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Sovereign Debt Crisis of the Eurozone Countries

JEL Classification: *F43; F36; H63*

Keywords: *sovereign debt; crisis of the euro area; EMU monetary policy; European semester; fiscal pact; European stability mechanism*

Abstract: *The aim of the publication is to examine the fiscal position of the euro area countries and fiscal policy architecture in Europe after the outbreak of the financial and economic crisis started in 2008. The first part of the publication consists of the analyses of the budgetary situation of euro area countries and complications with the increasing costs of servicing the public debt in the European market affected by the financial liquidity crisis. In the second section the most important changes in the framework of budgetary policies coordination process in the euro zone are presented. The final section describes the role and activities of the European Central Bank in minimising the negative consequences of the debt crisis in the euro zone.*

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Introduction

The global financial crisis has led to a significant deterioration of the fiscal position of the Eurozone countries. Reasons for the increase of budgetary imbalances and the increase of the public debt over safe and sustainable levels can be looked for among the actions taken by the national authorities of euro area Member States in order to rescue financial institutions in liquidity troubles. Fiscal position became worse because of the effects of cyclical economic slowdown occurring in the incomes and expenditures, because of discretionary, growth-enhancing fiscal policy measures and also due to a change in valuation of the risks of national debts by the financial market. The effects of the crisis among others are problems such as: excessive budget deficits, rapidly growing public debts and the placement of treasury securities on the European financial market. The main challenge for fiscal policy in the Eurozone after the outbreak of the crisis has become to bring these negative trends through fiscal consolidation and institutional activities to an end, as well as to provide possibilities for action of stabilizing function budgets along with subsequent ensuring of compliance with the European fiscal rules. Introducing savings measures in the budgets resulted in a deepening recession and further reductions of budget revenues, causing additional need to save, which contributed and contributes to a delay in overcoming the crisis by indebted countries. Because of the unsatisfactory consequences of corrective actions, an increasing fear of disintegration of the euro area, greater significance has raised to a need to find new legal and institutional framework. The programs and mechanisms launched by the Member States and the European Union have helped to maintain the integrity of the euro area. The most important of these activities include: the European Semester, so-called „Six-Pack", Fiscal Pact and the European Stability Mechanism. The key point to save the situation of the most indebted countries, however, were the actions taken by the European Central Bank. Powering the liquidity of the European financial system by the ECB at the moment of consecration the euro zone debt crisis, also during a crisis of liquidity, resulted in a decrease in debt servicing costs and de facto saved some member countries from insolvency, and the euro area from collapse.

The aim of the publication is to present the budgetary situation of the euro area countries and a framework of fiscal policy after the outbreak of European financial and economic crisis in 2008. The first part contains a description of budgetary situation of the euro area countries which is affected by increasing costs of servicing the public debts and a growth of interest on treasury securities on the European market affected by the fi-

nancial crisis of liquidity. The second section analyses the most important changes in the procedures of coordination of budgetary policies in the Eurozone. The final section presents the role and actions of the European Central Bank in stopping the negative consequences of the debt crisis in the Eurozone.

