Vaughne Miller, The Treaty on Stability, Coordination and Governance in the Economic and Monetary Union: political issues (27 March 2012)

Caption: This research paper published by the British House of Commons on 27 March 2012 examines the background to the negotiations for the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union and analyses the reasons for the United Kingdom's non-participation.

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The *Treaty on Stability, Coordination and Governance in the Economic and Monetary Union*: political issues

RESEARCH PAPER 12/14 27 March 2012

In December 2011 European Union Heads of State or Government, with the exception of the UK, agreed to adopt a "Fiscal Compact" as part of an overall strategy to tackle the sovereign debt crisis in the Euro area. The UK vetoed its adoption as an EU treaty, so the other Member States agreed to adopt it as an international treaty instead. On 30 January 2012, 25 Member States formally agreed the *Treaty on Stability, Coordination and Governance in the Economic and Monetary Union* (TSCG) and signed it in March 2012. The UK and the Czech Republic are not parties to the new Treaty, which can enter into force with 12 ratifications.

This paper looks at the background to the TSCG, the reasons for the UK's non-participation and some of the issues it raises, such as its effectiveness, its relationship with the EU Treaties and EU law, the use of the EU institutions in a non-EU treaty, and whether it could give rise to a 'two-speed' Europe and further UK isolation in the EU.

Standard Note 6274, "In brief: provisions of the fiscal compact and economic issues", 27 March 2012, provides further information on the economic aspects of the new Treaty and other EU measures intended to solve the EU debt crisis.

Vaughne Miller

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Summary

On 9 December 2011 the European Council discussed the adoption of a "Fiscal Compact" as part of an overall strategy to tackle the sovereign debt crisis in the Eurozone. In a statement the Euro area Heads of State or Government said the Compact would tighten fiscal discipline in the Eurozone and impose automatic sanctions on States that broke EU budget rules. The Fiscal Compact was supported by 26 of the 27 EU Member States - all the Eurozone States and all the non-Eurozone States except the UK. The UK Prime Minister vetoed the Compact as an EU agreement, largely on the grounds that he had not managed to secure a guarantee that it would not affect the UK's financial services industry.

The 26 decided to adopt an inter-governmental (international) agreement outside the institutional framework of the EU. On 16 December 2011 a draft International Agreement on a Reinforced Economic Union became the basis for negotiations by an ad hoc working group on a treaty to implement the Fiscal Compact. The group met on 20 December 2011 and 6 and 12 January 2012. The draft texts issued from mid-December until early January 2012 made frequent reference to the involvement of the European Commission and recognised the jurisdiction of the Court of Justice in disputes between participating States.

Shortly after the December 2011 European Council, a number of States were reported to be concerned about the implications of the agreement and whether they would be in a position to ratify it. Nine non-Eurozone Member States (Bulgaria, Czech Republic, Denmark, Hungary, Latvia, Lithuania, Poland, Romania and Sweden) might have difficulties with ratification and there have been press reports that some Eurozone Member States, including Ireland and Germany, might also face problems gaining parliamentary approval.

On 30 January 2012 25 Member States agreed to the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (TSCG). The UK did not agree to it and the Czech Republic said it might join at a later stage because its eurosceptic President, Vaclav Klaus, would not sign the ratification bill at present. On 28 February 2012 the Irish Taoiseach, Enda Kenny, announced that on the advice of the Attorney General, Ireland would hold a referendum on ratification of the new Treaty. It is not yet clear which other Member States will hold a referendum.

At a Council summit on 2 March 2012, 25 Member States formally signed the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union. The target for completing ratification is the end of 2012, although the Treaty can enter into force with 12 ratifications. It does not really add anything to existing EU obligations, other than a rule that structural deficits cannot exceed 0.5% of GDP and the requirement to implement the rule in national law, preferably constitutional law. The TSCG proposes that its provisions be incorporated into the EU Treaties within five years.

The Treaty raises political and economic issues concerning its effectiveness, its relationship with the EU Treaties and whether it will set a precedent for inter-governmental action in other areas of activity that will lead inevitably to a two-speed Europe. The implications of the UK's non-participation remain to be seen. While some analysts believe the Prime Minister was right to seek to protect the UK's interests by staying outside the Treaty, others think the UK has isolated itself even further from the EU, which could be damaging.

1 Background

Following the lengthy negotiations that resulted in the *Treaty of Lisbon* in 2008,[1] there was no great appetite among EU Member States for another major EU Treaty amendment. However, the financial difficulties experienced by some Member States over the last three years and the failure of the Stability and Growth Pact (SGP)[2] to ensure fiscal discipline forced the subject of Treaty change back onto the EU agenda to address these failings. Amid calls for greater fiscal integration, the European Council in October 2011 agreed new measures on closer monitoring and co-ordination of Eurozone States' fiscal and economic policies. In November 2011 the European Commission published two new proposals (the 'two-pack') for stronger economic governance. One allowed the Commission to ask Eurozone governments to revise their draft national budgets in line with their Eurozone obligations;[3] the other enhanced surveillance for Eurozone States being supported by financial assistance or threatened by serious financial instability.[4] Furthermore, the so-called 'six-pack' of EU economic governance legislation strengthening budgetary and macroeconomic surveillance, came into force on 13 December 2011.[5]

The initiative for a Treaty change to help resolve the Eurozone debt crisis was primarily a German one with French support, but initially without the support of the majority of other Member State governments. A limited Treaty amendment gradually gained favour and in the Euro Summit statement of 26 October 2011 Member States agreed that "limited Treaty changes" might be needed to implement measures to "strengthen the economic union to make it commensurate with the monetary union" and "to identify possible steps to reach this end".

1.1 Franco-German proposals

On 24 November 2011 the German Chancellor, Angela Merkel, the French President, Nicolas Sarkozy, and the Italian Prime Minister, Mario Monti, met in Strasbourg to discuss the future of the Eurozone and a possible fiscal union. They agreed that everything possible had to be done to strengthen the Euro. On 5 December 2011 France and Germany set out in a letter to the European Council President, Herman Van Rompuy, joint proposals for Treaty changes to address the Eurozone crisis, ahead of the European Council summit on 8-9 December 2011. The Franco-German letter contained the following proposals:

- Private sector bondholders would not in future be asked to bear some of the losses in a future debt restructuring - Greece was a one-off exception;

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1 The Lisbon Treaty entered into force on 1 December 2009.

2 The SGP is "a rule-based framework for the coordination of national fiscal policies in the economic and monetary union (EMU). It was established to safeguard sound public finances, an important requirement for EMU to function properly. The Pact consists of a preventive and a dissuasive arm", Commission Economic and Financial Affairs website. See also Commission summaries of legislation.

3 COM(2011) 821 final

4 COM(2011) 819 final. On 21 February 2012 the Council agreed a general approach on these proposals, allowing the Danish presidency to start negotiations with the EP. ECOFIN concluded "The aim is to adopt the regulations in first reading, before the end of the Danish presidency". ECOFIN press release, 21 February 012

5 Six-pack measures are: regulation amending regulation 1466/97 on surveillance of Member States' budgetary and economic policies; regulation amending regulation 1467/97 on EU's excessive deficit procedure; regulation on enforcement of budgetary surveillance in euro area; regulation on prevention and correction of macroeconomic imbalances; regulation on enforcement measures to correct excessive macroeconomic imbalances in euro area; directive on requirements for Member States' budgetary frameworks.

- Treaty change for all 27 EU Member States was preferable but failing this, they would accept a treaty for the 17 Eurozone Members alone;
- The treaty amendment would include automatic sanctions for Member States that breached the rule on deficits below 3% of gross domestic product;
- Balanced budgets would be enforced via a 'golden rule' to be written into the laws or constitutions of all 17 Eurozone States and verified by the European Court of Justice, although the Court would not have direct powers of sanction over national budgets;
- Germany also wanted to amend current Article 126 of the Treaty on the Functioning of the European Union (TFEU), which requires the Commission to monitor Member States' deficit and debt, so that Commission recommendations would apply unless there was a qualified majority of Member States against.[6]

1.2 Interim Report on strengthening EMU

The October 2011 European Council had given Herman Van Rompuy a mandate to examine, in close cooperation with the Commission President and the Eurogroup President, how the EU could strengthen economic and monetary union (EMU). On 6 December 2011, ahead of the European Council summit, Van Rompuy sent EU government leaders an Interim Report on strengthening economic union, setting out options and a possible two-step approach to Treaty change. Van Rompuy's suggestions included a consideration of the Franco-German proposals but he also made arguments and proposals which conflicted with them.

