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NEW POLICY BRIEF

Lessons in Crisis Management

Making the European Stability Mechanism Work

By Alessandro Leipold, chief economist

(BRUSSELS, Belgium, 21 February 2012) – The European Stability Mechanism (ESM) represents the most ambitious regional financing arrangement to date. It is an important institutional step in the right direction, but the mechanism as currently conceived remains too small in scale to provide reassurance that firewalls are impregnable, and its design fails to draw sufficiently on key lessons from crisis management. Europe's leaders must move decisively to shore up the mechanism's available capital to a credible critical mass, ensure predictable and readily deployable instruments and devise a governance structure that is able to respond swiftly to fast-moving crisis situations.

Those are the principal conclusions of **Lessons in Crisis Management: Making the European Stability Mechanism Work**, a new policy brief written by **Alessandro Leipold**, chief economist of the Lisbon Council and former acting director of the European Department at the International Monetary Fund (IMF), and published by the Lisbon Council, a Brussels-based think tank. The policy brief will be formally launched at The Europe 2020 Summit in Brussels on 27 February 2012, which will be keynoted by José Manuel Barroso, president of the European Commission.

Drawing on his decades of experience at the centre of financial crisis prevention and management and on the eve of the European Council meeting where key details of the European Stability Mechanism will be decided, Mr. Leipold offers a seven-step programme for making the European Stability Mechanism work better. The recommendations are:

1) **Recognise that linkages fuel the fire.** Given highly correlated risks, the euro area does not constitute an optimal set of countries for risk sharing. Once a crisis becomes systemic, self-rescue may be beyond reach even for a wealthy region.

2) **Supplement, do not supplant.** A self-standing European financial arrangement cannot suffice in itself. However the ESM can usefully provide an additional line of defence, supplementing IMF resources.

3) **Rely on a single crisis manager.** Effective crisis management requires a single coordinator. The troika's three "cooks" are two too many. The best suited organisation for centralised crisis management on a range of criteria is the IMF.

4) **"Show me the money,"** in the words of Jerry Maguire. Europe must be seen to make an adequate financial effort in a form that can be readily mobilised. The present cap on the ESM's lending volume must be raised, and the phased injection of paid-in capital accelerated.

5) **Ensure certainty about the ESM's interventions.** Different decisions taken over time have generated legal ambiguities, with related uncertainty. Precautionary instruments must be part of the ESM's readily deployable arsenal, beyond legal challenge. However there is no need to "re-invent the wheel" with untested facilities: keep it simple.

6) **Reduce the muddle of intergovernmental decision-making.** The euro-area crisis has been largely a crisis of governance, and its shortcomings are set to persist in the new mechanism. The ESM's decision-making structure should see extensive delegation from the ministerial (highly political) board of governors to the more technical board of directors.

7) **Strengthen the global financial architecture.** A priority, which Europe should actively support, is to advance work on a robust global financial safety net, and to revive consideration of a sovereign debt restructuring mechanism (SDRM). Europe holds the sway in the IMF to advance both objectives.

About Alessandro Leipold. Alessandro Leipold is chief economist of the Lisbon Council. Born in Italy, Mr. Leipold has had a distinguished career in international finance, banking, the European Union institutions and the International Monetary

Fund (IMF), where he was acting director of the European Department until the end of 2008. **Lessons in Crisis Management: Making the European Stability Mechanism Work** is his fourth paper on the European debt crisis and related issues for the Lisbon Council. Other Lisbon Council papers can be downloaded on the Lisbon Council website at http://www.lisboncouncil.net/publications. He also writes a regular column in *Il Sole 24 Ore*, the Italian financial newspaper.

About the Lisbon Council. The Lisbon Council for Economic Competitiveness and Social Renewal asbl is a Brussels-based think tank and policy network. Established in 2003 in Belgium as a non-profit, non-partisan association, the group is dedicated to making a positive contribution through cutting-edge research and by engaging politicians and the public at large in a constructive exchange about 21st century economic and social challenges. Its website is www.lisboncouncil.net.

Additional copies of **Lessons in Crisis Management: Making the European Stabilisation Mechanism Work** can be downloaded on the Lisbon Council website at www.lisboncouncil.net.

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