People's News

An introduction to the ESM | Publication by the EU Democrats, May 2012

What is this bail-out fund?

The European Stability Mechanism is a crisis fund that comes at the price of €11 billion for Ireland, that EU countries will be able to gain access to should they ratify the Fiscal Treaty. But will it be a handy insurance policy for Ireland - or an economic straitjacket?

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. The 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 Stablity 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 wih guarantees.

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ESM Treaty challenged

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.

6 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?

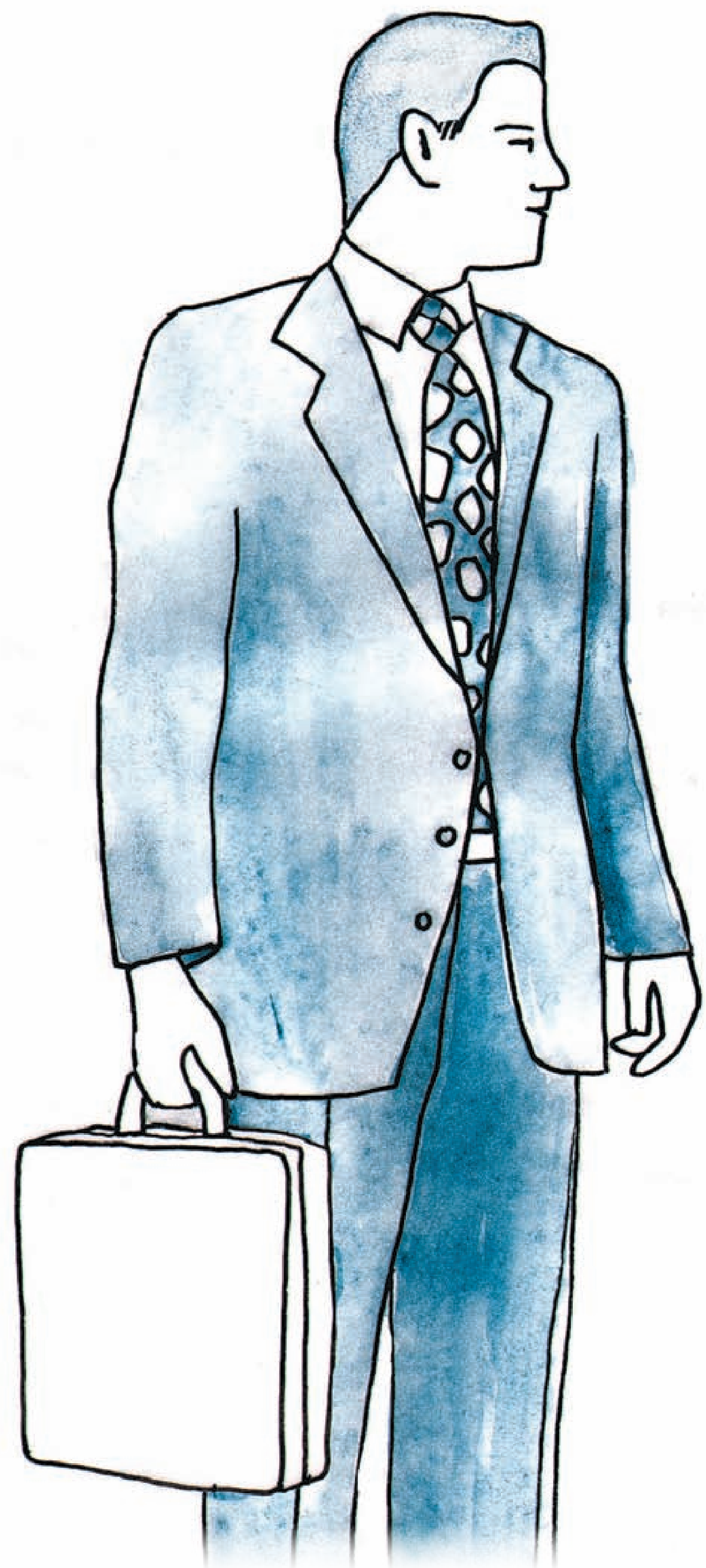
Read answers on the back page →

EUD

Founded in 2005, the EUDemocrats is a pan-European Eurorealist alliance. Our goal is to reform the EU: we work for increased transparency, accountability, subsidiarity, and most importantly budget control within the European Union.

