.

33 Statute of the European System of Central Banks and of the European Central Bank (Protocol No. 4), O. J. C 115/230 of 9 May 2008, Art. 10.1.

34 Treaty on the Functioning of the European Union, Art. 127(2); Statute of the European System of Central Banks and of the European Central Bank, Art. 3.1.

35 Statute of the European System of Central Banks and of the European Central Bank, Art. 16.

36 *Id.*, Art. 28.

37 *See id.*, Art. 18. For a critical analysis of the ECB's decision-making process: Marsh, *supra* note 13, 228 et seq.

C. SIGNS OF CRISIS

1. From Early Market Warnings to Greece

Early in 2009, the markets signalled that the banking crisis (triggered by the breakdown of the Lehman Group) had started transforming into a sovereign debt crisis. Germany failed to completely auction off ten-year government bonds. The yield spreads on sovereign bond markets for Euro zone widened considerably[38] and the spreads for Greek credit default swaps became more dynamic than those for bonds,[39] ushering in a period of market uncertainty and raising borrowing costs for the Greek government. On April 27, 2009, the European Council of Ministers determined that an excessive deficit existed in Greece.[40] By the end of 2009, the Greek government deficit had reached 12.7%[41] and the debt to GDP ratio was at 115%.[42] This ratio had risen to 132.4% in the first quarter of 2012.[43]

As early as 2009, sound business judgment would have advised banks to diversify their investment strategies and to move out of overly risky government bonds. Instead, an informal bargain was struck, providing ailing European banks with liquidity to continue buying high-yield, high-risk sovereign debt.[44] In May 2009, the ECB announced liquidity management measures, which provided banks with almost unlimited liquidity under the main and longer term refinancing operations (MRO's/LTRO's).[45] Banks could borrow from the ECB at historically low levels.[46] Moreover, the ECB initiated a programme to buy debt securities issued by banks (covered bond purchases),

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38 Bastasin, *supra* note 31, 88 et seq ; *see also* A. Alfonso, D. Furceri, P. Gomes, *Sovereign Credit Ratings and Financial Market Linkages – Application to European Data*, 6 et seq (European Central Bank Working Paper Series No. 1347, June 2011); The Economist, *European bond spreads*, May 27, 2008, available at http://www.economist.com/node/10926268 (Last visited on October 6, 2012).

39 Gaillard, *supra* note 15, 177 et seq.

40 Council Decision of April 27, 2009 on the existence of an excessive deficit in Europe (2009/415/EC), O. J. L 135/21 of May 30, 2009.

41 For an account *see* R. Olivares-Caminal, *The EU Architecture to Avert a Sovereign Debt Crisis*, 2 OECD Journal: Financial Market Trends 3 et seq. (2011).

42 European Commission, Directorate-General for Economic and Financial Affairs, *The Economic Adjustment Programme for Greece* (European Economy Occasional Papers 61, May 2010, 6/90).

43 Eurostat News Release Euroindicators*, First quarter 2012 compared with fourth quarter 2011*, July 23, 2012, available at http://epp.eurostat.ec.europa.eu/cache/ITY_PUBLIC/2-23072012-AP/EN/2-23072012-AP-EN.PDF (Last visited on October 6, 2012).

44 *See* C. Bastasin, *supra* note 31, 110 et seq.

45 J.-C. Trichet, President, European Central Bank, Keynote Address at University of Munich, Munich:*The ECB's Enhanced Credit Support*, July 13, 2009, available at http://www.ecb.int/press/key/date/2009/html/sp090713.en.html (Last visited on October 6, 2012).

46 *Id*.

which accommodated the maturity mismatch between assets and liabilities.[47] The ECB made it clear, however, that enhanced credit support schemes should be phased out in order to avert negative side-effects, resulting from a long-term misallocation of capital, the danger of central bank dependency and potential risks to price stability.[48] At the same time, national governments asked the recipient banks to reinvest in up to 70% of newly issued sovereign bonds.[49] Officials of national central and ministries held meetings with banks to administer doses of 'moral suasion'. Cooperative behaviour assured a tripartite deal, which was never formally underwritten.[50] But banks received cheap liquidity to invest into risk sovereign debt with high yields, invoking a *de facto* overdraft facility by the ECB.[51]

The 2009 secret bargain was designed to quell market volatility by stretching the powers of the ECB to the extreme. On the other hand, it marks a first attempt to defuse problems of European sovereign debt without testing the resolve of the Member States to engineer a legally binding anti-crisis policy. Lack of budgetary discipline, however, made the viability of 2009 secret bargain delusory.[52] In October 2009, truth prevailed over the "shortcomings in Greece's public finance statistics"[53] and it transpired that the deficit would amount to 12.7% instead of the officially proclaimed 3.7%.[54] The Greek government presented a long-term programme of economic restructuring and deficit cutting, but abstained from enacting more drastic measures on fiscal correction.[55] Although the Greek government had not requested any financial assistance, the Heads of State or Government of the EU declared their intention to take action to defend "financial stability in the euro area as a whole".[56] The ECB endorsed this policy statement, emphasising the necessity "to conduct

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47 *The ECB's Response to the Financial Crisis*, ECB Monthly Bulletin, October 2010, 59, 64 et seq., available athttp://www.ecb.int/mopo/implement /omo/html.index.en.html (Last visited on October 6, 2012) (for a survey of the ECB's open market operations and the corresponding communications); T. Linzert, D. Nautz, U. Bindseil, *The Longer Term Refinancing Operations of the ECB* (European Central Bank Working Paper Series No. 359/May 2004); *The liquidity management*, ECB Monthly Bulletin May 2002, 41, 42 et seq.

48 J. Stark, Executive Board member of the European Central Bank, Speech at University of Tübingen, Tübingen: *Monetary Policy before, during and after the Financial Crisis* (November 9, 2009) available at http://www.ecb.int/press/key/date/2009/html/sp091109.en.html (Last visited on October 6, 2012).

49 *See supra* note 44.

50 Bastasin, *supra* note 31, 111.

51 *Id*.

52 *Id*., 145 et seq.

53 Press Release, Council of the European Union, 2994th Council Meeting, Brussels, February 16, 2010 (6477/10(Presse 28)); Olivares-Caminal, *supra* note 41, 4.

54 *Id*.

55 Bastasin, *supra* note 31, 144 et seq.

56 *Statement by the Heads of State or Government of the European Union, Brussels*, February 11, 2010, available at http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/112856.pdf (Last visited on October 6, 2012).

sound national policies in line with the agreed rules".[57] These statements do not move beyond the institutional framework of TFEU and the Statute of the ESCB and of the ECB. In fact, they are sidestepping the issue on how to bridge the economic divide within the Euro zone and to emancipate the decision-making process in macroeconomics from the system of policy coordination under the existing legal rules.

