

Thematic Briefing #7/2017: The European Stability Mechanism

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Background

The European Stability Mechanism (ESM) entered into force on [27 September 2012](#) as the Eurozone's permanent rescue fund, defined in its founding treaty as an [international financial institution](#). From a legal point of view, the ESM is an [international organization](#) operating under international law, as it was established through an intergovernmental agreement between Eurozone Member States, and is not part of the EU treaties. This was necessary for the “no bailout” clause contained in [Article 125 TFEU](#) rules out Member States' mutual liability for insolvency. In 2013, an amendment to [Art. 136 TFEU](#) allowed euro area countries to create a rescue fund outside of the EU treaties' framework, so that it would not be bound by EU law. This enables the ESM to operate as a sort of [a lender of last resort](#) when euro area members are in financial difficulty and cannot access financial markets.

The euro crisis was so severe at its peak that EU leaders felt the [need to set up a bailout fund, regardless of treaty provisions](#), which could operate quickly and efficiently. The [EFSM and EFSF](#) were both created in 2010. While the former had a limited lending capacity of €60 billion, the latter could disburse up to €440 billion, and was established as a public limited liability company under the laws of Luxembourg. The EFSF provided aid to Portugal, Ireland and Greece, but was intended as a temporary measure, which led to the constitution of the ESM as its permanent replacement. The [EFSM](#) and the [EFSF](#) will however remain operational until their bailout programs will be terminated—the EFSM has provided loans to Ireland and Portugal. So far the ESM has provided [financial assistance to Cyprus, Spain and Greece](#)—the latter is the only programme that is still ongoing—and, together with the EFSF and EFSM, a total [exceeding €250 billion](#) in financial aid has been disbursed since 2010.

The ESM has a total lending capacity of [€500 billion](#) and is backed by Member States' budgets, who must collectively make up for any losses the fund may incur in case a state is insolvent. Eurozone countries have already paid in €80 billion that serve to refund the ESM in case of losses; [another €620 billion can be called](#) if necessary. The ESM finances its assistance programmes through the issuance of bonds on the financial markets; thanks to the high credit rating it enjoys, the fund can then loan money to requesting countries at very favourable rates, and with very long maturities, meaning that [beneficiaries' debt repayment obligations are considerably reduced](#). The ESM can provide financial assistance through [various means](#): bond purchases on the primary and secondary market, direct loans to a Eurozone country as well as direct or indirect recapitalisation of financial institutions.

Political Fault Lines

While the ESM's legal status has facilitated the provision of financial assistance, it has created issues of transparency and accountability. Financial aid is conditional on the acceptance of a [Memorandum of Understanding \(MoU\)](#) that sets out strict conditionality measures for the receiving state. The MoU, negotiated jointly by the ESM and the “Troika”—composed of the European Commission, the European Central Bank and the International Monetary Fund—often entails economic and structural reforms that may severely [undermine a state's social security schemes](#). Even though the Finance Ministers of the Eurozone sit in the ESM's Board of Governors, the fund's accountability remains questionable, since not only its legal nature shields it from judicial action, but also its internal debates are normally kept secret. Interestingly, the Ministers of Finance who sit in the ESM's Board of Governors [also make up the Eurogroup](#), namely the informal gathering of, precisely, the Eurozone's Finance Ministers. Indeed, the head of the Eurogroup, Jeroen Dijsselbloem, is also President of the Board of Governors of the ESM.

Given their almost identical composition, the ESM has often been accused of merely [executing decisions already taken by the Eurogroup](#). Indeed, Emily O'Reilly, the European Ombudsman, requested Dijsselbloem [to improve the Eurogroup's accountability](#), focussing on the public availability of internal files. Dijsselbloem has since taken steps in this direction, by freely adopting the “[transparency initiative](#)” in 2016, both for the Eurogroup and the ESM, whereby a number of internal documents are made publicly available. There are [exceptions](#), however: sovereign bond market risk and other sensitive information are still confidential, and meetings' minutes are kept secret. Interestingly, documents are now published ahead of ESM's meetings, but [after Eurogroup meetings](#), as if the latter were the actual locus of decision-making.

