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# How Europe's least controversial rescue fund became controversial

July 20, 2015

By Nik de Boer and Chris Koedooder



Over the past week, UK Prime Minister David Cameron and his Chancellor of the Exchequer, George Osborne, made a fuss about emergency funding for Greece. The source of their grievances is that some of the funding comes from the European Financial Stabilisation

Mechanism (EFSM). Use of this rescue fund entails that the UK indirectly guarantees short-term loans to Greece, whereas the UK is not part of the Eurozone. For this reason, Osborne vowed to block use of the rescue fund: "Britain is not in the euro, so the idea that British taxpayers will be on the line for this Greek deal is a complete non-starter. The Eurozone needs to foot its

own bill." By now, Osborne has backed down and use of the EFSM has been agreed upon. Yet, what was all the fuss about? Did the UK Government have a point? Were its objections based on sound legal arguments? And have its protests had any result?

## Why all the fuss?

After a marathon 17-hour summit on Sunday 12 July, Eurozone leaders agreed to a new bailout deal for Greece worth up to 86 billion euros. However, Greece first needs to adopt two sets of legislative measures before the new programme will be put into place. Until then, Greece urgently needs bridge financing to clear its arrears with the IMF and repay the ECB. The European Commission proposed to grant 7 billion euros in short-term emergency assistance via the EFSM. Here lies the source of the UK Government's concern.

The EFSM was established in May 2010 as part of a 'rescue umbrella' that also included the European Financial Stability Facility (EFSF). Both measures were adopted when it became apparent that the Greek sovereign debt crisis could potentially spread to other Eurozone Member States.

The EFSM was established by Regulation 407/2010. Its legal basis is Article 122(2) TFEU, which allows the

Council to grant Union financial assistance to a Member State experiencing difficulties caused by “exceptional occurrences beyond its control”. Under the EFSM Regulation, the Commission is empowered to borrow up to 60 billion euros on the capital markets on behalf of the EU. Following a decision by the Council, the Commission then on-lends the proceeds to the Member State seeking financial assistance. In return for a loan or a credit line, recipient Member States must put in place an economic adjustment programme.

The total possible amount of EFSM loans – 60 billion euros – is relatively small in comparison to the 440 billion euros made available under the EFSF. An important difference between these two rescue funds, however, is that EFSM loans are guaranteed by the EU budget, which in turn is financed by all 28 EU Member States. Lending operations of the EFSM are therefore, in part, indirectly financed by the UK. The EFSF, on the other hand, provides loans on the basis of financial guarantees given by the Eurozone Member States, not including the UK therefore. Furthermore, the EFSF was not based on EU law but established under Luxembourg private law as a company owned by the Eurozone Member States.

Another concern for the UK is that it cannot veto financial assistance under the EFSM. Article 3(2) of the EFSM Regulation determines that the Council adopts such decisions by a qualified majority on a proposal from the Commission. An affirmative vote by the 19 Eurozone Member States would be sufficient to provide financial assistance under the EFSM.

Until now, the EFSM was generally not considered controversial. Prior to the newly agreed emergency funding for Greece, the EFSM has been activated twice before: A total amount of 48.5 billion euros has been disbursed to Ireland and Portugal. While there were some doubts as to whether the EFSM Regulation could be based on Article 122(2) TFEU, it was the EFSF that was considered the controversial part of the rescue umbrella, because it was established outside the framework of the Treaties. By designing the EFSF as a ‘special purpose vehicle’, it has been argued, the Eurozone Member States circumvented EU law. Likewise, the Eurozone Member States controversially established the European Stability Mechanism (ESM), the permanent successor of the EFSF and EFSM, which has a maximum lending capacity of 500 billion euros, in October 2012 as a formally independent international organization under public international law.

In December 2010, the European Council announced that the Eurozone Member States would establish the ESM to safeguard the stability of the Eurozone. The ESM would replace the EFSF and the EFSM. The latter was said to remain in force until June 2013. As the ESM was designed to safeguard the stability of the Eurozone as a whole, the European Council Conclusions of 16-17 December 2010 stated that Article 122(2) TFEU – the legal basis for the EFSM Regulation – would “no longer be needed for such purposes”. It was furthermore noted that the Heads of State or Government agreed that Article 122(2) TFEU “*should* not be used for such purposes” (emphasis added). Cameron subsequently presented this deal as a victory for the UK. In his view, the Conclusions stated “in black and white the clear and unanimous agreement that from 2013 Britain will not be dragged into bailing out the Eurozone.” Last week, Osborne and Cameron invoked these Conclusions to object to use of the EFSM for providing emergency funding to Greece. However, the fact remains that the EFSM Regulation was never formally revoked and is legally still in force.

