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Abstract: This article presents a comparative study of the Troubled Asset Relief Program (TARP), established by the U.S. Treasury during the 2008 financial crisis, and the European Stability Mechanism (ESM), a permanent bail-out fund established by the European Union (EU) in 2012. The article begins by introducing the European Union and the Sovereign Debt Crisis briefly, and discusses TARP and its impact on the United States economy. Then the article summarizes the evolution of ESM along with the bail-out programs that have been provided by ESM and its predecessors. The article then outlines the similarities and differencesbetween ESM and TARP, particularly in the accountability structures of the two programs, and finally, analyzes the current situation in the European Union and how the region could achieve sustainable stability.

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I. INTRODUCTION

In October 2012, the European Union ("EU") established a permanent bailout fund called the European Stability Mechanism ("ESM").[1] Its main function is to provide liquidity to the Euro Area Member States through a variety of financial instruments.[2] Its objectives and functions are very similar to the Troubled Asset Relief Program ("TARP") established by the U.S. Treasury during the 2008 financial crisis.[3] However, in retrospect, there is much debate over whether the TARP was the right response.[4] This paper introduces the European Union and the Sovereign Debt Crisis briefly, discusses TARP and its impact on the United States economy, summarizes the evolution of ESM along with the bailout programs that have been provided by ESM and its predecessors, outlines the similarities and differences between ESM and TARP, particularly in the accountability structures of the two programs, and finally, analyzes the current situation in the European Union and how the region could achieve sustainable stability.

II. EUROPEAN UNION AND THE SOVEREIGN DEBT CRISIS: A BACKGROUND

The European Union was an unprecedented attempt to establish intergovernmental peace and cooperation in a war-torn Europe after World War II. What started out as the European Steel and Coal Community with six members has evolved today into a powerful organization with twenty-eight members.[5] The evolution can be traced through certain key treaties: The Treaty of Paris, the Treaties of Rome, the Treaty of Maastricht, the Treaty of Nice, and most recently, the Treaty of Lisbon.[6]

The Treaties of Rome, signed in 1957, created the European Economic Community ("EEC").[7] The EEC established a common market and free trade between the six signatory member nations.[8] A decade later, in 1967,

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[1] Matina Stevis, *Key Facts About the ESM*, WALL ST. J.: REAL TIME BRUSSELS, (Sep. 12, 2012, 10:02AM), http://blogs.wsj.com/brussels/2012/09/12/key-facts-about-the-esm.

[2] *Id.*

[3] Thomas Cooley, Matthew Richardson, & Kermit Schoenholtz, *Europe's Banks Need a TARP of Their Own*, BLOOMBERG: BLOOMBERGVIEW, (June 18, 2012, 6:30PM), https://www.bloomberg.com/view/articles/2012-06-18/saving-euro-starts-with-banks-cooley-richardson-schoenholtz.

[4] Danielle Kurtzleben, *The Case for and Against TARP*, U.S. NEWS & WORLD REPORT (May 24, 2011, 4:41PM), http://www.usnews.com/news/articles/2011/05/24/the-case-for-and-against-tarp.

[5] *The World Factbook: European Union*, CENTRAL INTELLIGENCE AGENCY, https://www.cia.gov/library/publications/the-world-factbook/geos/ee.html (last updated Oct. 31, 2017).

[6] *See id*.

[7] *Id.*

[8] *Id.*

the EEC was expanded to create the European Community ("EC").[9] The EC established a single Commission, a Council of Ministers, and the European Parliament.[10] The EC continued growing in membership in the intervening years, until in 1992, when the Maastricht Treaty expanded it to include wide-ranging intergovernmental cooperation in diverse fields such as foreign policy, defence, internal affairs, and economic and monetary policy.[11] The economic and monetary policy cooperation created the European Economic and Monetary Union ("EMU"), which is commonly referred to as the Eurozone.[12] The Maastricht Treaty laid the foundation for the European Union and the Eurozone that we know today.

The Treaty of Nice tried to institute greater integration by establishing a constitution for the EU.[13] The proposal was rejected in the referenda held in France and Netherlands.[14] The effort was renewed in the Treaty of Lisbon, and was successful the second time around in achieving the original vision of integration envisioned by the Treaty of Nice.[15] The Treaty of Lisbon established the EU as the successor of the EC, replacing it and providing the Treaty on European Union ("TEU") and the Treaty on the Functioning of the European Union ("TFEU").[16]

The common currency, the euro, came into existence in 1999 and was initially adopted by eleven member states.[17] In the meantime, the EU continued growing, increasing its membership to the current size of twenty-eight.[18] Only nineteen states of the twenty-eight use the common currency.[19]

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[9] *Id.*

[10] *Id.*

[11] *Maastricht Treaty*, BBC NEWS: IN DEPTH: EURO GLOSSARY (Apr. 30, 2011, 11:51AM), http://news.bbc.co.uk/2/hi/in_depth/europe/euro-glossary/1216944.stm.

[12] *Id.; Euro Area – EMU*, OECD (Apr. 17, 2013), https://stats.oecd.org/glossary/detail.asp?ID=862.

[13] *See* Bruno Waterfield, *Lisbon Treaty Q & A: Your Guide to What It Means and What Happens Next*, THE TELEGRAPH (Sept. 4, 2009), http://www.telegraph.co.uk/news/majornews/6257617/Lisbon-Treaty-Q-and-A-your-guide-to-what-it-means-and-what-happens-next.html.

[14] *Id.*

[15] *See id.*

[16] Kyriakos Fountoukakos, Kristien Geeurickx and Jacques Buhart, *The Lisbon Treaty – brief overview of the key changes*, LEXOLOGY (Nov. 4, 2009), https://www.lexology.com/library/detail.aspx?g=48a4327a-c5e8-41a7-8000-c93e90abe763.

[17] Edmund L. Andrews, *Outlook 1999: International; With Euro, Europe Reinvents Itself*, N.Y. TIMES (Jan. 04, 1999), http://www.nytimes.com/1999/01/04/business/outlook-1999-international-with-euro-europe-reinvents-itself.html.

[18] Will Martin, *The Entire History of the Euro in One Chart*, BUSINESS INSIDER (Jan. 03, 2017), http://www.businessinsider.com/knight-frank-chart-on-the-history-of-the-euro-2017-1.

