Statistical Agencies and Responses to Financial Crises: Eurostat, Bad Banks, and the ESM

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Abstract

We demonstrate the important role that the European statistical agency—Eurostat—plays in shaping tools for responding to banking crises. From 2009, Eurostat used its position as the interpreter of member state budget statistical rules to implement increasingly stringent rules for how financial crisis responses would affect public budgets. Rather than mere technical details, these rules affected crisis responses. Elected politicians, and especially those under bailout programs, have strong incentives to minimise the direct budgetary effects of aiding failing financial institutions. By establishing and enforcing new rules about which crisis responses directly hit member state budgets and which did not, Eurostat created incentives to choose certain policies. We explore this process by examining the creation of bad banks and the European Stability Mechanism. Our paper makes an original contribution to both the study of the European banking union and the general role that statistical agencies can play in shaping crisis responses.

Keywords: financial crises, bad banks, European Stability Mechanism, Eurostat, statistical agencies, fiscal policy

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An underappreciated component of the increasing supranationalisation of responses to troubled banks is the role that Eurostat (the European Union's statistical agency) plays at the centre of the European government finance statistics regulatory regime. This regime underpins the Stability and Growth Pact (SGP) and so the European Monetary Union (EMU) and the Euro. From mid-2009, Eurostat interpreted new rules for how crisis response policies would (or would not) count against member states' budgets. Almost three years before the mid-2012 Euro area summit that Posen and Véron (2014) identify as the starting point for Europe's banking union, these rules began to develop a European model of responding to financial crises.

Though political scientists who study fiscal policy and/or European integration rarely examine Eurostat, an important exception--Savage (2005)--has argued that Eurostat's harmonisation of statistical rules was important for creating EMU and has affected member states' budgetary choices under the Euro. No similar work has explored Eurostat's role in shaping responses to financial crises. Previous research also has not considered how Eurostat affects the design of the European banking union. Literature on the political economy of responses to financial crises (e.g., Culpepper and Reinke 2014, Keefer 2007, Rosas 2009, Weber and Schmitz 2011, Woll 2014) has not researched the part that statistical agencies may play in shaping policy responses. This body of work has taken public finance statistics rules as-is without examining how they vary over place and time or how they might shape policies.

Our paper allows us to understand the important role Eurostat played in the supranationalisation of crisis responses during the development of banking union. It also contributes to understanding how statistical agencies influence crisis policy choices.

Member states have delegated Eurostat considerable authority to interpret statistical rules about how policy choices affect public deficits and debts. With this in mind, financial crises present opportunities for Eurostat to influence policy choices. Responding to crises often involves the use of new policies with fiscal implications that are not pre-specified. The crisis gave the statistical agency a need to interpret how existing rules apply to new policies, which in turn affected the relative costs to policy-makers of using policy tools. Because statistical rules determine how a given policy affects public debts and deficits, they create incentives for elected politicians, especially those having difficulty financing their budgets, to choose certain policies over others.

We chart this process through an examination of how member states created new institutions both at the domestic and European levels during the banking and related European sovereign debt crisis from 2007 through 2014 (henceforth "the financial crisis"). At the domestic level, we discuss publicly created asset management companies (AMC)--bad banks--established to acquire and dispose of troubled assets from failing banks. Eurostat interpretations increasingly incentivised the creation of AMCs with more private sector involvement. At the European level, we show how Eurostat's decisions influenced design choices for the European Stability Mechanism (ESM)--the main EU institution created to assist member states with market funding difficulties. The issue again concerned Eurostat's debt definitions.

1. Understanding Eurostat's role

Eurostat's accounting rules may seem like technical details. However, recent research has highlighted the importance of such rules for shaping behaviour. Büthe and Mattli (2011, 1), for example, discuss how

accounting rules affect corporate behaviour. Savage (2005) shows that Eurostat's accounting decisions can impact member states' policy-making.

This section proceeds in four steps to make the argument that Eurostat played an important part in shaping countries' responses to the financial crisis. We draw on the principal-agent literature to establish the baseline-level of compliance with Eurostat decisions in normal times. Then we argue that the crisis further incentivised compliance. This is important to establish, as our argument assumes that member states adhere to Eurostat's decisions even when they negatively impact their budgets. We then show how Eurostat's interpretations affected crisis responses.

1.1 Incentives to comply during normal times

The literature on delegation from member state principals to supranational EU agents, particularly the Commission of which Eurostat is a part,[2] is well-established (e.g. Majone 2001, Pollack 1997, Savage 2005, Thatcher and Stone Sweet 2002). For our investigation, it is important to consider what powers Eurostat has received and what autonomy it has. Eurostat has been delegated considerable authority to help implement the SGP. The European System of Accounts (ESA) is the primary document Eurostat implements.[3] It establishes the principles that Eurostat ensures member states use when recording debts and deficits. Delegating to Eurostat provides a number of benefits to member states that are similar to other commonly studied policy areas in the EU principal-agent literature.

[2] As the European Commission's statistical office and following Savage (2005, 10), we treat Eurostat and the wider Commission as the same.

[3] The Protocol on the EDP establishes the use of the ESA to calculate public finance figures. See http://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX:12008M/PRO/12. Accessed April 2015.