Based largely on the interim report, by the time of the December 2011 European Council, there appeared to be five possible options for implementing measures on good economic governance in the Eurozone:

- Full EU Treaty amendment based on Article 48 TEU and entailing both a Convention and an IGC, requiring possibly lengthy negotiations and ratification in all 27 Member States;
- Implementing much of what was required through secondary legislation within the existing Treaty framework;
- The 17 Eurozone States (+ non-Euro States) forming their own agreement, with the EU institutions (according to the Franco-German letter) playing "an important role"; this kind of 'enhanced cooperation' would have to be agreed by all Member States;
- The 17 Eurozone States (+ non-Euro States) forming their own agreement, without using the EU institutional mechanisms; but legal and political difficulties in separating existing EMU arrangements which use EU institutions from new ones which do not.
- Amending Protocol 12 to the *Treaty on the Functioning of the European Union* (TFEU) on the Excessive Deficit Procedure,[7] using a *passerelle* procedure under

6 Summary based on *Financial Times* blog on the Eurozone crisis 5 December 2011
7 See Cm 7310, Consolidated Texts of the EU Treaties as Amended by the Treaty of Lisbon, pp 278-9

> Article 126(14) TFEU.[8] Under the Protocol the Eurozone could oblige Member States to reach and maintain a balanced budget over the economic cycle, introduce the 'golden rule', provide for the jurisdiction of the Court of Justice over the transposition and for an automatic correction mechanism in case of deviation. This would require unanimity in the Council on a proposal from the Commission, after consulting the EP and European Central Bank (ECB), but it would not require full national ratification, so might avoid the uncertainties of national referendums.[9] In the UK primary legislation would be needed to authorise use of the *passerelle* to amend Protocol 12.

The European Commission favoured the narrowest possible Treaty change and Olli Rehn, the EU Economic Affairs Commissioner, said the vast majority of economic measures needed to reinforce the Eurozone could be implemented, like the six-pack, by EU secondary legislation (i.e. directives, regulations, decisions). Commission officials thought only two measures - the balanced budget rule and making sanctions easier to impose by changing the voting system - would need to be in the proposed new text.[10] Herman Van Rompuy had indicated before the December summit a preference for amending Protocol 12. The German Government was not in favour of this and wanted a full Treaty change.

2 The December 2011 European Council

Before the European Council meeting on 9 December 2011, the UK Prime Minister, David Cameron, said that he wanted to be constructive at the negotiations but that he would have some "modest demands" to make. Both David Cameron and the Minister for Europe, David Lidington, talked about ensuring safeguards, protecting the single market and the UK's national interests, in particular its financial services industry. Neither would divulge details about the Government's strategy. David Lidington said in a Westminster Hall debate on 8 December (c 193WH):

> I am not going to go into detail about the Prime Minister's negotiating position. The only people who would benefit—indeed, who would be delighted—by a full disclosure of the Prime Minister's negotiating tactics would be the Governments of other countries represented around the table, who might not necessarily share identical negotiating objectives to us.

The European Movement UK criticised the Government's 'strategy' leading up to the December European Council summit:

> The Prime Minister went into the Summit with a wish-list, which was closely guarded and remained secret from his EU partners until the 11th hour. Here lies the first failure in the Prime Minister's strategy. By keeping the content of his proposals from his EU partners he did not allow time for him to make his case and win allies. The other member states were, understandably, unwilling

8 A passerelle clause in the EU Treaty allows the European Council to unanimously decide to replace unanimous voting in the Council with qualified majority voting (QMV) in specified areas with the consent of the European Parliament, and to move from a special legislative procedure (unanimity) to the ordinary legislative procedure (QMV).

9 See Reuters, 8 December 2011, "Factbox: How do you change a treaty?" for a useful overview of treaty ratification methods in the Member States

10 EUObserver, 13 December 2011

> to make a commitment when they had not had time to consider the implications. When the British demands were presented it was far too late.[11]

William Hague told the Foreign Affairs Committee that at the time of the December European Council "Almost all Member States preferred, in principle at least, to amend the Treaties rather than develop an inter-governmental agreement". Giving evidence to the Foreign Affairs Committee on 8 March 2012, Hague also implied that the UK's intentions had not been as secret as some believed. The Prime Minister had met the French President, Nicolas Sarkozy, a week before the European Council and had talked to Sarkozy and Chancellor Merkel of Germany about the UK's position just before the summit. There had been visits and calls, and "many conversations were held". However, he also emphasised that specific proposals from the Council had been circulated too late for the Government to respond in any detail.

2.1 The UK Government demands safeguards

The Prime Minister had made clear that he would veto any EU or intergovernmental arrangements he did not like. On 7 December 2011, setting out his aims for the forthcoming European Council summit, he was confident that even if the Eurozone Members decided to press ahead on their own, the UK Government would be in a position to exact conditions for allowing them to use the EU institutions to implement and police an agreement:

> ... there is the option of a treaty at 27, where we have the ability to say yes or no and as a result get a price for that, but there is also always the possibility that the eurozone members at 17 will go ahead and form a treaty of their own. Again, we have some leverage in that situation, because they need the use of EU institutions, but we should recognise exactly what our leverage is and make the most of it.[12]

Broadly speaking, the Prime Minister went to the European Council on 9 December believing the UK had allies, confident of being able to wield a veto as leverage to secure a UK-favourable outcome, which would also allow the Eurozone States to sort out their economic problems. At the European Council David Cameron made proposals which he deemed "modest, reasonable and relevant",[13] and which he maintained would protect the interests of the City of London and the UK as a whole. Perhaps the Government was over-reliant on its leverage potential in the context of a near unanimous preference for Treaty change. They blamed the French Government for blocking the guarantees the UK sought (FCO Minister, Lord Howell, said: "Unfortunately, one of the leading voices at the December meeting-namely, the French leadership-made it absolutely clear that there would be no acceptance of the safeguards ... the Prime Minister was seeking").[14] Nicolas Sarkozy had said of the UK protocol: "in order to accept treaty revision among the 27 EU states, David Cameron asked us—something we all judged unacceptable—for a protocol to be inserted into the treaty granting the United Kingdom a certain number of exonerations on financial services regulations ... We could not accept this, since we consider, quite on the contrary, that a part of the world's woes stem from the deregulation of the financial sector".[15]

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11 Evidence to the ESC January 2012
12 HC Deb 7 December 2012 c 298
13 HC Deb 12 December 2011, c 537
14 HL Deb 10 January 2012 c 7
15 *Financial Times*, 10 December 2011

The Government did not publish its proposed protocol at the time, but in a letter to the Foreign Affairs Committee in February 2012, William Hague outlined the matters on which he, the Prime Minister, the Deputy Prime Minister and the Chancellor had all agreed that they wanted assurances. In short, they wanted:

- a Treaty protocol requiring any transfer of competence from national to EU financial services regulatory bodies, any 'user charges' in financial services regulation, and any ceiling on capital requirements to require a unanimous vote (the term 'user charges' is intended to cover any possible variant of a financial transactions tax).

- the current EU regulator, the European Banking Authority, to retain its existing functions and remain in London

- financial institutions from outside the EU conducting business in one Member State to fall under the supervision of national, rather than EU, regulatory arrangements

- the ECB's location policy, that requires clearing houses that deal in significant volumes of euro-denominated transactions to be located within the euro-area, to be scrapped (contesting this policy, the UK Government launched legal proceedings against the ECB in September 2011, arguing that it contravened the principles of free movement of services and capital across the union).

The Commons European Scrutiny Committee criticised the Government for not informing the Committee of its concerns and its demands earlier, and the House of Lords EU Committee also found it "unacceptable that the Government have not released appropriate details of the safeguards which the Prime Minister sought at the December European Council. This makes it impossible to form a balanced judgement about the outcome".[16] It was not until David Lidington appeared before the Committee on 23 February 2012 that these were finally clarified in detail, following "collective discussion" among Government ministers:

> ... we wanted to see a general provision in the text of any amendment to the Lisbon Treaty that would, in terms, safeguard the integrity of the single market. We also asked for a number of more specific things in respect of the single market in financial services. Our reasons for so doing were that there is a clear relationship between aspects of financial services regulation, in particular banking regulation, and fiscal policy. The purpose of the proposed Treaty amendments in December was to give greater priority within the European treaties to the objective of securing the fiscal integration of the eurozone. We were also concerned, when we approached the European Council in December, about the fact that there were a number of specific financial services measures that we felt were threatening the integrity of the single market in order to safeguard particular interests of members of the eurozone, the most obvious example of this being the European Central Bank's location rules on clearing houses, which, as the Committee knows, the British Government is challenging before the European Court of Justice as a breach of single market regulations.
>
> When it comes to what specifically was asked on financial services, as the Chancellor has said, there were basically four things that we asked for. We wanted to see the principle of nondiscrimination on the grounds of currency

[16] Lords European Union Committee 25th Report on the Euro area crisis, February 2012

> embedded in the treaties and so governing any future financial services regulation. Secondly, we wanted assurances written into the treaties on the voting procedure for transferring supervisory powers to the European supervisory authorities. Third, we wanted comparable assurances on voting arrangements on financial levies and, fourth, we wanted the freedom for Member States to have domestic stability regimes that went further than European Union minimum standards. That fourth point sprang from our concern that what we had been seeing in the discussions on specific EU regulations was a watering down of the Basel III commitments on banking ratios, which at the time all parties to the Basel negotiations had agreed should be applied internationally.
>
> I would also make clear to the Committee finally, Chairman, that we did not seek a UK-specific opt-out. The safeguards on financial services that we sought in December were, I believe, perfectly reasonable and they were safeguards that would have applied to the single market as a whole and to every Member State of the European Union.

