

# The role of the European Stability Mechanism in the EMU architecture

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Guest lecture at the College of Europe (Bruges)

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27 October 2023



# ALL YOU WANTED TO KNOW ABOUT THE ESM (BUT NEVER DARED TO ASK)

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Why didn't the ESM exist at the start of EMU?

Why was the ESM created outside the EU?

How can the ESM contribute to addressing long-term EU challenges?

What is the ESM reform about?

Why was the Pandemic Crisis Support not used?

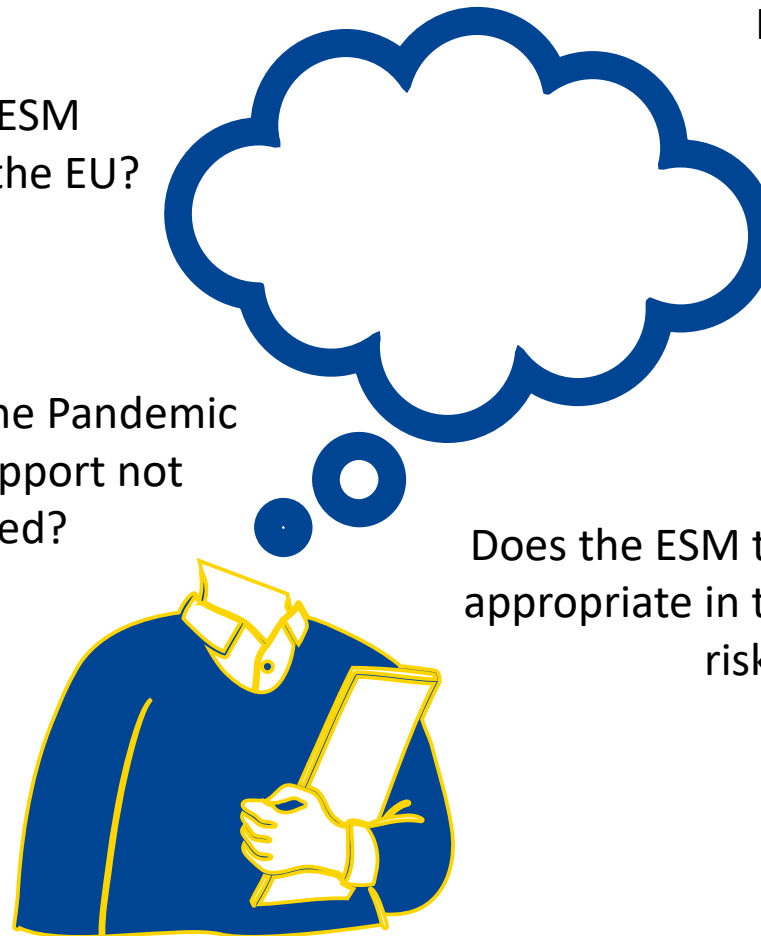
Should the ESM be integrated into the EU legal framework?

How could the ESM lend EUR 110bn with EUR 80bn capital?

Does the ESM toolbox remain appropriate in the face of new risks?

How is the ESM accountable?

What is the state-of-play with the revised ESM treaty?



# OUTLINE

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I. The creation of the ESM

II. Governance, financial structure & instruments

III. The reform of the ESM

IV. Outlook and conclusions

# THE CREATION OF THE ESM

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# CRISES AS A MOTOR OF EMU DEEPENING

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- *"Europe will be forged in crises, and will be the sum of the solutions adopted for those crises"* - Jean Monet
- Crisis management is in the ESM's "DNA"
- Greater focus on crisis prevention over time