The Budgetary Situation of Euro Area Countries

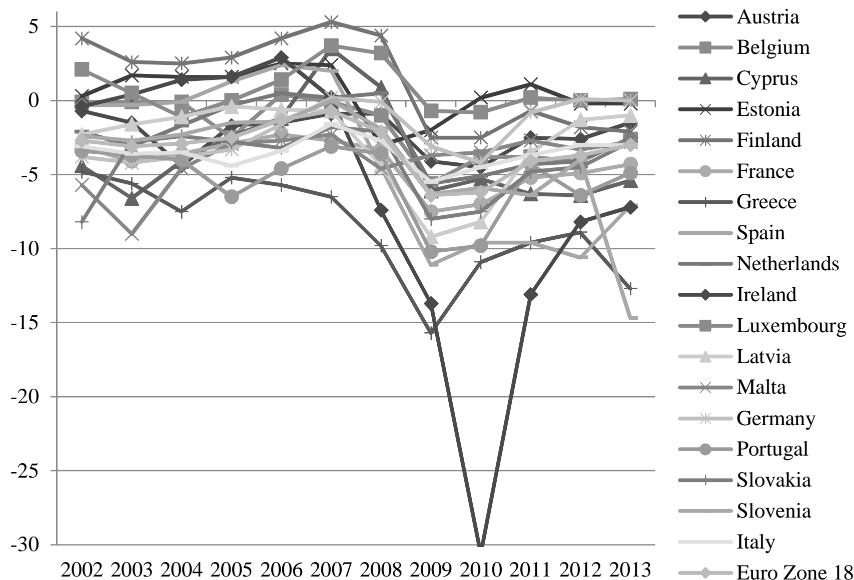
The financial crisis that began in the United States, has had a huge impact on the economy, the economic policy and the public finances of euro area countries. Eurozone countries and other countries of the European Union since mid-2008 until now have been going through the heaviest and most extensive recession since World War II. The growth of expectations that the Greek government would announce insolvency, which occurred in early 2010, and which have seriously begun to affect the situation of the public finances of Ireland, Spain, Portugal and Italy, can be considered the beginning of the debt crisis in the Eurozone (Cour-Thimann & Winkler 2013, p. 5).

The financial crisis that hit the world economy in autumn 2008 caused economic recession in almost all euro area countries. The decline in demand from major trading partners in Europe in the last quarter of 2008 contributed to the deepening of the financial crisis (Lane, 2012)). The dynamics of the national income measured in relation to GDP in the European Union is shown in Table 1. Despite the fact that in the period from mid-2009 by 2010 and 2011 in the euro area there was no decline in production, the public finances of Member States were still in a very difficult situation. Negative growths were recorded in some euro area countries, also in 2014. This is illustrated by Figure 1.

Deterioration of the public finances has become most evident in the peripheral countries of the euro zone, also called in short PIIGS: Portugal, Ireland, Italy, Greece and Spain and Slovenia. The deterioration of public finances of euro area countries was caused by both: the operation of automatic stabilizers, which counteracted the effects of the crisis by stimulating economic activity and the discretionary actions of the governments undertaken in order to support aggregate demand, as well as the direct impact of the financial crisis on the financial position of banks and financial institutions involved in the so-called toxic assets. The public sector debt has increased the most in Ireland, as much as 98.9 percentage points of GDP – from 24.9% of GDP in 2007, to the level of 123.7% of GDP in 2013 (Table 2). Then, in Greece, Portugal and Spain the public debt has increased by

67.7 percentage points of GDP, 60.6 by percentage points of GDP and 57.6 percentage points of GDP, respectively. In the case of Greece, the public debt increased from the highest level among the countries of the zone: 107% of GDP in 2007 to the level of 175% of GDP in 2013. Also in Slovenia in recent years 2010-2013 the debt has increased by almost 50 percentage points GDP. On average, in the euro area since the outbreak of the crisis, the public debt rose from 66.2% of GDP in 2008 to 92.6% of GDP. It equals to an increase of 26.4 percentage points of GDP.

Figure 1. The general government deficit (% of GDP)



Source: own calculations based on Eurostat. Retrieved from http://epp.eurostat.ec.europa .eu/cache/ITY_SDDS/Annexes/gov_dd_esms_an12.htm (19.08.2014).

Irish public finances have worsened the greatest attempt due to the expenditures made to save its banks, but in mid-December 2013 Ireland completed the three-year bailout program, which was administered by the European Commission, the European Central Bank and the International Monetary Fund (Troika). The aid package for the country, together with the funds to recapitalize banks and bilateral loans, amounted to 85 billion euros. Significant cuts in the public spending, together with structural reforms and austerity program were successful, because in 2013 the unemployment

Table 1. GDP growth in real terms (percentage change relative to the previous year)