[19] *Id.*

Title VIII of the TFEU lays the foundation of the economic and monetary union.[20] While the treaty creates a strong monetary union and the union exercises authority over the monetary policies, economic and fiscal policy are left primarily to the discretion of the member states.[21] Article 127 of the TFEU establishes that the European Central Bank ("ECB") would conduct the monetary policy of the union in conjunction with and supported by the National Central Banks of the member states of the EMU.[22] The ECB and National Central Banks of the Eurozone member nations constitute the European System of Central Banks (also referred to as the Eurosystem to differentiate them from the system of banks supporting the twenty-eight member EU).[23]

Article 125 of the TFEU calls for a "no bailout" policy for the European Union.[24] In the face of this policy and the lack of fiscal integration between the member nations, the economic health of the union depends largely on member states exercising discipline over their individual fiscal policies.[25] Article 126 of the TFEU establishes guidelines on monitoring and enforcing this fiscal discipline.[26] Historically, the member nations of the EU agreed on a pact to ensure fiscal discipline.[27] This pact was called the Stability and Growth Pact ("SGP") and was adopted in 1997.[28] However, the SGP did not have clout over the member nations and was found to be a weak form of control over national government spending in the member nations of the EMU.[29] Most members failed to strictly follow the rules set forth by the SGP.[30] In 2011, right in the midst of the sovereign debt crisis, significant amendments were introduced to strengthen the SGP.[31] These were called the Six-Pack and the Two-Pack.[32] Most recently, these amendments were followed by the 2012 Treaty on Stability, Coordination, and Governance in the Economic and Monetary Union (commonly referred to

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[20] Vassilis Paliouras, *Why Europe Should Say "No" to the Proposed Framework of Economic Governance: A Legal and Policy Analysis in Light of the Establishment of the European Stability Mechanism and the Euro Plus Pact*, 15 TOURO INT'L L. REV. 39, 41 (2012).

[21] *Id.* at 42.

[22] René Smits, *The Crisis Response in Europe's Economic and Monetary Union: Overview of Legal Developments*, 38 FORDHAM INT'L L.J. 1135, 1139 (2015).

[23] *Id.* at 1139.

[24] *See* Consolidated Version of the Treaty on the Functioning of the European Union art. 125, Sept. 5, 2008, 2008 O.J. (C 115) 47, 99 [hereinafter TFEU].

[25] *See* Smits, *supra* note 22, at 1140-41.

[26] *See* TFEU art. 126, *supra* note 24.

[27] *See* Smits, *supra* note 22, at 1141.

[28] *See id.* at 1141-42.

[29] *Id.* at 1142.

[30] *Id.*

[31] *Id.* at 1144.

[32] *Id.* at 1145-50.

as the "Fiscal Compact" or TSCG).[33]

The Fiscal Compact is different from the earlier initiatives in that it mandates that the member states implement national laws that require a balanced national budget, i.e., it requires an amendment to national constitutions (or the national equivalent to a constitution) requiring national governments to maintain a balanced budget.[34] It also empowers member nations to bring suits against another member that is violating this requirement in the European Court of Justice ("ECJ").[35] Member nations have given up significant control over their budgetary sovereignty under the Fiscal Compact.[36]

The divergence between how the monetary policy is exercised versus how the economic and fiscal policy is exercised creates a disconnect that is largely responsible for the crisis the European Union is currently facing.[37] The loss of monetary policy to the ECB had unforeseen, and in retrospect, catastrophic impact to the economies of certain member states.[38] The ECB's policy was based on averages, trying to establish a policy that would work "on average" for all economies that are a part of the EMU.[39] However, this view ignores the very real differences existing between the economies of the member nations—Germany's economy is fundamentally different from that of Ireland's, France's from that of Greece's.[40] There was no one single formula that fit all in this situation. This led to a monetary policy that created bubbles in economies like those of Spain and Ireland and encouraged irresponsible fiscal spending in economies such as Greece.[41]

Initially, during the boom between the years of 2003 to 2007, there was not much attention paid to how ECB's policy was impacting the fiscal policies of member states.[42] As mentioned above, states were not adhering strictly to the requirements under the SGP. It was only after the credit crisis of 2008, which led to a massive revaluation of assets and bursting of the real estate boom across the globe, that red flags were raised on the debt levels of member nations of the EMU (beginning with Greece).[43] Late in 2009, after Greece grossly violated the deficit to GDP ratio required by the TFEU due to a revaluation of the deficit levels, Greece's debt ratings were down-

[33] *Id.* at 1151.
[34] *Id.*
[35] *Id.* at 1152.
[36] *See id.* at 1151-52.
[37] *See id.* at 1143.
[38] *Id.*
[39] *See id.*
[40] *See id.*
[41] *Id.*
[42] Philip R. Lane, *The European Sovereign Debt Crisis*, 26 J. ECON. PERSP. 49, 54 (2012).
[43] *Id.* at 56.

graded.[44] The downgrade saw widening spreads between the yields on the sovereign bonds of Greece versus other countries in the EMU.[45] There was a domino effect where other countries with high debt to GDP ratios saw widening yield spreads and credit rating downgrades: Ireland and Portugal between late 2010 to early 2011, with Spain and Italy following in 2011.[46]

Although the sovereign debt crisis seems to be a very different animal compared to the financial crisis in the United States that was precipitated by the real estate crash, their effects have been strikingly similar in freezing the credit markets and drying up liquidity.[47] Before delving into the particulars of ESM and its impact on the EU economy, it would be helpful to consider how the United States responded to and contained the credit crisis. The next section discusses the TARP set up in the United States to counter the impact of the 2008 financial crisis.

III. TROUBLED ASSET RELIEF PROGRAM

In March 2008, Bear Stearns collapsed and was subsequently bought by J.P. Morgan Chase for a deeply discounted price of $10.00 per share.[48] An emergency loan from the Federal Reserve of New York had been unsuccessful in saving the bank once the losses on securitized mortgage products started piling up rapidly.[49] This was the beginning of a financial meltdown that almost completely froze capital markets in the United States and to a large extent, internationally. The weekend that Lehman Brothers went bankrupt also stands out as a key event in the financial panic of 2008.[50] Merrill Lynch was also on the brink of a very similar fate before being acquired by Bank of America the very same weekend.[51] A week before, on September 7, 2008, the federal government had nationalized Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation after billions of dollars were written off by these organizations as bad loans.[52] The Federal Reserve and Treasury were stretched beyond their means and were still unable to contain the panic in the financial markets. After the Lehman collapse, the Treasury Secretary, Henry Paulson, approached Congress with a proposal to purchase $700 billion of securitized

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[44] *Id.*
[45] *Id.*
[46] *Id.* at 57.
[47] *See* Nelson D. Schwartz, *Financial Turmoil Evokes Comparison to 2008 Crisis*, N.Y. TIMES, Aug. 11, 2011, at A1.
[48] Joshua Ruby, *Sound and Fury, Confused Alarms, (Fn2) and Oversight: Congress, Delegation, and Effective Responses to Financial Crises*, 47 HARV. J. ON LEGIS. 209, 213 (2010).
[49] *Id.* at 213.
[50] *See id.* at 213.
[51] *Id.*
[52] *Id.*

mortgage products that were behind the collapse of the markets.[53] Although the House of Representatives did not pass the initial draft of the bill, by October 3, 2008, an expanded bill with added legislation on areas such as tax and energy was passed successfully and signed into law by President George W. Bush as the Emergency Economic Stabilization Act ("EESA").[54] The authority to purchase troubled assets as part of TARP under EESA was set to expire on December 31, 2009.[55] The key aims of EESA and TARP were to ensure that families did not lose their homes, troubled assets were removed from the balance sheets of financial institutions, and that the taxpayers' interest were protected while achieving the first two aims.[56]

