2. A primer on the EU/IMF adjustment programmes in the euro area

Overcoming the sovereign debt crisis is a major challenge for the euro area. Unprecedented financial assistance programmes have been put in place in some euro-area Member States – Greece, Ireland and Portugal – as urgent policy intervention was needed to limit contagion risks in the common interest of all Member States. This section provides an overview of the joint EU/IMF adjustment programmes in Greece, Ireland and Portugal, explains the rationale behind their design and reviews their results. The programmes were designed by the European Commission and IMF, in liaison with the ECB, to address country-specific vulnerabilities of the Member States concerned in the structural, fiscal and financial domain. They aim at ensuring sound and rapid fiscal consolidation and at raising growth potential while tackling contagion risks. Overall, while the programme in Portugal is too recent to have yet yielded substantive results, the programme in Ireland is on track with both fiscal consolidation and banking sector recapitalisation well underway. While Greece has also delivered a notable fiscal adjustment to date, the overall progress is more complex in light of the debt level and the political context. Fiscal and broader structural reforms should be pursued vigorously in all three countries. This should allow for further reductions in government deficits and should generate a critical mass of reforms needed to improve the business climate and growth prospects, thereby paving the way for sustainable economic recovery.

This section casts a light on the joint EU/IMF financial assistance programmes put in place in three countries of the euro area — Greece, Ireland and Portugal. Its aim is to provide an overview of the ongoing programmes by explaining the rationale behind their design and reviewing their results to date. As the sovereign crises in these Member States were caused by country-specific factors, the assistance programmes have been tailored to country-specific vulnerabilities. This section therefore follows a country-by-country structure.

The unfolding of the 2008-09 financial crisis and, in its wake, the financial rescue operations, stimulus packages and operation of automatic stabilisers, have considerably strained public finances in all Member States. Pre-existing imbalances in terms of public debt have worsened. A lasting knock-on effect of the crisis is the upward reassessment of risk on all markets. Previously overlooked vulnerabilities in Member States have been driving sovereign yields and CDS spreads up, thus fuelling further the deterioration of public finances. Given the common currency and deep financial and trade integration, the macro-financial stability of both the euro-area and EU Member States was at stake. Urgent policy intervention was needed to manage contagion risks in the common interest of all Member States.

The Balance-of-Payments (BoP) assistance activated for Hungary, Romania and Latvia in 2008-09 in conjunction with the IMF served as a basis for the programme design for Greece, Ireland and Portugal. Besides their national specificities, the three joint EU/IMF conditional financial assistance programmes aim at safeguarding the integrity of the euro and all economies of the euro area in the face of unprecedented market turmoil. They address a wide range of economic challenges and tackle specific national weaknesses as the crises in Greece, Ireland and Portugal have very different root causes. They are articulated around three main fronts: financial repair, fiscal consolidation, growth and competitiveness. Their policy components are described in detail further on.

In Greece, public debt was on an unsustainable path before the crisis and public sector reporting was weak, even misleading. Price inflation and wage developments were at odds with labour market conditions. Thus the adjustment programme focuses on regaining competitiveness and fiscal health. In Ireland, the crisis was induced by the bursting of a property market bubble. The oversized banking sector faced large losses and its rescue by the government weighed heavily on public finances. Hence the programme emphases banking sector recapitalisation and streamlining of public finances. In Portugal, low productivity growth and significant wage increases over the last decade undermined the country’s competitiveness and its export market shares. Public expenditure growth outpaced GDP growth, leading to fiscal difficulties. The programme therefore focuses on reining in the public deficit and debt while enhancing the economy's growth potential.

These three financial assistance programmes are prominent parts of a broader euro-area/EU crisis

Box 2.1: **New financial instruments**

In May 2010, the Eurogroup agreed to provide financial assistance for a total amount of € 80 billion to Greece. This support is organised through bilateral loans by the participating Member States, pooled by the Commission to 'transform' the bilateral loans into a single loan to Greece. In March 2011 the Euro Area Summit agreed to extend the maturity of loans to Greece to 7½ years on average. The shares of participating Member States in the total loan are calculated on the basis of the ECB paid capital key. Three euro-area Member States — Ireland, Portugal and Slovakia — are currently not participating in the disbursement of bilateral loans to Greece. Slovakia opted for not participating, and has been joined by Ireland and later Portugal as these Member States themselves called for external financial assistance.

