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The plan to create "a European IMF"

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There has been an ongoing debate to create a European version of the International Monetary Fund (IMF) as preparation for the recurrence of financial crises. Currently, the European Stabilization Mechanism (ESM) exists as a permanent financial assistance entity for European countries. The idea floated by Germany's Finance Minister Wolfgang Schäuble is expanding its role by transforming the ESM into a European Monetary Fund (EMF).

The ESM, which was launched in October 2012 as a response to the European sovereign debt crisis, can provide financial assistance to countries that face default crises, arrange direct and indirect capital injections to financial institutions, purchase government bonds, and set up preventive credit facilities. It is an international financial entity founded according to the Treaty Establishing the ESM, which is the international treaty among eurozone countries, not an EU organization. It is allowed to provide financial assistance only when a threat exists to the entire eurozone.

So far, the idea of transforming the ESM into the EMF has received broad support from major eurozone countries, the European Committee and other key organizations for a number of reasons. The first is that conversion of the ESM into the EMF would give it strict inspection capabilities, similar to the IMF, and thereby facilitate provision of financial assistance without IMF involvement. The current ESM Treaty in principle requires the country receiving financial assistance to make a similar financial assistance request to the IMF and stipulates that the ESM members work in "very close cooperation" with the IMF in setting up assistance terms. Background to this format includes the lack of knowhow on designing reform programs at the time of ESM establishment and calls for the participation of the IMF with strict fiscal discipline to prevent moral hazard.

However, conflicting views on Greek debt sustainability between the IMF and the EU became clear in the discussion of an assistance program for Greece in 2015, which caused difficulties in the assistance negotiations and bolstered criticism of the IMF.

The second reason is associated with the United Kingdom (UK)'s decision to leave the EU. In response to the UK's decision, discussions on the approach to future European integration have been conducted by the 27 EU countries excluding the UK. The EU Summit meeting held in Rome in March adopted the "Rome Declaration" stipulating that the EU "will act together, at different paces and intensity where necessary." It can be understood that this declaration aims for "multi-speed" European integration in which countries with resolution and capabilities will take a lead in the integration.

The eurozone stands at the forefront of the multi-speed Europe. In a report on the future of the eurozone entitled "Reflection Paper on the Deepening of the Economic and Monetary Union" released in May, the

European Commission noted that “The European Monetary Fund would naturally build on the ESM, which has become a central instrument to manage potential crises in the euro area and which should be integrated into the EU legal framework.” President of the European Commission Jean-Claude Juncker commented in a State of the Union address in September that “the ESM should now progressively graduate into a European Monetary Fund.”

The third reason is the change in political landscape in France. President Emmanuel Macron, who has pro-EU and pro-Germany views, secured a victory in France’s presidential election held in April and May and has pledged to plough on with eurozone reforms while sustaining fiscal discipline. He reiterated his stance to press ahead with eurozone reforms through a partnership with Germany in his speech on EU reforms delivered in September.

While the idea of establishing an EMF has received general agreement from the eurozone member states, their opinions are divided about the role of the EMF. **Chart 1** presents country views regarding the EMF’s role. Opinions vary significantly from a stance that limits the role of the EMF to providing emergency financial assistance along the lines of the role currently played by the ESM to the idea of adding a role of a supervisory entity for the entire eurozone’s fiscal discipline and fiscal capacity as preparation for a future economic shock in the eurozone to the EMF.

First, the European Commission wants to limit the EMF function to financial assistance for a liquidity crisis or other events along the lines handled by the existing ESM. The European Commission intends to integrate the EMF into the EU framework over the medium term and views the EMF concept as a step toward the deepening of European integration.

Second, Germany plans to upgrade the EMF from an organization merely for providing financial assistance to a supervisory organization for fiscal discipline in the overall eurozone. The European Commission currently handles supervision of fiscal discipline. However, Germany thinks supervision by the European Commission is politicized and is seeking transfer of authority to the EMF.

Third, France and southern European countries appear to be looking to the EMF as an organization that can provide financial assistance not only for the case of national insolvency crises, but also for the case of economic shocks. These countries intend to adopt a eurozone-wide budget further down the road. President Macron pledged the creation of a common eurozone budget that equates to a few percent of GDP and commented regarding the EMF that, “it should be formed, but is an issue to discuss together with the common budget.” If countries contribute a certain amount of funds to the EMF and broaden usage scope to economic crisis response, the eurozone could obtain shared fiscal leeway without changing the EU Treaty. However, Germany is against the idea of introducing common euro bonds as a funding source.

Future of the EMF is still unclear. In addition to considerably different opinions on the role of this organization among the member countries, recently the German political situation has also been added as an uncertainty. Finance Minister Schäuble, a key proponent of the creation of an EMF, has agreed to become the speaker of parliament associated with coalition negotiations following Germany’s general election. Mr Schäuble's departure means that the finance ministry could go the Free Democratic Party (FDP) that calls for the abolition of the ESM. Prime Minister Angela Merkel is aiming for a coalition agreement “by Christmas” and has expressed support for the EMF. Nevertheless, discussion might be stalled until the formation of a new government in Germany.

[Chart 1: EMF Functions and Views from European Countries]

	European Monetary Fund (EMF) Functions	European Commission	Germany	France, Spain, Italy
(1)	Liquidity crisis response only (existing function), negotiate assistance terms and other details without IMF involvement	○： Integrate EMF as an EU organization to be under the EU Finance Ministry	×： Existing functionality not enough	×：Existing functionality not enough
(2)	Add supervision of fiscal discipline in member countries	×： Supervision of fiscal discipline is the European Commission's authority (not the EMF's)	○： Transfer supervision of fiscal discipline from the European Commission to the EMF	△： Not disputing Germany's policy at this point
(3)	Add fiscal capacity as preparation for future economic shocks	×： Common eurozone budget unnecessary	△： Willing to consider a small amount; though against mutual debt sharing	○： Ultimately aiming for a common eurozone budget

Source: Made by MHRI based on various media reports and materials