For some the Government's proposals were far from modest or reasonable; they were a step too far, threatening the foundations of the single market itself and possibly a dangerous precedent that could have led to other Member States making demands to protect other areas of economic activity. The European Movement concluded that "Had the Prime Minister allowed time for evaluation, explanation and discussion of these proposals, a mutually acceptable compromise might have been attainable. As it was, a combination of poor timing and excessive demands led to failure".[17] However, William Hague said in a letter to the Foreign Affairs Committee in February 2012[18] that there had been meetings and discussions with EU partners and officials, including the offices of van Rompuy and Barroso, before the December summit. He also described the run-up to the summit as somewhat frantic: "It would be fair to say that most Member States struggled to keep pace with and consider the detail of these various, competing proposals, but they were under pressure, particularly over the night of 8-9 December, to come to a swift conclusion on the prospect of Treaty change".

The Commission believed the UK protocol would pose "a risk to the integrity of the internal market"[19] and the Commission President proposed a compromise amendment, giving an assurance that any measures adopted by the Council and applied to the Eurozone only must not undermine the single market, including financial services. David Cameron rejected this wording.

2.2 Financial services legislation and QMV

The vast majority of EU financial services regulation is made under single market Treaty Articles, where the Ordinary Legislative Procedure (OLP or co-decision) using QMV is the norm. The exception to this is the proposed financial transaction tax (FTT), because as a taxation measure, it has remained subject to unanimity. Although FS legislation has been subject to QMV in the Council, the UK appears not to have been out-voted in this area. Views vary as to the UK's ability to muster a blocking minority on financial services matters. An Economist Bagehot blog on 9 December 2011 maintained "when it comes to financial services there have hardly ever been any cases of Britain being outvoted in the adoption of such legislation". Chuka Umunna, Shadow Secretary of State for Business, Innovation &

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17 Evidence to the ESC January 2012
18 See also Foreign Affairs Committee letter to the Foreign Secretary 17 January 2012
19 José Manuel Barroso to EP, 13 December 2011

Skills, said in a letter to the Secretary of State, Vince Cable, on 11 December that "the Government has never lost a QMV vote on financial services regulation since the formation of the Single Market in 1986". The *Guardian Wintour and Watt blog* on 9 December noted: "Britain is always nervous in negotiations on EU financial regulations because these are decided by the system of Qualified Majority Voting in which no country has a veto. Until now Britain has managed to assemble a "blocking minority" of like minded countries, such as the Netherlands, Sweden and Finland, to resist protectionist measures championed by France".

Perhaps the Government was trying to safeguard the UK's future position, when transitional voting arrangements end and post-2014 changes to weighted Council votes will make mustering a blocking minority more difficult. An *Open Europe* report in December 2011, Continental Shift: Safeguarding the UK's financial trade in a changing Europe,[20] commented that "the UK and other non-euro countries will never be able to form a blocking minority if the eurozone votes as a caucus", and illustrates how the UK could be outvoted by a Eurozone caucus.[21]

2.3 The Fiscal Compact

When it became clear that a unanimous agreement of the European Council would not be reached, Herman Van Rompuy abandoned any decision that required unanimity. This left no alternative, he lamented, but the inter-governmental route:

> An intergovernmental treaty was not my first preference, nor that of most Member States. However, it will make the fiscal compact binding. It must be negotiated as a matter of urgency. It will not be easy, also legally speaking. I count on everybody to be constructive, bearing in mind what is at stake. Our aim is to strengthen both fiscal discipline and economic coordination, going beyond what we have already achieved in the 'six-pack'.[22]

On 9 December 2011 26 Member States - all the Eurozone States and nine of the ten non-euro States - agreed the Fiscal Compact. The leaders of Hungary, Denmark, Sweden and Czech Republic indicated that they might have problems ratifying a binding agreement incorporating the Compact. Van Rompuy expressed his disappointment in the UK deciding not to participate, but indicated that the door would remain open for the UK to join.[23] Commentators noted that it would not be the first time that some EU States had acted by agreement among themselves: this was also the case with the Schengen Agreement on border controls, with the Prüm treaty on police cooperation and with implementation of the single currency.

The Fiscal Compact requirements are set out in full in the Statement by the Euro Area Heads of State or Government of 9 December 2011. It contained the following key elements:

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[20] By Stephen Booth, Christopher Howarth, Mats Persson, Vincenzo Scarpetta

[21] The European Scrutiny Committee also looked at the adoption of FS legislation in a Report in February 2011 on the Draft Directive amending Directives 2003/71/EC and 2009/138/EC in respect of the powers of the European Insurance and Occupational Pensions Authority and the European Securities and Markets Authority, noting the Lisbon Treaty changes to the comitology procedure with regard to the adoption of the details of FS legislation.

[22] EP Plenary, 13 December 2011

[23] See EurActiv, 14 December 2011: Van Rompuy is reported to have said "At some stage, we will be 27 around the table and will be able to hammer out something which we were unable to agree on just a few days ago".

- Eurozone States would introduce into their law or constitutions the requirement that the annual structural deficit does not exceed 0.5% of nominal GDP;

- Member States which breach a 3% deficit limit will face automatic sanctions at EU level (this is what happens under legislation adopted on 4 October 2011 - the Regulation on enforcement measures to correct excessive macroeconomic imbalances in the euro area), unless they can muster a blocking qualified majority in the Council

- The European Commission will look at national budgets and may make demands for action.

- The desired entry into force of the European Stability Mechanism (ESM) would be brought forward from mid-2013 to July 2012, once Member States representing 90% of the capital commitments have ratified the Treaty change;

- EU Member States would pay an extra €200 billion into the International Monetary Fund (IMF) to part-finance future bail-outs. Germany said it would transfer €45 billion to the IMF only if Member States outside the Eurozone join the operation and if the Bundestag approves it. The UK Government said it would define its contribution to reinforcing IMF resources early in 2012 in the framework of the G20;

- The European Council President, in cooperation with the President of the Commission and the President of the Eurogroup, would publish a report by March 2012 on the issuing of common Eurozone bonds in the longer term;

- Eurozone summits would be held at least twice a year.

Germany vetoed two further proposals: one to allow the ESM and European Financial Stability Facility (EFSF) to exist together after 2012 with a joint lending power of €940 billion; and another to allow the ECB to print money to underwrite ESM and EFSF debt.[24]

After the December summit, the German Chancellor, Angela Merkel, floated the idea of putting both the Fiscal Compact and the ESM into one single document. The French Government was opposed to this idea because the ESM Treaty is for the 17 Eurozone members only and provides an institutional role for the EU, while the Fiscal Compact would be open to all EU Member States but as an intergovernmental treaty rather than an EU treaty, could not legally use the EU institutions in the same way. This latter issue was to become one of the most contentious as drafting began on the new treaty to implement the Fiscal Compact.

Reaction to the European Council outcome was, predictably, mixed: while some (UK) commentators congratulated the Prime Minister for standing up for UK interests, others blamed David Cameron for obstructing the EU's attempts to resolve the Eurozone crisis, regretted the more complicated inter-governmental route, and envisaged a further step towards UK isolation in Europe. Allister Heath, the editor of *City A.M.*, welcomed the veto, believing it marked "the day the UK started a long journey towards a more global, more prosperous place in the world, increasingly detached from a declining and ever more closely centralised and undemocratic Europe".[25] Heath suggested that, with the continuing

[24] For further information on the ESM and EFSF, see Standard Note 5973 The European Financial Stabilisation Mechanism (EFSM) 20 May 2011
[25] *City AM*, 12 December 2011

emergence of markets in Latin America, the Middle East and Asia, trade links with Europe were becoming increasingly overvalued, and that many EU-based regulations were damaging to the UK's competitiveness. Alistair Macdonald and Nicholas Winning thought the UK veto might damage the UK's future negotiating abilities and reported that, according to several EU diplomats, David Cameron had "played into the hands of Sarkozy, who had been keen to blunt the UK's ability to influence events, not least in financial regulation".[26]

Dr Michael Geary[27] and Kevin Lees,[28] writing in the EUObserver on 12 December 2011, thought the outcome was long overdue, commenting that the European Council had "finalised many of the 'leftovers' from the Maastricht Treaty" of 20 years earlier, when the then European Community had decided that fiscal sovereignty would remain with national governments.

