European Financial Stability Facility Policy (EFSF) Used to Overcome the Eurozone Economic Crisis (2009–2010)

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Abstract

This study elaborates the policy of European Financial Stability Facility (EFSF), issued in 2010 by European Union in response to the Eurozone Economic Crisis, based on the agreement between Eurozone member states along with the European Central Bank (ECB) and International Monetary Fund (IMF). The EFSF policy subsequently elaborated includes the background information that caused the EFSF policy to be issued. This economic milieu was based on an institutional, neoliberal framework. In this context, this study determined that institutional weakness in the European Union, and the ECB—neither of which have regulations in place or an economic crisis management system—caused Eurozone member states to find other solutions to the economic crisis of 2010. This study also reveals the implications of EFSF for the economies of Eurozone member states that suffered from the crisis, disclosing how those members’ expectations may be fulfilled.

Keywords— Economic crisis, institutions, Eurozone member states, European Union, and ECB

1. Introduction

Economic crises in some Eurozone member states after 2008, including Greece, Ireland, and Portugal, has often been an interesting issue that has attracted the world and other Eurozone member states. The 2009 crisis was caused by an economic imbalance, specifically financial, and uncontrolled fiscal spending in some Eurozone member states that derailed the efficiency of its mutual monetary system.

The crisis featured huge national debts and large deficit increases in some countries. Eurostat noted that, in 2009, Greece had 129% in debt as a percentage of gross domestic product (GDP) (Eurostat). In addition, Ireland and Portugal suffered from similar circumstances: they were beleaguered by a huge debt and budget deficit. Even large economies like Italy and Spain were only marginally better.

Table of Greece, Ireland, And Portugal’s Economy

<table>
<thead>
<tr>
<th>Country</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>Greece</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>GDP (million euros)</td>
<td>232,920</td>
<td>231,942</td>
<td>227,318</td>
<td>215,088</td>
</tr>
<tr>
<td>Deficit (million euros)</td>
<td>-22,866</td>
<td>-36,103</td>
<td>-23,521</td>
<td>-19,565</td>
</tr>
<tr>
<td>(% from GDP)</td>
<td>-9,8</td>
<td>-15,6</td>
<td>-10,3</td>
<td>-9,1</td>
</tr>
<tr>
<td>Government’s Debt (million euros)</td>
<td>263,284</td>
<td>299,685</td>
<td>329,535</td>
<td>355,617</td>
</tr>
<tr>
<td>(% from GDP)</td>
<td>113</td>
<td>129,4</td>
<td>145</td>
<td>165,3</td>
</tr>
<tr>
<td>Ireland</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>GDP (million euros)</td>
<td>179,990</td>
<td>160,596</td>
<td>155,992</td>
<td>156,438</td>
</tr>
<tr>
<td>Deficit (million euros)</td>
<td>-13,219</td>
<td>-22,519</td>
<td>-48,607</td>
<td>-20,515</td>
</tr>
<tr>
<td>(% from GDP)</td>
<td>-7,3</td>
<td>-14</td>
<td>-32,1</td>
<td>-13,1</td>
</tr>
<tr>
<td>Government’s Debt (million euros)</td>
<td>79,582</td>
<td>104,602</td>
<td>114,241</td>
<td>169,264</td>
</tr>
<tr>
<td>(% from GDP)</td>
<td>44,2</td>
<td>65,1</td>
<td>92,5</td>
<td>108,2</td>
</tr>
<tr>
<td>Portugal</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>GDP (million euros)</td>
<td>71,983</td>
<td>168,504</td>
<td>172,670</td>
<td>171,015</td>
</tr>
</tbody>
</table>

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Table 1 shows the declining trends in these nation’s GDP, increasing budget deficits and government’ debt. The crisis hit Greece the hardest, indicated by its dramatic debt increase (up to 145 percent of GDP).

That condition, according to the Economic and Monetary Union (EMU) generated an emergency, because it was feared that the country could not manage its huge debt. The EMU had stated that every Eurozone member state could not have any debts in excess of sixty percent of its GDP and its budget deficit should be under three percent of GDP (European Commission, 2007).

The economic crisis in Greece, Ireland, and Portugal caused anxiety in all Eurozone member states, considering the huge accumulated debt. Such debt financing might affect the European Central Bank (ECB)’s banking system. This worry caused speculation of crisis that would financially affect other Eurozone member states involved in integrated banking system (Cameroon, 2010), especially Germany.

