

# European Monetary Fund – A Further Step towards Completing the Economic and Monetary Union?

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## Abstract

In this paper, the author focused on two areas. First he outlined the development of the financial assistance funds in Europe. Moving from EFSF and EFSM through ESM all the way to EMF was a long path. Will the EMF be a further step towards completing the economic and monetary union of the EU? It is the question the author tried to answer in the first part of the paper. Secondly, the author considered the position the EMF and the financial assistance funds have within the branch of financial law. Mainly, he tried to find answers to the question in which sub-policy within the public financial policy the financial assistance policy of the states (of the EU) belong and whether the public financial funds are rather of fiscal or non-fiscal nature. Having presented possible answers to these questions, the author expressed his hopes to instigate discussion among the financial law scholars on this topic.

## Keywords

Monetary Union; Euro; European Monetary Fund; European Stability Mechanism; European Financial Stabilisation Mechanism; European Financial Stability Facility; financial law; European Commission

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## 1 Introduction

At least since 2010, the financial assistance funds in the EU<sup>2</sup> have become part of the crucial topics of the EU public finance. The majority of them, however, were established outside of the EU legal framework. The current steps of the European Commission and the Council of the EU targeting a deeper monetary union will be largely based on transforming the non-EU legal framework into the EU law.

Having started with the European Financial Stabilisation Mechanism (EFSM) and the European Financial Stability Facility (EFSF), moving forward to the existing European Stability Mechanism (ESM), the EU is in the process of establishing the European Monetary Fund (EMF). The goal of this paper is twofold. First, I will briefly outline the mentioned financial assistance funds in the EU, as they developed over the last decade, with an emphasis on the currently-being-shaped EMF. I also try to answer the question whether the establishment of the EMF will be a step towards completing the economic and monetary union of the EU.

Secondly, I will view the issue of financial assistance funds from the perspective of the theory of financial law. This rather theoretical part should locate the financial assistance funds in the system of financial law and should highlight the importance of further theoretical research of these funds by the financial law theorists.

## 2 The Development of Financial Assistance Funds in Europe

At the general level, financial assistance provided from the financial assistance funds has been made via the so-called “adjustment programmes” with the intention to restore consumer and investor confidence in the countries facing certain macroeconomic challenges. These programmes, however, are not completely new to the EU. Already in the 1970s, a legal framework was established for a so-called Medium-Term Financial Assistance, which was to help the then members of the European Economic Community having difficulties mainly with the balance of payments.<sup>3</sup> However, in 2009, the question of having financial assistance funds appeared hand in hand with the problems of

<sup>2</sup> As it is explained above, some of these funds (EFSF and EMS) are not an official part of the EU legal framework. Nevertheless, as they were designed to support the functioning of the EU monetary union, they are here classified as the “financial assistance funds in the EU *sensu largo*”.

<sup>3</sup> Compare, for instance, Regulation (EEC) No. 397/75 of the Council of 17 February 1975 concerning Community loans, or Regulation (EEC) No. 398/75 of the Council of 17 February 1975 implementing Regulation (EEC) No. 397/75 concerning Community loans. In 1981, Council Regulation (EEC) No. 682/81 was passed on adjusting the Community loan mechanism designed to support the balance of payments of Member States; in 1988, Council Regulation (EEC) No. 1969/88 was passed on establishing a single facility providing medium-term financial assistance for Member States’ balances of payments, or in 2002, Council Regulation (EC) No. 332/2002 was passed on establishing a facility providing medium-term financial assistance for Member States’ balances of payments.

the banking sector and the public debts of some of the euro area countries. Numerous political decisions were taken in order to preserve the integrity of the Euro.<sup>4</sup>