Congress delegated its TARP oversight responsibilities to four bodies under the EESA: The Financial Stability Oversight Board ("FSOB"), the Special Inspector General for the Troubled Assets Relief Program ("SIGTARP"), the Congressional Oversight Panel ("Panel"), and the Government Accountability Office ("GAO").[57] Congress retained supervisory oversight over these bodies.[58] While FSOB and SIGTARP were executive bodies, the latter two (Panel and GAO) were legislative bodies.[59] The FSOB was responsible for monitoring and reporting on the effectiveness of the program and for recommending new or different courses of actions for the Treasury.[60] SIGTARP was responsible for monitoring TARP for fraud and abuse.[61] The Panel was tasked with producing monthly oversight reports on whether the Treasury was successful in stabilizing the US economy.[62] The Panel also had the power to hold hearings.[63] GAO was the implementation oversight arm of the legislative branch—in its bimonthly reports it reviewed the effectiveness of TARP and the acquisitions made by the program.[64] It was also responsible for an annual audit of TARP.[65]

However, on October 28, 2008, soon after President Bush signed the EESA under TARP, nine banks received liquidity injection from the Treas-

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[53] *Id.*

[54] *Breakdown of the Final Bailout Bill*, WASH. POST (Sep. 28, 2008, 12:23 PM), http://www.washingtonpost.com/wp-dyn/content/article/2008/09/28/AR2008 092800900.html.

[55] *Id.*

[56] *See* Ruby, *supra* note 48.

[57] *Id.* at 209.

[58] *Id.*

[59] *Id.* at 216.

[60] *Id*. at 217.

[61] *Id*.

[62] *Id*. at 218.

[63] *Id.*

[64] *Id.*

[65] *Id.*

ury through the Capital Purchase Program.[66] As part of this program, the Treasury purchased $250 billion worth of preferred equity in the nine participating banks.[67] The participating banks were: Goldman Sachs Group Inc., Morgan Stanley, J.P. Morgan Chase & Co., Bank of America Corp. (which had just agreed to purchase Merrill Lynch), Citigroup Inc., Wells Fargo & Co., Bank of New York Mellon, and State Street Corp.[68]

The Capital Purchase Program was designed to function through a voluntary election by the bank to apply for a credit line to their principle financial regulator.[69] However, there was controversy surrounding the banks' willingness to sell their preferred stock to the Treasury.[70] The meeting of the Chief Executive Officers of the nine banks with the Treasury Secretary, Mr. Paulson, was fraught with tension and there were banks amongst the nine that did not want to participate in the program at all.[71] They felt that their balance sheets were healthy and did not require a capital injection from the government.[72]

The other key initiatives undertaken as part of TARP were: the Community Development Capital Initiative ("CDCI"), Capital Assistance Programs ("CAP"), American International Group ("AIG") Investments, Targeted Investment Program ("TIP"), Asset Guarantee Program ("AGP"), Automotive Industry Support Program ("AISP"), Credit Market Program ("CMP"), Public Private Investment Program ("PPIP"), and TARP Housing Programs.[73]

The CDCI invested capital, up to $570 million, into Community Development Financial Institutions.[74] These institutions operate in markets that are not served by mainstream financial institutions.[75] The CAP was an initiative to develop and implement exhaustive "stress tests" to help assess the health of key bank holding companies in the United States.[76] The stress tests were helpful in restoring confidence in the financial markets and banks

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66 Capital Purchase Program, U.S. DEP'T TREASURY, https://www.treasury.gov/initiatives/financial-stability/tarp-programs/bank-investment-programs/cap/pages/default.aspx (last updated Dec. 31, 2015, 10:06AM).

67 *Id.*

68 *Id.*

69 Mark Lander & Eric Dash, *Drama Behind a Banking Deal*, N.Y. TIMES, Oct. 14, 2008, at A1.

70 *Id.*

71 *Id.*

72 Daniel G. Murray & William H. Quirk III, *Capital Purchase Program Funds: Thanks, But Maybe No Thanks*, BANK ACCT. & FIN., Jun-Jul. 2009, at 42 (2009).

73 OFF. OF MGMT. & BUDGET, BUDGET OF THE UNITED STATES GOVERNMENT: ANALYTICAL PERSPECTIVES, FISCAL YEAR 2017, at 342-45 (2016).

74 *Id.* at 342.

75 *Id.*

76 *Id.*

were able to raise capital from the private sector after the results of the successful tests were published.[77]

Under the AIG Investments plan, by December 31, 2008, the Treasury had invested $40 billion into buying preferred shares of AIG.[78] The Treasury's rationale was to mitigate systemic risks from a collapse of AIG.[79] AIG underwent recapitalization and restructuring followed by an IPO in May 2011.[80] After the IPO, the Treasury had a stake of 77% in the company, down from 92% in January 2011.[81] After several public offerings in the next two years, the Treasury exited their position in the company fully.[82] TARP's investments into AIG totalled $67.8 billion, of which $55.3 billion was recovered by the time the Treasury exited the program.[83]

TIP's aim was to stabilize financial institutions that were considered critical for the stability of the financial system.[84] Under this program, the Treasury invested $20 billion in preferred stock of Citigroup and another $20 billion in preferred stock of Bank of America.[85] By December 2009, both banks had repaid the investments along with $3 billion in dividend payments.[86] The program cost the Treasury $40 billion and yielded $44.4 billion.[87]

AGP was established to guarantee assets held by financial institutions considered to be critical to the financial system of the United States.[88] Under this program, losses of up to $5 billion were guaranteed by the Treasury on Citigroup's $301 billion portfolio.[89] A claim was never made and the program yielded $3.9 billion in cash back for the federal government.[90]

AISP was established to prevent the collapse of the automotive industry in December 2008.[91] TARP provided emergency loans to Chrysler, Chrysler Financial, and GM under this program.[92] TARP also invested in the financial arm of GM called GMAC (later Ally Financial) and helped

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[77] *Id.*
[78] *Id.* at 343.
[79] *Id.*
[80] *Id.*
[81] *Id.*
[82] *Id.*
[83] *Id.*
[84] *Id.*
[85] *Id.*
[86] *Id.*
[87] *Id.*
[88] *Id.*
[89] *Id.*
[90] *Id.* at 344.
[91] *Id.*
[92] *Id.*

Chrysler and GM with their bankruptcy proceedings.[93] Under this program, TARP invested a total of $79.7 billion and received $70.5 billion in cash back.[94] CAP provided lending for consumers and small businesses through loan facilities and programs.[95]

PPIP was established to help financial institutions remove mortgage backed securities from their balance sheets.[96] Under this program, public-private investment funds were set up to buy securities from financial institutions (since the private market for these securities had dried up).[97] By November 30, 2015, this program involved an investment of $18.6 billion and yielded $22.5 billion.[98]

TARP Housing Programs were aimed at ensuring that families did not lose their homes to foreclosure.[99] The programs provided financing for mortgages to homeowners who were making a good faith effort to repay their debts.[100] The program also aimed to contain the spill-over effects of foreclosures.[101]

As is evident by the breadth of programs undertaken as part of TARP and the magnitude of taxpayer funds committed to it, it was an unprecedented effort to stabilize the economy. The next section considers the impact of the program and discusses whether TARP was successful in its mission.