Accordingly, Eurozone member states tried to overcome the crisis in those three countries. The effort was conducted in the early 2010, with Germany and France’s central banks providing loans as much as 900 billion USD to Greece, Ireland and Portugal (Cameroon, 2010). The loans were intended to stimulate Greece, Ireland, and Portugal’s economies. The loans at least helped those economies. However, Greece did not succeed in managing the loan, as indicated by the unchanged percentage in Greece’s economic growth that should have undergone a specific change corresponding to its increasing debt ratio (Eurostat).

The unsuccessful efforts of France and Germany made other Eurozone member states demand that the European Union overcome the crisis immediately. The fact that Germany and France were the biggest funders of Eurozone banks made other Eurozone member states nervous and left them wondering whether Germany and France were able to handle the losses. Thus, they demanded that European Union enact a policy to prevent the negative impacts from spreading across Eurozone member states (Cameroon, 2010).

Some member states, e.g., Germany, France, Holland, Finland, and Slovakia, stated that the absence of austere fiscal policy caused the economic crisis in some Eurozone states. They urged Eurozone member states to unleash the fiscal regulation immediately that had been prepared in 2010 (Archik, 2016).

Wolfgang Schäuble, Finance Minister of Germany, stated in the Financial Times (2011) that the uncontrolled expenses of one country was the cause of its debts increasing, which coupled with its deficits threatened European Union’s economic welfare. Moreover, Jean Claude Trichet, the former President of the European Central Bank (ECB) stated that the root cause of huge debts in some Eurozone states was the lack of discipline and fiscal ignorance (Storm & Naastepad, 2016).

The urgency impelled by Eurozone member states to complain vociferously to the European Union, was affirmed by German Counselor, Angela Merkel, too. She stated, “if the euro fails, Europe fails” (Archik, 2016), showing that Germany was serious about finding the right solution for that economic problem in the Eurozone.

The request was then fulfilled by the European Union’s policy known as, European Financial Stability Facility (EFSF). EFSF was intended to prevent a crisis from impacting the economic market due to the common currency (EFSF, 2016). Furthermore, these states were also involved in an integrated banking system (Cameroon, 2010). EFSF policy was issued by the European Finance Ministers in May 2010 (Lange, 2012).

EFSF was in effect from 2010 through June 2013, serving the function of providing bailouts for Greece, Ireland, and Portugal, as well as to prevent the crisis from spreading to other Eurozone states (Gocaj & Muenier, 2010).

The EFSF found its basis in the Ecofin meeting held on May 9-10, 2010. It was the first bailout program in European Union. These leaders provided about 60 billion euros, plus 440 billion euros, as a warranty fund sourced from Eurozone states, Euro Area Member States (EAMS) (European Council, 2010). Besides dealing with the EAMS, EFSF also cooperated with the IMF that provided loans up to 250 billion euros (EFSF, 2016).

The President of France, Nicolas Sarkozy, stated that EFSF was expected to be able to resolve the crisis of Eurozone immediately. He suggested that it was necessary to increase EFSF’s funding by broadly imposing voluntary contributions on European Union member states, even though the state was not a member of the Eurozone (Gocaj & Muenier, 2010). In responding the suggestion, England affirmatively rejected the idea, England viewed the crisis and bailout policy were the problem of Eurozone member states, even though English banks in Ireland were also affected by Ireland’s national economic problem (Gocaj & Muenier, 2010).

EFSF’s control was handed over to the European Commission, as the instrument that was expected to overcome the crisis (Gocaj & Muenier, 2010). It had become the institution that had the duty to maintain financial stability in Europe by increasing capital market funds as necessary, using them to provide loans for Eurozone member states (EFSF, 2016).
As public policy, the EFSF provides an interesting case study since there were vested interests involving many actors. Negotiations, implementations, transparency, and interests in the European Union are interesting to study, upon observing a crisis in one or more Eurozone member state(s) and seeing the national economic interest served by Eurozone integration.

This study aims to answer the question, “Why did European Union release this public policy (EFSF) in 2010, in hope of prevent the crisis from spreading? In addition, has the implementation of EFSF fulfilled its policy expectations among Eurozone member states?”

2. Literature Review

An institutional, neoliberal perspective is used to analyze the chosen policy. This perspective may deliver a deeper understanding of the factors behind the policy, and may permit generating an indicator that is useful in determining both policy implementation and expectations for fulfilling its mission.