The May 2010 agreement was followed by a reflection on possible new support mechanisms, and two new instruments were devised to cover the financing needs of governments.

The European Financial Stabilisation Mechanism (EFSM) provides for the financing of up to €60bn for the benefit of all Member States. ([1]) It was established in May 2010 by a Council Regulation on the basis of Article 122(2) of the Treaty on European Union. The European Commission borrows on behalf of the EU on markets and lends to countries.

The European Financial Stability Facility (EFSF) was created by the euro-area Member States following the Ecofin Council's decision of 9 May 2010. It borrows on the markets under guarantees by euro-area Member States and on-lend the proceeds. The Commission and the EFSF coordinate their market activities closely. Euro-area heads of government agreed at the Euro Area Summit of March 2011 to raise the EFSF's effective lending capacity to €440bn until its expiry in 2013.

Member States agreed to the creation of a permanent crisis resolution mechanism — the European Stabilisation Mechanism (ESM) — in March 2011. Its effective lending capacity will be €500bn and it will be established by an international treaty. The ESM will take over the role of the EFSF and the EFSM in providing external financial assistance to euro-area Member States after June 2013. ([2])

([1]) Because of the EFSM's higher pricing, non-euro area Member States have a greater incentive to use the Balance-of-Payments facility.
([2]) However, the EFSF will remain in place after June 2013 to administer the outstanding bonds. It will remain operational until it has received full payment of the financing granted to Member States and it has repaid its liabilities. Any undisbursed or unfunded portions of existing loan facilities will be transferred to the ESM.

resolution package. ([7]) Overcoming the sovereign debt crisis is a major challenge for the euro area. The architects of Economic and Monetary Union (EMU) had not foreseen the unfolding of events that led to soaring sovereign spreads in peripheral economies. An underlying pre-crisis tenet of EMU was that the Stability and Growth Pact (SGP) as well as national self-interest would preclude highly vulnerable sovereign debt positions, and that there was therefore no need for such instruments. Innovative institutional solutions therefore had to be found in the face of the euro area's sovereign debt crisis. In particular, an institutional pre-requisite for the programmes was the creation of new financial instruments for euro-area countries, which are described in Box 2.1.

([7]) For a review of Europe's comprehensive policy response to the crisis see *Quarterly Report on the Euro Area*, Vol. 10, No 1 (2011).

Coordination with the IMF

EU/IMF joint programmes for Greece, Ireland and more recently Portugal have led to an unprecedented level of cooperation between the two institutions. The programmes were designed during joint missions with extensive information exchange. The Commission negotiates the programme on behalf of Member States and in liaison with the European Central Bank (ECB). Policy conditionality clauses on fiscal, structural and financial aspects are designed in a consistent way so as to avoid conflicting objectives. Legal documents (Memoranda of Understanding, Memoranda of Economic and Financial Policies and Letters of Intent) are fine-tuned with the IMF and the ECB. There is also joint communication, with an EU/IMF/ECB press conference at the end of the mission and coordinated publications.

As a rule of thumb — and in line with the country's financing needs and the facilities'

lending volume available — the EU provides two thirds of the programme funding and the IMF the remaining third. Both institutions seek to align their lending conditions and instalment schedule. Pooling EU and IMF institutional and financial resources thus achieves greater financial power and more financial stability and credibility.

Policy conditionality and review missions

Disbursements are subject to the fulfilment of policy conditionality criteria. These are assessed during quarterly review missions by the Commission in cooperation with the IMF and in liaison with the ECB. If targets are missed or are expected to be missed, additional action will be taken by national authorities to meet the targets set in the Memorandum of Understanding.

