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Three-Step Plan for a Better European Monetary Fund*

The European Commission has proposed further developing the European Stability Mechanism (ESM) into a European Monetary Fund (EMF). Firstly, the European Council should be given a greater say and should be able to approve or reject bail-out programmes. Secondly, it proposes giving the EMF more instruments and more money to support crisis-afflicted states and banks. Thirdly, the EMF should be obliged to report regularly to the European Parliament and national parliaments on its activities, with a view to achieving greater democratic control.

What should we make of these proposals? Unfortunately, these reforms are so one-sided that they can only exacerbate the Eurozone's existing problems and deepen the gulf between creditor and debtor states. Why?

It is the ESM's task to increase the euro area's stability and its ability to weather crises. This creates various problems that need to be weighed up against each other. Beefing up bail-out funds for crises can reduce the immediate cost of crises when they occur. At the same time, however, such funds undermine incentives to prevent crises from arising in the first place. Unfounded panic in the financial markets may be counter-productive; but investors should certainly not be encouraged to grant states easy access to credit in the knowledge that taxpayers of other countries will meet the costs of an excessive debt burden either. Democratic control over and participation in European institutions is desirable, but the latter must remain able to respond fast to crises. Control should ultimately remain with those who are responsible for funding the bail-out policy. To date that means national parliaments, not European institutions.

The European Commission's reform concept is unbalanced because it is exclusively based on beefing up bail-out programmes, but makes no contribution to preventing crises. It completely lacks any effective measures to protect taxpayers from liability for the costs of excessive debts accumulated by individual member states. If the European Council were required to give its approval, this would both complicate the bail-out procedure and blur the boundaries of responsibility for it. There is no harm in the EMF reporting on its activities and being held accountable to the European Parliament, but it won't improve matters either. The European Parliament is not responsible for financing the EMF, which is why it should not be given responsibility for supervising it. The Commission's proposals will primarily have the effect of expanding the Commission's powers. Under the Presidency of Jean-Claude Juncker, the European Commission has expressed its intention to act more politically in the future. This would overshadow its role as the neutral guardian of the European Treaties, which is an argument for limiting the Commission's influence over the future EMF. Indeed, the national parliaments are politically responsible for the EMF simply because they fund it. Overall, the

Commission's proposals would damage the Eurozone's stability and be detrimental to its target of improving transparency and democratic control.

So what would an EMF that could really bring improvements look like? There is a great deal in favour of increasing the EMF's funding in order to boost its ability to take action and reinforce its credibility in the case of a crisis. However, this must be accompanied by measures to prevent crises and protect taxpayers from liability for the debts of other states or insolvent banks. These measures can be broken down into three steps: firstly, supervision of the debt rules should be transferred from the European Commission to the EMF to de-politicise the process. The issue of whether states have violated debt rules is a matter of hard facts, not political assessment. Secondly, the EMF should discuss the emerging risks to financial stability in regular consultations with the euro member states and publish protocols of these discussions, following the IMF's example with its article IV consultations. Thirdly, private investors must be held liable for over-indebted states and banks. This means that banks need to hold more equity capital and fewer government bonds, otherwise liability in the case of state bankruptcies could trigger a banking crisis. A combination of equity cover and diversification regulations could induce banks to toe the line. Maturing government bonds should automatically be extended if a country applies for EMF funding. This should form part of the repayment conditions of all or at least a significant part of newly issued government bonds in the Eurozone; and any enforcement of the rule would not constitute a debt default. This would prevent private creditors from getting off the hook at the taxpayer's expense in times of crisis.

The creation of an EMF that more closely aligns liability and supervision while combining effective crisis prevention with better safeguards in case of a crisis would help the Eurozone. A reform unilaterally based on bigger budgets and blurred responsibility, on the other hand, could wreak serious damage.

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