This perspective is expected to be able to elaborate on countries’ needs, economic dependency, and the European Union as an institution. The institutional, neoliberal assumption is that a country is the main actor in international relations and how it views anarchic conditions of international political environment is important. Thus, the country trusts institutions to manage conflict possibilities in varied fields. Such neoliberal views consider relations between countries in an institution in and of itself, where cooperation has a complex interdependence. Accordingly, each policy must be considered and negotiated through involving multiple channels and issues.

Moreover, the study develops its analysis based on the assumption that there are collective action problems within the international system, including the European Union member states and the 2009 crisis. They should cooperate in resolving the Eurozone’s crisis using a shared policy.

Within the study, new institutional theory is used to analyze the role of European Union (as an institution) in enacting EFSF policy, which is brimming with vested national interests of its member states. The European Union simply becomes a means to negotiate and share information. Thus, member states’ interests can be acknowledged and managed collectively, with the European Union serving as a broker in managing collective interests.

3. Method

The study uses a suitable qualitative method; a continuous method where data collection, data processing, and data analysis can be conducted at one time during the process (Oetomo, 2010).

Both primary and secondary data are used. Primary data come from official European Union documents, speech texts, official documents of member states, a summary of the discussion of each European Union meeting, and media broadcasts related to the EFSF policy’s release. Secondary data collections included literature reviews (e.g., quotations, citations, or documentations from credible organizations or institutions, memos, official reports, scientific articles, books, and valid data found on the Internet (Oetomo, 2010).

The method used was analytic, a process describing variables based on writings, data, and valid written documents. The variables were then analyzed to answer the research questions using determined theories, taking a case study approach.

4. Results and Discussion

The study produces an analysis which is based on institutional neoliberal perspective with its theory (institution, country, complex interdependence, and collective problems).

![Figure 1 Collective Problems Solving](source: Illustration of Neoliberal Institutional Perspective (Keohane & Nye))

From an institutional neoliberal perspective, there are “collective action problems” that are defined as shared problems. These shared problems are the facts that change interaction patterns between involved actors. In the study, the Eurozone’s economic crisis became a collective problem that obligated institutions and countries to cooperate to find a solution in order to prevent the spread of further harm.
The effort involved in searching for a solution, when based on an institutional approach where institutional policies overcoming shared issues, produces a result that highlights the fact that effectively unregulated institutions make up the framework responsible for searching for solutions. Note that the states themselves have no means of overcoming this collective problem.

**Discussion**

Starting in 2009, the economy crisis in Greece, Ireland, and Portugal threatened to destabilize the Eurozone. The threat resulted from the economic integration and joint monetary policy in the Eurozone. The crisis was caused by several reasons, considering national economy policy: mainly fiscal unbalance. Viewed as an institution, the crisis was caused by the EMU’s policy and the ECB—leveling policies that weakened the economic base of member states.

Nevertheless, the economy crisis that affected some Eurozone member states was caused by various factors. Briefly, Greece had an unbalanced fiscal policy that its expenses exceed its revenues. Ireland suffered due to the low interest rate leveling policy imposed by the ECB, which increased demand for mortgages. When global economy crisis happened, natural processes to return to equilibrium were impeded by public policy. In covering their credit problems, banks were burdened by huge costs. By trying to save its banks, Ireland increased its foreign debt above the maximum level determined by Eurozone policy. Portugal had a similar problem as Ireland: a huge national debt and budget deficit in 2008.

As a result of these difficulties, the European Union (along with the EMU) were called upon to resolve the issues lest harm impact other Eurozone economies. The urgency came as the result of a complex interdependence within the Eurozone. This economic problem had become shared issue for other Eurozone member states. Thus, strong cooperation between Eurozone, EMU, and European Union institutions was necessary.

However, as an institution, the European Union did not have specific regulations that could be used to overcome an economic crisis within its member states. Thus, it could not provide any solution using its existing framework, and therefore let its member states negotiate and discuss solutions.

While the European Union could not provide any regulation, there was hope that its member states (as supporting institutions) could manage something similar. The Eurozone, in fact, did not have any functional means of overcoming such a crisis within its member states, so the individual members had to generate one.

They decided to issue EFSF policy in 2010. The policy was influenced by other institutions such as the ECB and the IMF. EFSF policy generated loans for Greece, Ireland, and Portugal for 750 billion euros. One-third came from the IMF (250 billion euros), permitting EFSF policy to be realized in the Eurozone.

