From ESM to a European Monetary Fund?

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Abstract

The EU integration has decelerated after the sovereign debt crisis in the Euro Area. The confront of this crisis raised the necessity of a European institution which will be responsible to refinance directly the EU member-states. This paper attempts to provide evidence regarding the establishment of a European Monetary Fund (EMF). The results highly support that a EMF will be in favor of the EU cohesion, stability and integration.

Keywords: EU, European Monetary Fund, European Integration, European Institutions, IMF, ESM

JEL: F33, F5, F53, H7

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1. Introduction

The third financial rescue package of Greece revealed the conflicts of interest among the Institutions (formerly Troika) concerning the supervision of a Euro Area member-state. Recently (2017), the President of France, as well as, the German Minister of Finance strongly declared that the creation of a European Monetary Fund (EMF) would be beneficial for the cohesion of the Eurozone and the EU. The idea of the establishment of a regional monetary fund is not new. During the East Asian crisis, in 1997, the Japanese government proposed the creation of an Asian Monetary Fund (AMF) in order to confront the Thai financial crisis (Mathews and Weiss, 1999). However, the idea of an AMF has been paused after the political pressure and intervention of the United States and some European countries. The main argument was that the role of the IMF would be demoted across the globe. The sovereign debt crisis in the Euro Area led to the establishment of the European Stability Mechanism (ESM). Despite the innovation of this institution in the Euro Area, the ESM needs the agreement of its member-states in order to transfer the funds to the supervised country. Some EU governments must be authorized by their national parliaments in order to give this "green" light. This is an extremely slow decision-making policy which is not operational during the boom of a financial crisis, where instant and effective decisions are needed in order to deal with the arrest in the international markets. This means that an independent European institution would be more effective in taking rapid decisions when the stability of the EU is imperiled. There are researchers who have argued in favor of a EMF in early 2010 when the Eurozone debt crisis had not commenced yet (Gros and Mayer, 2010). Moreover, Wyplosz (2016) strongly propose that the EMF must be transformed into an ESM+ or to EMF. He believes that it will aid the debt sustainability as well as a better public debt management for the Euro Area member states (Wyplosz, 2011). The aim of this letter is to express possible arguments in favor of a EMF, but also to indicate possible weaknesses of this new European institution. We believe that the results of our letter would aid the EU policy makers as well as the governments of the EU to consider carefully a potential establishment of a EMF. In summary, the findings of this research are in favor of a EMF creation since it will fortify the cohesion of the Euro Area and the economic stability in the European continent.

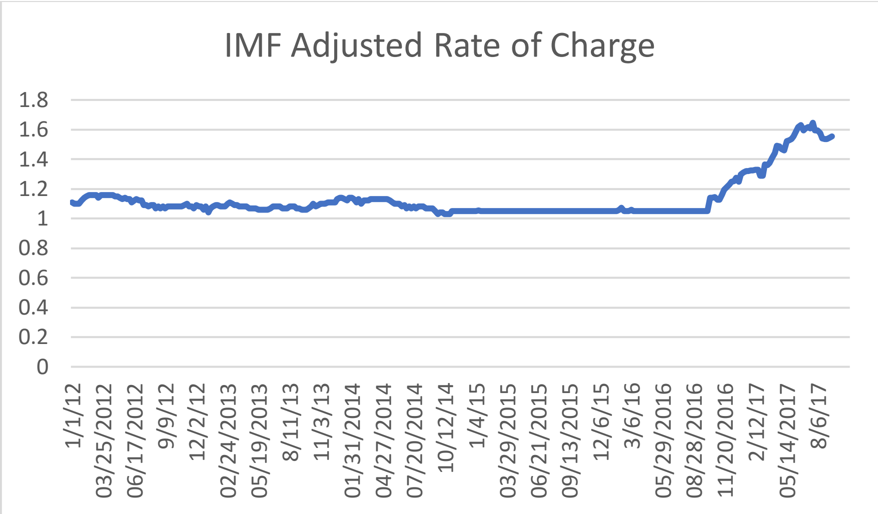
2. A European Monetary Fund

In this section, we present the arguments in favor of the establishment of a European Monetary Fund by taking into account the way that the debt crisis had been confronted by the EU policy makers since 2010.

a) The comparative advantage of the ESM

The ESM shows a strong comparative advantage of loan charge rates against the IMF. The following figures support that the average loan charge rate of IMF is approximately 1,15% until December 2016. However, there is an upturn tendency from January 2017 to September 2017 to 1,55% (loan charge rate).