A snapshot of programme implementation in Greece

The 2008-09 global crisis exposed Greece's vulnerabilities. Market sentiment vis-à-vis the country worsened sharply in early 2010 as the downturn took a heavy toll on public finances. Significant overspending and a sharp fall in government revenue pushed the general government deficit to an estimated 13.6% of GDP in 2009. Government debt reached 115% of GDP at the end of 2009. Moreover, the extent of the deterioration in the fiscal position was revealed with some delay due to serious deficiencies in Greece's accounting and statistical systems. Delays in the implementation of corrective measures disconcerted financial markets, which began questioning Greece's fiscal sustainability. Rating agencies downgraded the sovereign, and the yield on sovereign bonds and CDS spreads increased significantly.

Following a further worsening of market conditions in the course of April 2010, the authorities requested bilateral financial assistance from euro-area Member States and a Stand-By Arrangement from the IMF. On 2 May 2010, the Eurogroup agreed to provide bilateral loans pooled by the European Commission for a total amount of €80 billion, to be disbursed over the period May 2010-June 2013. The financial assistance provided by euro-area Member States is part of a joint package, with the IMF financing an additional €30 billion under a Stand-By Arrangement. This financial assistance package was designed to fully cover the government's financing needs related to its fiscal deficit and all its maturing medium- and long-term liabilities until the beginning of 2012, and progressively less thereafter. However, due to the settlement of unforeseen arrears accumulated in the past, the debt maturing within the programme period has increased. The Greek state has also accumulated new arrears. As market access remains limited to short-term market financing and the regaining of long-term market access in early 2012 is now unlikely, the programme has become underfinanced.

Euro-area Member States and the IMF have been devising solutions to cover the shortfall in Greece's revised financing needs, even beyond the current program, spanning the period between mid-2011 and mid-2014. A revised reform package — including an ambitious €50 billion privatisation plan — was adopted by the Greek Parliament on 29 and 30 June. Against this background, and on the basis of the debt sustainability analysis by the Commission and the IMF, Eurogroup ministers approved the disbursement of the fifth tranche of the current Greek Loan Facility (amounting to €12 billion, of which €8.6 billion from euro-area Member States) on 1 July. In addition, private sector involvement is being sought through voluntary rollovers of maturing Greek debt. All this prepares the ground for a second programme, which will be financed from both official and private sources, as agreed by the June 2011 European Council.

It should also be noted that, in order to improve debt sustainability, the Council decided in March 2011 to extend the maturities of loans to Greece to 7.5 years. The interest rate on the EU part of the loans is a floating rate based on the 3-month Euribor plus a margin of 2 pp until the third anniversary of the disbursement, and 3 pp thereafter.

The overarching objective of the programme is to durably restore Greece's credibility for private investors by securing fiscal sustainability, safeguarding the stability of the financial system, and boosting potential growth and competitiveness. To this end, the programme consists of a comprehensive set of ambitious and mutually reinforcing policies, grouped around the following three policy areas:

Fiscal consolidation. Sustainability-enhancing fiscal consolidation is urgently needed. The immediate priority is to contain the government's financing needs and reassure markets on the determination of the authorities to do whatever it takes to secure medium- and long-term fiscal

Table 2.1: **Overview of adjustment programmes in euro-area Member States**

	Greece	Ireland	Portugal
Period covered by EU assistance	Assistance available up to June 2013.	Assistance available up to December 2013.	Assistance available up to June 2014.
Financial instruments	Bilateral loans from euro-area Member States	EFSF; EFSM; bilateral loans from the UK, Sweden and Denmark , Irish reserves	EFSF; EFSM
Amount granted by the EU	Up to € 80 bn	Up to € 45 bn	Up to € 52 bn
Total size of the assistance (including other lenders)	€ 110bn (30 bn from IMF)	€ 85bn (22.5 bn from IMF)	€ 78bn (26 bn from IMF)
Number of instalments under EU assistance	Up to 12 instalments	Up to 12 instalments	Up to 12 instalments
Amount disbursed under EU assistance so far	€ 38.5bn (4 instalments)	€ 15bn (2 instalments)	€ 6.5bn (1 instalment)
Main areas of policy conditionality	* Fiscal consolidation * Fiscal governance and reporting reform	* Fiscal consolidation * Labour market reform	* Fiscal consolidation * Banking sector recapitalisation and deleveraging
	* Reform of the public wage system	* Public administration and taxation reforms	*Prudential Capital Assessment Review
	* Pension reform	* Energy sector liberalisation	* National Recovery Plan to mitigate adverse effects on growth
	* Financial sector regulation and supervision reform	* Financial sector regulation and recapitalisation	* Labour market reform
	* Other structural reforms (related to Europe 2020 agenda)	* Other structural reforms (related to Europe 2020 agenda)	* Other structural reforms (related to Europe 2020 agenda)