Importantly for our investigation, Eurostat monitors member state budgets and enforces incomplete contracts. In terms of monitoring, it performs "police patrols" (McCubbins and Schwartz 1984) of member state government budgets. These allow for the observation of defection from budget constraints set out in the SGP (Savage 2005, 5-10, 45). Eurostat conducts on-site visits where it questions statistical classifications and reports on its discussions. Similarly, Eurostat issues regular reports through it annual certification of member state budgets. It can choose to refuse certification to highlight non-compliance with budget rules.

Delegation also utilises Eurostat's technical expertise to enable the effective interpretation of an incomplete contract in the SGP. Member states--similar to many other contracting parties (Majone 2001, 117, Milgrom and Roberts 1990)--have not laid down all of the rules for how policies are to be accounted. EU treaties, related legislation, and the ESA do not fully specify the statistical classifications of all policies that member states may use. If established ESA rules are unclear, Eurostat, in consultation with national statistical agencies and central banks in the Committee on Monetary, Financial, and Balance of Payment Statistics (CMFB), can establish new rules by interpreting the ESA.[4] These "constitute secondary case law, and cannot be overruled by the [European] Council" (Schelkle 2009, 836). In addition, to help address incomplete contracting problems, member states can ask Eurostat to review how they have classified a policy.

[4] A list of these decision can be found at: http://ec.europa.eu/eurostat/web/government-finance-statistics/methodology/decisions-for-gfs. Accessed April 2015. Though Eurostat consults with the CMFB, it makes the ultimate decision.
The power Eurostat has been delegated when it comes to interpreting statistical rules could be thought of as a "trusteeship" (Majone 2001, see also Savage 2005). As we will see, Eurostat has been given exclusive competence in this area.

As we show below, different statistical interpretations of a given policy can have important budgetary consequences. Member states have at least four potential responses to a Eurostat decision.[5] They can comply with it. If they dislike the decision, they can threaten to bring a case to the European Court of Justice against Eurostat. They can threaten to overrule Eurostat with new legislation. Finally, they can refuse to comply on an individual basis. The first two threats are often not credible due to the EU's legislation and legislative process, which give Eurostat a wide "zone of discretion" (Thatcher and Stone Sweet 2002, 5) when it comes to interpreting statistical rules.

A court case could be brought if Eurostat does not make an interpretation "objectively" and in line with "established rules and statistical principles" (see the Online Appendix for details). However, such a case would be difficult to make if Eurostat's interpretation is based on established international statistical documents such as the ESA, which comprises the established statistical principles, and in consultation with the CMFB, which is composed of all of the relevant European and international statistical professionals. Moreover, attempting a court challenge would take some years. Even if a decision was made in the member state's favour, it would be long after the relevant budget in question was published.

It is practically difficult for member states to overturn Eurostat's interpretations with new legislation. Eurostat's legislative autonomy to interpret statistical rules comes from the Commission's--and Eurostat itself as the Commission authority solely responsible for statistics[6]--ability to act as a legislative gatekeeper. It chooses whether to propose legislation under the ordinary (codecision) procedure,[7] which

[5] *Ex ante* controls are very weak. Member states do not directly control the Eurostat recruitment process and can only dismiss the entire Commission. As such we do not discuss these possibilities in detail.

[6] See Regulation (EC) 223/2009 http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:087:0164:0173:en:PDF. Accessed April 2015.

[7] There is an extensive literature on the Commission's agenda setting power under codecision. Important contributions have argued that the Commission's power is weak. It has to propose a policy that satisfies both the European Parliament and the Council (Crombez 2001). It is largely not involved in the final stages of the legislative process (Tsebelis and Garrett 2000). This all may be true when the Commission wants to change the status quo. In

makes legislative overrides difficult. Member states in the Council could introduce an amendment to other proposed legislation. However, strict germaneness rules (Crombez and Hix 2015) limit this.

While Eurostat cannot impose fines, it has limited, but important, abilities to sanction member states ignoring its rulings. It can ask member states to revise their statistics. It can also choose not to certify a member state's budget figures. Non-certification may damage a country's credibility, leading other member states to support tougher enforcement of the Excessive Deficit Procedure (EDP), as happened with Portugal in 2002 and France in 2003 (Schelke 2009, 832). There could also be an adverse market reaction, which would affect financing costs.

1.2 Heightened incentives to comply during crises

During the crisis there were particularly strong reasons for member states--both creditors and debtors--to have Eurostat certification. Net contributors to financial assistance programs, such as Germany, benefit from an effective regime monitoring government finance statistics. It helps ensure that countries will be less likely to cheat on their budget commitments. Though not directly concerning interpretations of statistical rules, policy-makers already had a learning opportunity in Germany and France's successful attempt in November 2003 to suspend the EDP sanctions and subsequent weakening of the procedures in 2005. This move was widely regarded as having a "corrosive effect" on other countries' behaviour such that their fiscal discipline, especially Greece's, deteriorated (Bordo and James 2014, 281). During the financial crisis, surplus countries were exposed to the negative externalities of budget cheating, as they

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regards to legislative override of Eurostat's status quo interpretations, Eurostat can simply be a legislative gatekeeper, preventing the introduction of legislation that would overturn its interpretations.

