Extraordinary times require extraordinary measures. The case for a new toolbox in the COVID-19 European Union

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Abstract

The epidemiological COVID-19 crisis is probably the hardest challenge the European Union has ever faced since its foundation, proving to be an even harder threat than the 2009 European debt crisis. With special attention to the Italian context, the first part of this paper will cover the increasing criticality of the European Union and of its crisis management toolbox. In particular emphasis will be placed on the instrument of the European Stability Mechanism, which has been for a long time one of the protagonists of the Italian political-economic debate. Concerning the ESM, the tool was born with different purposes, and its application to the COVID-19 crisis would not prove only insufficient but also the wrong medicine for the disease at hand, notwithstanding the potential usefulness of the tool to deal with minor debt crises. After a brief interlude on Eurobonds, not least because of the speed with which they disappeared from the political debate, the analysis of the ESM in all its aspects, including the reform project, will be resumed. Below we will analyse the ECB's OMTs instrument with a brief overview of the German Constitutional Court ruling of 5 May 2020's consequences on the economic governance of the crisis. Consequently, an attempt will be made to lay down the possible outcomes of the current political stalemate. The underlying idea will be that the strategy of the fait accompli, political optimism and consensus laid down an institutional framework unfit to deal with the extraordinary and suited only to deal with ordinary business. Finally, the issue of debt monetisation will be addressed with potential perspectives and suggestions on the governance of the euro area.

Keywords: European Stability Mechanism; Coronavirus; European Central Bank; OMT.

1 Introduction

The COVID-19 pandemic has struck Europe with a first outbreak of the disease in Italy at the beginning of February, originating a cascade of cases now widespread throughout the world, freezing economies, lives and institutions. Striking out of the blue, the COVID-19 outbreak has quickly prompted a radical turn in economic policy thinking. When China announced draconian measures to contain the pandemic last February, it was clear to many that the spread of the virus in Europe was more than a mere conjecture. After hiding the scale of the outbreak for weeks, if not months, Beijing's authorities went wild, by isolating a province of almost 60 million inhabitants manu militari. Since the lockdown implied the freezing of economic activities, only a mammoth injection of $242.72 billion of the People's Bank of China (PBOC) in the economy (followed suit by other liquidity injections and manoeuvres of the PBOC) managed to keep Chinese markets alive. Few days later, the pandemic caught Italian politics by surprise, having hastily reached Italy and Europe. Chaos followed. After spending the whole month of February by attempting to lock down the outbreak in the industrious north, Giuseppe Conte, Italian Prime Minister, chose to lock down the entire country. The measure has not been accepted without raising some eyebrows, as many industrial and manufacturing professionals have asked for guarantees on the possibility of reopening as soon as possible. In fact, the Italian lockdown has first affected citizens and movements within the country, and then shut down most of the productive activities deemed as non-essential by the Government, however the consequences for the economy are forecasted to be harsh to the point that the medicine may prove worse than the illness. As data pointed out, Italy has endured three recessions in recent years: a first recession with the financial crisis of 2009, a second recession with the European debt crisis of 2012 and a third recession in 2018 (Ghiglione, Romei, & Hall, 2020). Now, recent estimates have foreseen a plummet of around 9-11% [1] of Italian

[1] The Great Lockdown: Worst Economic Downturn since the Great Depression, International Monetary Fund, `https://blogs.imf.org/2020/04/14/the-great-lockdown-worst-economic-downturn-since-the-great-depression/`

GDP in 2020 due to the coronavirus crisis[2]. Globally speaking, the outlook is grim, with an expected cumulative output loss of around 9 trillion USD in terms of global real GDP.

The crisis has taken increasingly global connotations: for the first time since the Great Depression both advanced economies and emerging market and developing economies are in recession, with a growth for 2020 respectively projected at -6.1 percent and -1.0 percent. Even India and China, which were growing at a rate of 6-7 percent so far, are now approaching a 0 percent GDP growth rate, as IMF estimates show. As if that were not enough, recent estimates from the ILO monitor show that full or partial lockdown measures are currently affecting almost 2.7 billion workers, representing around 81 percent of the global workforce. Moreover, the worsening of the crisis and the economic lockdown, which is affecting manpower and businesses alike, is putting at risk 3.3 billion workers all over the world, with a decline of around 6.7 percent of 2020 Q2 working hours, with a possible outcome of almost 195 million unemployed people as a consequence [3]. An extraordinary crisis requires extraordinary measures. It is the case, for example, of the United Kingdom, which has become the first country to embrace a full monetary financing of government measures in order to fund the immediate costs derived from the coronavirus outbreak: in fact the Bank of England has agreed to directly finance London's spending needs on a strict temporary basis (Giles & Georgiadis, 2020). With this move, the British government is able to entirely bypass the bond market for the entire duration of the COVID-19 crisis. Alongside the monetisation of the British debt, the Bank of England has agreed with the British Treasury to support businesses by offering liquidity to pay for their corporate debts, allowing them to pay wages and supplies, even in the case of firms bound by NPLs [4]. In the United States the Federal Reserve mainly cut interest rates to near zero, as per the case of the Bank of

[2]Italy GDP, -11.6% this year (Goldman Sachs), Ansa, https://www.ansa.it/english/news/business/2020/04/08/italy-gdp-11.6-this-yr-goldman-sachs-2$_d$67f8f60-31a8-40fd-858a-ba00d0ca76fe.html

[3]ILO Monitor: COVID-19 and the world of work. Second edition. International Labour Organisation, https://www.ilo.org/wcmsp5/groups/public/@dgreports/@dcomm/documents/briefingnote/wcms$_7$40877.pdf

[4]Our Response to Coronavirus (COVID-19), Bank of England, https://www.bankofengland.co.uk/coronavirus

England, and launched a massive $700 billion quantitative easing program, making easier for US banks to borrow from the Fed (Setser, 2020). With respect to monetisation, in the United States has long since ceased to be a dogma (Blanchard & Pisani-Ferry, 2020).

Coming to Europe, the political debate, at least in Italy, the country that, along with Spain, has been harshest hit, is focusing exclusively over the usage of the ESM or common "euro" or "corona"-bonds, a package of solutions which can be roughly translated with: more debt, with the real difference being who gets to bear the responsibility for that debt.

2 Only a few of euros, a bloody few, and right away: the ESM.

A spectre is haunting Europe: the European Stability Mechanism. Blessing and curse of the European political debate, the ESM has become one of the leading players in the dramatic tale of the economic crisis by coronavirus. Before jumping to the case, few premises are needed. The sovereign debt crisis of 2010 immediately revealed a series of critical issues related to the Union: the entire European economic governance was based on pro-cyclical instruments, without any real framework that could be used in the event of a crisis such as the one that was taking place in Greece. As a consequence, the May 10th extraordinary ECOFIN meeting the Council of the European Union agreed upon a comprehensive package of measures to preserve the financial stability of the Eurozone, providing for two temporary assistance instruments for member States in financial distress: the European Financial Stabilisation Mechanism (EFSM) and the European Financial Stability Fund (EFSF). At first glance, the major difference between the two funds was in their firepower: the EFSM with €60 billion and the EFSF with €440 billion. The EFSM was a funding programme reliant upon funds raised on the financial markets and guaranteed by the European Commission, through the EU budget, used as a collateral. The strength of the EFSM was that, given its structure, it was entirely under the control of the European Commission, therefore it could be deployed quickly. The EFSF, on the other hand, is the proper forerunner of today's ESM. It is an intergovernmental tool, which can issue bonds or other instruments on the market, the EFSF, being a fund, is backed by several guarantees for capital given by Eurozone countries. The amount of said guarantees are based on ECB capital key weightings, with the highest quotas being Italy with 17.9 percent of the EFSF quotas, followed by France's 20.38 percent, led by Germany with 27.13 percent of the quotas.

