Stop the reform of European Stability Mechanism

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In Italy, a discussion developed, first in the media and then in the parliamentary halls, about the proposed reform of the European Stability Mechanism treaty, which should be approved by Eurozone leaders at the Euro summit on December 13th. The leader of the Northern League sovereign party, Matteo Salvini, said that Prime Minister Giuseppe Conte had approved the reform in June 2019 without informing Parliament and then accused him of "high treason". Salvini is now in opposition with the current government, but only a few months ago he was a Minister in the government that participated in the European EMS negotiations.

Transform Italia believes that the issue is crucial, because it fits into the economic *governance* of the European Union and raises serious questions of defense of democracy. So, we tried, in two articles, to rebuild, with the necessary and appropriate reference to institutional documents, the story of the European Stability Mechanism (ESM). The theme is complex and therefore worthy of further checks and updates.

What is the ESM

The European Stability Mechanism was established in October 2012 at the height of the economic crisis that seriously compromised economic growth and financial stability and caused a serious deterioration of the deficit and debt positions of the EU Member States.

The ESM is part of the EU strategy to ensure financial stability in the euro area. It provides assistance to euro area countries facing financial difficulties and continues the work of its predecessor, the European Financial Stability Facility (EFSF), established in 2010, which, pursuant to the Council Regulation 407 of 11 May 2010 would have allowed the Union to respond in a coordinated, rapid and effective manner to serious difficulties in a given Member State and its activation would have taken place in the context of a joint EU / International Monetary Fund (IMF) support, in connection with the European Central Bank (ECB), formalizing, in such a way, the intervention of the **troika** in the economy of the States.

The countries of the euro area signed the intergovernmental treaty that established the ESM on February 2, 2012. Opened at the end of 2012, ESM is an intergovernmental organization governed by public international law, based in Luxembourg. Its shareholders are the euro zone countries. ESM issues debt instruments to finance loans and other forms of financial assistance in euro zone countries.

The ESM is authorized to:

- grant loans as part of a macroeconomic adjustment program;
- purchase debt securities on the primary and secondary financial markets;
- provide financial assistance in the form of credit lines;
- finance the recapitalization of financial institutions through loans to the governments of its Member States.

As we saw, in the urgency of the moment an intergovernmental solution was adopted, but experience has shown that the coexistence between the EU institutions and a permanent intergovernmental mechanism like the ESM generates a complex situation in which the judicial protection, the respect of the fundamental rights and democratic accountability are fragmented and inconsistently applied. Furthermore, the decision-making process within the intergovernmental method usually involves a complex national procedural process and often does not guarantee the speed required for effective crisis management. The ESM, also referred to in the Fiscal Compact Treaty, is therefore outside the scope of the European Union. This is a significant limit because it accentuates the intergovernmental character of some of the most important eurozone decisions and because the ESM is not accountable for its actions to the European Parliament.

The proposed reform

Following the mandate received from EU leaders at the Euro Summit of December 14, 2018, the Eurogroup of June 13, 2019 reached a broad agreement on the revision of the Treaty of European Stability Mechanism (ESM), whose main contents are reported in a letter from President Centeno addressed to the President of the European Council in view of the Euro Summit of 21 June 2019, which at present would seem to go beyond the proposal to establish a European Monetary Fund, aimed at including the Mechanism in the legal framework at a later stage.

This intention, in fact, descends directly from the Franco-German agreement ("Renewing Europe's promises of security and prosperity", a joint declaration adopted during the Council of Ministers of France and Germany of 19 June 2018 held in Meseberg, Germany), which rules that “As a first step, we need to modify the inter-governmental ESM treaty in order to include a common support tool, strengthen the effectiveness of precautionary instruments for Member States and strengthen its role in evaluating and monitoring future programs. And then, we can therefore guarantee the integration of the ESM into EU law, preserving the key features of its governance."