Schelkle (2009, 837) documents how Eurostat learned that it had far more discretion to interpret rules than power to propose legislation changes when in the early 2000s it attempted and failed, due to Council opposition, to change a clear ESA rule regarding financial swaps.

committed to financially support troubled debtor states. Surplus countries needed a credible budget monitoring system to predict if their financing would be paid back. They needed to follow the same statistical rules that they expected debtor countries to follow.

Debtor countries also had stronger incentives to comply with Eurostat's decisions. During the financial crisis, a lack of Eurostat certification carried additional costs. It could hamper debtor access to financing. A Eurostat refusal to certify a government's numbers would worsen investors' lack of trust and put further pressure on sovereign borrowing costs. The mechanism for those debtor countries under a Troika--European Commission, European Central Bank, and the IMF--programme that did not need private financing would be different, but the result would be the same--rather than lose market confidence one would receive the rebuke of the Troika, which could delay or cancel planned payments.

1.3 Crisis and demand for Eurostat decisions

The crisis created opportunities for Eurostat to make new interpretations. Governments used many policies to respond to the recent financial crises not clearly considered in the version of the ESA in place at the time--ESA 1995. The manner in which governments assisted and resolved troubled banks affected government finances in ways that required interpretation. If a government buys equity in a troubled bank--as, for example, Ireland did with Irish Nationwide Building Society (INBS) and the Educational Building Society (EBS) in 2010--has the government spent money or does it have a different, but equivalently valued asset? Does the transaction increase the deficit, or is it what ESA 95 termed a "financial transaction", with no effect on the deficit? If a government owns a stake in an AMC--as the German government did with its AMCs--are the AMC's liabilities government liabilities counted against its debt? Or are they what the ESA 95 terms "contingent liabilities", where the government is liable only if the AMC cannot repay them? When the crisis began, the ESA did not provide clear answers.

Eurostat needed to develop new definitions for assessing how these policies would impact public debts and deficits. The initial result of this effort--based on consultations with the CMFB--was a 15 July 2009 decision on "The statistical recording of public interventions to support financial institutions and financial markets during the financial crisis",[8] followed on 10 September 2009 by a more detailed statistical guidance note.[9] Together these documents clarify how certain policies affect budgets under ESA 1995. The 2009 documents dealt with bank recapitalisations, liquidity support, guarantees, direct government asset purchases and exchanges, as well as support for "certain new bodies", such as AMCs.

The rules made distinctions about which policies, and implementations of these policies, counted as financial transactions and contingent liabilities. For example, Eurostat established that a recapitalisation would count as a financial transaction if the bank had not suffered a loss over more than one accounting period. This decision had practical implications. Ireland's repeated injections into troubled INBS and EBS were thus considered capital injections because the losses were incurred over more than one period.[10]

Over the rest of the crisis, subsequent Eurostat rule changes, which we discuss in more detail below, further constricted the types of policies that could be considered financial transactions and contingent liabilities.

Nonetheless, Eurostat's statistical rules do not mandate which policies are required or prohibited. How could they play an important role in harmonising member state responses to the crisis?

[8] See: http://bit.ly/1832ENm. Accessed January 2015.
[9] See: http://bit.ly/1KK2JaL. Accessed January 2015.
[10] See: http://bit.ly/1EJnwpy. Accessed January 2015.

1.4 Rules and policy choices during the crisis

Eurostat's interpretation of the ESA incentivises incumbent politicians to choose certain policies that limit increases in their debts and deficits. Governments are sensitive to how their public finances are accounted. Changes in recorded debts and deficits affect (a) EDP enforcement actions, (b) the need for, and costs of, financing from investors and international financial institutions, and (c) support from voters who are sensitive to threats to fiscal sustainability. Responding to crises can greatly strain public budgets, increasing pressure from all three of these sources. Because of this, accounting rules can strongly influence policy choices during financial crises.

Starting in 2008, governments faced budget difficulties from stabilising their banking sectors, falling tax receipts, and increased social spending through automatic stabilisers. For countries in international bailout programs, there was pressure from international actors to minimise gross debt. A focus of the Troika's negotiations with programme countries was "debt sustainability", i.e. re-establishing access to private market funding. The Troika required gross debt limits as a condition of assistance.[11]

Finally, though voters want financial stability, many of them are also taxpayers hesitant to spend public funds on bailouts (Keefer 2007 and Rosas 2009). Increased spending that threatens public finance sustainability could lead to tax increases. Other voters benefit from public spending on programs such as pensions, so also do not want the government to make costly bailouts that endanger the government's

[11] From interviews with officials at the ECB in October 2014. Interviewees emphasised that gross was their primary concern, believing that market actors paid more attention to gross debt. Gross debt is comparatively more reliable than net debt. Calculating net debt requires many more assumptions about future asset values.

ability to provide spending programs. Voters are sensitive to gross debts and deficits, changes to which could affect their vote choices.[12]

Incumbent politicians face a dilemma. They may want to assist banks in order to reestablish financial stability and bolster banks that are important for their local economies (see Deo et al. 2015 and Reinke 2014). They also face opposing pressures in terms of EDP enforcement, more expensive financing, and the possibility of being voted out of office for costly bailouts.

Table 1: Crisis Response Policy Types and Their Effects on Public Deficits and Gross Debt

		Debt	
		No Immediate Effect	**Immediate Effect**
Deficit	**No Immediate Effect**	- Financial transactions - Contingent liabilities	- Financial transactions funded with borrowing - Immediately realised liabilities used to fund lending
	Immediate Effect	- Capital transfers	- Capital transfers funded by borrowing

How can incumbents attempt to balance these opposing pressures? One way is to select policy responses that are largely treated as not increasing debts and deficits in the short-term.