2. The Greek Bail-out – The Beginnings

In spring 2010, it had become clear that the Greek government was no longer able to borrow on the international bond markets at sustainable rates. The government had issued new bonds and the bonds spreads kept spiralling.[58] On March 25, 2010, the participants of the EU Brussels summit agreed on a package[59] for Greece, which combined financial assistance under international economic law with coordinated bilateral loans from the Member States, pooled by the EU Commission.[60] The package plan employs an 'extra-territorial' enforcement mechanism to the extent that Greece would be asked to apply to the IMF for financial assistance which would invoke its traditional conditionality mechanisms. The package cannot be firmly located within the established confines of EU law, but it relies on the monitoring skills of the EU Commission and the ECB (which together with IMF would form the 'Greek troika').[61] On April 23, 2010, Greece formally requested financial assistance from the Euro zone Member States and the IMF.[62] Negotiations between the IMF, the EU, Euro zone Member States and the ECB produced a complicated web of conditionalities, ad-hoc-payout mechanisms and uncertainty about the legal foundations. A

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[57] J. C. Trichet, President of the European Central Bank, *Statement following the meeting of the Heads of State and Government on February 11, 2010*, available at http://www.ecb.europa.eu/key/date/2010/html/sp100211.en.html (Last visited on October 6, 2012).

[58] Council on Foreign Relations, C. Alessi, *The Eurozone in Crisis*, available at http://www.cfr.org./eu/eurozone-crisis/p22055 (Last visited on October 6, 2012); For an analysis of the Greek political economy at the outbreak of the sovereign debt crisis: L. Tsoukalis, *Greece in the Euro Area: Odd Man Out, orPrecursorof Things toCome*in Resolving the European Debt Crisis, Peterson Institute for International Economics Bruegel – Special Report 21, 19 et. seq. (W.R. Cline, G.B. Wolff ed., February 2012).

[59] *Statement by the Heads of State and Government of the Euro Area, Brussels,* March 25, 2010, available at http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/113563.pdf (Last visited on October 6, 2012).

[60] Council Decision of May 10, 2010 (2010/320/EU), O. J. L 145/6 of June 11, 2010, Recital 8 (addressed to Greece with a view to reinforcing and deepening fiscal surveillance and giving notice to Greece to take measures for the deficit reduction judged necessary to remedy the situation of excessive deficit).

[61] Financial Times on-line edition, K. Hope, *Troika to assess Greek economic reforms*, July 25, 2010.

[62] *See Joint Statement of the President of the Eurogroup, the EU Commission and the ECB following the request of financial support by the Greek government*, April 23, 2010, available at http://europa.eu/rapid/pressReleasesAction.do?reference=IP/10/446 (Last visited on October 6, 2012); c*.f. Statement on the support to Greece by Euro area Members States, Brussels*, April 11, 2010 (MEMO/10/123), available at http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/10/123 (Last visited on October 6, 2012).

joint package was agreed whereby Greece was to receive a total of €110 billion of loans over three consecutive years.[63] With respect to the IMF, Greece accepted a Stand-by Arrangement covering three yearly tranches of €10 billion each. As part of the IMF conditionality Greece signed a Letter of Intent and Memorandum of Understanding on Economic and Financial Policies in which it undertook to modernise its economic and financial policies, including a pledge to introduce budget cuts.[64] A second letter of intent and a Memorandum of Understanding on Specific Economic Conditionality were sent to the ECB, the EU Commission and the President of the Eurogroup to protect the interests of the lending Member States.[65] Technically, the Memorandums of Understanding were delivered to different addressees. But they constitute a novel instrument of international financial assistance as their implementation is jointly monitored by the 'troika', i.e. the IMF, EU Commission and ECB.[66] The Letters of Intent and the Memorandums of Understanding can be updated when a tranche is due to be paid or economic circumstances so require.[67]

At the time the first bailout for Greece was negotiated, Greek citizens had started withdrawing money from their banks and there was a growing fear that financial 'contagion' would engulf the Euro zone completely.[68] With the benefit of hindsight it seems that the markets had priced in the bad news from the Greek sovereign debt market whereas the announcement of a bailout positively affected the stock of even banks without any exposure to European sovereign debt.[69] This appears to confirm the policy judgment that the first Greek bailout was designed to protect those European banks, which had invested heavily in Greek sovereign debt.[70] Conversely, bad news about Greek government bonds may have operated as 'wake-up call' for investors,[71] who began to reassess the vulnerability of other countries and the potential resolve of the Euro zone to help out with another aid scheme.

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63 Bastasin, *supra* note 31, 186 et seq.

64 *See IMF, Greece and the IMF, Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding*, available at http://www.imf.org/external/np/loi/2012/grc/030912.pdf (Last visited on October 6, 2012).

65 *Id*.

66 E. Desli, T. Pelagidis, *Greece's Sudden Faltering Economy: From Boom toBustwith Special Reference totheDebt Problem* in The Euro Crisis, International Papers in Political Economy 119, 139 et seq. (P. Arestis, M. Sawyer eds., 2012).

67 *Id*.

68 Bastasin, *supra* note 31, 188 et seq.

69 M. Mink, J. de Haan, *Contagion during the Greek Sovereign Debt Crisis* (DNB Working Paper No. 335, 2012), available at http://www.dnb.nl/en/binaries/Working%20Paper%20335_tcm47-267897.pdf (Last visited on October 6, 2012); *see supra* note 42 (for a less optimistic perspective).

70 *C.f.* A. Blundell-Wignall & P. Slovik, *The EU Stress Test and Sovereign Debt Exposures* (OECD Working Paper on Finance, Insurance and Private Pensions No. 4, August 2010).

71 Mink, *supra* note 69.

3. Institutionalisation of Rescue Mechanisms I: The EFSM

After the EU had engineered the Greek bailout with the assistance of the IMF, it became imperative to devise a medium-term rescue mechanism for situations envisaged by Art. 122(2) of the TFEU. Member States had an interest in avoiding direct liability for financing the programme. The Council decided to establish a temporary European Financial Stabilisation Mechanism ('EFSM'),[72] which was designed to provide loans or a credit line to Member States in distress.[73] The EFSM for the Euro zone is modelled after the Union legislation for non-Euro Member States with balance of payment problems.[74] The EU Commission finances EFSM assistance programmes by issuing bonds on behalf of the EU. The proceeds from the sale of the bonds are to be disbursed as Union loans to the applicant Member State. The Commission repeatedly placed bond issues in order to raise funds for Ireland and Portugal.[75] The EFSM scheme will only be activated in the context of joint EU/IMF assistance.[76] Financial support under the EFSM scheme is predicated upon strict conditionality.[77] The recipient Member State is expected to submit a programme of fiscal and structural adjustments. On July 3, 2012 the Commission extended the latest EFSM loan to Ireland: €2.3 billion with a maturity of 15 years.[78] The necessity of the EFSM is reviewed every six months.[79] At the time of its establishment the Commission was authorised to borrow a maximum of €60 billion on the financial markets under an implicit EU budget guarantee:[80] financing operations under the EFSM scheme is back-to-back. In case of default the Commission will have to rely on its cash reserves;[81] Member States will only be asked to contribute additional cash resources if the Commission's funds are exhausted.[82]

72 *See* D. Adamski, 49 Common Mkt. L. Rev. 1319, 1329 et seq. (2012) (for a criticism of the 'rescue-funds institutional puzzle').