IV. IMPACT OF TARP ON THE US ECONOMY

There are divergent views on how TARP impacted the US Economy in retrospect. While it has largely been credited as being instrumental in stemming the wave of bankruptcies during the crisis and bringing stability to a panicked financial markets,[102] many critics have found TARP to have been woefully lacking in addressing the needs of the wider population during a moment of immense financial turbulence.[103]

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[93] *Id.*

[94] *Id.*

[95] *Id.*

[96] *Id.* at 345.

[97] *Id.*

[98] *Id.*

[99] *Id.*

[100] *Id.*

[101] *Id.*

[102] *See* Jonathan Weisman, *U.S. Declares Banks and Auto Bailouts Over, and Profitable*, N.Y. TIMES, Dec. 19, 2014, at B1.

[103] *See* The Editorial Board, Editorial, *The Real Bailout Victims*, N.Y. TIMES, Oct. 23, 2014, at A26; *see also Emergency Economic Stabilization Act: One Year Later Before the Subcomm. on Banking, Housing and Urban Affairs*, 111th Cong. (2009) (testimony of Elizabeth Warren, Chairwoman, Congressional Oversight Panel, Troubled Asset Relief Program).

In its final report published in March 2011, the Congressional Oversight Panel ("COP") critically analyzed the impact of TARP.[104] The COP found that the program was an extremely high-risk undertaking for the government, especially when using the taxpayers' money to fund the program.[105] If there had been another wave of bankruptcies or if the recovery had not proceeded as planned, the program could have lost the federal government trillions.[106] The program further fed into the financial markets perception of large banks being "too big to fail" and smaller banks not having the same protection.[107] This implicit assumption was built into the borrowing costs of these institutions in the financial markets, leading to higher costs for smaller actors and discounted costs for the larger actors.[108] This further incentivized large banks to take federal protection for granted in the future, creating moral hazard problems.[109]

Capital injection using TARP sent out a strong negative signal to the financial markets about the health of the participating banks. Of the nine banks that participated initially in the program, many were hesitant to accept the investment into their preferred equity stock because they expected private investors to interpret it as a sign of weakness.[110] In an environment of financial panic and chaos, even a minute negative signal to the market could potentially lead to substantive loss in stock value.[111] The potential participants also worried about greater regulatory scrutiny by the regulators in the future if they decided to participate.[112] A study on the impact of Capital Purchase Program on the stock performance of participating banks indicated that these banks underperformed the non-participating banks by 5.6% during the period the program was initiated.[113] However, after the initiation, the valuation of the bank stocks adjusted upward such that they were outperforming the non-participating banks by 10.3 percent.[114] The research

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[104] *See* CONGRESSIONAL OVERSIGHT PANEL: MARCH OVERSIGHT REPORT: THE FINAL REPORT OF THE OVERSIGHT PANEL (2011).

[105] *Id.* at 2.

[106] *Id.*

[107] *Id.*

[108] *Id.*

[109] *See id.*

[110] *See* Murray & Quirk III, *supra* note 72, at 42.

[111] Eric Dash & Jack Healy, *New Plan, Old Doubts*, N.Y. TIMES, Feb. 11, 2009, at B1.

[112] *Id.*

[113] Jeffrey Ng, Florin Vasvari & Regina Wittenberg-Moerman, *The Impact of TARP's Capital Purchase Program on the Stock Market Valuation of Participating Banks*, 14 (Dec. 2011) (unpublished manuscript) (on file with University of Chicago Booth School of Booth School of Business), http://faculty.chicagobooth.edu/Regina.Wittenberg%20moerman/research/pdf/ImpactTARP'sCapitalPurchaseProgram.pdf.

[114] *Id.*

found that banks with stronger fundamentals were more likely to participate in the program, i.e. the banks that participated in CPP were generally more profitable and had lower ratio of non-performing to total loans compared to the non-participating banks.[115] Given this, the devaluation in the stock was likely due to negative investor sentiment existing in the market.[116] This sentiment reversed post-initiation period of the CPP, the study suggests, as a result of positive stress test results for the banks, early repayments by the banks of the capital injections, and regular payments on the investment made by TARP.[117]

Further, there were concerns over transparency and accountability of the program.[118] TARP was conceived originally for the purchase of troubled assets; however, a majority of its initiatives went towards injecting capital in the form of equity purchases.

When TARP purchased equity of banks under the CPP, there was no way of determining whether the capital was used to divest the bad assets or was diverted towards something else.[119] There was widespread public anger over the program that seemed to be handing taxpayer money to large banks while it was ineffective in ensuring that people were not losing their homes.[120] The COP report found that TARP had failed in ensuring that the tide of foreclosures was stemmed.[121]

Having considered the structure and impact of TARP in detail, we are now in a position to pivot our attention towards European Stability Mechanism and its role in helping the EU manage the sovereign debt crisis. Fundamentally, ESM and TARP are both programs involving direct liquidity injection into economies dealing with frozen credit markets. The next section lays out the structure of ESM and its impact in stabilizing the EU countries that were most severely impacted by the crisis.

V. EUROPEAN STABILITY MECHANISM: HISTORY AND EVOLUTION

The objectives and functions of the ESM are very similar to those of TARP. It is the most recent step in a long series of steps by the European Union to contain a sovereign debt crisis that has raised existential doubts for the union. Yield spreads widened considerably for the EU countries burdened with rising sovereign debt, leading to them being locked out from

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115 *Id.*

116 *Id.*

117 *Id.*

118 *Id.*

119 *See* CONGRESSIONAL OVERSIGHT PANEL: MARCH OVERSIGHT REPORT: THE FINAL REPORT OF THE OVERSIGHT PANEL, *supra* note 104, at 3.

120 *Id.*

121 *Id.*

the bond markets.[122] The EMU member states agreed that intervention was required to ensure that liquidity was available to the economic ecosystem of these countries.[123] This intervention took the form of direct financial aid, leading to several temporary measures to help the affected nations, ranging from loans from the International Monetary Fund[124] to *ad hoc* bailout funds such as the European Financial Stability Mechanism ("EFSM")[125] and the European Financial Stability Fund ("EFSF").[126] Finally, and most recently, the ESM was established as a permanent bailout fund for the region.[127] So far, five countries have received aid from these vehicles: Greece, Ireland, Portugal, Spain, and Cyprus.[128]

The EFSM was established in early 2010, authorizing the EU Commission to raise money from financial institutions and to then lend that money to the impacted nation.[129] The EFSF was established outside of the European Union, as a corporation under the jurisdiction of Luxembourg.[130] The EMU member states were the shareholders of the corporation.[131] To raise capital for providing aid to struggling member nations, EFSF issued bonds in the capital market insured by collateral posted by the shareholders as paid in capital to the corporation.[132] The EFSF, through its capacity to raise capital as a corporation, had access to provide significantly higher amount of aid compared to EFSM.[133]

