Sovereign Debt Crisis 2010-2011: Institutional Improvisation on Margins of the EU Treaty Framework

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Institutional unreadiness of the EU for the crisis

The sovereign debt crisis experienced by the Eurozone in years 2010-2011 demonstrated that the EU lacked both institutional structures and tools to tackle the crisis in an efficient and predictable manner. Reaction of the EU institutions was, moderately speaking, chaotic and unpredictable, and suffered from problematic legality and legitimacy.

Lack of the EU’s “institutional toolbox” for the 2010-2011 crisis was surprising in the perspective of the fact that the EU spent the majority of the first decade of the 21st century by debates on its institutional reform which ultimately materialized in the Lisbon Treaty, effective from January 2010. With more detailed analysis of the Lisbon Treaty, the lack of the EU institutional toolbox for Eurozone crisis is much less surprising. The Lisbon Treaty has introduced significant institutional changes in the EU system but those reforms concentrated primarily on the institutional framework of the external relations of the EU and on strengthening of the EU governance in domain of internal security and criminal law.

In contrast, the Lisbon Treaty has been rather conservative regarding the institutional structure of the Eurozone. With exception of a formal recognition of the role of Eurogroup (meeting of ministers of finance of EU states using Euro), the Lisbon Treaty maintained all key institution-
The structural and policy tools of Eurozone which date back to the Maastricht Treaty from the beginning of the 90s, such as the “no bail-out clause” for Eurozone states, the structure of the European Central Bank and the mechanism of Stability and Growth Pact. The Lisbon Treaty thus maintained an asymmetry between a strong, quasi-federal European governance of the monetary policy of Eurozone, represented by the European Central Bank, and a weak European control over national fiscal policies, as represented by the practically unenforceable Stability and Growth Pact.

While the EU had a limited “toolbox” to tackle the economic crisis of 2008–2009 (general EU rules for internal market and, in particular, EU rules for state aid, EU fund for assistance to EU states outside Eurozone, such as Hungary, Latvia or Romania), the EU and/or Eurozone lacked a similar toolbox for the crisis of 2010–2011. The result of this unreformed Eurozone institutional framework and rapid development of the sovereign debt crisis of several Eurozone states in 2010–2011 resulted in the following elements of the EU response to the crisis:

a) Unpredictability and improvised character of the EU response—since the EU treaty framework did not provide for a blueprint of the EU reaction, European elites had to create *ad hoc* tools and use them virtually without delay. This unpredictability tormented not only state and private actors within the EU but also global players, such as the US or Japan.

b) Problematic legality of the EU reaction

c) Problematic legitimacy of the EU action

**Greek Package I: Bundle of bilateral loans**

with the EU as coordination platform

Lack of EU readiness for problems with sovereign debt of a Eurozone state was first tested by the EU reaction to troubles of Greece.
Shortly after new Greek administration made clear that the state of Greek public finances was significantly worse than predicted, the trust in Greek capacity to comply with its (present and future) obligations to private investors (private holders of bonds issued by Greek state) deteriorated. As a consequence, conditions under which Greek state could borrow from private investors worsened to a level that Greek administration was forced to ask EU institutions and EU states for protection from pressures of the markets.

As already mentioned, the Lisbon Treaty neither provides for a scenario of the EU reaction to risk of a default of a Eurozone state nor does the Lisbon Treaty vest the EU with tools to tackle with such a crisis. The only vague provision in the Lisbon Treaty (art. 122 par. 2 TFEU) permits the EU to financially assist a member state which “is in difficulties or is seriously threatened with severe difficulties caused by ...... exceptional occurrences beyond its control.” However, the Lisbon Treaty did not provide the EU with financial resources for such assistance neither it established an obligation of the EU to act. At the same time, the Lisbon Treaty contained so called “no bailout clause” preventing the EU or Eurozone states to guarantee or pay for public debts of individual Eurozone members.

Under extreme time presume, the Eurozone states adopted a political decision to financially assist Greece by amount exceeding 100 billion Euros and thus protect it temporarily from the pressure of global markets. However, in order to comply with the limitations of the Lisbon Treaty, the “Greek Loan Facility” took a very peculiar institutional form. Assistance for Greece is provided by a bundle of bilateral loans between Greece and the rest of Eurozone states, i.e. outside the formal EU or Eurozone framework. However, the Eurozone states used the European Council and the Eurogroup as a negotiating platform for coordination of conditions of the bundle of bilateral loans, such as the required interest rate, amounts of finances provided by individual states and time sched-
ule of loan trenches.

