

PROPOSALS AND SELECTED MEASURES OF EUROPEAN UNION HOW TO DEAL WITH FINANCIAL AND DEBT CRISIS

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Abstract

During the crisis and post-crisis years was designed and adopted a whole series of measures at both national and the EU-levels. It turned out that the EU-wide conceived solutions cannot solve national problems. There are no indisputably effective central strategic instruments and their application seems to be problematic as well. This is due to insufficient efforts of domestic politicians to effectively enforce these measures. Therefore, for several years the measures adopted at the supranational level have been only short-term, stabilization and ad hoc ones, often at or beyond the limits of primary law. This paper deals with a critical analysis of two proposals of European institutions - common European bonds and taxes on financial transactions, sometimes referred to as the Tobin tax. Essential objectives and characteristics of Fiscal Pact and rescue funds are presented in another part of this article.

Key words: *European Union, crisis, common bonds, tax on financial transaction, Fiscal Pact, rescue funds*

1. INTRODUCTION

During the period 2010 – 2013, the European Union proposed or adopted a number of measures and instruments related to strengthening the fiscal responsibility, tackling the economic crisis, and enhancing the competitiveness. Another part of the text deals with the detailed analysis of European bonds, taxes on financial transactions, the Fiscal Pact, the debt brake mechanism and rescue funds. In most cases, these measures have one common feature - the EU uses them rather for solving and responding to the crisis rather than for addressing its causes. There is a controversial instrument - network of bailout funds, which required revision of primary law during the establishment of a permanent European Stability Mechanism (a legally unclear also seems the variant to directly recapitalize the euro-area banks from this Mechanism). At least some of these measures, together with the proposal for a common European bond market, clearly violate one of the basic rules contained in Article 104 of the Maastricht Treaty on refusing the assistance to other countries (no-bailout clause). The tax on financial transactions, which should be implemented by 2014 within the so-called enhanced cooperation, according to some legal analyses distorts competition and unlawfully encroaches on national jurisdictions of other EU countries that decided not to join the proposal. The Fiscal pact, which should bind the signatory countries to a greater fiscal responsibility, seems to be a generally better instrument in comparison with the above-mentioned measures. However, its unclear methodology for measuring the structural deficit raises some controversy.

2. COMMON BONDS

The discussion on introducing common bonds has been a kind of a political evergreen in the European area for several years. The main initiators are France and the European Commission, who in 2011 presented its vision of three possible scenarios for the euro-area countries (COM 2011(818):

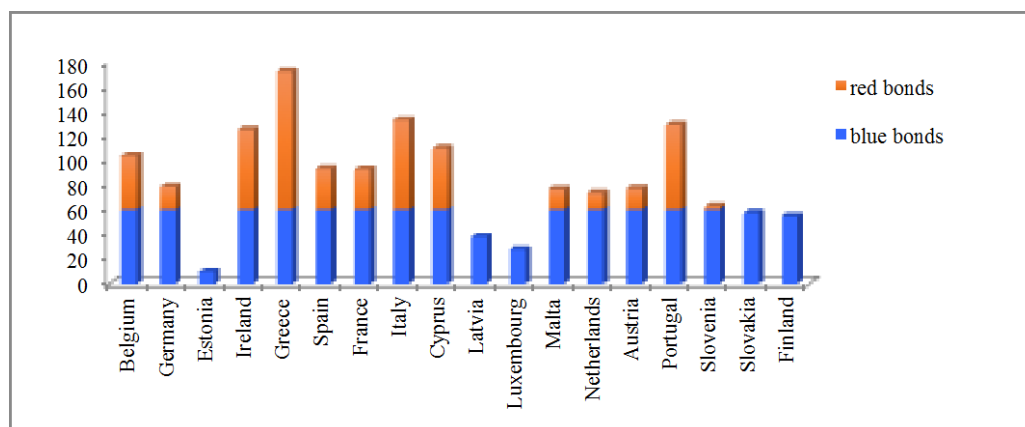
- 1) Emissions of common bonds in which everyone is jointly and severally liable for all debts (joint and several liability and complete replacement of national emissions).
- 2) Eurobond emissions where the liability is shared from and to a certain amount and the respective states, who continue with their own bond emissions, are responsible for the remaining part (partial replacement of national emissions by common bonds with joint and several liability).

3) Each country is responsible for a major part of its debts and liabilities, common Eurobonds cover only a certain share of the debt according to a specific key. In some respects, the mechanism is similar to bonds issued under the EFSF (partial substitution of national emissions by common shared-liability bonds).

In the first and second point the fundamental treaties would have undoubtedly to be revised. Both options allow a relatively high risk of moral hazard. In case of introduction of common bonds for all countries with the full liability, the classic national bond markets would disappear.