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Austria	1,7	0,9	2,6	2,4	3,7	3,7	1,4	-3,8	1,8	2,8	0,9	0,3
Belgium	1,4	0,8	3,3	1,8	2,7	2,9	1	-2,8	2,3	1,8	-0,1	0,2
Cyprus	2,1	1,9	4,2	3,9	4,1	5,1	3,6	-1,9	1,3	0,4	-2,4	-5,4
Estonia	6,6	7,8	6,3	8,9	10,1	7,5	-4,2	-14	2,6	9,6	3,9	0,8
Finland	1,8	2	4,1	2,9	4,4	5,3	0,3	-8,5	3,4	2,8	-1	-1,4
France	0,9	0,9	2,5	1,8	2,5	2,3	-0,1	-3,1	1,7	2	0	0,2
Greece	3,4	5,9	4,4	2,3	5,5	3,5	-0,2	-3,1	-4,9	-7,1	-7	-3,9
Spain	2,7	3,1	3,3	3,6	4,1	3,5	0,9	-3,8	-0,2	0,1	-1,6	-1,2
Netherlands	0,1	0,3	2,2	2	3,4	3,9	1,8	-3,7	1,5	0,9	-1,2	-0,8
Ireland	5,4	3,7	4,2	6,1	5,5	5	-2,2	-6,4	-1,1	2,2	0,2	-0,3
Luxembourg	4,1	1,7	4,4	5,3	4,9	6,6	-0,7	-5,6	3,1	1,9	-0,2	2,1
Latvia	7,1	7,7	8,8	10,1	11	10	-2,8	-17	-1,3	5,3	5,2	4,1
Malta	2,4	0,7	-0,3	3,6	2,6	4,1	3,9	-2,8	4,2	1,5	0,8	2,6
Germany	0	-0,4	1,2	0,7	3,7	3,3	1,1	-5,1	4	3,3	0,7	0,4
Portugal	0,8	-0,9	1,6	0,8	1,4	2,4	0	-2,9	1,9	-1,3	-3,2	-1,4
Slovakia	4,6	4,8	5,1	6,7	8,3	10,5	5,8	-4,9	4,4	3	1,8	0,9
Slovenia	3,8	2,9	4,4	4	5,8	7	3,4	-7,9	1,3	0,7	-2,5	-1,1
Italy	0,5	0	1,7	0,9	2,2	1,7	-1,2	-5,5	1,7	0,4	-2,4	-1,9
Eurozone 18	0,9	0,7	2,2	1,7	3,3	3	0,4	-4,5	1,9	1,6	-0,7	-0,4
EU 28	1,3	1,5	2,6	2,2	3,4	3,2	0,4	-4,5	2	1,6	-0,4	0,1

Source: own calculations based on Eurostat. Retrieved from http://epp.eurostat.ec.europa.eu/cache/ITY_SDDS/Annexes/gov_dd_esms_an12.htm (19.08.2014).

Table 2. Changes of the public debt levels in the euro area (percentage points of GDP)

	1999	**2007**	**2010**	**2013**	**Change 1999–2007**	**Change 2007–2010**	**Change 2010–2013**	**Change 2007–2013**
Austria	66,8	60,2	72,5	74,5	-6,6	12,3	2	14,3
Belgium	113,6	84	96,6	101,5	-29,6	12,6	4,9	17,5
Cyprus	59,3	58,8	61,3	111,7	-0,5	2,5	50,4	52,9
Estonia	6,5	3,7	6,7	10	-2,8	3	3,3	6,3
Finland	45,7	35,2	48,8	57	-10,5	13,6	8,2	21,8
France	58,9	64,2	82,7	93,5	5,3	18,5	10,8	29,3
Greece	94	107,4	148,3	175,1	13,4	40,9	26,8	67,7
Spain	62,4	36,3	61,7	93,9	-26,1	25,4	32,2	57,6
Netherlands	61,1	45,3	63,4	73,5	-15,8	18,1	10,1	28,2
Ireland	47	24,9	91,2	123,7	-22,1	66,3	32,5	98,8
Luxembourg	6,4	6,7	19,5	23,1	0,3	12,8	3,6	16,4
Latvia	12,4	9	44,5	38,1	-3,4	35,5	-6,4	29,1
Malta	55,2	60,7	66	73	5,5	5,3	7	12,3
Germany	61,3	65,2	82,5	78,4	3,9	17,3	-4,1	13,2
Portugal	51,4	68,4	94	129	17	25,6	35	60,6
Slovakia	47,8	29,6	41	55,4	-18,2	11,4	14,4	25,8
Slovenia	24,1	23,1	38,7	71,7	-1	15,6	33	48,6
Italy	113,1	103,3	119,3	132,6	-9,8	16	13,3	29,3
Euro Zone 18	71,6	66,2	85,5	92,6	-5,4	19,3	7,1	26,4