There were several measures taken as a response to the immediate challenges. Within the EU framework, the EFSM was established by means of Council Regulation No. 407/2010 [Council Regulation (EU) No. 407/2010]. The adoption of this regulation was based on Art. 122(2) of the Treaty on the Functioning of the European Union (“TFEU”), stating that: where an EU member state faces difficulties or is seriously threatened with severe difficulties or exceptional occurrences beyond its control, such a state may be granted, under certain conditions, the EU’s financial assistance. The Council of the EU believed that the whole financial stability in the EU was endangered and thus it was necessary “*to respond in a coordinated, rapid and effective manner to acute difficulties*” in particular of the EU member states [Council Regulation (EU) No. 407/2010, introductory provisions]. The existing facility providing medium-financial assistance [based on Council Regulation (EC) No. 332/2002] was to remain in place. The EFSM was established as an additional source of funding to be used by the European Commission (“EC”), by means of which the EC may raise up to €60 billion in the capital market for lending to the EU state facing exceptional circumstances.<sup>5</sup> Such a raising up of funds was made via issuance of bonds guaranteed by the EC using the public budget of the EU as a collateral. Over the following years, there were three euro area countries who obtained financing from this facility.<sup>6</sup>

The other two financial assistance facilities have not been established within the EU framework. The first of the two was EFSF, which was agreed upon in 2010. EFSF, however, was only created as a temporary solution by the euro area member states. Financial assistance via this fund was provided to three euro area members.<sup>7</sup> EFSF has been entitled to raise funds through the issuance of its bonds on capital markets. As for the equity, the EFSF shareholders are the euro area countries (excluding the Republic of Latvia and the Republic of Lithuania).<sup>8</sup> The temporary solution in the form of EFSF was then accompanied by (or “merged with”) the “permanent” ESM.

ESM was established as a “permanent” feature of the monetary union. The Treaty establishing the permanent crisis resolution mechanism – the ESM was signed in February 2012. The ESM Treaty entered into force in September 2012 and the ESM was inaugurated in October 2012, following ratification of the ESM Treaty by the then 17 euro area countries (EFSF, 2017: 7). ESM is thus a financial institution (organisation) set up by the euro area countries, but it is not a part of the EU. ESM raises funds by issuing money market instruments and medium and long-term debt with maturities of up to 30 years. The debt instruments being issued by the ESM are regularly nominated in Euro, but now, the ESM is preparing an issue in US Dollars, which is thought to bring

<sup>4</sup> Compare e.g. European Commission COM (2017) 291, 31 May 2017.

<sup>5</sup> Compare e.g. Deutsche Bundesbank, *EFSM* (Deutsche Bundesbank, s. a.).

<sup>6</sup> Ireland, Portugal and Greece (the latter only received a short-term bridge from this fund in 2015).

<sup>7</sup> Ireland, Portugal and Greece.

<sup>8</sup> Latvia and Lithuania joined later directly the ESM.

more investors from abroad, mainly from the Americas. Its maximum lending capacity is €500 billion, the subscribed capital is currently nearly €705 billion, paid-in capital nearly €80.5 billion (ESM, 2017: 44). The ESM programmes have currently assisted Greece, Spain, Ireland, Cyprus and Portugal.

The ESM is now the only mechanism to finance new financial assistance programmes. As from July 2013, the EFSF may no longer engage in new financing programmes; it should continue to manage the existing programmes and the repayment of any outstanding debt (ESM, 2017: 7). Despite having been called “permanent”, the ESM is not the final objective at which the economic and monetary union (“EMU”) aims. In the last few years, the Council of the EU, together with the EC kept on emphasising that they support the further “deepening” of the existing incomplete EMU. There were two crucial papers issued on these issues by the EC in 2017 [COM (2017) 291 and COM (2017) 358]. As a part of this process of “deepening”, the EMF is to be established.

In the following chapter, there are more details given on the role and purpose of EMF.

### 3 The Proposed European Monetary Fund

The EC claims that it is “*difficult and cumbersome to articulate a collective action*” when the core financial assistance fund, i.e. ESM, as an intergovernmental mechanism, lies out of the EU framework. This creates delays in the decision-making process. For instance, where there was needed to make a quick solution in July 2015 concerning the bridge-financing for Greece, EFSF had to be used instead of ESM due to the abovementioned difficult decision-making within ESM [COM (2017) 827 final: 4].

