A “European Mechanism for Financial Stability”
A Progressive response to the Euro-zone sovereign debt crisis

Adopted by the Prime Ministers’ and Leaders’ Conference on 25th March 2010

As the consequences of the financial and economic crisis continue to shape the policy environment in Europe, Euro-zone countries are faced with intense pressure on their sovereign debts. If no swift and comprehensive actions are taken by EU policy-makers, the events we witnessed in Greece over the last three months are likely to be just the first episode of a Euro-zone public debt crisis.

The Euro-zone is under the constant threat of speculative attacks from hedge fund managers and their ilk. Speculators bet on our currency falling, and because of the herd behaviour on the markets, they succeed in effectively driving it down.

Speculators also bet on Greece defaulting, and they still have the power to turn this bet into reality. In two months, as George Papandreou puts it, “a few kids in New-York sitting in front of computers” brought Greece to its knees and brought severe social and economic hardship to its people. The actions of these hedge funds are threatening the economic recovery and the social cohesion in Greece.

The speculators behave exactly as one buying an insurance against fire on her neighbour’s house, later to set it on fire and then cashing in the insurance money.

We will not let speculators govern our societies.

The PES has been a pioneering force in promoting a solution not only for Greece but also for the whole Euro-zone, and will continue to be.

If the Euro-zone is so vulnerable, it is because we lack a real, effective coordination of our economic policies. The Stability and Growth Pact is in that respect perfectly useless.

We need to enhance our coordination, because we are stronger when we stand together in solidarity.

We need to develop a specific mechanism to deal with such a crisis, to ensure that what happened in Greece will never happen again.

On 10th February 2010, the PES Prime Ministers agreed a common declaration calling for a consistent framework to be defined, combining fiscal solidarity and responsibility.

Our progressive plan was tabled at the EU council the next day. It was rejected by the conservatives, who were still hoping at the time to ‘quarantine’ Greece and leave it alone to resolve its problems.

Party of European Socialists
Parti Socialiste Européen
98 Rue du Trône, B-1050 Brussels
T+ 32 2 548 90 80 F+ 32 2 230 17 66
AISBL – BBCE – n°0897.208.032
info@pes.org www.pes.org

We presented our plan to the public at a press conference on 2nd March. Since then, the conservatives have been trying to regain credibility by cannibalising our proposal. But their idea of a “European Monetary Fund” – not to mention their subsequent non-commitment to it – falls short of what a fast response to the situation requires.

The Eurogroup meeting of 15th March as well as the ECOFIN meeting of 16th March 2010 have passed the approval of a solution for Greece to the Spring European Council, on 25-26th March. The European Council must now meet its responsibilities and act decisively.

We need a truly European solution to a truly European problem.
We need a fair, progressive and long-term plan.
We need a concrete mechanism to be put on the table now.

The PES, together with the S&D Group at the European Parliament, thus proposes a three step strategy to address the sovereign debt crisis and to strengthen economic policy coordination in the Euro-zone.

1. First, **the Greek sovereign debt crisis must be solved without delay**. In this respect, we ask for the establishment of an emergency *credit facility mechanism* at the European level, allowing Greece to re-finance its economy at a fair price.

2. Second, **this emergency mechanism must be converted, over the medium-term, into a permanent feature of the Euro-zone**. Our proposal for a permanent crisis-management mechanism, the “European Mechanism for Financial Stability” (EMFS), is **presented** herein**.**

3. Third, **we must develop further the EMFS into a long-term framework for strengthened economic governance in the Euro-zone**. The European progressive family will come up with proposals on how to coordinate fiscal and budgetary policies within the European Monetary Union in order to serve the twin purposes of protecting the single currency, now part of the *acquis communautaire*, and enhancing the efficiency of economic policy in promoting sustainable economic growth and job creation. A properly designed “European Monetary Fund” can be part of this.

The European Mechanism for Financial Stability

The European Mechanism for Financial Stability is based on common sense and respect for the fiscal sovereignty of the EU Member States. **It does not require any changes of the EU Treaty** and, above all, will effectively provide the Euro-zone with a ‘mosquito net’ against hovering speculators.

The European Mechanism for Financial Stability is based on the provision of Article 122 of the TFEU, which allows Member States to act *“in a spirit of solidarity*” to help a Member State *“threatened with severe difficulties caused by […] exceptional occurrences beyond its control*.” It constitutes the crisis-management arm of the future economic government of the Euro-zone.

It has democratic legitimacy granted by the European Parliament, in particular with respect to Article 121.6 of the TFEU which allows for the EP and the Council to co-decide on rules of mutual surveillance.

Underlying this legitimacy, the European Parliament is the lead institution in the establishment of the plan; the European Commission and the ECOFIN Council deal with its technicalities.

A similar mechanism, called the "Balance-of Payment Assistance" already exists in the EU, but only for non-Euro-zone Member States (Art 143 TFEU). Our plan aims at filling this gap without contradicting the no-bailout clause (Art 123 TFEU).