In contrast to the EFSM, the EFSF has been comprehensively negotiated, notably by Germany [5], which has always been wary of the idea of a large state-saving fund based on the issuance of pro-quota guaranteed bonds. At the beginning, the EFSF had a capital guarantee of €440 billion, amount later expanded to €780 billion, amidst the criticism [6] of many exponents of the German parliament. Criticism which could be someway justified from the German point of view as according to the then Italian Minister of Finance Giulio Tremonti: "We proposed as a solution to the crisis the issuance of Eurobonds to finance a state-saving fund, thus loans to distressed countries would be covered by the issuance of common European bond." (Sala, 2020). It is therefore not surprising the German scepticism concerning the establishment of said rescue funds, which is still alive and well today in the COVID-19 emergency context. All in all, for some countries, the underlying idea of the two funds was to lay down the purposes for a step forward in terms of European integration, while for the defenders of the status quo the two funds were merely an extraordinary measure for extraordinary times. However, it should be borne in mind that when the EFSF and subsequently the ESM were established, strong conditionality criteria were considered necessary for their intervention, since only those member States who had lost market access as a result of erroneous economic policy choices had to resort to the Fund (Graziani, 2020). In the end, both EFSM and EFSF have become key players in keeping member States'

[5] Early days: the EFSF and its doubters, ESM, https://www.esm.europa.eu/publications/safeguarding-euro/early-days-efsf-and-its-doubters

[6] German Bundestag rallies against euro bailout fund, Euractiv, https://www.euractiv.com/section/euro-finance/news/german-bundestag-rallies-against-euro-bailout-fund/

public finances steady, with Cyprus, Ireland, Portugal, Spain and Greece, the latter unfortunately being famous for the issue of "conditionality", which is going to be explored later. Besides the political context, the current ESM, which was established in 2012 bears little differences to the baseline text of 2011, except that the final text bound the usage of the ESM to the acceptance of the Fiscal Compact. The ESM is an intergovernmental organisation under public law, officially established in September 2012, governed by a Board of Directors and Board of Governors and managed by a Director.

The Board of Governors consists of the Ministers of Finance of the member States and is usually chaired by the President of the Eurogroup, while the Board of Directors is a more technical board, whose members are appointed by the member States and are usually either the Director General of the Treasury of the member States or a senior politician with an high competence in economic and financial matters. It is up to the Board of Governors to appoint the Managing Director of the ESM. The European Commissioner for Economic and Monetary Affairs and the President of the ECB serve as observer members. The ESM holds an authorised capital of around €700 billion, split into shares with a nominal value of €100.000 subscribed by the member states in accordance with the ECB's capital key subscribed by the national central banks, in accordance with Articles 8 and 11 of the ESM Founding Treaty. Of said €700 billion of authorised capital, €80 billion is paid-in capital with the remaining €620 billion which can be loaned through the issuance of ESM obligations at the capital markets (with a rating equivalent to AAA). Basically, each member State has provided a cash guarantee of around €80 billion euros, of which Italy's share amounts to around €14 billion, based on the ECB capital key. The operational capacity of the mechanism is subject to the availability of the quotas of subscribed capital. A substantial difference of the ESM from the EFSF is that the member States do not provide guarantees for the ESM's bond issues, as they are the shareholders of the fund instead. As per its treaty, the ESM purpose is to "mobilise funding and provide stability support under strict conditionality appropriate to the financial assistance instrument chosen, to the benefit of ESM Members which are experiencing, or are threatened by, severe financing problems, if indispensable to safeguard the financial stability of the euro area as a whole and of its member States" purpose which can be reached by entitling the ESM to "raise funds by issuing financial instruments or by entering into financial or other agreements or arrangements with ESM Members, financial institutions or other third parties" in accordance with article 3 of the ESM Founding Treaty. By its nature, the ESM operates through bailouts, which are conditional on member States first signing a Memorandum of Understanding negotiated with the Authorities of the ECB and the European Commission, detailing the conditionality attached to the financial assistance facility.

Thus, the MoU will outline the programme for the reforms or fiscal consolidation required to be implemented as a condition to restore the financial stability, in accordance with the principles laid out in articles 12 and 13 of the ESM Treaty. The Fund can offer five different kinds of support programmes: a stability support loan within a macroeconomic adjustment programme [7], a recapitalisation of financial institutions of an ESM member [8], bond purchases operations in the primary market [9], an ESM secondary market intervention [10] and lastly, but most important in the present context of crisis, the precautionary financial assistance [11]. Given the range of means available to the ESM, it can be safely assumed as a complementary instrument to the European Central Bank, given that the ESM has been assigned functions that the treaties have precluded the ECB from performing [12], such as, for example, accessing to the primary market for the bonds of States in distress or recapitalising their banks. For these reasons, including its scarce financial resources to act on a large scale, many experts have referred to the ESM as incomplete, suggesting a merge or a deeper integration with the ECB to provide the Union with a real last resort actor for emergencies (Buch, 2013). On 6 September 2012, the ECB, under the

[7] "ESM Loans" in accordance with article 16 of the ESM Treaty

[8] Bank recapitalisation, in accordance with article 15 of the ESM Treaty

[9] Primary Market Support Facility – PMSF, in accordance with article 17 of the ESM Treaty

[10] Secondary Market Support Facility – SMSF, in accordance with article 18 of the ESM Treaty

[11] PCCL/ECCL in accordance with article 14 of the ESM Treaty

[12] As ascertained by Articles 123-125 of the Treaty on the Functioning of the European Union

Presidency of Mario Draghi and with the sole opposition of the President of the Bundesbank, launched the technical framework for running an unlimited amount of bond purchases in secondary sovereign bond markets (i.e. the famous Whatever it takes) for all Eurozone countries involved in a sovereign state bailout or an ESM precautionary programme, the so called Outright Monetary Transactions (OMTs) [13]. According to the ECB's technical guidelines, however, the OMT programme can be launched only at the point of time where the interested country possesses a complete market funding access, and only if the member States is still compliant with all terms in the ESM MoU, emphasising therefore the prominent role of conditionalities and contractual commitments under the ESM Treaty.

Moreover, it should be noted that the OMT programme has never been effectively implemented, thus little is known about its concrete consequences on the markets and the financial outlook of the applying States, apart from the fact that it is not possible to access the programme without accepting a certain degree of conditionalities. Since its foundation until today, the necessity of a comprehensive reform of the ESM has arisen, in an attempt to provide the Union with its own IMF. The debate over the reform of the ESM has been subject to a great deal of controversy, particularly from the most Eurosceptic political forces, but in reality, we are only interested in it in order to go over some of the technicalities of the ESM. In fact, it is the pivotal argument of this work that, with or without reform, with or without conditionality, the ESM is an inadequate tool to deal with the coronavirus economic crisis that Europe is currently facing. The content of the reform has been properly outlined in the June 2019 Eurogroup. With the reform, the ESM would be given the backstop function to support the Single Resolution Fund (SRF), one of the pillars of the European banking union, which has the purpose to finance the restructuring of failing credit institutions of the member States. The reform would make it impossible to use the ESM bank recapitalisation, which, on the other hand, has never been applied to date, since the ESM would end up integrated with SRF in this regard. On this point, one should remember, the devil is in the details. As recalled by Antonio

[13] Technical Features of Outright Monetary Transactions, `https://www.ecb.europa.eu/press/pr/date/2012/html/pr120906`$_1$`.en.html`

Patuelli, President of the Italian Banking Association, there has been a political dyscrasia regarding the treatment of European banks, as affirmed in a statement on 14 December 2019: Italian banks have been mistreated in Europe, not in general terms but by the EU Commission. With the Tercas case, the first crisis of one of our banks, from which all the subsequent ones, including Ferrara and Etruria, derived. The Commissioner for Competition, Margrethe Vestager, opposed the rescue of the bank by the Interbank Deposit Protection Fund (part of the Single Resolution Mechanism of the banking union), judging it to be state aid, but on 19 March 2019 the EU Court of Justice upheld our appeal, arguing that the Commissioner committed an error. The statement was a response to Commissioner Vestager's decision not to consider the €3.6 billion granted by the Länder of Lower Saxony and Anhalt to rescue the Norddeutsche Landesbank, of which they are shareholders, as state aid [14].