Figure 1: IMF Loan Charge Rate



Source: IMF (2017)

On the other hand, the ESM is able to provide less expensive loan charge rate to its member-states. The cases of Cyprus, Greece and Spain are characteristic paradigms which unveil the comparative advantage of the ESM against the IMF. Particularly, the average loan interest rate for Cyprus and Spain was approximately 0.9%. Greece achieved extremely low loan interest rate near to 0.7%. The following figure show the loan interest rate trend for the Euro Area countries which demanded the financial assistance of the ESM after its establishment in 2012.

Figure 2: ESM Loan Charge Rate (CY)

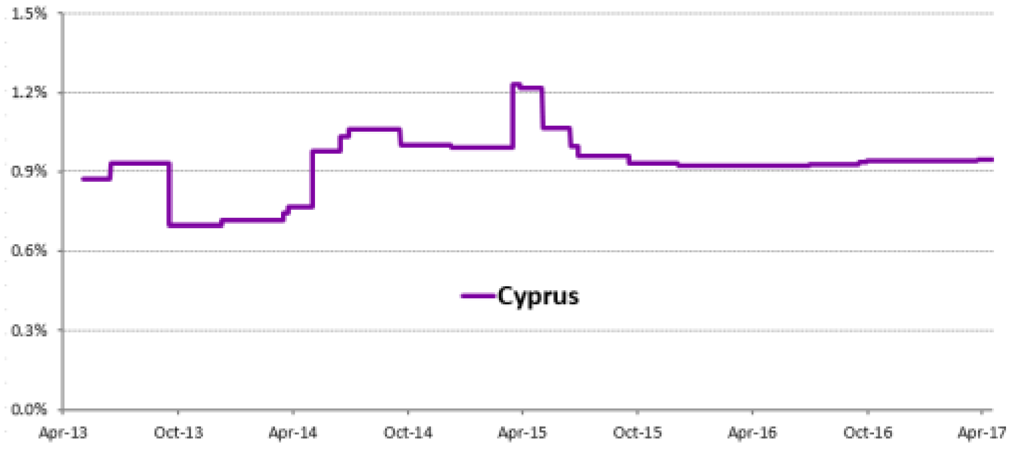


Figure 3: ESM Loan Charge Rate (SP)