The second variant of the European Commission has been inspired by Delpla, J. and von Weizsäcker, J. (2010) who designed the principle of blue and red bonds. As illustrated in Graph 1, blue bonds would form the core of Eurobonds and the Member States would be fully and jointly liable for them. The authors used a reference value of 60% of GDP. The difference between the threshold and the total debt should be filled up by the red bonds, which would be issued by individual states and for which the respective states would be also liable. Delpla, J. and von Weizsäcker (2011, p.3) exclude the possibility that the red debt could be guaranteed or financed from any of the rescue funds created the European Union or by the other member countries.

Graph 1. Proposal of liability for the so-called blue and red bonds



Source: Delpla, J., Weizsacker, J. 2010, own modification and update to 2013

Logically, blue and red bonds incorporate a different level of risk and therefore they differ in interest rates and financial ratings. In addition, blue bonds are based on the principle of seniority (the rights of their owners are settled before the rights of others)¹, which should guarantee a maximum security for bondholders and a minimal risk in case of the country's insolvency. The red bonds have it the other way around. The proposed elite Eurobonds would represent a major financial instrument of a total value of more than EUR 5.3 trillion (at the end of 2013) and their volume and liquidity would make them a strong competitor to the U.S. and Japanese bond markets.

A differently designed variant is the "European Redemption Pact" drawn up by the German Council of Economic Experts (2012). The basic prerequisite to tackling a state's debt crisis is division of its debt into two parts. The part of the public debt which exceeds the thresh value of 60% of GDP will become a part of the European redemption fund (joint liability and guarantee) which will then issue its own bonds. The repayment period of this separated excessive debt (countries should annually pay at least five percent of the debt transferred to the fund) is estimated to be between 20 to 25 years. The value of bonds will gradually decrease and ultimately the fund will cease to exist. According to Doluca & Huber & Rumpf & Weigert (2012) the interest costs should fall within the range of 2.5 - 3% and the expected ERF rate should stabilise at 4%, similarly to EIB and EFSF rates. One of the strict rules

¹ A higher level of seniority have only loans from the International Monetary Fund.

binds the participating countries not to get into debt above the threshold set by the Maastricht criteria. At the time of publication of texts of the German authors the absolute amount of debt in excess of the permitted level was EUR 2.3 trillion. At the end of 2013, this sum already represented more than EUR 3.5 trillion.²

According to expert estimates the yield rate of European bonds would range between 3-5%, which does not correspond with Delpla, J. and von Weizsäcker (2011, p.5), who say that the borrowing costs will be comparable or even higher than in German bonds, which are considered the safest investment. Logically, countries like Germany, the Netherlands, Finland, and others that are generally more disciplined, have lower debt, higher growth, more financial claims, and borrow money for the lowest interest rates, are against these measures. On the other hand, they would suit Greece, Portugal, Italy, and Spain.

The possible introduction of common European bonds raises a number of conflicting opinions. Its great supporters are the former EU commissioner and Italian PM Mario Monti, the famous investor George Soros (2013), the former chairman of euro area finance ministers Jean-Claude Juncker, and Commissioner for Monetary Affairs Olli Rehn, Paul De Grauwe and Wim Moesen (2009) argue that common bonds, which could be issued by, for example, the European Investment Bank (or even directly by member countries' governments), would help to increase liquidity in the entire euro area. The liquidity disappeared from the market due to the so-called "creditors' flee to safe assets"³ (it means above all American, French, and German bonds). However, the proposal keeps different interest rates for each country. The rates are calculated from the country's share in the relevant bond. EIB's participation is also taken into account. This variant is closest to the third point of the European Commission's scenario. On the contrary, the former member of the Board of the European Central Bank Otmar Issing (2009) has strong objections and argues that common bonds are definitely not the right means by which a greater fiscal responsibility should be achieved. He also warns against the parallel "too big to fail", which arose during the global financial crisis, and its modified application "sovereign debtors are impossible to default" which was formulated during the current debt crisis. The best alternative (except the zero option = no change in the current situation) for consolidating the public finances and debt in the euro area seems to be the European Redemption Fund.

In my opinion, Eurobonds inherently constitute a violation of the "no-bailout" principle (Article 125 of the EU Treaty) and support moral hazard in some countries. The latter negative aspect is also admitted in the Green Paper of the European Commission (2011). In the context of evaluation of activities carried out by the European Central Bank (printing money and de facto prohibited monetization), this is a slightly less controversial European solution.

3. TAX ON FINANCIAL TRANSACTION

In 2013, eleven euro-area countries agreed on a European Commission's proposal to jointly establish a tax on financial transactions.⁴ The participants in this administrative measure taken within the "enhanced cooperation" were Belgium, France, Germany, Italy, Spain, Portugal, Greece, Austria, Slovenia, Slovakia and Estonia.⁵ However, its implementation was suspended in the same year due to some conflicting legal opinions relating to breaches of EU law and unauthorized intervention in legal orders of individual Member States in the field of taxation, including distortions of competitive environments of countries which decided not to join the proposal. This is because in some cases they would have to pay the tax as well, for example when trading with securities that were issued in one of

² The terms of the fund do not allow it to accept the excessive debt of countries that during the given period participate in recovery programs. Currently, this would limit only one member of euro zone - Greece.

