

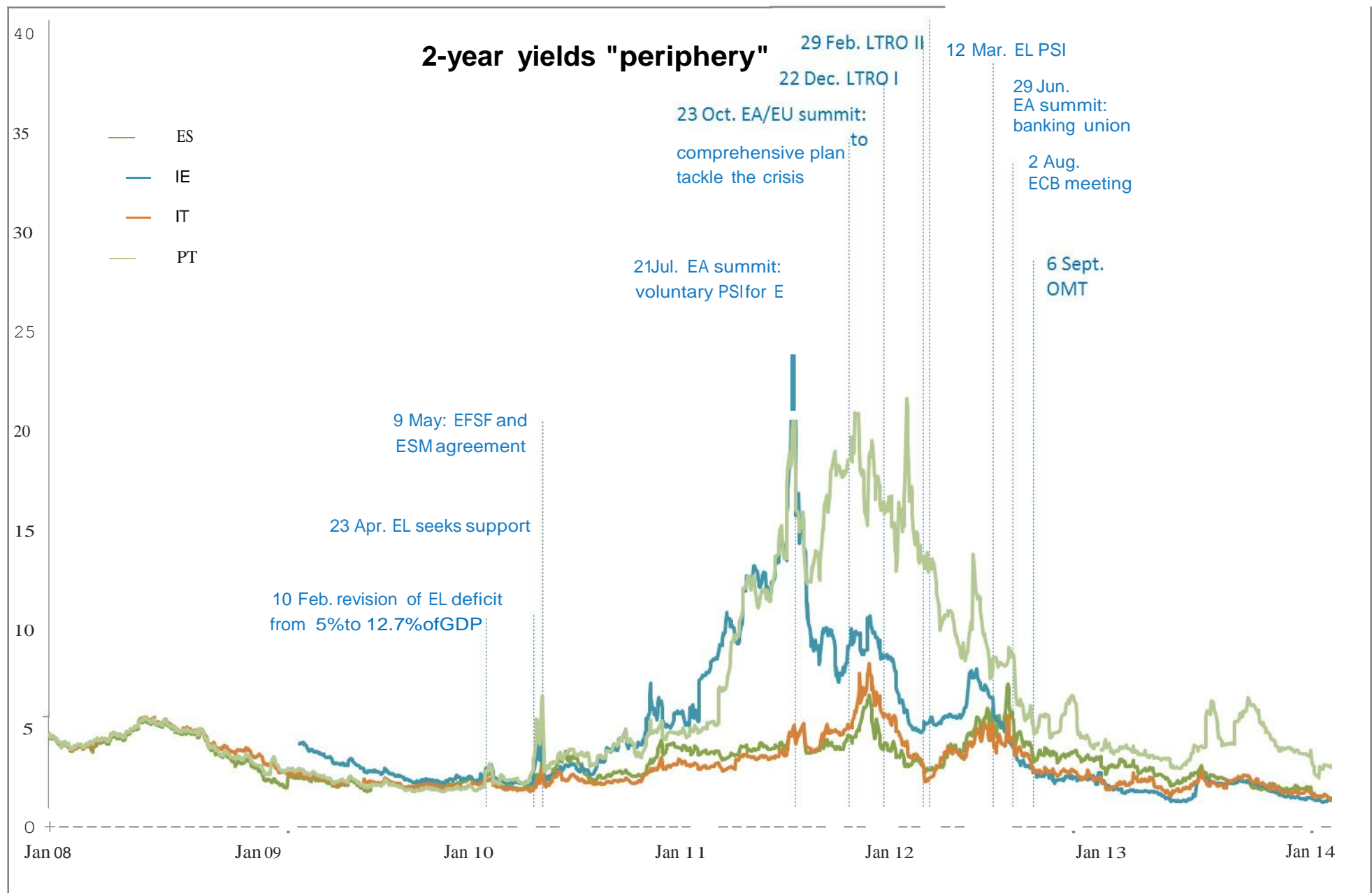
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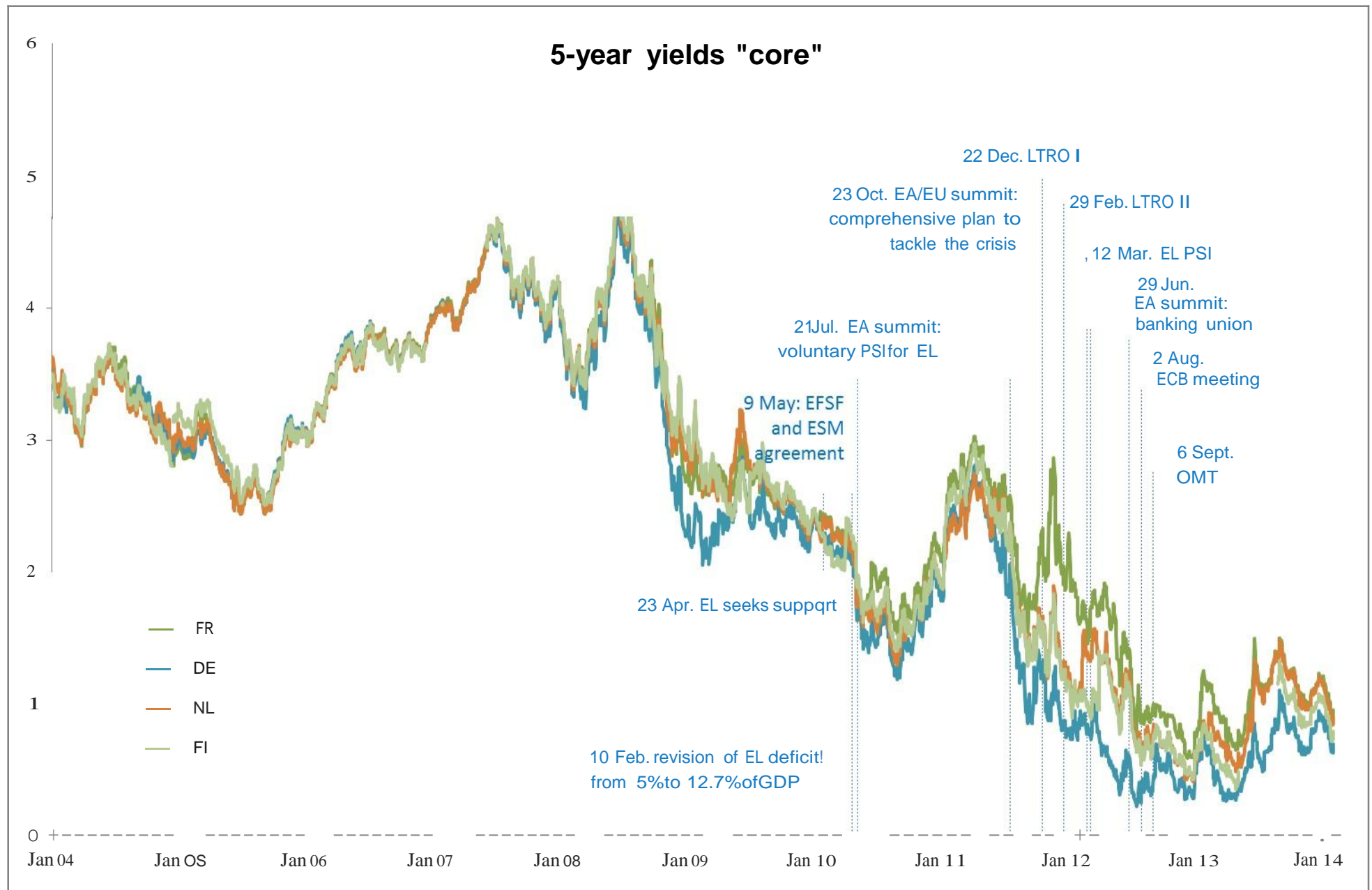
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Charts showing developments of spreads