Source: own calculations based on Eurostat. Retrieved from http://epp.eurostat.ec.europa.eu/cache/ITY_SDDS/Annexes/gov_dd_esms_an12.htm (19.08.2014).

rate approached 12% with the record 15% in 2012. Ireland is the first country assisted by the European Commission, the ECB and the IMF, who managed to get out from the guardianship of the Troika. As a result, since the beginning of 2014 Ireland can finance itself independently by issuing bonds on the international market.

In May of 2014 Portugal as the third largest country in the euro area announced its resignation from the extension of the assistance the European Union and the International Monetary Fund, which totalled 78 billion euros. The aid consisted of equal parts of funds from the European Financial Stabilisation Mechanism, the European Financial Stability Facility and the IMF. After the decision of Portugal, the financial markets evaluated Portuguese debt as more secure. Rating Company S & P raised the credit rating of Portugal from negative to stable, while Moody's changed the rating at Ba2 and is considering its further improvement. In addition, interest rates on 10-year government bonds of Portugal decreased from the beginning of 2014 from 6.03% to 3.77% in May, which also indicates a gradual recovery of confidence of the financial markets in the Portuguese economy. Two Eurozone countries: Greece and Cyprus still are covered by aid programs.

Financial and economic crisis in the euro area completed with the debt crisis and liquidity crisis, only revealed a number of structural problems in the area of the common currency, which are most visible on the example of Greece. The basic problem of Greece is not just a periodic lack of liquidity. The sources of the Greek problem lie in the long-lasting wrong economic policy. The current state of the public finances of Greece is not only the responsibility of the incorrect national fiscal policy, but also monetary policy. Mismatched of the monetary policy to the realities of the economy of the Mediterranean countries induced a reduction in the competitiveness of domestic products on the international markets, which entailed a long-term deficit on the current account. Also, the policy of low real interest rates led to a disproportionate increase in private and public debt.

According to some economists, further tranches of aid to the national economies of the countries of southern Europe only temporarily delay the problem of insolvency (Pronobis, 2013 p. 9). The creation of the European Stability Fund may, paradoxically, in their opinion, only exacerbate the abovementioned problems of the euro zone. The creation of these instruments can be translated into a weakening of motivation indebted countries to carry out the necessary internal reforms and changes in the order of budgetary system of the EU. Overcoming the current crisis in the euro area is a long-term project, and now it is difficult to say when the public finances zone countries will be balanced, and using what tools it will be achieved.

New Rules for Budgetary Policy Coordination in the Eurozone

The debt, economic and financial crisis which affected the Eurozone have forced reforms of budgetary policy coordination between European Union countries. Among others, budgetary surveillance system was modified, and a new timetable for the budgets coordination for the euro countries was introduced. The most important rules in this area are: Six-Pack, Twin Pack, the Treaty on Stability, Coordination and Governance. The new rules are based on the European semester – new policymaking calendar in EU.

Closer coordination of budgetary and economic policies – the European Semester

Before the crisis, fiscal policy and economic situation in the EU were planned through different processes (Buti & van den Noord, 2003). There was no consistent insight into the efforts undertaken at the national level, and the Member States had no opportunity to study a common strategy for the EU economy (Hagemann, 2011). The coordination of the economic policies of the EU countries closer than before the crisis was possible due to the introduction in 2011 the procedure called European Semester, and by providing a more coherent budgetary framework for the Member States. According to the Commission's assessment, the economic policy within the Eurozone should be carried out not only ex-post, through the statement of the actual fiscal data with reference values of the financial convergence criteria, but also ex-ante, which would allow adjustment of the measures of individual countries in order to coordinate them at the EU level. In the past, the implementation of commitments made at the EU level by Member States was reviewed by the EU authorities only ex-post (Debrun *et al*., 2009).