³ Its modification is the "flight to quality". See e.g. Issing (2009, p. 2).

⁴ The EC proposal COM/2013/71.

⁵ From the former EU17 did not agree: Cyprus, Malta, Finland, Luxembourg, the Netherlands and Ireland. Other members may voluntarily join the project in the future.

the signatory countries (application of the principle of place of issue).⁶ These apparent contradictions led to either temporary or permanent suspension of the concept.

The new tax should operate on the principle of taxing financial transactions in which at least one party is a financial institution located in a country that has signed the Agreement (principle of residence).⁷ In most situations, the tax should be paid by both parties, seller and buyer, at the moment of transfer, purchase or sale, or negotiation of a contract. The tax rate depends on the subject of transaction and differs for trading with stocks and bonds and for operations with other financial derivatives. Taxation should not apply to classic procedures and transactions between banks and ordinary citizens (mortgages, insurance) and banks and business (loans). It also does not apply to issues of shares or bonds in the primary market (this does not mean transactions on the secondary market), transactions with central banks of member countries, and transactions with the ECB, EFSF, ESM, and the EU.⁸

Table 1. Tax rates and the expected annual incomes according to the EC' proposal for the EU

Subject to tax	Tax rate	Total revenue in billions of EUR
trading with securities	0.10%	19.4
a) shares	0.10%	6.8
b) bonds	0.10%	12.6
other financial derivatives	0.01%	37.7

Source: EC, Revenue estimation

The estimated total revenue from this tax is about 30-35 billion Euros per year for the eleven participating countries.⁹ According to the original proposal, the entire tax revenue should go to the European budget, but eventually it was agreed that a part of it will be diverted into national budgets of signatory countries.

From a theoretical point of view, this regulatory measure can be described as the so-called Tobin tax. Tobin tax was designed in the late seventies by a Nobel laureate in economics J. Tobin (1978, p.153-159). It applied to monetary transactions (currency transaction tax) or spot foreign exchange transactions. Its aim was to reduce short-term financial speculations, simply by making them more expensive. However, already long before this J.M. Keynes (1936) dealt with taxation of short-term speculative transactions (trading with shares) because he considered them as the causes of bubbles in financial markets.¹⁰ Taxation of certain financial transactions, although usually in a very limited form, is used e.g. in France (since 2012) and also in the UK (1986).

⁶ The tax would affect also the Czech Republic through its transactions (trades) with parent banks, especially in Belgium, Austria, and France.

⁷ Financial institutions are in particular: credit institutions, insurance companies, pension funds, investment and leasing companies, hedge funds, and others. The tax would apply to more than four-fifths of their operations, which would probably prevent the outflow of investors or substitution of the taxed instruments with untaxed ones.

⁸ Viz. COM (2013) 71 final, p.20-24.

⁹ The Explanatory Memorandum of the initial proposal for a Council Directive on a common system of financial transaction tax and amendment of Directive 2008/7/EC from the 2011 includes the estimated tax revenues across the European Union in the amount of 57 billion Euros a year. Some authors consider it overrated.

¹⁰ See his comparison of trading in NY Stock Exchange with casino gambling.

The proponents of the measure argue mainly by lower taxation of the financial sector (e.g. the VAT exemption, which according to the EC accounts for about EUR 18 bn. per year) in comparison with the other segments of the economy, and especially by the fact that the tax should become an effective tool in the fight against dangerous speculative transactions and currency crises.¹¹ However, the effect of the additional taxation could lead to a substantial decline in the number of transactions, including the reduction of the overall liquidity, which may cause an increase in the price volatility (the intention of its proposers and advocates is exactly the opposite though). The main consequence of this regulation would be a lower capital inflow into the economy which adopted the measure. The critics argue that this tax will never work effectively, unless it is implemented on a global scale. A perverse result would come very soon - financial transactions will move to countries that do not have the tax. Even the implementation on a global scale (The U.S. though, unlike the EC, are explicitly against it) can do harm to poor developing countries, because the majority of capital would remain "trapped" in developed economies. Norberg, J. (2006, p.164) states that: "In fact, Tobin Tax is not a tax levied on the capital but a duty which makes trade and investments more expensive." This is confirmed by Kenneth Rogoff's (2011) idea that in a longer term this measure would increase the cost of capital (it would reduce investments) which would lead not only to a loss of capital, but also to a decline in product and tax revenues. The classification of capital to the "speculative and destabilizing" and "speculative and desirable" also seems to be problematic.