The EUD does not take a position on left-right policy issues, believing that these issues should be decided in national parliaments.

"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."

Capital contributions

One of the major issues in the discussions on the ESM fund is the obligation of the member-states to supply capital stock.

What will Ireland's contribution to the ESM be?

"The method and extent of contributions to be made by countries is outlined in the ESM Treaty. It is logical that if we are potentially one of the benefactors of the fund we would make such a contribution. It remains our intention to return to the markets by the end of 2013, and it remains the case that access to the safety net that is the ESM is dependent on a ratification of the Stability Treaty."

On economic sovereignty

The legal challenge by Thomas Pringle TD 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

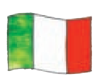
How do you perceive the risk of a second Irish bail-out?

"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. To put it 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.

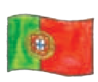
ESM at best only part of the

Peripheral Europe, sometimes insultingly labelled the "PIIGS countries" in the European de euro 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 Valiante, 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."

...continued

What is this bail-out fund?

The ESM can decide to increase the total capital stock (or speed up the contributions of the initial capital) if needed. The Irish Government will then be obliged to "meet all capital calls on a timely basis in accordance with the terms set out in this Treaty." This increase of capital stock can become relevant if a bail-out of one of the euro zone's larger economies, such as that of Spain or Italy, becomes necessary some day.

Votes

Ireland is to cover 1.59 per cent of all capital stock in the ESM fund, and votes on the ESM board will be distributed in accordance with this percentage.

A "qualified majority" is needed to make most decisions concerning the programmes and management of the fund. Germany, with 27 per cent of the votes, is the only country that can veto these majority decisions by itself.

The decision to initiate a bail-out programme in any of the member-countries will be taken by the ESM's Board of Governors. The ESM Treaty does not specify the exact conditions under which its programmes will be initiated, leaving room for political decisions.

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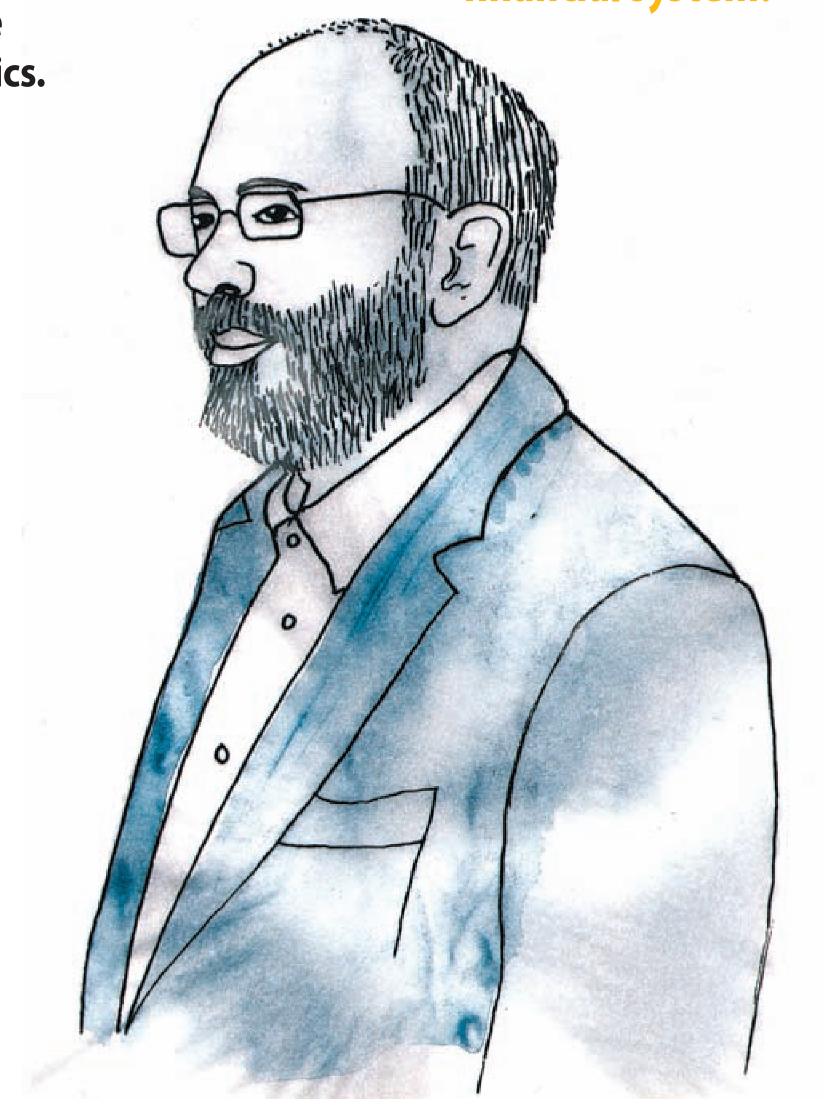
“Gun to the head argument doesn’t hold up!”