In this respect, Patuelli contested the bank bailouts carried out towards banks exposed with Greece, on the grounds that the criterion used by the EFSF/ESM was not the bank exposure of the member States, but the member States capital key, for a bailout which, however, was carried out towards banks and not towards the public accounts of a State. As a matter of fact, against a private bank exposure of 5 percent, 18 percent of debts linked to Greek position were settled by the Italian side (Bucchi, 2019). In a sort of a counter-reforming attempt, he also pointed out the issue of having The presence of a single supervisory authority, but under the vigor of different national banking law and criminal laws governing finance. If an operation is prohibited in one state and permitted in another, money moves to the most attractive country, leaving the most rigorous one in poverty. The structural issue here is that the ESM and European economic governance are not encapsulated in a harmonised regulatory framework but refer to a heterogeneous corpus of rules. Other points of the ESM reform. Further points of the ESM reform concern an enhanced role for the institution in monitoring the debt sustainability of member States, and a reform of the Collective Action Clauses (CACs), which would

[14] State aid: Commission concludes that recapitalisation of German NordLB is market conform, `https://ec.europa.eu/commission/presscorner/detail/en/IP_19_6684`

be transformed from dual limb to single limb clauses. On this issue, it should be recalled that the objective of the ESM is precisely to stem a potential solvency crisis before it becomes one. Sometimes, however, it may not be possible to restore a State's solvency through loans such as those of the ESM, as in the case of Greece. In this case, a comprehensive debt consolidation has been carried out, involving a complex mechanism, which requires clear regulatory foundations. This is the purpose of the Collective Action Clauses (CACs), as they allow the terms of all issued debt to be changed provided that the new terms are approved by a majority (not the whole) of the debt holders. Since January 2013, all government bonds with a duration of more than one year issued by Eurozone countries contain the double-limb CACs, which require two different types of majorities to change the terms of the bonds: a majority of the debt holders in terms of total number of bonds issued, and a majority in terms of each "series" or "issuances" [15], thus a double majority. With the reform, however, a majority of the total number of public debt holders will be sufficient and any majorities in the various subcategories will therefore not be able to block debt restructuring (i.e. single limb) [16].

Criticism from many members of the economic world stems from the fact that the reform conveys the idea that the sovereign debt restructuring will become a precondition for obtaining ESM funding, triggering speculation on state bonds with less balanced public budgets (Galli, 2019). In this case, an originally unnecessary restructuring may therefore become inevitable (Visco, 2019). With the reform, the CACs will find a more efficient ground for application, but it will also be easier to proceed towards the possible restructuring of a sovereign debt of a country in difficulty that has had the need to turn to the ESM. However, recent research is also pointing out that CACs should not increase per se the probability of a debt restructuring, but it would rather smooth the process and make it less expensive (Carletti, Colla, Gulati, & Ongena, 2018). Nevertheless, the most overlooked factor when it comes to European economic

[15] Since different bonds are given different maturities, different interests and so on, they create different subcategories

[16] `https://www.esm.europa.eu/press-releases/explainer-esm-reform-and-revisions-esm-treaty`

governance, is that politics has a far greater influence than a technical-economic analysis would suggest, and this can be noticed from the very wording of the Treaties (Majone, 2014, p. 52) . In the case of the EMU, moreover, it is possible for us to speak of a context that is articulated in a political vacuum, no reform has whatsoever addressed the fact that the institution of the ECB without any concrete collateral or without any intention to fully create a central bank on the model of the FED left a political vacuum in which the Eurozone member States found themselves with a currency that they cannot control, at the mercy of predatory attitudes (Soros, 2013). Needless to say, the ESM reform is currently on hold, its terms have yet to be debated and negotiated, so it will be necessary to examine what the final reform package will bring, and with which guarantees.

3 The "conditionality" hysteria and inherent criticalities.

All this discussion on ESM reforms served to get to the topic most closely linked to the economic crisis by coronavirus: the credit lines. As stated before, the ESM provides, among its tools the grant of financial assistance in the form of credit lines. Said credit lines, according to the ESM guideline on precautionary financial assistance can take the form of a Precautionary Conditioned Credit Line (PCCL) or of an Enhanced Conditions Credit Line (ECCL), which can be drawn via a loan or a primary market purchase. Both credit lines have an initial availability period of one year, and are renewable twice, for six months. The new ESM reform is addressing only the PCCL, leaving the ECCL untouched. PCCL is granted to States which accept certain conditionality, laid down in a Memorandum of Understanding, which needs to meet the unanimity of the ESM members to be approved. Quoting the ESM guidelines: Access to a PCCL shall be based on pre-established conditions and limited to ESM Members where the economic and financial situation is still fundamentally sound. Finances are deemed to be sound using as basis six different criteria, among which a deficit and public debt under control, financial market financing facilities in previous years and the absence of solvency problems in the banking system. With the ESM reform, the access to the revamped PCCL would no longer be conditional on the signing of an MoU, but it would require for the member State to meet more specific requirements, among which to have debt below 60 percent of GDP, or converging towards that target with a reduction of one twentieth per year. However, recent data show that 10 out of 19 Eurozone countries, which Italy is part of, would not be able to meet these requirements (Claeys & Collin, 2018). As a consequence, Italy would need to rely on the ECCL, which has also been deemed by the Eurogroup the right tool for the coronavirus crisis [17]. Although the precautionary credit line tool has never been used to date, the issue of conditionality is recurrent, as the ECCL is based on the acceptance of a Memorandum of Understanding which needs, as for the case of the pre-reform PCCL, unanimous agreement of the ESM members. Without the need to venture into the issue of whether or not to use the ESM, the fact that accession to the Fund is subject to the stipulation of a MoU linked to strong conditionality could allow other countries to include all sorts of policy conditions to it, thus a country might be reluctant to apply to the ESM for fear of losing economic sovereignty (Guttenberg, 2018), if not even political elections, depending on the government (Claeys & Collin, 2018). That said, let us go back to the case of Greece. First of all, it should be clarified that Greece has never used or requested the PCCL/ECCL. Yet, the idea is that the issue of conditionality is inevitably linked to any possible use of the ESM. And when it comes to Greece, the issue of conditionality is complemented by that of enhanced surveillance. Let us take a few steps back. Since 2010, Greece has been the subject of three economic assistance programmes, the last one dating back to 2015. It was in fact in June 2015 that the EFSF programme for Greece ended, and again in the same month Athens was unable to repay a loan received from the IMF.