73 Council Regulation (EU) No. 407/2010, May 11, 2010, O.J. L 118/1, May 12, 2010 (establishing a financial stabilisation mechanism); *see* survey by R. Olivares-Caminal, *supra* note 41.

74 *See*, Council Regulation (EU) No. 407/2010, Recital 9 and Art. 1; Communication from the Commission to the Council and the Economic and Financial Committee on the European Financial Stabilisation Mechanism, Brussels, October 30, 2010, COM(2010) 713 final.

75 *See* European Commission, Economic and Financial Affairs, *European Financial Stabilisation Mechanism (EFSM)*, available at http://ec.europa.eu/economy_finance/eu_borrower/efsm/index_en.htm (Last visited on October 6, 2012) (list of loans disbursed to Ireland and Portugal).

76 *See* Council Regulation (EU) No. 407/2010, Recital 5.

77 *See* Council Regulation (EU) No. 407/2010, Recital 7.

78 *See supra* note 75.

79 Council Regulation (EU) No.407/2010, Art. 9.

80 *See* Commission Communication, *supra* notes 74 and 75; S. Collignon, *The ECB, the ESM and Stability Bonds: A Way Out of the Crisis* in The ECB, the EFSF and the ESM – Roles, relationships and challenges, Monetary Dialogue 22 (December 2011) (European Parliament, Directorate-General for Internal Policies, Economic and Monetary Affairs, IP/A/ECON/NT/2011-04 – PE 464.463).

81 Olivares-Caminal, *supra*note 41.

82 Olivares-Caminal, *supra*note 41; *c.f.* Commission Communication, *supra* note 74.

4. Institutionalisation of Rescue Mechanisms II: The EFSF

The EFSM was not designed to alleviate the day-to-day plight of Euro zone Member States struggling to raise money on the capital market at sustainable interest rates. But as the Greek crisis accelerated claims for a sovereign firewall intensified, European politicians faced a quandary. Representatives from countries with enormous sovereign debt problems loathed IMF conditionalities and looked for a European institution with greater leniency whereas others were afraid of financing public deficits contrary to the letter of TFEU.[83] The foundation of the European Financial Stability Fund ('EFSF') attempts to strike a balance between these positions while pacifying the markets. The EFSF is an institution, which transcends the framework of Union law. In May 2010 the Member States of the Euro zone agreed on the incorporation of a *société-anonyme* under Luxembourg law, which was designated to "collect funds and provide loans in conjunction with the IMF to cover the financing needs of euro area Member States in difficulty, subject to strict policy conditionality".[84] The shareholders of this Luxembourg company are the Member States of the Euro zone. The authorised capital (at some €28.5 billion) is relatively low in view of the initial €400 billion of loans which the EFSF could distribute to Member States in need. §3 of the 'Statuts coordonnés' of the 'EFSF Société Anonyme' conditions any assistance to a Member State in difficulties on a memorandum of understanding with the EU Commission containing policy conditionality. The EFSF is authorised to issue financial instruments or enter into arrangements with its shareholders or third parties. The liabilities of the Company may be guaranteed by shareholders or may be collateralised by credit support mechanisms.

The institutional framework of the EFSF was established under the 'EFSF Framework Agreement', which was concluded between the EFSF in its capacity as a Luxembourg Société Anonyme and the Member States of the Euro zone. As of August 3, 2012, the EFSF had to power to raise funds on the capital markets for a total of €780 billion backed by guarantees of the Member States of the Euro zone in accordance with their share in the paid-up capital of the ECB.[85] Organisation support to the EFSF is supplied by the German Debt Management Office and the European Investment Bank.[86] Since its incorporation in 2010 the role of the EFSF has evolved. It is now part of a larger safety net which includes €60 billion originating from the EFSM, and potential loans

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83 *See* The Economist, *Europe's sovereign-debt crisis – Acropolis now. The Greek debt crisis is spreading*, April 29, 2010 available at http://www.economist.com/node/16009099 (Last visited on October 6, 2012).

84 *Terms of reference of the Eurogroup, European Financial Stability Facility,* Luxembourg, June 7, 2010, available at http://www.consilium.europa.eu/uedocs/cms_Data/docs/pressdata/en/misc/114977.pdf (Last visited on October 6, 2012).

85 *See* European Financial Stability Facility Newsletter (November 2011).

86 European Financial StabilityFacility, *Frequently Asked Questions*, available at http://www.efsf.europa.eu/attachments/faq_en.pdf (Last visited on October 6, 2012).

which might be drawn from the IMF.[87] With respect to other creditors the EFSF is not a preferred creditor. EFSF debt instruments may be offered as collateral in ECB refinancing operations, but the EFSF is not recognised as a bank, which is eligible under the ECB credit schemes.[88] In the event of a default of sovereign borrower, the irrevocable and unconditional guarantees of the shareholders will be called in.[89]

The EFSF has moved from a back-to-back funding strategy to diversification, which includes short-term bills and liquidity buffers. The funds raised are no longer attributed to a particular country. Instead, they contribute to a general pool from which assistance will be disbursed to programme countries.[90] The EFSF may not enter into new programmes after June 20, 2013. Currently, both the EFSF and the EFSM are in the market. In July 2011, the Heads of State or Government of the Euro zone formally acknowledged that efforts to alleviate the sovereign debt crisis would be jeopardised by the precarious situation of some banks.[91] The EFSF was authorised to manage bank recapitalisations with the help of national governments, which do not participate in an economic adjustment programme.[92] Technically, the EFSF will make a loan to a national government which in turn will hand out a State aid to financial institution. This allows for a *rapprochement* with EU law and rules on State aids. Each beneficiary will have to subscribe to a restructuring plan. An additional horizontal conditionality could be imposed on the recipient Member State to improve on financial supervision, corporate governance and national legislation and bank restructuring or resolution.[93] In 2011, the EFSF began to implement temporary programmes, which were to enable the recipient Member State to overcome external shocks or to re-enable a Member State to borrow on the capital markets.[94] In the context of an EFSF loan to a Member State, the fund is authorised to intervene on the primary market for bonds, it may also purchase government on the secondary markets.[95] Beneficiary Member States will have to accept a conditionality, to be laid down in a specific memorandum of understanding.[96] As the EFSF's scope of duties and powers broadened, its