A single plan for two purposes:

The EMFS is aimed at creating conditions in which a sovereign default from any Euro-zone Member State is clearly judged impossible by the markets. The mechanism thus protects the Euro-zone against speculative attacks on sovereign debt and the single currency.

It also creates the conditions for Euro-zone Member States to borrow at a fair price, in line with real economic fundamentals. Therefore, by enhancing the efficiency of fiscal policies through coordination, the mechanism benefits both economic growth and fiscal consolidation of the whole Euro-zone.

The process:

Following a formal request by the European Commission, the Council of Economic and Finance Ministers (ECOFIN) can decide to set up a *trustee fund,* managed by the Commission. This decision is based on a set of predetermined rules, codified in a joint European Parliament and Council regulation.

The rules must ensure that only a Member State suffering from a speculative attack can benefit from the mechanism.

The *trustee fund* can borrow on the markets, using the Commission's expertise on bond issues. With the money thus raised, the fund can then lend money to the Member State which needs it.

This loan is only granted if a conditionality agreement is reached with ECOFIN. The loan conditionality must follow a set of principles which guarantee a right balance between the necessary fiscal consolidation and economic growth, job creation and social cohesion. The agreement details a credible medium term strategy, aimed at putting the recipient Member State back onto the right track, with a solidarity support, but not with grants.

The implementation of the plan, and in particular the granting of loans, relies on strengthened mutual surveillance between Euro-zone member States. This mutual surveillance must take into account, on an equal footing, the criteria of public finance sustainability, economic growth, social cohesion and trade imbalances reduction. Reinforcing the balanced approach of the EMFS, the definition of mutual surveillance rules is subject to the co-decision procedure, and is regulated jointly by the European Parliament and the Council.

If the measures decided are not implemented in the receiving Member State, ECOFIN can interrupt the payment of the loan. As a last resort, if no progress is recorded, it can decide to withdraw the execution of the plan altogether. This ensures that both the plan and the Member State's commitment to a fiscal consolidation strategy are credible.

When it is clearly established by ECOFIN that there is no risk of further speculative attacks on the benefiting Member State anymore, and *only* once the Member State has access to market financing at a fair price, would the plan be deactivated.

Principles of conditionality:

1. Revenue measures should be favoured over spending measures to achieve fiscal consolidation.

2. In increasing fiscal revenues, the benefiting Member States should favour the taxation of capital over the taxation of labour, as well as the use of innovative instruments, such as carbon taxes and financial transaction taxes, as a measure against speculation.

3. If spending cuts have to be made, measures with a higher long-term multiplier, such as public investment, should be protected. In relation to the economic situation of the relevant Member State, measures aimed at supporting the internal demand should be maintained, if required. Spending cuts should concern primarily public consumption measures.

4. The fiscal consolidation should be assessed on a medium to long-term basis. No excessive fiscal contraction should be implemented before the recovery is secured.

5. Social transfer measures can only be affected by the fiscal consolidation programme under the condition that the principle of fair burden-sharing is respected.

6. Financing sources other than national budget, in particular EU funds and EIB loans, must be used to their full extent to finance innovative, job creating investments.

This mechanism is simple, fair and if implemented, would be efficient in protecting our economies against the risk of default.

It is balanced and respects both the need for fiscal consolidation and economic growth. It is a way out of the dilemma that Governments are currently facing all across Europe.

It is progressive and ensures that this 'mid-crisis' policy environment, does not result in the wrong choices being made for our societies.

It is part of a wider strategy, which starts by addressing the specific Greek case and aims to strengthen economic policy coordination for the whole Euro-zone.

A long-term plan to strengthen the Euro-zone

In the very short-run, we must address collectively the problem that Greece faces, in a spirit of solidarity and fairness, to ensure that the people of Greece do not pay an undue price and can adjust to structural reforms, ease out of the crisis and safeguard social cohesiveness.

To tackle the foreseeable pressures on other Euro-zone Members' sovereign debt, we propose, in a second step, to establish a "European Mechanism of Financial Stability" *which does not require Treaty changes*, to provide us with a built-in crisis-management mechanism and guarantee that a loaded gun will remain on the table for all countries' protection.

In the long-run, the Euro-zone needs more. In strengthening the European Monetary Union (EMU), we must equip it with a fully fledged set of instruments to monitor and protect its Members in a fair and effective way, under the provision of the Article 136 of the Lisbon Treaty. The coordination of fiscal policy must be promoted, to make it more efficient in generating growth and creating jobs. This will require a reform of the institutional architecture of the EMU – and the creation of new institutions, such as a European Monetary Fund.

The principles of the European Mechanism for Financial Stability, presented in this document, must be respected when establishing a progressive European Monetary Fund (EMF). The Euro-zone does not need IMF conditionality, nor does it need the Conservative proposal's undue sanction mechanisms. It needs a balanced, considered feasible approach which our strategy will deliver.