The ESM is a permanent bailout fund, which was established in October 2012.[134] Similar to EFSF, ESM was established out the European Union by an *ad hoc* treaty, a treaty establishing the European Stability Mechanism.[135] It replaces EFSF and is structured similarly as an intergovernmental organization established as a corporation under the laws of Luxembourg.[136] TFEU was amended to include verbiage in Article 136 indicating that the member states of EMU could establish a bailout fund to stabilize

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[122] *See* Lane, *supra* note 42, at 56-57.
[123] *Id.*
[124] *See* Hofmann, *supra* note 37, at 525.
[125] *Id.*
[126] *Id.* at 527.
[127] *Id.* at 528.
[128] *Id.* at 529.
[129] *Id.*
[130] *Id.*
[131] *Id.*
[132] *Id.*
[133] *Id.* at 528.
[134] Martina Stevis, *Key Facts about the ESM*, WALL ST. J.: REAL TIME BRUSSELS (Sep. 12, 2012, 9:50 am), http://blogs.wsj.com/brussels/2012/09/12/key-facts-about-the-esm.
[135] *See* Hofmann, *supra* note 37, at 530.
[136] *Id.*

the euro if required.[137]

The Euro area member states are ESM's shareholders and provide a total capital stock of €704.8 billion, divided according to a "contribution key" amongst the member states.[138] ESM has a board of governors, a board of directors and a board of auditors.[139] The Board of Governors is composed of finance ministers of the member states of EMU.[140] Each member state selects a governor on the board and the governor appoints a director and an alternate director to the board of directors.[141] The Board of Auditors is composed of five members appointed by the Board of Governors.[142] The Managing Director of the ESM is appointed for a term of five years and is the legal representative of the organization.[143] Each of the three governance bodies has specific functions described in the ESM bylaws, Rules of Procedures, and various ESM Guidelines.

ESM is capitalized through paid-in capital and committed callable capital of its shareholders.[144] Currently, the paid-in capital equals €80.5 billion and the committed callable capital equals €624.3 billion, leading to a total capital of €704.8 billion.[145] The lending capacity of ESM is a maximum of €500 billion.[146] ESM uses its subscribed capital to raise money in the capital markets through the issuance of financial instruments to a variety of investors.[147] It can provide aid to member states of EMU who have been shut out of the bond markets through six key instruments: stability support loan, primary and secondary market support facility, indirect recapitalization, direct recapitalization, and preventative credit lines.[148]

VI. BAILOUTS FACILITATED THROUGH THE ESM AND ITS

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[137] *Id*.

[138] *Shareholders*, ESM, https://www.esm.europa.eu/esm-governance#anc_shareholders(last visited Feb. 06, 2017).

[139] *ESM Governance Structure*, ESM, https://www.esm.europa.eu/esm-governance#board_of_governors (last visited Feb. 06, 2017).

[140] *Board of Governors,* ESM, https://www.esm.europa.eu/esm-governance# board_of_directors (last visited Feb. 06, 2017).

[141] *Board of Directors,* ESM, https://www.esm.europa.eu/esm-governance# board_of_directors (last visited Feb. 06, 2017).

[142] *Board of Auditors,* ESM, https://www.esm.europa.eu/esm-governance/board-auditors (last visited Feb. 06, 2017).

[143] *See* ESM, *supra* note 140.

[144] *ESM Factsheet*, ESM, https://www.esm.europa.eu/sites/default/files/2015-12-16esmfactsheet.pdf (last visited Jan. 02, 2018).

[145] *Id.*

[146] *Id.*

[147] *Id.*

[148] Alienor Anne Claire Duvillet-Margerit & Marcel Magnus, *European Stability Mechanism (ESM): Main Features, Oversight and Accountability*, EUR. PARLIAMENT 3-5 (Jan. 17, 2017).

PREDECESSORS

This section delves deeper into the problems experienced by the economies of the five countries that have received aid from ESM, and its predecessors, and investigates the impact of these bailouts.

Greece

Greece was the first EMU member state to find itself on the brink of default in 2009.[149] In May 2009, the new post-election government in Greece announced that the debt figures for that year had to be revised upwards from 6.0 to 12.7 percent.[150] This large and unexpected revision was followed by the Greek government's retrospective adjustment of debt figures for the past several years.[151] It was found that Greece had been reporting much lower figures for its debt to GDP ratio than what it should have been.[152] Further investigation revealed that Greece was able to do this through buying derivatives from investment banks, such as interest rate swaps, that had a long-term payout policy.[153] Neither the derivatives, nor the payouts were included in the debt calculations as they were not considered to be loans held by the government.[154] Eurostat, the European Union's statistical office, published a report in January 2010 with allegations of fraudulent data.[155]

Greece owed its creditors $300 billion and most of that debt was held by banks, both domestic and international.[156] This was a situation very similar to the "too big to fail" banks in the United States. It was thought that a default would create panic in the financial markets, which would thus freeze lending for a protracted amount of time.

In May 2010, The European Commission set up the Greek Loan Facility to provide bilateral loans of up to €80 billion over the period of May 2010 to June 2013.[157] The final amount disbursed was much lower at €2.7 billion.[158] This was in conjunction with €30 billion provided by the IMF

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[149] *See* Lane, *supra* note 42, at 56.
[150] *Id*.
[151] *Id*.
[152] Louise Story, Landon Thomas Jr. & Nelson D. Schwartz, *Wall St. Helped to Mask Debt Fueling Europe's Crisis*, N.Y. TIMES, Feb. 14, 2010, at A1.
[153] *Id.*
[154] *Id.*
[155] *Id.*
[156] *See id*.
[157] *Financial Assistance to Greece*, E.U. COMMISSION, https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/eu-financial-assistance/which-eu-countries-have-received-assistance/financial-assistance-greece_en (last visited Feb. 05, 2017).
[158] *Id.*

under a standby arrangement.[159] On March 14, 2012, a second bailout program was instituted for Greece.[160] The undisbursed amount from GLF along with an additional €130 billion was to be provided.[161] This program was to be financed primarily through EFSF, a predecessor of ESM.[162] Until June 2015, a total of €164.5 billion were disbursed through this program—144.7 billion from the EFSF and 19.8 billion from the IMF.[163] After the second bailout program expired, the Greek government made a formal request for further capital on July 8, 2015.[164] This bailout was financed through the ESM—the first disbursement of €13 billion was made on August 20, 2015 and an additional €10 billion was earmarked for bank recapitalization.[165] The first disbursement was closely followed by the signature of an MoU between the EMU and Greece that contains wide-ranging fiscal policy conditionality.[166]