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87 *See* European Financial StabilityFacility Newsletter (June 2012) (For data on EFSF lending per country).
88 *Supra* note 86.
89 *Id*.
90 European Financial StabilityFacility Newsflash, March, 2012, available at http://www.efsf.europa.eu/attachments/201203-efsf-newsflash-n02.pdf (Last visited on October 8, 2012).
91 *See EFSF Guideline on Recapitalisation of Financial Institutions (FIs) via loans to non-programme countries*, available at http://www.efsf.europa.eu/attachments/efsf_guideline_on_recapitalisation_of_financial_institutions.pdf (Last visited on October 6, 2012).
92 *Id*.
93 *Supra* note 91.
94 *Supra* note 86.
95 *Id*.
96 *Id*.

shareholders agreed on enhancing its lending capacity with special purpose vehicles, provided that close cooperation with the IMF could be ensured.[97]

Current EFSF interventions reveal that each programme relies on a combination of a national contribution from the beneficiary Member State, EU-related funds and financial assistance from the IMF in order to assure a maximum of compliance with the various macro-economic conditionalities. In November 2010, the European Ministers of Finance agreed with the Commission and the ECB on a lending programme for Ireland, which, apart from an Irish contribution, assembles funds from the IMF, the EFSM and the EFSF and bilateral loans from the United Kingdom, Denmark and Sweden.[98] In 2011 and 2012 EFSF loans under another Irish programme followed.[99]

Portugal made a formal request for financial assistance to the Eurogroup and the European Ministers of Finance in April 2011. Like the Irish assistance scheme, financial assistance came from various sources, the EFSM, the EFSF and the IMF.[100] Under this joint EU/IMF scheme Portugal had to accept a fiscal adjustment programme to reduce the excessive budget deficit, reform the labour market, the judicial system and network industries and housing and services sectors and enhance competitiveness.[101] Once these conditions had been laid down, the EFSF placed issues in 2011 and 2012 to raise funds for the Portuguese programme.[102]

At the Euro zone summit of June 26, 2012, the most recent assistance scheme was designed to facilitate the restructuring of Spanish banks. Financial assistance will be provided through an EU-related loan to the Spanish Fund for Orderly Bank Restructuring which is to channel funds to financial institutions in need.[103] The Spanish government had to accept a Memorandum of Understanding and Financial Assistance Facility Agreement and the EU State aid conditionality.[104] In as far as the Spanish government undertook to reform its banking sector, however, the EU State aid conditionality does not apply. The Euro summit of June 29, 2012 envisages direct financial assistance to banks once a supervisory mechanism under the auspices of the ECB would be institutionalised. Spain was also authorised to establish a bad bank. The exact

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97 *Id*.

98 European Financial StabilityFacility Newsletter, January, 2011, available at http://www.efsf.europa.eu/attachments/201101-efsf-newsletter-n00.pdf (Last visited on October 8, 2012) (The programme for Ireland).

99 *Supra* note 86.

100 European Financial StabilityFacility Newsflash, June, 2011, available at http://www.efsf.europa.eu/attachments/201106-efsf-newsflash-n01.pdf (Last visited on October 8, 2012).

101 *Supra* note 86.

102 *Id*.

103 *See infra* note 106, Part III.A.2.

104 *Id*.

recapitalisation needs of Spain will have to be ascertained after the stress test of the banking groups.

D. GREECE: THE 2012 DEBT SWAP

Under the terms of the Greek aid package, the country will receive IMF/EU payments in three tranches. After Greece had delivered a Memorandums of Understanding to the IMF and the EU the first payment was made in spring 2010. Subsequent payments are conditioned upon positive findings by the 'troika' (i.e. representatives from the IMF, the EU Commission and the ECB). This mechanism is intended to avert moral hazard and to establish an incentive mechanism to implement the obligations under the memorandums of understanding. On the other hand, this policy approach has proved to be highly inefficient since it forced Member States of the Euro zone into recurrent negotiations on whether and how to institutionalise mechanisms of financial guarantees for the benefit of countries in distress. Admittedly, this negotiation machine allows for strategic games among the Member States of the Euro zone. But it also enables the players on the market for European sovereign debt to exploit potential weaknesses of a makeshift approach towards fiscal policies and the economics of globalisation. Whenever Greece was scrutinised for the disbursement of the next tranche, the EU had to move for deeper institutionalising of financial assistance funds.[105]

In July 2011, the debate on the conditions for financial assistance to Greece changed direction. The Heads of State and Governments of the Euro zone called for the voluntary participation of the private sector before clearing the disbursement of the second tranche.[106] This policy decision is the result of combination between domestic politics in many Member States, the anticipation of future bail-in schemes in the banking sector and the acknowledgement that Greek debt needed a 'haircut' to be manageable. However laudable the policy considerations of this decision, it could produce negative repercussions on the morale of investors purchasing sovereign debt from countries in Europe with less than perfect ratings.

On October 26/27, 2011 Greece accepted a Memorandum of Understanding whereby private creditors would be cajoled into a 'voluntary haircut' to reduce the country's level of government debt to around 120% by 2020.[107] In March 2012, a debt swap was finalised whereby investors renounced

105 *See The European Stability Mechanism,* ECB Monthly Bulletin July 2011, 71-75, available at http://www.ecb.int/mopo/html/index.en.html (Last visited on October 8, 2012).

106 *See Memorandum of Understanding between the European Commission Acting on Behalf of the Euro Area Member States and the Hellenic Republic*, Deutscher Bundestag, 17.Wahlperiode, Drucksache 17/8731, Anlage 3, February 22, 2012, 4, available at http://dipbt.bundestag.de/dip21/btd/17/087/1708731.pdf (Last visited on October 6, 2012).

107 *Id.; See* A. Gelpern, M. Gulati, *CDS Zombies*, 13(4) European Business Organization Law Review (forthcoming 2012) (For an analysis of the negotiating game).

to 53.5% of the original principal. The remainder of 46.5% was exchanged for 30 years bonds with the amortisation starting in the 11th year after the swap. The EFSF, the Greek government and the Bondholders signed a co-financing agreement whereby up to €30 billion were made available to guarantee interest payments.[108] The debt swap demonstrates the complicated interface between private contracting and sovereign debt management.[109] The Greek government had issued bonds, which were partly subject to English law, others to Greek law. English law bond contracts contained a collective action clause, which made restructuring more manageable.[110] Greek law bond contracts, however, did not and the Greek government had a mandatory law passed inserting retroactively a collective action clause into the contract.[111] 85.8% of the bondholders the Greek-law governed contracts and 69% of the foreign-law law bondholders accepted the swap.[112] Greece used the collective action clauses to force the remainder of bondholders into a new contract,[113] thereby triggering the credit event clauses under sovereign credit derivatives agreements, which insured the country's repayment obligations.[114] Once the debt swap had been perfected, Greece received the next tranche from the EFSF and the IMF.[115]

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[108] *Co-financing Agreement between the Hellenic Republic, Bank of Greece, EFSF, Wilmington Trust (London) Limited (as Bond Trustee), the Bank of Greece Acting as Bond Paying Agent and Common Paying Agent,*Deutscher Bundestag, 17.Wahlperiode, Drucksache 17/8731, Anlage 13, February 22, 2012 available at http://dipbt.bundestag.de/dip21/btd/17/087/1708731.pdf (Last visited on October 6, 2012).