Based on an institutional, neoliberal framework, the interaction patterns between Eurozone member states, EMU, ECB, and IMF may be designated as “multiple actor” patterns. Both shared issues and the condition of European governmental institutions could not overcome crisis within existing regulations, making EFSF become a reality for the Eurozone’s political economy.

Such political economy provided by the EFSF tended to focus more on the absence of policies and the requisite steps taken by the European Union, EMU, and beleaguered states in crisis. Outside the Eurozone, monetary policies could have been issued to stabilize foreign debt, but that action was impeded in the Eurozone, making it impossible to take such steps.

As institutions, the European Union and EMU should have been able to predict and provide regulations when crises occurred in their member states. Managing the stability of the Eurozone was important since its member states relegated their monetary policy rights to the ECB and EMU.

The role of Eurozone member states in EFSF policy was also important. Even though states cooperate as an institution, the position of the states remains important in determining the nature of monetary policies. States’ roles in the EFSF were divided into creditor and debtor positions. Generally, creditor states gave loans to the EFSF in an effort to prevent Eurozone economies from collapsing.

Creditors trusted the policies by giving the necessary loans and demand that the debtors apply the economic savings attained in order to fix their economic maladies. Debtors were in emergency situations. Nevertheless, the solutions suggested were expected to improve their economies. The absence of a policy’s instrument in the EMU and European Union to overcome the crisis made debtors rely on EFSF policy.

Since its inception, the EFSF had made debtors undertake economic austerity programs. Economic changes had occurred in Ireland and Portugal by decreasing deficits years ahead of time. Greece is the only country that still
needs to continue the hard work of implementing the EFSF’s criteria and expectations for deficit reduction.

Greece, Ireland and Portugal’s needs (as debtors) triggered an urgent need for emergency financial help. The crisis in Greece was precipitated by its ineffective fiscal policy that ignored its international economic competitiveness. The crisis in Ireland was generated by low interest rates that spawned huge mortgage loan activity, without a way to steer its banking system. The crisis in Portugal was similar to Ireland’s, started by bad loan decisions in the banking sector. The study reveals that Eurozone member states suffered from difficulties to manage their funds and had to be assisted by the Eurozone’s larger countries.

Germany and France’s interest in every negotiation tended to be built on their moral responsibility to keep the Eurozone stable. However, Germany and France moved as a result of being part of the cause of the crisis.

That Eurozone need not have undergone such turmoil if they really had the same currency. Maintaining economy stability is the responsibility of each member state. Yet, the Eurozone’s incapability was a phenomenon that occurred after this notorious crisis. Countries no longer had monetary policy instruments to regulate their national currencies since they had ceded that power to the controllers of the euro, leaving them without a means to solve their own debt, deficit, and unemployment issues.

EFSF policy with warranty loans was expected to resolve the economic calamity by stimulated troubled economies with emergency options in cooperative EFSF framework, given that the Eurozone did not have any specific regulations for overcoming such crises. Thus, the EFSF was enacted.

5. Conclusions

The absence of parties that should have been responsible for resolving the 2009 crisis in the Eurozone is odd, especially given the structure of regional organization with a single currency. Even though the Eurozone does not encompass the entirety of European Union states’ interests (there are nine-member states of the Eurozone), the crisis that happened in member states Greece, Ireland, and Portugal was, therefore, also the responsibility of European Union for lacking the appropriate policy tools to fight the crises.

As a result, Eurozone member states had to take the initiative to enact a policy to overcome the crises and to prevent them from spreading into the rest of the Eurozone: EFSF policy.

EFSF is a policy instrument emitted under Luxembourg Law (the “Luxembourg agreement”), by engendering cooperation between many parties. EFSF involves some Eurozone member states, the European Union, the ECB and the IMF, and was the first bailout program pursued by the European Union, which divided member states into creditors and debtors.

The economy crisis in the Eurozone related to unbalanced economic policies. The process showed that even though economic integration could be viewed as a strong system, it also has inherent weaknesses that can at times lead to financial disaster or collapse.

Learning from the economic crisis of 2009, the European Union and EMU should make policy moves to prevent similar crises from reoccurring and to determine appropriate instruments to overcome them if they do. The Eurozone should pay close attention to the economic activity in its member states to keep overall economic goals in line.

References