Ireland

Ireland's economy entered a severe recession in 2008.[167] Until 2007, Ireland had been experiencing a boom in economy founded primarily on rising housing prices and high labor productivity in its construction sector.[168] The rise in construction and subsequent housing prices was driven by Irish financial institutions offering mortgages at extremely low rates compared to the historical precedent.[169] The growth in house completions can be seen through the extraordinary numbers: total stock of houses stood at 1.2 million in 1991, rising to 1.4 million by 2000, and then rapidly increasing to 1.9 million by 2008.[170] Similarly, house completions went from 19,000 in 1990 to 50,000 in 2000 and exploding to 93,000 in 2006.[171] The boom in the economy was fuelled single-handedly by the housing demand and the construction industry.[172]

The gross overvaluation of the housing prices started correcting itself

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159 *Id.*
160 *Id.*
161 *Id.*
162 *Id.*
163 *Id.*
164 *Id.*
165 *Id.*
166 *Id.*
167 Karl Whelan, *Ireland's Economic Crisis: The Good, the Bad, and the Ugly*, U.C. Dublin CTR. ECON. RES. 1, 8 (June 2013), http://www.karlwhelan.com/Papers/Whelan-IrelandPaper-June2013.pdf (last visited Nov. 21, 2016).
168 *Id.* at 6.
169 *Id.*
170 *Id.*
171 *Id.*
172 *Id.*

after the financial crisis in the United States triggered a worldwide slowdown.[173] There was a halt in the construction activities, a fall in the demand for houses and a consequent fall in housing prices.[174] The collapse in the construction industry led to high unemployment as this was the industry that had singlehandedly created the booming economy and employed a large number of people in the workforce.[175] This was the beginning of a fiscal collapse for Ireland. With high unemployment, tax revenues collected by the government fell sharply along with an increased outflow of social welfare payments.[176] A decline in real GDP with a magnitude of up to 10 percent combined with decrease in tax revenues and increased social welfare payments led to a sudden increase in the country's debt to GDP ratio.[177] The final straw for the Irish economy was a banking crisis that followed bursting of the construction bubble and increasing sovereign debt.[178] Irish banks had large exposure to the real estate market through the mortgage loans.[179] With the real estate market declining, investors became increasingly hesitant to lend money to these banks, eventually freezing them out of the bond markets.[180] In September 2008, the Irish government provided a blanket guarantee to the existing and future liabilities of domestic Irish banks.[181] However, this guarantee was not enough to stem the tide of negative investor sentiment and Irish banks continued to face difficulties in raising capital from the financial markets.[182]

By 2010, Irish banks were borrowing from ECB in much larger volumes than seen before.[183] By November 2010, the Irish government had requested support from the EMU and an Economic Adjustment Program was formally agreed by December.[184] The bailout consisted of contributions from the two predecessors of ESM (€22.5 billion from EFSM and €17.7 billion from EFSF), bilateral loans from the United Kingdom (€3.8 billion), Sweden (€0.6 billion) and Denmark (€0.4 billion), and loans from the IMF (€22.5 billion).[185]

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[173] *Id.* at 7.
[174] *Id.* at 9.
[175] *Id.*
[176] *Id.* at 10.
[177] *See id.*
[178] *Id.* at 11.
[179] *See id.*
[180] *Id.*
[181] *Id.* at 13.
[182] *Id.*
[183] *Id.*
[184] *Financial Assistance to Ireland*, https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/eu-financial-assistance/which-eu-countries-have-received-assistance/financial-assistance-ireland_en (last visited Feb. 02, 2017).
[185] *Id.*

Spain

The Spanish economy went through a very similar cycle of a real estate market bubble, construction boom, irresponsible bank lending practices, and the eventual bursting of the bubble as the Irish economy.[186] Spanish banks were typically considered a model for conservative lending among the Western economies because they were required to maintain capital to a much larger extent than comparable banks in other countries.[187] However, during the bubble in the real estate market, the capital requirements for Spanish banks were relaxed, leading to a situation where banks were saddled with bad mortgages and were frozen out of the credit markets.[188]

Until 2012, the Spanish government tried multiple times to recapitalize its banks.[189] Unfortunately, these measures did not lead to lowering of borrowing costs.[190] The rating agencies downgraded Spain's ratings multiple times in this period and its debt to GDP ratio reached unsustainable levels for the country.[191]

In July 2012, EMU approved aid for Spain of up to €100 billion to be disbursed through ESM.[192] The program was designed to provide capital to the banking sector of Spain.[193] The Spanish government used about €41.3 billion (39.5 billion in December 2012 and 1.8 billion in February 2013).[194] The ESM raised capital for the bailout by issuing debt securities in the form of bills and floating rate notes.[195] The bailout funds were provided to the Spanish government's bank recapitalization fund which then further disbursed it to the impacted banks.[196] The bailout was accompanied with policy conditionality focused on Spanish banking sector reforms.[197]

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186 Juan Carlos Hidalgo, *Looking at Austerity in Spain*, CATO INST.: CATO AT LIBERTY BLOG (May 31, 2012, 1:39PM), https://www.cato.org/blog/looking-austerity-spain.

187 Jonathan Weil, *The EU Smiled While Spain's Banks Cooked the Books*, BLOOMBERG: BLOOMBERGVIEW (June 14, 2012, 6:30PM), https://www.bloomberg.com/view/articles/2012-06-14/the-eu-smiled-while-spain-s-banks-cooked-the-books.

188 *See id.*

189 *Id.*

190 *Id.*

191 *Id.*

192 *Financial Assistance to Spain*, https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/eu-financial-assistance/which-eu-countries-have-received-assistance/financial-assistance-spain_en (last visited Feb. 02, 2017).

193 *Id.*

194 *Id.*

195 *Id.*

196 *Id.*

197 *Id.*

Portugal

Portugal requested aid from the EU, the EMU, and the IMF in April 2011.[198] The Economic Adjustment Program was agreed upon by May 2011 and included €52 billion from EFSF and EFSM (€26 billion from each) along with another €26 billion from the IMF.[199] An MoU was signed between Portugal and the lending bodies to enact fiscal reforms in the country to jumpstart the economy.[200]

Portugal's woes were a result of market contagion from the troubles of Greece and Ireland.[201] Robert M. Fishman, writing in the opinion pages of the New York Times, argued that Portugal had been driven into a crisis because of rating agencies and speculative traders who had driven up borrowing costs for the country.[202] He argued that Portugal had strong fundamentals and would not have needed the bailout at all if it were not for market distorting forces of actors such as rating agencies and speculators.[203]

Cyprus

The financial crisis in Cyprus was largely a result of the crisis in the banking sector of the country. After the United States' crisis in 2008, the economy of Cyprus went into a recession.[204] Growth kept declining in the next few years, while unemployment kept rising, property values declined, and the volume of nonperforming loans rose on the balance sheets of the banks.[205] The banking sector of Cyprus had large exposure to Greek debt and with the crisis in Greece, their assets were devaluing rapidly.[206] The assets took a haircut of 50% in 2011 in the midst of the Greek crisis.[207] Between March and June of 2012, rating agencies downgraded Cyprus' ratings twice.[208] Eventually, after being frozen out of the credit markets, the Cypri-

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[198] *Financial Assistance to Portugal*, https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/eu-financial-assistance/which-eu-countries-have-received-assistance/financial-assistance-portugal_en (last visited Feb. 02, 2017).