There are three important financial centres in the European Union. Two of them are located on the continental part - Frankfurt and Paris - and the third is the City of London. It is not surprising that the biggest opponent of the proposal is Great Britain, of course because of the City, and also Luxembourg whose economy is heavily interlinked with financial services.¹² One European country already has a negative experience with this tax. It is Sweden who introduced it in the mid 80s. The tax was based *on the principle* of taxpayers' residence (domestic brokers) and its object were operations with securities (stocks and bonds) and some selected financial derivatives. Not only it didn't have the expected effect of a higher income into the state budget,¹³ but it also led to a large reallocation of investors to neighbouring countries (especially to the UK and the USA) or to extensive use of untaxed substitutes. These effects eventually led to complete abolition of the tax in the early nineties.¹⁴

Rather pessimistic is also the working paper published by the European Commission in which the authors say that the introduction of this tax can have long-term adverse macroeconomic impacts resulting in annual declines of GDP in range between 0.53 to 1.75% if the tax rate was 0.1% and 0.17% decline of GDP if the tax was imposed on other financial derivatives.¹⁵ More realistic estimates of potential negative economic impacts - more than two-percent decline of GDP - are presented in the evaluation analysis of the EC's materials (Oxera, 2013) which was drawn up on the order of Association for Financial Markets in Europe. Thus the final result can be a 15% reduction in volumes of traded shares and bonds and up to 75% reduction in volumes of trades with financial derivatives.¹⁶ A further decline in the prices of these instruments may occur due to expectations related to introduction of the tax and with increased transaction costs.

¹¹ For more about the beneficial effects see e.g. Summers and Summers (1989, p.261-286) or Stiglitz (1989). On the other hand, critical arguments are offered in IMF's report (2010b). A Fair and Substantial Contribution by the Financial Sector: Final report for the G-20 (2010, p.19-24). In 1998, the activist group ATTAC (Association for the Taxation of Financial Transactions and Aid to Citizens) was formed in France. It aims at introduction of the Tobin tax.

¹² In the UK, the financial sector contributes about 10% to the GDP.

¹³ The annual revenue was only about 3.3% of the originally expected amount (SEK 1500 mil. SEK). Campbell (1994, p. 277-308).

¹⁴ More about the Swedish attempt: Campbell (1994).

¹⁵ EC, Executive summary of the impact assessment, 2011. For evaluations of macroeconomic impacts the Commission uses its own DSGE model (Dynamic stochastic general equilibrium model). EC, SEC (2011) 1102 final, Annex 15

¹⁶ EC, Impact Assessment, 2013.

4. FISCAL PACT

"Treaty on Stability, Coordination and Governance in the Economic and Monetary Union" is the full name of the Fiscal Pact, the text of which is fully applicable only to Eurozone members, but any other EU member can join it voluntarily.¹⁷ The medium-term objective is to keep balanced or even surplus budgets - the so-called golden budgetary rule - during the agreed time horizon.¹⁸

This mechanism complements and expands a not very effective instrument - the Stability and Growth Pact (1997) - and in some parts it represents a continuation of the Six-Pack (2011). The Fiscal pact allows the signatory countries the maximum annual structural deficit (cyclically-adjusted balance without one-off and temporary measures) of 0.5% of GDP at market prices.

Countries which total public debt is well below the 60% threshold are allowed to have their state budget deficit of up to 1%. In cases where the debt exceeds the reference Maastricht criteria, the recommended pace of the debt's reduction is five percent per year for three consecutive years. The criterion is also considered met if according to the European Commission's forecasts the required reduction will be achieved during three-year period, which includes the two years following the last year for which the required data are available.¹⁹ By the way, more than a half of all EU countries currently have their total public debts higher than the required 60%. In the context of the overall economic and fiscal situation of EU members, it may be difficult for some of them to meet the new condition.

Monitoring of this indicator is also problematic due to an unclear methodology for measuring the structural deficit, for example the calculation of the output gap in estimates of potential output, for which are used different methods (now it is the Cobb-Douglas production function, before it was the Hodrick-Presscot filter, which is still used as a complementary technique). With a certain amount of simplification we can say that the structural deficit is the result of the actual deficit minus the deficit that arises in connection with business cycle, or with the cyclical deficit. For determining the cyclical component of the deficit it is necessary to identify both revenues and expenses that relate to a greater extent with cyclical fluctuations and that are sensitive to them. In standard theoretical approaches these items include primarily incomes i) direct taxes (individual income tax, corporate income tax), followed by health and social taxes (social insurance and health insurance), ii) indirect taxes (mainly VAT and consumption taxes). In the area of expenses the items include primarily the transfer payments of unemployment benefits. An important role plays the estimation of the GDB-related elasticity of these items. To quantify the cyclical and structural deficits it is important to identify trend and cyclical components of real GDP. The input variable for determining the deficit's cyclical component is the difference between the actual and potential GDP.

