Finanzgruppe
Deutscher Sparkassen-
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STANDPUNKTE
DER CHEFVOLKSWIRTE

Strengthening Stability: Developing a European Monetary Fund

Berlin, 20st June 2018

In the view of the chief economists of the Savings Banks Finance Group, the current debate about the development of Europe and the European Monetary Union is generally moving along the right lines. Overall, considerable progress has been achieved in recent years. What is now needed from the summit conclusions of the heads of state and government is an even clearer demonstration of the added value of Europe and the euro. A strong indication of this value is the creation of a European Monetary Fund (EMF), for which the following fundamental elements will have to be considered:

→ Strengthening the effectiveness of the European Monetary Fund.

→ Strengthening the competence to assess the sustainability of the fiscal policies pursued by Member States.

→ Maintaining the principle of weighting votes in accordance with capital shares.

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Strengthening Stability: Developing a European Monetary Fund

Europe needs leadership

The change of government in Italy has reminded us once again of the strength of some of the political centrifugal forces stemming from the European integration project and also of the difficulty for Member States to agree on a common economic policy agenda. This is why the continued development of the institutional architecture in the euro area has top priority. While it is true that it will be very difficult to gain the broad majorities required for a comprehensive reform package, there is an urgent need to define conceptual steps for strengthening cohesion within the euro area.

Against this background, we welcome the fact that Chancellor Merkel's fundamental positioning on the future of Europe and the European Monetary Union will provide new momentum for the upcoming negotiations at the summit meeting of the European heads of state and government in June 2018. It is particularly commendable from an economic perspective that, with a view to Europe's future, the truly important challenges and tasks facing Europe have been brought to the fore and that the summit will now examine the instruments with which these challenges can be addressed. A European defence policy, securing the external borders (also with a view to the continuing migratory pressure), as well as the question of how to cope with disruptive developments triggered by innovation, will rightly be on the summit's agenda, along with the topic of strengthening monetary union.

We believe that two fundamental principles are essential with regard to ideas for the continued development of European monetary union and the European Union:

- Unless the economic environment in all the Member States is continually adjusted in response to the ongoing changes in the demands of the world economy, Europe will be unable to cope with the enormous challenges posed by the ongoing structural change and will jeopardise its current prosperity. Wherever reforms have been carried out in Europe in the past, they have had a positive impact. However, some countries such as Italy have such an extensive reform backlog that the efforts made to date have been far from sufficient to achieve progress in terms of the soundness of public finances and raising the standard of living.

→ Before restructuring the euro area, the question of what progress is actually feasible should be examined very thoroughly. In this respect, a great deal of headway has been made in the past decade. Specific measures such as the creation of a European Monetary Fund should therefore now be adopted to demonstrate to the public that Europe has sustainable structures and that these structures will continue to be developed so that the euro has good institutional prospects in the long run.

Strengthening the euro: Basic principles

In our view, two levels can be distinguished in the debate about reforms in the euro area. The first level has to do with ways of coping with economic and financial crises, both in the regions and in the European currency area as a whole. Shocks affecting regions and the currency area as a whole are often interconnected and can also be a result of many years of misguided political developments. In the event of such crises, it makes sense to leverage common crisis mechanisms designed to prevent escalation for the currency area as a whole and to facilitate the management of crises in the affected regions. The European Stability Mechanism (ESM) is currently the key institution for crisis management.

Strengthening European Stability Mechanism and ...

This should be distinguished from a second level in the debate, which deals with the general harmonisation of economic standards in the European Union., The differences in living standards and economic conditions in the European Union and the Monetary Union are so significant that it is desirable in the eyes of many Union citizens to bring about further approximation. However, Europe is still far from having a truly federal structure, both politically and constitutionally. For a long time to come, the Member States' self-responsibility for their own financial soundness will be paramount, despite all the offers of European solidarity in the event of a crisis.