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.

“ If we were to be denied funds and forced into a default, that would call into question the entire European financial system.”



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 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.”

Éamon 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?

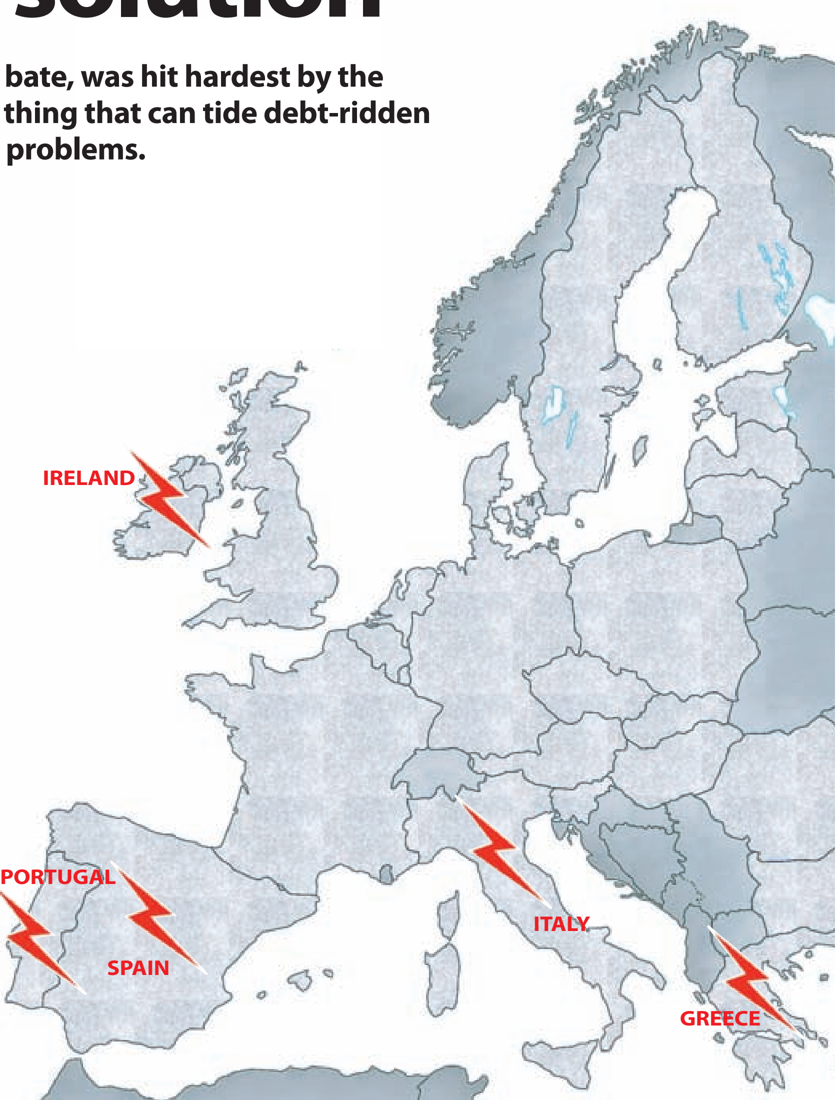
“It’s more or less inevitable. Ireland’s debt is probably unsustainable in the long run. If we continue to try and pay it off, basically we go deeper into debt in order to pay off our existing debt.

“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.”

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

solution

bate, was hit hardest by the thing that can tide debt-ridden problems.



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

6 Questions and answers

Is the ESM the same as the Fiscal Stability Treaty?