Up to that moment Greece had received numerous loans in exchange for major structural socio-economic reforms. Thus, in July, the Eurogroup decided to approve a new aid package

[17] Report on the comprehensive economic policy response to the COVID-19 pandemic, Eurogroup `https://www.consilium.europa.eu/it/press/press-releases/2020/04/09/report-on-the-comprehensive-economic-policy-response-to-the-covid-19-pandemic/`

for Greece through the ESM, with the first tranche of €13 billion loan to Athens being disbursed in August. While Greece finally managed to exit the ESM loan programme in 2018, it did not, however, leave the conditionality loop. The June 2018 Eurogroup meeting [18], in addition to deciding on debt-relief measures for Greece, also drew up a list of specific commitments that Athens was invited to follow. Said list includes commitments to maintain a 3.5 percent primary budget surplus; to keep the minimum wage in line with the provisions of the 2012 legal framework; to complete the investment licensing reform, the cadastre project and the privatisation strategy - even reporting a list of companies to be privatised [19]. And this is where doubts arise, mainly of a political nature: indeed, the bailout was over, while the strict conditionality loop and scrutiny conducted by the European institutions were not. In terms of conditionality, what was requested from Athens, in terms of quality and quantity and level of detail, was unprecedented (Zsolt, 2018). The aforementioned list of specific commitments to ensure the continuity and completion of reforms adopted under the ESM programme has reached such a level of sophistication that the EU bailout conditionality has been defined by some as a de facto mode of government (Katsaroumpas, 2013). A fortiori, the implementation of these measures is scrupulously monitored by the Commission. As a matter of fact and as a contractually bound condition for the provision of the necessary economic aid, Greece came within the scope of the "Enhanced surveillance framework", which was codified in the Two-Pack legislation of 2013 [20]. For the present case, the Two-Pack provides in Article 2(1) that "textitThe Commission may decide to subject to enhanced surveillance a member State experiencing or threatened with serious difficulties with respect to its financial stability which are likely to have adverse spill-over effects on other member States in the euro area, moreover The member State concerned shall be given the opportunity to express its views be-

[18] Eurogroup statement on Greece of 22 June 2018, Eurogroup `https://www.consilium.europa.eu/en/press/press-releases/2018/06/22/eurogroup-statement-on-greece-22-june-2018/`

[19] Specific commitments to ensure the continuity and completion of reforms adopted under the ESM programme `https://www.consilium.europa.eu/media/35767/enhanced-surveillance-annex-22-06-2018.pdf`

[20] Articles 2-4, Regulation (EU) 472/2013

fore the Commission adopts its decision to subject that member State to enhanced surveillance" and said enhanced surveillance would also apply whenever "texita member State is in receipt of financial assistance on a precautionary basis from one or several other member States or third countries, the EFSM, the ESM, the EFSF, or another relevant international financial institution such as the IMF". Moreover, according to the current ESM guidelines on precautionary financial assistance, the application of an enhanced surveillance is also mandatory whereas "*An ECCL is granted, or a PCCL drawn*" [21]. What is clear, however, is that the coronavirus crisis will leave an overall increase in public debt, especially in the eurozone. In Italy public debt is expected to increase to 155.7 percent of GDP, up from the pre-virus outbreak forecast of 135.2 percent, and the 134.8 percent recorded in 2019. Likewise, in France public debt is expected to increase from 98.6 percent of GDP to 115 percent, as well as Spain, whose debt is expected to increase from 97 percent of GDP to 115.5 percent. In this respect, Italy's debt growth forecasts, when weighed against the strict conditionality clauses of the ESM, justify the general hysteria that pervades the debate. Since the general idea is to base the ESM's pandemic credit line on the ECCL, it is appropriate to recall the topic of the PCCL and ECCL guidelines referred to above. Moreover, since the Treaty establishing the ESM, its guidelines, the two-pack and the TFEU have not yet been amended at this stage, this analysis will continue taking into account the current scenario. Going back to the ESM guidelines mentioned above, Article 5 defines a very strict perimeter in terms of obligations for the country under enhanced surveillance. In fact, Article 5, speaking of enhanced surveillance, provides that the country under enhanced surveillance shall adopt appropriate measures to resolve any systemic criticality, under the recommendation of the European Commission, in liaison with the ECB, the European Supervisory Authorities (ESA) and the European Systemic Risk Board (ESRB) and, where required, the IMF (reconfiguring the "troika" so famous during the Greek debt crisis. The combination of these ESM guidelines and the two-pack regu-

[21] European Stability Mechanism Guidelines on Precautionary Financial Assistance, `https://www.esm.europa.eu/sites/default/files/esm_guideline_on_precautionary_financial_assistance.pdf`

lation leads to the umpteenth key concern: Article 7. While some scholars have argued that Article 7 of the two-pack, concerning macroeconomic adjustment programme, does not apply with credit lines and hence with the ECCL or the hypothetical "textitcovid credit line". , the ESM guidelines provide a different warning. Article 7(1) of the ESM guidelines "*The adequacy of the precautionary financial assistance shall be assessed on a proposal from the ESM Managing Director based on the findings referred to in Article 5(3)* [22]" and then continuing with Article 7(2) "textitIn case the beneficiary ESM Member deviates from its policy conditions or if those commitments have become clearly inadequate to resolve the threat of financial disturbance, the Board of Governors may decide to close the credit line. The beneficiary ESM Member would then be expected to request a regular stability support, with a full macroeconomic adjustment programme, following the procedure applicable to it". There is therefore a basis for the activation of Article 7 of the two-pack regulation, along with everything that follows from it, first and foremost Article 7(5): "*The Commission, in liaison with the ECB and, where appropriate, with the IMF, shall examine with the member State concerned the changes and updates that may be needed to its macroeconomic adjustment programme (...) The Council, acting by a qualified majority on a proposal from the Commission, shall decide on any change to be made to that programme*". In short, whatever the conditionality agreed at the time of the loan, creditors can change the conditions at any time, even by imposing more stringent conditions. Indeed, according to the report over the COVID-19 recovery measures of the EU approved by the Eurogroup, and later discussed by the European Council, the underlying idea of the "covid credit line" envisages a simplified and facilitated access to the ECCL, specifying that, however: the provisions of the ESM Treaty will be followed. Let us be clear, as also stated by ESM's Managing Director, Klaus Regling [23], the Fund was born in a completely different context, and its instruments were designated for specific interventions, related to that time. They were not designed to manage sym-

[22] A/N: ESM ehnahced surveillance

[23] Transcript of Klaus Regling's interview for the Financial Times, `https://www.esm.europa.eu/interviews/transcript-klaus-reglings-interview-financial-times`

metrical crises or the deployment of large sums of money or multilateral interventions. At present, the Fund's credit line would only be useful to cover short-term crisis-related financing needs, and while simplified access clauses can be envisaged, hence the much talked about "ESM light", the ESM Managing Director Regling himself has been very clear that the procedures for monitoring the Treaty, as well as the other provisions of the Treaties, would instead have to be fully implemented.

With an interest rate of 0.76 percent [24], compared to other forms of debt, the ESM is certainly attractive at first sight. However, the possibility of the ESM to mobilise only 2 percent of the GDP of the requesting country (in this case Italian GDP), in a preferential way only to support healthcare costs and in any case in compliance with the Treaties, makes this instrument less attractive and controversial than other solutions, such as the issuance of bonds or the monetisation of debt tout court. Finally, although the conditions apparently advantageous (to date an interest rate of 0.1 percent against 1.7 for Italian bonds) for access to ESM credit, the most widespread fear is that of image damage. Historically, in fact, the ESM has only been used by countries with highly distressed public finances, the "PIGS". Access to the Fund, now, could imply, in the eyes of the markets, an admission of weakness from which it would be difficult to escape. Returning to the conditionality of the ESM, we have therefore seen that, once engaged in the contractual relationship, the State can actually be imposed new conditions as a result of a regulatory chain culminating in Article 7(5) of the two-pack regulation, which is usually not applicable on credit lines. In this case, the only way to avoid the chain of reinforced surveillance, and therefore the constraint of a Troika scrutiny, which is also provided for in Article 6 of Regulation 472/2013, is the suspension or the amendment of the provision with an act of equivalent legal value (Cottarelli & Moavero Milanesi, 2020). On this issue, the Greek experience is now a case study. However, as well recalled in an article in the Italian economic newspaper "Sole 24 Ore": "Since the loan is a contractual relationship, the change of the terms cannot intervene at any time, but only when the party has to meet an obligation. At the time of a new dis-