European Semester is an instrument for ensuring that Member States have to discuss their budget economic plans with its EU partners at certain times during the year. On this occasion, Member States may comment their economic plans, and the Commission in advance may influence decision at the national level. The Commission also monitors whether the Member States take appropriate measures to achieve the objectives of the strategy for long-term growth „Europe 2020", which includes such areas like: employment, education, innovation, climate and poverty reduction.

The reformed Stability and Growth Pact

Stability and Growth Pact was adopted at the time of the introduction of the common currency in order to ensure the sustainability of public finances in Eurozone. However, the way in which its commitments were implemented before the crisis did not prevent the development of significant fiscal imbalances in some Member States. In the face of effects of financial, economic and sovereign debt crisis in the euro area, the European Union reformed the fiscal policy framework by adopting: the so-called „Six-Pack" (which came into force in December 2011), the „Two-Pack" (which entered into force in May 2013), and Fiscal compact – the Treaty on Stability, Coordination and Governance (which came into life in January 2013 in the 25 countries).

Strengthening economic governance – "Six-Pack"

The deep changes in the framework of economic governance in Eurozone are very important from the point of view of long-term impact on the economic policy and the budgetary policy in the euro area in the European Union. The six acts that strengthened the coordination of economic policies in the EU are called: „Six-Pack". They were proposed by the European Commission in September 2010. Some of them are completely new legal solutions, but the rest is the substantial rebuilding of the current rules. Now, after negotiations involving the three EU bodies – the Council – the European Parliament – the European Commission, the key changes concerned the following six documents.

Directive on the requirements for budgetary frameworks of the Member States (2011/85/EU of 8 November 2011) harmonises the rules for the establishment of national budgets (budget accounting rules, statistics, forecasting methods, stability rules and budgetary institutions). Member States would also ensure greater transparency of processes while creating national budgets, and have to introduce such legal solutions that allow for fulfilling the Treaties' obligations (i.e. keeping the deficit to 3% of GDP and the debt – to 60% of GDP (Hallerberg *et al.*, 2005).

Regulation on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies (1175/2011 of 16 November 2011 amending Council Regulation (EC) No 1466/97) is a "preventive" part of the Stability and Growth Pact. It forces the countries with high levels of debt to improve their structural balances by more than 0.5%. GDP per year, while the growth rate of government

expenditure should not exceed the rate of economic growth in the country in the medium term.

Regulation on speeding up and clarifying the implementation of the excessive deficit procedure (1177/2011 of 8 November 2011 amending Regulation (EC) No 1467/97) does not change the threshold deficit of the general government 3% of GDP. However, in the new EDP countries whose debt exceeds the threshold of 60% to GDP have to ensure sufficient pace of reduction (reduction of excess over 60% at the rate of 1/20 of the debt per year).

Regulation on the effective enforcement of budgetary surveillance in the euro area (1173/2011 of 16 November 2011) establishes a system of financial sanctions for failure to comply with the Stability and Growth Pact. For a country that deviates substantially from their medium-term budgetary objective (in the euro area it is usually required to have a balanced budget, but for Poland it is a structural deficit of 1% of GDP), the European Council would impose the obligation to pay interest-bearing deposit amounting to 0.2% of GDP, which would be returned only if the Council determines that the state has improved its policy. If a country fails to comply with the "corrective" part of the pact, the EU Council also imposes the obligation to pay a deposit of 0.2% of GDP – but this time interest-free – and the deposit will turn into a non-refundable penalty, if the Council concludes that its recommendations regarding the excessive deficit have not been implemented.

Regulation on the prevention and correction of macroeconomic imbalances (1176/2011 of 16 November 2011) aims to create a new procedure – equivalent of the excessive deficit procedure. The European Commission annually assesses whether in the Member States there are signs of build-up of imbalances (e.g. high growth in mortgage lending combined with high private debt). If the EC initiates action, the Council of the EU (Ecofin) may issue recommendations. A country with excessive deficit procedure must submit a corrective action plan. As in the case of the excessive deficit procedure, here as well there is the possibility of penalties, which are described in the last part of "Six-Pack":

Regulation on enforcement measures to correct excessive macroeconomic imbalances in the euro area (1174/2011 of 16 November 2011) stipulates that the state covered by the "imbalance procedure" would have to pay a penalty every year – 0.1% of GDP – if the Council of the EU acknowledges that its recommendations are not implemented or the recovery plan is unsatisfactory. The penalty would be imposed only if the EU Council twice took a negative stance towards the country concerned.