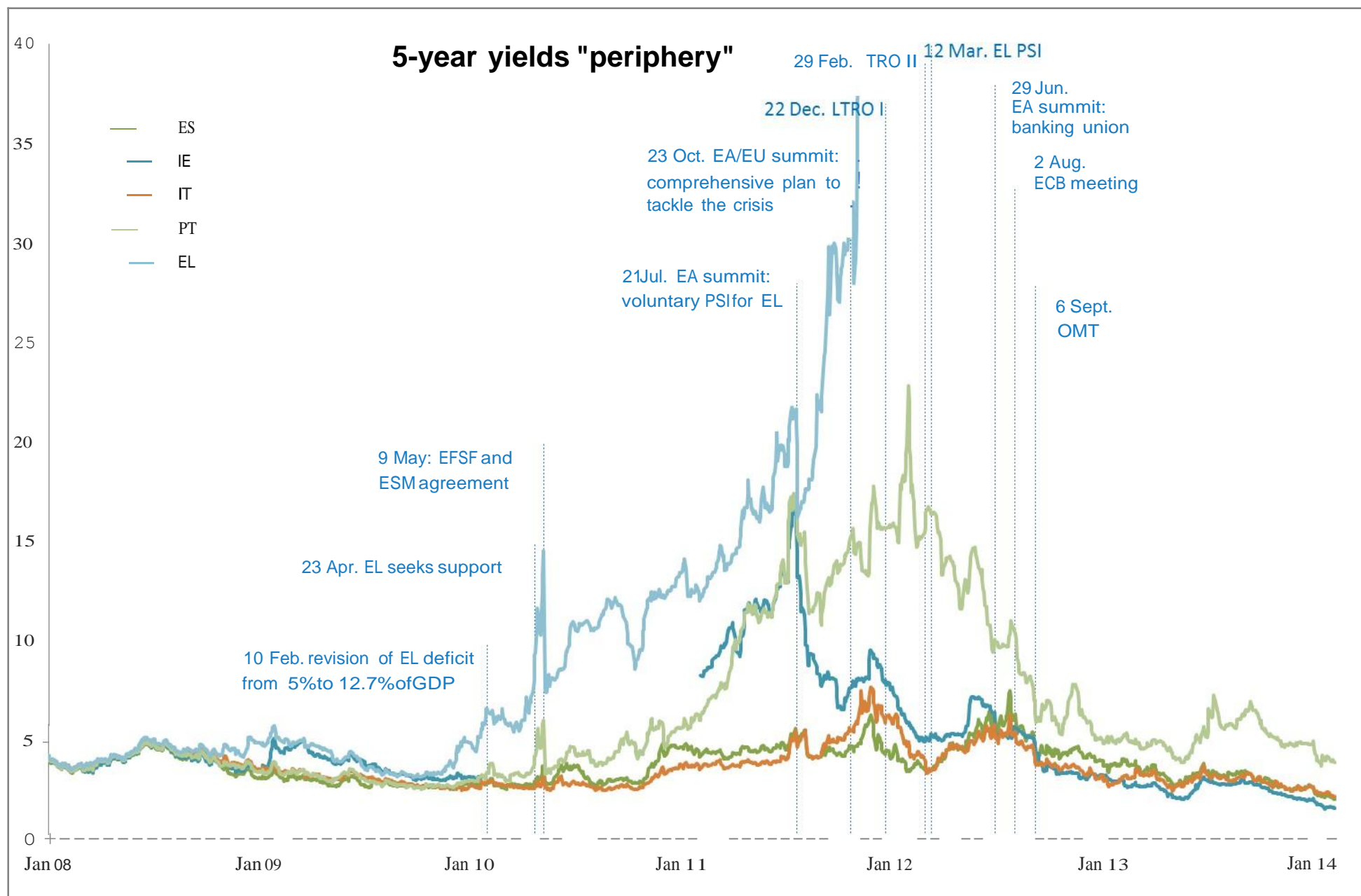


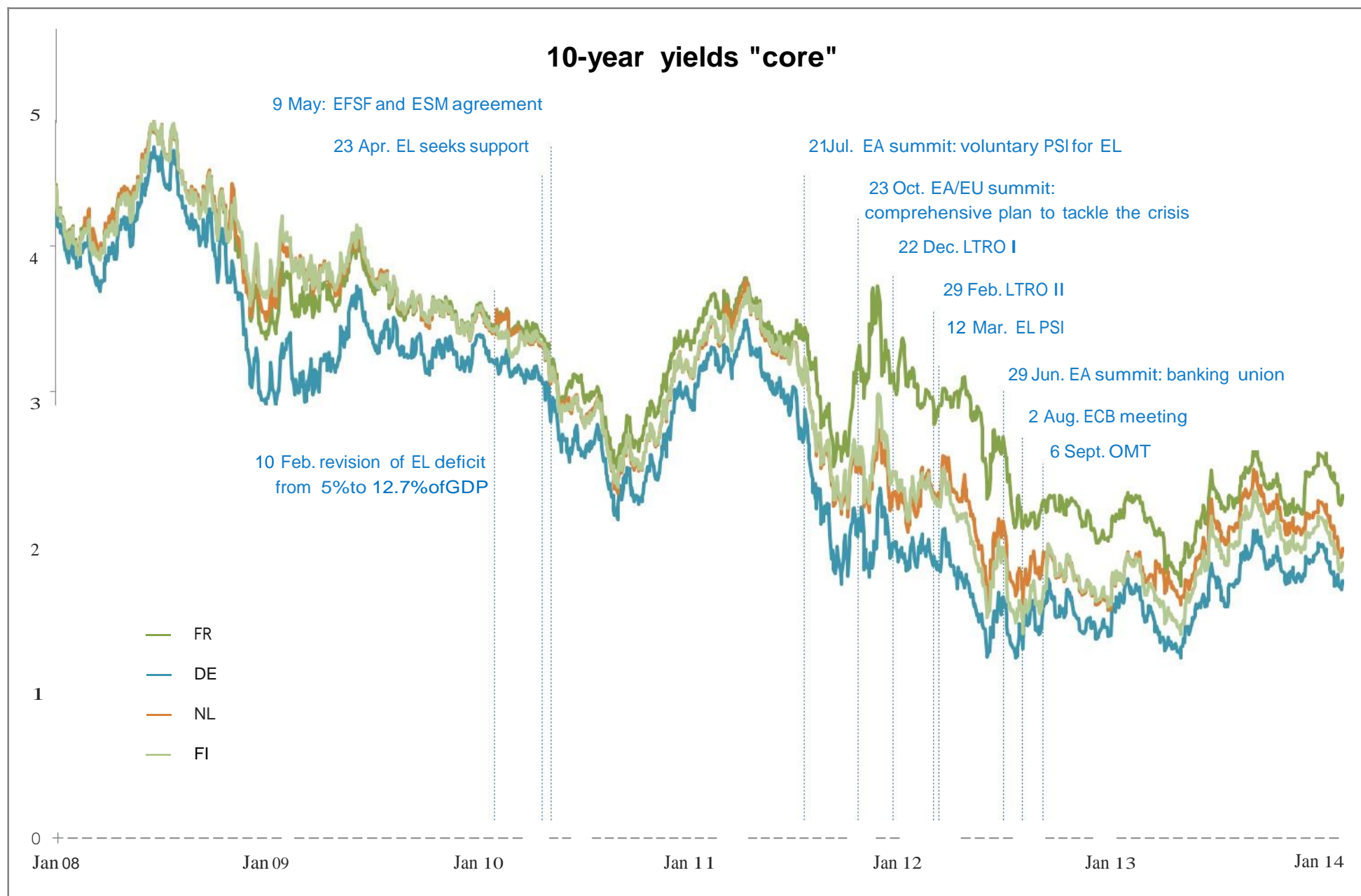