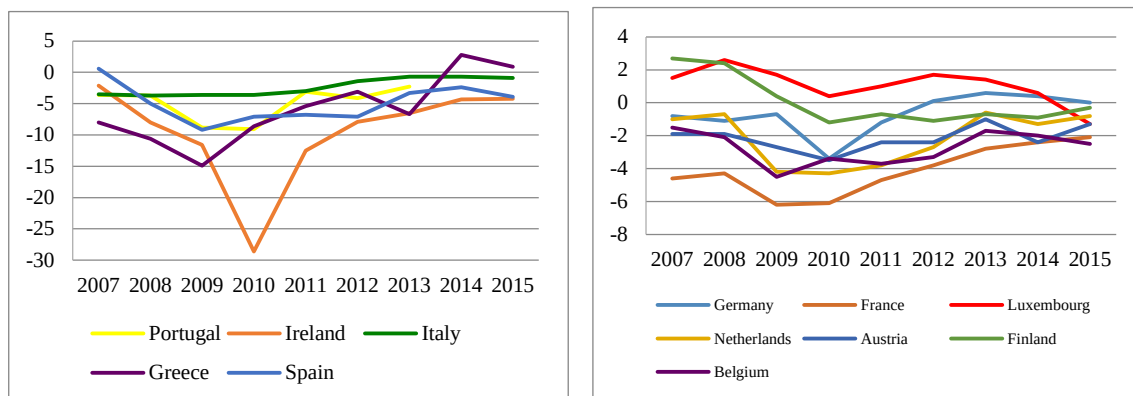
Graph 2 shows the development of structural deficit since 2007. It is apparent that none of the peripheral countries, except for Spain in the years 2005 to 2007, would have been able to fulfil the 0.5% limit. As for the core countries, Germany's deficit has been under the threshold since 2012, Luxembourg's deficit throughout the entire period for which the data are available, and Finland's deficit between 2007-2009 and in 2011. Estimates for the years 2014 and 2015 are in favour of a structural surplus in Germany and Greece (given by the conditions of rescue assistance) and for 2014 also in Luxembourg.

¹⁷ As a Contracting Party the country may decide to which articles of the Pact it will accede. Even if the country decides to be bound by all provisions of Titles III and IV, until the adoption of the euro it still won't be a full partner in meetings of the euro area's highest representatives. A detailed description of individual articles of the Pact is presented, for example, in the Analysis of Section for European Affairs of the Government Office, Strategies and Institutional Department, April 2012. The Stability and Growth Pact has 25 signatory countries.

¹⁸ The agreement defines a balanced budget as the public deficit lower than 3% in relation to GDP.

¹⁹ The calculation mechanism is explained on the example of Spain. In 2012, its total public debt in relation to GDP was 86%. The required reduction is calculated from the difference between the debt and the reference value, not from the total value: $0.05 \cdot 26 = 1.3\%$ per year => during three years the debt ratio will be reduced to 82.1%.

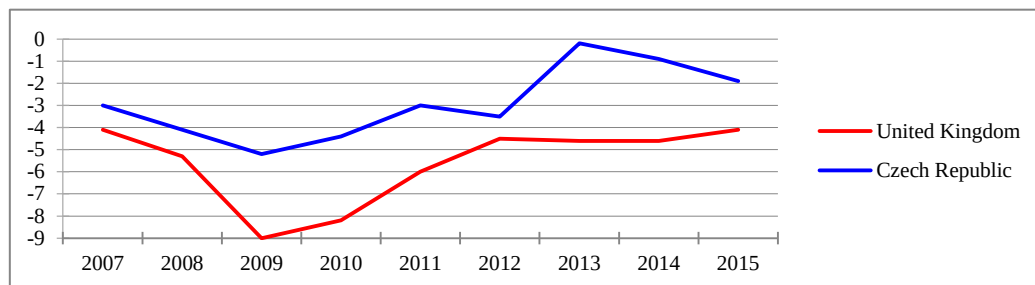
Graph 2. Development of structural deficits of core and peripheral countries (% of GDP)



Source: EC, *Cyclical adjustment of Budget Balances*, 2014. Estimated values for 2014 and 2015, own processing

All countries have already joined the Stability and Growth Pact, with the exception of Great Britain and the Czech Republic which should join the Pact in the autumn of 2014.²⁰ The UK had large structural deficits already in the pre-crisis period and these deficits have been widening since 2008. As in the case of Ireland, deficits were primarily related to the costly bailouts of the domestic financial sector. Also other predictions are not too optimistic. The Czech Republic was able to meet this criterion only in 2013 and probably in 2014, estimates for 2015 predict widening of structural deficit beyond the one-percent threshold.

Graph 3. Development of structural deficits of the Czech Republic and the UK



Source: EC, *Cyclical adjustment of Budget Balances*, 2014. Estimated values for 2014 and 2015, own processing

Table 2 compares characteristics of the Fiscal Pact and the Stability and Growth Pact, it focuses on their common base (fiscal responsibility, exceptions, partly analogous legal scope) while showing the different sanctions mechanisms and also the differences in the form of the analysed deficit.

²⁰ Croatia, which became a member of the EU on July 1, 2013, is also not a signatory country. The new Government of the Czech Republic, which was formed in January 2014, has already approved the intention to join the Pact as soon as possible, now the decision has been shifted to the Senate.

