Focus

I. The EU's comprehensive policy response to the crisis

This Focus section aims to provide an overview of recent milestones in strengthening economic governance, financial stability and economic growth potential in the euro area. The exceptionally challenging circumstances in the euro area since the onset of the crisis have necessitated swift yet profound action by Member States in cooperation with the Commission, supported by the ECB's policy stance, in order to regain financial stability and deal with a very deep recession. The policy measures adopted since the crisis can be broadly divided into crisis management measures and permanent systemic responses.

Additional important policy decisions to address the euro area's ongoing challenges have been taken by the European Council at its meeting of 24/25 March 2011. The Council has notably introduced further systemic innovations that represent an overhaul of the legislative and operational framework governing EU economic policy coordination. Specifically, the Council has established a permanent crisis resolution mechanism and strengthened the political commitment within the euro area to spur economic adjustment and support growth and convergence. This Focus concludes that EU's comprehensive policy response will go a long way towards setting the euro area back on course towards stability, growth and employment.

I.1. Introduction

The economic and financial crisis that struck the euro area in 2008 and 2009 has had wide-ranging and long-lasting repercussions, which notably manifested themselves in 2010 as a number of Member States experienced rising yields and CDS spreads amidst sizeable rollover needs. The scale and scope of the euro-area's challenges remains considerable, primarily in terms of ensuring public debt sustainability, fostering growth, providing financial assistance to Member States in need, and strengthening the framework for governance.

While measures to tackle these challenges were already been put in place over the course of the crisis, additional important policy responses have been taken by the European Council at its meeting of 24/25 March 2011. These cover both the immediate crisis response as well as permanent systemic measures, and the Council notably agreed two major improvements to economic and financial policy coordination in the euro area: A permanent crisis resolution mechanism has now been agreed, and euro-area Member States are now bound more closely together by a so-called Euro Plus Pact, which solidifies their commitment to foster competitiveness, growth and convergence.

The focus section at hand provides an overview of the comprehensive policy package adopted by the March European Council and sets it in the context of the broad and ambitious policy response to the crisis elaborated in the euro area and the EU since the beginning of the crisis.

I.2. Immediate crisis responses accompanied by systemic overhaul

Policy action designed to mitigate the adverse effects of the crisis and reducing future risks has spanned virtually all realms of economic and financial policy in the euro area. It has also involved a combination of the immediate crisis management response, aimed at responding to pressing needs in specific countries or sectors, and more systemic measures aimed at improving the euro-area's governance system.

The crisis management measures are the result of a search for a comprehensive approach to the immediate adverse effects and threats posed by the crisis. The aim of safeguarding the integrity of the euro and all economies of the euro area in the face of unprecedented market turmoil lies at the heart of this strategy, which comprises action on three fronts:

- In the early stages of the crisis, action has been taken to stabilize the financial system and its institutions through various measures, including the granting of public guarantees, capital injections and liquidity support to financial institutions via central banks.

- Secondly, subsequent to the expiry of national stimulus measures taken in accordance with the European Economic Recovery Programme (EERP) of December 2008, sizeable budgetary consolidation is necessary to bring public finances in the euro area back on a sustainable path. The consolidation strategy agreed at the EU level is differentiated in that the more vulnerable Member States have begun to consolidate sooner. The fiscal stance is set to turn restrictive in 2011 in all euro-area Member States. However, fiscal efforts vary substantially in the short to medium term, as deadlines for correction and required structural efforts under the Excessive Deficit Procedures (EDP) have been differentiated across Member States, taking into account country-specific circumstances. Once an excessive deficit has been corrected, Member States are required to continue their consolidation to bring their budgetary positions in line with the country-specific medium-term objectives, which require either a structural position close to balance or a surplus.