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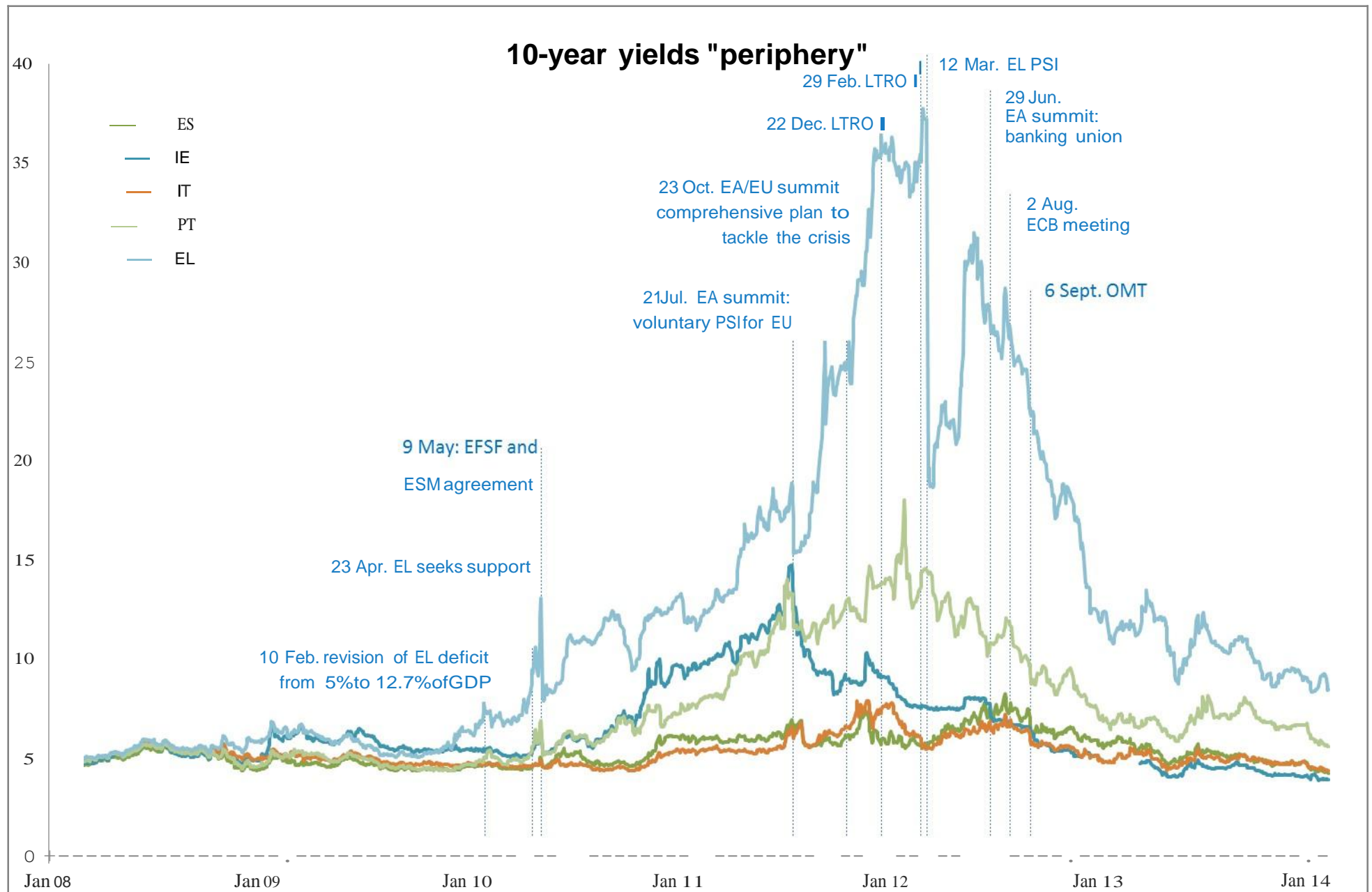