[24] Average ESM lending rates of pool funded loans, over Q1 2020, including margin and fees, `https://www.esm.europa.eu/lending-rates`

bursement of the loan, and only at that time, the creditor can change the conditions. Once again, it is useful to rethink Greece, and the Eurogroup. The new adjustment programmes, the notorious Memoranda of Understanding, were imposed when new tranches of the loan were disbursed" (Saraceno, 2020). It is clear that on the subject of ESM and conditionality the devil is in the details. In the Italian case, the liquidity needs for healthcare expenses (which have already been incurred in the critical period of March) will probably amount to less than 35 billion, perhaps around half. In light of this, the only realistic possibility of using the instrument is to request a deviation from the current rules for one single tranche, with clear and simple requirements, and then move on to other methods of financing public expenditure. The risk that medicine is worse than evil can jeopardise the viability of the entire European economic system. Unfortunately, it is very complex to imagine a scenario other than the one just described. First of all, despite the fact that the Eurogroup and then the European Council have agreed to adopt a series of measures, including the setting up of a "covid credit line" within the ESM and the establishment of a recovery fund (which is still at the proposal stage like many others), the criticalities remain (Fleming & Khan, 2020). For the sake of intellectual honesty, in fact, it is impossible to imagine an ESM light without a modification of the TFEU, two-pack and ESM Treaty. To date, none of these documents has been amended. So, none of the provisions mentioned here have been suspended, including Articles 13 and 14 of the ESM Treaty. The same provision which, together with the aforementioned ESM credit line guidelines, may lead both to the withdrawal of the credit line granted and to the imposition of a macroeconomic adjustment programme, with all the consequences of the case. And also, the possible feasibility of such a radical change project, in such a short time, raises many doubts. First of all, an injectable liquidity of 410 billion, as it seems to be the liquidity available (Valero, 2020) it is not enough to support all the countries in the eurozone, when you think of the figures put in place by countries such as Japan, the United Kingdom or the United States, but that is not the main point. The point is that, even if a particular credit line or the entire ESM were to receive more funding, it is the expectation of changing this tool that, on the basis of existing European provisions, would not be so obvious. Indeed, while the ESM can be qualified as an intergovernmental instrument, it is in fact explicitly provided for in the Treaties, Article 136 TFEU itself, as amended in 2012, following the birth of the ESM, makes express mention of it: "textitThe member states whose currency is the euro may establish a stability mechanism to be activated if indispensable to safeguard the stability of the euro area as a whole. The granting of any required financial assistance under the mechanism will be made subject to strict conditionality". The Court of Justice of the European Union has expressed a decisive ruling on this matter in its judgment C-370/12, Pringle (1/2013) [25]. With this judgment, the Court has justified the same amendment to Article 136 as compatible with the Treaties as being a coordinated and homogeneous integration of the European law itself. And with regard to conditionality clauses, in paragraph 69, the Court says: "textitHowever, the reason why the grant of financial assistance by the stability mechanism is subject to strict conditionality under paragraph 3 of Article 136 TFEU, the article affected by the revision of the TFEU Treaty, is in order to ensure that that mechanism will operate in a way that will comply with European Union law, including the measures adopted by the Union in the context of the coordination of the member States' economic policies".

It follows that the ESM Treaty is based on an ancillary provision of the Treaties, which presupposes its conformity with the existing rules and is intended to implement this legitimate amendment to the TFEU. Secondly, the legitimacy of both the amendment to Article 136 of the Treaty and of the ESM Treaty, as laid down by the aforementioned judgment of the Court, based on Article 125 TFEU [26] is guaranteed only if any of the ESM interventions are subject to strict conditionality. Therefore, not to any conditionality or the absence thereof. The Court's ruling can therefore be interpreted to mean that the lack of conditionality of the ESM's intervention, or its lightness, directly contradicts the provision of Article 136(3), being con-

[25] For a commentary and further analysis of the ruling, in Italian: `https://www.osservatoriosullefonti.it/archivio-2013/fonti-dellunione-europea-e-internazionali/707-ue-la-sentenza-nella-causa-c-37012-pringle`

[26] A/N: The prohibition of financial solidarity between States

trary to the fundamental framework of European law. In that sense, it is therefore legitimate to consider that the Court has ruled in those terms precisely to ascertain the compatibility of Article 136 with other provisions of the EU Treaties, including Article 125 TFEU. Thus, it could be assumed, in this sense, that even an amendment to Article 136 no longer providing for strict conditionality concerning the use of the stability mechanism would be struck by the Court and sanctioned as contrary to the legal framework of the Treaties. On May 8th, 2020, the Eurogroup was able to further discuss the extraordinary assistance package to respond to the coronavirus crisis, among the topics on the table the ESM "Pandemic Crisis Support (PCS)" [27]. In particular, two documents published by the European Commission are noteworthy. The first, a letter [28], legally non-binding, from European Commissioners Valdis Dombrovskis and Paolo Gentiloni addressed to the Eurogroup; the second, an eligibility assessment [29] for Pandemic Crisis Support, a financial assessment foreseen by the ESM Treaty and the two-pack. It is clear from this premise that one document brings consequences, while the other has only political value. The letter contains 8 points regarding possible conditions for the activation of the ESM emergency credit line. On the matter of substance, it should be recalled, once again, that the only real ESM without conditions can be achieved by legislation of equivalent rank amending the Treaties and regulations currently in force. In this sense, even an amendment to Regulation 472/2013 would be of the utmost importance. While the letter talks about conditions for access to the credit line, even if it were to become a regulatory proposal, it would be of little relevance. The expressions used about the non-application of some of the provisions of Regulation 472/2013 are quite hazy, "sees no scope for a possible activation" or "does not apply". Moreover, in the case of the most binding expression, "does not apply", this applies only to point 5 of the letter, which refers to the macroeconomic adjust-

[27] Eurogroup Statement on the Pandemic Crisis Support https://www.consilium.europa.eu/en/press/press-releases/2020/05/08/eurogroup-statement-on-the-pandemic-crisis-support/#ftnref1

[28] https://ec.europa.eu/info/sites/info/files/economy-finance/letter˙to˙peg.pdf

[29] https://ec.europa.eu/info/sites/info/files/economy-finance/20-05-04pre eligibility.pdf

ment programme. The issue here would be that the macroeconomic adjustment programme is already by its very nature not directly applicable at the time of applying for the credit line, given that, as also provided for in Article 7 of the two-pack: "*The draft macroeconomic adjustment programme shall address the specific risks emanating from that member State for the financial stability in the euro area*". If access to the credit line is granted for extraordinary reasons, which do not imply, at least initially, unsustainable public finances, it is clear that there is no need for any adjustment programme at this early stage, the letter states the obvious. That said, the letter makes no mention of Article 6 of the two-pack concerning the evaluation of the sustainability of the government debt, and in all its other points only states " sees no scope for activation" in relation to the provisions of Articles 3(3-4-7) and 14(2-4). However, the exclusions are incomplete, since there is no mention of the non-application of Article 3(1) of the two-pack, which expressly provides that: "*A member State subject to enhanced surveillance shall, after consulting, and in cooperation with, the Commission, acting in liaison with the ECB, the ESAs, the ESRB and, where appropriate, the IMF, adopt measures aimed at addressing the sources or potential sources of difficulties. In so doing, the member State shall take into account any recommendations addressed to it under Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of budgetary positions and the surveillance and coordination of economic policies*".

This expression seems to suggest rather a request to the European Authorities not to exercise their powers of control than a real non-application of existing provisions. Finally, no other provisions, and not even the ESM Treaty, are mentioned. Furthermore, the letter deals only with applications to the ESM credit, no mention is made of what the Treaties provide for afterwards. After a first reading, therefore, it is clear that even if the various Memoranda of Understanding and macroeconomic adjustment programmes are not foreseen at the time of access to the credit line, they are in any case destined to return at a later date, especially if we consider the case of Italy where all estimates indicate an increase in the debt-to-GDP ratio to at least 155 percent. As if that were not enough, the second document, the PCS eligibility assessment, is part of a procedure regularly provided for in Article 13 of the ESM Treaty, as well as the two-pack Regulation and the ESM guidelines on precautionary financial assistance. Therefore, it has greater weight than the aforementioned letter. Only to show the lack of consistency between the two documents, the PCS eligibility assessment clearly states that: "*The provisions of the ESM Treaty will be followed*". This is also confirmed by points 3, 4, 5, 6 and 7 of the Eurogroup press release of May 8th, 2020, which, among the many confirmations, provides that: "*Afterwards [the coronavirus crisis], euro area member States would remain committed to strengthen economic and financial fundamentals, consistent with the EU economic and fiscal coordination and surveillance frameworks, including any flexibility applied by the competent EU institutions*".