In June, European leaders called on the Eurogroup in an inclusive format to continue working on all elements of the global European Monetary Union (EMU) strengthening package, and first of all, they agreed to continue the work **to finalize the package of documents related to the revision of the ESM Treaty by December**. This includes the documents relating to the introduction of the common backstop (Guidelines on the main features of the backstop, abolition of the instrument of direct recapitalization of the institutions), the work on the early introduction of the backstop, "the changes to the orientation of the precautionary instruments and the common methodological working document on debt sustainability analysis. We (*the Council*) have invited the Commission and the ESM to start working on it as soon as possible. We will strive to make significant progress on these issues by November."

These are very important elements, not yet defined, which make an actual definition of all the factors uncertain to allow a general consensus on the reform at the end of December 2019.

The changes agreed to the ESM treaty, on which the President of the Eurogroup expressed the hope that an overall agreement can be found on the whole reform package by the end of 2019, in order to allow an immediate start of the ratification process in the Member States, are as follows.

The ESM, in addition to supporting the resolution of crises related to the public finances of the Member States, would also provide a common guarantee (backstop) to the Single Resolution Fund of the banks in the form of a revolving credit line; a common position should establish new modes of cooperation between the ESM and the European Commission inside and outside financial assistance programs, in full respect of the EU legal framework. Note that already in April 2018 ESM and European Commission signed a memorandum of understanding on their future cooperation, which preserves the institutional role and prerogatives deriving from the treaties. Commission and ESM should conduct periodic meetings and exchange of information in relation to their specific competences.

In preparing financial assistance, the Commission should ensure consistency between the measures adopted and the European economic policy coordination framework, working on the basis of its own growth forecasts and further estimates, while the ESM should evaluate, **from the perspective of creditor**, the potential for market access by Member States and the related risks. In the event that the collaboration does not lead to a common position, the European Commission would be responsible for the general assessment of the sustainability of public debt, while the ESM that of the capacity to repay the loan by the Member State concerned.

The ESM, in collaboration with the European Commission and the ECB, would have the task of monitoring and evaluating the macroeconomic framework and the financial situation of its members, including the sustainability of the public debt; this activity would take place in advance, independently of requests for support and exclusively for internal use, to put the ESM in a position to respond promptly to any requests (article 3), or in any case after the formal presentation of a request for financial support. In the latter case, the evaluation should be carried out in a transparent and predictable manner, but there is room to allow a sufficient margin of judgment (Article 13); collective action clauses would be reformed with the introduction, starting from 1 January 2022, of collective action clauses with single majority approval (single limb CACs) (article 12); about precautionary instruments (i.e. the opening of credit lines to requesting countries), stricter criteria would be introduced and a simplified procedure for countries able to guarantee compliance with specific requirements (Annex 3 of the Treaty).

A first instrument of intervention would be the precautionary conditional credit line (PCCL), limited to member states whose economic and financial situation, although fundamentally solid, could nevertheless be influenced by a negative shock beyond their control. The requesting country **should meet a set of 3 criteria and sign a letter of intent** committing itself to continue to meet these criteria.

Member States should comply with certain quantitative budgetary parameters during the two years preceding the request for financial assistance (including a deficit below 3% of GDP and a debt-to-GDP ratio of less than 60% of GDP or a reduction of this ratio by 1/20% per year), not being subject to the excessive deficit procedure, having no excessive imbalances and their public debt should be considered sustainable.

The second credit line subject to enhanced conditions (ECCL), on the other hand, would be open to ESM members who are not eligible for PCCL, due to the non-compliance with the aforementioned eligibility criteria, but whose economic and financial situation remains strong and whose public debt is considered sustainable. The requesting country should sign a **Memorandum of Understanding** (MoU) committing to intervene with the necessary reforms in its areas of vulnerability.

Therefore, while the PCCL would be based on the unilateral definition of the interventions to be implemented to resolve the crisis underlying the request for support, the ECCL would be based on the negotiation of conditionality, to be graded according to the intensity of the intervention, with a substantial participation of the Commission, the ESM and the ECB in the definition of the interventions to be implemented for the resolution of the crisis.