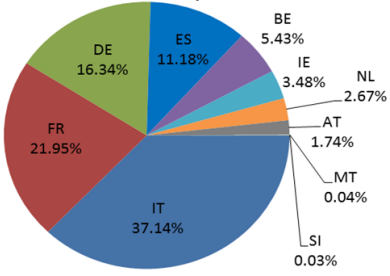
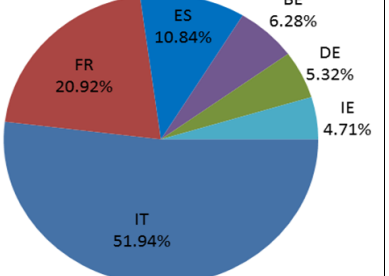
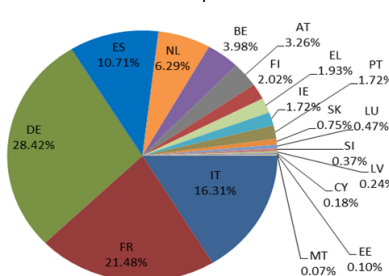
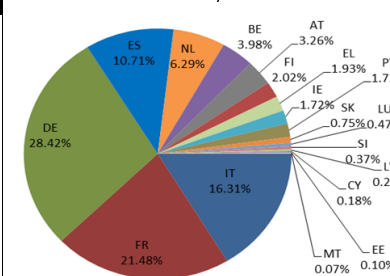
Charts showing developments of spreads







Illustrative table on main models for DRF/P

	DRF/P original (GCEE)	DRF/P smaller (>75% GDP)	DRF/P smaller (equal share of 20% GDP debt) Short Version	DRF/P smaller (equal share of 20% GDP debt) Long Version
Guarantee Structure	Joint + several	Pro rata	Pro rata	Pro rata
Maturities in joint insurance	>2 years	>2 years	>2 years	>2 years
Membership	Euro area MS not in programme + with debt > 60% GDP	Euro area MS not in programme + with debt > 75% GDP	Possibly all euro area MS (but voluntary for MS with debt below 60%)	Possibly all euro area MS (but voluntary for MS with debt below 60%)
Total amount of debt transferred (in EUR trillion)	3.1*	1.7	1.9	1.9
Duration (roll-in + redemption)	25 years (6 years + 19 years)	15 years (4 years +11years)	10 years (2 1/2 years + 7 1/2 years)	15 years (4 years + 11 years)
Yearly Redemption (in EUR trillion)	0.16	0.16	0.25	0.17
Composition	<p>10 Member States (AT, BE, FR, DE, IE, IT, MT, ES + NL + SI)</p> 	<p>8 Member States (AT, BE, FR, DE, IE, IT, MT, ES)</p> 	<p>Possibly all 18 Euro area MS (voluntary for 6 i.e. EE, LU, LV, FI, SI, SK)</p> 	<p>Possibly all 18 Euro area MS (voluntary for 6 i.e. EE, LU, LV, FI, SI, SK)</p> 

Volume of the ERF¹

The ERF's exact volume, shares held by the individual member states, and duration all depend on the shape of the roll-in phase and assumption about the ERF's refinancing costs and future economic growth. The Council of Economic Experts presented calculations regarding the ERF's volume in its Annual Report published in November 2011, with the assumption that the ERF would be in place on 1 January 2012. In the following, these calculations are updated with an assumed date of establishment of 1 January 2013. Therefore, the volume is higher, in that the debt levels of the member states suffered far worse developments in 2012 than were assumed six months prior. In addition, because Cyprus became a programme country, it is therefore no longer eligible for the ERF. This was different in November 2011 when the ERP was published for the first time.

Therefore, updated calculations about the ERF volume are based on the following assumptions:

- a. The ERP would have started on 1 January 2013.
- b. The key macroeconomic parameters for the ERP rely on the EU Commission forecast for 2012. The GDP growth rate for the participating member states for 2013 likewise came from the relevant forecast. For subsequent years, we assume nominal (real) annual growth of around 3% (1%).
- c. When calculating the amount of debt outsourced, the debt threshold established under the Maastricht Treaty (60%) is applied.
- d. Assumptions about the ERF's refinancing costs draw on current refinancing costs for similarly guaranteed bonds, such as those of the EFSF and the European Investment Bank (EIB). Assumptions about refinancing costs for bonds issued by the state are summarized in Table 1. Because long-term bonds protect against a direct rise in the average interest rates, the average interest rate is assumed to rise steadily to a higher level over seven years.
- e. Short-term debt (maturity of up to two years) is excluded when calculating the volume of the bonds financed by the ERF during the roll-in phase. This assumption prolongs the roll-in phase. In Italy, it is now six instead of five years; Spain will cover almost its entire (long-term) financing requirement in the first three years.

¹ This part is an updated and extended version of Doluca, H., M. Hübner, D. Rumpf, and B. Weigert (2012), The European Redemption Pact: Implementation and Macroeconomic Effects, *Intereconomics: Review of European Economic Policy*, 47, 230-239.

Table 1

ERP¹⁾: Key figures for participating countries

		Gross domestic product	Public debt	Primary balance	Interest rates assumed		
					ERF ²⁾ bonds	national issued bonds	
						w ith ERP	w ithout ERP
				2012			% p.a.
Germany	Euro billion	2 629,9	2 160,7	27,9			
	% of GDP	100	82,2	1,1	3,5	3,0	2,5
France	Euro billion	2 035,1	1 845,8	– 63,8			
	% of GDP	100	90,7	– 3,1	3,5	3,5	4,0
Italy	Euro billion	1 590,4	1 963,9	14,8			
	% of GDP	100	123,5	0,9	3,5	4,5	7,0
Spain	Euro billion	1 064,3	861,5	– 47,9			
	% of GDP	100	80,9	– 4,5	3,5	4,5	7,0
Netherlands	Euro billion	606,2	424,8	– 14,6			
	% of GDP	100	70,1	– 2,4	3,5	3,0	2,5
Belgium	Euro billion	376,6	378,5	– 1,2			
	% of GDP	100	100,5	– 0,3	3,5	4,0	5,0
Austria	Euro billion	309,6	229,6	– 2,4			
	% of GDP	100	74,2	– 0,8	3,5	3,5	4,0
Malta	Euro billion	6,6	4,9	0,0			
	% of GDP	100	74,8	0,2	3,5	4,5	5,5

1) European Redemption Pact.– 2) European Redemption Fund.