The adoption of the six abovementioned changes means profound changes in the coordination of economic policies in the European Union, which will enhance the credibility of the Member States, including members of the Eurozone, and this in turn will contribute to the stability of the financial markets.

Euro Plus Pact

The second initiative is a plan of complementary reforms adopted by the euro area countries and approved in March 2011. Popularly called "Fiscal Pact". Due to the fact that the Pact was signed by the six non-euro countries, including Poland, it was called the Euro Pact „Plus". The pact focuses on four areas:

- competitiveness,
- employment,
- long-term sustainability of public finances,
- strengthening financial stability.

The implementation of the Euro Plus Pact is incorporated into the European Semester and the enforcement of commitments of the Pact by the Member States is monitored by the European Commission.

The Fiscal pact is an intergovernmental agreement agreed by the euro area countries and willing countries outside the Eurozone. After the boycott of this document by the UK's the name and rank of Pact was reduced from the "Treaty on Stability, Coordination and Governance in the Economic and Monetary Union" to the level of the intergovernmental agreement. The main task of the Pact is to tighten budgetary discipline and to improve the credibility of the euro area financial markets. The new treaty obliges subscribers to put the principles of sustainable deficit in national laws. The exception of compliance to this rule is a time of deep recession. According to the provisions of Treaty on Stability, Coordination and Governance starting from January 2014 Mid Term Objectives (MTO) need to be recorded in national legislation. Signatory States of the euro zone must implement 0.5%. GDP limit the structural deficit (the limit can be incurred up to 1%, if the deficit ratio is much lower than 60%). This principle is called the Fiscal pact. The Treaty also provides that if the limit of a structural deficit (or the adjustment path) is affected, automatic correction mechanisms must be lunched. Provisions also include obligation of the Member States to determine how and when the violation is corrected within the budgets during the incoming years. The EU court in Luxembourg (The European Court of Justice (ECJ) is determined to uphold compliance with these provisions. If a Member State fails to reduce its deficit, it may be charged a fine of 0.2%

of GDP. Fines can be increased to the maximum of 0.5% if detected the counterfeit of statistics. Penalties may include the suspension of EU regional funds (even for countries outside the euro area). At the same time, 25 Member States which signed the Treaty may be imposed a fine of 0.1% of GDP, if they do not implement fiscal pact into national law in the right way. Ratification of the pact for the euro countries is prerequisite to assistance from a $ 500 billion rescue fund for the Eurozone – the European Stability Mechanism.

Strengthening of supervision in the Eurozone – "Two-Pack"

The crisis has shown that problems in one member state of the Eurozone could trigger a domino effect in neighbouring countries. Due to the possibilities of domino effects and contagion effect in the euro area, strengthened supervision was introduced, to solve problems before they become systemic. The so-called. „Two-Pack" includes two regulations, whose aim is to strengthen further economic integration and convergence between Eurozone Member States. These regulations are based on the „Six-Pack" that reform the Stability and Growth Pact, on a European framework for fiscal surveillance and on the European Semester for economic policy coordination, as well as complement established in these documents solutions. Under the „Two-Pack", which came into force on 30 May 2013, a new, cyclical monitoring process of the Eurozone is introduced. According to this process, Member States are obligated to submit annually draft of budget in October (excluding the countries covered by the macro-economic adjustment programs). After reviewing the assumptions and feasibility of budgetary projects, the Commission may issue an opinion on the compatibility of the projects with the requirements of the Stability and Growth Pact and country-specific recommendations formulated in the framework of the European semester in the area of fiscal policy. Such a measure enables a more in-depth monitoring of the euro area countries that are subject to an excessive deficit procedure and tighter control over those countries where there are serious difficulties. It should be noted, however, that the „Two-Pack" does not authorize the Commission to amend the draft of national budgets, nor does it oblige Member States to strictly comply with the Commission's opinion. The value added of such an assessment is direct guidance given during the adoption of the budget. They provide all participants in the national budgetary procedure the information needed to decide on the budget and other member states about the fiscal policy of the other members of the Eurozone.