Hence, when trying to deepen the EMU, there were strong efforts to bring ESM – a bit modified – within the framework of the EU law. In general, the EMF should create a possibility to decide whether to grant financial support to a country that is not able to roll its debt because of no access to markets (Gros and Mayer, 2017). Aside from its role of providing assistance and loans to EMF member countries, the new fund should also work as a common backstop to the single resolution fund (“SRF”) introduced within the so-called banking union.<sup>9</sup> The so-called second pillar of the banking union introduced “single resolution mechanism” (“SRM”), which shall via its board called single resolution board (“SRB”) and via SRF manage the resolution of a failing bank.<sup>10</sup> SRF is financed via the banking sector and it should reach the target level of at least 1% of the amount of covered deposits of all credit institutions within the Banking Union

<sup>9</sup> The Banking union is rather a set of reforms to regulation of the banking sector; it is not a “union” as a legal entity. The reforms of the bank regulation in the EU law emerged as a response to the financial and sovereign crises.

<sup>10</sup> SRM has been established by Regulation (EU) No. 806/2014 of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) No. 1093/2010.

by 31 December 2023.<sup>11</sup> When the SRM was being shaped, it was clear that the funds in SRF would not suffice when another deep crisis hit. This lack of funds was to be solved via a so-called “backstop”. The backstop should serve as a last-resort fund, to be activated only when the SRF was insufficient, and whose purpose was to provide “*enhanced confidence to all parties concerned with regard to the credibility of the actions to be taken by the SRB and to increase the financial capacity of the SRF*” [COM(2017) 827 final: 4].

Below, I will outline some of the core principles on which the currently being shaped EMF is to be built, as there have been outlined in the EC’s proposal for a council regulation on the establishment of the EMF and in the draft statute of the EMF [COM(2017) 827 final: 4].

The EMF shall succeed (replace) the ESM. However, it shall be made a part of the EU legal framework, i.e. to be established by means of an EU regulation. The EMF should continue to provide financial stability support to EMF member states.<sup>12</sup> As being a part of the EU legal framework, the decision-making within the EMF should be much faster than that of ESM. The EMF should provide the common backstop for the SRF as a part of the banking union framework. The EMF should play a more direct role in the management of the programmes of financial assistance and it shall be accountable to the European Parliament and the Council of the EU for the execution of its tasks.

As for the particular parameters, the overall lending capacity should be no less than €500 billion. The initial authorised capital stock of EMF shall be nearly €705 billion. Any references in the EU law to ESM shall be construed as references to the EMF. The initial authorised capital stock is to be divided into paid-in shares and callable shares. The initial total aggregate nominal value of paid-in shares shall be nearly €80.5.<sup>13</sup> As opposed to EFSM, the EU budget should not be held liable for the expenses or losses of the EMF. The main decision-making body should be a “board of directors”, which *inter alia* may call in authorised unpaid capital by simple majority decision or even decide to increase the authorised stock of the EMF.

There are to be several types of supports or loans to be provided by the EMF, i.e. stability support, precautionary financial assistance, financial assistance for the re-capitalisation of credit institutions and direct loans. Bonds of an EMF member may be purchased by the EMF either on primary or secondary market. One can see a difference here from the European Central Bank, which is banned to purchase such bonds on the primary market; and can only do so on the secondary market under strict conditions (Art. 123 of the TFEU and the Court of Justice of the EU, Case No. C-62/14). The EMF may provide direct recapitalisation only if the credit institution concerned is of systemic relevance or poses a serious threat to the financial stability. Financial support to the SRB should be through credit lines or ceilings for guarantees on liabilities of the SRB. The combined amount of outstanding commitments arising from such guarantees is subject to an initial ceiling of €60 billion.

<sup>11</sup> As of 30 June 2018, SRF reaches ca. €24.9 billion. For more, see in SRB, 2018.

<sup>12</sup> A euro area country or a non-euro area country participating in the banking union.

<sup>13</sup> Compare Art. 8 of the proposed regulation.

Each EMF member country should appoint a governor (and an alternate governor). The governor should be a finance minister of that country. The chairperson of the board of governors shall be the president of the euro group.<sup>14</sup>

At the EU level, further discussion concerning the EMF regulation should take place at the European Council to be held in March 2019 and at the Sibiu Meeting to be held in May 2019.<sup>15</sup>

As for this part, it may be concluded that the EMF is a step towards the further integration of the EMU, as a financial assistance fund that existed out of the EU legal framework will have been brought within the realm of the EU law.