Table I.1: **Overview of EU economic policy measures since the crisis**

Crisis management measures

Financial Rescue
Emergency public interventions

Macroeconomic stabilisation
European Economic Recovery Plan

Differentiated fiscal consolidation
Excessive Deficit Procedure

Support for vulnerable countries
Programmes for Greece and Ireland,
EFSF and EFSM (combined lending capacity €500bn)

Systemic measures

Strengthened surveillance
6 legislative proposals on imbalances, SGP reform, national fiscal frameworks, sanctions

European Semester
Integrated annual surveillance cycle
Ex-ante guidance of national economic policies

Permanent crisis resolution mechanism
European Stability Mechanism

Europe 2020
Comprehensive strategy for growth, employment and social cohesion

Euro Plus Pact
Strengthen economic pillar of EMU and improve policy coordination and competitiveness

Financial Repair
Restructuring and stress testing

Strengthening Financial Regulation
Regulating hedge funds and rating agencies
Prudential regulation changes; crisis mechanism for banks

European System of Financial Supervisors
European Systemic Risk Board
European Supervisory Authorities

Source: Commission services.

- Thirdly, supporting vulnerable countries is essential to ensure stability within the euro area. Adjustment programmes for Greece and Ireland have therefore been developed over the course of 2010 between the respective national authorities and the European Commission in partnership with the IMF and the ECB. The programmes notably feature detailed strategies for consolidation and rebalancing in troubled economies, as well as medium-term loans via the European Financial Stability Facility (EFSF) and European Financial Stabilisation Mechanism (EFSM) to prevent sovereign funding needs in these economies being obstructed by prohibitive market conditions. The Euro Area Summit of 11 March 2011 decided to grant an effective lending capacity of €440bn to the EFSF until its expiry in 2013([1]) and to lower the interest rate applicable to the pooled loan from euro-area Member States to Greece by 100bps while extending its maturity to 7½ years on average.

Systemic Response

Looking beyond the more short-term initiatives, a more fundamental and permanent overhaul of economic policy coordination at the EU level has proven necessary in light of the crisis. The principal elements of this systemic response agreed at the EU level are a strengthened economic surveillance framework (six new legislative proposals, the so-called 'governance package'), an integrated annual surveillance cycle ("European Semester"), a permanent crisis resolution tool (European Stability Mechanism, or 'ESM'), a Euro Plus Pact, and a European System of Financial Supervisors. In conjunction with the aforementioned crisis management measures these systemic responses constitute the EU's comprehensive approach to tackling the crisis.

The strengthened surveillance framework comprises six legislative proposals which were adopted by the Commission on 29 September 2010. ([2]) They aim at overhauling the EU economic policy framework by reinforcing the rules of the Stability and Growth Pact, strengthening national budgetary frameworks, preventing and correcting harmful macroeconomic imbalances, and establishing an effective enforcement arm for euro-area countries.

([1]) For more details on the EFSF please consult *http://www.efsf.europa.eu/*

([2]) For a detailed overview of the September 2010 governance package see the editorial of the *Quarterly Report on the Euro Area*, Vol.9, No. 3 (2010).

The new surveillance framework is expected to be enacted in mid-2011, once agreement between the Commission, Council and Parliament has been reached.

The integrated annual surveillance cycle enshrined in the 'European Semester' will draw together all the elements of EU economic surveillance, including policies to ensure fiscal discipline, macroeconomic stability, and to foster growth. The processes under the SGP and the Europe 2020 European growth strategy will thereby be aligned in timing, while remaining legally separated. ([3]) The aim of the European Semester is to provide *ex ante* policy guidance so as to strengthen policy synergies and avoid policy inconsistencies. The annual cycle begins with the Commission's publication of the Annual Growth Survey at the start of each year, which then feeds into Member States' Stability and Convergence Programmes and National Reform Programmes, which they submit in April. ([4]) The Commission then issues assessments and proposes country-specific opinions and recommendations, which the Council adopts in June before national budgets are finalised, thereby having a much stronger impact on national policy-making than in the past.

