THE ISSUE

e creation of the European Stability Mechanism (ESM) and the banking union were instrumental in stemming the euro-area sovereign crisis. However, both remain incomplete. While the ESM reduces the risk of sovereign debt crises, it still lacks an instrument to deal

2. The second step was the creation of the ESM, an intergovernmental instrument to provide financial assistance to euro-area countries with temporary financial problems. Membership of the ESM is restricted to countries that are part of the Fiscal Compact. Its current members are all the euro-area countries. The ESM offers three main facilities: lending to governments subject to a macro-economic adjustment programme (*ex-post* conditionality); precautionary financial assistance consisting of credit-lines available to countries that meet certain conditions (*ex-ante* conditionality); and lending for bank recapitalisation.
3. The third step was the decision to create a European banking union to strengthen financial stability in the euro area. The banking union architecture will consist of three separate mechanisms: the Single Supervisory Mechanism (SSM), the Single Resolution Mechanism (SRM) and the European Deposit Insurance Scheme (EDIS). So far, only the first two mechanisms have been set up. Membership of the banking union is open to all EU countries, but only euro-area countries are members currently. After the creation of the Single Resolution Board (SRB) and its Single Resolution Fund (SRF), the ESM decided to extend its bank recapitalisation instrument, initially only available to governments, to banks under strict conditions (see section 2.2).
4. The fourth step was the decision by the ECB to create the Outright Monetary Transactions (OMT) facility. The OMT programme allows the ECB to purchase government bonds on the secondary market subject to *ex-post* or *ex-ante* conditionality in the form of an ESM macro-economic adjustment programme or a precautionary credit line.

The current architecture, resulting from these four successive steps taken

provided it meets certain conditions, could mitigate or even prevent full-blown crises, thereby saving money and jobs. e same logic applies to the direct recapitalisation instrument for banks.

3 TRANSFORMING THE EUROPEAN STABILITY MECHANISM INTO A EUROPEAN MONETARY FUND

The weaknesses of EMU 2.0 can be corrected by turning the European Stability Mechanism into a European Monetary Fund. The EMF should be fully capable of acting as the fiscal counterpart of the ECB to guarantee the financial stability of the euro area in the event of a sovereign or banking crisis, or a threat of a crisis. This risk sharing function of the EMF must go hand-in-hand with the reduction of the risk of sovereign and banking crises. The creation of the SSM, which reduces the risk of banking crises, was an important step forward. Giving the EMF the responsibility for dealing with insolvent sovereigns

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4. ECB

8. , *Germany needs to accept the idea of more risk sharing in the euro area – but should insist that this is done in a way that maintains sound incentives, does not become a vehicle of permanent redistribution and increases the credibility of the no-bailout rule for sovereigns and of the bail-in framework for banks…* [and] *France needs to accept the idea of more market*