

#### Box 4.1: Financial architecture of the euro and role of the ESM

The European Stability Mechanism (ESM) reform, agreed in 2020 by Eurogroup members, entrusts, among other changes, the ESM to become the backstop to the Single Resolution Fund once the amended ESM Treaty is fully ratified. With its contribution to the funds available in case of a bank resolution, the common backstop would help ensuring that the ability to provide funding for resolving banks is delinked from the creditworthiness of the Member State where a bank is located, thus limiting divergence in financial conditions. The introduction of a common backstop to the Single Resolution Fund would thus strengthen and add credibility to the euro area's crisis management toolkit. The proposed ESM reform aims to simplify and clarify the eligibility conditions to access ESM precautionary credit lines and it tasks the ESM with the monitoring of macro-financial risks in the euro area to prepare for potential adjustment programmes. However, as the amended ESM Treaty has not yet been fully ratified, the reform has not been finalised. In the meantime, following its accession to the euro area, Croatia joined the ESM in March 2023.

The amendments to the ESM Treaty have not addressed the issue related to its institutional nature. The ESM remains a purely intergovernmental body operating under public international law. Recently, European Court of Auditors (ECA) published a special report on the EU's financial architecture recommending that, once the ESM Reform is fully ratified, a broader reflection on a possible integration of the ESM in the EU legal framework takes place.<sup>(1)</sup> Before the ECA report, the case for an ESM integrated into the EU legal framework has been made on several occasions. For example, the "Five Presidents' report on completing the Economic and Monetary Union", issued in 2015, underlined that the ESM's intergovernmental structure entailed a complex governance and lengthy decision-making processes, and advised to integrate the institution within the EU Treaties. Similar positions were adopted by the European Parliament<sup>(2)</sup> when reflecting on the future of the Economic and Monetary Union.

In 2017, the European Commission presented a proposal to integrate the ESM in the EU legal framework through its transformation into a union body, the "European Monetary Fund". The Commission's proposal aimed at strengthening the institutional anchoring of the ESM and aligning its governance with other EU bodies through the introduction of qualified majority voting and increased accountability towards the European Parliament. Overall, the integration of the ESM into the EU legal framework could simplify the ESM's governance and make it more agile, allowing to respond to any unfolding crises more promptly and efficiently.

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<sup>(1)</sup> The ECA recommends that by 2025, the European Commission engages with the Council and the parliament with a view to finalise the integration of the ESM into the EU legal framework. See ECA, 2023.

<sup>(2)</sup> See European Parliament, 2013.