Furthermore, in response to the lack of consistent and rigorous financial oversight in the EU prior to the crisis, the European System of Financial Supervisors was established in November 2010 in order to monitor macro-financial risks and strengthen financial oversight in the EU. ([5]) The central task of the European Systemic Risk Board (ESRB) is to monitor and assess macro-financial systemic risk to mitigate the exposure of the system to systemic failure and enhancing the financial system's resilience to shocks. In this way the ESRB should contribute to preventing financial crises and limiting their negative impact on the internal market and the real economy, while the three European Supervisory Authorities will ensure a more rigorous and timely oversight of individual financial market sections. This overhaul of the supervisory framework is complemented by improvements in the financial regulatory environment, including for banks, hedge funds and credit rating agencies, by the development of crisis resolution mechanisms for banks and by improvements in consumer protection. The revised Capital Requirement Directive further transposes capital requirements for banks under Basel III into EU legislation. It will entail a significant increase in the level of capital which banks and investment firms must hold to cover their risk-weighted assets. ([6])

At the current juncture, a new round of stress tests is foreseen for mid-2011, which will help to address remaining weaknesses in the euro-area banking sector. The EU-wide stress test is a supervisory tool designed to assess the resilience of European banks to hypothetical external shocks. The stress test assesses what might happen to banks if external circumstances deteriorate markedly and helps to identify vulnerabilities and relevant remedial action, including strengthening capital levels where this is needed notably to meet the higher capital requirements under the Basel III regulations. Results are expected in June 2011.

As the 'governance package', the European Semester and the new supervisory architecture have already been presented or are already in operation, the remainder of this Focus will present the more recent elements of the EU's systemic crisis response, namely the creation of the permanent crisis resolution mechanism (ESM) and the Euro Plus Pact in greater depth.

I.3. Towards a permanent ESM

At its meeting on 24/25 March 2011, the European Council acted upon the need for a permanent crisis resolution mechanism by establishing the European Stability Mechanism (ESM). Financial assistance will be provided by mutual agreement, ([7]) if and when euro-area Member States are experiencing or are threatened by severe financing problems, in order to safeguard the financial stability of the euro area as a whole. The ESM will take over the role of the European Financial Stability Facility (EFSF) and

([3]) Europe 2020 is the EU's growth strategy for the coming decade with the aim of delivering high levels of employment, productivity and social cohesion. Concretely, the Union has set five ambitious objectives - on employment, innovation, education, social inclusion and climate/energy - to be reached by 2020. Each Member State will adopt its own national targets in each of these areas. Concrete actions at EU and national levels will underpin the strategy.

([4]) The January 2011 Annual Growth Survey is available at http://ec.europa.eu/europe2020/pdf/en_final.pdf

([5]) The ESFS comprises: the European Systemic Risk Board (ESRB); the three European Supervisory Authorities (European Banking Authority, European Insurance and Occupational Pensions Authority, European Securities and Markets Authority); the Joint Committee of the European Supervisory Authorities; and the competent or supervisory authorities in the Member States.

([6]) For an assessment of the economic impact of the Basle III capital requirement in the euro area see Section III.1. in this issue.

([7]) A decision taken by mutual agreement is a decision taken by unanimity of the Member States participating to the vote, i.e. abstentions do not prevent the decision from being adopted.