The member state and the European Commission negotiate the Memorandum of Understanding on behalf of the ESM. The conditions are usually specific reforms, which can normally focus on three areas:

• Tax consolidation - measures to reduce public spending, reducing public administration costs and improving efficiency, and to increase revenue through privatization or tax reforms;

• Structural reforms - measures to stimulate potential growth, create jobs and improve competitiveness;

• Financial sector reforms: measures to strengthen banking supervision or recapitalize banks.

The financing of the ESM would therefore be even more conditioned by "agreements" to define plans for cuts, restructuring and reform, along the lines of the "*planes de ajuste estructural*" imposed by the World Bank and the IMF on Latin American countries in the

1980s , and which contributed significantly to the increase in poverty and the decline in the quality of education, health, social protection and the environment of those countries.

The progress of the process of deepening the EMU

In preparation for the Euro Summit on 21 and 22 June 2019, the Commission prepared a document assessing progress made in the deepening of the Economic and Monetary Union and of economic governance and budget surveillance, truly worthy of reading, where it is recalled that immediately afterwards the financial and debt crisis, one of the first steps was to equip the euro area with crisis management mechanisms in support of governments that lose access to the market at sustainable interest rates. With a total capacity of 500 billion euros, the European Stability Mechanism can now provide financial assistance to euro area Member States affected or threatened by serious financing problems.

Furthermore, key elements of the Banking Union have been put in place aimed at “strengthen the financial sector, weaken the link between banks and their sovereigns, limit public bailouts of banks and overcome the disruptive effects of regulatory and supervisory fragmentation along national borders. The Single Rulebook for banks provides a single set of prudential rules applicable throughout the EU. It also acts as a foundation for the single market in banking. The Single Supervisory Mechanism oversees the most significant banks in the Banking Union. In case a significant bank fails and its resolution is in the public interest, it is resolved centrally by the Single Resolution Mechanism in accordance with a consistent set of rules." (*Editor's note*: provided it is not a German bank, considering that, apparently, the Directorate General for Competition (DG Comp) has expressed a favorable opinion for the rescue of 3.6 billion Nord Lb through the injection of public capital by the State of Lower Saxony (which will provide capital for 1.7 billion) According to Dg Comp, this rescue method would not involve State aid).

Discussions between euro area member states on the implementation of the roadmap for deepening the EMU, with the package of Commission proposals of 6 December 2017, took place in the Eurogroup and in other partially intergovernmental forums, in particular with regard to the budgetary instrument for convergence and competitiveness, the reform of the European stability mechanism and the future of the banking union. The Commission has played a mainly technical and role-oriented role in ensuring that political compromises are consistent with the EU legal framework. This aspect appears to us to be particularly problematic.

With regard to the European Stability Mechanism, the Commission emphasizes that "in due course" it should be included in the EU legal framework, and that the proposed revision of the Treaty establishing the European stability mechanism, as an intermediate solution, aims to further strengthen the prevention and resolution of crises in the euro area. It should not lead to duplication with the tasks of the EU institutions or make the economic surveillance framework more complex. In this respect, the Commission and the European Stability

Mechanism reached a common understanding on coming cooperation in 2018 in order to clarify their respective roles.

The European Stability Mechanism reform project foresees a revision of the precautionary financial instruments intended to support countries with sound economic fundamentals that could suffer due to negative shocks that are beyond their control. It is essential to clarify the conditions of access to these instruments, to ensure transparency and to specify how much it is possible to expect from them. At the same time, the eligibility conditions should not prevail over the objective of the precautionary instruments, should be consistent with the conditions set by the EU surveillance framework and should be shaped so as to respect the competences of the EU institutions.