Source for basic data: EU

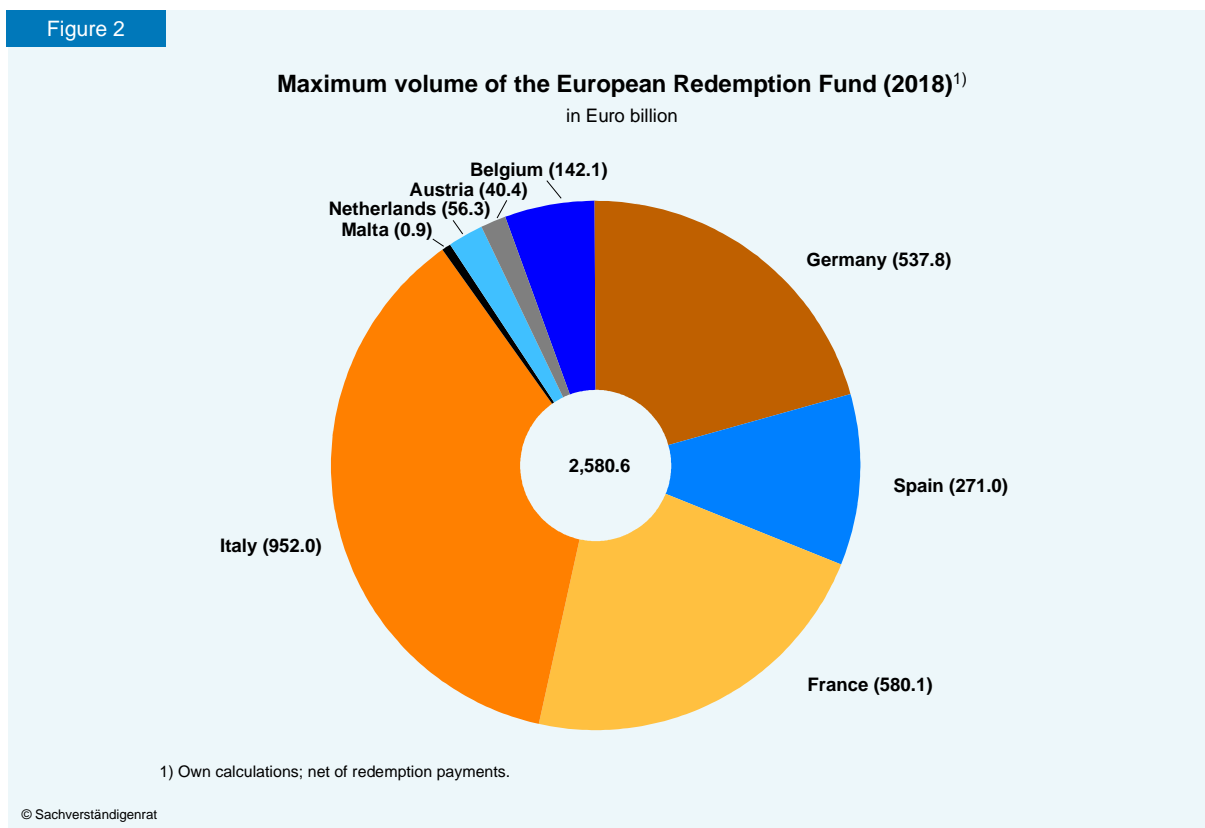
With these assumptions, roll-in phases must last a maximum of six years, after which the fund volume will reach its maximum of € 2.6 trillion (Figure 2). The largest share will be held by Italy, with 36.9% of the outsourced debt, followed by France with 22.5% and Germany with 20.8%. After the roll-in phase, the member states move into the redemption phase, during which the fund volume gradually declines. After 25 years, the outsourced debt will have been completely repaid. As the volume of the ERF gradually decreases, the volume of bonds issued jointly falls; in 2038, all bonds issued under joint and several liability will have been completely redeemed (Figure 3).

The joint and several liability for the sovereign debt outsourced to the ERF means that member states participating in the ERP face lower average refinancing costs, with the apparent exceptions of Germany and the Netherlands. The primary balances required to comply with the consolidation paths prescribed by the ERP thus fall heavily on specific member states, such that it appears realistic to reduce the ratio of debt to a level below 60% of GDP.

Payment obligations to the ERF are defined as a fixed proportion of GDP. Unlike payments to private borrowers, these payments fluctuate with the economic cycle. At least temporarily, an automatic stabilizer is necessary, with mutual insurance against asymmetric shocks at the European level.

Obligations by a country to the redemption fund are inviolable, until the debt outsourced by the country and the interest accrued has been completely repaid.

Figure 2

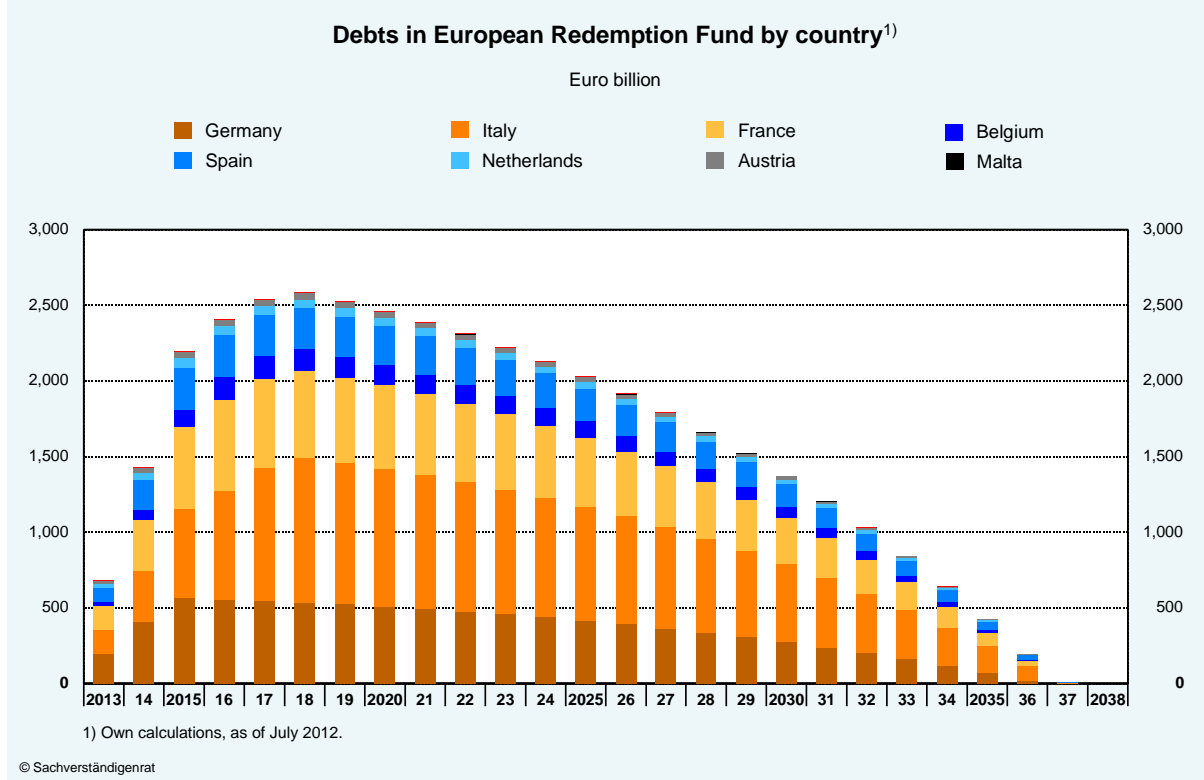


The allocation level could be defined, such that each country in the first year it participates must repay 1% of the debt outsourced to the ERF and make interest payments on its own share in the fund. The GDP share of these allocations would thus remain constant; the allocations would rise nominally over time, but the burden in terms of GDP would remain constant. Payment obligations to the fund remain in place until all of a country's debt has been repaid. The member states enjoy an interest advantage of outsourcing the debt. This advantage which can be used to repay the debt without placing an extra strain on national budgets. This option particularly would benefit member states with greatly distressed public finances. Only Germany and the Netherlands would face an additional charge.