Table I.2: **Main features of the EFSM, EFSF and ESM**

EFSM *European Financial Stabilisation Mechanism*	EFSF *European Financial Stability Facility*	ESM *European Stability Mechanism*
	Lending capacity	
Lending capacity of €60 bn	Effective lending capacity raised to €440 bn	Effective lending capacity of €500 bn
joint and several guarantee by EU budget	guarantees and over-guarantees	paid-in capital + callable capital + guarantees
AAA rating	AAA rating	AAA rating
	Instruments	
Loans	Loans + bond purchases on primary market (as an exception)	Loans + bond purchases on primary market (as an exception)
Strict policy conditionality under a macro-economic adjustment programme	Strict policy conditionality under a macro-economic adjustment programme	Strict policy conditionality under a macro-economic adjustment programme
EU Commission + IMF + ECB involvement	EU Commission + IMF + ECB involvement	EU Commission + IMF + ECB involvement
	Pricing	
Euribor + 292.5 bps	Euribor + 247 bps + EFSF costs	Funding costs + 200bps +100bps for amounts outstanding after 3 years
	Beneficiaries	
EU Member States	Euro-area Member States	Euro-area Member States
	Duration	
New lending capacity expires on 30 June 2013	New lending capacity expires 30 June 2013	Permanent from 1 July 2013
	Legal basis	
Council Decision based on Art. 122 of the TFEU	Temporary intergovernmental agreement	Treaty among euro-area MS to establish an intergovernmental organisation + Regulation based on amended Art. 136 of TFEU

Source: Commission services

the European Financial Stabilisation Mechanism (EFSM) in providing financial assistance to euro-area Member States after their expiry in June 2013.

The function of the ESM will be to mobilise funding and provide financial assistance under strict conditionality, whereby the beneficiary Member State will be required to put in place an appropriate form of private-sector involvement, according to the specific circumstances and in a manner fully consistent with IMF practices. ([8]) Support from the ESM will be conditional on the adoption of an appropriate macro-economic adjustment programme by the recipient country and will be based on a rigorous analysis of public debt sustainability, conducted by the Commission together with the IMF and in liaison with the ECB.

Structure and Instruments

The ESM will have a Board of Governors consisting of the Ministers of Finance of the euro-area Member States (as voting members), with the European Commissioner for Economic and Financial Affairs and the President of the ECB as observers. The Board of Governors will be the highest decision-making body of the ESM and will take the following major decisions by mutual agreement:

- the granting of financial assistance,
- the terms and conditions of financial assistance,
- the lending capacity of the ESM,
- changes to the menu of instruments.

All other decisions by the Board of Governors will be taken by qualified majority, unless stated otherwise. Voting weights within the Board of Governors and the Board of Directors ([9]) will be proportional to the Member States' respective subscriptions to the capital of the ESM. A

([8]) In line with the IMF, debt is considered sustainable when a borrower is expected to be able to continue servicing its debts without an unrealistically large correction to its income and expenditure. This judgement determines the availability and the appropriate scale of financing.

([9]) The Board of Directors will carry out specific tasks as delegated by the Board of Governors. Each euro-area Member state will appoint one Director and one alternate Director. In addition, the Commission and the ECB will each nominate an observer and an alternate to the Board of Directors.

qualified majority is defined as 80 percent of the votes. The Board of Governors will appoint a Managing Director responsible for the day-to-day management of the ESM. The Managing Director will chair the Board of Directors.

The ESM will aim to obtain and maintain the highest credit rating from the major credit rating agencies. In order to secure this, the ESM's total subscribed capital of €700bn is well in excess of the ESM's effective lending capacity of €500bn. €80bn of the total subscribed capital will be in the form of paid-in capital provided by the euro-area Member States, phased in from July 2013 in five equal annual instalments. In addition, the ESM will also include a combination of committed callable capital and guarantees from euro-area Member States, to a total amount of € 620 billion. During the transitory phase from 2013 to 2017, Member States commit to accelerate the provision of appropriate instruments, if needed, in order to maintain a minimum 15 % ratio between paid-in capital and the outstanding amount of ESM issuances. The contribution key of each Member State in the total subscribed capital of the ESM will be based on a slightly adjusted paid-in capital key of the ECB.

As long as the ESM has not been activated and provided that the effective lending capacity is not less than €500bn, the proceeds from the investment of the ESM paid-in capital will be returned to the Member States, after deductions for operational costs. Following the first activation of the ESM, the proceeds from the investment of ESM capital and financial assistance activity will be retained within the ESM.

The ESM will as a rule provide financial assistance through loans. The Board of Governors may review the instruments at the ESM's disposal and may decide to make changes to the menu of instruments.

