What is this bail-out fund?

The European Stability Mechanism (ESM), also known as “the secret treaty”, is part of an overwhelming bunch of initiatives designed by the EU to stabilise the euro. Essentially, the ESM is a new bail-out fund designed to supply loans to countries in two situations:

1. Where they find themselves in danger of a default, or
2. Where they are found to be in an economic situation that threatens the stability of the euro zone as a whole.

The ESM will be a permanent replacement for an existing temporary fund, the European Financial Stability Fund (EFSF), which will expire by June 2013, holds €500 billion. The ESM will initially hold €700 billion.

How did it come about?
The ESM is connected to the Fiscal Stability Treaty, which is the subject of a referendum in Ireland.

Access to the ESM has been made contingent on the ratification of the Fiscal Stability Treaty, thus increasing the pressure on governments to ratify. But the ESM is a separate entity based on a two-line amendment of the Lisbon Treaty, which was decided by an EU summit on 16 December 2010, and an intergovernmental treaty specifying working mechanism and procedures.

Where does the money come from?
The ESM will build its capital stock from contributions from the euro countries and from capital already invested in the existing EFSF. Ireland is to contribute €11,145,400,000 to the initial capital.

Like other countries in financial troubles, Ireland will have to supply a portion of this amount in cash, whereas triple-A rated countries like Germany can make do with guarantees.

...to be continued on page 2

In Ireland, Estonia, and Germany, legal challenges are being made to the ESM Treaty.

“Under the Irish Constitution it is the houses of the Oireachtas that have the sole responsibility in raising sovereign debt; this treaty places the ESM at a higher level than our own Constitution in terms of financial government.”

Thomas Pringle, independent TD, Donegal South-West, and patron of the People’s Movement.

QUESTIONS

- Is the ESM the same as the Fiscal Stability Treaty?
- Will there be a referendum in Ireland on the ESM?
- How much money will Ireland have to contribute to the fund?
- Who is in charge of the ESM?
- What are the conditions of the bail-out programmes?
- Will Ireland have access to loans if the Fiscal Stability Treaty is not ratified?
“You hope your house never burns down, but does that stop you from buying insurance?”

“As a government, we only deal in certainties”

The ESM will be a safety net for Ireland, and an important step on the way to bringing Ireland back onto the financial markets by the end of 2013, according to the Government.

The main concern for the Government is ensuring financial stability in Ireland and in the euro zone. They regard the European Stability Mechanism as an important step in reaching that goal.

“The European Stability Mechanism is essentially a rescue fund, designed to be accessed by countries who find themselves in financial difficulties,” a spokesperson explains on behalf of the Government. “This fund will replace the EFSF [European Fiscal Stability Fund] and will only be open to countries that ratify the Stability Treaty.”

Alternative funding
In many cases around the world, threats of government defaults are being dealt with through loans from the International Monetary Fund. In Europe the IMF has been working closely with the EFSF in handling bail-outs. But will these rescue funds be viable alternatives to the ESM in the future?

“No. Firstly, because the EFSF ceases to exist next year; secondly, because the only thing we deal in as a government is certainty. It is for those who claim that there are alternatives to outline what they could be. Exactly where do we get it, how do we get it, and from whom? There is no certainty around any of the options that have been tabled by those who are against the passage of the treaty.”

On economic sovereignty
The legal challenge by Thomas Pringle TO is in large part based on the claim that ratifying the ESM will be giving up national sovereignty over taxpayers’ money.

“We will disagree with that, obviously. This Government is working to regain our economic sovereignty. That’s exactly what we’re trying to do. We are presently in a rescue programme, and we are taking steps to ensure that we live up to the provisions of this programme and regain our economic sovereignty.”

Second bail-out ruled out
How do you perceive the risk of a second Irish bail-out?

“I don’t. The whole point of the ESM Treaty is that having access to the ESM makes that even less likely, because it provides the investors with the certainties they need, and we will be back at the markets in 2013. Top it up in layman terms, You hope your house never burns down, but does that stop you from buying insurance?”

This interview was with a spokesperson answering on behalf of the Government.

ESM at best only part of the
Peripheral Europe, sometimes insultingly labelled the “PIIGS countries” in the European debt crisis. Economists from these countries see the European Stability Mechanism as some countries over in the short run; but it is far from providing a solution to more fundamental

Diego Valante, Italian research fellow in European policy:

“We all know that the size of public debt in the countries that are now in trouble is so high that no ESM can provide enough assistance to solve the problems. It can give a short-term liquidity relief to gain a little time, and that’s what the euro zone is trying to do. But in my opinion we don’t have the institutional set-up to deal with a monetary union of this size. It was fine for an economic free-trade area where you just have a single market, but not a common currency. The ESM has been introduced to circumvent the problem of not having the right institutions.”