> Anglo-Saxons had argued that a single currency would never work without the fiscal and tax authority of a single state. Even if their skepticism now seems wise in retrospect, they nonetheless failed at the time to prevent its creation. So at last week's summit, staring down the possibility of a continent-wide sovereign debt crisis, the majority of EU leaders agreed to greater convergence in their economic and fiscal policies, all of which implies a significant loss of national sovereignty.

The authors also thought Cameron's veto was an attempt to "quell the backbench revolt without forcing him to hold a referendum on membership, the result of which would almost certainly lead to a serious rupture". The UK veto was therefore "a much more statesman-like option than allowing the Eurosceptics to open the Pandora's box of a referendum". The UK veto, they believed, was inevitable, given the history of the UK's relations with the EU. Paul Yowell[29] agreed that the veto arose from a concern that the Government might have been forced to hold a referendum on the new treaty under the *European Union Act 2011*, which "might well have ended in an embarrassing defeat for Cameron, given the public's Eurosceptic mood". This led the author to further speculation about the possible effect of the EU Act on the UK's involvement in EU treaty negotiations:

> [...] Whatever the accuracy of the above speculations about British national interests and Cameron's motive for the veto, they serve to highlight a potential negative consequence of the EU Act 2011 raised during scrutiny by the House of Lords. Several Lords pointed out that the bill would tie British hands in treaty negotiations. [...] The EU Act 2011, for better or worse, limits the power of leaders and diplomats in such a situation to make decisions and the promises that may be needed to secure concessions, and delegates authority to the people acting through a referendum.[30]

Rafael Behr, Chief Political Commentator for the *New Statesman*, argued that the UK veto had left the UK marginalised in Europe, preventing the UK from having an influence on the shape of the single market.[31] Andrew Rawnsley, political editor of the *Guardian*, thought the veto had gained the UK nothing, suggesting that the Prime Minister had been so easily 'marooned' in a minority of one because the earlier Conservative decision to take the

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26 *Wall Street Journal*, 10 December 2011
27 Lecturer in the History of European Integration at Maastricht University
28 Associate with Latham and Watkins LLP
29 Lecturer in law at New College, Oxford.
30 UK Constitutional Law Group blog, 19 January 2012
31 *New Statesman*, 'We're heading for the exit but this is no sceptic's fantasy', 30 January 2012

Conservatives out of the EPP group had already marginalised the UK and excluded him from crucial pre-summit meetings.[32] Simon Jenkins, writing in the *Guardian*, thought David Cameron had "performed Europe a good deed" in vetoing the fiscal compact, which he thought would "trigger a series of probably disastrous national referendums"[33] (implying it would not come into force in any case). In his view, the Prime Minister "was right to plead the cause of the simpler disciplines of the single market against the baroque authoritarianism of the Franco-German treaty".

2.4 UK views on the Fiscal Compact

Government statement

In a statement to the House on the European Council summit on 12 December, David Cameron defended his position at the European Council, insisting he had responded to the Franco-German based proposal for Treaty change to implement the fiscal compact "in good faith"; that he had not sought "to create an unfair advantage for Britain," or an opt-out, or a special exemption or an emergency brake on financial services legislation, but had sought a "level playing field for open competition for financial services companies in all EU countries, with arrangements that would enable every EU member state to regulate its financial sector properly". He insisted his aim was to safeguard the single market:

> Those who say that this proposed treaty change was all about safeguarding the eurozone, and so Britain should not have tried to interfere or to insist on safeguards, are fundamentally wrong as well. The EU treaty is the treaty of those outside the euro as much as it is for those inside the euro, so creating a new eurozone treaty within the existing EU treaty without proper safeguards would have changed the EU for us, too. It would not just have meant a whole new bureaucracy, with rules and competences for the eurozone countries being incorporated directly into the EU treaty; it would have changed the nature of the EU—strengthening the eurozone without balancing measures to strengthen the single market.[34]

Cameron conceded that the intergovernmental arrangement was not "without risk", but insisted that the Government "did not want to see that imbalance hard-wired into the treaty without proper safeguards" (c 521), and that no treaty was better than a treaty with no safeguards. In his view the UK veto did not change Britain's relationship with the EU and membership of the EU was "vital to our national interest", but he believed in "an EU with the flexibility of a network, not the rigidity of a bloc". He went on to outline some of the issues that would arise as a result of the proposed intergovernmental treaty, including the use of the EU institutions. The Government would "be vigorously engaged in the debate about how institutions built for 27 should continue to operate fairly for all member states, Britain included" and would "look constructively at any proposals with an open mind" (c 521). He did not claim to have achieved a safeguard in the UK's interest through his veto of an EU treaty, but to have stopped "a treaty without safeguards".[35]

Parliamentary debate

The debate after the statement was lively and polarised between those who championed 'standing up to Europe' and those who lamented isolating the UK in Europe. Noting the

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32 *Guardian*, 'Now it's a Three Speed Europe. And We're Left on the Hard Shoulder', 11 December 2011
33 *Guardian*, 'Europe's hopeless last stand in defence of the single currency', 13 December 2011
34 HC Deb 12 December 2011 c 520
35 Ibid

absence of the Deputy Prime Minister, Nick Clegg, from the Chamber, the Leader of the Opposition, Ed Miliband, said the Prime Minister had "given up our seat at the table; ... exposed, not protected, British business; and ... come back with a bad deal for Britain" (c 522). He argued that the Eurozone crisis had not been resolved as a result of his action, that the Court of Justice *could* be given jurisdiction over the new agreement under Article 273 TFEU, that it was unlikely that the 26 Member States would use institutions other than the existing EU ones, and that the Government would be cut off from information on progress being made under the new agreement. He also questioned the Government's motive of safeguarding the UK financial services industry from EU regulation, stating "he has been unable to point to a single proposal in the proposed treaty that would entail the alleged destruction of the City of London" (c 523). He accused the Prime Minister of losing the fight and of losing potential allies in the Council (the Swedes, the Dutch and the Poles). In his view the PM had acted as he did "because he could not deliver it through his party. He responded to the biggest rebellion of his party in Europe in a generation by making the biggest mistake of Britain in Europe for a generation" (c 524). Miliband concluded: "We will rue the day this Prime Minister left Britain alone, without allies, without influence. It is bad for business, it is bad for jobs, it is bad for Britain" (c 525).

John Redwood was one of many Conservative backbenchers who congratulated David Cameron on his statesmanship, while the Prime Minister was also supported by a few Labour eurosceptics (e.g. Austin Mitchell and Kate Hoey). Bernard Jenkin said David Cameron had "the support not only of the Conservative party but of the British people" (c 532). Andrew Rosindell thanked him "for displaying the bulldog spirit in Brussels" (c 533) and for Jacob Rees-Mogg he was "the pilot who weathered the storm", because he had "stood up for democracy, ... free trade and ... free markets" (c 536).

Several MPs were worried about the diplomatic damage the UK veto might have caused, expressing fears about UK isolation and EU caucusing. Denis MacShane, the former Labour Europe Minister, suggested that the UK was now viewed throughout the world as having committed a "diplomatic catastrophe" (c 528). Nigel Dodds (DUP) asked what would happen now with regard to financial services legislation, since the Government had not succeeded in removing QMV and the UK could still be outvoted by "perhaps a vindictive Europe" (c 529). He asked the Prime Minister to set out how he would "change the fundamental nature of the relationship that we currently have towards one based on co-operation and free trade and away from ever-closer political union". David Cameron replied that he had long thought the balance of powers between Britain and Europe was not right, and wanted to repatriate some powers, but (c 530) "No one quite knows where this new organisation outside the European treaties will go, what powers it will seek and how it will act. Neither does anyone know exactly how the eurozone will develop".

The Prime Minister would not be drawn into a discussion of coalition government splits, noting on more than one occasion that it was natural for members of a coalition to differ in some policy areas, and also that he and the Deputy Prime Minister had agreed the negotiating strategy for the European Council beforehand (c 544).

On 13 December, in an Opposition Day debate on a motion put forward by the DUP commending the Prime Minister's veto, the Shadow Foreign Secretary, Douglas Alexander, maintained that David Cameron's isolation was "a sign of weakness not of strength" and that

Britain was now "more isolated than at any point in the 35 years of British membership of Europe".[36]

The Chair of the European Scrutiny Committee, Bill Cash, tried to find out from David Lidington whether the UK Government had been given legal advice that the EU institutions could be used to implement the Fiscal Compact.[37] David Lidington reminded the Chair that governments do not comment on legal advice that Ministers may or may not have received (c. 720). Mr Cash pursued the matter of the proposed use of the EU's institutions, "this spurious method that people are trying to stitch together to give the measure some degree of authority".[38] He insisted that any change to the deployment of the EU institutions would require a Treaty change, which would have to be agreed unanimously by all Member States.

