The **European Stability Mechanism** (ESM) is currently undertaking a process of reform. Although a broad consensus exists among European institutions and governments about the need to extend its functions, and to turn it into a **European Monetary Fund** (EMF), the nature of its future tasks is far from uncontested: the proposals by the different European policy-makers reflect, in fact, divergent views on the process of European integration. Mainly, the dispute hinges on two dimensions. On the one hand, about whether the ESM should **turn into a full-fledged supranational body**, or **retain its intergovernmental character**. On the other, whether it should maintain its **market-correcting** purpose, and play a supporting role together with other European institutions, or be more oriented toward the **market discipline**, and monitor the compliance of the Member States with the European fiscal rules. This article will review the positions of the main actors involved in the reform process.

The **European Stability Mechanism** (ESM) is an intergovernmental organization established in October 2012, as a successor to the European Financial Stability Facility (EFSF), to provide financial assistance, in exchange for structural reform programmes, to countries that have lost access to the markets. Since its foundation at the height of the raging Euro crisis, the ESM, along with the EFSF, has supplied five European countries (Greece, Portugal, Ireland, Spain and Cyprus) with an overall amount of €254.5 billion.

Roughly five years later, the reform of the ESM is at the centre of a wider **debate on the future of the Economic and Monetary Union** (EMU). Different positions emerge when looking at the different top-players taking part in the reform process. Through an analysis of their initiatives and public statements, the rest of this article will attempt a reconstruction of the perspective of the **Commission**, the one of **Germany** and the one of the current ESM leadership and of its CEO **Klaus Regling.**

The position of the European Commission

On December 6th, the **Commission** issued a package of policy proposals, setting out an ambitious roadmap for deepening the EMU by 2025. The initiatives put forward by the Commission include a proposal to turn the ESM into a European Monetary Fund; the integration of the Fiscal Compact into the Union legal framework; the establishment of new budgetary instruments for the Eurozone; a proposal for a European Minister of Economy and Finance. The purpose of the Commission is clear: **putting back on a supranational track the process of economic and monetary integration**, that in the years of the crisis has been largely dominated by the intergovernmental method. This strategy is epitomised by the controversial proposal of establishing a European Minister of Finance, that would serve as Vice-President of the Commission and President of the Eurogroup.

In the context of this plan, the Commission proposes, then, to **turn the ESM into a EMF**, and anchor it within the EU legal framework. Efficiency and democratic accountability are the main grounds invoked for this change. The co-existence of supranational institutions with a permanent intergovernmental mechanism, such as the ESM, not only undermines the effectiveness of the policies, because of the slowness of intergovernmental decision-making, but also raises concerns about the transparency and the democratic nature of the decisions. On the first hand, incorporating the new EMF within the EU law would improve its swiftness. On the other, it would make the EMF democratically accountable to the Parliament (without any prejudice to the prominent role of the Council on the decision-making and the appointment of governing bodies, that is maintained in the Commission proposal).

Furthermore, the Commission proposal puts forward a number of limited new features for the EMF. First, it should provide a **backstop for the Single Resolution Fund** (SRF), thus contributing to the architecture of the Banking Union. Second, the EMF should be more involved in the definition and management of the financial assistance programmes. Third, the proposal mentions the possibility for the EMF to be conferred **further financial instruments**, to support other European programmes, and improve the stability of the Eurozone in case of asymmetrical shocks.

The Commission envisions, then, the future EMF as a **supranational organism**, anchored within the European law and accountable to the European democratic bodies, that carries out its **market-correcting** function by providing support to the other European institutions and States within the framework of the EMU.

Wolfgang Schäuble’s reform suggestions

Within the Council, three different positions exist about the reform of the EMU. The first one is upheld by those – mostly Southern (such as Italy, Greece or Spain) – governments, that share the Commission’s supranational, market-correcting approach. The second one is maintained by France: though agreeing with the Commission’s market-correcting stance, president Macron claims that the impulse for the reforms should stem from an intergovernmental, Franco-German initiative. The German position, the third one, is more complex, and is complicated by the outcome of the last elections.

Before leaving his position as German finance minister, Wolfgang Schäuble circulated a non-paper on the reform of the EMU, that closely recalls Bundesbank's position. This document does not explicitly reject the Commission's call for a deeper European integration. Rather, it notes that a transfer of national sovereignty and control of fiscal rules to the EU level would indeed be desirable in the future, but is now infeasible, due to the lack of political willingness. According to the **German government**, the development of instruments to prevent and overcome the crisis was not matched by a sufficient increase in control over the behaviour of the Member States. Structural imbalances among them persist, and the lack of control prevents governments from seriously addressing structural problems. Moreover, attempts to approach these imbalances from above (e.g., through dedicated budgets for structural reforms) create incentives for unfair behaviours, and hence are doomed to fail. This undermines the stability of the EMU, and diminishes the willingness (of Germany and its allies, we should add) to further integration.