Table 2. Fiscal Pact versus Stability and Growth Pact

	Fiscal Pact	Stability and Growth Pact
The amount of the maximum annual government deficit/GDP	0.5% structural deficit 1% when the total debt is significantly lower than 60% of GDP	3% deficit (structural and cyclical)
Purpose	The requirement for balanced or surplus budgets, fiscal discipline and deeper coordination of economic policies	Adherence to fiscal discipline after adoption of the single currency
Sanctions	Automatic, rejection of sanctions on the basis of a qualified majority (only members of the euro area), the so-called reverse qualified majority vote	EU Council Decision (only members of the euro area) on the basis of a qualified-majority decision on imposing the sanction
Legal scope	Mandatory for all euro area countries, the other signatories select the provisions they want to be bound by	Binding for all EU countries but sanctions apply only to Eurozone countries
Exceptions	Yes	Yes

Source: Stability and Growth Pact, Fiscal pact, own selection and processing

The procedure in case of an excessive GDP deficit, or the corrective mechanism, in fact becomes automatic and is activated when either the threshold or the total debt are exceeded. Any potential abandonment of sanctions must be approved by a qualified majority in the EU Council (only euro-area members), the vote of the country in question wouldn't be included. The Stability and Growth Pact worked on a reverse principle where the Council approved the actual imposition of sanctions. A failure to comply with the conditions may be fined by the European Court of Justice by up to 0.1% of the national nominal GDP. The penalties paid by non-members of the euro area will become revenues of the EU budget, the penalties from countries with the common currency will go to the European Stability Mechanism.

4.1. Debt brake and balanced budgets mechanism

The Fiscal pact was a response for requirements of a more responsible fiscal policy, balanced budgets, and particularly of anchoring a debt ceiling into national legislations. The so-called debt brakes are used in various forms in countries across the continents. They differ in rules and if they exceed certain parameters they often lead to the vote of (no)confidence in the government. The basic rules some of them are listed in Table 3. Switzerland uses the debt brake since 2003, while in most EU countries it will come into effect in the coming years. In the US, legislators had to move the debt ceiling several times in recent years.

Table 3. Debt brakes (debt ceilings) in selected countries

Country	Limits, activation mechanism, exceptions
Slovakia	• activation when the total debt exceeds 50% • vote of confidence when the total debt exceeds 60% of GDP

Germany	• maximum annual structural deficit of 0.35% of GDP • exceptions in the recession
Spain	• maximum budget deficit of 0.4% of GDP
Switzerland	• does not allow any deficit • commitment to maintain a long-term balance of revenues and expenditures (the goal is to keep a constant value of debt, not necessarily to reduce it) • exceptions
Poland	• activation when the debt exceeds 50%, if it exceeds 55% the government is prohibited from providing state guarantees and loans, including other extensive measures

Source: own processing, debt brakes in individual countries

In 2012, the Czech government has drawn up and approved its own concept of domestic financial constitution.²¹ The draft law on fiscal responsibility allows a maximum total government debt (including counties and municipalities) of 60%, the same as in the Maastricht criteria. But already from the debt level above 40% there are various measures and instruments that the government should implement, such as a pay freeze in the public sector or one-fifth reduction of wages of state representatives. If the debt exceeds the 50% limit, the government should ask the Chamber of Deputies for a vote of confidence. The proposal counts with creation of a new coordinating body - the National Budget Board. It differs from the Fiscal Pact, inter alia, by the fact that it does not specify a limit for annual deficits. A half-percent annual structural deficit, which is set out in the Pact, would currently oblige the Czech Republic to a maximum annual deficit somewhere around CZK 20 bn. in proportion to nominal GDP. Given that in 2013 the deficit amounted to more than CZK 56 bn., in 2012 to more than CZK 100 bn., and during the years 2009-2011 on average even more than CZK 160 bn., the Czech government will have to create a more effective public administration and introduce some spending cuts and other austerity programs.

5. BAILOUT FUNDS NETWORK - EFSM, EFSF, ESM

In connection with the crisis situation in Greece and the country's impending insolvency, in the spring of 2010 appeared first proposals for creation of various "salvific" financial programs and instruments. These temporary or permanent funds and other resources became part of the so-called safety net in the following form:

EFSD – European Financial Stability Facility - 440 billion EUR, later increased to 780 billion EUR EFSD –European Financial Stabilisation Mechanism - 60 billion EUR IMF - International Monetary Fund - 250 billion EUR

²¹ Draft constitutional law on fiscal responsibility and change of the constitutional law no. 1/1993 Sb., Constitution of the Czech Republic, as amended (constitutional law on fiscal responsibility). The adoption of the proposal will require a three-fifth majority. In the case of adoption of the Fiscal Pact, the use of the constitutional majority is arguable, even though the European Union Committee evaluated the agreement on the governmental level as an international treaty which is subject to provisions of Article 10a of the Constitution.

The original firepower should generally represent EUR 750 bn. designed for lending and providing government guarantees.

