ESM REFORM

Shared views of the Finance Ministers from the Czech Republic, Denmark, Estonia, Finland, Ireland, Latvia, Lithuania, the Netherlands, Sweden and Slovakia

A well-functioning EMU is vital to the stability and prospects of the euro area, as well as to the EU as a whole. We are therefore committed to contributing positively to the debate on strengthening the EMU architecture. An important part of this architecture is the euro area's crisis-management mechanism, the ESM. Building on the lessons of the financial crisis, we are committed to ensuring that it is properly equipped to respond to all future challenges.

A credible and effective EMU crisis-management framework is not only important for the euro area, but also for the EU as a whole, given the close economic and financial ties. In particular, the ESM reform matters for the EU-27 as a whole. The Leaders agreed that, as part of a broader reform, the ESM should backstop the Single Resolution Fund of the Banking Union, which is open also to non-euro area Member States. Further, the ESM treaty in general foresees the possibility of parallel financing arrangements, such as bilateral loans and the European Financial Stabilisation Mechanism agreed during the crisis, both of which involved non-euro Member States.

The ESM's original setup reflected the urgency of the crisis and the need to act fast; in a complete EMU, however, a reinforced role for the ESM increases the credibility and effectiveness of the crisis management framework.

We support such reinforced role for the ESM, as an intergovernmental institution accountable to its shareholders. Its primary role should remain the lender of last resort for euro area Member States in need. The first line of defence in financial difficulties will always have to be at the national level, in the form of prudent fiscal policies in respect of the SGP and determined structural reforms that strengthen the overall economy and public finances. The ESM should only provide stability support when indispensable to the financial stability of the euro area as a whole and its Member States.

Union legislation grants the task of economic policy coordination to the Commission and the Council, while other Union bodies are granted tasks in the fields of micro and macroprudential supervision. Equally important, TFEU Article 136(3) requires the granting of any financial assistance to be made under **strict conditionality**. The European Court of Justice has established that conditionality is crucial to ensure compatibility with the EU Treaties, including the fiscal rules and the no-bailout clause.

It is fully in line with Union law for the ESM as a lender to bear the responsibility for assessing and approving the conditionality and determining the financing terms, including size and maturity of financial assistance. This is an inseparable part of its role as creditor and its fiduciary duty to act in the interest of its shareholders, who bear the ultimate responsibility for providing financial assistance.

The no bail-out clause (TFEU Article 125) requires that the borrower remains liable for its debts. Accordingly, the ESM must always ensure that the Member State has adequate repayment capacity, before financial assistance is granted. The current ESM treaty already recognizes the possibility of private sector involvement in exceptional circumstances and an amendment of the treaty should be used to reaffirm this principle. Concretely, in line with established IMF practices, **the ESM Managing Director should be tasked to verify the adequacy of the borrower's repayment capacity** before presenting the programme to the Board of Governors for approval. In the unlikely situation where strict conditionality alone could not reasonably be expected to restore adequate repayment capacity, financial assistance would only be granted after measures to improve debt sustainability, taken in cooperation with existing creditors. **The introduction of single limb CACs**, with proper safeguards to ensure smooth market conditions, is an important element to increase the predictability of such a framework. This would also ensure that no future programme country is left with an unduly heavy burden of debt as a result of the programme.

An assessment of repayment capacity should precede the granting of financial assistance, as well as every subsequent disbursement. The assessment should be prepared independently by the ESM, taking into account the debt sustainability analyses prepared by other institutions, in particular the Commission and the IMF, and the beneficial effects of program conditionality and ESM support on market confidence. The assessment should lead to clear advice on the likelihood of repayment and be based on an ex-ante agreed and transparent methodology, while allowing the ESM sufficient margin of judgement.

To be properly prepared to assess risks to a country's repayment capacity, the ESM needs analytical expertise and full access to information of the economic and financial situation in normal times. A key part of its work is early identification of risks and vulnerabilities and contingency planning to ensure timeliness of actions. **During crisis times, the ESM should participate in all stages of program preparation and (ex-post) monitoring.** The ESM's stronger role in these tasks should be implemented in a manner that preserves the integrity and consistency of the EU's economic-policy coordination and respects the roles of the Council and the Commission under EU law, avoiding overlaps.

Finally, we stress that the common backstop to the SRF should allow non-euro area Member States participating in the Banking Union to take part with equivalent rights and obligations, including financial terms and governance.

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