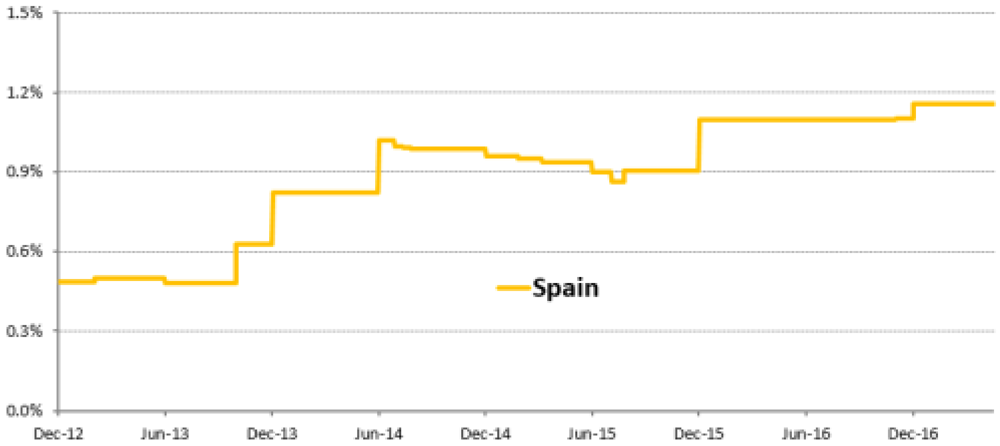
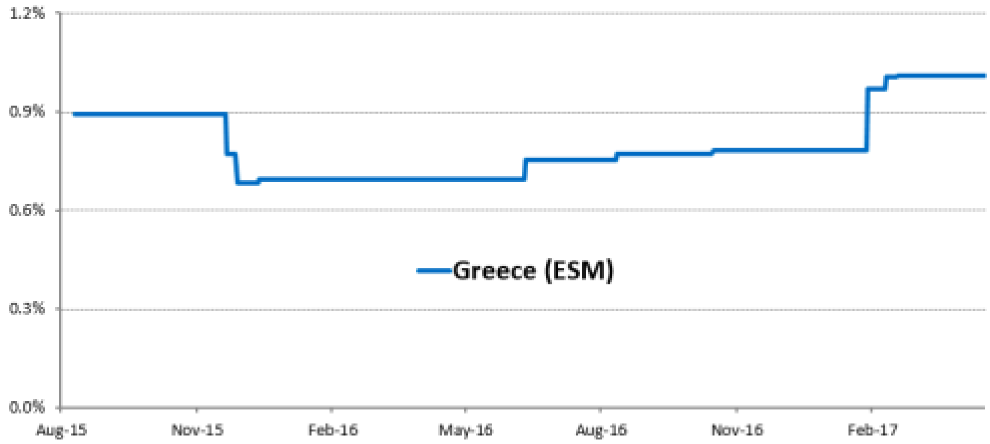


Figure 4: ESM Loan Charge Rate (GR)



Source: ESM (2017)

b) The comparative disadvantage of the IMF

The role of the IMF has decreased across the globe, especially, after its failure to confront successfully, the Argentinian crisis in 2001. In fact, the Euro Area crisis was an opportunity to recover its previous fame by dealing with an important economic problem in the "heart" of the European Union. In addition, the United States are the primary shareholder of the IMF. This means that there are political interests of IMF involve in the Euro Area crisis. Despite the fact that the Managing Director of the IMF is traditionally a European, there are many concerns that the IMF was unofficially an information channel to the United States. Furthermore, the IMF usually implements high austerity measures in order to ensure that its loans would be paid back and the funding of its shareholders would be safe. Finally, the sovereign debt crisis in the Euro Area revealed the weakness of the IMF to fund successfully a Euro Area country. This occurred because the fund has limited funding. Therefore, it is extremely unlike to rescue a country which has a strong currency. For instance, a possible bankruptcy of Italy cannot be managed solely by the IMF, since it has a maximum capacity of 1 trillion US dollars to lent to its members.

c) The role of information

The sovereign debt crisis of Greece in 2010 enhanced the "spirit of solidarity" among the Euro Area countries. It is true that a financial solidarity is easier to be developed within a region where the countries share a common interest. Especially, the solidarity would be greater if the countries have economic, political and financial linkages being a part of a union (monetary or military). This happens due to the fear of a contagious/domino effect in the economy. The political interests of the EU leaders are not always common but they understand that the cohesion of the EU is vital, especially after the official application of the UK to withdraw from the EU. In addition, the EU has plenty of executive bodies which convene at least one time per month. In fact, the political linkages among the EU member-states are continuous and frequent in the European Council, the board of the ECB, the Eurogroup and the European Parliament. This means that the EU has a complex and multilateral information networking system. Actually, the EU has plenty of information channels due to their institutions. This means that European Commission (EC) is able to extract real-time information from the European Stability Mechanism (ESM), the European Central Bank (ECB), the European Parliament (EP) and the Eurostat. Additionally, the ECB is able to have detailed information for a banking institution through the channel of the Euro system. In addition, the EC and the ESM have acquired significant lending operation knowledge and experience throughout the Euro Area debt crisis. The lack of experience and technical support in lending operation was the key role where the IMF participated in the Memoranda of Understanding (MoU).

