Investing Immobilized Russian Assets, Monetarizing the Common Foreign and Security Policy

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Again, the Commission and EU Member States are talking about new sanctions against Russia. The focus, according to Commission President Ursula von der Leyen, should be on tackling sanctions circumvention and loopholes. In a scoop, however, it was also uncovered that the Commission has drawn up a non-paper "on the generation of resources to support Ukraine from immobilized Russian assets". The idea behind this non-paper is to invest the immobilized assets of the Russian Central Bank in EU Member States' bonds and bills and use the proceeds to support the reconstruction of Ukraine. The plan, as the non-paper indicates, is fraught with a number of legal and technical issues. These do not only relate to the question of whether or not such an investment of immobilized assets is compatible with international law and EU law, but also to the question of who should undertake and oversee these investments.

Nonetheless, the non-paper strikes a rather positive note, indicating that such "exceptional measures" are in line with international law and could be adopted on the basis of Art 29 TEU. Accordingly, the Council could adopt a decision providing for the active management of immobilized assets, which could be regarded as a "restrictive measure of geographic nature in its own right". Although the details for the uniform implementation in all Member States are to be spelled out in a regulation on the basis of Art 215 para 1 TFEU, the very basis and structure of such "exceptional measures" would be established within the domain of the EU's Common Foreign and Security Policy (CFSP).

Since the amount of immobilized assets of the Russian Central Bank in the EU, according to the non-paper, is suggested to be around some € 200 billion, the proceeds could be quite substantial: the Commission estimates that if these assets were to be invested in a mix of short-term bills and bonds from a range of EU Member States the median return could be around 2,6 % annually. And indeed, the idea of investing these immobilized assets seems all the more pertinent, as the risk assessments sets out that these returns come with a "high degree of statistical confidence".

That being said, one is well advised to read the rather rosy assessment of the non-paper with a good dose of skepticism. As any learned international lawyer will tell you, the question of whether or not such an "exceptional measure" is compatible with the international rules on state immunity is far from clear.

What is, however, less obvious, and indeed not even discussed in the non-paper are the potential financial and economic side effects and in this sense again legal implications for the EU's monetary policy.

Unconventional monetary policy

While the investment of some € 200 billion in Member States' bonds is intended to generate resources for Ukraine, the investment of such large amounts over a relatively short period aimed at a specific segment of EU Member States' bonds could and most certainly would affect the interest rate structure of these bonds. Very much like the quantitative easing policy of the ECB the influx of substantial amounts of money from a price-insensitive buyer could lead to a crowding-out of private investors and thereby put a downward pressure on yields.

In the current environment, these effects could be all the more relevant, as the ECB has reversed course and since March is pursuing a policy of quantitative tightening, writing off some € 15 billion of its balance sheet every month, while Member States at the same time have been issuing ever more bonds to cover their rising debt levels. In combination with the general rise of interest rates there is thus a looming upward pressure on yields of Member States' bonds. The investment of some € 200 billion immobilized Russian assets, while in principle conducted as an extraordinary CFSP measure, hence, could also provide a welcome means for Member States to make financing their debts more affordable.

In the context of the broader economic implications of Russia's war against Ukraine, however, one could also argue that such an investment could be seen as an instrument to counter some of the adverse economic effects of Russia's aggression. This would be particularly true if the investments where to be directed to support economically weaker Member States, who are hit particularly hard by the need to finance additional measures to support their economies. Moreover, such an investment would also be beneficial for Ukraine as the investment in higher yielding bonds of economically weaker Member States would generate more resources. But even besides such a utilitarian argument, the fact that any CFSP decision on the investment of Russia's immobilized assets needs to be taken unanimously leaves ample room for horse trading, implying that an uneven flow of investments is more likely than not.

From the perspective of the ECB and the EU's monetary policy the installation of a large price-insensitive buyer, though, could create some headache as the downward pressure on Member State's bond yields would create additional inflationary impulses, challenging the ECB's current policy stance of quantitative tightening and raising interest rates. If taken at face value and at the current rate of pace of quantitative tightening the investment of some € 200 billion could offset the ECB's operations for more than a year. Now clearly, if set against the overall balance sheet of the ECB, standing at some € 8 trillion, the ECB has ample room to counter these effects by simply running off some more bonds or resort to raising interest rates further.

Nevertheless, it seems evident that such an exceptional sanctions measure in the domain of the CFSP would give the Council, and for that matter the Member States, a powerful financial instrument, allowing them to interfere with the ECB's monetary policy. And while there is the obligation of mutual cooperation between the EU's institutions (Art 13 para 2 TEU) and to ensure consistency between the different EU policies (Art 7 TFEU) there is also Art 40 TEU and the limitation that

the “implementation of the common foreign and security policy shall not affect the application of the procedures and the extent of the powers of the institutions laid down by the Treaties for the exercise of the Union competences referred to in Articles 3 to 6 of the Treaty on the Functioning of the European Union.” And although, Art 40 TEU so far has been read in a rather restrictive way – meaning that as long as the substantive objective falls within the CFSP collateral side effects on and in other policies do not stand in the way of adopting these measures as CFSP measures – it is all but self-evident that the same calculus applies here. The EU’s monetary policy is after all not only an exclusive EU competence but conducted by a fully independent ECB.

Money makes the world go round

The monetarizing effects of exceptional CFSP measures therefore do not only come with potential macroeconomic ramifications, but also entail legal implications that are yet to be fully considered. This caveat, in fact, seems all the more relevant as these side effects certainly would not only work one-way. That is to say that in a scenario of a possible unfreezing of said Russian assets and a consequential abrupt divestment of these assets form the European bond market, EU Member States would in all likelihood be faced with rising bond rates and consequently macroeconomic headwinds. This in turn means that the financial and economic side effects could themselves become dominant policy factors, undercutting the objective of pursuing an effective CFSP.

To counter this risk, one could imagine inserting some contingency provisions that would allow either the EU or the Member States to reimburse Russia and in exchange take over the stock of invested bonds. And while this would make sense in economic terms and in terms of limiting the monetarizing spill-over effects into the CFSP, this again raises profound legal questions as to whether such an obligation, amounting to a mutualization of Member States’ debt, would be compatible with the no-bail-out clause of Art 125 TFEU.

The idea to make good use of the vast amounts of immobilized Russian assets that sit idle in European vaults for the benefit of Ukraine, is laudable and certainly worthwhile considering. The effects of such a policy, however, could lead to an unprecedented intertwining of the EU’s Common Foreign and Security Policy with the EU’s monetary policy and the financial interests and stability of EU Member States. Against this backdrop, any decision to go down this road should be subject to a more thorough analysis and discourse about the economic, political and legal ramifications.