The Role of the ECB in Mitigating the Effects of the Debt Crisis

Potential dangerous consequences of the euro zone debt crisis that may occur in the banking system and the real economy, have prompted the European Central Bank, responsible for the stability of the EU financial system, to introduce strong, violent and previously not encountered changes in the monetary policy. The European Central Bank (ECB), as well as other major central banks in the world, took the unconventional monetary policy in response to the global financial crisis. Although the reaction of the ECB was not so far-reaching, like the US Federal Reserve – it can be assessed that the actions taken by the ECB had saved some euro area countries from insolvency, and the whole euro area from decay (Pronobis, 2013, p. 2).

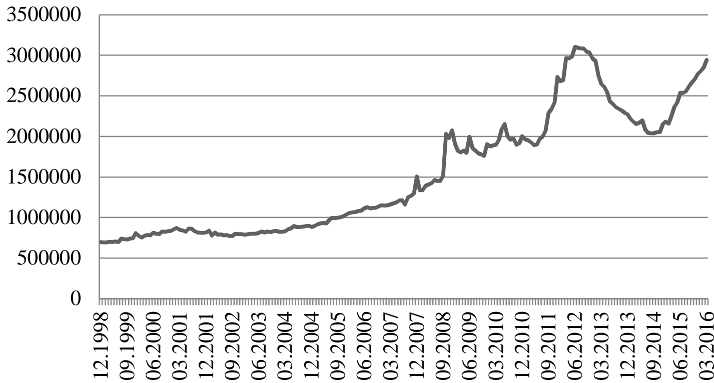
In 2011, it became clear that the debt crisis cannot be solved solely by fiscal policies applied by the endangered Eurozone countries (Romana & Bilan, 2012, p. 767). In addition, in the euro area financial system the crisis of liquidity was still deepening. When the members of euro area were touched by the crisis of liquidity, interest rate rose and the crisis turned into a crisis of insolvency. Investors' behaviour in such a situation appears to be a self-fulfilling prophecy: the country becomes insolvent, as investors feared insolvency. Due to worsening difficulties in this area, the main objective of the European Central Bank, after taking office by the new President Mario Draghi in November 2011, was to increase the liquidity of banks affected by the debt crisis and the banks that have in their portfolios government securities issued by euro area countries being in the debt crisis. The activities of the ECB were to aimed to increase the money supply and loans in the financial system and the real economy, and to ensure the proper functioning of the transmission mechanism of monetary policy of the ECB (Skrzypczyńska, 2012).

The European Central Bank in the face of threats to the stability of the financial system of the Union since October 2008 has undertaken effective action by using standard and unconventional monetary policy instruments (Miruszewski, 2010, p. 96). Standard measures consisted of lowering interest rates to historically low levels, and maintaining them at an extremely low level. In the first phase of the debt crisis in May 2010 – June 2011 unconventional instruments of monetary policy took the form of credit support term refinancing operations with a fixed interest rate, long-term refinancing operation – LTRO operations supply period extraordinary, six-month and twelve-month refinancing operations LTRO, providing operations in US dollars, covered bond purchase program (CBPP) and Programme Market derivatives ECB (SMP).

Action under the OMT is a paradigm shift of the ECB, which according to the letter of the law cannot occur through the purchase of government bonds to finance the deficit of any country. It should, however, be emphasized that the ECB used this practice in relation to government bond purchases made on the secondary market. The rationale for OMT was to prevent a situation in which investors in the financial markets for their investment play on the disintegration of the euro area (Kowalczyk, 2012, p. 53). Bank within the framework of OMT was buying only bonds of countries that have agreed to carry out the necessary, specific reforms required by the provision of aid by the European Stability Mechanism, or were demanded before creating the ESM by one of the temporary European rescue funds *European Financial Stability Facility, EFSF* or *European Financial Stabilisation Mechanism, EFSM*) (ECB, 2011, p. 71). Action of ECB leads to lower bond yields on the open market, and reduces the level expected by the investors interest on the newly emitted debt. By these measures, ECB reduces tensions in the financial markets and facilitate the functioning of the euro area financial system. Consequently, OMT ties with the terms of the assistance from the European Stability Mechanism impose an obligation to continue efforts to reduce budgetary and structural imbalances, and thus more easily emit debt, on which they pay a lower interest rate. The program of OMT is limited to the secondary market of government securities, and does not involve the ECB with direct financing of public debt, as the money goes for investors who already have government bonds, and not governments, which emit these bonds.