[199] *Id.*

[200] *Id.*

[201] Robert M. Fishman, Opinion, *Portugal's Unnecessary Bailout*, N.Y. TIMES, Apr. 13, 2011, at A25.

[202] *Id.*

[203] *Id.*

[204] *See* Jack Ewing, *As Cyprus Recovers From Banking Crisis, Deep Scars Remain*, N. Y. TIMES, Mar. 17, 2015, at B1.

[205] *Id.*

[206] *Id.*

[207] Tim Worstall, *There's Something Very Strange About the Cyprus Bank Haircut. Very Strange Indeed*, FORBES (Mar. 31, 2013, 11:10AM), http://www.forbes.com/sites/timworstall/2013/03/31/theres-something-very-strange-about-the-cyprus-bank-haircut-very-strange-indeed/#52113f4817d8.

[208] Catherine Boyle, *Cyprus Rating Downgraded Due to Greek Exposure*, CNBC

ot government requested a bailout from ESM on June 25, 2012.[209]

A bailout package of up to €10 billion was agreed by the EMU, with ESM providing €9 billion and IMF providing the remaining €1 billion.[210] Eventually, due to healthy economic recovery, bank recapitalization, and access to private markets, Cyprus only needed to use 6.3 billion of the 9 billion provided by ESM.[211]

VII. IMPACT OF THE ESM BAILOUTS

The impact of the ESM bailouts on the economies of the countries discussed in the section above raises similar issues as the ones discussed under the impact of TARP on the US economy: social unrest, moral hazards, and accountability issues. However, one key difference stands out in the context of EMU—the impact of austerity measures on the economic, political, and social climate of these countries.

The fiscal policy conditionality attached to the Economic Adjustment Programs frequently includes austerity measures that bring about drastic reductions in public spending.[212] Austerity economics is a dangerous, sliding slope, especially when a country's economy is in recession. When the GDP is growing sluggishly, cutting back on public spending entrenches unemployment.[213] With increasing unemployment, the population generally cuts back consumption and saves more of their disposable income, further contracting the economy.[214] In the midst of this phenomenon, the decrease in social welfare payments as a result of austerity measures creates social backlash within the country.

The catastrophic impact of austerity measures was very clearly seen across almost all the participants in the bailout programs of the EMU. There was a double-dip recession after the implementation of austerity measures: in 2012 and 2013, respectively; the economy of Cyprus contracted 2.4 and 6 percent; the economy of Greece contracted 6.4 and 3.7 percent, the economy of Portugal economy contracted 3.2 and 1.6 percent; and the economy of Spain contracted 1.6 and 1.2 percent.[215] There were widespread protests

(May 31, 2011, 1:43AM), http://www.cnbc.com/id/43220821.

[209] *Cyprus*, ESM, http://www.esm.europa.eu/assistance/cyprus (last visited Feb. 02, 2017).

[210] *Id.*

[211] *Id.*

[212] Paul Krugman, *The Austerity Delusion*, THE GUARDIAN (Apr. 29, 2015), https://www.theguardian.com/business/ng-interactive/2015/apr/29/the-austerity-delusion.

[213] *Id.*

[214] *Id.*

[215] Michael D. Arena, *The Legal Frameworks Governing Sovereign Debt and Borrowing in the United States and European Union*, 20 COLUM. J. EUR. L. 283, 283 (2014).

across these countries, calling for cessation of the austerity measures.[216] Many of these protests were indicative of a rising wave of populism across the politics of the European Union.[217]

These protests were closely related to the stigma attached to these bailouts, with the general population feeling disenfranchised over the distribution of funds. There was a feeling of discontent that the funds received went disproportionately into strengthening banks and their executives while the middle class did not see any results.[218]

To mitigate the problem of moral hazard, the bailouts were initially provided with punitive premiums of up to 300 basis points.[219] However, not only did these punitive interest rates create a situation where it was harder for the struggling economies to make payments on the loans, they also led to a perception that the rest of EMU and the IMF profited from the unfortunate situation in crisis-stricken countries.[220] Eventually, the assistance from EMU and related intergovernmental organizations (ESM, EFSF, EFSM) were given without the punitive premiums.[221]

Finally, the billions that were handed out in aid have not trickled down into the economy for these countries.[222] The funds have been used to make payments on international loans and sovereign bond payments to large bank, who held the majority of the sovereign European debt.[223] A lot of the capital has also been diverted into bolstering the balance sheets of banks teetering on the verge of bankruptcy.[224] However, it is not clear how these funds have been utilized beyond ensuring the credit markets that the banking sector of the European countries receiving aid are not recapitalized.

VIII. TARP AND ESM COMPARED

TARP and ESM arose from similar needs to bolster struggling economies in which traditional financial markets had failed to provide capital and have similar goals. This section compares the two organizations in two key facets: their accountability structures and their impact on the economy.

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[216] Eric Reguly, *From Fringe to Spotlight: European Austerity Breeds Radical Politics*, THE GLOBE & MAIL (Nov. 5, 2014), http://www.theglobeandmail.com/report-on-business/international-business/out-of-the-fringe-and-into-the-spotlight-european-austerity-breeds-radical-politics/article21462957.

[217] *Id.*

[218] *Id.*

[219] *See* Lane, *supra* note 42, at 56.

[220] *Id.* at 57.

[221] *Id.*

[222] Liz Alderman et al., *Explaining Greece's Debt Crisis*, N.Y. TIMES (June 17, 2016), http://www.nytimes.com/interactive/2016/business/international/greece-debt-crisis-euro.html?_r=0

[223] *Id.*

[224] *Id.*

Accountability Structures

As summarized in the earlier section on TARP, there were robust accountability structures around the program. In fact, due to pressures from regular audits of the program, the Treasury had to modify its behavior and strategies while implementing it.[225] In comparison, ESM does not seem to have the same amount of scrutiny on its actions.[226] This section discusses the accountability structures in place for ESM and argues that they are neither democratic in nature, nor are they enough to affect decision-making by the Board of Governors and Board of Directors.

There are certain accountability tools that are entrenched in the structure of the EU Agencies.[227] Some of these tools are consultation procedures, transparency duties, access to information, and the obligations to report to the European Parliament.[228] Since ESM was established through intergovernmental treaty between the ESM members, it falls outside the purview of the traditional European law and EU Institutions.[229] Instead, it is governed by international law.[230] This structure of ESM drastically reduces the level of oversight that the EU bodies, such as the European Parliament ("EP"),[231] European Court of Justice ("ECJ"),[232] or the European Council of Auditors ("ECA"),[233] could exercise over it.

Three provisions in the ESM Treaty could be interpreted as establishing a sort of accountability structure.[234] First, a public annual report containing an audited statement of its accounts along with providing the member states with quarterly profit and loss statements.[235] Second, ESM is required to set up an internal audit function that is compatible with international standards.[236] This audit function is the ESM's Board of Auditors.[237] ESM is also required to be audited by external auditors approved by the Board of

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[225] *See supra* note 116, at 11.