The Government has maintained that its position before and at the December European Council had been endorsed by the Deputy Prime Minister, Nick Clegg, although some concluded from Mr Clegg's absence from the Prime Minister's statement on 12 December 2011 that they disagreed over the veto. Nick Clegg appeared to support the use of the EU institutions when he said on the BBC's Andrew Marr Show on 11 December 2011 that it would "clearly be ludicrous for the 26 ... to completely reinvent or recreate a whole panoply of institutions". He told *The Guardian* in mid-December that it was "very significant" that the Government had agreed to co-operate with the EU by allowing Eurozone countries to use the EU institutions to enforce the fiscal agreement,[39] and that the Government had "taken some very big steps to re-engage, get back in the saddle and get back into the mainstream of the debate".[40] By early January 2012 Nick Clegg appeared confident that the proposed Treaty change was so small that the UK would in time be minded to ratify it. He told the press after a meeting of Liberal politicians on 9 January that the LDs thought the new treaty should over time be merged into the existing EU Treaties, and that the current separate arrangement was temporary. He also noted that the new agreement should be about fiscal reforms only and not affect the single market.

Devolved legislatures

Scotland

Following the European Council, the *Guardian* reported on 21 December that Scotland's First Minister, Alex Salmond, and the Welsh First Minister, Carwyn Jones, wrote to David Cameron asking him to explain why he had vetoed the proposed EU Treaty changes, and asked him to attend an "urgent" meeting of the devolved governments to explain why they had not been consulted. According to the *BBC News* on 12 December 2012, in his letter, Mr Salmond demanded answers to "crucial questions" on the veto decision, including:

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36 HC Deb, 13 December 2011, c 718

37 HC Deb 13 December 2011 c 720. During a later debate in the House of Lords (see below), it transpired that the Prime Minister had taken the advice of Lord Brittan of Spennithorne (a former European Commissioner and Home Secretary) not to veto the use of EU institutions.

38 Ibid c 738

39 The Government says it did not agree to the use of the EU institutions. David Lidington told the ESC on 23 February 2012 that it had not been asked to give its consent and it had not volunteered it. Yet press reports and headlines such as "Britain officially drops opposition over use of European Union courts to enforce fiscal pact, says William Hague", *Daily Telegraph*, 30 January 2012, suggested the Government had formally agreed to their use.

40 *The Guardian* 16 December 2011

- what risk assessment, if any, did the UK government undertake of the impact of its veto decision on investment into Scotland and the UK and on negotiations affecting key Scottish industries
- what assessment, if any, was made of how Scotland's interests will be affected in the EU by being represented by a UK government that is excluded from important decision-making meetings
- and why were the Scottish Government and other devolved administrations not consulted on the use of a veto

Speaking on BBC Radio's *Today Programme* on 14 December 2011, Alex Salmond thought the UK veto would make it harder for Scotland to "obtain the support of the countries we need to fend off regulation which would be disastrous for the Scottish fishing industry".

Wales

In an interview for *EurActiv* on 26 January 2012 Carwyn Jones said he agreed with the substance of the UK veto but thought the Prime Minister had got the "mood music" wrong. He distanced himself from Cameron's euroscepticism and thought it was clear that "the usual work that would be done in advance of a meeting such as this wasn't done", leaving the UK isolated – a "failure of diplomacy", which lay more with the Government than with UK representatives in Brussels, for whom he had "great respect". He thought the Government needed to work to "win friends again" and to "to ensure that the UK is seen as a full and committed" EU Member, and to dispel any impression that in December the UK had been "awkward for the sake of it".

Northern Ireland

Alex Attwood, the SDLP Environment Minister, said the UK veto "could have major implications for the relationship between the devolved administrations and their European neighbours".[41] He was reported to have asked the Northern Ireland First Minister, Peter Robinson, and Deputy First Minister, Martin McGuinness, to challenge the veto, even though the Stormont Executive has no powers in foreign policy matters, in view of the "particularly negative implications" for Northern Ireland's trading relations with the Republic of Ireland.

3 The January 2012 European Council

3.1 Agreement on the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (TSCG)

On 30 January 2012 25 EU Member States agreed the final text of the TSCG. The UK and the Czech Republic did not agree to it, the Czech Prime Minister Petr Nečas saying that there could be ratification difficulties at the present time. There is a more detailed summary of the TSCG in **Appendix II** of this paper. Briefly, it contains the following key requirements:

- National budgets must be in balance or in surplus, which will be achieved if the annual structural deficit does not exceed 0.5% of nominal GDP.
- If a Member State deviates from this rule, an automatic correction mechanism will be triggered.

[41] *Belfast Telegraph* 11 December 2011

- Within a year from the Treaty entering into force, the Contracting Parties will have to incorporate the balanced budget rule into their national legal systems, preferably at constitutional level.
- If a Contracting Party fails to do this on time, the European Court of Justice will have jurisdiction to make a binding decision on the matter and may impose a fine of up to 0.1% of GDP on the State(s) in question.
- Contracting Parties must report their public debt issuance plans to the European Commission and the Council;
- Contracting Parties must support the Commission's decision when it considers there is a breach of the debt criterion, except when there is a qualified majority of States against the decision.
- Eurozone States will meet at least twice a year and will elect a president of the summit. Meeting reports will be presented to the EP and the EP President may be invited to be heard at the summits.

3.2 UK Government and parliamentary views

When David Cameron reported to the House on the informal European Council on 31 January 2012, he appeared to take a more pragmatic approach to the new treaty, in particular the matter of an EU institutional role in upholding it. He made clear that the Government wanted the Eurozone to sort out its problems, and did not want to stop this from happening, but upheld the Government's intention to challenge any misuse of the EU institutions with legal action.[42] He later conceded that the EU institutions did have some role to play, even in this non-EU treaty: "Clearly, there are uses for the institutions they have set out in this treaty, some of which are legal under existing EU law and some of which are highly questionable" (ibid c 683). He also reiterated his intention to act if the treaty encroached on single market matters: "we want those institutions to sort out the problems of the European Union, and we want them to stick to fiscal union and not go into single market issues. If they were to go into single market issues and threaten Britain's national interests, of course we would act" (c 691). Mr Cameron outlined how the veto was a better option for the UK than an "opt-out" (c 691):

> There is a very important difference. Let us consider what happened with Maastricht, for instance. There was a European Union treaty to which Britain was a full signatory. We opted out of certain parts of it, but we were still subject to a huge amount of additional EU law. That is why there were so many agonised debates in the House about whether it was a good thing or a bad thing. The same can be said of all EU treaties. The difference in this case is that there is no EU treaty. We are not going to put something in front of the House, and nothing will be voted on, so it will not affect the UK.

The House of Lords debated developments in the EU on 16 February 2012, just after the publication of the European Union Committee report on the Eurozone crisis. The Foreign Office Minister, Lord Howell, insisted that the new treaty did not affect the UK or undermine EU law or the EU institutions:

> This is a treaty outside the European Union. We are not signing it, we are not ratifying it and it places no obligations on the United Kingdom. It does not have the force of European Union law for us, European Union institutions or even the

[42] HC Deb 31 January 2012 c 678

> countries that have signed it. European Union legislation can be agreed only in the European Union Councils of Ministers, and we are a full member of them. There will be no inner group of European countries distorting the single market from inside the EU treaties. That is the protection that the Prime Minister secured in December, and that protection remains.[43]

Furthermore, in case anyone had been thinking the Government had turned a blind eye to the use of the institutions confirmed in the final version of the treaty, Lord Howell said that the legal implications of using them were "complicated and hinge upon how the agreement is implemented. It is for this reason that we have reserved our position" (ibid) and the Government would watch closely the implementation of the treaty and "take action if our national interests are threatened" (c 937). He spelt out four areas where the Government thought involvement might damage the single market and UK national interests (c 941):

> First, we were concerned about the voting powers on financial levies; secondly, we were concerned when we sought assurances, including on the voting procedure for handing powers to European adviser agencies; thirdly, we were concerned about the freedom that member states had to wreck their own financial stability regimes. I believe that we also sought a fourth assurance. None of those assurances was forthcoming.

The Labour Peer, Lord Davidson of Glen Clova, was sceptical about the Government's claims that the UK treaty veto would protect the UK's financial institutions (c 942) and described the veto as a "foreign policy failure" (c 944). The former Chancellor, Lord Lamont, was somewhat underwhelmed by the veto ("I did not regard the veto itself as a seismic event") and by the summit outcome, which he found "extremely disappointing", although he favoured the inter-governmental treaty over an EU one (c 951):

> On balance, it seems to me preferable to have an intergovernmental treaty outside the main EU treaties because it lessens the read-across from the treaty to the single market and to the issues raised by financial regulation. It is true that, of course, a regime for financial regulation has already been agreed but it was agreed in different circumstances where there was a different relationship to the rest of the EU from that which there is now, when there is to be a fiscal union within the EU. That seems to me to raise profound issues for a pan-EU regulatory system.