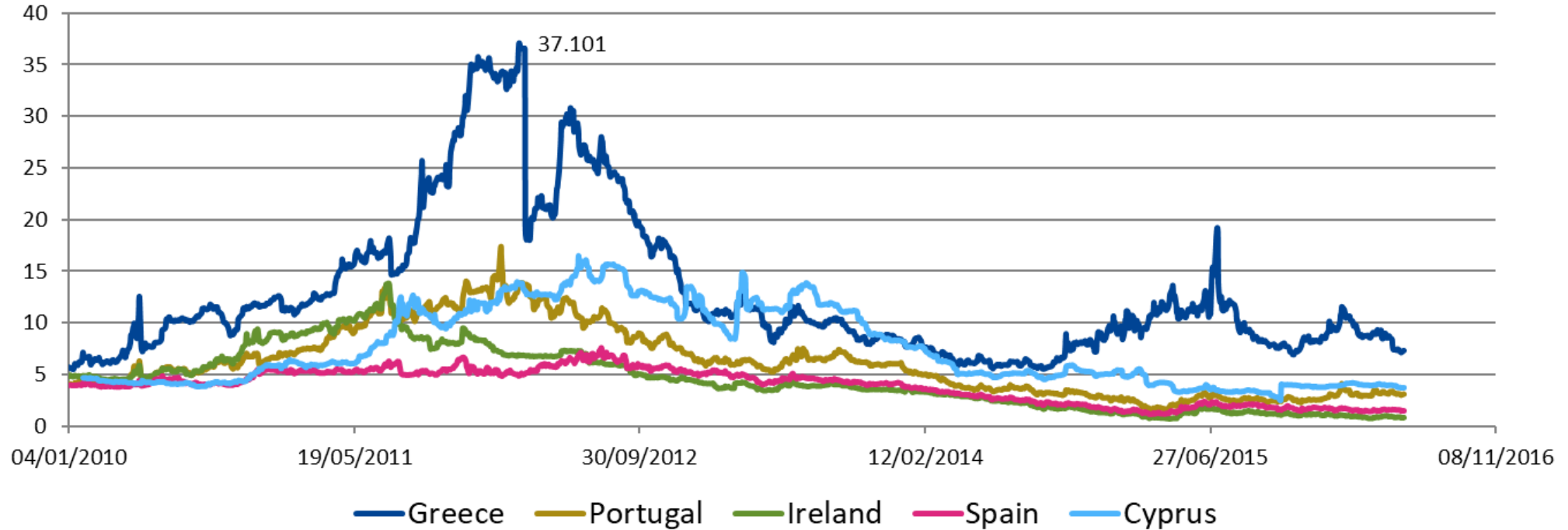




# LOSS OF MARKET ACCESS

As a result, borrowing costs rose to unsustainable levels

## 10-year bond yields



Source: ECB

## CREATION OF THE EFSF AND ESM

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- The **European Financial Stability Facility (EFSF)** was created in June 2010 as a **temporary** mechanism to provide financial help to euro area countries
- The permanent **European Stability Mechanism (ESM)** was inaugurated in October 2012. Its **intergovernmental setup** enabled a swift establishment.



*ESM Board of Governors (euro area finance ministers) at inauguration of ESM, 8 October 2012*



# GOVERNANCE, FINANCIAL STRUCTURE & INSTRUMENTS

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# MISSION OF THE EFSF AND ESM

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- The ESM's mission is to **prevent and overcome financial crises** in the euro area and to maintain its long-term financial stability and prosperity
- ESM can provide **financial assistance** to euro area countries experiencing or threatened by severe financing problems
- This assistance is granted if necessary **to safeguard the financial stability** of the euro area as a whole and of ESM Members.



# ESM DECISION-MAKING

## Board of Governors

- Highest decision-making body
- Chaired by President of the Eurogroup
- Comprises euro area finance ministers

## Board of Directors

- Tasks mandated in ESM Treaty or delegated by Board of Governors
- One Director per ESM Member
- Chaired by ESM Managing Director