Source: Commission services.

sustainability. The policy programme provides for a very large macroeconomic adjustment, especially in the public sector. The fiscal deficit is projected to be reduced from almost 14% of GDP in 2009 to below 3% of GDP in 2014. Consolidation should rely on measures that generate savings in public sector expenditure and improve the government's revenue-raising capacity. To this end, an ambitious programme to privatise state assets and enterprises has also been spelled out. In parallel, measures are needed to provide reassurance on the durability of the fiscal adjustment, including by specifying and locking in consolidation measures for 2011 and 2012, reforming the pension system and strengthening the fiscal framework. The programme also includes associated structural measures, such as public administration reforms and measures to fight corruption and tax evasion.

Notwithstanding the considerable efforts needed, the programme ensures that the burden of the adjustment is shared fairly. Policies were designed to protect the most vulnerable in society from the effects of the economic downturn. By contrast, a larger contribution to the consolidation of government finances is expected from those who have so far not carried their fair share of the tax burden. Although public sector wages and pensions have been reduced, the programme aims to limit the burden on minimum wage earners, while preserving an adequate safety net.

Safeguarding the financial sector. Financial sector policies aim to restore confidence and ensure the long-run viability of the banking sector. This is ensured through short-term bank liquidity support, measures to recapitalise banks without prejudice to competition rules, and the establishment of the Hellenic Financial Stability Fund (HFSF). The objective of the Fund is to safeguard the stability of the Greek banking system. It may provide equity capital to credit institutions by acquiring preference shares and, under certain conditions, common shares in the banks concerned.

Structural measures. Finally, the structural reform agenda prioritises those reforms that have a large growth-enhancing or budgetary impact in the short-to-medium run. Reforms to tackle undeclared work will broaden the scope of the formal economy, thereby improving tax collection. Unleashing the economy's growth potential is the core objective of these structural reforms. Labour market reforms will spur job creation and increase wage flexibility. Product market reforms, not least in the services sector, will step up market contestability, reduce the rents of vested interest groups and help to curb price pressures. Synergies between these measures will help to improve the business environment and competitiveness of the economy by removing rigidities, reducing production costs and increasing competition.

Latest Developments: The fourth Greek review mission in May 2011 concluded that while significant progress had been achieved during the first year of the adjustment programme, there had

been implementations problems and the recession in 2010 had been more pronounced than anticipated. The private sector has shown wage moderation and has even registered wage cuts in some sectors. Gains in competitiveness have supported export growth. However, reinvigoration of fiscal and broader structural reforms was considered necessary to further reduce the deficit and achieve the critical mass of reforms needed to improve the business climate and pave the way for sustainable economic recovery.

In the fiscal area, further sustained deficit reduction requires comprehensive fiscal structural reforms. This strategy includes significant downsizing of public sector employment, restructuring or closure of public entities, and rationalisation in entitlements, while protecting vulnerable groups. On the revenue side, the government intends to reduce tax exemptions, raise property taxation, and step up efforts to fight tax evasion. The government is also committed to significantly accelerate its privatisation programme with the aim of realising revenues of € 50 billion by the end of 2015.