The former Labour minister and EU Trade Commissioner, Lord Mandelson, welcomed the Government's "more emollient approach" (c 954) in not vetoing the use of the institutions. However, he warned against lack of engagement with Europe and of difficulties to come (c 955):

> The steps that the eurozone will have to contemplate and prepare for, politically and institutionally, will make the current negotiations over the fiscal treaty look like a casual walk in the park. It will be no good saying, "We are not in it, so it does not concern us and we needn't bother". For Britain, that is not an option. The Government will find themselves in a substantial dilemma.

Lord Brittan wished the UK had joined the agreement and claimed that no one had "been able to explain convincingly - to me, in any event - what that agreement, if we had signed up to it, would have forced us to do that we do not want to do or what it would have prevented us from doing that we do want to do" (c 968). Lords Radice and Kerr shared this view, the

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[43] HL Deb 16 February 2012 c 936

latter stating that having read all the drafts he could "not understand at all why we could not sign up to it. It contains no provisions that could damage UK interests" (c 990). Lord Hannay of Chiswick too could not see what was "objectionable" to the UK (c 1007). Lord Hannay remained unconvinced by the Government's four objections to the treaty, because they did not, in his view, relate to the text of the treaty, but to the (unseen) UK protocol (c 1007). He hoped that when the treaty entered into force, the Government would "give serious and constructive consideration" to joining it under the provisions of Article 16 (c 1008).

There was also some strong opposition to the treaty and praise for the Government's rejection of it, not least from Lord Flight, who described the Fiscal Compact as a "framework and enforcement machinery for brutal and self-defeating internal devaluation measures, where the economies in trouble need growth and not to be ground into the dirt"(c 975).

The Foreign Secretary's letter to the Chair of the Commons Foreign Affairs Committee in February 2012 emphasised the involvement of Government ministers in discussions on further fiscal and economic integration, both with other EU partners, with Herman van Rompuy's Chief of Staff, Frans van Daele, and among Government departments. The letter revealed the Government's major concern that tighter fiscal integration in the Eurozone would be at the expense of non-Eurozone Member States such as the UK. William Hague noted particular concerns about "financial services and the risks of caucusing by the Member States of the Eurozone". He also made six references to the unified approach taken by members of the coalition Government for the tactics and "broad lines of our approach" before the December European Council, including the content of the proposed UK protocol, leaving open – or to implication - the question of support from the Deputy Prime Minister for the Government's ultimate rejection of the Fiscal Compact when the strategy failed to deliver the UK guarantees.

> "We concluded that allowing the further fiscal and economic integration of the Eurozone Member States within the framework of the existing EU Treaties without proper safeguards would risk changing the EU profoundly, with significant consequences for the UK – strengthening the governance of the euro area but without corresponding balancing guarantees that this integration would not spill over into areas properly the preserve of the 27, such as the Single Market".
>
> William Hague, Letter to FAC, February

On 23 February 2012 David Lidington gave evidence to the European Scrutiny Committee for its report on "Reinforcing the Eurozone". The ESC criticised the Government for not clarifying its position in December 2011 and at the post-European Council negotiations at which it was an observer. Henry Smith reminded the Minister about the Government's commitment to parliamentary scrutiny over EU and EU-related matters. Lidington replied that transparency had to be "weighed against the freedom of Governments to take part in diplomatic exchanges. ... One cannot simply have a running commentary on that kind of conversation" (Q.137).

On 29 February Bill Cash introduced an emergency debate on the fiscal compact treaty under Standing Order No. 24 (on emergency debates, which take place within 24 hours of being granted). The debate differed from the earlier debates in that it was almost as much about the need for more parliamentary scrutiny of important EU developments as it was about the treaty. Several Members emphasised a need for more debate on Europe, not put by the Backbench Business Committee, but on the initiative of the Government. Mr Cash

described the new Treaty as "the triumph of expediency over the law" and pointed on several occasions to EU coercion in the "pursuit of ideology".

At the European Council summit on 1-2 March 2012 the TSCG was formally signed by 25 EU Member States; Herman Van Rompuy was re-elected as European Council President for a second 30-month term; he was also appointed president of the Eurozone, and thus will chair the twice-yearly Eurozone summits established by the TSCG. Nicolas Sarkozy warned that France was unlikely to ratify the new Treaty before the 6 May presidential election. The Socialist presidential candidate, François Hollande, has said that if elected he would seek to renegotiate the Treaty to include intervention from the European Central Bank, the creation of eurobonds and a financial relief fund. He criticised the incorporation of the balanced budget rule into national laws or constitutions, "in effect preventing future governments from exercising expansionary fiscal policies".[44] In an interview published in *Le Monde* on 9 February 2012, Hollande expressed his concerns about the "ambiguous role" of the Court of Justice in the TSCG and the lack of growth initiatives.

4 Issues

4.1 Is the Treaty effective?

While the EU institutions and the majority of Member States celebrated the conclusion of the TSCG at the end of January 2012, many politicians, experts and commentators did not think the treaty would, for practical and political reasons, as well as economic ones, achieve its aim. Questions had already been raised during the negotiation stages about whether it would add anything of substance to the eight recently adopted economic governance measures, or be any more effective than the Stability and Growth Pact. In short, would it really help to resolve the Eurozone crisis?

> "I have never thought that new treaties were likely to be a silver bullet in solving the eurozone crisis ... but there is an economic logic to say that, if you have a single currency, you need to move over a certain time span towards much closer fiscal and economic integration".
>
> David Lidington, 23 February 2012

Political and economic credibility?

David Lidington told the Lords EU Committee on 17 January 2012 that the main justification for the treaty was the German view that getting rules right for the future meant restoring confidence about long-term stability, which in turn would help to secure confidence and recovery in the present. He added, however, that "even on the optimum assessment of what is likely to come out of the intergovernmental negotiations there is still a great deal more that needs to be done in both the short and long terms" (QQ 73 & 74). Giuliani Amato had agreed that in the short-term the Treaty would not be enough, but that it "was and is necessary to restore trust" on the part of Germany; "trust may be the main outcome of this treaty, on which you can build what in the treaty itself is missing" (Q 102). Lord Sassoon, the Commercial Secretary to the Treasury, said in February 2012 that the TSCG was "a necessary but not sufficient part of what we hope to see".[45]

Simon Hix[46] thought the national budgetary discipline rule lacked political credibility.[47] He was not convinced that national electorates, governments or spending ministries would abide by

[44] *EUObserver* 15 December 2011
[45] HL Deb 7 February 2012 c 124
[46] Professor of European and Comparative Politics, LSE.

the rules, noting that "If a national parliament approves a national budget which exceeds this threshold, there will be tremendous pressure on a national court not to strike down the budget as unconstitutional".[48] And even if a national court did so, "it is not clear that this would have the desired aim". He also thought the sanctioning mechanism for exceeding 3% of GDP would have to involve a substantial fine, but that this, if a government were running a deficit, "would be pro-cyclical, and lead to higher deficits in subsequent years". He also pointed out that the sanction would not be automatic, since a reverse QMV could be mustered against it (David Cameron described reverse QMV as "basically a way to impose the will of a group of countries on to others").

> "There was a widespread view amongst our witnesses that [in the short term] the treaty was necessary, but not sufficient; and that the direct impact of the treaty would be more about preventing future crises by hardwiring fiscal rectitude into the system, and not directly resolving the current crisis".
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> House of Lords European Union Committee, 25th Report 2010-12, The Euro Area Crisis, February 2012

Professor Jagjit S. Chadha,[49] looking at all the recent economic and monetary legislation put together, concluded that "The enhanced successor to the Growth and Stability Pact which includes both the European Semester and the Euro Plus Pact and the new 'fiscal compact' does not really address the problems of the Growth and Stability Pact". Roger Bootle, Managing Director of Capital Economics, also thought that attempts so far, including the fiscal compact, fell short of "the action needed to solve the crisis".[50]

Paul Craig thought the correction mechanism had been so weakened throughout the drafting process that the final text, which provides that the debt rules in Article 3(1) must take effect in national law "through provisions of binding force and permanent character, preferably constitutional, *or otherwise guaranteed to be fully respected and adhered to throughout the national budgetary processes*", would mean that "a contracting state can claim that the precepts in Article 3(1) have taken effect in national law even if they are not to be found in any statute or constitutional norm".

Carole Ulmer,[51] writing in *EurActiv* on 7 February 2012, thought the TSCG alone was not enough but was a start:

> It is important that we see this treaty as a first step in convergence, which must be greatly improved. We need to push for a more effective firewall, for a solution to the Greek issue, for the adoption of an employment policy and for the launch of Eurobonds. It is also time to address the issue of the new division of power between the member states and the Union that must come with sharing a common currency. The fundamental consolidation of the eurozone has to become a political objective, as of today."

