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A European Monetary Fund

by Michael Heise

Angela Merkel and Emmanuel Macron are seeking radical reforms in Europe and are not ruling out changes to the EU treaties. Where might there be common ground? A sensible initiative would be to expand the European Stability Mechanism (ESM) into a European Monetary Fund. The fund would have two key functions. Firstly, it would be an independent instrument to tackle crises and, in the event of financing bottlenecks in individual member states, would have to decide whether it was dealing with a temporary liquidity problem or a long-term solvency issue. In the first case, loans conditional on reforms can help, as worked so well for Spain or Ireland. In the second case, the focus would be on restructuring. Thanks to majority clauses in bond contracts, the conditions for debt restructurings have improved, but further steps are needed to arrive at a clear procedure for orderly sovereign defaults that would have a twin crisis-averting impact: Heavily-indebted member states would recognize more clearly the risks to their own population of taking on further debt, and investors would be warned that government bonds can be written off.

A second function would be to monitor member states' economic policy, thus assuming an early warning role for crises. This is a task which the International Monetary Fund also performs – its Germany consultation was concluded last week. The EMF would be controlled by a governing council of the eurozone member states. Like today's ESM, it would be financed via bonds for which all eurozone members would be liable. As the EMF can provide member states with funds, its opinion would doubtless carry weight. In the long term it could tie the conditions for bridging loans or aid for bank restructuring to economic indicators that capture the progress made on reforms by the recipient country.

Would such a Monetary Fund also be in France's interest? An orderly insolvency procedure, no doubt. Greece's disorderly insolvency, which dragged on for almost a year, cost especially French banks dear in the form of hefty write-downs and capital losses. Critics of the idea see it as an attack on European institutions, above all the Commission. But this criticism fails to acknowledge that the money and the guarantees behind the financing of today's ESM and a possible Monetary Fund will come directly from the member states for the foreseeable future. For this reason, control by the eurozone finance ministers and national parliaments is essential. If the EMF is one day to become a European budget with its own tax revenue, as France imagines, the role of the Commission and the European Parliament would have to be redefined. Given the current political situation, that is likely to be some way off.