[109] *Antrag des Bundesministeriums der Finanzen, Finanzhilfen zugunsten der Hellenischen Republik; Einholung eines zustimmenden Beschlusses des Deutschen Bundestages nach § 3 Absatz 1 Stabilisierungsmechanismusgesetzes*, Deutscher Bundestag, 17. Wahlperiode, Drucksache 17/8731, available at http://dipbt.bundestag.de/dip21/btd/17/087/1708731.pdf(Last visited on October 6, 2012) (The draft documents have been published).

[110] *See* S.J. Choi, M. Gulati&E.A. Posner, *Pricing Terms in Sovereign Debt Contracts: A Greek Case Study with Implications for the European Crisis Resolution Mechanism* (John Olin Law & Economics Working Paper No. 541, 2nd Series, 2011).

[111] PSI Press Launch Press Release, Ministry of Finance, Hellenic Republic (February 21, 2012).

[112] Forbes – Markets, *ISDA Says Greece In Default, CDS Will Trigger*, March 9, 2012, available at http://www.forbes.com/sites/afontevecchia/2012/03/09/on-greece-defaults-and-the-future-of-derivatives/ (Last visited on October 6, 2012).

[113] *See* Press Release, Ministry of Finance, Hellenic Republic (February 24 and March 9, 2012); O. Sandrock, *Ersatzansprüche geschädigter deutscher Inhaber von griechischen Staatsanleihen (Compensation claims of damaged German owner of Greek government bonds)* Recht der Internationalen Wirtschaft (RIW) 429 et seq.(2012) (For an analysis of the impact of the EU's anti-crisis policy on private bondholders' rights after theGreek 'haircut').

[114] News Release, International Swaps and Derivatives Association, Inc. (ISDA), *ISDAEMEA Determinations Committee: Restructuring Credit Event Has Occurred with Respect to the Hellenic Republic,* London (March 9, 2012); Financial Times on-line edition, *Greek debt swap triggers massive payouts*, March 9, 2012, available at http://www.ft.com/cms/s/0/7e3855ce-69ba-11e1-a26e-00144feabdc0.html#axzz269YNZapa (Last visited on October 6, 2012).

[115] Press Release, Council of the European Union, *Greece: Decision paves the way for next disbursement*, Brussels (March 13, 2012) (7576/12-PRESSE 106); Press Release, IMF, *Statement by IMF Managing Director Christine Lagarde on Greece*, (March 9, 2012) (Press Release no. 12/72); Press Release, German Federal Government, *Second aid programme for Greece finalised*, Berlin (February 21, 2012).

E. CRISIS MANAGEMENT BECOMES PERMANENT

1. The Treaty on the Permanent Stability Mechanism

As the crisis continued, it became clear that the EMU needed a permanent anti-crisis mechanism. On February 2, 2012, the Member States of the Euro zone signed an amended treaty for a permanent crisis mechanism, the European Stability Mechanism ('ESM'),[116] which will replace the EFSF.[117] Contrary to the EFSF, the ESM will be constituted as an intergovernmental organisation under public international law.[118] It shall be governed by a board consisting of the Ministers of Finance of the Euro zone Member States with the EU Commissioner for Economic and Monetary Affairs and the President of the ECB as observers.[119] The total subscribed capital of the ESM shall amount to €700 billion, which shall be raised in several instalments and by Member State guarantees.[120] It is understood that the ESM will cooperate with the IMF.[121] The ESM will have a lending capacity of €700 billion. Financial assistance from the ESM can be obtained by subscribing to a strict conditionality including a macro-economic adjustment programme, an analysis of public-debt sustainability and rigorous surveillance.[122] The president of the ECB has observed that the ESM should discourage incentives for moral hazard by insisting on pre-emptive and macroeconomic adjustment.[123] To accommodate German constitutional sensitivities, a paragraph (3)[124] will be added to Art. 136 of the TFEU, specifying that the ESM procedures should only be used as *ultimaratio*, when the Euro's stability is jeopardised.[125]

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[116] *Statement by the Eurogroup*, November 28, 2010, available at http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/118050.pdf (Last visited on July 14, 2011).

[117] *See Transition from EFSF to ESM,* European Financial Stability Facility Newsletter (February 2012).

[118] *Treaty Establishing the European Stability Mechanism*, available at http://consilium.europa.eu/media/1216793/esm%20treaty%20en.pdf (Last visited on July 14, 2011); *See also* European Commission News, *Eurogroup Meeting*, Brussels, July 11, 2011, Ref. 78856, available at http://ec.europa.eu/avservices/services/showShotlist.do?out=PDF&lg=En&filmRef=78856 (Last visited on July 14, 2011).

[119] *Id.*; European Stability Mechanism Treaty, Arts. 5 and 6(2)

[120] European Stability Mechanism Treaty; European Council Conclusions, March 25, 2011, Art. 36.

[121] *See* European Stability Mechanism Treaty; European Council Conclusions, March 25, 2011, Art. 33.

[122] Press Release, European Commission, *European Stability Mechanism (ESM) – Q&A*, Brussels, (December 1, 2010), MEMO/10/636.

[123] J.C. Trichet, *Introductory statement*, Hearing at the Committee on Economic and Monetary Affairs of the European Parliament, Brussels, March 21, 2011, available at http://www.ecb.int/press/key/date/2011/html/sp110321_1.en.html (Last visited on July 14, 2011).

[124] *See* Treaty on the Functioning of the European Union, Art. 136 (3): 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 financial assistance under the mechanism will be made subject to strict conditionality.

[125] Note by the UK House of Commons Library, *Amending the EU Treaty: the European Stability Mechanism*, London, December 21, 2010 (SN/IA/5612(IADS), available at www.parliament.