Again the Commission, in June 2019: "It has been agreed that the European Stability Mechanism will provide a common backstop to the Single Resolution Fund in the form of a credit line. The Leaders agreed to introduce the backstop as of 2020 and by 2023 at the latest. As a last resort, the common backstop will support effective and credible bank crises management within the Single Resolution Mechanism, and will be repaid via contributions from the European banking sector. To ensure a credible resolution framework of banks, the agreement on the common backstop needs to ensure that resources will be made available swiftly. In that regard, short time limits for decision-making (12/24 hours) are essential, together with an emergency voting procedure. In addition, it is important that the responsibilities of the European Stability Mechanism are clearly defined and do not overlap or create frictions with the EU institutions and bodies that have been tasked to supervise banks or manage bank crises.

Most importantly, the reform of the Treaty establishing the European Stability Mechanism must not create obstacles to future amendments of EU legislation, which would give rise to fundamental problems affecting the autonomy of the EU legal order. The EU's banking legislation must remain open to further developments in accordance with the Community method to adjust to changing market circumstances and complete the Banking Union. "

Among the authoritative opinions expressed on the subject of this article, we report the governor of the Bank of Italy, who recalled that "*In the United States, in Canada and in other federal countries, a significant share of individual states' income variability is offset by the federal fiscal system (estimates based on different methods average at 10-15 per cent for both the US and Canada). … In addition, an integrated market helps to absorb local macroeconomic shocks, increases the robustness of the economic system, and strengthens financial stability. It would also obviously aid the effective and speedy transmission of fiscal and monetary policy measures. … There is a lack of significant progress with the European construction.* ***There has been a substantial transfer of sovereignty on economic and financial matters****, especially in recent years. It is indeed illusory to believe that we can direct the course of the economy and finance, patently global phenomena, from within the narrow confines of individual European countries. The construction, however, is lopsided and incomplete; its very sustainability requires that the missing elements be incorporated soon.*

Commenting on the draft Italian financial law for 2020 we wrote that once again it is necessary to reiterate that the economic maneuver from a member state can be exercised only within the very narrow limits dictated by the EU, and consequently that in the current situation it is not possible to practice a policy fiscal expansion that can effectively reverse the course of an economy in serious difficulty.

The deficit of democracy in the European Union is increasingly evident, where finance is in government and politics is powerless. Or rather, instead of working to regulate the economy and adapt it to society, politics has committed itself to adapting society to the economy. Instead of protecting citizens from socio-economic insecurity, politics aims to serve as a last resort rescuer for those most directly affected.

The European institutions are no longer (only) those envisaged by the Treaties of the European Union, but are enriched by other non-elective bodies, with variable geometry and skills, in the context of the new governance, and all this translates, in the era of budget discipline, in the accentuation of the disconnect between the "technical" governments, national or supranational, and the democratic representation.

The progress of European negotiations

The Eurogroup work program for the second half of 2019 includes the commitment to post-program surveillance in Cyprus, Ireland, Portugal and Spain and the quarterly improvement in the Commission's surveillance reports on Greece. This includes, among other things, "an evaluation of the state of progress of the post-program commitments attached to the declaration of the Eurogroup of June 2018 and of the continuous implementation of the main reforms agreed within the ESM program".

The Eurogroup will also continue to play its role in preparing Euro summit meetings (i.e. the Council of Heads of State and Government of the eurozone countries). Finally, the Eurogroup is ready to contribute to further work on the deepening of the Economic and Monetary Union, following the results achieved in June 2019, including: the ESM treaty, the budgetary instrument for competitiveness and convergence (BICC), the EDIS (a common deposit guarantee system that aims to create a more European system, disconnected from the financial resources of individual countries) and the banking union (all EU banks are subject to supervision according to the same rules and the most important banks in the euro area are centrally supervised by the European Central Bank (ECB), which acts as the supervisory authority in the framework of the Single Supervisory Mechanism (SSM). Banks can be resolved centrally, according to the same rules, within the framework of the single resolution mechanism (SRM) supported by a Single Resolution Fund (SRF)). As is well known, the Banking Union project started in 2012, with a Communication from the European Commission called "A blueprint for a deep and genuine economic and monetary union Launching a European Debate".

