

Eurozone economy

Europe must create its own ‘big bazooka’ monetary fund

It would be a mistake to ignore Wolfgang Schäuble’s idea for a second time

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In February 2010, Wolfgang Schäuble, then German finance minister, proposed the creation of a European Monetary Fund. His suggestion was quickly dismissed by the French government and other European partners. This year, Mr Schäuble, now the speaker of the Bundestag, floated the idea again. It would be a big mistake for Germany’s partners to ignore it a second time.

Europe needs a monetary fund to shore up its resilience and capacity to absorb shocks. The eurozone almost collapsed in 2011-12 when money stopped flowing from one country to another.

Emerging economies are familiar with such “sudden stops” in cross-border capital flows. They call for a two-pronged remedy: ample – and temporary – external liquidity support, and austerity measures that remedy the underlying imbalances. It is the job, and the art, of a monetary fund to find the right mix between such “financing” and “adjustment”.

The European Stability Mechanism, the eurozone bailout fund created in the heat of the crisis, could play that role. However, to transform the ESM into a true European Monetary Fund, three significant changes must be introduced.

First, the EMF must have direct access to European Central Bank financing. At the moment, all emergency support inside the

eurozone comes from national budgets. The ESM borrows on capital markets with a full and unconditional guarantee by member governments. This makes little sense over the long term. Fiscal resources are scarce. Taxpayers’ money should not be used to fund a liquidity support mechanism. Budget contributions will never provide the kind of firepower necessary to stabilise financial markets and prevent damaging speculation. Experience has shown that, in periods of high volatility and tension, significant amounts of support may be necessary – the so-called “big bazooka”. Almost by definition, a monetary fund must have monetary resources that provide the necessary elasticity.

Many people will oppose the idea of drawing on the ECB to finance the European Monetary Fund. “Monetary financing” of governments is a cardinal sin in the eurozone and strictly prohibited by the founding treaties. But this is different. Exactly the same kind of financing occurred when Greece, Ireland, Cyprus and Portugal borrowed from the IMF in 2011-12, with other European countries committing monetary resources to those programmes.

Second, defining the conditions, in particular the degree of fiscal austerity to be imposed on those countries receiving support, will not be easy. It was obvious during the crisis that governments do

not agree on the proper approach. Some insisted on providing all the liquidity needed to stabilise financial markets. Others wanted to see strong fiscal consolidation as a prerequisite to any help. The solution is simple: together with its own instrument, the eurozone must have its own doctrine.

Finally, the EMF governance would have to be adjusted to allow for decisions to be taken by a qualified majority, with “super majorities” for very important matters. At the moment, because support ultimately comes from national budgets, decisions must be taken unanimously and, for some countries, with prior parliamentary approval – a constitutional imperative in Germany. It is a big source of weakness: in crisis times, speed of decision and action is absolutely necessary.

Members of the eurozone will have to make choices through vigorous debate. Increasing the area’s financial resilience is as important as improving economic policy co-ordination. A good crisis management tool is an essential complement to a developed capital market union. The eurozone will benefit both over the short and long term, as confidence will be strengthened by its ability to absorb shocks.

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