d) *The ECB conflicts of interest*

During the sovereign debt crisis in the Eurozone (2010), the supervisors of the MoUs were the EC, the IMF and the ECB. According to the ECB statute, the role of the European Central Bank is to manage the euro, keep prices stable in the Euro Area and conduct Eurozone economic and monetary policy (ECB, 2014). In addition, ECB has no right to be a lender of last resort directly to the governments of a Euro Area member. On the other hand, it is eligible to provide liquidity through the banking institutions and its financial tools, such the Emergency Liquidity Assistance (ELA) and the Quantitative Easing (QE). Thus, there is a conflict of interest about the role of the ECB. In fact, the ECB has been involved into an unfortunate situation. On the one hand, ECB cannot finance directly the governments of the Euro Area countries. On the other hand, the ECB is a part of group where its role is to monitor the successful implementation of the austerity measure in a Eurozone country, which has been signed a MoU. Actually, the ECB has inaccurately extended its role from conducting the monetary policy to supervising the fiscal policy.

On the contrary, we display our awareness against the creation of an EMF, especially if the EU policy makers do not take into account any anomalies that may arise worldwide.

a) *The role of the primary stakeholder*

If the EU leaders and policy makers follow the official establishment procedure of an international government institution, then the EMF will have stakeholders. They EU countries will contribute to the new EMF according to their economic power. If the EU follows the establishment process of the European Financial Stability Faculty (EFSF) or the ESM, then, we expect another leading role of Germany. The contribution of Germany was 27.15% of the total funds of the ESM and EFSF. This made Germany a primary stakeholder of the ESM/EFSF. Also, the managing director of the ESM is German. Hence, the political influence of Germany on a EMF will be high. There are plenty of possibilities to see the transformation of the EMF, to an instrument of political pressure on the European countries when they demand the assistance of the fund in the future.

b) Political and legal jurisdiction

The role of the IMF, since its establishment in 1944, is to offer financial assistance (loans) to its member countries in order to refinance its liabilities. The creation of a European "IMF" in the European continent raises a legal jurisdiction among these institutions. Will the EMF be eligible to offer loans only to the EU member-states? For instance, if Montenegro will need financial aid, which institution would be legally responsible to provide the loans? The IMF or the EMF?

c) Moral hazard and conditionality

Conditionality is an essential requirement to limit official borrower moral hazard but, in fact, it can increase both official lender and borrower moral hazard. On the one hand, the long list of conditions leaves the borrower to select the less difficult conditions, while explaining that it would be not possible to enact everything. On the other hand, the conditions safeguard the lender against the possible failure of the adjustments program (Wyplosz, 2017). The organization of the EMF must have similar hierarchical levels of a traditional global institution in order to eliminate a possible confidential information leakage. This means that the information management and control must have high quality standards in order to minimize the moral hazard. For instance, any confidential information about the supervised member-state must remain within the information channel of the EMF. Otherwise, there is a high possibility to see speculation financial behavior over the governmental bonds or the stock market of the supervised country. In fact, the new institution must be characterized with deep transparency in order to secure its potential validity and trustworthiness in the future.

d) The supervision of the EMF

A significant matter is the supervision of a EMF. According to the political organization of the EU, the EC has plenty of possibilities to be the monitor of the EMF. However, there are enough arguments supporting that it will not operate. Firstly, the information never flows accurately from one institution to another. This information asymmetry may leave the new institution unprepared during the boom of a new crisis. Secondly, this kind of supervision will most likely arise bilateral tensions between the EMF and the EC due to lack of effective supervision. This means that the EMF must be managerially autonomous.

3. Conclusion

The goal of this letter is to evaluate and criticize a possible creation of a European Monetary Fund. An EMF would improve the integration of the EU in political and economic level. The union will be more protected against the shocks of a new financial crisis. Furthermore, the EU will assure that no third-party countries will involve in the internal matters of the union. However, the effective creation of a regional monetary fund is not an easy choice. The EU policy makers must take into account the legal jurisdiction in order to assure that the EMF does not involve in the jurisdiction of the IMF. In addition, the EMF must be staffed with experienced and well-educated technocrats who could provide accurate reports to the European institutions about the supervised country. Finally, the matter of moral hazard and the transparency of information is the vital key stone in order to achieve and secure the validity and the trustworthiness of this regional monetary fund. Otherwise, its establishment will not last in the long run.

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