Under its loan facility, called ESM stability support (ESS), the ESM can grant short-term or medium-term stability support to a euro-area Member State experiencing severe financing problems. Access to an ESS will require a macroeconomic adjustment programme with adequate policy conditionality commensurate with the severity of the underlying imbalances in the beneficiary Member State. The length of the programme and maturity of the loans will depend on the nature of the imbalances and the prospects of the beneficiary Member States regaining access to financial markets within the time that ESM resources are available. Adequate and proportionate private-sector involvement will be expected in cases where financial assistance under the ESM is provided to the beneficiary State. The nature and extent of this involvement will be determined on a case-by-case basis and will depend on the outcome of a debt sustainability analysis. If public debt is deemed sustainable, the main private investors will be encouraged to maintain their exposure, whereas for non-sustainable public debt trajectories the beneficiary Member State will be required to engage in active negotiations with its creditors.

In exceptional circumstances, the ESM may also intervene in debt primary markets through its Primary Market Support Facility so as to engage in the purchasing of bonds of a Member State experiencing severe financing problems. Such primary market interventions require the mutual agreement of the Board of Governors, and will be conducted on the basis of a macro-economic adjustment programme with strict conditionality. The underlying objective is to maximise the cost efficiency of the support programme. Conditions and modalities under which bond purchasing would be conducted will be specified in the terms and conditions of financial assistance.

Pricing

The Board of Governors will decide on the pricing structure for financial assistance to a beneficiary Member State. The ESM will be able to lend at a fixed or variable rate. The pricing of the ESM will be in line with IMF pricing principles and, while remaining above the funding costs of ESM, will include an adequate mark-up for risks. ESM loan rates will have to cover the funding costs of the ESM, supplemented by a charge of 200 bps applied on the entire loans, plus a surcharge of 100 bps for loan amounts outstanding after 3 years. For fixed rate loans with maturities above 3 years, the margin will be a weighted average of the charge of 200 bps for the first 3 years and 200 bps plus 100 bps for the following years.

Collective Action Clauses (CACs) will be included for all new euro-area government securities with maturity above one year from June 2013 onwards. The objective of such CACs will be to facilitate agreement between the sovereign and its private-sector creditors in the context of private sector involvement.

I.4. *The Euro Plus Pact*

On 24 and 25 March 2011 the European Council agreed to adopt the 'Euro Plus Pact' (EPP). Its principal goals are to strengthen the economic pillar of EMU, achieve a new quality of economic policy coordination in the euro area, and to improve competitiveness and facilitate convergence. The EPP focuses primarily on areas that fall under national competence and that are integral to competitiveness and the avoidance of harmful imbalances. Six non-euro area Member States have decided to join the Pact.

The EPP has the following four principal objectives at its core, and euro-area Member States undertake to take all necessary measures to pursue the following objectives:

- Foster competitiveness
- Foster employment
- Contribute further to the sustainability of public finances
- Reinforce financial stability

The EPP is fully embedded in the institutional set-up of the EU, including the European Semester, and adds a political impetus to the objectives of the Europe 2020 growth strategy and the steps taken to reinforce economic governance in EMU. The Pact makes it each participating Member State's responsibility to specify the concrete measures needed to reach the objectives of the Pact that are deemed relevant to the country. Progress towards the common objectives will be monitored by the Heads of State or Government on the basis of a series of indicators covering competitiveness, employment, fiscal sustainability and financial stability. Countries facing major challenges in any of these areas will be identified and will have to commit to addressing these challenges in a given timeframe. The Commission will assess these commitments in the context of its enhanced surveillance.

On substance, the objectives of the Euro Plus Pact are fully in line with those proposed by the Commission in the first Annual Growth Survey (AGS), which was published on 12 January 2011. Within the broad objectives of the Pact listed above, attention will be paid to the following possible measures, listed by objective:

Foster competitiveness

Progress will be assessed on the basis of wage and productivity developments and competitiveness adjustment needs. To assess whether wages are evolving in line with productivity, unit labour costs (ULC) will be monitored by comparing developments in other euro-area countries and in the main comparable trading partners, as large and sustained increases in ULCs may lead to the erosion of competitiveness. Action to raise competitiveness is required in all countries, but particular attention will be paid to those facing major challenges in this respect.