The European Financial Stability Facility (EFSF) operated on the principle of a business company (shareholders were Eurozone countries). The facility was used for issuing bonds backed by state guarantees. The received funds were provided as credits and loans to the countries that were unable to obtain the capital themselves for acceptable interest rates on the capital markets. The fund possessed EUR 780 bn. which were guaranteed by all euro area countries. The key to the share on this guarantee was the paid-up share of capital in the European Central Bank. A part of the money served as a reserve to maintain the highest credit rating, which the EFSF lost in the winter of 2012 anyway. Article 7 allowed any participating country to waive the joint liability in a situation where the country itself would be forced to ask for a financial aid. During its duration the EFSF provided financial resources to Greece (second package), Portugal and Ireland. This instrument is now (2014) running down, including the ongoing settlement of its liabilities. The rest of its funds in the form of claims was transferred to its permanent successor - the European Stability Mechanism.

European Financial Stabilisation Mechanism EFSM ²² operated with a significantly lower amount of resources which were provided by the European Commission. The Commission has been obtaining these resources on the financial markets. The collateral were 60 billion Euros from the common EU budget, implying that all countries, not only Eurozone members (including the Czech Republic) were participating in these guarantees. The argument of some economists and politicians that until we adopt euro we do not have to provide guarantees to other economies is therefore actually misleading. Theoretically, all EU countries could ask for loans from the EFSM. The practical usage of this tool included provision of more than 48 billion Euros to Ireland and Portugal in the years 2011 - 2013.

In 2012 entered into force the international treaty creating a permanent rescue mechanism. Based on the treaty the euro area countries created a new international organization - **the European Stability Mechanism - ESM**, whose seat is in Luxembourg. ²³ In European law, it uses the Article 122, paragraph 2 of the Treaty on the Functioning of the European Union (the same did the previous rescue mechanisms) which reads: "If a Member State gets into difficulties because of natural disasters or exceptional occurrences beyond its control, or if there is a danger of severe difficulties from the same reason, the Council, acting on the EC's proposal, may provide the concerned Member State, under certain conditions, a financial assistance from the EU funds." The question whether Greece's, Ireland's, Portugal's and other affected countries' insolvency was primarily caused by "extraordinary" events beyond their control is thus shifting from a merely legal issue to a completely different dimension.

The registered capital of this permanent fund is 700 billion Euros (80 billion cash + 620 billion in payable-on-demand guarantees). The resources can be used to buy government bonds from countries with a limited solvency in the primary and secondary markets, to loans to Eurozone economies that are facing difficulties within their recovery programs (including preliminary financial assistance in the form of credit lines), or to recapitalizations of banking sectors. The latter area of direct recapitalizations of banks seems to be advantageous for the already over-indebted countries, because it does not add to their public debts. In fact, the authors of the contractual texts didn't primarily consider recapitalizations and it is still not clear whether their actual implementation is in line with the agreement's conditions. The ESM's lending capacity is lower (500 billion Euros), the difference between the capacity and the total amount of funds serves for obtaining the highest financial rating.

The Fund's shareholders are all euro area countries. The countries are liable for their contributions according to the same key as the shares in the ECB. ²⁴ The greatest guarantor is Germany with 27.15%,

²² EU Council's decision on creation of the Mechanism. Council of the European Union. Press Release. Extraordinary Council Meeting. Economic and Financial Affairs. 9/10 May 2010.

²³ Treaty establishing the ESM.

²⁴ The modification applies to countries whose GDP at market prices per head is lower than 75% of the EU average.

which means guarantees worth 190 billion EUR, followed by France (20.39%), Italy (17.91%), Spain (11.90%), and the Netherlands (5.72%).²⁵ The aid may be requested by any Eurozone country, the specific conditions and processes are evaluated by the European Commission. The International Monetary Fund is also involved in the assistance - in conjunction with the EC it arranges the so-called Memorandum of Understanding with the affected state. ESM (in 2012 and 2013) has so far provided financial assistance to the Spanish banking sector (EUR 41.3 bn.) and to Cyprus (EUR 9 bn.), which brought its capacity down by 10%.

The European Stability Mechanism is essentially a broader platform of banking union which should complement the measures taken in the past (e.g. the European Semester, the Stability and Growth Pact), as well as the Fiscal Pact, whose ratification and the fundamental element in the form of balanced budgets enshrined in national constitution is one of the conditions for obtaining financial assistance from ESM's resources.

Before ESM's creation some politicians, economists, as well as the ECB's representatives said that the amount of 700 billion Euros will not be enough. For comparison, this sum is equivalent to 70% of all expenditures contained in the EU's financial perspective for the years 2014-2020 (in layman's terms, it represents about 5 annual budgets of the entire European Union). The question is whether a further increase (requirements vary around 2 billion Euros) would create a sufficient intervene capacity in the case of a wider financial and economic crisis or collapse or bankruptcy of some of the major European countries, such as Italy or Spain. The estimate is that all ESM's resources would barely suffice for two years for the third and fourth largest euro-zone economy.

Table 4 compares all three instruments in terms of their time of operation, the amount of funds available, the nature of the provided guarantees, and the list of countries to which the assistance has been pledged so far.