The stability mechanism will be authorised to impose sanctions as envisaged by the European Stability and Growth Pact.[126] At the time the draft treaty was discussed, the European Council (of Ministers) conditioned future financial assistance programmes on private sector participation.[127]The Council's conclusions of March 25, 2011 and the ESM Treaty, however, give little information on the thrust of private sector involvement. Member States have been admonished to observe notions of proportionality, transparency and fairness in negotiating with creditors.[128] It requires little imagination that the perspective of private burden-sharing will provoke less forgiveness by private banks *ex ante* as they rely on contracting to make the road towards sovereign restructuring more difficult.[129]

2. The Fiscal Compact

The Treaty on Stability, Coordination and Governance in the Economic and Monetary Union is the latest addition to the arsenal of international law instruments concluded by Member States to address the sovereign debt crisis without formally respecting the framework of EU law. In January 2012, all Member States except the United Kingdom and the CzechRepublic agreed to strengthen the pillars of the economic and monetary union.[130] Although the treaty will not constitute an integral part of EU law, the signatories have agreed to apply it in conformity with existing EU laws, including procedural law and secondary legislation.[131] The most important part of the treaty is the new fiscal compact, which requires the signatories to balance their budget position or to produce a surplus.[132] The obligation to balance the budget translates into a reduction of spending if the structural deficit cannot be controlled. A correction mechanism is established if deviations from mid-term balanced budget objectives persist. The Contracting Parties undertake to inform the EU Commission *ex ante* of public debt issuance plans.[133] The fiscal compact provides for a specific enforcement mechanism: if a Contracting Party fails

uk (Last visited on October 8, 2012).

126 European Council Conclusions, Brussels, March 25, 2011, *Term Sheet on the ESM,* EUCO 10/11 – CO EUR6/CONCL3, Annex II, available at http://www.european-council.europa.eu/council-meetings/conclusions.aspx (Last visited on July 14, 2011).

127 *Id.*; Euro Summit Statement, Brussels, October 26, 2011, available at http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/125644.pdf (Last visited on October 8, 2012).

128 European Council Conclusions, *supra* note 126 (Modalities for involving the private sector).

129 *C.f.* Marsh, supra note 13, 288.

130 Press Remarks, Herman Van Rompuy, President of the European Council, *Following the Informal Meeting of the European Council*, Brussels (January 30, 2012), EUCO 15/12 – PRESSE 59 – PR PCE 12.

131 *See* Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, Art. 2 (Consistency and Relationship with the Law of the Union).

132 *See id.*, Art. 3 (Fiscal Compact).

133 *Id.*, Art. 6.

to observe its budget obligations the matter may be decided by the European Court of Justice upon application by another signatory.[134]

The treaty envisages a coordination and convergence of economic policies within the Euro zone in order to foster competitiveness and promote employment, thereby contributing to sustainability and financial stability.[135] It is at this stage where the treaty will have to be fleshed out by political practice. It is obvious that the provisions on coordination and convergence are of a less binding nature than the enforcement procedure in the context of budgetary discipline. The treaty, however, also establishes more efficient governance structures in the Euro zone.[136]

F. THE ECB HELPS OUT AGAIN

On September 6, 2012 the Governing Council of the ECB changed its policy approach towards interventions on sovereign bond markets. A programme of Outright Monetary Transactions was ushered in order to avert tension on the secondary bond markets within the Euro zone. Without any limitation the ECB will exercise its discretion to acquire government bonds on the secondary market provided that the issuing government has submitted to a conditionality under a macroeconomic adjustment or precautionary administered by the EFSF or the ESM.[137] In purchasing these bonds on the secondary markets the ECB – contrary to IMF practice – will not insist on preferential treatment. It will accept *pari passu* treatment with respect to private creditors.[138] In developing the conditionality the ECB will seek the involvement of the IMF, although this is not a *condition sine qua non* for launching an outright monetary transaction with regard a Euro zone country in distress.[139] Although the ECB's new scheme does not contradict the language of TFEU it comes very close to fiscal policy, which is not the province of the bank.[140] The ECB emphasises the enforcement of conditionalities. The litmus test will come when the ECB will have to enforce a conditionality against a government faced with a choice

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134 *See id.*,Art. 8; *c.f.* Press Release, Informal Meeting of the Members of the European Council, *Agreement on strengthening fiscal discipline and convergence*, Brussels (January 30, 2012).

135 *See supra* note 131, Art. 9.

136 *See id.*, Art. 12 et seq.

137 Press Release, European Central Bank, *Technical features of Outright Monetary Transactions* (September 6, 2012) at http://www.ecb.int/press/pr/date/2012/html/pr120906_1.en.html (Last visited on October 8, 2012).

138 *Id*.

139 Answers given by M. Draghi, President, European Central Bank, Press Conference, Frankfurt am Main, September 6, 2012, available at http://www.ecb.int/press/pressconf/2012/html/is120906.en.html (Last visited on October 6, 2012).

140 *See EZB-Staatsanleihenkäufe – Bundesbankkritisiert Beschlussoffen(ECB government bond purchases Bundesbank openly criticized decision)*, Frankfurter AllgemeineZeitung (Online Edition)September 7, 2012, available at http://www.faz.net/aktuell/wirtschaft/wirtschaftspolitik/ezb-staatsanleihekaeufe-bundesbank-kritisiert-beschluss-offen-11881725.html (Last visited on October 6, 2012).

between moral hazard[141] and populism giving way to an electorate unwilling to swallow austerity measures.[142]

III. THE BANKING CRISIS –STATE AIDS AND RECAPITALISATION

A. STATE AIDS FOR THE BANKING SECTOR

1. The Policy Challenge

The financial crisis unleashed a shockwave in the banking sector. On September 15, 2008, Lehman Brothers Holding International, Inc. filed for protection under chapter 11 of the US Bankruptcy Code, triggering the largest bankruptcy in US history.[143] Various non-US Lehman subsidiaries went into bankruptcy or were subject to regulatory proceedings under the banking laws of their host states. The market for inter-bank credits broke down almost immediately. A global banking crisis unfolded and credit institutions experienced both, market illiquidity and funding illiquidity.[144] Governments rushed to save banks of systemic importance. International cooperation was urged to avert beggar-thy-neighbour policies.[145] In Europe, this raised questions to what extent EU law imposed a duty of cooperative behaviour on Member States governments. The EU Commission recognised the need for immediate crisis management, but insisted on safeguarding the single market.[146] National aids to the banking sector were authorised in order to remedy a serious disturbance in the

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[141] *C.f. Mario Draghi's audacious gamble*, Financial Times (Online Edition) September 6, 2012, available at http://www.ft.com/cms/s/0/43ef8050-f820-11e1-828f-00144feabdc0.html#axzz26B9Qu32F (Last visited on October 6, 2012).

[142] *C.f.* J. Makintosh, *Test to come for Super Mario's plan*, Financial Times (Online edition) September 6, 2012, available at http://www.ft.com/intl/cms/s/0/c83c65d6-f842-11e1-bec8-00144feabdc0.html#axzz26B9Qu32F (Last visited on October 6, 2012).

[143] Report of Anton R. Valukas, Examiner, In re Lehman Brothers Holdings, Inc., et al, United States Bankruptcy Court Southern District of New York, Chapter 11 Case No. 08-13555, Vol. 1, March 11, 2010, 2; United Kingdom Financial Services Authority, *A regulatory response to the global banking crisis*, 59 et seq. (Discussion paper 09/2, London, March 2009); Joseph Tibman, The Murder of Lehman Brothers – An Insider's Look at the Global Meltdown 177 et seq. (2009) (For an insider's account on the sequence of events leading to the chapter 11 petition).

