
10 The European Stability Mechanism: The path to reform

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While the European Stability Mechanism can be credited for having played a vital role in safeguarding the financial stability of the euro area and of its member states, thus discharging its mandate (Article 12(1) ESM Treaty), its design and operation have not escaped criticism:

- first, as an international treaty it lacks the usual accountability channels found in EU law, for example bypassing the European Parliament;
- second, the conditions attached to its loans attracted criticism for harming fundamental rights of EU nationals and eroding national democracies;
- third its governance structure gave large member states blocking votes, causing resentment about its operation;
- finally, the linkage with the IMF caused some friction with the EU institutions.

Post-crisis, how should the ESM be redesigned to ensure continued stability for the euro area? In this chapter, I start by contrasting two ambitious positions on the design of the European Stability Fund (ESF) that emerge from the member states. I then contrast these with the timid institutional proposals of the Commission and close by suggesting that retaining the ESM as an international treaty allows for a quicker process for achieving meaningful reforms.

Divergent national preferences

The two member states at the heart of European integration appear to have different views on the role of a European Stability Fund (*Financial Times* 2017). A ‘German’ vision for the ESF entails giving it greater power over member states: overseeing compliance with the fiscal compact and monitoring the implementation of the Stability and Growth Pact. Its technocratic design would replace the politicisation of the Quadriga (the decision-making group involving four institutions - the ESM, the IMF, the Commission, and the ECB) for countries receiving loans and the ineffective supervision of member states by the EU institutions. Successive enhancements of EU-level economic policy coordination have failed to prevent member states making poor policy choices (Leino and Saarenheimo 2016), but one has to wonder whether simply passing the task to another agency resolves the difficulty of enforcing rules on sovereign states when the policy choices at stake are so central to what a state does.

Perhaps an alternative would be to offer positive incentives for states to undertake important economic reforms (discussed by Steinbach 2016), or simply to place more hope in the softer forms of governance (for example, the review of national budgets) serving as a way for the EU to learn more about national priorities and engage in a constructive dialogue with states (Klipatrick 2016 suggests this possible reading). Substantively, the ESF would be able to engage in debt restructuring. This would complete the process begun with the introduction of Collective Action Clauses, required by the ESM Treaty (Martinelli 2016). Moreover, the ESF would serve as a fiscal backstop to the Single Resolution Framework.

In contrast, a ‘French’ vision aligns the ESF with the mandate of the IMF, whose role is “to give confidence to members” by providing them with resources so that the states do not have to “resort to measures destructive of national or international prosperity” (IMF Treaty, Article 1(v)). In this vision, funds would arrive before a crisis happens, to pay for structural reforms or to facilitate investment spending.

While it is hardly conceivable that either of these approaches would be embraced, they reveal a continued division on the causes of the crisis and on the best policy response: the German vision rests on better discipline *ex ante*, the French vision believes that solidarity among member states requires a means by which assistance can be afforded

to those states that need it. More technically, it is hard to see how these two proposals could be implemented within EU law absent a revision of the Treaties, which is not on the horizon. They remain, however, markers of what kinds of cures the euro area ideally needs to render it sustainable.

The Commission's proposal

The Commission's opening gambit is to opt for an institutional reconfiguration. The major move is to integrate most of the ESM Treaty into the EU Treaties. The renamed European Monetary Fund (EMF) would largely function as the ESM does now, only under EU law and not as an international organisation.

This raises two legal questions.

- The first is how far the Treaty provides a sound legal basis for the ESF. The Commission relies on the provision that confers competence to legislate should this prove necessary to attain the Treaty's objectives (Article 352 Treaty on the Functioning of the EU), but one might wonder, given that the ESM has served its purpose so far, whether it is necessary to integrate the ESF into EU law, in particular since no new tasks appear to be assigned to it which could only be achieved within the framework of EU law.
- The second is what sort of "unique legal entity" (European Commission 2017: 5) the ESF would be under EU law. This issue becomes more pertinent when we consider how the ESF would operate: if a member state requests stability support, the EMF's decisions to grant it and its approval of the Memorandum of Understanding are both subject to the Council's approval. In all but name, this turns the EMF into an agency, providing its advice to other EU institutions.

We should welcome the more innovative substantive reforms: extending the EMF to provide a fiscal backstop, and the commitment to carrying out a social impact assessment of the Memorandum of Understanding. Some might want to see a stronger footing for protecting social rights (Kilpatrick 2016). However, these important reforms

could be achieved by reforming the ESM Treaty. Moreover, it does not appear that the reform of the voting rules (80% as opposed to unanimity) will do much to accelerate decision-making or remove the power of the larger states.

How best to move forward?

The main problem with the Commission's existing proposal is that it is not clear that the reforms proposed are necessary – reforming the ESM Treaty could provide similar outcomes. Its lending policies have been controversial but also largely successful, and there are lessons to be learned which can be integrated within a reform of the Treaty (for an initial assessment, see Corsetti et al. 2017). Indeed, an internal and an external review recommended a number of modifications to enhance the ESM's legitimacy, and many of these adjustments are doable without major architectural reform (Transparency International 2017, Tumpel-Gugerell 2017), such as improving the ESM's governance and transparency and enhancing the legitimacy of the conditions set for member states receiving funds. This would appear an easier pathway that can achieve the same objectives as the Commission's proposal with less fuss, thus creating a more effective emergency mechanism. Deepening the ESM's risk-sharing function would be welcome but, as noted, one has to address the division among member states and the not insignificant factor that this probably requires amending the EU Treaties, a risky process given the political fragility of the EU today.

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About the author

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