[226] *The European Stability Mechanism (ESM): No Democracy at the Bailout Fund*, CORP. EUR. OBSERVATORY: ECON. & FIN. (Jun. 5, 2014), https://corporateeurope.org/economy-finance/2014/06/european-stability-mechanism-esm-no-democracy-bailout-fund.

[227] Gregory Terrace, *The Difficult Trade-Off Between Economic Stability and Democratic Accountability: The Case Study Of The European Stability Mechanism*, UNIV. GHENT 3 (2015), http://lib.ugent.be/fulltxt/RUG01/002/214/780/RUG01-002214780_2015_0001_AC.pdf.

[228] *Id.*

[229] See *id.* at 15.

[230] *Id.* at 16.

[231] *See id.* at 23.

[232] *See id.* at 27.

[233] *See id.* at 29.

[234] *See id.* at 20-21.

[235] *Id.* at 20.

[236] *Id.* at 21.

[237] *Id.*

Governors.[238] These external auditors have the full power to inspect ESM's accounts.[239] Finally, ESM is obliged to make the annual report published by the Board of Auditors available to national parliaments and audit institutions of the member states.[240]

These provisions leave a lot to be desired. While they establish procedures for transparency, they do not establish a dialogue between the various EU institutions and ESM.[241] The European Commission ("EC") or the EP cannot directly interrogate ESM on its actions.[242] Furthermore, they do not have the power to change ESM's behavior through sanctions or hearings.[243] ESM is not answerable to the European Court of Justice unless a member state files a suit against it.[244] There is broad legal immunity for the board of governors and board of directors.[245] Contrast this with the power Congress wielded over the actions taken under TARP and the tangible ways in which TARP was modified due to Congressional oversight and hearings.[246]

Impact on the Economy

As elaborated in the sections above on the impact of TARP and ESM on the economy of the United States and the impact EMU countries respectively, both programs led to negative signals in the financial markets for the participants, whether they were sovereigns or financial institutions.[247] Both programs also created incentives for market distorting behavior, such as moral hazard.[248]

There are also similarities between the two programs in the amount of control exercised by the lending party over the funds disbursed. ESM and TARP did not exercise complete control over how the aid recipients used the capital provided to them. One of the key criticisms discussed earlier in the paper for TARP was the CPP, through which billions of dollars were injected into the balance sheet of banks without any control over how those

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238 *Id.*

239 *Id.*

240 *Id.*

241 *Id.* at 23.

242 *Id.*

243 *Id.*

244 Michael Schwarz, *A Memorandum of Misunderstanding – The Doomed Road of the European Stability Mechanism and a Possible Way Out: Enhanced Cooperation*, 51 COMMON MKT. L. REV. 389, 399-400 (2014).

245 *Id.*

246 *See supra* note 104, at 3-4.

247 *See* Ross Douthat, *Opinion, The Great Bailout Backlash*, N.Y. TIMES, Oct. 25, 2010, at A27. *See also* Daniela Schwarzer, *The EU Debt Crises: Three Weaknesses of the European Stability Mechanism*, TRIPLE CRISIS (Apr. 6, 2011), http://triplecrisis.com/the-eu-debt-crises/.

248 Schwarzer, *supra* note 247.

funds were used by the banks.[249] Comparatively, ESM arguably exercises greater control over the disbursed funds through the policy conditionalities that are tied together with the funds in the signed MoUs. However, this control exercised by ESM might actually be counterproductive. Through the policy conditionalities attached to the aid, participating EMU countries were mandated to institute austerity measures.[250] However, the oversight over how financial institutions used the funds disbursed to them through ESM was not this rigorous. Also, austerity measures prolonged the recession in several of the participating EMU nations.[251]

While TARP was based on a philosophy of quantitative easing, ESM was structured with fiscal conservatism in mind. These divergent attitudes are understandable given the fundamental difference between the United States and any individual nation member of the EMU: while the United States can control its fiscal and monetary policies, members of EMU only control the fiscal policy. Without a closer alignment of the fiscal policies of the EMU nations, ESM's success will be limited. The economy of the EU is still highly fragile and cannot be considered to have completely recovered. It would be invaluable for the region to have greater fiscal integration.

The European Union has made strong progress towards better fiscal integration in the wake of the sovereign debt crisis through the establishment of a banking union for the region.[252] However, one of the key requirements for a banking union, deposit insurance, is missing from the current implementation.[253] There is strong opposition from some member states over an EU-wide deposit insurance (nations with healthy economies are worried over having to insure assets in unhealthy economies).[254]

However, it would be prudent for the EU to strengthen the union as soon as possible because of recent developments in the region. First, Italy's banks seem to be heading towards a similar banking crisis as faced by those in Spain and Cyprus.[255] Second, while the economic situation remains tense in the region, the political situation has also taken a turn for the worse.[256] The United Kingdom voting to leave the EU ("Brexit") has fanned national-

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[249] NEIL BAROFSKY, BAILOUT: HOW WASHINGTON ABANDONED MAIN STREET WHILE RESCUING WALL STREET 27 (2012).

[250] *See* Krugman, *supra* note 212.

[251] *Id.*

[252] Hugo Dixon, *European Union's Banking Union Can Work*, INTL. N.Y. TIMES, Mar. 10, 2014.

[253] William Rhodes, *Eurozone must complete banking union to avert crisis*, FIN. TIMES (Jul. 28, 2016), https://www.ft.com/content/5eb51992-5413-11e6-9664-e0bdc13c3bef.

[254] *Id.*

[255] *Id.*

[256] *See* The Editorial Board, Opinion, *A Loss of Faith in the E.U.*, INTL. N.Y. TIMES, Sep. 19, 2016, at A10.

ist and populist movements throughout the EU.[257] This will only worsen the existing anti-EU sentiment that had arisen as a result of the widespread austerity measures.[258] A well-functioning banking union that establishes fiscal integration could be a uniting factor in this climate.[259]

IX. CONCLUSION

EU and EMU have the difficult task of functioning as a well-integrated federation of member states while maintaining the sovereignty of the members over important matters such as fiscal policy. Efforts to create a more robust integration such as the banking union have exposed the internal divisions within the union further. Like TARP, ESM is a fire-fighting mechanism and to be successful it requires better accountability structures to ensure that funds are channelled into the right growth areas. In the long-run, the EU cannot rely on capital injections to ensure financial stability in the region. Greater fiscal integration would ensure that conditions that give rise to crises like the one facing the EU today do not arise again in the future.

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[257] James Kanter & Stephen Castle, *'Brexit,' Migration, Trade: E.U.'s List of Crises Keeps Growing*, N.Y. TIMES, Oct. 20, 2016, at A6.

[258] Gregor Aisch, Adam Pearce & Bryant Rousseau, *How Far Is Europe Swinging to the Right?,* N.Y. TIMES (Nov. 17, 2016), http://www.nytimes.com/interactive/2016/05/22/world/europe/europe-right-wing-austria-hungary.html.

[259] *See* Rhodes, *supra* note 253.