Reforms that will be given particular attention are those designed to ensure that national cost developments are in line with productivity developments, while respecting national traditions of social dialogue and industrial relations. Furthermore, measures to increase productivity, for instance by supporting R&D and innovation, infrastructure as well as an open and competitive business environment will be most important.

Foster employment

A well-functioning labour market is central to the competitiveness of the euro area. Progress on reaching this aim will be assessed on the basis of long-term unemployment rates, youth unemployment rates and labour participation rates. Amongst the reform measures that will be given particular attention are labour market reforms to promote “flexicurity”, ([10]) increase formal labour market participation, increase lifelong learning and employment-activating tax reforms.

Enhance the sustainability of public finances

In order to bring public finances back onto a sustainable footing, the highest attention will be paid to measures that increase the sustainability of pensions, health care and social benefits. These will be assessed on the basis of sustainability gap indicators. ([11]) These indicators measure whether debt levels are sustainable based on current policies, notably pensions schemes, health care and benefit systems, and they also take into

([10]) 'Flexicurity' combines features of flexibility and security in one labour market and welfare model. Its key feature is that not the specific job position is protected, but rather the capability of the individual to move between jobs.

([11]) The sustainability gap are indicators agreed by the Commission and Member States to assess fiscal sustainability, see e.g. Public Finances in EMU 2010: http://ec.europa.eu/economy_finance/publications/european_economy/2010/pdf/ee-2010-4_en.pdf account demographic factors. Reforms necessary to ensure the sustainability and adequacy of pensions and social benefits could include aligning the pension system to the national demographic situation, and increasing the participation of older workers.

Furthermore, as part of the Pact, euro-area Member States commit to translating EU fiscal rules as set out in the Stability and Growth Pact into national legislation. The commitment should be seen as reinforcing - for the adherents to the pact - the legally binding minimum requirement for national budgetary frameworks established in the corresponding Directive, which forms part of the 'governance package'. Member States will retain the choice of the specific national legal vehicle to be used, but will make sure that it has a sufficiently strong binding and durable nature (e.g. constitution or framework law). The exact formulation of the rule will also be decided by each country (e.g. it could take the form of a "debt brake", rule related to the primary balance or an expenditure rule), but it should ensure fiscal discipline at both national and sub-national levels. The Commission will have the opportunity, in full respect of the prerogatives of national parliaments, to be consulted on the precise fiscal rule before its adoption so as to ensure it is compatible with, and supportive of, the EU rules.

Furthermore, attention will be paid to tax policy coordination. Pragmatic coordination of tax policies is a necessary element of stronger economic policy coordination in the euro area, which is key to supporting fiscal consolidation and growth. Besides exchanging best practices, Member States could engage in the development of a common corporate tax base, which would be a revenue-neutral way of working towards a consistent tax framework in the euro area. To this end, the Commission tabled a proposal for a Council Directive on 16 March. ([12])

Reinforce financial stability

A strong financial sector is key for the overall stability of the euro area. A comprehensive reform of the EU framework for financial sector supervision and regulation was launched after the breakout of the financial crisis. Strict bank stress tests, coordinated at EU level, will be undertaken on a regular basis, with the aim of guiding subsequent bank recapitalisations. In addition, the President of the ESRB and the President of the Eurogroup will be invited to regularly inform Heads of State or Government on issues related to macro-financial stability and macroeconomic developments in the euro area requiring specific action. In particular, for each Member State, the level of private debt of banks, households and non-financial firms will be closely monitored.