... limiting regional compensation

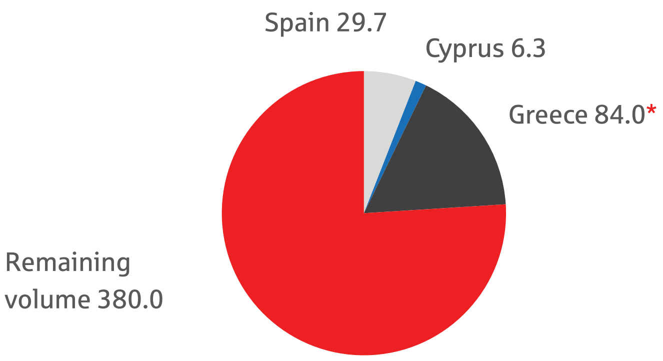
The European Stability Mechanism: A crisis mechanism for the euro area

The European Stability Mechanism (ESM) was established in 2012 in the wake of the sovereign debt crisis. The ESM grants loans to European countries whose access to the capital market is compromised – when this jeopardises the financial stability of the euro area as a whole. Lending is based on strict conditionality and thus goes hand in hand with an adjustment programme of reforms in the debtor country. In light of recent developments, it should be emphasised that such conditionality should also apply to programmes specifically designed for banks. The ESM's share capital currently amounts to approx. EUR 700 million and its lending capacity totals EUR 500 billion, of which EUR 120 billion is currently tied up in loans granted to Greece, Spain and Cyprus.

Converting ESM to EMF

In a large number of the programmes, the International Monetary Fund (IMF) is also involved with credit tranches and in monitoring conditionality. The ESM is not embedded in the law of the European Union; instead, it is an inter-governmental organisation, so that the ESM's credit decisions are directly monitored by the parliaments of the countries contributing to the ESM. Within the framework of continued development, we would very much appreciate future decisions being taken, as in the past, in accordance with the capital shares of the ESM, meaning that, in Germany, the German Bundestag would be involved in the decision-making process. In addition, however, it can also be examined whether the European Parliament should be granted the right to be heard in future.

Utilisation of the ESM's lending volume (in billion euros)



Source: German Federal Ministry of Finance

Status: as of 28 February 2018

* EA fourth tranche of EUR 6.7 bíllion was approved in March

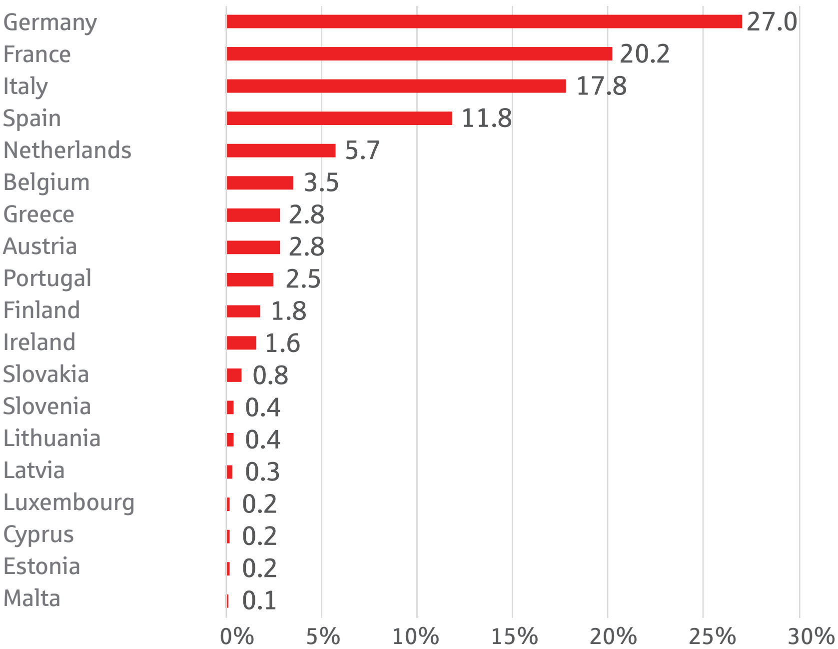
The ESM's loan programmes helped to cope with the euro crisis of 2011-2012. At the same time there is a consensus in the capital markets to the effect that the ESM's financial clout would probably not be sufficient to cope with a systemic crisis in a larger Member State. We suggest that, where possible, an EMF should combine all crisis backstops under its umbrella. It does not make sense to use a variety of different emergency funds for countries, banks, and deposits. The task of stabilising national economies in Europe and in the euro area in crisis situations should be pooled in the European Monetary Fund.

In terms of its role, the current ESM resembles the IMF: Countries without access to the capital market are granted loans; at the same time, the countries concerned are expected to carry out a macroeconomic adjustment programme to eliminate imbalances and thereby restore solvency.