Governments select from policies that have different effects on the budget (Table 1). Governments can make capital transfers to banks by, for example, buying equity at above market prices. These transfers increase both the government's deficit and, if funded with borrowing, the gross debt. A second option is to

[12] In theory if voters are concerned about the sustainability of public finances they should be more concerned with net debt. However, it is reasonable to assume, especially if sophisticated market actors are stymied by the measurement of net debt, that citizens will focus on gross debt.

provide contingent liabilities. Unlike immediately realised liabilities, such as the government borrowing money that it then lends to banks, contingent liabilities have no immediate effect on the debt or deficit. In the medium to long-term they could prove costly if, for example the guarantees are called. Financial transactions funded through borrowing do not impact the deficit, but do immediately impact the gross debt.

Elected politicians prefer contingent liabilities and financial transactions that do not require borrowing rather than financial transactions funded with borrowing. They least prefer capital transfers funded with borrowing.

Which policies fit into each cell in Table 1 is not fully defined *a priori*--importantly, Eurostat's rules define the accounting rules of the game. Eurostat therefore makes a given crisis response policy more or less attractive. This leads to our main hypothesis:

H1: *The cumulative result of Eurostat's decisions is to create a model of responding to failing banks common across member states where governments prefer policies that are classified by Eurostat to be contingent liabilities or financial transactions.*

One should note that Eurostat rules only prescribe a policy's statistical treatment, not the policy. Thus we expect that even if a country fully complies, a number of factors interact with Eurostat rules to create policy choices. First, the greatest impact will be on countries that face the strongest pressures to minimise debts and deficits. So we expect that:

H2: *There should be an* interaction *between accounting rules and governments' fiscal positions. Governments in more dire fiscal positions will be more likely to choose contingent liability and financial transaction-creating policies.*

Second, there are likely situations where governments find it in their interest to choose policies creating large immediately realised liabilities and/or capital transfers. This is particularly true when an AMC is being created for a publicly-owned failed bank. In general, creating a privately-owned AMC is attractive because many of its costs would be contingent liabilities. For privately-owned failed banks, their shareholders can be "bailed-in". However, incentivising private investors to invest in a bad bank for a publicly-owned failed bank likely means imposing considerable losses on the failed bank's owner--the state. Otherwise private investors would not find it profitable to participate. On balance, in these situations a public bad bank may have smaller immediate budgetary implications. This leads to our final hypothesis that:

H3: *Given the specifics of Eurostat's ruling regarding AMC ownership, there should also be an* interaction *between accounting rules and the investor environment. If governments cannot attract private investors such that on net the AMC is less immediately costly, then they will create publicly-owned AMCs.*

In theory, the hypothesised mechanism could also lead to a public AMC being created for a privately-owned bank. For example, a crisis could so contract private capital that insufficient funds are available to finance a private bad bank. Nonetheless, this would be unlikely given Europe's partial, though significant, integration with global capital markets and the greater political feasibility of bailing in private bank shareholders in order to make a private AMC more attractive to investors.

2. The three stages of European AMCs

At least 15 AMCs and related institutions were created from 2008 through 2014 by 12 EU countries to assist at least 37 banks (Gandrud and Hallerberg 2014, 5). AMCs acquire,[13] manage, and dispose of distressed assets, such as non-performing loans. They can play an important role in bank restructuring. They are used to separate distressed assets weighing down a bank's balance sheet from performing assets that could form the basis of a healthy bank.

Their acquisition of assets can be funded in a number of ways, including through the issuance of liabilities--that may be government guaranteed--or direct capitalisation by governments' and/or private investors' equity. As such, AMCs are not all the same; there are many design choices that politicians can make, especially concerning their ownership and funding structures. AMCs have a spectrum of ownership structures, ranging from entirely publicly-owned to entirely privately-owned. These designs affect how AMCs impact public budgets.

We can identify three AMC stages in Europe during the recent crisis that Eurostat shaped. The first stage existed before the 2009 decisions and is characterised by a variety of AMC ownership types. The second stage followed the 2009 decision, when governments tended to create AMCs with a minimal majority share (51 percent) of private ownership. In the third stage, which was implemented beginning in mid-2014, bailed-in shareholders of failed banks own AMCs created to resolve them. Table 2 summarises the three stages.

[13] An AMC can also be structured such that the failed bank's good assets are "acquired" by a new bank. The failed bank thus becomes the bad bank.

2.1 Stage 1: Mixed ownership types

The first stage predates the implementation of Eurostat's 2009 decisions. Some AMCs in this period were created with significant private sector involvement. One case is Royal Park Investments (RPI), used to restructure the failed and partially nationalised[14] Fortis bank. The Belgian government created RPI in May 2009. It is co-owned with the remaining healthy part of Fortis--known as Ageas--, and BNP Paribas. The Belgian government's 43 percent stake in RPI gave the AMC majority private ownership.[15] France created an institution to assist banks[16] in 2008 called Société de Financement de l'Economie Française (SFEF). SFEF was owned by the French government and the six main French banks. The banks owned 66 percent of SFEF, so it also had majority private ownership (Grossman and Woll 2014, 591).