Guiding Rules

Overall, the Pact represents a renewed effort for stronger economic policy coordination for competitiveness and convergence and will be subject to the following guiding rules:

Firstly, the Pact is designed to be in line with and strengthen the existing economic governance arrangements in the EU. It will be consistent with, and build on, existing instruments (Europe 2020, European Semester, Integrated Guidelines, Stability and Growth Pact) and new legislation under the governance package, but will involve a special effort going beyond what already exists. It is foreseen to include concrete commitments and actions that are more ambitious than those already agreed, and all measures should be accompanied with a timetable for implementation. This process will be fully in line with the Treaty, and the Pact will respect the integrity of the Single Market.

Secondly, the Pact will be action-oriented and cover priority policy areas that are essential for fostering competitiveness and convergence. Euro-area Member States are fully committed to the completion of the Single Market which is key to enhancing the competitiveness in the EU and the euro area. The Pact will concentrate on actions where the competence lies with the Member States. In the chosen policy areas common objectives will be agreed upon at the Heads of State or Government level. Participating Member States will pursue these objectives with their own policy-mix, taking into account their specific challenges.

Thirdly, each year concrete national commitments will be undertaken by each Head of State or Government. In doing so, Member States will take into account best practices and benchmark against the best performers, within Europe and vis-à-vis other strategic partners. The Commission will monitor the implementation of the various national commitments and will prepare an annual report that will be examined by the Heads of State or Government of the euro area and participating countries. In addition, Member States commit to consult their partners on each major economic

([12]) COM/2011/121

reform having potential spill-over effects before its adoption.

Finally, in order to demonstrate a real commitment to change and ensure the necessary political impetus to reach the Pact's common objectives, each year Member States of the euro area will agree at the highest level on a set of concrete actions to be achieved within 12 months. These commitments will also be reflected in the National Reform Programmes and Stability Programmes submitted each year, which will be assessed by the Commission, the Council, and the Eurogroup in the context of the European Semester.

Those Member States in a position to do so have already announced at the European Council of 24/25 March the concrete commitments to be achieved in the next 12 months. Concrete commitments should be included in the National Reform and Stability Programmes to be submitted in April and will be presented to the June European Council.

I.5. Conclusion

The exceptionally challenging circumstances in the euro area since the onset of the global crisis have necessitated swift yet profound action by the Commission and Member States in cooperation with, notably, the ECB and the IMF in order to regain financial stability and deal with a very deep recession. Both crisis management measures and a systemic overhaul of economic and financial policy coordination have been enacted in order to support growth, fiscal sustainability, financial stability and convergence. First and foremost, this comprehensive response has ensured that output and employment did not contract excessively in Member States, while taking into account the limits to demand stimuli that are posed by individual countries' budgetary positions. The coordination of Member States' budgetary consolidation strategies will support the regaining of sustainable fiscal positions following the unprecedented shock of the crisis.

Vulnerable Member States have received conditional financial support through the EFSF, EFSM and IMF lending and through bilateral loans, as their access to sovereign bond markets has been severely impeded during the crisis. The temporary lending facilities of the EFSF and EFSM will be succeeded in 2013 by a permanent crisis resolution mechanism, the European Stability Mechanism. All country-specific assistance is and will be accompanied by comprehensive macroeconomic adjustment programmes for the countries in question, which support the rebalancing of the economy and strengthen its growth potential. Structural measures to boost growth and employment for all Member States are also pursued under the Europe 2020 initiative and the Euro Plus Pact, all within the streamlined channels of the European Semester.

On the financial front, the EU policy response has brought major improvements to the functioning and stability of the financial system. Public capital injections combined with greatly enhanced liquidity provision by the ECB have averted a full-blown credit crunch in the short-term. Financial stability is now safeguarded in a more rigorous way through the European System of Financial Supervisors and through manifold improvements in the financial regulatory environment. Regular stress tests for banks will asses the resilience of systemically important financial institutions and will guide further capital injections, notably to meet the higher capital requirements under the Basel III regulations. Overall, this combination of policy measures in the context of a systemic overhaul of the EU's economic policy framework will go a long way towards setting the euro area back on course towards stability, growth and employment.