In June of 2014 the ECB announced the launch of the possibility of obtaining loans by private sector totalling EUR 400 billion, so-called „Targeted LTRO." The purpose of the program is to facilitate the financing of enterprises in particular operating on the periphery of the Eurozone, where borrowing costs are relatively high (Codogno *et al.*, 2003). At the same time President of ECB Mario Draghi announced a cessation of „sterilization" in the framework of the Securities Market Programme – SMP, which has translated into an increase in the money supply in the euro area financial system. ECB also communicated that the ECB starts work on the possibility of purchase of private debt in the form of bonds Asset Basked Securities (ABS). Financial market institutions estimate that these operations are to reach a value of between 500 billion and 1 trillion euro. This is indirectly confirmed by the words of President Mario Draghi on 4 September 2014., which indicated that he would like to balance the European Central Bank has returned to the level of 2012 (cf. Figure 2).

Figure 2. The assets of the European Central Bank (thousands euros)



Source: The end of the myth of the strong Euro, Independent Financial Portal.

The total assets of the ECB have declined in the past two years by more than one trillion euros not because the central bank intentionally limited the supply of money, but because commercial banks have very limited lending. Such a significant reduction of the monetary base resulted in an economic slowdown, signs of which were recorded by Eurostat in August 2014.

The actions recently announced by the ECB may increase not only lending or providing the liquidity in the banking system, but also some hidden aims. A purchase of ABS by the bank can be interpreted as a situation in which the ECB creates new euro, for which he buys from commercial banks various assets, also significantly riskier government bonds or private, unpayable mortgages and other bad debts. As a result, the European Central Bank will become the owner of the relatively most toxic or unwanted securities in the euro area. In addition, the increase in the monetary base could lead to higher inflation, and thus to reduce the debt-to-GDP ratio (Independent Financial Portal, 2014). The result of this indirect action of the ECB may be the depreciation of the euro against the US dollar, which aims to improve the competitiveness of European economies and stimulating influence on the low economic growth in the Eurozone.

Conclusions

Economic and financial crisis which the euro zone countries have been experiencing since 2009 has triggered a process of positive reform of the formation and coordination of budgetary policies in the European Union.

Among others, monitoring of budgetary system and economic policies of the Member States and a new timetable for the budget for the euro area has been introduced. The most important in the area of new solutions were: the so-called “Six-Pack”, so-called “Two-Pack” and the Treaty on Stability, Coordination and Governance. The new rules are based on the European Semester – EU calendar for formation and coordination of economic policies in euro area countries. With these new solutions, the Eurozone may conduct better coordination of anti-crisis measures and repair in all Member States. To a greater extent than before, the European Commission may affect national initiatives initiated by the state.

The ECB has so far played an important role in reviving the liquidity of the euro area financial system. The monetary policy of the ECB effectively helped to stabilize government bond yields, but made rising debt in some euro area Member States more complicated. Eliminating component of premium for default risk in the prices of individual Treasury bonds is beyond the control of monetary policy. Despite the favourable policies of the ECB facilitate the processes of public debt servicing, structural weakness of some national economies is a factor determining the inevitability of further problems in the near and distant future.

Overcoming the current crisis in the euro area is a long-term project, and up to now it has been difficult to say when the public finance of the euro area member states will be balanced, and by what tools it will be achieved. Certainly, cuts of budget spending and structural reforms tailored to the specifics of national economies will be absolutely necessary. For those reasons, credible and sustainable corrective measures in public finances may restore the competitiveness of the European economies on the international arena, and may contribute to a sustainable economic recovery, which is necessary to sustain long-term process of reducing the debt of the Eurozone countries.

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