To overcome this situation, the document advocates a solution centred on **a new role of the EMF as an independent surveillance authority**. In its conversion to the EMF, the ESM should maintain its intergovernmental character, and be entitled with the task of monitoring Member States' macroeconomic risks, their **compliance with the Fiscal Compact and, eventually, with the Stability and Growth Pact**. Moreover, the EMF should also be able to determine whether the States asking for its assistance face a liquidity problem, or a more fundamental problem of debt sustainability. In the latter case, the Member State should be obliged to carry out a comprehensive debt restructuring, while the EMF should play an intermediary role, driven by clear and predictable rules. **The ratio of this proposal is to reassert national responsibility, and to reduce as much as possible risk-sharing among Member States**. These new functions should be supplemented with an automatic extension of the maturities of sovereign bond if the financial assistance by the EMF is granted, and by an amendment of the collective action clauses to prevent holdout. Further, Germany agrees that the EMF should provide a backstop for the SRF. By contrast, any other plan regarding future financial capacities for the EMF is resolutely ruled out, and dismissed as opposed to its core purpose of bailing-out countries in severe difficulty.

Schäuble's EMF is, then, oriented toward market discipline, and has an intergovernmental character. Under the first aspect, with its new, broad powers on macroeconomic monitoring and debt restructuring, the EMF would dramatically increase its relevance in the economic governance of the Union: it would **turn into the principal European supervisory body** (at the expenses of the Commission), and be endowed with the task of dealing with the main threat – according to Germany – to the Eurozone: **unsustainable debt**. Under the second, the call for entrusting the EMF with monitoring functions, now competence of the Commission, reflects German mistrust toward this institution and its discretionary power. Germany claims that an intergovernmental, rule-driven EMF would play a stronger, neutral role in assessing Member States' compliance with their obligations, and reduce moral hazard. Above all, it would represent an effective guarantee against Northern States' greatest concern: the possibility of a **financial transfer toward indebted countries**.

However, the result of the last German election complicated the situation. A government coalition that involved the liberals of the **FDP** would have supported Schäuble's intergovernmental, market-discipline oriented stance. Nonetheless, the failure of such hypothesis has forced the CDU/CSU to negotiate a third ***Grosse Koalition*** with the **SPD**. A preliminary agreement has been reached on January 12th: if the SPD had to adhere to conservative domestic policies (mainly, on fiscal and migration issues), the social-democrats imposed their view on the future of Europe. In the text of the provisional agreement, Schäuble's tone gives way to a much more pro-European approach, closer to the proposals of the Commission and of France: **Europe needs a Franco-German pulse**, the EMF must be under control of the Parliament, new financial instruments are needed to foster stability and reforms.

The pro-European approach of the SPD looks set to influence the future German government, but much will depend on the further negotiations, and on the formation of the next government.

Klaus Regling's compromise

Klaus Regling, German CEO of the ESM, locates himself between these two different positions. **He holds a mild, pragmatic intergovernmental position, and a resolute market-correcting stance**. Regling doubts that the Commission's more radical proposals (as the European Minister of Finance, or the Eurobonds) can currently find sufficient consensus among the governments, yet he defends its prerogatives: the EMF should exert new functions of macroeconomic monitoring, and of management of financial assistance and debt restructuring process **in cooperation, not in contrast with the Commission**. According to Regling, **the EMS has embodied European solidarity**: not as a financial transfer mechanism – [despite what disingenuous voices claim] – but as a risk-sharing device. The EMF should maintain this role and strengthen it, through means of a limited fiscal capacity that would work as a **‘rainy-day fund’** in case of asymmetric shocks. Overall, Regling claims that **the EMF should be a part of a wide, European stabilization system**, that should include the Banking Union (to which it should provide a backstop), and a European unemployment insurance scheme (a proposal strongly advocated by the Italian government).

The debate over the reform of the ESM has just begun. While **a broad consensus exists on its transformation into a EMF, on its future role as backstop for the SRF, and on a greater involvement in the management of the financial assistance programmes**, other substantive questions are still to be settled. It is likely that the next months will be crucial, as the reform should be set up before the European elections in 2019. **However, the real discussion will start once a German government will be formed**. A Euro Summit on these issues is scheduled for March 2018, and **the first concrete decisions will be taken in Summer.**

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