[144] H. Weenink& P.S. Steinen, *State aid in the Financial Services Sector*, 514, 518 et seq., J.I.B.L.R. 2008, 23 (10).

[145] *See* C. Bates, *Regulatory Rondeau on Market Turmoil*, 213, 215 et seq., 1712 PLI/Corp (2009) (For an account of the efforts of national regulators to coordinate anti-crisis measures on an international level); *See also* Financial Stability Forum, *FSF Principles for Cross.-Border Cooperation on Crisis Management*, April 2, 2009, available at http://www.financialstabilityboard.org/publications/r_0904c.pdf (Last visited on October 6, 2012).

[146] J. Almunia, Vice-President, EU Commission, Speech at Brussels: Financial stability, a level playing field in Europe and healthier financial sector: the role of competition policy, SPEECH/10/618 (November 4, 2010).

economy of a Member State unless the single market was jeopardized.[147] Late in 2010, the Commission declared its intention to phase out public assistance to banks, encouraging the exit of sound banks and inducing others to restructures.[148] But the predicament of banks in Member States in distress has added new momentum to a policy mix between traditional State aid theory and innovative restructuring schemes in the wake of the sovereign debt crisis. Some Member States have introduced specific aid schemes to help their banks suffering from the fall-out of the sovereign bond markets and private debt.[149] There is a policy debate whether the emergency funds of the ESM might be tapped without having to submit to strict joint EU/IMF conditionalities under State aid or financial assistance rules.[150]

2. State Aids and the Spanish Recapitalisation Scheme of 2012

The EU Commission's authorisations for national recapitalisation schemes demonstrate that State aids to ailing banks will only be accepted if they enable the recipient bank to master the stress test imposed by the European

[147] K. Lannoo& C. Napoli, *Bank State Aid in the Financial Crisis – Fragmentation or Level Playing Field, A CEPS Task Force Report*, Brussels, October 2010, 10 et seq., available at http://www.ceps.eu/book/bank-state-aid-financial-crisis-fragmentation-or-level-playing-field (Last visited on October 6, 2012) (For a survey of the EU's policy on state aids during the crisis).

[148] Communication from the Commission on the application, from 1 January 2011, of State aid rules to support measures in favour of banks in the context of the financial crisis (2010/C 329/07), O. J. C 327/9, December 7, 2010.

[149] *See Giant Lender in Spain Asks for Billions to Fend Off Collapse*, New York Times, (Online Edition) May 25, 2012, *Bankia to receive € 4.5 billion Spanish loan*, Financial Times (Online Edition) September 3, 2012 (This assumes that Member States dispose of sufficient funds to finance national aid schemes); IMF Survey on-line edition, *IMF Approves € 30 billion for Greece on Fast Track*, May 9, 2010, available at http://www.imf.org/external/pubs/ft/survey/so/2010/new050910a.htm (Last visited on October 6, 2012) (Greece had to apply to the IMF and European crisis funds to honour its obligations under sovereign bond contracts); *see* Memorandum of Understanding of July 2012 on Financial-Sector Policy Conditionality, *Bank-specific conditionality in line with State aid rules and horizontal, financial sector specific horizontal conditionality,* available at http://estaticos.elmundo.es/documentos/2012/07/10/memorando.pdf Last visited on October 6, 2012) (This is, however, a policy choice which national politicians choose as a venue of last resort because they will have to accept conditionality. Spain decided to apply for EU assistance for the banking sector, thereby escaping a list of broad conditionalities).

[150] *See* Handelsblatt on-line edition, *ESM-Rettungsschirm – SchäubleschließtschnelleBankenhilfefürSpanienaus (the policy debate on additional aid for Spanish banks),* September 14, 2012; Le Monde on-line edition, September 14, 2012, *L'Espagne, dossier brûlant au menu de la reunion de l'Eurogroupe*, available at http://www.lemonde.fr/economie/article/2012/09/14/l-espagne-dossier-brulant-au-menu-de-la-reunion-de-l-eurogroupe_1760313_3234.html (Last visited on October 6, 2012); *see* Joint Report provided by the EU Commission in liaison with the ECB, the European Banking Authority and the IMF, *Assessment of Spain's eligibility for EFSF/ESM loan to recapitalize certain financial institutions*, June 26, 2012, available at www.rijksoverheid.nl (Last visited on October 6, 2012) (For an assessment of the decision-making processes at the time the Spanish government applied for an EFSF/ESM loan to recapitalise its banking industry).

Banking Authority.[151] Spanish recapitalisation programmes have to face double threshold test: in July 2012, the Commission approved a Spanish recapitalisation scheme which was to bolster the short-term capital needs of domestic banks which were discovered after administering the stress test.[152] This scheme will introduce a backstop facility for banks, which prepare for meeting the requirements of the stress test. The authorisation is conditioned on a ban on dividend payments and pay-outs under hybrid capital instruments. Moreover, the recipient Spanish banks had to prepare a restructuring plan how to restore long-term viability.[153] In addition to these requirements under EU's rules on State aids the Commission's implements the Memorandum of Understanding concluded between Spain and the Governments of the Euro zone. Spain received funds under the monetary anti-crisis policy, but had to assume obligations under a Bank-specific, sector policy conditionality.[154]

The Spanish capitalisation scheme gives ample evidence of the development of the Commission's policy on State aids since the financial crisis triggered government action on a global level. The EU's policy was originally designed to protect banks of systemic importance and others in need of bridge funds. Although the policy instruments have remained unchanged, the Commission uses its discretion now to supplement the EU's anti-crisis policy in the context of the sovereign debt crisis. From a purely legalistic perspective this is a remarkable policy development. From a constitutional perspective many of the most recent anti-crisis measures do not qualify as instruments of Union law as they have been concluded outside the institutional framework of the EU. Nonetheless, the EU Commission uses its TFEU powers to further policy schemes devised as instruments of public international law by the Member States of the Euro zone.

B. RECAPITALISATION

The financial crisis of 2008 has unleashed policy initiatives to strengthen global capital and liquidity as many banks had built up excessive on and off-balance leverage.[155] In this context the Basel Committee on Banking Supervision suggested to back bank exposure by a high quality capital base,

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[151] Press Release, European Commission, *State aid: Commission temporarily approves a second recapitalisation in favour of NLB and opens in-depth investigation on the restructuring plan of the bank*, Brussels (July 2, 2012) IP/12/724; and *State aid: Commission temporarily approves recapitalisation of CaixaGeral de Depósitos*, Brussels (July 18, 2012) IP/12/805; *see infra* Part III.B (For criticism of the stress test).