## Managing Director

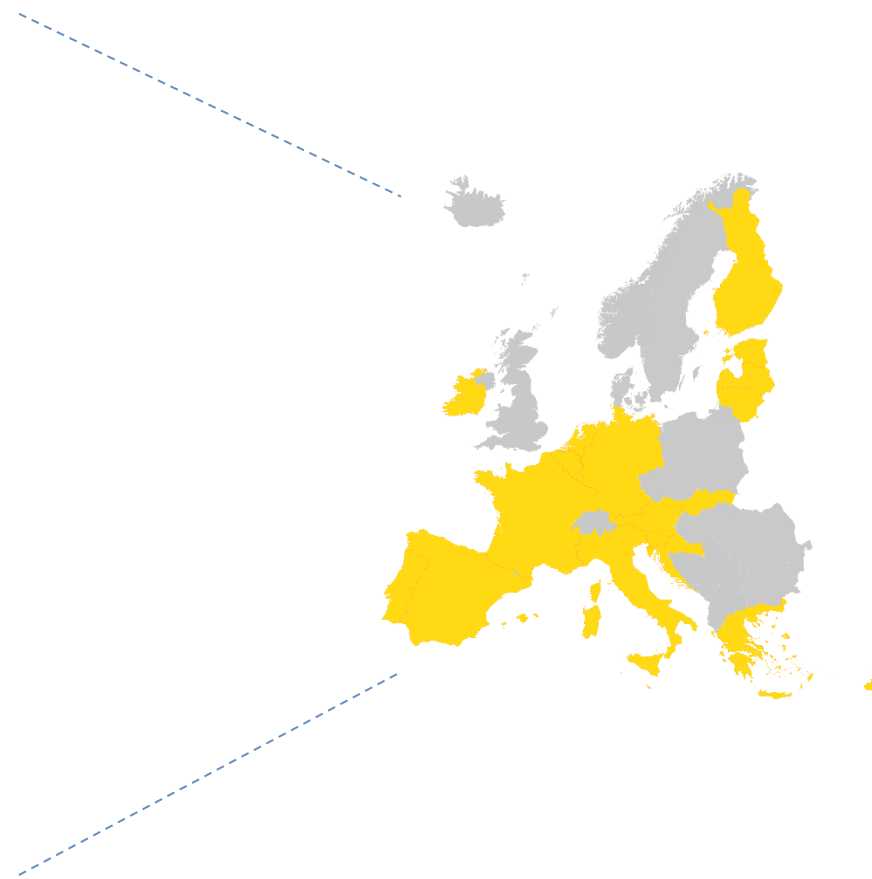
- Appointed by Board of Governors for 5-year term (renewable once)
- Heads ESM staff and directs current business
- Assisted by 6 members of Management Board



*Paschal Donohoe, Chairman of ESM Board of Governors, and Pierre Gramegna, ESM Managing Director*



# THE ESM RELIES ON NATIONAL ACCOUNTABILITY CHANNELS



# THE ESM ISSUES BONDS TO FINANCE ITS LOANS

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*The ESM's trading room*

- To finance its loans, **the ESM borrows money by issuing bonds**
- ESM bonds are bought by institutional investors, such as commercial banks, central banks and investment funds
- The ESM can borrow money **at very low rates** because its bonds are backed by over **€80 billion in capital paid in** by Member States and €628 billion in committed callable capital
- The **ESM does not lend taxpayer money** to countries – only funds raised through the sale of bonds

# ESM FINANCIAL ASSISTANCE TOOLKIT

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**Loans**



**Precautionary  
credit lines**



**Bank recapitalisations  
Through loans  
to governments**



**Direct  
recapitalisation of  
banks**



**Primary market  
purchases**



**Secondary market  
purchases**

# ESM PANDEMIC CRISIS SUPPORT

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## ■ Europe's coordinated response to the pandemic crisis

- In April 2020, the Eurogroup decided that the ESM, European Commission and European Investment Bank would create **3 safety nets**: for sovereigns, workers and businesses
- Total package worth **€540 billion**

## ■ ESM Pandemic Crisis Support: a credit line for sovereigns

- Precautionary credit line with a total volume of up to **€240 billion**
- Created to support domestic **financing of Covid-19 related healthcare costs** by euro area countries
- Countries could receive a loan of **2% of their GDP**
- Unlike other ESM instruments, **limited conditionality applied**
- Credit line was available **until end of 2022**