A number of fully publicly-owned AMCs were created to assist largely privately-owned banks. Denmark's publicly-owned Finansiel Stabilitet was created in October 2008.[17] Similarly, the original plans for the Irish National Asset Management Agency (NAMA) from 7 April 2009 anticipated that it would be wholly publicly-owned.[18] Germany is a further example, albeit with a more circumscribed path to public ownership. It passed legislation enabling bad banks on 3 July 2009,[19] shortly before Eurostat's decision. Two AMCs resulted from this legislation in late 2009 and 2010: Erste Abwicklungsanstalt (EAA) and FMS Wertmanagement (FMS WM). They were created to clean up WestLB and Hypo Real

[14] See: http://on.ft.com/1HvtqvV. Accessed April 2015.
[15] See: http://bit.ly/1Gxbhi8. Accessed January 2015.
[16] SFEF provided liquidity to troubled banks, rather than acquiring their assets. It was nonetheless classified alongside AMCs for Eurostat accounting purposes.
[17] See: http://bit.ly/1Aa6dJl. Accessed January 2015.
[18] See: http://bit.ly/1834FsY. Accessed January 2015. There was a provision made in this proposal for special purpose vehicles of the type implemented later (see below). But these were for "some" of NAMA's loans, not all of them as was actually implemented.
[19] The Finanzmarktstabilisierungsfortentwicklungsgesetz went into effect on 23 July. See: http://www.bgbl.de/banzxaver/bgbl/start.xav?startbk=Bundesanzeiger_BGBl&jumpTo=bgbl109s1980.pdf. Accessed January 2015.

Estate, respectively.[20] The public owns these institutions: provincial governments and state-owned banks in the case of EAA and the German Federal Government in FMS WM's case. The institutions also received extensive public guarantees.

It is important to note that while these two AMCs are publicly-owned, this does not appear to have been what German policy-makers intended with their bad bank legislation. The law was designed to bail-in a failed bank's owners so they would own the bad bank. This would in theory create high private sector ownership. Key German politicians wanted high levels of private involvement in bank rescues (see Woll 2014, Ch. 6). Indeed, it was well reported at the time[21] that key German politicians were critical of France's SFEF for being *only* 66 percent privately-owned and were disapproving of Eurostat's decision allowing SFEF to not count against the debt.

Why were EAA and FMS WM publicly-owned? Despite politicians' efforts, WestLB and HRE were not able to be restructured with a private solution. Instead, the public sector took over the failed institutions. Woll (2014) and Culpepper and Reinke (2014) discuss how factors such as Deutsche Bank's high international mobility prevented a private sector solution to the crisis. At the same time there were strong political motivations to save WestLB and HRE. Deo et al. (2015) discuss motivations that sub-national politicians and, relatedly, public savings banks had to save WestLB. Together they were important owners of WestLB. Allowing WestLB to fail outright would have harmed them and the economy of the local region. HRE was regarded as systemically important for Germany's *pfandbrief* covered bond market.

[20] These institutions began operating well after Eurostat's ruling--Erste Abwicklungsanstalt in December 2009 and FMS Wertmanagement in October 2010. The legislation enabling these types of institutions was enacted in Summer 2009.

[21] See: *Euroactiv* http://bit.ly/1AV4Qxl, *Frankfurter Allgemeine* http://bit.ly/1wj4R2E, and *Zeit* http://bit.ly/1E0M1eb. Accessed January 2015.

German politicians, with the advantage of small bond yields, had low budgetary pressure relative to the strong political pressures to save these failed institutions. It was then the public that nationalised these banks, the resolution of which was assisted by AMCs that were also publicly-owned.

Table 2: Stages of Asset Management Company and Related Institutions Design in the European Union

Stage	Time period	Handle Privately-Owned Banks	Handle Publicly-Owned Banks
Mixed, including Majority Public Ownership	Until mid-2009	Finansiel Stabilitet (Denmark), NAMA original structure (Ireland), RPI (Belgium), Société de Financement de l'Economie Française (France)	Erste Abwicklungsanstalt (Germany), FMS Wertmanagement (Germany)
Slim Private Majority Ownership	Mid-2009 to mid-2014	NAMA SPV (Ireland), Sareb (Spain)	Dexia (Belgium/France/Luxembourg), DUTB (Slovenia), Parvalorem/Parups/Parparticipadas (Portugal), KA Finanz (Austria), Propertize (Netherlands), UK Asset Resolution (United Kingdom)
Large Majority Private Ownership	Mid-2014 onwards	Banco Espírito Santo (Portugal)	HETA Asset Resolution (Austria)

Note: the table contains all of the AMCs that we are aware of created by member state governments during the crisis beginning in 2008 through 2014.

2.2 Stage 2: Slim private majority ownership

In July 2009 Eurostat ruled, citing the ESA and following consultation with the CMFB, that AMCs with less than 51 percent private ownership would not be classified as contingent liabilities. They would instead be considered entirely in the public sector and immediately count against public debts and deficits. In September 2009, Eurostat specified further rules for AMCs' treatment.[22] This decision had an

[22] Eurostat's September 2009 guidance note expanded on the 51 percent private ownership rule by adding the following three requirements:

- They were temporary institutions.
- They had a reasonable business plan that would ensure no or minimal losses.

immediate effect on the ownership structure of existing and subsequently created AMCs, especially in countries under pressure to contain their debt.