In the Italian case, without substantial changes to the agreements and acts in force, as long as the ESM loan lasts, the country will be subject to periodic assessments of debt sustainability, with all the consequences thereof. Recent developments in PCS and ECCL have led to the publication of draft agreements for the use of the credit line, which in a sense confirm the evidence highlighted in this paper. First of all, contrary to what is proposed here, Managing Director Klaus Regling has put forward a model credit line arrangement whereby member States can receive at most monthly instalments equivalent to 15 percent of the required sum (2 percent of GDP). In the Italian case, this would be equivalent to monthly instalments of around €5.4 billion each, allowing the target figure of €36 billion to be reached in about 7 months [30]. Secondly, in an interview on the use of the Fund, Managing Director Regling did not rule out the use of monitoring mechanisms, as in any case the amount received (to be used primarily to co-finance existing expenses and not new expenses) will have to be – clearly – returned. Too little, too late.

[30] Proposal from the Managing Director for financial assistance in the form of a Pandemic Crisis Support `https://www.esm.europa.eu/sites/default/files/20200515_esm_bog_md_proposal_for_financial_assistance_draft.pdf`

4 OMTs? After Karlsruhe, not so fast.

Even the other single element supporting the adoption of an ESM credit line, the OMT, seems to lose its appeal when properly analysed. We have already emphasised that, although never applied in reality, the ECB's guidelines provide that the first requirement for the adoption of OMT is to be subject to an ESM support programme, and therefore to a Memorandum of Understanding. The activation of the OMT requires, on the one hand, an application from a euro area member State and, on the other hand, acceptance by all other euro area member States. Secondly, the acceptance of a series of conditionality by the requesting member State is mandatory. Basically, the surrender of one's own economic sovereignty is a necessary requirement for the implementation of the OMT programme, which has been envisaged as a nuclear option. If, on one side, this instrument, with its current features, still does not meet the needs of "firepower" and flexibility of manoeuvre required by Italy, on the other side it can, as in the case of the ESM, be appropriately adapted for the occasion, as also stated by Blanchard (2020). The ECB is sound, with interest rates below 1 percent, and even a general debt increase of 10 percent or 20 percent would not jeopardise the sustainability of its debt. The problem, if any, stems from the private investor side. Times of crisis and uncertainty inevitably lead to an increase in member States' bond interest rates, making the debt burden increasingly less sustainable and giving rise, albeit indirectly, to the preconditions for the crisis that all public and private investors alike want to avoid (Blanchard, 2020). In such situations public institutions, here the ECB, guarantee sustainable interest rates. In this case, the ECB can intervene more effectively through a programme of outright monetary transactions. The only nub lies in the fact that the authorities of the member State in need, in this case Italy or whoever applies for it, should submit a request, and the other euro area member States would have to approve the request. Secondly, there would be conditionalities to be accepted. However, as already proposed, these conditionalities could also be drafted in a simple and clear way: spend what is necessary to avoid any economic crisis in the best possible way, and commit to wind down everything once the crisis is over (Blanchard, 2020). However, any modification of the existing toolbox takes time. In the short term, the ECB can instead purchase Italian bonds, as well as bonds from any member state that needs them, at a predetermined rate. This is what the Bank of Japan has done, and it seems to work, since yields have not increased. In a way, this is what the ECB is trying to pursue with the Pandemic Emergency Purchase Programme (PEPP), a flexible quantitative easing programme of 750 billion euros [31], which could be considered as a hybrid between QE and OMTs. In this case, the only obstacle to the implementation of the programme seems to be the German Constitutional Court, which, in its ruling of May 5th,2020 questioned the legitimacy of the ECB's quantitative easing (namely the 2015-2018/19 PSPP programme), giving 3 months to provide corrective measures. For now, the Bundesverfassungsgericht did not deem quantitative easing illegal, however it took the chance to dismiss the European Court of Justice rulings over sovereign bond purchase programmes as inadequate, but most importantly, as stated above, it gave a three months' notice: if by then the ECB has not complied with the Bundesverfassungsgericht doctrine, the Bundesbank and other German authorities are banned from participating in the QE programme (Sandbu, 2020). In detail, the Court found that by lowering interest rates, QE helps governments and hurts savers, allowing economically unsustainable companies to stay on the market. The replies of the Commission and the ECB were not long in coming, affirming the supremacy of European law, but the political implications of such a ruling, and the three-month ultimatum, could have repercussions for the whole of the European Monetary Union. It is clear now that any policymaker intending to put wide-ranging expansionary measures on the European agenda, or supporting an expansion of the PEPP, must take into account the apparent hostility of the German constitutional system to such manoeuvres. Secondly, Karlsruhe pointed out, in a very abrupt manner, that while, according to the Treaties, the ECB must work to support European growth policies, it must also work to maintain price stability, as this

[31] ECB announces €750 billion Pandemic Emergency Purchase Programme (PEPP), `https://www.ecb.europa.eu/press/pr/date/2020/html/ecb.pr200318_1~3949d6f266.en.html`

is the ECB's mandate. On this point, it pointed out that the two elements must be harmonised and not pitted against each other. While the Bundesbank in all likelihood will continue to be part of the QE programme, it is clear that the value of this ruling is mainly political. The German Court decision threatens to undermine confidence in the euro and surely killed off any hope of Eurobonds or joint debt issuance (Evans-Pitchard, 2020). As stated by the Director of the Jacques Delors Centre: "*The BVerfG raises the question of the limits of ECB independence. They insist that the ECB independence ends when the ECB starts to get into "economic policy" as opposed to "monetary policy". The problem is that the border between the two can't be really defined. (...) The BVerfG wants to keep discretion to decide on this border all by itself*" (Sandbu, 2020).

It is clear that, in a context of immense hardship such as the present COVID-19, which requires promptness, bravery and political ambition, a European Union that is also divided on the foundations of economic governance, with some member States being more equal than others, does not help to square the situation. In this case, the Court's ruling does not have a direct impact on coronavirus pandemic-related purchasing programmes such as the PEPP, but it has opened the way for numerous possible complaints against them. More concretely, the judgment, if not upheld by subsequent ECB actions, could legitimate a complete sale of the bonds held by the Bundesbank as a consequence of the exit from the ECB's purchase programmes. In its ruling, however, Karlsruhe did not reject the purchase of the bonds as incompatible with Article 123 TFEU. While this leaves open the possibility for future interventions by the ECB, the issue of proportionality is all the more open for discussion, as it is clear that the ruling, albeit indirectly, refers to the ECB's intentions to extend the PEPP programme beyond the spending limits linked to the capital key and also to low-rated bonds (Evans-Pitchard, 2020). Moreover, as underlined by Evans-Pitchard, the real criticality lies in the fact that: "*The ruling kills off any residual hope of eurobonds or joint debt issuance. That would require a change in the EU treaties and the Grundgesetz. Fiscal support for Club Med states may have to come mostly in the form of formal loans from the EU bailout fund (ESM), and subject to the hairshirt of the Fiscal Compact* *once the crisis is over*". The Bundesverfassungsgericht has to some extent affirmed German sovereignty, which means that the German Constitution comes before EU law. However, there is no automatism, the Bundesbank and the German government can maintain their political autonomy as long as the ECB decisions are not deemed to be a problem for the German taxpayer. Shortly after the German Court ruling, a more comprehensive response from the ECB was not long in coming. In detail, President Lagarde has fended off the criticism levelled against the ECB's bond purchase programme, saying she was "undeterred" by the an order from Germany's highest court to produce a justification of its action (Arnold, 2020). Commenting again on the need for action to counter the coronavirus crisis, President Lagarde said that: "*The Central Banks have to go beyond the normal tools to use exceptional measures(...) to avoid a tightening [of financing costs] and to ensure our monetary policy is transmitted across the euro area*". Moreover, a majority of the ECB Council members oppose providing a justification to the German Constitutional Court. In light of the German ruling, it has been suggested that the smartest response to it would be for the EU to address the structural problems of the eurozone: "*lack of convergence between north and south, debt sustainability and, most important right now, the issuance of mutualised debt to finance a recovery fund*".