The structure of the ERP thus assumes joint and several liability. However, the advantages of the ERP also might be achieved through an ERF that is not jointly and severally guaranteed. Risks could be limited if the ERF (similar to the EFSF) operated according to partial liability and excess collateralization. To obtain refinancing terms as favourable as those available through joint and several liability, the guarantees would need to exceed the actual volume of debt outsourced, but they would be far lower than those for joint and several liability. If the debt to be outsourced served as the benchmark, each country would need to guarantee about 210% (190%) of its debt to be

outsourced to ensure the ERF's bonds enjoyed the same rating as French (Belgian) government bonds. Each country would then commit to the (theoretical) event of complete liability, requiring them to take up foreign debt of approximately 110% (90%) of the sum outsourced, in addition to its own debt.

Figure 3



The ERP is not the only risk-sharing mechanism already in place. Therefore, outsourcing part of the sovereign debt outstanding raises the issue of total exposure to risks at the European level. The volume of liability associated with the ERF cannot simply be added to the volumes of the rescue plans and facilities already launched. Through the ERP, it should be possible to avoid further resorts to funding still available under the main rescue plan. The difference between the ERP and existing measures is less the scale of the jointly shouldered risk and more the transparency rendered by the ERP and the conditionality associated with the guarantees, which the ECB cannot impose. Unlike the assistance provided by rescue plans, the guarantees come to bear before the country has been completely cut off from the capital markets.

Table 2

Consolidation requirements and ERP¹⁾²⁾

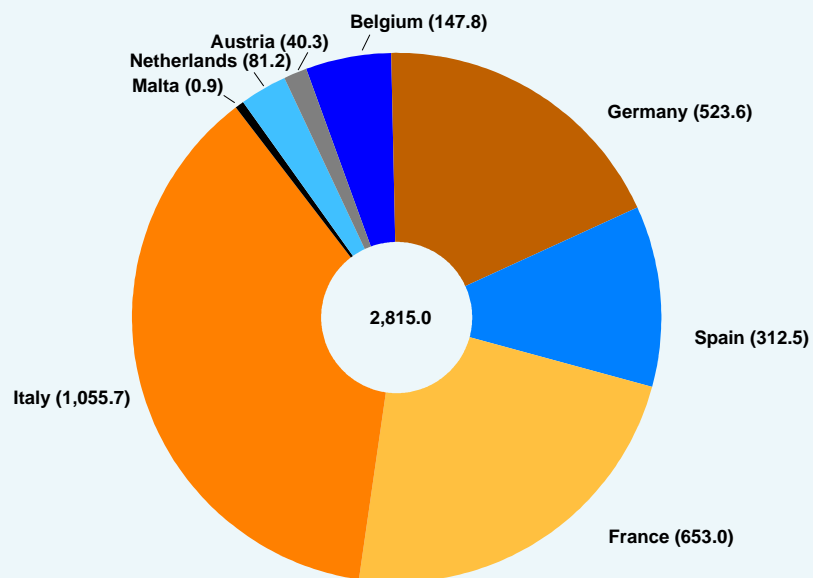
	Primary balance in 2011		Primary balance required ...			Improvement of actual primary balance required to meet budget rules ¹⁾ ...	
			to meet budget rules ³⁾ ...		to stabilize current debt ratio		
	actual	structural	with ERP	without ERP	without ERP	with ERP	without ERP
	Percent of GDP		Percent of GDP			Percentage points	
Germany	1,1	1,6	2,0	1,8	0,0	0,9	0,7
France	– 3,2	– 1,2	2,4	3,0	1,2	5,6	6,2
Italy	0,9	4,1	4,2	6,8	4,7	3,2	5,8
Spain	– 4,5	– 1,7	2,5	4,0	2,7	6,9	8,5
Netherlands	– 2,4	0,1	1,5	1,4	0,0	3,9	3,8
Belgium	– 0,3	– 0,7	2,9	4,2	2,4	3,3	4,5
Austria	– 0,8	0,1	2,2	2,4	1,1	3,0	3,2
Cyprus	– 4,3	– 1,3	2,3	3,8	2,5	6,6	8,1
Malta	0,2	– 0,2	2,7	3,3	2,0	2,5	3,1

1) European Redemption Pact.– 2) Own calculation, basic Data from EU, November 2011.– 3) Maximum primary balance which is necessary to ensure deficit not exceeding 0.5% of GDP and national debt not exceeding 60% of GDP if ERP would be implemented. Without ERP: Maximum primary balance needed to reach same evolution of debt ratio.

All calculations that were presented in the previous paragraphs based on debt levels in 2012 and assumed as a starting year the year 2013. However, as time evolved since then, debt levels increase significantly in some countries. Therefore, we can provide the updated calculations based on the original consolidation paths used by Doluca et al. (2012), with the new level of nominal debt, in Figure 4.

Figure 4

Maximum volume of the European Redemption Fund (2019)¹⁾
in Euro billion



1) Own calculations; net of redemption payments.

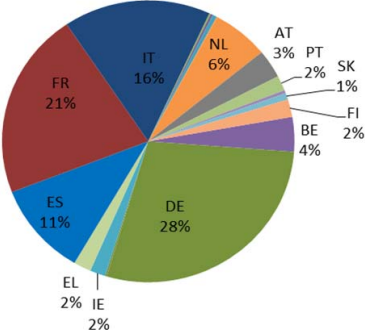
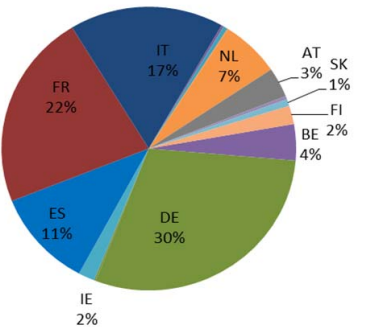
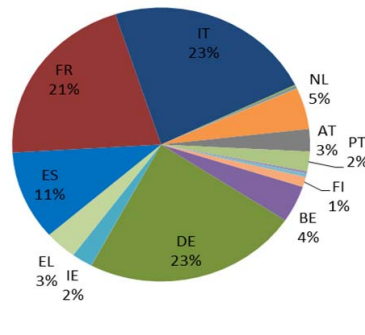
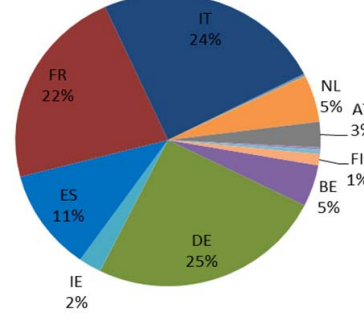
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Tables on possible volumes of DRF and eurobills funds