No, the ESM (European Stability Mechanism) is a separate legal body, with its own separate treaty. All euro countries will become members of the ESM if they ratify the ESM Treaty. To obtain access to the ESM crisis fund a country must also ratify the Fiscal Stability Treaty.

The ESM Treaty is not yet ratified and the rescue fund will only come into existence if at least 90 per cent of the initial paid in capital stock is provided by the member countries.

Will there be a referendum in Ireland on the ESM?

No, the Government has no plan to put the ESM Treaty to a referendum. The ESM has, however, been challenged by a member of the Dáil, Thomas Pringle. 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 1.59 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 1.59 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 1.59 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.

People's Movement
The People's Movement campaigns against any measures that further develop the EU into a federal super-state and works to defend and enhance popular sovereignty, democracy and social justice in Ireland.

Trade unions divided

Trade unions agree on the need for public investment and growth but are split on the question of the ESM.

David Begg, general secretary, Irish Congress of Unions:
"We have taken no position on the ESM, because our members are divided. Our view is that essentially the rules of Europe are being rewritten right now and social Europe is being dismantled. The balance has shifted. We are certainly against those austerity measures, but this country is in need of money. It would be a huge risk to take if we hope for an alternative solution."

Fifty-five unions are affiliated to the ICTU. This makes it the largest civil society organisation in Ireland, representing some 830,000 people.

John Douglas, general secretary, Mandate Trade Union:
"We say 'No' to the ESM. To support the bail-out fund will not be free. Ireland will be forced on a Greek-type menu of severe austerity, and millions in debt will be heaped on the Irish people. It is a failed strategy to deflate all the European economies at once. We need a growth strategy to put money back into people's pockets and create more jobs."

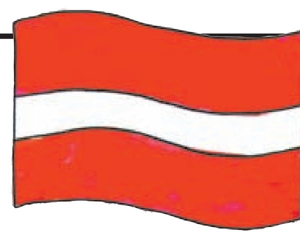
Mandate Trade Union represents 45,000 workers in retail, bar and administrative jobs.

Jack O'Connor, general president, Services, Industrial, Professional and Technical Union:
"We have not taken a position on the ESM yet. Given the alternative, I would personally go for a 'Yes.' Without a debt brake the last four to five years might end up feeling like a walk in the park. But we want a social Europe, and we think you will need to underpin these measures with an investment plan to stimulate growth."

SIPTU represents more than 200,000 workers in a wide variety of industries, including services, production, and industry.

Iceland and Latvia:

Weathering crises outside the ESM



The Latvian rollercoaster

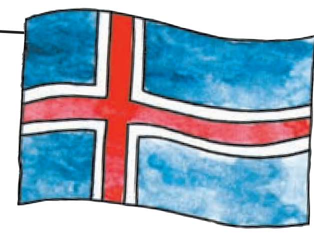
The economic rise and fall of Latvia is a tale of how credit-fuelled growth and its resulting bubbles can burst really fast. The crisis hit the small Baltic state with an unprecedented fervour in 2008 and saw the economy retract by 25 per cent within two years, while unemployment soared to over 20 per cent.

But it is also the story of a fierce response from local politicians to try to 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 more than 200,000 people from the tiny country.

Despite this the prime minister, Valdis Dombrovskis, elected in early 2009, has managed what not a single euro-zone head of government could do: he has gone on to be re-elected by the people. And not only once but twice.

Today Latvia is out of its lending programme. But the cost of the deep cuts is a higher number of people in poverty and the highest inequality rate in Europe.



Iceland: Just say No

For many, the epicentre of the financial crisis can be traced to a rock in the Atlantic Ocean inhabited by little more than 300,000 people, where the biggest banking collapse in economic history to be experienced by a single country relative to its size took place. But the very sudden and very public melt-down of the Icelandic banking industry has today been converted to growth and a return to the markets.

On a combination diet consisting of loans from the IMF and Nordic countries and a severe devaluation of the Icelandic króna on the one hand and debt relief to Icelandic house-owners on the verge of defaulting on their mortgages on the other hand, Iceland has weathered the crisis by doing what many European governments don't dare to even think about: they let their banks go under, leaving foreign investors to fend for themselves.

Without the burden of bank debt on the shoulders of the taxpayers Iceland is slowly but steady working its way out the crisis.