Supporters of the ESM however argue it is precisely due to [informality and secrecy](#) that the ESM—and the Eurogroup—are capable of acting efficiently and swiftly. There is, it appears, a [trade-off](#) between efficiency and accountability.

Legal actions were indeed taken to question the ESM's legal status and to obtain clarification over its little accountability. In the [Ireland vs. Pringle case](#) of 2012, the ECJ ruled that not only was the creation of the ESM procedurally legal, but also that the ESM is not an EU body, and that Member States acted outside of EU law when they established it. Consequently, the EU Charter of Fundamental Rights cannot be applied to the ESM and to Member States operating within the ESM. Another case, brought before the [German Constitutional Court in 2011](#), claiming the ESM would undermine the Bundestag's independence, produced mixed results. The Court ruled, in 2012, that, while the establishment of the ESM was legal, no decision impinging on the [Bundestag's budgetary autonomy](#) can be taken without the Bundestag's assent. Moreover, the secrecy that pertains to some of ESM's files cannot be invoked if the Bundestag requests to view them.

The German Court's case highlights how some of the ESM's decisions, especially those included in the MoU imposing conditionality measures, may easily conflict with [national sovereignty](#). Reforms imposed by the MoU, the acceptance of which is required to receive financial aid, heavily impinge on a state's social security scheme; the latter, whose features depend on a nation's culture, history and societal arrangement, is normally the outcome of

internal, democratic decisions. Considering how the ESM, via the MoU, alters the way a country distributes resources and services, more transparency and accountability, relative to how decisions are arrived at, would be welcome. MoU provisions, moreover, have been found to [violate human rights](#): considerable budget cuts, in particular those regarding education and healthcare, have resulted in a diminished capacity of the state to provide these services to the public. Even the [UN Special Rapporteur](#) on foreign debt and human rights deemed the reform measures entailed by MoU to undermine a number of socio-economic rights.

Defenders of the ESM point to its effectiveness in tackling the euro crisis: in effect, without the joint action of the ESM, the Eurogroup and the Troika, the [crisis could have had much worse effects](#). And yet, considering the importance of the decisions it takes, requests for transparency and accountability cannot be ignored. For instance, the IMF has recently [agreed to join the third Greek bailout programme](#), whereby €86 billion will be disbursed to Greece over three years (2015-2018). Until July 2017 however, the IMF's participation to the plan was not assured, as it publicly disagreed with the ESM over the size of [Greece's debt and of its primary surplus targets](#); these, according to the IMF were way too optimistic, and would have implied a further tightening of austerity measures in the country, to a point where recovery would have been impossible to occur. Had the IMF been right however, a financially unsustainable rescue package would have been approved, without the Greek public having had a chance to do anything about it.

What's next?

Bringing the ESM within the EU treaties' framework would be a move towards more accountability. Ideally, once it becomes part of the EU law, the ESM would obviously be bound by it and would therefore be liable for the decisions it takes when arranging rescue plans. In theory, amended Art. 136 TFEU implies the ESM will eventually become part of EU treaties, which should happen [by 2025](#).

The German proposal to turn instead the [ESM into an European version of the IMF](#)—a European Monetary Fund—seems to go in the opposite direction. Albeit surprisingly, the plan is backed by Wolfgang Schauble and Angela Merkel, with [Dijsselbloem's support](#); the German executive however has its motives behind this sharp change of approach. First, the proposal is said to be a display of [goodwill towards French President Emmanuel Macron](#), who has promised to deepen EU integration. Moreover, in Schauble's vision a European Monetary Fund would monitor the financial activities of all Eurozone countries, which has so far been a Commission's task: in practice, this reformed ESM would operate independently of any European institution, resulting in an even more powerful and less accountable body. [Pierre Moscovici, EU Commissioner for Economic and Financial Affairs, is against this option](#), arguing that institutional involvement is necessary if the plan is to go through.