However, there are also significant differences. Unlike the IMF, the ESM is not funded by central banks, but from the public budgets of the participating countries and from loans that are also covered by these countries. Direct financing via the ECB is not possible because the central bank is not allowed to provide funds directly to states. Hence, the ESM – and in future the EMF – rightly will not have the option of issuing money itself by means of special drawing rights (as the IMF does). Furthermore, the countries contributing to the ESM – unlike the member countries of the IMF – have already reached agreements designed to prevent crisis situations, such as the rules in the Treaty of Maastricht, as well as the rules on macroeconomic imbalances and on bank bailout, which were added later.

EMF strengthen the global stability (IMF)

Distribution key of euro countries
(Financing contributions as a percentage of total capital)



Source: German Federal Ministry of Finance

Future development of the European Monetary Fund

In light of the special position of the ESM in the European Monetary Union, it makes sense to continue to develop this successful approach. A European Monetary Fund (EMF) should not only play the role of a "financial fire brigade" during a crisis; its function of avoiding divergencies in the euro area should also be strengthened. Two elements are paramount in this context: The EMF should play a crucial role in monitoring the Maastricht criteria. Regular assessment of the financial and economic policies pursued by Member States can help to identify misguided developments early on. The EMF should therefore serve as an entity acting alongside the Commission, which should also continue along its successful path within the framework of the European Semester; calling for structural reforms even in economically good times for the EU's Member States. Overall, the expertise of the European Commission and that of the EMF should therefore be complementary.

EMF as guradian of sustainability

In this context, we suggest that the EMF should firstly draw on the work of a group of independent experts in order to mitigate the risk of political decisions taken by the ministers of finance. Secondly, by granting loans with conditions attached before the onset of a crisis, an EMF can also help to cushion short-term burdens caused by economic reform programmes in the participating countries. A loan programme with shorter terms than those of the crisis facilities makes sense. Additionaly, further efforts should be made to set clearly defined time limits such as those proposed by the Deutsche Bundesbank in cases where states are no longer able to meet their obligations, and to establish rules on creditor involvement.

On this basis, the EMF should be able to build up a similar reputation in the field of macroeconomic analysis to that of the IMF, in particular with a view to the sustainability of financial policies.

The EMF cannot serve as an instrument for systematic regular redistribution among regions. While the EMF's lending terms include substantial elements of subsidy compared with capital market financing, the EMF works exclusively with the instrument of granting loans, and in each loan programme, the beneficiary country is expected to make efforts of its own to improve economic conditions. This is in line with the understanding that financial solidarity among regional authorities is not a one-way street.

Debate on federalism

It would only be possible to implement additional measures and to establish additional institutions within the framework of a federal model for the euro area. The purpose of a federal model is not only to prevent crises and to ensure that emergency mechanisms are available in the event of a financial crisis; such a model would also mean that Member States move closer together for good. In this context, the primary focus is on jointly performing State functions, such as border controls, defence, and infrastructure. However, any debate on a federal Europe would also need to consider ideas about equal material living conditions in all the regions of the increasingly political Union, including concepts of comprehensive fiscal equalisation. The debate about introducing a budget for the euro area or for the European Union, for instance, is part of a grey zone between resilience in a crisis and federal equalisation. However, investments (in infrastructure or research) would be made on a pro-rata basis in very different regions of Europe and therefore trigger regular interregional transfers. The idea of introducing a "reinsurance" scheme for the national unemployment insurance systems in Europe would have a similar effect; such a reinsurance scheme would direct financial flows from very prosperous regions in the euro area to economically depressed regions.

Increasing investments in Europe

In our view, the debate on federalism has revealed opportunities but also imposes limitations. Opportunities are provided by the joint performance of true community functions. Along with trade policy, which is already a Community responsibility, defence and border controls as well as strategic innovations are at the very top of the list (which is otherwise relatively short). The development of common policies and budgets enjoys much more support among the public than the establishment of abstract common funds. Such joint projects are better suited to foster identification with Europe than a common finance minister. It is particularly within the framework of such community functions that the financial burden of financially weak regions can be significantly reduced, so that federalist objectives could also be achieved.

The limits to regional redistribution are currently quite obvious: As long as the differences in terms of social benefits and the size of the public sectors are as significant as they currently are among the Member States, redistribution is not acceptable in economic terms and, politically, impossible to communicate to the public. The pursuit of a European social policy requires the harmonisation of social security systems and labour markets, of state activity and effectiveness of administration. In addition, such a transformation of Europe on the path toward fiscal union requires much stronger democratic roots at European level than those which are currently provided by the European Parliament.

Disclaimer

The present position paper of the Chief Economists does not necessarily correspond to the attitude of the DekaBank or the attitude of the respective Landesbanken and Savings Banks or the DSGV.

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