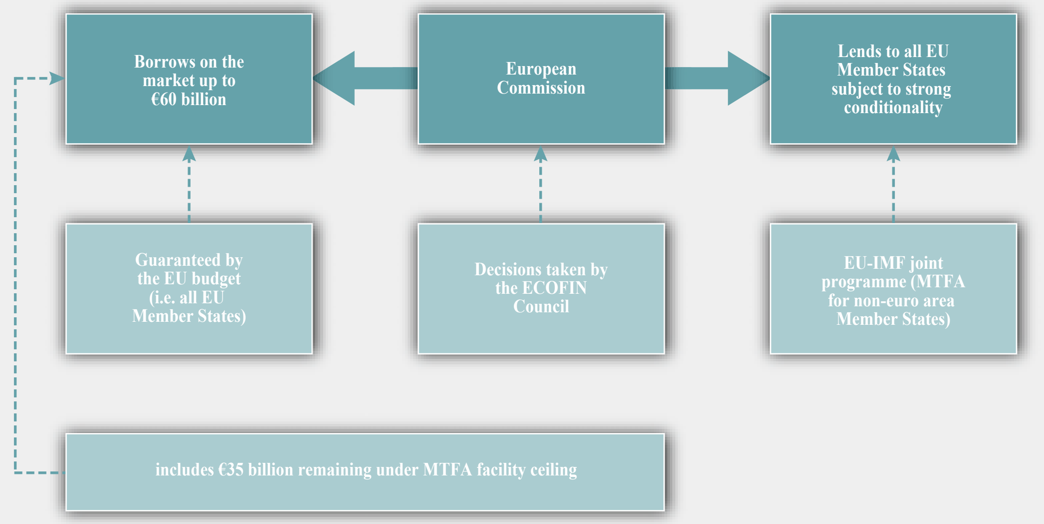
Box 4

GOVERNMENT MEASURES TO SAFEGUARD FINANCIAL STABILITY IN THE EURO AREA

From early 2010 fiscal imbalances in certain euro area countries have been causing tensions in sovereign debt markets. Euro area countries responded by affirming their willingness to take determined and coordinated action, if necessary, to safeguard financial stability in the euro area as a whole. In this context, on 2 May 2010 euro area countries agreed to activate, together with the IMF, a three-year financial support programme for Greece. On 6-7 May 2010, tensions escalated abruptly in financial markets. In line with their earlier commitment, European governments took urgent and unprecedented action to safeguard financial stability. On 9 May 2010, the Member States agreed to establish a comprehensive package of measures, consisting of three elements.

Chart A European Financial Stabilisation Mechanism (EFSM)



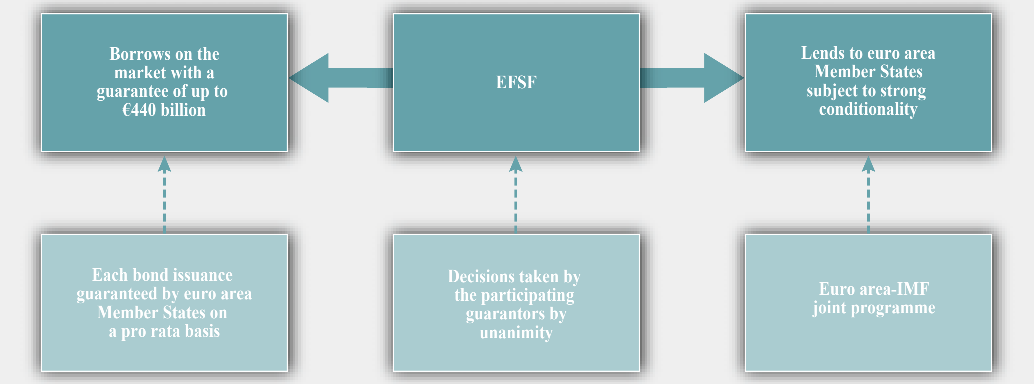
Note: MTFA denotes medium-term financial assistance.

Firstly, in line with the overall pledge to accelerate fiscal consolidation where warranted, countries experiencing strong market pressures committed to implement significant additional fiscal consolidation in 2010 and 2011 and take structural reform measures aimed at enhancing growth performance. Spain and Portugal announced additional measures on 12 May 2010 and 13 May 2010, respectively. An acceleration of fiscal consolidation plans has also been set in motion for most EU countries in the course of the year.

