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The creation of the European Stability Mechanism

The European Stability Mechanism (ESM) was created on 27 September 2012. The basis for the discussion concerning its creation was established by the agreement concluded on 18 October 2010 in Deauville between the President of France, N. Sarkozy, and the Chancellor of Germany, A. Merkel. Germany obliged itself to support the strive of France to dilute the sanctions imposed on countries with excessive public debt. France, on the other hand, made a commitment to aid the German initiative to make changes to the Treaty on the functioning of the European Union (TFEU). These changes were supposed to enable the creation of ESM - a mechanism of permanent nature. German politicians were afraid that the already existing solutions were insufficient to battle the debt crisis and that it was necessary to adopt a permanent instrument.

The FRG managed to convince other countries of the eurozone to its initiative. Thus, during a meeting on 28-29 November 2010, the European Council pointed, among others, to the necessity of creating a permanent anti-crisis mechanism in order to ensure the financial stability of the eurozone as a whole. At the same time, ministers of the Eurogroup defined the general rules for the functioning of this mechanism during a statement of November 28. This statement was approved by the European Council. They were, therefore, able to call on the Ministers of Finance of the eurozone and the European Commission, during a meeting on 16/17 December 2010, to finish the works on the intergovernmental agreement creating the mechanism until March 2011. It was also agreed upon that its creation would require changes in the TFEU and that the mechanism will substitute the European Financial Stability Facility (EFSF) until the second half of 2013.

The Ministers of Finance managed to finally establish the rules for the functioning of the ESM on 22 March 2011. It was described as a new international financial organization modeled on the International Monetary Fund. The ministers decided that the mechanism would administrate funds amounting to 700 billion euros, 80 billion of which would be constituted by paid-in capital provided by the member states. The remaining 620 billion euros would be covered by guarantees and callable capital. Half of the paid-in capital is supposed to be provided by the member states in 2013.

The size of the contributions to the ESM became a subject of a debate among the Ministers of Finance. The German Minister, W. Schäuble, proposed the use of the well-tryed rules employed at the European Central Bank (ECB). Estonia, Slovakia and four other East-European countries were opposed to this idea. They argued that the criteria preferred by the German Minister would burden them with excessive financial strain. Finally, it was decided that the contributions to the ESM would be established in accordance with the rules of the ECB concerning the shares in the paid-in capital. With regard to the East-European countries, the strength of their economies would be taken into consideration to some degree. Otherwise, the contributions of these countries would be too high.

According to the decisions made by the Ministers of Finance, the member states of the ESM would be able to benefit from the financial aid of the organization on three conditions. Firstly, such a country has to experience financial difficulties and a danger to the financial sector and economic stability. Secondly, the so called Memorandum of Understanding needs to be signed, containing a program for the necessary reforms or financial consolidation aimed at restoring financial stability; thirdly, full ratification of the European fiscal pact is required.

Countries applying for aid will be able to use one or more of the five different instrument available. These instrument are: stability aid, precautionary financial assistance, financial aid for the recapitalization of financial institutions, loans from ESM and the purchase of loans contracted by ESM member states on the primary market. The application for aid will be considered by the so called Troika, composed of the representatives of the European Union, the European Central Bank and the International Monetary Fund. Final decisions will be taken by the ESM Council of Governors with Ministers of Finance as its members.

During a meeting on 24/25 March 2011, the European Council approved the majority of the regulations concerning the ESM proposed by the Ministers of Finance of the eurozone. However, a change was made to the date on which the contributions for the mechanism will be made - this will now take place annually for 5 years, starting from 2013. This change was forced through by A. Merkel, who acted according to the position of the



CDU/CSU faction, FDP and certain conditions of economic nature. The adopted solution was supposed to decrease the net debt of the FRG, whose financial situation was not easy. Its budget deficit in 2010 reached 4.1% of GDP, while the public debt - 82.5%. During this meeting the European Council added to art. 136 of the TFEU a paragraph stating that "The Member States whose currency is the euro may establish a stability mechanism to be activated if indispensable to safeguard the stability of the euro area as a whole. The granting of any required financial assistance under the mechanism will be made subject to strict conditionality.". The change of the Treaty is supposed to take effect on 1 January 2013, on condition that all notifications of the member states are received before this date. Otherwise, it will take place on the first day of the month after the reception of the last notification.

The treaty on the creation of the European Stability Mechanism was signed in its final version on 2 February 2012 in Brussels by the ambassadors of the eurozone countries and immediately faced criticism. The signing of the treaty in the Federal Republic of Germany caused anxiety on the part of certain politicians of the governing coalition (especially CSU and FDP), the Left party and a circle of professors around a constitutionalist, K. A. Schatzschneider, and economists, W. Hankela and J. Starbatty'ego. They concluded that the activity of the ESM may cause a further increase in debt and inflation, which will be inconsistent with art. 125 of the TFEU, formulating the prohibition of bailout. They also pointed out that the Bundestag will lose its control capabilities and, at the same time, the budget autonomy will be violated. This will be inconsistent with art. 20 and 79 of the Constitution and art. 38 of the election law. This critical evaluation of the treaty on the creation of the ESM resulted in several constitutional complaints forwarded to the Constitutional Court in Karlsruhe. The Court pronounced that the treaty does not violate the Constitution, however, certain conditions for the ratification of the treaty were set. According to these conditions:

- the (financial) responsibility of Germany is limited to 190 billion euros, which must to be secured by the President and the Federal Government in international law acts;
- the consent of the Bundestag is required for any potential increases in the above mentioned amount;
- German representatives in ESM bodies cannot invoke the obligation of confidentiality (towards the Bundestag and Bundesrat) and must act according to the guidelines of the Parliament;
- the Bundestag must ensure the German right to vote in the Council of Governors (by paying the German contribution);



- the ESM cannot serve as an instrument for any unconstitutional funding of states by the ECB. The purchase of state loans on secondary markets by issuing banks would also constitute a bypass of the prohibition of monetary budget funding.

The conditions formulated by the Court were approved on 14 September 2012 in an additional statement of the Eurogroup Ministers of Finance, which enabled the President of the FRG to sign the treaty. The Troika is now (the last quarter of 2012) concerned with the potential ESM aid for Cyprus and Spain.

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