	As of 6 February 2014				
	debt to be transferred (in EUR bn)			Eurobills 1 year	Eurobills 2 years
	original ERP [part above 60%- debt/GDP-threshold]	Equal share ERP [Debt amounting to 20% of GDP]	ERP [part above 75%- debt/GDP-treshold]	Outstanding debt with original maturity below 1 year (EUR bn)	Outstanding debt with original maturity below 2 years (EUR bn)
Belgium	165,87	75,91	108,93	29,18	29,18
Germany	499,15	542,56	92,24	47,00	165,00
Estonia	0,00	1,82	0,00	-	-
Ireland	106,28	32,80	81,68	-	-
Spain	341,46	204,47	188,11	51,36	101,91
France	670,53	410,11	362,95	178,74	193,78
Italy	1134,76	311,32	901,27	131,93	215,69
Latvia	0,00	4,61	0,00	0,21	0,21
Lithuania	0,00	8,99	0,00	-	-
Malta	1,17	1,41	0,11	0,33	0,33
Netherlands	81,70	120,15	0,00	27,83	27,83
Austria	53,19	62,21	6,53	1,96	1,96
Slovenia	1,01	6,97	0,00	0,61	1,72
Slovakia	0,00	14,37	0,00	0,25	0,25
Finland	0,00	38,50	0,00	0,28	0,28
Greece	206,49	36,94	178,79	15,80	20,42
Cyprus	8,33	3,36	5,81	2,93	3,01
Portugal	112,61	32,78	88,03	4,80	17,88
sum non-progr. countries	3055,13	1836,21	1741,82	469,67	738,14
sum progr. countries	327,43	73,08	272,62	23,53	41,31
sum total	3382,57	1909,29	2014,44	493,20	779,45

Source: Eurostat, own calculations

Illustrative table on main models for eurobills

	<1 year: Hellwig / Philippon	<1 year: Variant (pro-rata)	<2 years : Variant	<2 years: Bishop
Guarantee Structure	Joint + several	Pro rata	Joint + several	Pro rata
Maturities in joint issuance	< 1 year	< 1 year	< 2 years	< 2 years
Membership	All euro area MS	All euro area MS not in programme	All euro area MS	All euro area MS not in programme
Maximum size in EUR trillion (legal cap)	0.96 (= cap at 10% of GDP)	0.91 (= cap at 10% of GDP)	1.9 (= cap at 30% of total debt)	1.8 (= cap at 30% of total debt)
Estimated size* (in EUR trillion)	0,493	0,47	0,78	0,738
Duration	Permanent	Permanent	Permanent	5 years, renewable
Composition at maximum size				

*calculations based on outstanding amounts of T-bills as of 6 February 2014

Article 123

1. Overdraft facilities or any other type of credit facility with the European Central Bank or with the central banks of the Member States (hereinafter referred to as "national central banks") in favour of Union institutions, bodies, offices or agencies, central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of Member States shall be prohibited, as shall the purchase directly from them by the European Central Bank or national central banks of debt instruments.

2. Paragraph 1 shall not apply to publicly owned credit institutions which, in the context of the supply of reserves by central banks, shall be given the same treatment by national central banks and the European Central Bank as private credit institutions.

Article 125

1. The Union shall not be liable for or assume the commitments of central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of any Member State, without prejudice to mutual financial guarantees for the joint execution of a specific project. A Member State shall not be liable for or assume the commitments of central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of another Member State, without prejudice to mutual financial guarantees for the joint execution of a specific project.

2. The Council, on a proposal from the Commission and after consulting the European Parliament, may, as required, specify definitions for the application of the prohibitions referred to in Articles 123 and 124 and in this Article.

Article 136

1. In order to ensure the proper functioning of economic and monetary union, and in accordance with the relevant provisions of the Treaties, the Council shall, in accordance with the relevant procedure from among those referred to in Articles 121 and 126, with the exception of the procedure set out in Article 126(14), adopt measures specific to those Member States whose currency is the euro:

(a) to strengthen the coordination and surveillance of their budgetary discipline;

(b) to set out economic policy guidelines for them, while ensuring that they are compatible with those adopted for the whole of the Union and are kept under surveillance.

2. For those measures set out in paragraph 1, only members of the Council representing Member States whose currency is the euro shall take part in the vote.

A qualified majority of the said members shall be defined in accordance with Article 238(3)(a).

3. The Member States whose currency is the euro may establish a stability mechanism to be activated if indispensable to safeguard the stability of the euro area as a whole. The granting of any required financial assistance under the mechanism will be made subject to strict conditionality."

Article 352

1. If action by the Union should prove necessary, within the framework of the policies defined in the Treaties, to attain one of the objectives set out in the Treaties, and the Treaties have not provided the necessary powers, the Council, acting unanimously on a proposal from the Commission and after obtaining the consent of the European Parliament, shall adopt the appropriate measures. Where the measures in question are adopted by the Council in accordance with a special legislative procedure, it shall also act unanimously on a proposal from the Commission and after obtaining the consent of the European Parliament.

2. Using the procedure for monitoring the subsidiarity principle referred to in Article 5(3) of the Treaty on European Union, the Commission shall draw national Parliaments' attention to proposals based on this Article.

3. Measures based on this Article shall not entail harmonisation of Member States' laws or regulations in cases where the Treaties exclude such harmonisation.

4. This Article cannot serve as a basis for attaining objectives pertaining to the common foreign and security policy and any acts adopted pursuant to this Article shall respect the limits set out in Article 40, second paragraph, of the Treaty on European Union.

Aspects of German constitutional law on budget autonomy of the Bundestag

In its recent case law on European economic governance matters¹, the German Constitutional Court (BVerfG) established general principles, derived from the principle of democracy, regarding parliamentary responsibility for Germany's participation in schemes of financial assistance within the euro area. Since the principle of democracy is part of the so-called "eternity clause" of German constitutional law, these principles could not be changed by normal constitutional amendment, but only by way of referendum (or possibly another special procedure of constitutional re-foundation).