Secondly, the ECOFIN Council adopted a Regulation (No 407/2010) setting up the European Financial Stabilisation Mechanism (EFSM) (see Chart A). The Regulation allows the Commission to raise up to €60 billion on behalf of the EU for lending to EU Member States experiencing or being threatened with severe economic or financial disturbances. EFSM financial assistance will be subject to strong policy conditionality and take place in the context of joint EU-IMF programmes, on terms and conditions similar to those of IMF lending. The extension of the Regulation has to be reviewed every six months.

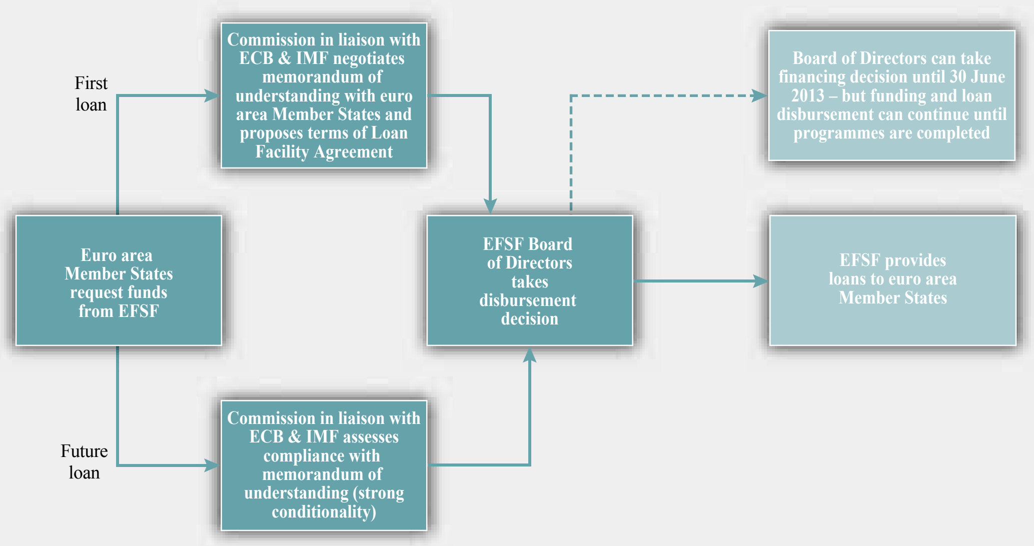
Thirdly, euro area Member States, on an intergovernmental basis, established the European Financial Stability Facility (EFSF) as a limited liability company under Luxembourg law (see Charts B and C). Its purpose is to provide loans to cover the financing needs of euro area Member States in difficulty, subject to strong policy conditionality in the context of joint euro area-IMF programmes. These loans will be financed through the issuance of debt securities, guaranteed up to a total of €440 billion by euro area Member States on a pro rata basis. On 15 June, the EFSF agreement entered into force and on 4 August Member States representing 90% of shareholding had completed national procedures regarding their guarantee obligations, thus triggering the activation of the EFSF. The EFSF can enter into loan facility agreements with euro area countries until 30 June 2013, with programmes continuing until completion. The IMF is expected to provide financing amounting to at least half as much as the euro area contribution to each programme, on terms and conditions in line with recent European programmes.

Chart B European Financial Stability Facility (EFSF)



Notwithstanding the determination demonstrated by European governments in May 2010 to safeguard financial stability in the euro area, the crisis demonstrated the clear need to strengthen economic governance in the EU and euro area. To this end, the European Council in March 2010 established a Task Force on Economic Governance under the chairmanship of its President, Herman Van Rompuy. The Task Force focused mainly on three areas: (i) strengthening fiscal surveillance, (ii) enhancing macroeconomic surveillance and (iii) establishing a crisis management framework. The ECB actively contributed to the work of this Task Force and in June 2010 submitted detailed proposals to strengthen governance and enforcement structures in the economic policy framework of the euro area. The Task Force submitted its final report to the European Council in October 2010. Subsequently, Mr Van Rompuy was invited to start

Chart C EFSF lending



Note: Loans will be extended on terms "comparable to Greece".

consultations on the establishment of a permanent crisis mechanism, including on a limited Treaty change required to that effect. The Commission is carrying out preparatory work on the general features of this new mechanism.

On 29 September 2010, the Commission came forward with six legislative proposals to strengthen surveillance which are being discussed by the Council and the European Parliament. Agreement on the legislative proposals is expected by June 2011.