The effect of Eurostat's ruling on NAMA's structure is notable. At the time of the ruling, the NAMA legislation had not been passed. If passed as proposed, under the new rules NAMA would have had a dramatic impact on Ireland's already strained public finances. It would have been an entirely publicly-owned entity and so would have counted against the debt. To prevent this, very soon after Eurostat's decision the Irish government began to consider different designs. They ultimately chose a plan that did not change the ownership structure of NAMA itself. Instead, NAMA would create a special purpose vehicle (SPV) for acquiring distressed assets that was 51 percent privately-owned. The design change was explicitly made in response to Eurostat's ruling to keep NAMA's liabilities off-budget. As stated by NAMA:

> "The National Asset Management Agency is structured in such a way that the debt it issues to purchase acquired loans is not treated as part of Ireland's General Government Debt under European accounting rules".[23]

Eurostat's decisions had further implications for NAMA and bank resolution. From 2010, the Irish government effectively nationalised many of NAMA's private investors, such that by July 2011 NAMA was more than 51% publicly-owned. As such, according to the 2009 decision, NAMA should have been

- A large haircut was applied to the purchase price of acquired assets and the haircut required public recapitalisation of the affected bank. This recapitalisation would be counted against the public debt.

[23] See: https://web.archive.org/web/20150309095718/https://www.nama.ie/about-us/group-structure/. Accessed January 2015.

counted against the country's debt. To avoid this, the Irish government rushed through sales of the nationalised banks' stakes in NAMA to private overseas investors.[24]

This move was particularly urgent because of Eurostat's decision that capital injections into Anglo Irish Bank (among other banks) constituted spending and not investments, and these injections meant that the Irish budget deficit increased from almost 14 percent of GDP in 2009 to over 30 percent of GDP in 2010. Ireland was under significant budgetary pressure and thus, as predicted by hypothesis 2, very responsive to incentives to design a privately-owned AMC.

New institutions created after Eurostat's 2009 decisions and subsequent rulings[25] took on structures that Eurostat's rules incentivise. An important example is Spain's Sociedad de Gestión de Activos Procedentes de la Reestructuración Bancaria (Sareb). Created in November 2012, Sareb was designed through a process that included the Spanish government negotiating with the Troika, the ESM, and Spain's bank bailout and restructuring entity FROB.[26] The Troika and FROB in particular were keen to minimise Sareb's impact on the Spanish budget. As such, there was a back and forth between FROB and Eurostat to ensure that Sareb's design would be approved as a contingent liability. The result is that Sareb is 55 percent privately-owned and meets the three other criteria that Eurostat laid out.[27]

The German bad banks were classified as being in the public sector and not contingent liabilities due to the public ownership of the institutions that they were restructuring. This was only after, as described in the Eurostat ruling,[28] the German Ministry of Finance initially tried to classify EAA as a contingent

[24] See: http://perma.cc/EV3L-CUZ4 and http://bit.ly/1NzIsmZ. Accessed January 2015.
[25] For example, see the 2013 edition of the *Manual on Government Deficit and Debt*, which specifies how to implement ESA 2010.
[26] Fondo de Reestructuración Ordenada Bancaria
[27] From interviews with European Stability Mechanism staff conducted in July 2014.
[28] See: http://bit.ly/18ulYTR. Accessed January 2015.

liability. It was not until 2010 that Eurostat examined the Ministry of Finance's original classification. Clearly, the government preferred that the AMCs would not increase the public debt. It was Eurostat's decision and subsequent enforcement in conjunction with the German statistical agency that forced this change.[29] Though this decision increased Germany's gross public by about 10 percent of GDP in 2010 (Braakmann and Forster 2011, 12-13), Germany nonetheless complied with the decision, as predicted.

Eurostat decisions have had other effects on existing AMCs' ownership structures. Its rulings about how other crisis response policies would be accounted created incentives for governments to change the ownership structure of their AMCs. The Belgian government divested its minority stake in RPI following a Eurostat decision. In March 2013, Eurostat ruled that Belgium's 2012 recapitalisation of the troubled Dexia bank should be treated as a non-financial transaction, not as a financial transaction without an impact on the deficit, as the Belgian government had requested.[30] The Dexia recapitalisation would then have an immediate affect on the public budget, pushing Belgium's deficit over 3 percent of GDP. The gross debt burden continued to worsen and approached 100 percent of GDP.[31] The following month the government sold its stake in RPI to improve its deteriorating budget situation.[32] The sale changed RPI from small majority private ownership to wholly privately-owned.

Interaction in Stage 2: Limited policy options when states own troubled banks

The wholly publicly-owned AMCs created after Eurostat's 2009 decision all share the same characteristic: they restructure *publicly-owned banks*. Hypothesis 3 predicts that under Eurostat's rules public AMCs will be created if governments are unable to attract private investment. In practice, public ownership of a failed bank makes it more difficult to attract private investment. Large haircuts on assets

[29] ibid
[30] See the original ruling at: http://bit.ly/1NzIBa7. Accessed January 2015.
[31] See: http://perma.cc/4F5S-TZCW. Accessed January 2015.
[32] See: http://bit.ly/1E0NAJ2. Accessed January 2015.

transferred to AMCs that would make them more attractive to private investors are less attractive to politicians for publicly-owned failed banks. They effectively impose a costly and so politically unattractive bail-in on the government.