Professor Karl Whelan[52] told the Oireachtas European Affairs Committee on 2 February 2012 that the Fiscal Compact "does not correspond to mainstream thinking among economists as to how an ideal fiscal policy framework should operate", while Massimiliano Marcellino[53]

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47 Evidence to Commons European Scrutiny Committee January 2012, Reinforcing the Eurozone.
48 Written evidence, European Scrutiny Committee, 4 January 2012
49 University of Kent
50 Evidence to ESC 13 January 2012
51 Carole Ulmer is the Director of Institutional Relations at the think tank Confrontations Europe.
52 University College Dublin
53 Professor of economics at the European University Institute, Florence.

thought it had several shortcomings which "does little to address the most pressing short term problems of the euro area". He questioned whether the Treaty would achieve its own goals, and, looking at each of its key objectives, he did not think it would.[54]

Marcellino concluded that the TSCG does not really improve on the SGP and includes "measures that are either too vague or likely to be ineffective", that it "fails to address the current crisis", and that "without bolder actions to prevent a break-up of the euro area this new Treaty is likely to become redundant".

Is a new treaty really necessary?

Legally, almost everything in the TSCG is either already enshrined in EU law, or could be enacted under existing Treaty provisions. Steve Peers told the Lords EU Committee that it added "very little to the measures already set out in EU law or which have been or could be proposed as part of EU law", but that it "might nonetheless have a useful impact if it encourages Germany or the European Central Bank to take a more active role in saving the euro". David Lidington gave two examples of where the EU Treaties did not currently provide adequate budget rules:

> There is no provision in the European Union treaties to make a balanced budget rule binding in a Member State's national law or subject to the jurisdiction of the European Court of Justice. There is no provision in the existing treaties for an automatic correction mechanism where a Member State deviates from that balanced budget path.

Paul Craig pointed out to the ESC that "the extent of what might be achieved under the existing Treaty rules has not been fully tested", while for Steve Peers, the plethora of economic governance rules was now too complicated to make sense. Peers concluded that "the EU's economic governance rules fail the test of transparency, because of their near-total complexity and unreadability, scattered across a dozen primary, secondary and soft-law sources, with more to come".[55] He found "it is hardly acceptable that the basic rules on the EU's coordination and control of fundamental national economic decisions are essentially unintelligible".

So how will the new treaty be more effective than the Stability and Growth Pact, the 'six-pack' and the 'two-pack' in guaranteeing good economic governance and fiscal discipline in the EU? The answer lies, in the view of many supporters, in the strong political commitment towards saving the euro that Member States, particularly Germany, will make in ratifying the TSCG. David Lidington conceded that the Treaty was "an expression of political will, as much as anything else".[56] However, Desmond Lachman,[57] in an article called "Europe as a major risk to the US economic outlook", 8 March 2012, did not think political will alone would survive the economic strictures of the balanced budget requirements:

> This will involve deficit reduction programs on the order of 3 percentage points a year in both 2012 and 2013 for Ireland, Portugal, and Spain. Attempting to comply with this fiscal compact without the benefit of devaluation to boost exports will produce very deep recessions in these countries. That in turn will

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54 *Eurointelligence* 30 January 2012

55 "Analysis: Draft agreement on reinforced economic union (REU treaty)", Statewatch, 21 December 2011.

56 Evidence to ESC 23 February 2012

57 Resident Fellow American Enterprise Institute

> erode these countries' tax bases and will sap those countries' political will to stay the austerity course.

Furthermore, even if the political will in EU governments holds, public opposition to austerity measures brought in under the TSCG could be damaging.

Some commentators did not think the TSCG would be any more effective than the SGP, and would be flouted as it had been;[58] also, that the provision allowing States to deviate from the rules in "exceptional circumstances" (Article 3(1)(c) TSCG) meant that in fact the rules were not binding. However, Jean Claude Juncker, Luxembourg's Prime Minister and President of the Eurogroup, was confident the TSCG would succeed, in spite of the failings of the SGP, because of the political commitment in giving constitutional status to the debt brake rule. He also rejected claims that the Eurozone will collapse if the TSCG is not ratified by all 25 signatory States and he is convinced that once the ratification process had begun, the political momentum will lead to all the signatory States implementing it.[59]

Failure to ratify

A number of issues arise as a result of the intergovernmental nature of the TSCG. The Treaty will be binding on Eurozone States and on those non-Eurozone States that wish to be bound by it. However, if a Member State does not ratify the treaty because of a negative referendum or parliamentary vote, can the Treaty provisions still be implemented, and how effective will they be if certain Eurozone States cannot ratify?

25 of the 27 Member States signed the Treaty. The Czech Republic decided not to join (even though the Czech Government supported the Fiscal Compact in December 2011) and there may also be ratification problems in Denmark, Finland, Hungary, Ireland and even in France, if François Hollande wins the presidential election. Thus, the TSCG could enter into force in some but not all the signatory States. A *Globaldashboard* commentary warned on 9 December 2011: "expect the core to shrink as the summit's aspirations are chewed up by domestic politics. Each defection will provide a potential trigger for wider breakdown". It is not clear what will happen if fewer than twelve Eurozone States fail to ratify before 1 January 2013.

Undemocratic

Simon Hix thought the Fiscal Compact's lack of democratic legitimacy would detract from its effectiveness: "any decision which has major redistributive consequences requires significant political legitimacy for the decision to be accepted by the net losers of the outcome".[60] The Commission, being an unelected body, did not have a "sufficiently democratic mandate to pass judgement on national budgetary discipline", and "why would the public or a parliament in a Eurozone state accept a majority decision against them by the Eurozone Finance Ministers (such as the imposition of a fine for breaching the 3 per cent budget deficit rule)?" Hix concluded that "From a political point of view ... the plan is neither credible nor legitimate. As a result, I am sceptical that it is workable or sustainable".

Jean-Claude Piris, the former director general of the EU Council Legal Service, who helped draft the Maastricht, Amsterdam, Nice, Constitutional and Lisbon Treaties, emphasised the political determination of Member States to tackle the Eurozone crisis, but did not think the

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58 France and Germany breached the Pact in 2002–03

59 *Tax News* 3 February 2012

60 Written evidence, European Scrutiny Committee, 4 January 2012

TSCG was sufficient. He dismissed it as a "little piece of paper" and "a treaty outside a treaty".[61] Piris's solution lay in the creation of a "temporarily avant-garde" group outside the EU Treaties, and more involvement in the reform process by national parliaments to give it democratic legitimacy. The two-speed structure would work, he thought, because "Europe is committed to austerity".[62]

Anatole Kaletsky, writing in *The Times*,[63] argued that the new treaty was skewed towards Germany's demands for greater austerity and that it would not save the euro from collapse:

> If [German Chancellor, Angela] Merkel succeeds in imposing her present onesided Treaty, and if her demands are taken literally, then the euro will surely collapse. The Treaty as it stands gives Ms Merkel everything she demanded while offering nothing in return. Greece and the other debtors are condemned to endless austerity and German economic colonisation, with no reciprocal benefits, since joint debt guarantees or monetary easing have been ruled out.

Tackling growth and jobs?

Many critics of the TSCG have pointed to the absence of any real commitment to growth and job creation (there are references to growth and employment in the recitals, and Articles 1 and 9 in general terms as EU objectives). An editorial in the *New York Times* on 31 January called "Making it worse in Europe" thought the EU ought to have focussed on increasing the bailout fund, and that the European Council had only "made ritual nods in the direction of more jobs and higher growth, without providing any new money to achieve this". There was particular criticism of the German Government:

> As the European Union's biggest economy, and biggest contributor to the bailout fund, Germany continues to determine the approach in managing the Continent's economic crisis. Others, particularly those needing help paying their bills, have little choice but to go along, whether or not they really believe that German-dictated austerity will help their ailing economies. Many leaders — Prime Minister Mario Monti of Italy, for example — have made clear that they do not.
>
> A leader wiser than Mrs. Merkel would build a stronger European Union by helping her neighbors grow their way out of debt, not squeeze them to the breaking point. A wise leader would also remind German voters that the prosperity of their own export-dependent economy requires sustained demand in neighboring countries.
>
> Poor German leadership in this crisis has exacted an increasing economic and social price from Greece, Ireland, Portugal, Spain, Italy, Belgium and France. The longer Germany insists on putting fiscal austerity ahead of growth, the more likely it becomes that Germany, too, will suffer economic pain.

4.2 The relationship between the new Treaty and the EU Treaties

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61 *EUObserver* 11 January 2012. 10 January 2012, at launch of his book, *The Future of Europe - Towards a Two-Speed EU?*

62 *EUObserver* 11 January 2012

63 "Crises and bailouts are what's best for the euro", 2 February 2012

Legal questions have arisen over the relationship between the TSCG and the EU Treaties, and the exact nature of this relationship remains subject to some legal uncertainty. When it became impossible to conclude an EU treaty, Member States opted for a binding international agreement, rather than mutual personal commitment, as in the Euro Plus Pact.[64] The TSCG was concluded under international law and is therefore not part of the EU's *Acquis Communautaire*,[65] although it clearly aims to uphold the aims of the EU Treaties and EU law.