## 4 Financial Assistance Funds from the Financial Law Theory Perspective

Financial assistance programmes may be understood as a net of legal relationships. Despite bearing some of the “private law” aspects, these relationships generally fall within the area of public law.<sup>16</sup> As they are connected with public debt, financial stability and the stability of the banking sector<sup>17</sup> may be further classified as part of financial law. In the continental system of law, financial law is considered to be a part of public law (Mrkývka, 2014: 126; Bakeš et al., 2012: 510).

Financial assistance programmes are inextricably intertwined with public funds from which the necessary funds needed for carrying out of these programmes are obtained. These public funds are considered to be established in the “public interest” in order to achieve the goals, such as financial stability, stability of the banking sector, access of a state to the markets, or even the further existence of the Euro. May these goals be considered to be “public goods”, as the term is understood by the theory of financial law? Mrkývka outlines the public goods as follows: *“A public good is everything that is generally beneficial and there is a general (society-wide, public) interest that the good exists, is provided and is ensured”*. (Mrkývka, 2014: 30) The abovementioned goals of the financial assistance, such as financial stability, may be considered generally beneficial and there is a general interest that it be enhanced. Thus, the goals may be viewed as public goods. For public goods, it is typical to be financed from public funds. The public funds mentioned above – whether it was EFSF, EFSM, ESM or the currently being shaped EMF – were established by the public entities – either by the states on bilateral bases (such as EFSF or ESM) or by the EU law (EFSM, EMF) in order to serve public interest. These programmes are financed from public funds.

<sup>14</sup> The euro group is an informal body established according to the Protocol No. 14 on the Euro Group annexed to the Treaty on European Union. However, for instance, during the negotiations concerning Greece in 2015, the euro group showed it is of high significance.

<sup>15</sup> This paper is completed in July 2018.

<sup>16</sup> For more on the division between the private and public law in the continental system of law, see e.g. Knapp, 1995: 264.

<sup>17</sup> Compare the types of assistance that may be provided from the EMR.

The public funds from which the financial assistance programmes are funded are part of the “public financial policy”, as the term is understood by the theory of financial law. Public policy is a policy of a public entity; it consists of all types of strategic activities targeting achievement of particular social goals. Public policy consists of several policies, including “public financial policy”. The latter is sometimes described as the “policy of public financial activities” (Mrkývka, 2014: 27–29). The financial activities of a public entity usually reflect in so-called financial-law acts (Bakeš et al., 2012: 11). Within the public financial policy, usually three core sub-policies are identified, i.e. 1. budgetary policy (Mishkin, 2004: 852); 2. fiscal policy; and 3. monetary policy (Mrkývka, 2014: 30).

As the financial assistance programmes are of huge importance for the stability of the EU, they are not just a minor financial law institute not requiring a further, more detailed insight. They may be viewed as an important state policy and an area of financial law. The theory of financial law should now focus on answering the question, in which particular sub-policy of the public financial policy the policy of financial assistance programmes belongs. It is definitely not a part of the monetary policy, as these two policies have different goals and use different tools.<sup>18</sup> It shall also not be considered a part of the budgetary policy, as these funds are neither budget funds which the state’s income flows into, nor the state expenses are covered from them.<sup>19</sup>

Are they thus part of the state’s fiscal policy? Let us first have a look at several definitions of fiscal policy. Fiscal policy may be viewed as: *“A government’s plan for deciding how much money to borrow and to collect in taxes, and how best to spend it, in order to influence the level of economic activity”* (Cambridge Dictionary) or *“policy, by means of which government carries out the income and expense programmes and intentionally influences the aggregate demand and aggregate supply”* (Mrkývka, 2014: 30) or *“fiscal policy involves decisions about government spending and taxation”* (Mishkin, 2004: 12). The ECB defines fiscal policy as follows: *“Fiscal policies have a significant impact on economic growth, macroeconomic stability and inflation. Key aspects in this respect are the level and composition of government expenditure and revenue, budget deficits and government debt”* (ECB, Fiscal policies). Analysing these definitions, it seems that the financial assistance policies may hardly be classified as part of fiscal policy. Although they are construed to deal with the problems of the states that are facing macroeconomic difficulties due to their excessive budget deficits, the financial assistance does not fit into any of the above definitions.