A debt which should, in case, guaranteed by the ECB as a whole and not by national central banks (Münchau, 2020). Nevertheless, it is since 1993, with the Maastricht Treaty, that the Bundesverfassungsgericht has always ruled this way or that way with regard to European law, but this is the first time that it has decided to take a stance vis-à-vis Brussels. In light of the coronavirus crisis, the ever-increasing demands for more expenditure and bolder manoeuvres, the question arises: what to do? The first option is the nuclear option, to which the southern European countries are quite accustomed: the infringement procedure. In this regard, it is the President of the European Commission, Ursula Von Der Leyen, who has not ruled out opening an infringement procedure against Germany, also in view of the enormous pressure exerted by the national courts in the member States (Khan & Fleming, 2020). After all, there'd already be precedent. With ruling C-416/17 it was the turn of the French Conséil d'État, but it is evident that any response to the Karlsruhe ruling would not comply with a legal order as much as a political one. There are also a number of doubts about the political merits, because in this context of crisis and tension, it is not sure how far the Commission would like to go in a dogfight against Berlin. What is certain is that the Karlsruhe ruling in a certain way marks a border as thin as it is rigid between Berlin and Brussels. The German court in effect has declared null and void a 2018 ruling by the Court of Justice of the European Union, namely the lawfulness of ECB asset purchases. The Bundesverfassungsgericht said that the Court of Luxembourg had not considered the ECB's proportionality and so had acted *ultra vires* [32]. In a way, while we have tried to diminish the German ruling, it is also true that it cannot go unnoticed, as it constitutes a kind of declaration of independence for German constitutional law from European law, despite the supremacy of EU law. As mentioned above, the risk of emulation is a problem here. On the internal side, the Karlsruhe ruling opens the way for other complaints against ECB asset purchases, such as the PEPP. On the Union side, on the contrary, all those attempts to impose a supremacy of the specific law of the member States over that of the Union have found political support, as in fact is happening in some Eastern European countries, first and foremost Poland. But that's not the main issue. The main point is that while the German Bund has always supported quantitative easing, the same cannot be said for the Bundesbank, which could thus support the path paved by the German Constitutional Court. Secondly, the role of the German Government is not a given either, as Chancellor Merkel recently expressed her intention to support the decisions of the Bundesverfassungsgericht [33]. The elephant in the room is that the European Union is crystallised in its Treaties, in its procedures and without political clout, and that Brussels' rules are no longer dogmas, if even those who defended its absolute independence have begun to challenge them. The matter examined

[32] N/A: Beyond its authority.

[33] Merkel, vowing to respect court's ECB ruling, wants strong Euro, Reuters `https://www.reuters.com/article/ecb-policy-germany-merkel/merkel-vowing-to-respect-courts-ecb-ruling-wants-strong-euro-idUSS8N2C8054`

so far, regarding the suitability of the ESM and of related tools, arises from a technical context, but results in a political deadlock, which requires political responses, potentially outside the toolbox currently available. As said by the former President of the ECB, Mario Draghi: we face a war against the coronavirus and must mobilise accordingly (Draghi, 2020). As of now even the ECB President, Christine Lagarde, has asked eurozone governments to come up with more bold economic measures (Hall & Arnold, 2020). On the one hand, this positioning of the ECB is comforting, as it opens the way to a whole range of possible far-reaching measures, but on the other hand, and in the light of the orientation of the German Constitutional Court, further clashes between Frankfurt and Berlin are not to be excluded.

5 We face a war and must mobilise accordingly.

We have examined some of the cards on the table, now it may be a useful drill to try to examine some of the alternatives available. The leitmotif of the instruments currently laid down by the European Union is based mainly on loans, in whatever form, guaranteed in various forms, with capital subscriptions. SURE, ESM and EIB, in spite of their use in putting resources and liquidity in circulation, have the great limit of being instruments conceived in the ordinary toolbox of the European institutions, leaving the ECB as the only "unpredictable" actor. In Italy, for a short time, the debate was fossilized on which between ESM and Eurobonds was the best instrument. Within a short time, the Italian government's position in favour of common European bonds disappeared. However, in the perspective of a courageous issuance of debt and liquidity common to the eurozone countries in the long run, the recourse to an ESM credit line in the short term would also find its own place (Bénassy-Quéré, et al., 2020). However, in this case, there are two main technical aspects to take into account. Firstly, the European budget cannot provide for any debt other than financial assistance measures, and the ESM, although celebrated as the panacea for all ills, is an instrument designed to be applied to one State at a time. Secondly, member States have adopted very different economic and financial solutions to the coronavirus crisis, some preferring capital expenditure and others preferring to guarantee state loans. It is clear that with such heterogeneous economic approaches a common factor is not taken for granted in a short time. Moreover, the ECCL, upon which the PCS is based, has technical limits. It is a specific tool intended to address market access risks, designed to lend for one year, with a maximum extension up to another year. An intervention instrument in the short term should have the technical courage to be long-lasting, without any kind of conditionality, so as to be more attractive than debt issuance. For the reasons already explained in this document, however, the technical dictates of the Treaties do not allow such instruments, leaving them at the mercy of political debate. Back to basics, the coronavirus has created a symmetrical exogenous shock on the European Union. As the ECB has also reiterated, the primary responsibility for taking action against possible economic contingencies lies within the member States, but it is clear that the support of the European Central Bank is crucial to give credibility and continuity to any measure. In fact, this crisis, being a predominantly real economy crisis, with cascading effects on the financial economy, requires large investments. In this respect, the fact that the ECB is pursuing asset purchasing policies such as the PEPP is undoubtedly a positive factor, but not enough. In fact, an asset purchases policy is in any case susceptible to criticism of political legitimacy, as indeed demonstrated by the recent Karlsruhe ruling. The whole European economic debate should have the courage to choose, at this point, between massive economic interventions at European level or a total return to national sovereignty. There is no middle ground envisaged. As already recalled, the cost of hesitation may be irreversible (Draghi, 2020). On the one hand, measures such as EIB guarantees and the SURE programme (the latter perhaps with more certainty regarding the start-up pace and intervention capacity) can cover at macro level, and at European level, what is already being done at national level. Secondly, a credit line is clearly necessary, as already mentioned, but it should be based, like all other measures, on a sharing of the costs of the crisis, launched in the long term (at least 20-30 years) and provide specific measures for a relaunch of the European Union system in the aftermath of the crisis (Bénassy-