In the financial sector, liquidity remains tight, but policies are in place to ensure adequate liquidity provision for the banking system. The banking sector remains fundamentally sound and the authorities are increasing capital requirements to further strengthen capital buffers, giving priority to market-based solutions. However, the Financial Stability Fund is available as a backstop for viable banks that cannot raise capital in the private market.

Further progress has been made with structural reforms. Legislation has already been passed or is under way to modernise public administration, reform healthcare, improve the functioning of the labour market, remove barriers to setting up and operating a business and liberalise transport and energy. The government is committed to continue pushing ahead in these areas, with particular emphasis on growth drivers.

Building on the comprehensive policy package, discussions on the financing modalities for Greece’s economic programme took place in June and early July 2011. End June, the Greek Parliament adopted a set of key laws on fiscal and economic reform strategy and privatization. This paved the way for the approval by the Eurogroup and the IMF’s Executive Board of the disbursement of the July instalment under Greece's first financial assistance programme.

A snapshot of programme implementation in Ireland

From the summer of 2010 onwards, investors became increasingly concerned about the Irish banking sector and public finances. Banks' losses turned out to be much bigger than foreseen earlier. This affected the funding of the banks, which became increasingly difficult. Also the financing costs of the sovereign increased sharply, in part owing to the blanket guarantee it had given to the banks' financing in 2008. Although the Irish authorities implemented measures and announced plans with the aim of restoring confidence and ensuring funding, these efforts did not succeed in improving the financing situation. Banks lost access to market funding and corporate deposit outflows accelerated, and the cost of government borrowing reached unsustainable highs. Consequently, the Irish authorities requested financial assistance from the EU and IMF on 21 November 2010 and discussions on the programme were finalised during the following week.

A programme of €85bn financial assistance was agreed at staff level with the European Commission and the IMF, in liaison with the ECB, and approved by the Ecofin Council and the IMF Board in December 2010. Of the overall package, €67.5bn is split equally across the following sources (i.e. € 22.5 billion each): (i) the European Financial Stabilisation Mechanism (EFSM), (ii) the European Financial Stability Facility (EFSF), together with bilateral loans from the United Kingdom, Denmark and Sweden (together: €4.8bn), and (iii) the International Monetary Fund. In addition to this €67.5bn, €17.5bn will be financed by an Irish contribution through its treasury cash buffer and investments by Ireland’s National Pension Reserve Fund (NPRF). The programme provides for up to €50bn in fiscal needs and up to €35bn in banking support measures between 2011 and the end of 2013. The interest rate of the EFSM and EFSF depends on the prevailing market rates at the time of each drawdown plus a margin. These margins were calculated at the beginning of the programme to align the EU and the IMF lending rate. Margins were set at 292.5 basis points for the EFSM and 247 basis points for the EFSF. The lending rate of the EFSF is further increased by costs of credit enhancements.

The key objective of the programme is to restore financial market confidence in the Irish banking sector and the sovereign. To achieve this

objective, the programme has three key components.

Safeguarding the financial sector. The first aim of the programme is a fundamental downsizing and reorganisation of the banking sector. Addressing market perceptions of weak capitalisation, overhauling the banks' funding structure, as well as gradual downsizing and deleveraging of the banking system will be required. These steps will be backed by the availability of programme funds for both recapitalisation and deleveraging.

Fiscal consolidation. Second, the programme comprises a strategy to restore fiscal sustainability. Building on the authorities' National Recovery Plan, the consolidation strategy will rely to a large extent on broad-based expenditure restraint. International experience shows that this is a typical characteristic of successful and sustainable fiscal consolidation episodes. At the same time, the tax system will undergo profound change. The formerly narrow tax base is being broadened with a view to enhancing revenue stability and, together with increases in specified tax rates, contributing to the generation of additional revenue.

Structural measures. Third, structural reform is needed to boost growth. The programme includes measures to remove potential structural impediments to competitiveness and employment creation. Specifically, labour market measures should boost employment. Product market reforms should include the opening up of sheltered service sectors and thus contribute to stronger competition and productivity growth.

