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# **Legal considerations on the Avgouleas-Micossi proposal**

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*Recently, Micossi (2020)<sup>i</sup> and Avgouleas and Micossi (2021)<sup>ii</sup> proposed to transfer the sovereign bonds purchased by the ESCB to the ESM in order to counter the recessive effects of the pandemic and the low growth of inflation. This policy brief offers an assessment of the legal and institutional practicability of that proposal.*

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<sup>i</sup> Stefano Micossi (2020), [Sovereign debt management in the euro area as a common action problem](#), Luiss SEP Policy Brief 38/2020.

<sup>ii</sup> Emiliios Avgouleas and Stefano Micossi (2021), [On selling sovereigns held by the ECB to the ESM: institutional and economic policy implications](#), Luiss SEP Policy Brief 5/2021.

# Legal considerations on the Avgouleas-Micossi proposal

**Gian Luigi Tosato\***

## 1. Introduction

This note aims to verify whether the proposal is compatible with the ESM and EU treaties.<sup>3</sup> The proposal states that the ESM should purchase from the ECB (intended to include the NCBs) the public debt securities (acquired during the pandemic and before) that the ECB should divest once the monetary policy justification is exhausted.

In essence, it is a question of examining whether such an operation can be carried out without modifying the aforementioned treaties or if it requires a prior review thereof.

## 2. On compatibility with the Treaty on the ESM (TESM)

- 2.1 The ESM was established with the aim of safeguarding the stability of the euro area through financial support interventions in favour of MSs in difficulty (art. 3 TESM). Two main forms of intervention are envisaged: loans to MSs that are already in serious financial difficulty and precautionary credit lines to prevent such a situation from occurring (Articles 14 and 16 TESM).

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<sup>3</sup> E. Avgouleas-Micossi, On selling sovereigns held by the ECB to the ESM – Institutional and economic policy implications, in CEPS Policy Insights, No PI 2021-04/March 2021.

ESM support is subject to specific conditions (conditionality), some general, others relating to the specific form of intervention. The former include the existence of a risk to the stability of the euro area as a whole and the sustainability of the public debt of the beneficiary states (art. 13.1 TESM). The latter range from a macroeconomic adjustment programme, in the case of loans, to continuous compliance with eligibility criteria, in the case of precautionary credits (art. 12.1 TESM).<sup>4</sup>

- 2.2 The proposal provides that the purchase of the ECB's securities is carried out by the ESM using a special precautionary credit line (precisely in the form of an ECCL).<sup>5</sup> There are no preclusions in this sense. The TESM considers credit lines as a flexible instrument, not bound to particular purposes.

It can therefore be used to address various needs, which could jeopardise the stability of the euro area. This has been done recently to allow the financing of anti-Covid health expenses (Board of Governors, decision 5.05.2020), without any objections being raised. And there is no doubt that the placing on the market of the sovereign bonds accumulated by the ECB could have a disruptive effect on the euro area, no less than the damage caused by the pandemic.

Of course, the establishment of this new tool should be preceded by an accurate assessment of the eligibility conditions established in the Treaty, as was the case for the launch of the Covid line.<sup>6</sup> It should also be accompanied by continuous monitoring of compliance with these conditions once the purchase of the securities has begun.

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<sup>4</sup> We should recall that art. 14.1 TESM provides for two types of precautionary credit lines: the Precautionary Conditioned Credit Line (PCCL) and the Enhanced Conditions Credit Line (ECCL). The two credit lines differ in the financial status of the beneficiary states (less sound in the case of an ECCL) and in the consequent nature of the conditionality (stricter for the ECCL). The eligibility conditions for access to the PCCL and ECCL are specified in Annex III of the TESM.

<sup>5</sup> See previous footnote.

<sup>6</sup> See the Commission document of 7.05.2020: Pandemic Crisis Support - Eligibility Assessment.

Ultimately, there seem to be no reasons for incompatibility between the proposal under consideration and the TESM.

- 2.3 It should be noted that, for the purposes of the planned intervention of the ESM, the distinction between securities purchased by the ECB under the Pandemic Emergency Purchase Programme (PEPP) or the previous, and more general, Asset Purchase Programme (APP) does not seem to be relevant. The “pandemic” securities can be viewed more favourably on the political level due to reasons of solidarity at their origin. But their purchase by the ESM is subject to the same statutory requirements applicable to other securities; notably, there must be a risk of financial instability in the euro area. Now this depends on the effects that the dismissal of the sovereigns held by the ECB can have on the market; effects that should not be different depending on the securities involved (whether they are attributable to the PEPP or the APP).

### 3. **On compatibility with EU law**

- 3.1 On the basis of general principles of international law and European law, the establishment of the ESM and its operations are lawful as long as they do not conflict with the provisions of EU law. This was confirmed by the CJEU Pringle judgment (judgment 27.11.2012, case C-370/12, spec. para. 99-107).

For the purposes of this investigation, the provisions of the TFEU to be mainly taken into consideration, as indeed in Pringle, are Articles 127, 125 and 123 TFEU. Art. 127 gives the ECB exclusive competence in monetary policy; art. 125 prohibits the Union and its MSs from assuming the obligations of another MS (no bailout); finally, art. 123 prohibits any monetary financing of the MSs by the ECB and NCBs.