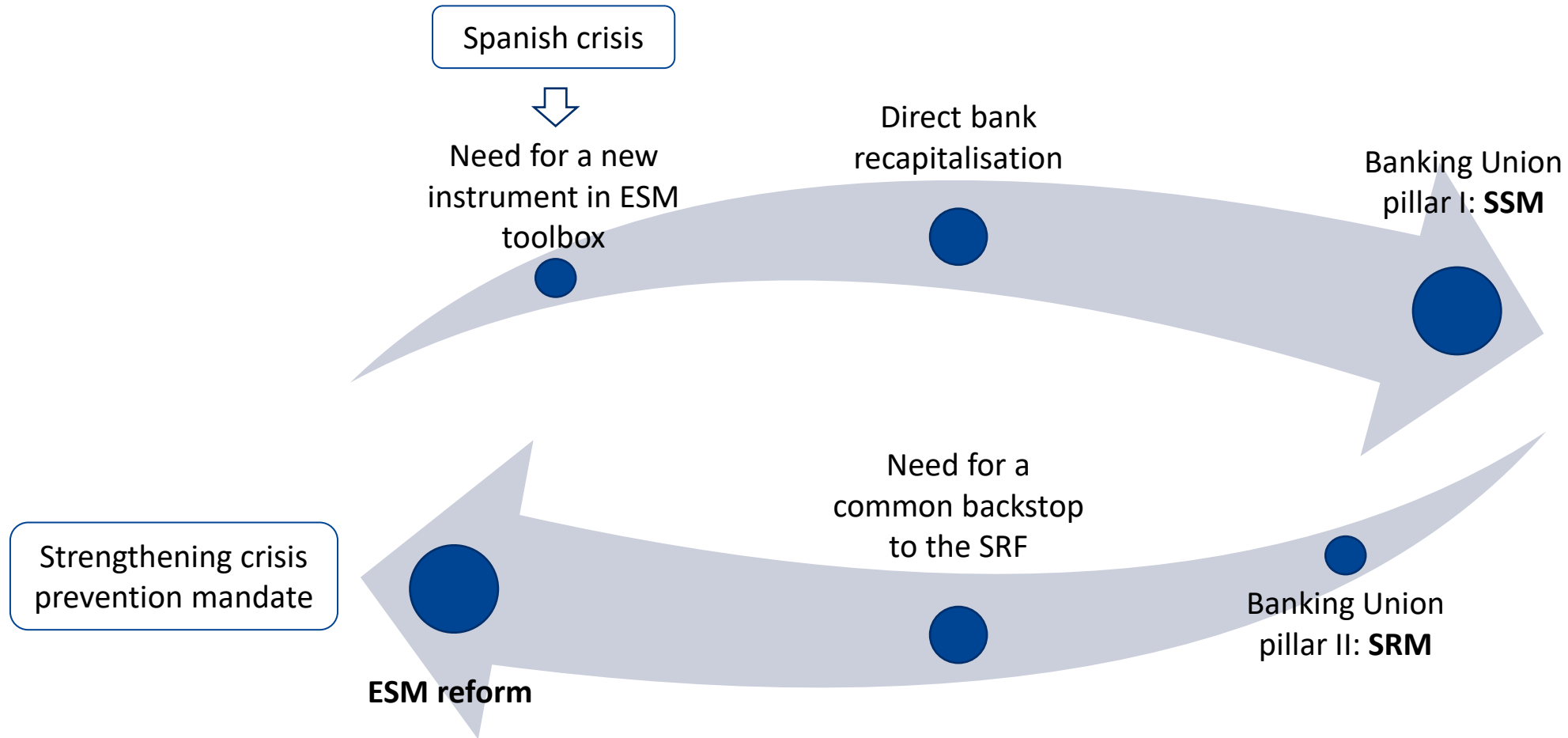
## THE REFORM OF THE ESM

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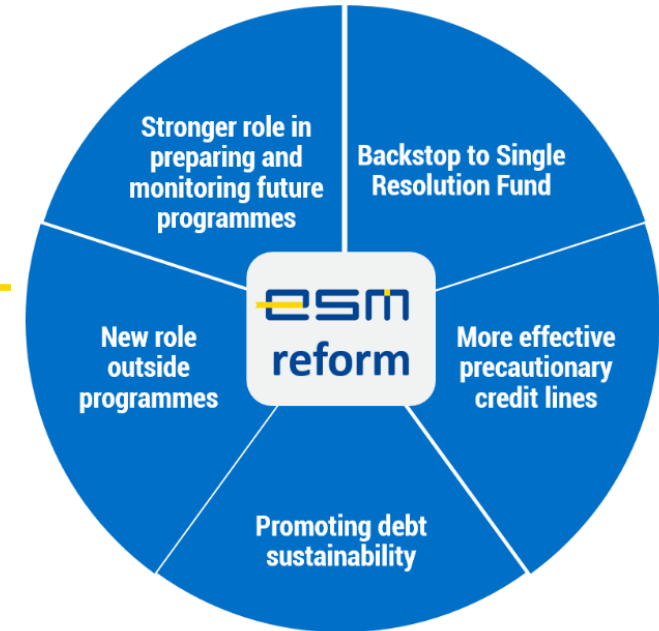