Quéré, et al., 2020). In Europe, whenever there has been a need to act politically, outside of technical dictates, there has always been a country that has been a reference point, with an uncommon ambition. France. Again, to be fair, this is no exception. In a recent interview, French President Emmanuel Macron referred to the need to 'think the unthinkable', with unprecedented forms of solidarity and economic power, which also find the support of those more reticent member States, such as the Netherlands or Germany. The only alternative is the failure of the European project (Mallet & Khalaf, 2020). More concretely, and almost in total antithesis to the communicative line taken by Berlin, the Governor of the Banque de France, François Villeroy de Galhau, has highlighted how "helicopter money" has come to be less and less a hypothesis and more and more a certainty. According to Villeroy, on the basis of the British and American experiences, in a context of deflation such as that of the euro area, the ECB could take care of printing money to finance economic operators in the euro area directly (Arnold, 2020). All else being equal, the options available to the ECB are running out. With the PEPP underway, significant support for the banking system, interest rates at minimum levels, the scope for doubt and uncertainty is increasingly reduced. Yet, despite the symmetrical nature of the crisis, its consequences are asymmetrical, which alone should be a necessary and sufficient condition for ECB muscle intervention. The greatest impact of the crisis has undoubtedly fallen on Italy and Spain, but France is also moving closer to their trends. The elephant in the room is that given the interdependence between European economies, even the frugal countries of northern Europe could suffer devastating economic consequences. In this context, the dynamics of the development of European instruments to support member countries, first and foremost the ESM credit lines, have made it clear that a great risk is also represented by the sustainability of the debts of eurozone countries. To be more precise, one of the critical issues is the compatibility between the sovereign debts of the Eurozone countries and the rigid economic architecture of the European Treaties. In a context of crisis such as the present-day one, in fact, the deterioration in terms of sovereign debt sustainability has even cast doubt on the foundations of the eurozone (Ibidem). The role of the State firstly, and of the European Union secondly, in resolving this crisis is based on three margins of intervention: healthcare support, economic support and restart. Especially with regard to the last two, the economic intervention should be divided into short and medium to long term provisions. Short-term interventions to provide liquidity and resources, with as few constraints as possible and as quickly as possible, to firms and households, in order to compensate the lack of liquidity arising from the lockdown measures. Higher spending at this stage means less damage control at a later stage. Ultimately, however, the restart phase should be based on a wide-ranging intervention that recognises that it must be gradual but involve all sectors of the economy. It is widely believed that, as a result of a crisis of this magnitude, higher public debt will become a constant in Europe and in the economic world of tomorrow. These characteristics, moreover, are common to war economies. On this point, it is therefore the great gamble on the ability of the national and European public sector to save the real economy (Draghi, 2020). Having said that, it is clear that the theoretical approach that should move policy makers should be oriented towards more vigorous and courageous interventions, favouring grants to loans, with important expenditure entries, although they should be considered an investment to avoid a permanent contraction of production capacity. What about debt? *In advanced economies, the answer must be that, short of a defeat in the fight against the virus, debt will remain sustainable (And if we lose that battle, debt sustainability will be the least of our problems).* (Blanchard, 2020). This does not mean, however, that unsustainable and insane expenditures should be initiated, but that public finance control should be responsive and prompt. A flexible approach, open to more spending to boost domestic demand, but also to avoid bankruptcies, without overlooking the possibility of following even less orthodox approaches, is of the essence. Large public investment programs should be, an option on the table, rather than a mandatory choice, but an option not dogmatically precluded. The solution, at least in theory, is as simple as it is complex in practice. In fact, only an intervention of the only Central Bank of the European Union, the ECB, can guarantee the debt sustainability of the member countries. This crisis represents, for the ECB and European economic governance, a unique opportunity to take a stand on the future of the

Union (Blanchard, 2020). In response to the crisis, the general tendency has been to combine fiscal support programmes with large government bonds purchase programmes. This has been done by the Federal Reserve, the Bank of England, the Bank of Japan and, at least in part, the European Central Bank with the PEPP. In a way, it could be said that helicopter money, in a more targeted way, has become the mainstream doctrine to deal with the coronavirus crisis. As a consequence, fiscal deficits are rising, as well as debt to GDP ratios. Said economical context has been made, up to a certain point, sustainable by the bond purchase programmes. In this context debt monetisation, especially taking into account the European economic landscape, has become a viable, yet unforeseen tool. Monetisation in the eurozone is less complicated than it seems: *an internal transfer of risks from the holders of securities issued by the high debt country to the shareholders of the ECB with no implication for the total debt held by the public* (Blanchard & Pisani-Ferry, 2020). The only issue in this case, as it has been highlighted by the German Constitutional Court with May 5th, 2020, ruling, is that the interest paid on the bonds held by the ECB involves a transfer from the high debt country to the low debt country, as the interest paid on the bonds held by the ECB is redistributed to its shareholders. While this could be regarded as a remuneration for the risk transfer on one hand, on the other it could only fuel up criticism against anti-cyclical ECB policies, as in effect the recent Karlsruhe ruling has shown. As pointed out within the debate (Blanchard & Pisani-Ferry, 2020), the reason why the ECB has chosen, up to now, to establish a €750 billion PEPP instead of a larger programme? The main reason lies within the differentiated nature of the European sovereign bond markets. Without any full-fledged European economic integration, sovereign bond markets are differentiated, if not polarised between low and high interest rate markets. In the former case the debt is widely deemed as sustainable, within the former it is considered less sustainable, riskier and consequently more expensive for the State to hold. A strong commitment of the Central Bank means a guarantee of riskier titles, thus eliminating the negative externalities of high interest rate bond markets: this is the policy which has been followed up to a certain point by the Bank of England and extensively by the Bank of Japan. The ECB's approach, given its statutory limits, was instead to intervene when interest rates should exceed the thresholds deemed feasible – vis-à-vis the current economic outlook – by the Central Bank. The outcome of the strategy is not as predictable as in the Japanese or British case, but if Frankfurt's deterrence were to take effect in the long term, it could achieve similar effects, protecting more unstable markets, without any monetisation or major costs. In any case, the ECB, whether it involves effective monetisation or not, is the only institution capable of smearing the damage and impact of the coronavirus economic crisis on the entire euro area. While this approach is certainly useful in stabilising the outlook, it is not enough. The unsolicited and unwelcome recommendation is for member States to choose whether to put forward ambitious economic recovery programmes individually or collectively, in both cases under the aegis of the ECB.

6 Conclusion.

The coronavirus crisis has affected all EU countries symmetrically. Despite the fact that it has revealed numerous critical issues in each state, the crisis is not attributable to any of them. On the basis of these elements, the ESM, a fund created for emergencies related to the financial economy, in the current political view, has been readjusted as a fund to act on the real economy. In the long run, this approach risks proving to be politically and legally unsustainable, entailing possible political costs that could inevitably damage the process of European integration. The conditionalities of the ESM remain, despite the premises and promises, a knot to unravel, a source of hesitation for many member States, such as Italy, Spain or even France. On the other hand, the establishment of an ad hoc fund, a recovery fund, could change the game. In this case, it is vital to define loose conditions of use and significant resources. The lending strategy is not ambitious enough to make economic recovery a truly European recovery. In light of the above, the ECB has proved to be an important asset, being able to ensure the sustainability of sovereign bond markets. This implies, on the one hand, ensuring that member States can find resources without excessive risks, and on the other hand, it provides the components for possible better overall strategies. Against the ESM's €36 billion, to be distributed in monthly instalments, bond issuance allows for many more resources to be recouped in much less time, compared to a derisory saving in terms of yield, considering the sums retrieved through the ESM. What is clear is that the European Union is caught in a freeze on its own rules and treaties, and only a massive economic intervention by the ECB on the one hand and an ambitious political programme on the other is capable of breaking the deadlock. Despite the ruling of the German Constitutional Court, which has effectively stopped any enthusiasm for greater ECB expansiveness, this is the real test to see where the Union is willing to move. Excessive optimism and the pursuit of easy political consensus could only pay off in the short term, accumulating further political contradictions that would increase future risks of instability. As pointed out by the former President of the European Central Bank, the cost of hesitation could be catastrophic. Europe and the rest of the world are facing a shock beyond the cyclical and countercyclical mechanisms of the economy, and only a conscientious and coherent combination of forces between the ECB and the banks, under the aegis of the member States, can save Europe. Low-priced and affordable solutions might bring unsustainable costs.

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