- 3.2 Any conflict with art. 127 TFEU must immediately be ruled out. By purchasing sovereigns from the ECB, the ESM pursues non-monetary financial stability objectives. There may also be repercussions on price trends, but these are secondary effects with

respect to a clearly stated economic policy operation. The exclusivity of the ECB in monetary policy is therefore not affected (Pringle, para. 93-98). On the contrary, it could be said that its correct exercise is facilitated. In fact, a substantial volume of sovereign bonds in the ECB's balance sheet, hitherto justified by monetary policy needs, may no longer be so later, forcing the ECB to gradually dispose of them. The intervention of the ESM would respond to this need, avoiding the disruptive effects of a disposal of these securities on the market.

- 3.3 Any conflict with art. 125 TFEU is also to be immediately ruled out. As stated in Pringle (para. 129-147), art. 125 is not intended to prohibit any form of financial assistance to an MS. However, it requires compliance with two conditions: that the beneficiary State remains solely responsible for its obligations and that assistance prompts the MS to implement a virtuous economic policy. In our case, the debtor of the sovereign bonds remains the State that issued them; only the creditor changes, passing from the ECB to the ESM. On the other hand, the preventive and continuous assessment of compliance with the eligibility conditions of the new credit line, created to support ESM purchases, guarantees virtuous behaviour throughout the euro area. Those two conditions therefore appear to be fully satisfied.

Violation of art. 125 must also be ruled out from another point of view. The purchase of the securities may result in losses for the ESM, for market reasons or by default of an issuing State. Besides, losses can arise from any ESM operation. In such cases, it may be necessary to ask the MSs for a supplementary capital payment and a State may fail to provide it. As set out in art. 25.2 TESM, the missing share is provisionally covered by the other MSs, but the obligation and liability of the defaulting State remains valid. Not even in this case - the Pringle judgment (paragraphs 144-146) argues it well – can there be a violation of art. 125.

- 3.4 A similar conclusion applies with regard to art. 123. As the CJEU points out (again in Pringle, paragraphs 125-127), the prohibition contained therein is specifically addressed to the ECB and NCBs only. It therefore does not apply to the ESM. However, apart from this preliminary observation, which is at any rate diriment, the details of a

monetary financing are completely absent. The ESM buys sovereign bonds from the ECB that the latter has purchased on the secondary market. This is what art. 123 does not prohibit and it does not constitute monetary financing - provided that the ECB's purchases have complied with the conditions set out in the Gauweiler (16.06.2015, case C-62/14) and Weiss (11.12.2018, case C-493 / 17) judgments.<sup>7</sup> The non-existence of an upstream monetary loan a fortiori excludes that it can be envisaged for downstream purchases by the ESM.

- 3.5 For the purposes of the considerations made in the previous paragraphs, the fact that the purchase by the ESM relates to "pandemic" securities or other securities is irrelevant. As already noted (par. 2.3), the major element of solidarity that characterises the former can be relevant for the political level, but not for the juridical one. The reasons for compatibility with EU law are in all cases the same. Nor is it conceivable that the planned intervention of the ESM is legitimate only if it is aimed at the purchase of "pandemic" securities. The financial stability needs of the euro area, at the basis of this intervention, make it compatible with Articles 127, 125 and 123 TFEU regardless of the type of securities involved.

#### 4. **Some clarifications**

- 4.1 The proposal under consideration introduces the possibility that the purchase of ECB securities takes place at face value rather than market value. As noted in the proposal, no losses should arise for the ESM since (in principle) it should hold the securities until maturity. However, the lawfulness of such an operation remains questionable on a

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<sup>7</sup> In these judgments, adopted following a preliminary ruling by the German Constitutional Court, the CJEU legitimised the ECB's programmes entitled Public Sector Purchase Program (PSPP) and Outright Monetary Transactions (OMT), but at the same time required that their implementation be adequately motivated, especially with regard to the principle of proportionality (Gauweiler, para. 66-92; Weiss, para. 71-100). The CJEU also established that the purchase of sovereign bonds by the ECB takes place in such a way as to exclude any circumvention of the prohibition pursuant to art. 123 TFEU (Gauweiler, para. 66-92; Weiss, para. 101 et seq.). As is known, the Karlsruhe Court conformed, albeit with reservations, to the Gauweiler judgment (decision 11.06.2016), while it rejected the Weiss judgment, which was deemed lacking on the point of proportionality (decision 5.05.2020).

legal level. Pursuant to art. 18 of its Statute, the ECB is authorised to buy and sell securities on the market under the conditions set out therein. If the purchases by the ESM are made at face value, there is a risk of ending up outside this authorisation, thus lacking suitable legal coverage.

- 4.2 The proposal in question also envisages the possibility of leaving to the ECB (more precisely to the NCBs) the default risk of the sovereign bonds sold to the ESM. In other words, the ESM would purchase these bonds while the NCBs would guarantee their proper fulfilment by the issuing States. I fear that this is not allowed by art. 125 TFEU. The market price already takes into account the reliability of the debtor. If the envisaged guarantee is added, the assignor becomes responsible for the fulfilment of the assigned credit. In our case, the NCBs would become responsible for the fulfilment of obligations assumed by an MS, which most likely falls under the prohibition on bailout pursuant to art. 125 TFEU.

## 5. **Conclusion**

Except for the clarifications just made, the proposal in question appears compatible with the existing treaties of the ESM and the EU. It could therefore be carried out without the complex procedures required for the Treaties' revision.