The BVerfG requires that the Bundestag keeps control over the fundamental fiscal decisions, also in relation to international and European liabilities. The Bundestag cannot transfer its budgetary responsibility to other actors nor subdue to mechanisms which could lead to incalculable future fiscal charges without its prior consent. It cannot establish permanent international-law mechanisms that would amount to assuming the responsibilities for the decisions of other States, especially if such mechanisms entail consequences that would be difficult to evaluate. Any measure of solidary assistance of "larger extent" by Germany within the international or EU context must be authorised individually by the Bundestag. In addition, sufficient parliamentary influence and information rights must be ensured regarding the management of the funds. The BVerfG limits the extent of its judicial scrutiny over some of these principles to evident violations and accords a wide margin of appreciation to the Bundestag when authorising guarantees. It has so far left open whether one can derive, from the principle of democracy, a justiciable upper limit for guarantee authorisations that the Bundestag is constitutionally permitted to grant; in both cases before it (Greece+EFSF; ESM) it found that such a limit would not be exceeded, since, given the amounts, the Bundestag's budgetary autonomy was not completely undermined in practice for a considerable time. Applying these principles, the BVerfG cleared the EFSF and the assistance to Greece, stressing also that the German laws adopted for those purposes did not establish any automatism of assistance, given that under the EFSF assuming guarantees was only possible for a limited time, was made conditional on agreeing an economic and budgetary policy programme with the Member State and such conditionality is agreed upon unanimously (securing Germany's influence on it). Subsequently, the BVerfG also cleared the ESM, subject however to a clarification by the contracting parties that the ESM Treaty limits the amount of all payment obligations of Germany to its share in the authorised capital stock of the ESM – i.e. that the *pro rata* principle is respected - and that the ESM Treaty does not stand in the way of the comprehensive information of the Bundestag and Bundesrat. The

¹ In particular, the judgment of 7 September 2011 on assistance to Greece and the EFSF; the judgment of 12 September 2012 in interim proceedings on the ESM Treaty, the TSCG and the amendment to Article 136 TFEU; and the judgment of 19 March 2014 in the main case. See also the order of preliminary reference of 14 January 2014 on the OMT decision of the ECB. The judgments and corresponding press releases can be found – also in English translations – on the website of the Court (www.bundesverfassungsgericht.de).

Aspects of German constitutional law on budget autonomy of the Bundestag

absence of an express right of withdrawal or termination in the ESM was deemed constitutional given the clear upper limit of Germany's liabilities in the ESM Treaty. Moreover the BVerfG considered that even absent express rules Member States could withdraw from the ESM. The BVerfG further underlined that the budgetary authority of the Bundestag is also safeguarded by the EMU as a "stability union" as designed in the EU Treaties, citing the prohibition of monetary financing, the no-bail-out clause and the stability criteria for sustainable budgeting (Articles 123 – 126 and 136). However, the German Constitution does not require this design of EMU to stay in force unchanged; instead it requires structures and procedures which, also in the context of a continuous further development of EMU, keep the democratic process open and safeguard the Bundestag's budgetary responsibility. On this basis, the BVerfG accepted the Treaty amendment in Article 136.

An intense legal debate has unfolded in Germany on whether and in what circumstances, given this case law, joint issuance of debt and German guarantees for it could at all pass the requirements posed by the BVerfG (knowing that otherwise a referendum or possibly another special procedure would be required).² It would go beyond the scope of this report to examine this in detail. The following general point can however be made: The more clearly it would be legally ensured, in the act establishing joint issuance of debt, that the maximum German liability, even if significant, is strictly limited in advance, that there are regular authorising decisions by the Bundestag for concrete liabilities assumed (as well as parliamentary information rights and rights to influence the management of the scheme) and that the scheme encompasses strict conditions and safeguards designed to ensure fiscal discipline on all participant States, the more likely the scheme could be found in line with the constitutional limits at issue.

Applying this general proposition to possible eurobills and DRF/P regimes is challenging but there might be possible solutions. In a eurobills scheme, in any event the maximum volume of German liability during each period must be kept at an amount not completely undermining budget autonomy³; it should allow for periodic⁴ Bundestag decisions to approve concrete

² M. Nettesheim, 'Der Schuldentilgungsfonds: Rechtliche Rahmenbedingungen eines umstrittenen Instruments zur Eurorettung', in: M. Breuer et al. (eds.), *Der Staat im Recht*, 2013, p. 603.; F. Schorkopf, *Verfassungsrechtliche Grenzen und Möglichkeiten für eine Umsetzung des Schuldentilgungspaktes des Sachverständigenrates*, Gutachten 2012; F.C. Mayer/Heidfeld, 'Eurobonds, Schuldentilgungsfonds und Projektbonds – eine dunkle Bedrohung?' *ZRP* 2012, p. 129; S. Müller-Franken, 'Der Schuldentilgungsfonds aus Sicht des Verfassungsrechts wie des Europarechts', *NVwZ* 2012, 1201.

³ See the figures in footnote below, discussed in the context of a DRF.

⁴ A question needing more in-depth analysis would be needed on the necessary rhythm: i.e. whether setting a financial framework for several years, by act requiring national ratifications might suffice, or whether in addition the Bundestag would have to pass an annual law authorising the limit of Germany's liabilities under a eurobill fund.

Aspects of German constitutional law on budget autonomy of the Bundestag

volumes of liability; and it should be coupled with strict and credible rules tackling moral hazard. A eurobills scheme might be more easily accepted to the extent it is temporary and covers only a minor part of the State's issuance activity (only the shortest maturities and a small overall scale). A permanent scheme or one in which there is considerable flexibility to extend joint issuance are more challenging and then the other parameters of constitutional scrutiny would become all the more important. A DRF/P scheme is inherently temporary but challenges may flow from the fact that it might be established for a longer period and with a maximum liability – at least in a peak moment and especially if underpinned by joint and several liability – coming close to what the BVerfG might rule as exceeding an absolute upper limit to what the Bundestag can commit without undermining its budget autonomy for a considerable time. A legal opinion⁵ suggests that a DRF/P might - while appearing a close call - pass muster if the legal instrument establishing the DRF/P was unambiguously established as a temporary one, if the total amount of liabilities does not reach a level putting at risk the debt sustainability of Germany itself – this is identified as a key problematic point⁶ - , and if the DRF/P was combined with a precise legal framework ensuring fiscal discipline.

⁵ See F. Schorkopf, Verfassungsrechtliche Grenzen und Möglichkeiten für eine Umsetzung des Schuldentilgungspaktes des Sachverständigenrates, Gutachten 2012. see also M. Nettesheim, loc. cit., who however considers an amendment to the German constitution necessary in order to allow for some of the "pact elements", i.e. powers of monitoring and enforcement regarding the fiscal conditions of the pact and earmarking of taxes.

⁶ Schorkopf considers that, while a total volume of liability of 2 Trillion €, under joint and several liability, would likely be found unconstitutional, an amount of 560 Billion €, under *pro rata* liability, has a chance of passing muster.

List of References

Official Documents

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ANNEX 8

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