Pedro Lains, research professor, Institute of Social Sciences, University of Lisbon:

“The way the crisis has been fought has taken too long. If there are no radical changes in the kind of policies that are used to fight it, it will aggravate. I think that the Portuguese government and the Portuguese voters have shown that they are willing and able to redress imbalances and show the political will to change policies. But even if Portugal works very hard to fix the problems, it might not be enough. This is a problem that cannot be dealt with by the Portuguese government alone. And in that case a structure like the ESM is of much help.”

Janis Emmanouilidis, senior political analyst, European Policy Centre, Athens:

“You can ask whether the ESM has been constructed in the right way and whether it is big enough. But without it the entire grand puzzle of enhanced economic governance would not make sense. The euro crisis has shown clearly that under the bad weather conditions in which the EU is operating, you need a mechanism that can provide assistance if the entire system is being threatened by a crisis in individual member-states. And that is what the ESM is about. It is like a fire brigade. Without it you will not be able to extinguish huge fires that can spill over from one member-state to the other.”

Miren Etxezarreta, professor emeritus in applied economics, University of Barcelona:

“I think that it is clear that the ESM is far from a solution. Instead it is destroying economic activity by all the accompanying austerity measures. In that sense the medicine the EU is giving is killing the patient, which people have also started to realise by now. Now they speak about austerity measures combined with growth, which in my view is impossible. We need to make structural changes that go much deeper than that.”
“Gun to the head argument doesn’t hold up!”

The ESM bail-out fund is no less risky than the alternatives in a possible future bail-out. Its primary function is not to bail out countries but to bail out the financial system, according to Terrence McDonough, professor of economics.

Professor McDonough does not agree with the idea that the European Stability Mechanism will work as a sort of insurance policy for countries in the euro zone. He focuses on the fact that a country under an ESM programme will be under an obligation to pay back its creditors and will not be able to renegotiate debt with, for example, private bond-holders.

“We have to recognise that the European bail-out funds are not there to bail out Ireland or other countries,” Prof. McDonough says. “They are there to bail out the European and international financial system.”

ESM bail-out conditions
Prof. McDonough is also highly sceptical about the conditions attached to the new bail-out fund.

“It’s very difficult to predict what the conditions will be. Interest rates in the existing programmes haven’t been as high as 7 per cent, which is where a country will have to abandon the private markets, but Europe initially charged Ireland in the vicinity of this upper limit.”

“I think the conditions could be either lenient or onerous. By ratifying the Fiscal Treaty and the ESM we would throw ourselves on the mercy of a single funding source. That’s in itself quite risky.”

Alternatives to the ESM
Prof. McDonough does not accept that the ESM is the only bail-out fund available to Ireland. He points to the International Monetary Fund (IMF), and to the EFSF, which will continue to exist at least a year from now, claiming that borrowing outside the ESM is not necessarily bad.

“If we would go elsewhere for the loans, one of the things on the table would be a renegotiation of the private debt that we ended up taking upon us as taxpayers in the form of sovereign debt. The money which we’re paying into saving Anglo-Irish Bank is €3 billion per year. This is quite simply odious debt and should be renegotiated in any case.”

Eamon Gilmore, minister for foreign affairs, has rejected your claim that alternative funding would be provided. So what do you base your opinion on?

“I base it on the fact that Ireland is small, but scary. It would not cost very much for Europe to continue to provide funds, simply because we’re a small economy. Whereas if we were to be denied funds and forced into a default, that would call into question the entire European financial system. I find it highly unlikely that Europe would shoot itself in the foot in order to spite the Irish electorate.”

The future
How do you perceive the risk of a second Irish bail-out?

“It’s more or less inevitable. Ireland’s debt is probably unsustainable in the long run. If we continue to try and pay it off, basically we go deeper into debt in order to pay off our existing debt.

“It would be in Ireland’s and Europe’s best interests if we move away from austerity and towards a more constructive approach to get out of the crisis.”

Terence McDonough, professor of economics, National University of Ireland, Galway.

Possible violation of Irish and European laws

The independent TD Thomas Pringle challenges some of the basic aspects of the ESM Treaty.

He believes that the treaty raises serious legal difficulties, both at the level of EU treaty laws and Irish constitutional law.