[152] Press Release, European Commission, *State aid: Commission approves Spanish recapitalisation scheme for credit institutions*, Brussels (July 25, 2012) IP/12/849.

[153] *Id.*

[154] *See* Memorandum of Understanding between Spain and the Euro zone, Chapter IV.

[155] Bank for International Settlements, Basel Committee on Banking Supervision, Basel III, *A global regulatory framework for more resilient banks and banking systems*, 1 et seq., December 2010, Revised June 2011, available at https://www.bis.org/publ/bcbs189.pdf (Last visited on October 8, 2012); *c.f.* L. Laeven& F. Valencia*, Systemic Banking Crises: A New*

enhance risk coverage by taking into account a leverage ratio and to provide for countercyclical buffers.[156] But even under the more restrictive rules of the Basel III rules by the Basel Committee on Banking Supervision capitalisation rules do not require mandatory risk provision strategies for contingent losses from sovereign bonds.[157] Moreover, when the EU conducted its stress test of banks, it only assessed the trading book holdings, assuming that sovereign defaults would not occur.[158] Closer inspection of the banks' exposure to sovereign debt suggests banks bought heavily debt of their own country.[159] Some banks have also bought government debt from non-Euro countries, which are not covered by the guarantee mechanisms of the Euro zone.[160] In this context, recapitalisation strategies proposed by the EU Commission have a doubly beneficial effect:[161] they protect banks against external shocks; but they also shield credit institutions against the potential fall-out from a haircut or a sovereign default. The Commission has been pushing for a directive, which implements the recommendations of the Basel III committee.[162] A proposal of a directive for the recovery and resolution of credit institutionsand investment firms is to the lay down the basic rules for EU regime on bail-ins.[163] For practical purposes, the ECB has tried to smoothen the transitional period for banks towards more demanding capitalisation requirements by offering favourable money tenders.[164]

IV. CONCLUSION

After the IMF had held bilateral discussions with the member countries of the Euro zone, it decided to pressurise. Although the IMF recognises European crisis management, it deplores the deficiency of tools to halt the sovereign debt, banking and economic crises.[165] The Euro zone is sufficiently integrated to facilitate negative cross-border spillovers, but is seen as to lack the

Database (IMF Working Paper WP/08/224, November, 2008); *id.*, *Systemic Banking Crises Database: An Update* (IMF Working Paper WP/12/163, June, 2012).

156 Basel Committee on Banking Supervision, Basel III, 2 et seq (2010-11).

157 J. Lüttringhaus, *Die risikolose Welt der Staatsanleihen unter Solvency II und Basel III*, Gastkommentar, Europäische Zeitschrift für Wirtschaftsrecht (EuZW), 23(9) (2012).

158 S*upra* note 70.

159 *Id.*; *see* J. A. Andritzky, *Government Bonds and Their Investors: What Are the Facts and Do They Matter?*(International Monetary Fund (IMF) Working Paper WP/12/158, June, 2012) (On the change of investor behaviour with respect sovereign bonds after the financial crisis).

160 S*upra* note 70.

161 *See* Statement of the EU Heads of State or Government, Brussels, October 26, 2011; P. Mülbert & A. Wilhelm, *Reforms of EU Banking and Securities Regulation after the Financial Crisis*, 26 BFLR187 et seq. (2011).

162 EU Commission, *Proposal for a Directive of the European Parliament and of the Council on the access to the activity of credit institutions*, Brussels, July 20, 2011, COM(2011) 453 final, SEC(2011) 952 final, SEC(2011) 953 final;United Kingdom Financial Services Authority, *FSA statement regarding CRD IV implementation*, August 1, 2012.

163 EU Commission, *Proposal for a Directive of the European Parliament and of the Council, establishing a framework for the recovery and resolution of credit institutions and investment firms*, Brussels, COM(2012) 280, 3 (SWD(2012) 166, SWD(2012) 167.

164 *See supra,* Part II.C.1.

165 *Supra* note 5.

political will to enshrine the stability of the banking system and fiscal union.[166] The IMF sides with European supporters of a banking union and supervision and common debt:[167] common bond financing should be ushered in, eventually providing backstops for the common frameworks within the banking union.[168]

The original framework of the TFEU does not resolve conflicts of interests among the Member States of the Euro zone. It does not avert moral hazard. It does not guarantee that internal transfers of wealth within the Euro zone will be engineered on a give-and-take basis to foster growth and competitiveness on a global scale. Since the outbreak of the financial and sovereign debt crises the Member States of the Euro zone have developed a system of emergency measures to pacify the capital markets, eventually establishing a permanent stability mechanism to give assistance to countries in distress. Financial assistance is based on conditionalities in order to assure reform, but also to assuage the electorates in Northern Europe fearful of moral hazard situations. The Euro zone has rightly been accused of exacerbating situations of crisis, as its decision-making processes are painfully slow. It should, however, not be overlooked that these decision-making processes reflect the negotiation games and incidences of power play provoked by the lacunae of TFEU. In this context, the question of whether the countries in distress receive sufficient support in order to both modernise and create growth is a variation of the negotiation game between the members of the Euro zone. The ECB is acutely aware of this interface between supply of money and reform.[169] Its outright monetary transactions may be sufficient to build a sovereign firewall,[170] but the quality of the conditionalities rest on the Bank's will to enforce, and the recipient governments' inclination to obey.[171] Ultimately, this hinges on the open-mindedness of politicians and their voters.[172] But so does the acceptance of the EMU in those countries who see themselves as giving, but do not always assess the benefits of a common currency.

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166 *Id.*

167 *C.f.* Press Release, European Commission, *Commission proposes new ECB powers for banking supervision as part of a banking union*, Brussels, Strasbourg (September 12, 2012); Financial Times on-line edition, A. Barker, *Brussels shelved bank deposit scheme,* September 13, 2012; *C.f.* J. Delpla, J. von Weizsäcker, *Eurobonds: The Blue Bond Concept and its Policy Implications*, Bruegel Policy Contribution Issue 2011/02 (March 2011), available at www.bruegel.org (Last visited on October 8, 2012) (the policy proposal on Eurobonds); *see* S. Claessens, A. Mody& S. Vallée, *Paths to Eurobonds* (IMF Working Paper, July. 2012, WP/12/172) (for a detailed analysis).

168 *Supra* note 5.

169 P. De Grauwe, *Only a more active ECB can solve the euro crisis*, CEPS Policy Brief No. 250, August, 2011, available at http://www.google.co.in/search?client=safari&rls=en&q=… (Last visited on October 8, 2012) (For an argument in support of a more active ECB as the EFSF and ESM lack credibility).

170 The latest developments may also convert the ECB into a political player, becoming more vulnerable to pressures from the Member States.

171 *C.f. supra* note 141.

172 *C.f.* G. Rachman, *Democracy loses in struggle to save euro*, Financial Times (Online Edition) September 10, 2012.