Latest developments: The EC/ECB/IMF review mission in April 2011 found that the authorities adequately complied with the conditionality underpinning financial assistance.

In the banking sector, the comprehensive recapitalisation and reforms announced on 31 March are a major step towards restoring the Irish banking system to health. The Central Bank of Ireland published the Financial Measures Programme (FMP), which presented bank capital requirements and deleveraging commitments based on the Prudential Capital Assessment Review (PCAR) and the Prudential Liquidity Assessment Review (PLAR). These exercises found that banks need €24bn of fresh capital to provide banks with adequate levels of capital to cover lifetime losses and to help deleverage the banking system to sustainable levels. The banks will be recapitalised by 31 July 2011, after eliciting contributions from subordinated bondholders through liability management exercises. The credibility of the exercise has been reflected in a positive market reaction, with Irish bond yields declining following the announcement.

On the fiscal front**,** the targets for end-December 2010 and end-March 2011 were met with a comfortable margin. The budget deficit is projected at about 10½ percent of GDP in 2011, and the authorities reaffirmed their strong commitment to the fiscal consolidation agreed in the EU/IMF-supported programme, as well as to a deficit of 3 percent of GDP in 2015.

Regarding structural reforms, supportive measures in the Jobs Initiative and reform of sectoral wage-setting arrangements on the basis of an ongoing review will foster job creation. The government also plans to introduce legislative changes to remove restrictions on trade and competition in sheltered sectors, including the legal profession, medical services and pharmacies. Other measures to combat structural unemployment and protect vulnerable groups include a temporary reduction in the lower rate of social contributions, the reallocation of capital expenditure to more labour-intensive projects and a temporary increase in the number of internships and specific skills training courses to deal with structural unemployment. In addition, the Department of Social Protection will draw up a programme of reforms to better target social support at those on lower incomes, and ensure that work pays for welfare recipients.

In summary, Ireland is making good progress in overcoming the worst economic crisis in its recent history. Continued programme implementation, with support from the EU and the IMF, remains key to ensure Ireland's return to capital markets at affordable interest rates. The successful conclusion of the first review has allowed the disbursement of €4.6bn (€3.0bn by the EU, and €1.6bn by the IMF). The next programme review mission is scheduled for July 2011.

A snapshot of programme implementation in Portugal

Unfavourable fiscal developments and a bleak outlook for economic growth led to a deterioration of confidence and rising pressures in sovereign bond markets in early 2011, culminating in Portugal's request for official assistance. In

parallel, the banking sector, which is heavily dependent on external financing, became increasingly cut off from market funding and resorted extensively to Eurosystem funding. The government stepped down after failure to gain parliamentary approval for the Stability Programme in late March 2011. In the wake of consecutive downgrades of Portuguese sovereign bonds, interest rates reached levels that were no longer compatible with long-term fiscal sustainability.

Following the formal request for financial assistance made by the Portuguese authorities on 7 April, the terms and conditions of the financial assistance package were agreed by the Eurogroup and the Ecofin Council on 17 May 2011. The financial package covers Portugal's financing needs of up to €78bn. The European Financial Stabilisation Mechanism (EFSM) and the European Financial Stability Facility (EFSF) will provide up to €52bn (€26bn from each), to be disbursed over three years. Further support will be made available by the International Monetary Fund (IMF) for up to €26bn under an Extended Fund Facility. The EFSM loan will have a maximum average maturity of 7.5 years and a margin of 215 basis points on top of the EU's cost of funding. For the EFSF, a margin of 208 basis points, as well as the costs of its cash buffers, is added to the EFSF cost of funding. This yields conditions similar to those of the IMF support. The aid is being provided on the basis of a three-year policy programme for the period up to mid-2014. It includes a banking support scheme of up to €12bn to provide the necessary capital in case market solutions cannot be found.

The programme has received the backing of the main political parties and is structured around three main areas. First, a credible and balanced fiscal consolidation strategy, with the government deficit projected at 5.9% in 2011 and falling to 3% of GDP by 2013. Second, deep and frontloaded structural reforms, including in the labour market and the judicial system. Third, efforts to safeguard the financial sector through recapitalisation supported by back-up facilities.

