European Stability Mechanism and the Covid-19 pandemic

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Introduction

The European Stability Mechanism (ESM) is an international financial institution financed by Eurozone countries to provide financial assistance in times of severe economic distress.[1] It borrows money from financial markets at low interest rates and lends this money to eurozone countries in financial difficulty and provides capital to banks. It achieves a good credit rating as its debts are in effect guaranteed by all eurozone countries through subscribed capital (i.e. money paid or promised to the ESM by eurozone countries). This reassures investors that debt will be repaid. This subscribed capital consists of paid in capital (actual monies) and callable capital (a commitment by States that they will pay the amount when requested to do so).[2] For Ireland, the paid-in capital is €1.3 billion and callable capital is a further €9.8 billion. [3]

ESM role in the Covid-19 pandemic

In April the Eurogroup (Finance Ministers of Eurozone countries) agreed on a range of measures to support economies affected by the COVID-19 pandemic. [4] As part of these measures, it was agreed that the ESM would provide funding to countries affected by the pandemic. This will take the form of an Enhanced Conditions Credit Line (ECCL). Details were agreed on the 8th May by the Eurogroup and it is expected that the scheme will be operational from 15th May.[5]

Details of ESM Pandemic Crisis Support

All Eurozone countries are eligible for the ESM's Pandemic Crisis Support. The level of funding available to Eurozone countries will be based on the size of their economy. Countries will have access to funding of up to 2% of their respective GDP at the end of 2019. Based on this methodology, the maximum value from this credit line available to Eurozone countries is €240 billion (assuming every country draws down the maximum amount available). Requests for use of the credit line will be available until the end of 2022, though this could be subject to an extension.

The loans would have a maximum average maturity of 10 years. Furthermore, the Member States will be required to pay a margin of 10 basis points (0.1%) annually and an up-front service fee of 25 basis points (0.25%). This is lower than other ESM precautionary credit lines and will reduce the cost of the Pandemic Crisis Support to a Member State.

Conditionality

There will be a requirement that the credit line is only used for direct and indirect healthcare costs arising from the COVID-19 crisis. The funding will also have to be unanimously approved by the Eurogroup, who make up the ESM Board of Governors. The European Commissioner for Economy, Paolo Gentiloni, has encouraged

1 ESM (2020) About Us, https://www.esm.europa.eu/about-us

2 Parliamentary Budget Office 2019) An Overview and Analysis of Contingent Liabilities in Ireland, https://data.oireachtas.ie/ie/oireachtas/parliamentaryBudgetOffice/2019/2019-05-01_an-overview-and-analysis-of-contingent-liabilities-in-ireland_en.pdf

3 Fiscal Council (2019) Fiscal Assessment Report June 2019, https://www.fiscalcouncil.ie/wp-content/uploads/2019/06/FAR-June-2019-Box-D-Reforms-to-the-European-Stability-Mechanism-ESM-.pdf

4 European Council (2020)Report on the comprehensive economic policy response to the COVID-19 pandemic, https://www.consilium.europa.eu/en/press/press-releases/2020/04/09/report-on-the-comprehensive-economic-policy-response-to-the-covid-19-pandemic/

5 ESM (2020) ESM's role in the European response, https://www.esm.europa.eu/content/europe-response-corona-crisis

Eurozone countries to make use of this ESM finance by assuring them that the funds will not come with "draconian" conditions. [6]

During the COVID-19 pandemic, there is flexibility applied by the European Commission under the Stability and Growth Pact. However, after the crisis, it is expected Eurozone countries would strengthen the economic and financial fundamentals to ensure they are consistent with the EU's economic and fiscal coordination and surveillance frameworks.

The use of these Pandemic Crisis Support funds will be monitored through the Enhanced Surveillance process of the European Commission, through the usual mission visits of the European Semester. Such monitoring is to ensure that the funds are used to cover direct and indirect healthcare costs arising from the COVID-19 pandemic.

Risk to the ESM's funding activities

There should be no immediate risk to the funding activities of the ESM for Member States. The average maturity of 10 years and the agreed processes for disbursements will utilise a wide range of funding instruments. This should raise additional financing smoothly over this crisis period.

In terms of the credit rating of the ESM, it should not be impacted by new loans under the Pandemic Crisis Support.[7] The ESM's long-term credit ratings are AAA, Stable Outlook (Fitch) and Aa1, Stable Outlook (Moody's).

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6 https://www.politico.eu/article/paolo-gentiloni-eu-emergency-finance-has-no-draconian-strings-attached/
7 ESM (2020) ESM's role in the European response, https://www.esm.europa.eu/content/europe-response-corona-crisis