When faced with an inability to attract private investment, governments--especially in Slovenia and Austria--made additional policy decisions that, according to Eurostat rules, offset at least some of the cost of publicly controlling their AMCs. If they had been able to classify their AMCs as off-budget, many likely would not have needed to take these measures. We describe these cost-offsetting measures below.

Slovenia's Bank Asset Management Company (Slovenian acronym "DUTB") illustrates economic constraints that can limit governments' abilities to involve the private sector in AMC ownership and costs. DUTB was created in March 2013 with full government ownership. It acquired assets from two majority-state owned banks.[33] Why would the Slovenian government create a fully publicly-owned AMC given the large negative implications for the country's budget? Indeed, immediately realised liabilities for the state from assisting Slovenian banks increased from under 5 percent of GDP in 2012 to about 14 percent in 2013. The answer likely lies in the ownership structure of the Slovenian banking sector. Approximately 40 percent of loans are issued by state-owned banks and many other banks are controlled by the state (OECD 2013, 9). Because of the high level of state ownership in the banking sector, a majority privately-owned AMC, or other policies that would have been considered beyond the direct public budget by Eurostat, were not realistic options. At the same time, public assistance was needed to avert potentially much more costly failures of state-owned banks. To partially offset the cost of public AMC ownership, assets were transferred to DUTB with high haircuts relative to those applied at AMCs in other EU countries (Gandrud and Hallerberg 2014, 16).

[33] See: http://bit.ly/194EcMJ (p. 14) and http://perma.cc/4WX3-UUEZ. Accessed January 2015.

Portugal and the United Kingdom created publicly-owned AMCs in 2010. Austria created one in 2014. UK Asset Resolution was an outgrowth of the 2008 nationalisations of Northern Rock and Bradford and Bingley.[34] It is effectively an institution for managing assets that the UK public already owned. The Dexia bad bank was created by hiving off its Belgian operations into a good bank called Belfius in 2011.[35] Dexia was also effectively publicly-owned. By the end of 2008, the Belgian and French governments and associated public entities controlled about two thirds of the company.[36] Similarly, Portugal's three-part asset management vehicle Parvalorem/Parups/Parparticipadas was created to restructure Banco Português de Negócios, a bank that in contrast to BES had been nationalised in 2008. Austria's Heta Asset Resolution (created during the third stage) was built as a wholly-owned subsidiary of Hypo Alpe-Adria Bank (Hypo) in 2014. Hypo was nationalised in 2009, so the Austrian state owns Heta Asset Resolution. The bad bank was created only after the government was unable to secure voluntary private sector participation.[37] In an unusual measure designed to minimise the public budgetary effects of restructuring Hypo and bail-in its creditors, the national government annulled guarantees given by its home province Carinthia.[38]

2.3 Stage 3: Bailed-In bad banks

Eurostat has continued to tighten the rules on accounting AMCs to be outside of the state sector. Major changes were made in ESA 2010, which was published in 2013 and implemented from mid-2014. The new rules expanded the definition of publicly controlled AMCs.[39] They now include institutions that are nominally banks, but are in effect public bad banks that do not conduct normal banking business. The

[34] Northern Rock Asset Management was created in January 2010 to deal with Northern Rock's bad assets and was later folded into UK Asset Resolution when it was created in October 2010. See: http://bit.ly/1CUj3S2. Accessed January 2015.
[35] Dexia's Belgian operations were bought by Belgium.
[36] See: http://bit.ly/1OAEdqD (p. 5). Accessed July 2015.
[37] See: http://bit.ly/1KKfuCb. Accessed January 2015.
[38] See: http://bit.ly/1aWKPRS. Accessed January 2015.
[39] Reflecting the broader focus, Eurostat now uses the more general term "financial defeasance structure".

hard 51 percent ownership rule was expanded to focus not just on nominal equity ownership, but also on who is effectively in control and who bears the AMC's risks. This means that an AMC entirely privately-owned, but backed by state guarantees, such that the state is shouldering most of the risks, is considered a public AMC.[40]

Though a relatively new AMC stage, we have already seen this process play out in the August 2014 restructuring of failed Portuguese bank Banco Espírito Santo (BES). The bank was split into a good bank--Novo Banco--, recapitalised by the public, and a bad bank. Novo Banco was recapitalised by 4.9 billion Euros from a public bank resolution fund and further supported by a 4.4 billion Euro government loan. Rather than being a public entity, the remaining bad bank is owned by bailed-in junior BES shareholders and bondholders.[41] Having the AMC owned by private shareholders, while good assets are held by a publicly recapitalised bank closely fits the model Eurostat laid out to minimise the impact on the public budget. It potentially imposes a considerable proportion of BES's restructuring costs on the failed bank's private sector owners.

3. Eurostat and the European Stability Mechanism

Eurostat's impact on policy responses to the financial crisis is not limited to AMCs. It has been instrumental in incentivising member state choices in other financial assistance areas and in the development of new European institutions. A key example is the role Eurostat played in replacing one of the Eurozone's early collective crisis responses--the European Financial Stability Facility (EFSF)--with the ESM.