Hence, it seems that the financial assistance policy is rather an independent (although interconnected with the other policies) part of public financial policy, aside from the other sub-policies mentioned above. The question how to classify the financial

<sup>18</sup> Although the asset purchase programmes carried out by the ECB in the last few years also aimed mainly at the sovereign bonds of the states that required financial assistance from the abovementioned funds.

<sup>19</sup> If we do not consider a potential recapitalisation assistance to be a state expense (which it is, from a certain point of view).

assistance policy is however still open and waiting for a more detailed answer by other financial law theorists.

The theory of financial law distinguishes the scientific field into two core classes: 1. fiscal part; and 2. non-fiscal part (Mrkývka, 2014: 57–59). In each of these classes, there are several sub-branches of financial law. The fiscal part of financial law is believed to incorporate mainly the following sub-branches of financial law: tax law, customs law and budgetary law, where the non-fiscal part of financial law includes mainly monetary law, assays law, public banking law, public insurance law and law of financial markets. Some sub-branches of financial law are still subject to consideration whether they are part of the fiscal or non-fiscal part of financial law, such as balance law.<sup>20</sup>

The second question I would like to pose is a question whether regulation of financial assistance funds is rather of fiscal or non-fiscal nature. As for the differentiation between the fiscal and non-fiscal part, the financial law theory explains that the fiscal part rather deals with such relationships in which the primary object is the “flow of money”, whereas in the non-fiscal part, the primary objective is regulation of the essence of money and the monetary system (Mrkývka, 2014: 57). As for the particular sub-branches, it covers some relationships that rather seem to be fiscal (flow of finance means to and from the states), but some relationships seem to be rather of non-fiscal nature (for instance, selling of the bonds issued by the public funds on the financial markets, issuance of off-balance guarantees by public funds, etc.). Some relationships are even of private law nature (such as, liability for damage of the funds, etc.).

Hence it seems that the regulation of financial assistance funds is rather a hybrid standing somewhere in between the fiscal and non-fiscal parts of the financial law. But again, the question is still open for the financial law theorists to dig deep into it.

## 5 Conclusion

In the first part of the paper, I outlined the development of the financial assistance funds in Europe.<sup>21</sup> Moving from EFSF and EFSM through ESM all the way to EMF was a long path. The question in the title of this paper reads: “*Is EMF a further step towards completing the monetary union?*” As explained in this paper, EMF brings certain change in the two intertwined areas of 1. providing of financial assistance/loans to the EMF member countries in need and 2. securing the functioning of SRF by having a function of a common backstop.

<sup>20</sup> Balance law (in Czech: “bilanční právo”) is a term used by the theorists of the Department of Financial Law and Economics of the Faculty of Law, Brno, Masaryk University. The theorists of the Charles University of Prague rather use the term “accounting law”. Nevertheless, there are several approaches to this sub-branch of law, some considering it a part of the fiscal part, some part of the non-fiscal part of the financial law, and some even understanding it to be a hybrid standing somewhere in between the two parts.

<sup>21</sup> I rather use the term “Europe” than “EU”, as some of these funds were established out of the EU legal framework (see above).



The EMF is a step towards further integration of the EMU, as a financial assistance fund that existed out of the EU legal framework will have been brought within the realm of the EU law.

In the second part, I focused on rather theoretical questions of how to classify the financial assistance funds in the system of the financial law. Posing a question, in which particular sub-policy of the public financial policy the policy of financial assistance programmes belongs, I came to the conclusion that the financial assistance policy rather seems to be an independent (although interconnected with the other policies) part of public financial policy. Next, asking a question whether the regulation of financial assistance funds is rather of fiscal or non-fiscal nature, I concluded that it seems that the regulation of financial assistance funds is rather a hybrid standing somewhere in between the fiscal and non-fiscal parts of the financial law. I, however, consider the answers to these questions just an incentive for other financial law researchers to focus more on this subject and possibly come to more appropriate findings.

EMF and financial assistance funds in general, are definitely legal institutes that should be further researched not only by economics and practising legal experts, but also by academic financial law scholars.

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