It is worth dwelling on the fact that the Eurogroup is an **informal body** and therefore does not adopt any formal conclusions. Following each meeting, the president writes a letter to all Eurogroup Members to summarize the debate, convey his interpretation of the meeting, propose how to proceed further and suggest topics to focus on later.

In order to clearly present the analysis and conclusions of the common policy, the Eurogroup can use "terms of reference" or "common understandings" to summarize common positions and common lines of action.

The procedures of the Eurogroup are confidential. The results must be communicated systematically and visibly, taking a position on the economic policy of the euro area and sending clear messages and thus supporting support for policies and reforms, with one voice in the Member States, thus increasing their legitimacy. In particular, only the president of the Eurogroup is in charge of communicating the results of the Eurogroup, together with the Commissioner for Economic and Monetary Affairs, and possibly the president of the ECB, for example on the exchange rate messages.

The work of the Eurogroup is prepared by the working group "Eurogroup", a preparatory body composed of representatives of the euro area member states of the economic and financial committee, of the European Commission and of the European Central Bank. The Group assists both the Eurogroup and its president in preparing ministers' discussions. The group usually meets once a month before the Eurogroup meetings. The members of the "Eurogroup" working group are also part of the board of the European Stability Mechanism.

The Eurogroup of 4 December 2019 discussed the fourth report on reinforced surveillance for Greece, which monitors the reforms adopted under the ESM and verifies that the objectives of the reforms adopted in the context of financial assistance programs are safeguarded. It also examined whether the agreed conditions have been met to confirm the go-ahead for the second tranche of debt-related policy measures. In addition, the European Commission and the European Central Bank (ECB) informed the Eurogroup on the main results of post-program surveillance missions in Cyprus and Spain, which will be triggered automatically at the end of the financial assistance programs and will continue until it is at least 75% of the financial assistance received was repaid.

In the subsequent afternoon meeting the Eurogroup in inclusive format, as foreseen by the Treaty on Stability, Coordination and Governance (TSCG), prepared a report for the Euro Summit on December 13, and took concrete decisions and provide guidance on the way to follow to deepen the EMU focusing in particular on the following aspects:

• the package of legal documents related to the reform of the ESM, based on the revised provisions of the ESM treaty approved in June 2019

• further strengthening of the banking union, including the European deposit insurance system (EDIS)

• the agreement on a budget instrument for convergence and competitiveness achieved in October.

At the Ecofin on 5 December (EU Council of Economic and Financial Ministers), the *ad hoc* Group "Strengthening the banking union" of the Council presented the progress report on the strengthening of the **Banking Union**.

The path to the Banking Union at the moment did not go much further than defining, with regard to the EDIS, the common insurance system for deposits, a model project for the collection of data in order to support the calculation methodology of **risk-based** contributions and a study of 22 national options and discretions (NOD), which aims to support the negotiation by providing an overview of the current use of NODs in the Member States and contribute to the discussion on their treatment in the context of the EDIS, formulating policy recommendations, also in light of the impact on EDIS in terms of financial exposure and administrative burdens.

The Ecofin also discusses the action plan to tackle the issue of impaired loans in Europe, which, while continuing to decline overall, remain high in quantity in some Member States. On this subject, the Commission has proposed a package of legislative measures for minimum coverage of losses, while the EBA and the European Central Bank (ECB) have taken steps to address the issue of non-performing loans, for example through guidelines and guidelines.

At the European Council of 12 and 13 December the Heads of State and Government will finalize the guidelines on the long-term EU strategy on climate change to be presented to the secretariat of the United Nations Framework Convention on Climate Change (UNFCCC) at early 2020. EU leaders will focus on how to achieve the goal of climate neutrality by 2050.

They will also discuss the multiannual financial framework (MFF), which is the EU's long-term budget for the period 2021-2027, based on a full-scale negotiation scheme prepared by the Finnish Council's rotating presidency, as requested by the leaders in October.