Fiscal consolidation. The fiscal objectives of the programme are ambitious but realistic. The government deficit is expected to reach 5.9% of GDP in 2011, 4.5% of GDP in 2012 and 3% in 2013, in line with the requirements under the Excessive Deficit Procedure. Government debt is expected to peak at around 108% in 2013 and start declining thereafter.

Consolidation efforts are frontloaded, broad-based and supported by a wide range of measures to reduce expenditure and increase revenue. On the expenditure side, the measures include wage moderation in the public sector, lower transfers to local and regional administrations and state-owned enterprises, pension adjustments and lower capital expenditure. On the revenue side, some of the measures include broadening the corporate and personal income tax bases by reducing tax deductions and special regimes, ensuring convergence of personal income tax deductions applied to pensions and labour income, modifying property taxation, broadening the VAT base by reducing exemptions and reclassifying goods subject to intermediate and reduced rates.

Fiscal consolidation will be supported by supporting measures aimed at strengthening the fiscal framework to improve all stages of the budgetary process, including monitoring and risk management. In addition, Portugal will reap efficiency gains from substantial reorganisation of its public administration at the national, regional and local level.

Structural measures. Structural reforms cover a wide range of areas, including the labour market, the housing market, education, energy, transport, the business environment, the judicial system, services and healthcare. The approach to structural reforms is heavily frontloaded. Already in 2011, Portugal is expected to implement a first batch of measures aimed at strengthening labour market functioning by limiting severance payments and making working time arrangements more flexible. Unemployment benefits will be reformed with a view to avoiding unemployment traps and increasing the fairness of the system. In the energy sector, network industries and services, Portugal will adopt measures to promote competition and flexibility. The overarching objective of these structural reforms is to raise potential GDP growth, notably by boosting productivity and labour use. Making rapid progress towards this goal is key for employment and welfare, as well as for long-term fiscal sustainability.

Safeguarding the financial sector. Bank liquidity remains tight, even if the Portuguese banking system has weathered the crisis relatively well so far. On the back of the programme, Banco de Portugal is monitoring carefully the liquidity situation of the banking system and will intervene if necessary. In particular, government-guaranteed bonds may be issued up to a maximum of €35bn.

During the programme period, the banking sector should adopt a strategy for balanced and orderly deleveraging so as to eliminate its funding imbalances on a permanent basis. Furthermore, the bank solvency support mechanism is endowed with resources of up to €12 billion. At the same time, banks are required to further strengthen their capital buffers by raising their Tier 1 capital ratio to 10% by the end of 2012.

Conclusion

The far-reaching financial assistance programmes for Greece, Ireland and Portugal aim to ensure sound and rapid fiscal consolidation and increase growth potential while limiting contagion risks. As such, they are in the common interest of all euro-area Member States. In the face of the ongoing sovereign debt crisis, joint EU/IMF programmes make the most of the European Commission's in-depth knowledge of Member States and the institutional set-up of the EU, and of the IMF's long-standing experience in international crisis management. This has contributed to making joint policy conditionality better enforceable. The partnership of the Commission, IMF and ECB with the programme countries also enhances the programmes' credibility within financial markets and bolsters public acceptance.

Overall, while the programme in Portugal is too recent to have yet yielded substantive results, the strong political consensus on the program bodes well for its implementation. Significant progress has been achieved in Ireland, in particular in the area of recapitalising and restructuring the banking sector and in fiscal consolidation. Ireland has also substantially improved its competitiveness through wage adjustments.

While Greece has also delivered a notable fiscal adjustment to date, the overall progress is more complex in light of the debt level and the political context. Reinforcement of the programme is therefore needed to ensure Greece's return to a sustainable trajectory of public finances.

Fiscal and broader structural reforms must continue to be pursued vigorously in all three countries. This should allow further reductions in government deficits and should generate the critical mass of reforms needed to improve the business climate and growth prospects, thereby paving the way for sustainable economic recovery.