# FEEDBACK LOOP BETWEEN THE ESM AND BANKING UNION



# REFORM OF THE ESM : NEW TASKS

In January 2021 the revised ESM Treaty was signed, giving new tasks to the ESM. It will enter into force when ratified by all 20 ESM Members



- **Backstop to the Single Resolution Fund (SRF)**
  - ESM will be able to provide a credit line of up to €68 billion
- **Stronger role in future country programmes**
  - ESM more involved in the design of policy conditionality, monitoring and debt sustainability analysis with the European Commission
- **ESM’s role outside programmes**
  - The ESM will follow macro-economic and financial developments in all euro area countries
- **More effective precautionary credit lines (PCCL and ECCL)**
  - The eligibility process for the precautionary credit lines will be made more transparent and predictable
- **Promoting debt sustainability**
  - Single-limb Collective Action Clauses (CACs) will make sovereign debt restructuring more orderly and predictable (reduced “holdout” risk)

## OUTLOOK AND CONCLUSIONS

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# CRISIS PREPAREDNESS IN A SHOCK-PRONE WORLD

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- New risks on the horizon: climate change, geopolitical risks...
- Recent series of unexpected exogenous shocks (COVID, Ukraine war, etc)
- **The next crisis will be different**



This raises many **policy challenges** for the EU:

- ? How can EMU contribute to the EU's strategic autonomy and resilience?
- ? How to finance the investments needed for the twin transition and to boost Europe's competitiveness?
- ? What should happen after NGEU expires in 2026?
- ? Should there be a permanent stabilisation function for the euro area, or even the whole EU?
- ? How to promote a European safe asset?

# ESM COUNTRY VISITS AND TOOLKIT REVIEW – STATE OF PLAY

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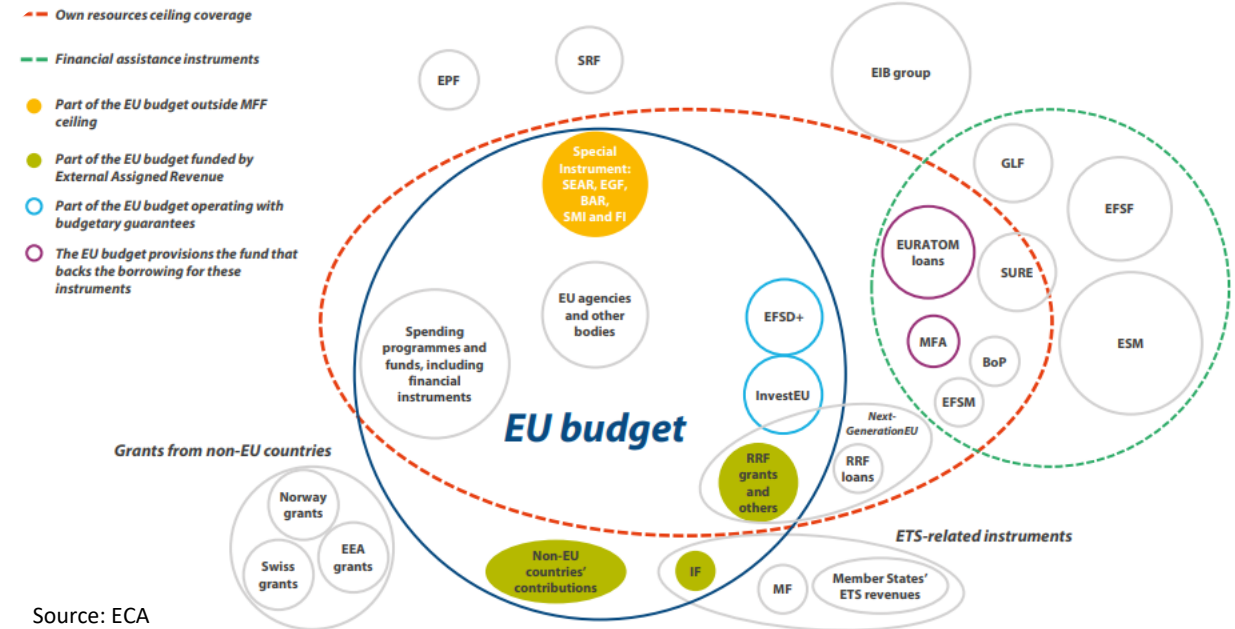
- Purpose of the visits is to engage with all shareholders on how the ESM can better discharge its mandate, and which role it should play going forward
- Comprehensive review of the toolkit: ensuring that the ESM toolbox remains fit for purpose in view of new risks
- Treaty ratification in Italy still pending