Due to the format of the Greek Loan Facility, there was no need to create a specific EU fund or mechanism based on article 122 TFEU, mentioned above. Instead, this clause of Lisbon Treaty was used as the argument in favor of the compatibility of the Greek package with the EU law. Also, the declaration establishing the Greek Package explicitly argued that the interest rates used in bilateral loans for Greek ō will be non-concessional, i.e. not contain any subsidy element 6) in order to avoid collision with “no bail-out” provisions of the Lisbon Treaty.

By political decision made by Eurozone states, the EU institutions, specifically the European Commission and the European Central Bank, together with the International Monetary Fund, were invited to participate in another ad hoc created institution, the “Troika”. “Troika” has been vested with responsibility to negotiate conditions of the pseudo-Eurozone assistance for Greece and to monitor the compliance of Greek reforms with agreed conditions of the loan mechanism.

Regardless recommendations issued by Troika, the final decision to release individual financial disbursements/tranches of loans to Greece has been performed by the Eurozone states. The reason for creation this specific new institution of Troika is twofold. The first is to “shield” Eurozone states from direct responsibility and critique for severity of conditions linked with the Greek package. Instead, it is the “Troika” which occupies the niche of the strict enforcer of the conditionality of financial assistance. The second reason for establishment of “Troika” was an attempt to benefit from the expertise of the International Monetary Fund with monitoring and enforcement reform and stabilization programs for public finances of troubled states, by inviting the IMF into a structure composed of both EU and non-EU actors.

The specific character of the Greek Loan Facility was demonstrated shortly after its creation. Regardless of the fact that Slovak center-left government lead by Robert Fico agreed politically to participate in the
Greek Loan Facility, the newly elected Slovak Prime Minister Radicova refused to activate the loan just several weeks later. While the new Slovak administration gained several harsh comments by its Eurozone counterparts, Slovak veto did not threatened the existence of the Greek Loan Facility as such, due to the (relatively) autonomous character of bilateral loans for Greece.

The Greek crisis was just the first test of the EU response to the sovereign debt crisis is Eurozone and it already demonstrated its non-predictability, concerns about legality and question of the legitimacy of the EU action. The Greek Loan Facility was shortly followed by another EU policy step which was of more general nature. This new EU action was even more institutionally blurred than the former EU reaction to Greek crisis.

**Irish and Portugal Packages: Combination of Limited Internal EU Solidarity and External Eurozone Improvised Toolbox**

Greek Loan Facility was tailored to specifics of Greek crisis and did not provide the EU with a general, preferably more efficient and more elegant, toolbox for similar crises in other Eurozone states. The need for such a toolbox was not only hypothetical, as signs of eroding trust in credibility of other Eurozone states, in particular Portugal, Ireland and Spain, started to emerge in 2010.

The EU reaction was to create a more general mechanism of EU/Eurozone assistance to states in trouble, theoretically open to any EU/Eurozone state experiencing significant problems with financing of its public debt. Again, legal constrains set by the Lisbon Treaty and political tension between Eurozone and non-Eurozone states of the EU resulted in an extremely complex and non-elegant solution.

The new EU mechanism has been built on three pillars: European Financial Stabilisation Mechanism (EFSM), European Financial Stability
Facility (EFSF) and the change in behavior of the European Central Bank. In addition to the EU or quasi-EU mechanism, the toolbox agreed within the EU framework does also expect the International Monetary Fund to get involved, albeit in a limited way.

EFSM is an internal EU mechanism, with full participation of all EU states (i.e. not only states of the Eurozone) and full involvement of standard EU institutions. EFSM is based on the article 122 par. 2 TFEU and formally established by a Council regulation. The maximum amount which can be provided via the EFSM is 60 billion Eur, i.e. less than total size of Greek Loan Facility. Reason behind this lack of ambitions of the EFSM was the opposition of non-Eurozone members of the EU to significantly contribute into a project which was (politically) aimed at rescue of Eurozone states. Thus, the 60 billion Euros was the maximum assistance limit which could be generated by the solidarity within the whole European Union. The positive element of the EFSM was its (relatively) unproblematic compatibility with the EU law (as mentioned, the EFSM was established by standard EU legal instrument, a regulation) and absence of ratification of the respective regulation by national parliaments (due to legal character of regulation, approval by the Council of the EU and consequent publication in the Official Journal of the EU was sufficient).