“The problem is that the ESM Treaty establishes a new institution with total legal autonomy that is not accountable to any of the existing European institutions or to the member-states,” says Deputy Pringle.

Fast, but not fair
The ESM Treaty has been agreed under what is called the "simplified amendment procedure" in the Lisbon Treaty.

According to Deputy Pringle, this is in violation of European laws that state that the much slower ordinary procedure, entailing a constitutional convention and the European Parliament, should be used in cases where new competences are being conferred on EU bodies.

A referendum on the ESM?

“The interesting thing is that the Irish Government says that we are to have a referendum on the Fiscal Treaty, but they’ve decided that we don’t need a referendum on the ESM.

“If both treaties are, as they say, outside the Union, and therefore international agreements - and that seemed to be the reason why we need a referendum for the Fiscal Treaty - surely the same reason would stand up for the ESM as well,” says Deputy Pringle.

“What the Government should do is postpone the referendum until these legal issues have been resolved.”

Two court cases may show the way
Acknowledging that this seems unlikely, Deputy Pringle believes a court case may force the Government to postpone the ratification of the ESM Treaty.

In Estonia the Ombudsman has challenged the legality of the ESM Treaty, and a court case is under way that may postpone the ratification of the treaty.

The most important case is the German challenge, led by Herta Daubler-Gmelin, former minister of justice in the Gerhard Schröder government, 1998-2002. Without ratification in Germany, 27 per cent of the ESM capital stock will go missing, and this will prevent its entering into force.

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Weathering crises outside the ESM

Iceland and Latvia: The Latvian rollercoaster

The economic rise and fall of Latvia is a tale of how credit-fuelled growth and its resulting bubbles can burst really fast. The crisis hit the small Baltic state with an unprecedented fervour in 2008 and saw the economy contract by 25 per cent within two years, while unemployment soared to over 20 per cent. But it is also the story of a fierce response from local politicians to try get the country back on track the hard way. Through it all, the Latvian government dug the crisis deeper by keeping the national currency pegged to the euro, forgoing the possibility of quantitative easing.

Instead Latvia got loans from the International Monetary Fund, the European Union and the Nordic countries and went through what most people consider to be the toughest austerity programme in Europe, slashing public wages by an average of 25 per cent, shutting down schools and hospitals, and raising VAT and income tax, leading to an exodus of the Latvian people and a severe devaluation of the Latvian lats. The outcome of this challenge is not yet known, but one of the demands is that the ESM should be put to a referendum.

How much money will Ireland have to contribute to the fund?

Ireland is to provide 1.39 per cent of the initial paid-in capital stock in the ESM fund. The total amount of capital stock will be €700 billion. This includes the €500 billion capital stock of the EFSF that is to be transferred to the ESM.

Ireland will be called upon to supply five payments, each consisting of €237 million, over the first two years after the ESM comes into effect. This amounts to a total of €11,145,000,000. Should the ESM require more money at some point, Ireland is obliged to pay 1.39 per cent of that amount when called upon.

Who is in charge of the ESM?

A Board of Governors drawn from each member-country will be in charge of the ESM. Decisions on the basic workings of the ESM, and the decision to make a call for extra capital, will be decided unanimously. Decisions on loans and bail-out programmes will be taken by a qualified majority (80 per cent of the votes).

Votes will be distributed according to the amount of capital stock supplied. Ireland will therefore hold 1.39 per cent of the votes. France will have 20 per cent and Germany 27 per cent.

What are the conditions of the bail-out programmes?

In the preamble to the ESM Treaty it is clearly stated that “the granting of any required financial assistance under the mechanism will be made subject to strict conditionality.” The ESM Board of Governors, consisting of representatives from each of the member-countries, will decide in principle whether a loan can be granted.

The exact conditions will then be negotiated in what is called a “memorandum of understanding” drawn up by the European Commission, the European Central Bank, and the International Monetary Fund.

One condition would be the “macro-economic adjustment programme” mentioned in the treaty. It is up to the ESM to specify the exact adjustments needed in the programme countries’ financial policies. Any part of a country’s financial policies can in theory be included in such a programme.

Will Ireland have access to loans if the Fiscal Stability Treaty is not ratified?

Ireland’s existing loan or bail-out options are not directly affected by the Fiscal Treaty or the ESM Treaty. Ireland will not have access to loans from the ESM in the event that the Fiscal Stability Treaty is not ratified. The International Monetary Fund (IMF) would still accept an application, and the granting of a loan would not be ruled out in case of a second Irish bail-out.