Cameron’s victory was not as clear-cut as he claimed. Reportedly, the UK prime minister wanted the European Council Conclusions to state that Article 122(2) TFEU “*will* not be used” for the purposes of safeguarding the stability of the Eurozone. However, the wording of the Conclusions cited above reveals that

there was disagreement within the European Council as to whether Article 122(2) TFEU could still be used as a legal basis to grant Union financial assistance to Eurozone Member States. Blocking the future use of a legal basis laid down in the Treaty was unacceptable for Commission President Barroso. The Commission President is an *ex officio* member of the European Council. As he disagreed, it was not the European Council as *an institution* that concluded that Article 122(2) TFEU should no longer be used, but only the Heads of State or Government among themselves.

### ***Assessing the UK Government's claims***

What to make of the UK Government's claims? Legally speaking, its claims are weak. European Council Conclusions are not legally binding and therefore cannot be used to limit a legal basis found in the Treaties. The EFSM Regulation is still legally valid and pursuant to Article 3(2) thereof Council decision-making proceeds by qualified majority. In other words, it would have been legal to override the UK's concerns relating to the emergency funding for Greece. Moreover, even if we were to accept that these Conclusions could have such a legal effect, their wording is too weak to entail a moratorium on the use of Article 122(2) TFEU. In that case, the Conclusions should have stated unequivocally that Article 122(2) TFEU "*will* not be used" rather than the "*should* not be used". Furthermore, Cameron did not have an agreement with the Commission.

Morally speaking, Osborne and Cameron's claims may be a bit more convincing. The wording of the European Council Conclusions provides some ground to refrain from activating the EFSM. In addition, they argue in essence that the UK should not have to contribute to the mess that the Eurozone has gotten itself into. Both points can be contested, however. The wording of the European Council Conclusions is weak and hence the agreement that Osborne and Cameron invoke is weak as well. Greece's situation is pressing and there were simply no good alternatives to provide the required bridge financing. Second, Cameron and Osborne's principled rejection of contributing to Eurozone rescue measures is somewhat misleading. The provision of Union financial assistance to Greece is in the UK's own interest and there are good grounds for the UK as well not to see Greece slide into a dire economic situation. For such reasons, the UK Government has previously agreed to provide a bilateral loan of 3.2 billion pounds as part of the rescue package for Ireland, because it was "in the UK's national interest that Ireland has a successful economy and a stable banking system". The idea that the UK should not contribute to any Eurozone rescue measures as a matter of principle, therefore, has not been lived up to in the past. Vice versa, the Eurozone Member States have also contributed to the balance-of-payments assistance provided to non-Eurozone Member States Hungary, Latvia, and Romania under Article 143 TFEU. Third, Cameron has indicated that he would expect the British people to be "generous" in providing humanitarian aid to Greece in case it would exit the Eurozone. However, if the UK would be willing to give humanitarian aid, it is unclear why it should not help to prevent the need for such aid in the first place.

### ***How fears of a Brexit provide the UK leverage in EU negotiations***

To sum up, George Osborne and David Cameron were angry about the proposed activation of the EFSM. Despite their anger, the EFSM was used to support Greece. Morally, the grounds for Cameron and Osborne's anger are contestable and not wholly principled. Legally, their claims were simply weak.

Nonetheless, their protests have sorted effects. The Council approved 7 billion euros in short-term emergency assistance via the EFSM, but a mechanism has been designed to ensure that non-Eurozone Member States do not carry financial risks should Greece default. Furthermore, the Council and Commission have agreed that any future use of the EFSM Regulation for the purpose of safeguarding the

financial stability of a Eurozone Member State will be made conditional upon similar arrangements. Also, the Commission will propose "appropriate changes to the EFSM Regulation as soon as possible".

So why did morally questionable and legally weak arguments lead to an actual victory for the UK? It seems that fear of a Brexit played a decisive role. The controversy over the EFSM, Europe's least controversial rescue fund, thus illustrates how the impending referendum on UK membership of the EU presently provides its Government with extra leverage in EU negotiations. To be continued.



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