Lack of solidarity within the European Union which resulted in evident insufficiency of the EFSM capacity had to be compensated by an additional mechanism created within a group with a significantly more intensive political will to mutually cooperate. The result of this situation was the creation of the EFSF by decision of Eurozone states. In contrast to the EFSM, the EFSF was created outside, or at the margins of the European Union structures. The EFSF was created by an interstate agreement of Eurozone members only and took form of a special legal entity ruled by the Luxembourg law, with Eurozone states as its exclusive share-holders.
By political decision of Eurozone members from 2010, written in the legally binding agreement creating the EFSF, the EFSF could provide up to 440 billion Euros to Eurozone states in trouble. Due to its specific legal character, the EFSF did avoid several obstacles of the Lisbon Treaty (such as a risk that non-Eurozone states would veto its activation) but also created new legal and political challenges, in particular the requirement to be ratified by all Eurozone states. For the 2010 version of the EFSF, the ratification in all Eurozone states was not a significant challenge. However, the new 2011 format of the EFSF, debated below, caused significant political turmoil in Germany and triggered a ratification crisis in Slovakia.

The third element of the EU reaction was a change in behavior of the European Central Bank; in particular its willingness to purchase bonds issued by problematic Eurozone states from private investors at the secondary markets. In contrast to the EFSM and EFSF, Eurozone members’ states had only limited formal influence, due to the autonomy of the European Central Bank in the EU institutional system, on the ECB behavior. Instead, the political influence and communication and the forthcoming selection of the ECB governor played crucial role. Therefore, due to the institutional position of the ECB, its steps were the most flexible but also the least transparent and democratically legitimized elements of the EU reaction.

The new EU general financial mechanism was activated in relation to two states, Ireland and Portugal, until 2011. In both situations, Eurozone state in trouble was approached by a coordinated action of EFSM and EFSF, supplemented by the International Monetary Fund (or even additional international actors).
Long term solutions: Greek Package II, EFSF 2.0, European “Solidarity” Plan and Greek Referendum

The institutional adaptation of the EU to sovereign debt crisis of the Eurozone states did not exhausted itself by activation of Greek Loan Facility and loans for Ireland and Portugal under the EFSF/EFSM scheme. With continuous problems of Greece to comply with the condition of the “Greek Package” and worsening financial perspective of Italy, the EU continued to search for institutional solutions both within the EU Treaty framework and on the margins thereof.

After years spent on negotiations and ratification of the Lisbon Treaty, there was an obvious opposition (and even anxiety) about a potential new amendment of the EU Treaty. Therefore, only a very limited explicit change of the EU Treaty framework, adopted by simplified Treaty amendment procedure (under article 48 par. 6 TEU), was politically agreed in 2010. The change concerned inclusion of one single paragraph into article 136 TFEU which would provide explicit basis for creation of permanent European Stability Mechanism (ESM) to replace the EFSF whose existence was limited (by political decision of the Eurozone states) by year 2013.

Another format of the institutional adaptation to the developing Eurozone crisis in 2011 was the expansion of mechanisms created in the first phase of crisis in 2010. This solution was chosen regarding the EFSF whose borrowing capacity was increased in summer 2011 while more ambitious potential reforms, such as transformation of the EFSF into a bank eligible for direct borrowing from the European Central Bank, were rejected. Even this rather conservative change, however, triggered a ratification crisis in Slovakia which approved this “EFSF 2.0” version only at the expenses of the fall of the Slovak reformist government led by Ms. Radicova.
At the same time, several legislative and non-legislative instruments were agreed within the existing Lisbon Treaty framework. The most famous of them was a package of six legislative measures proposed by the European Commission and labeled as the “European economic governance six-pack.” In particular, the European Commission “six-pack” strengthens the efficiency of the Stability and Growth Pact, for instance by introducing the reverse voting about sanctions for violation Eurozone rules in the Council. While according to the pre-crisis rules, sanctions against a Eurozone state required approval of a (positive) majority of the Eurozone states, the newly proposed set of rules allows the sanctions to be imposed unless the majority of Eurozone states objects them. However, even new rules do not introduce sanctions automatically against all states violating the Eurozone rules.

In addition to internal EU legislation, the Eurozone states agreed, albeit in form of non-binding European Council conclusions from March 2011, to comply with a broader set of rules regarding the control of their public finances. The most explicit expression of this de facto and politically based expansion of Eurozone regulatory powers was the Euro Plus Pact which, in addition to (already mentioned) plan to strengthen the Growth and Stability Pact, introduced an obligation for member states to write some elements of a new EU-level political agreement into their constitutional law.

Open Way to Treaty Reform (Again)?

As demonstrated above, a lion share of the EU institutional response to the Eurozone debt crisis balanced on the margin of the EU Treaty framework. By the end of 2011, the EU politicians also formulated, albeit in very vague terms, their visions of the solution for this two years long institutional wandering.