# DISCUSSION ON THE FUTURE OF THE ESM

The ESM remains the only permanent crisis resolution mechanism in the euro area

Firepower of EUR 417bn: no new capital nor guarantees needed

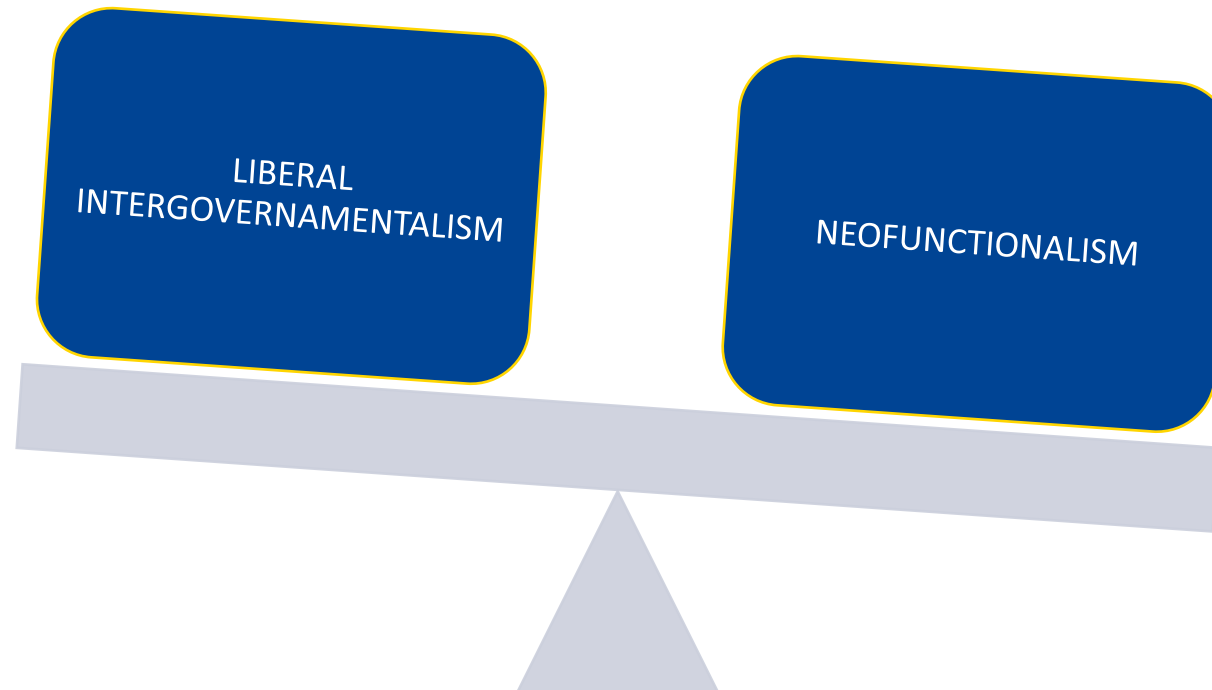
The discussion on the ESM future should be part of the broader debate on a more integrated and efficient EU framework



## SOME FINAL THOUGHTS...THE ACADEMIC PERSPECTIVE

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Which theory of European integration does account best for the evolution of the ESM?



## LEARN MORE ABOUT THE ESM

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### **Website:**

[www.esm.europa.eu](http://www.esm.europa.eu)

### **Follow us on social media:**

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