[40] See Part IV.5 in http://bit.ly/194DW0n. Accessed January 2015.
[41] See: http://bit.ly/1Aa9LeG. Accessed January 2015.

The EFSF funded itself by issuing member state-guaranteed bonds. If counted as contingent liabilities, these guarantees would push member states' recorded costs into the future. At the same time the guarantees removed private sector creditors' risks. However, in January 2011 Eurostat decided, based on principles in the ESA, that because the EFSF was effectively controlled by member states, EFSF borrowing would count as government gross debt, not contingent liabilities.[42] This made the EFSF politically unpalatable in many member states. Any action that the EFSF took increased member states' debt proportional to their part of the EFSF guarantee. This decision was one reason to replace the EFSF with an institution that would minimise the budgetary effects of assisting troubled countries.

In its January 2011 decision, Eurostat implicitly laid out a way for an EFSF replacement to have fewer budgetary effects. If the entity was an independent international financial institution, in the general mould of the IMF for example, the institution's debt would not be directly counted against member state budgets. Member states responded by making the ESM an independent international institution with autonomous decision-making powers.[43] The ESM's structure and accounting rules limit the costs for member states to paid-in capital, for which borrowing increases their gross debt. They also commit to providing call capital if needed, for example if the ESM cannot pay back its creditors. The call capital is treated as a contingent liability by the accounting rules.[44] ESM borrowing--the bulk of its resources--does not directly affect government budgets. There are budget implications for member states only if an ESM recipient defaults.

[42] See: http://bit.ly/183bj2l. Accessed January 2015. The decision makes specific reference to ESA 95 2.12.
[43] From an interview with a Eurostat official in July 2014. In addition see: http://bit.ly/1EuFUnK. Accessed January 2015.
[44] For more details about the ESM's capital and borrowing structure see: http://bit.ly/18unYeP. Accessed January 2015.

Conclusions

We found evidence that Eurostat played an important role in shaping member states' responses to the financial crisis. As our first hypothesis predicted, Eurostat's constriction of what institutional designs could be considered off-budget led to more similar bad banks across Europe. The same mechanism also shaped the ESM's design. We found that this process was mediated by governments' fiscal positions (hypothesis 2). Highly fiscally strained countries, such as Ireland, were more likely to choose designs incentivised by Eurostat than countries, such as Germany, that were in better fiscal shape. The investor environment (hypothesis 3) also played an important role as governments found it difficult to attract private AMC investment if the failed bank was publicly owned.

Our study suggests that Eurostat's influence will be relevant in the future. In particular, we expect that Eurostat's interpretations will be important during future resolutions of banks that are formally outside of the Single Resolution Mechanism and are instead resolved by individual member states. Eurostat tightened accounting rules complement the 2014 European Bank Recovery and Resolution Directive's (BRRD) goal to minimise the public costs of bank restructuring. One of the four tools for cleaning up failed banks prescribed by the BRRD is the "asset separation tool". This involves assets being transferred from a failed bank to an "asset management vehicle"--e.g. an AMC. This vehicle can be wholly or partially publicly-owned under the BRRD.[45] Eurostat's decisions incentivise designing the asset separation tool with more private sector participation than required by the BRRD.

Our work also forms the basis of a framework for understanding the role that statistical agencies globally can play in shaping policy responses to financial crises. Eurostat is unique as a supranational government

[45] For the full text of concerning the asset separation tool see Article 42 in the BRRD: http://perma.cc/T5T4-L2LL. Accessed January 2015.

finance statistics agency. However, there are a number of other settings where politicians could find it in their interests to have more transparent public finances enforced by independent statistical agencies. These include when there is equal competition between the major political parties (e.g. Alt, Lassen, and Rose 2006) and when a country receives assistance from an international institution that has an interest in fiscal sustainability. Future work on responses to financial crises could benefit from treating accounting rules as variable, possibly shaped by independent statistical agencies, and able to incentivise politicians to choose particular policy responses over others.

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Online Appendix

Legal basis of Eurostat's autonomous decision-making authority

Eurostat has considerable autonomy to interpret statistical rules and enforce these interpretations on member states. Schelkle (2009, 836) and Savage (2005, 192) discuss how Eurostat's decisions regarding the interpretation of the ESA constitutes secondary case law that cannot be overturned simply by the Council.

The legal basis of this authority during the period under investigation in this paper originates with the Treaty Establishing the European Community[46] Article 285, later Article 338 of the Treaty on the Functioning of the European Union.[47] These articles specify that "measures for the production of statistics where necessary for the performance of the activities of the [Community/Union]" shall be adopted "in accordance with the ordinary legislative procedure". In addition, "the production of [Community/Union] statistics shall conform to impartiality, reliability, objectivity, scientific independence, cost-effectiveness and statistical confidentiality; it shall not entail excessive burdens on economic operators."

Based on this, Regulation (EC) No. 223/2009,[48] Article 6(2) sets out the Commission--Eurostat specifically--as having "*sole responsibility* for deciding on processes, statistical methods, standards and procedures", based on "established rules and statistical principles" for gathering statistics (emphasis added).

[46] See http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:12002E/TXT. Accessed April 2015.
[47] See http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:12012E/TXT. Accessed April 2015.
[48] See http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:087:0164:0173:en:PDF. Accessed April 2015.