The first vision tackled the increasing tension between Eurozone
states and the remaining members of the European Union. The non-Eurozone EU members grew increasingly worried about the dominant role of the EU17 Eurogroup meetings at the expense of standard EU 27 Council meeting format. A provisional solution was found at the European Council meeting in October 2011 when H. van Rompuy was vested with tasks both to (temporarily) preside regular meetings of the leaders the Eurozone states (in addition to his position of permanent chair of the EU27 European Council) and to act as the communicator between Eurozone states and non-Eurozone states at the top level.

The second vision of the future development of the institutional response to the Eurozone crisis materialized at the European Council summit in December 2011. De facto amendment of the Lisbon Treaty was agreed by a majority of EU states (including all Eurozone countries). Details of this political decision are expected to be agreed by March 2012, including the legal method how to avoid veto power of the dissenting EU members (in particular, the United Kingdom). However, even in December 2011 was clear that a “taboo” of significant EU Treaty reform would not survive the Eurozone crisis.

**Conclusion: Looking for Balance between Efficiency, Legality and Legitimacy**

Eurozone crisis of 2010–2011 triggered a variety of political decisions by the EU elites, both with short-term and long-term objectives. Regardless whether those actions used the EU/Eurozone instruments or the EU/Eurozone was used simply as a platform for negotiation, all those actions did (or should) follow the combination of three objectives: efficiency, legality and legitimacy.

The efficiency element of the EU action attracted the most attention so far. It was evident that the Lisbon Treaty institutional structure was not ready for the Eurozone crisis of 2010–2011. However, the institution-
al structure of the EU, such as European Council, Council of the EU, Eurogroup, proved to be a surprisingly flexible platform for negotiations between the European elites in search for ad hoc crisis response.

Questions of legality and legitimacy seem to have been relatively neglected. In years 2010–2011, the EU demonstrated significantly lower sensibility towards respect to legal limits of the EU action. A lip-service was given to rules of the Lisbon Treaty but those rules were interpreted in an unprecedentedly flexible way to comply with the political and economic objectives. The former French Minister of Finance (and present head of the IMF), Christiane Lagarde even supposedly said in December 2010 that the EU politicians (including herself) “violated all rules because (we) wanted to close ranks and really rescue the Eurozone”.

Ultimately, tension between the formal EU legal rules and the reality of the EU actions lead to the decision to formally amend the treaty framework in December 2011.

The legitimacy issue remains the key challenge to the EU reaction to the Eurozone crisis. EU’s action has been elite driven and tried to avoid or postpone being “tested” by opinion of the voters, demonstrated by the hostile reaction of the EU elite to Greek considerations about potential referendum. However, strengthening of existing EU institutions or creation of new European structures will ultimately be tested by national elections sooner or later. Therefore, the capacity of the EU elites to explain and justify their actions to their voters might be the crucial condition of medium- and long-term survival of the EU-wide action. If the EU elites fail this test, their concentration on the institutional adaptation of the EU will turn into a futile effort.

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Stability and Growth Pact emerged later than the Maastricht Treaty but its origins still date back in the period of formation of the Eurozone. The Lisbon Treaty also maintained in force significant weakening of the Stability and Growth Pact agreed by Eurozone states in 2005.

3 Council Regulation 332/2002/EC, based on article 119 TEC (143 TFEU, in post-Lisbon numbering). Using this regulation, the Council authorised loans for Latvia (3.1 billion Eur), Hungary (6.5 billions Eur) and Romania (5 billion Eur). Loan recipients usually used only a segment from the loan limit authorised by the Council; for instance, Hungary received only 5.5 billion Eur out of 6.5 billion loan capacity.


6 Statement by the Heads of State and Government of the Euro Area, Brussels, March 25, 2010, p. 1. The complete phrase used was as follows: “The objective of this mechanism will not be to provide financing at average euro area interest rates, but to set incentives to return to market financing as soon as possible by risk adequate pricing. Interest rates will be non-concessional, i.e. not contain any subsidy element”.


8 Regardless its formal independence of the EU, there is strong personal interconnection between the EFSF and the EU. Not only in capacity of its share holders but also its management. It was Klaus Regling, former high official of the European Commission, who was appointed as the first CEO of the EFSF.

9 For instance, Ireland was assisted not only by EFSM, EFSF and by IMF but also by specific bilateral loans provided by the United Kingdom, Denmark and Sweden.

10 For genesis of debate about new voting rules, see Featherstone, “The Greek Sovereign Debt Crisis and EMU: A Failing State in a Skewed Regime”, 208–209.


13 By using term “de facto amendement” I refer to the fact that the Lisbon Treaty will be suplemented by a specific international treaty concluded by majority of the EU states while formally the Lisbon Treaty will remain untouched.