The Euro Summit of 13 December 2019 (composed of the Heads of State and Government of the countries belonging to the Eurozone) will focus on deepening the economic and monetary union. In particular, EU-27 leaders will take stock of progress made in implementing the June 2019 Euro Summit declaration, including:

• the revision of the Treaty establishing the European Stability Mechanism (ESM)

• the budget instrument for convergence and competitiveness (BICC)

• technical work related to strengthening the banking union.

The **budget instrument for convergence and competitiveness** (BICC), as we see above, is one of the three pillars in the "package logic", on the basis of which Italy asked to proceed for the approval of the proposed reforms and referred to by the European Council in its conclusion of last June meeting.

The Eurogroup of last October 9 approved all the essential elements of governance and financing, defining its allocation and modulation, of the euro-area BICC. As stated in the Commission's proposal for a regulation on a governance framework for the budgetary instrument for convergence and competitiveness for the euro area, the BICC "would contribute to the resilience of the Economic and Monetary Union as it would support reform packages and coherent investments to address the challenges in terms of competitiveness and convergence of the euro area Member States.

The proposed regulation stipulates “that the Council (following discussions within the Eurogroup) define strategic guidelines on reform priorities each year and investment for the entire euro area, as part of the euro area economic policy recommendation (hereinafter "euro area recommendation") ". ... "consistent with the consolidated process of the European semester for the surveillance and coordination of the economic policies of the Union ... in line with the calendar of the European semester."

In summary, the tool aims to define the strategic guidelines for the reform and investment priorities of the entire euro area and the country specific guidelines to the objectives of the reforms and investments relevant for the budget instrument for convergence and competitiveness, which must be consistent with the country-specific recommendations. The BICC would operate within the framework of the reform support program, and would be governed on the basis of the strategic lines defined by the Eurogroup (and Eurosummit), whose governance framework would be codified in an additional act. The financing of the instrument would be defined by an (other) intergovernmental agreement between the member states that participate, obligatorily, on the basis of the regulation being defined.

It was noted that the consent of the Member States to be bound by the provisions of this new intergovernmental agreement depends on the respective national constitutional rules and not on the obligations imposed by an act of secondary EU law such as a Regulation.

In the opinion of the European Central Bank on the proposed Regulation for the BICC, Mario Draghi, in one of his last letters as Governor, underlines how the tool must necessarily be guided in its uses, by the Country Specific Recommendations issued each year by the Council. Furthermore, he considers that precisely for the purposes of the BICC **further studies are needed on how to establish a macroeconomic stabilization function**, which is still absent in the Euro area, while it exists in all monetary unions in order to counter the economic shocks that cannot be managed at national level. A sufficiently large fiscal stabilization function would improve the resilience of Member States and the Eurozone as a whole, as well as supporting the common monetary policy.

From an analysis of the documents, the discussions and the opinions of the various institutions involved in the process, it emerges how complicated is the process of deepening the Economic and Monetary Union, that was the aim of the package of documents and legislative proposals of February 6, 2017.

We also know how many of the proposals have so far had slowdowns in the march, but also stops, postponements, second thoughts (think of the proposal for a European Monetary Fund or the proposal for a European Minister of Finance). We therefore say that it is likely, as well as desirable, to postpone the approval decision on the ESM.

The fact is that a superfetation of funds, instruments, guidelines and agreements is taking place, which aim to redress an incomplete European institutional structure, where a common fiscal policy is lacking, a consistent budget that can carry out anti-cyclical actions and also equalization between member states (as the FED does in the United States), the possibility of issuing European securities (those “safe assets” they are talking about), and a central bank that can operate as a lender of last resort through the purchase of States issued securities, that can also reduce the debt of the States.

And of course we should reverse the course that has led the EU to focus only on budgetary discipline and austerity policies, which have contributed to the increase in poverty and the decline in the quality of education, health, social protection, hampering, with financial parameters, the possibility of implementing policies for developing the economy and incomes.

We should get to work for a different Mechanism, a European Development Mechanism, based on expansive fiscal policies and a democratic government of processes and instruments, under the control of elective institutions, in an effectively federal and solidarity framework. How far are we from it?