Table 4. Safety net - comparison of selected measures

	ESM	EFSF	EFSM
Type	permanent (from 9/2012)	temporary (until 2013)	temporary (until 2013)
The amount of funds	EUR 500 bn. + EUR 200 bn. from EFSF	EUR 440 bn., or EUR 780 bn.	EUR 60 bn.
Funds' characteristics/guarantees	equity guarantees of countries cash in the form of each country's paid-up capital (80 bn. of 700)	guarantee of countries	common EU budget
Assistance granted	Spain (recapitalization of banks) Cyprus	Greece Ireland Portugal	Portugal Ireland
Options	loans to countries in difficulties recapitalization of banks	loans to countries in difficulties	loans to countries in difficulties

²⁵ The complaint about a constitutional conflict of the ESM's mechanism with the law of the German Bundestag aimed on the issue of deciding on the use of public funds was rejected by the German Constitutional Court in Karlsruhe in March 2014 on the grounds that the Bundestag's budgetary autonomy remains unchanged. The Court also decided that another EU's measure – the Fiscal Pact – is not in conflict with the German constitution.

	purchase of bonds in the primary and secondary markets		
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Source: own processing, ESM, EFSF, EFSM

On the basis of the TFEU Article no. 143 the European Union provides financial assistance also to countries that are not members of the euro area, in case they find themselves in difficulties or have serious problems with their balance of payments. This assistance is provided through the Balance of Payments (BoP) programme. Between 2010 – 2012, the recipients were Romania, Latvia and Hungary.²⁶ In addition to the joint support from the European institutions and the International Monetary Fund, the IMF between 2008 – 2013 provided funding to Greece, Portugal, Ireland, Hungary, Latvia, and Romania (IMF, 2013).

6. CONCLUSION

In any case, its implementation in the EC's draft for Eurobonds (point 1 and 2) represents a shift to fiscal federalization of the EU and it is also an initial stage in prospective establishing of a joint Ministry of Finance. Moreover it is a clear signal of the process of common socialization of debt. I would like to mention the scheme of Greece's debt and the issue of cheap money, because there is a danger of a similar situation. For the affected and uncompetitive countries Eurobonds will represent another cheap money, i. e. again, access to this money will be granted to the countries that should rather save (it's actually nothing more than further debt, only slightly cheaper).

The guarantee of fundamental reforms as a certain moral consideration is uncertain. The indisputable advantage for the troubled countries would be a lower interest on their state debts. On the other hand, the fiscally disciplined countries would pay for this measure through a higher common interest rate than they could use when issuing their original government bonds. Their interest costs would increase. The discussion whether this measures in its principle is solidary (the rich help the poorest) or vice versa the prudent pay for the careless, who get the help and guarantees without having discipline, is definitely justified.

The proposed measure of tax on financial transaction raises a certain dichotomy: increased requirements for recapitalization of European banks in recent years versus reduction of liquidity through capital regulation in the form of additional taxation. The introduction of the tax would also require considerable initial implementation and other administrative costs. Its effects are quite controversial, including those relating to the decline in the price volatility of financial assets. Thus the tax on financial transactions is one of the attempts to increase resources to the common European budget in the situation when some of the previous proposals were rejected (e.g. the proposal of an EU-wide tax). It is also highly probable that this experiment would most affect the individual clients (individuals and companies) of financial institutions, because it is almost certain that banks would gradually transfer the increased costs to their clients.

In its essence, the Fiscal Pact allows creation of deficits during economic downturns or recessions and expects surpluses in times of growth. It would be much better though if this rule has already been implemented a long time ago as a preventive measure, rather than using it as a tool to tackle an existing crisis. Procedures that can motivate European countries towards a greater fiscal responsibility are in principle correct but the methodology of measuring structural deficits raises a considerable controversy. We should keep in mind that the optimal fiscal discipline is different for each country, which is not much reflected in the current Fiscal pact.

All of these temporary or permanent rescue mechanisms have one main ambition: to mitigate, even for a short time, the financial uncertainty and prevent the imminent insolvency of certain countries.

²⁶ EC. Balance of Payments. Economic and Financial Affairs. 2014.

Simply speaking, European countries and politicians are buying time, even though that in the long term the currently running ESM should, according to the wishes of its signatories, operate on a more stable foundations. None of the above mechanisms, however, will not save countries from their debt problems. Unfortunately, they rather only postpone them and in some countries probably even deeper them. We should not overlook the fact that all the countries that were in trouble in the past will have to provide their assistance through their funds and guarantees to other countries in the future, if needed. In addition, some of the possibilities of the European Stability Mechanism, e.g. the recapitalization of banks, can disrupt the functioning of the financial-services internal market of the twenty-eight (individual support to selected subjects). The intergovernmentally organised creation of the ESM also showed how the "intergovernmentalism" can be cleverly used to another aims and purposes of integration which would normally go beyond the contractual conditions laid down in European law.

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