> "... it is a separate international agreement that deals with how the European Union might act. Although it is said to be an international agreement, it is not an EU treaty and it will not describe itself as such, but the EU runs through it like a golden thread. It is as if the EU has come up against an obstacle in proper legal procedure and just decided to ignore proper legal procedure and go its own way; it has looked at the rulebook, the rulebook was not convenient for it and so it has torn up the rulebook and drawn up a new set of rules".
>
> James Clappison, 29 February 2012

How will an intergovernmental treaty work in practice alongside existing EU frameworks? Is it legally possible for 25 Member States to adopt rules that are at times explicitly different from the EU Treaties (e.g. the use of reverse QMV to block sanctions for breaching the balanced budget requirements)? Can the Contracting Parties make use of the existing EU institutional mechanisms to monitor and enforce compliance with Treaty rules?

EU law takes precedence

The EU Treaties and EU law take precedence over the TSCG requirements, which is acknowledged repeatedly in the Treaty. Article 2 provides that "This Treaty shall be applied and interpreted by the Contracting Parties in conformity with the Treaties on which the European Union is founded", and "The provisions of this Treaty shall apply insofar as they are compatible with the Treaties on which the Union is founded and with European law. They shall not encroach upon the competences of the Union to act in the area of the economic union." Article 3 states that the Fiscal Compact is to be applied "without prejudice to the obligations derived from European Union law". Article 7 on sanctions for States in excessive deficit procedure is applicable, "While fully respecting the procedural requirements of the European Union Treaties" and Article 10 on enhanced cooperation applies "In accordance with the requirements of the European Union Treaties".

However, the possibilities implied in the above for a conflict between EU and international law would mean logically that the new Treaty could not be binding on Contracting Parties. In breaching the TSCG, a State could be acting in accordance with EU law. The European Commission, as 'guardian of the EU Treaties', will need to ensure that there is no conflict between the two treaties, for which there are precedents: Schengen was outside the EU Treaties to start with, but did not contradict them. Initially, the Commission participated in Schengen deliberations as an observer, but was later given the power to initiate proposals to the Council.

In their written evidence to the ESC Professor Michael Dougan and Dr Michael Gordon[66] considered the relationship between the new Treaty (with reference to the first, second and

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64 This was a set of commitments agreed in March 2011 by the Eurozone Heads of State or government, plus Bulgaria, Denmark, Latvia, Lithuania, Poland, Romania, to achieving stronger economic policy coordination for competitiveness and convergence.

65 The *Acquis* is the accumulated body of EU law, Treaty law, Court of Justice rulings etc

66 Liverpool Law School, University of Liverpool

third drafts) and the legal order created by the EU Treaties. They pointed to the "very close relationship" between the subject matter of the new treaty and "a core part of Union business", and the "significant degree of overlap between the terms of the draft treaty and the EU's own competences" in the primary provisions of the TEU and TFEU and also secondary legislation such as the 'Six Pack' and the Euro Plus Pact. They highlighted potential problems of duplication and inconsistency or even contradiction between these instruments but noted that the second and third drafts sought to align the new treaty with the "relevant substantive and procedural provisions of Union law".

William Hague emphasised in his February 2012 letter that the principle of the primacy of EU law will not be affected by the TSCG being outside the EU Treaties, and that it was the "express intention of the parties to the Treaty that insofar as there may be any conflict or overlap between the proposed treaty and the EU Treaties, the EU Treaties shall prevail. Indeed, any other arrangement would be contrary to EU law".

Role for the EP and national parliaments

Article 13 TSCG provides for oversight of the Treaty by the EP and national parliaments, "As foreseen in Title II of Protocol (No 1) on the role of national Parliaments in the European Union". However, as the Lords EU Committee report on the Euro Area Crisis points out, "While the reference to the EU treaties is helpful, the Protocol was not drafted foreseeing its application outside the ambit of those treaties". Furthermore, although the UK participates in Protocol 1, as a non-signatory to this treaty, the UK (and presumably the Czech Republic) will not be involved; nor is it apparent why the EP should be involved in determining the organisation and promotion of a non-EU conference to discuss national budgetary policies and other treaty issues.

Enhanced cooperation

Another potential contradiction concerns the use of enhanced cooperation. Article 20 TEU allows groups of Member States to proceed with action among themselves, allowing other States to join later. This arrangement is to be used "as a last resort", when agreement among all Member States cannot be reached through negotiation or for practical reasons. However, all four drafts and the final text referred in Article 10 to an enhanced cooperation procedure "whenever appropriate and necessary" to ensure the "smooth functioning of the euro area". While for some commentators this is anomalous, in written evidence to the ESC on 24 January 2012, David Lidington was confident that this use of enhanced cooperation would conform with EU Treaty requirements.

The question also remains as to why, given the urgency of the situation, Eurozone States did not seek to use enhanced cooperation among Eurozone States under existing EU Treaty provisions to implement budgetary discipline rules and procedures. According to David Lidington, the Commission and possible President Van Rompuy had discussed this possibility in 2011:

> ... the Commission and, I think, President Van Rompuy too, were keen to look at mechanisms that did not involve treaty change. They certainly saw the use of existing EU Treaty powers, including, where appropriate, enhanced cooperation, as a means of trying to provide extra help for the eurozone 17, given the particular nature of the challenge they faced with the single currency, without the need to resort to treaty change, with all the inherent complexities

> and risks of trying to negotiate and then ratify a deal among 27 sovereign countries.[67]

Incorporation of new provisions into EU Treaties within five years

The Treaty provides for its own incorporation into the EU Treaties within five years from entry into force. David Lidington told the House on 29 February that this was "only an aspiration, not a given"[68] and David Cameron insisted that while in office, the Government's position would remain the same on its incorporation: "We did not sign this treaty, because we did not get the safeguards that we wanted, and that position absolutely remains".[69] However, this determination might not be enough to prevent similar provisions from being adopted as EU law under QMV.

Incorporation as a Treaty amendment would presumably be via the Ordinary Revision Procedure, requiring the unanimous ratification of an amending treaty containing the changes. The TSCG incorporation provision recalls the 2005 Prüm Convention, which was agreed by a group of EU Member States outside the EU framework. It contained a clause stipulating "Within three years at most following entry into force of this Convention, on the basis of an assessment of experience of its implementation, an initiative shall be submitted, (…), with the aim of incorporating the provisions of this Convention into the legal framework of the European Union." In 2007 a Council Decision on the stepping up of cross-border cooperation, particularly in combating terrorism and cross-border crime, incorporated the main provisions of the Prüm Treaty into the framework of the EU.

4.1 Effect of the Treaty on the single market?

The single market is one of the main objectives and achievements of the EU, is Treaty-based and applies to all 27 Member States. The TSCG is not intended to affect the single market and cannot be the basis for negotiations or agreements on financial services, or other matters that would have an impact on the single market. However, many have expressed fears that it will provide such a basis.

Martin Howe QC said in evidence to the ESC that "In law, the parties to this treaty cannot cut down or alter the obligations which they owe under the anterior EU treaties", but again, he was concerned about precedent, asking: "If under this Treaty its members get used to caucusing together to talk about excessive deficits in the euro area and improving competitiveness of the euro area economies, will they then be more encouraged to behave as a caucus when involved in matters which directly affect non-euro states including the United Kingdom?"

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The Government is concerned about a possible encroachment on the single market but believes the single market is outside the competence of the new Treaty. Lord Liddle asked on 7 February 2012:

> I recognise the concern of the Government that a caucus of eurozone member states should not compromise the integrity of the single market, but does the Minister agree that the best guardians of that integrity are the Commission and the Court? How does he expect them to act in that role if the Government keep saying that they are reserved about the position of the Commission and the

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67 Evidence to ESC, 23 February 2012
68 HC Deb 29 February 2012 c 345
69 HC Deb 31 January 2012 c 683

> Court in the treaties and there is a chorus of criticism from his own Back Benches in the House of Commons demanding that these institutions be kept out of any role?

Lord Sassoon replied that the Treaty was clear about the principle of non-encroachment on EU competences and that the Government had concerns about the use of the EU institutions:

> Some of the proposed uses of EU institutions in this intergovernmental agreement are already in the EU treaties and others are not. The Government will watch very carefully how this develops.[70]

The Financial Secretary to the Treasury, Mark Hoban, set out to the ESC on 14 March 2012 the Government's concerns in December 2011 and its belief that these have been assuaged by the TSCG:

> The concern that we had in December was that there were ideas floating around suggesting ways in which the eurozone could have acted on matters that would have affected the single market or financial services. Those proposals did not get into the intergovernmental treaty. We were seeking safeguards in case they got into a treaty that affected all 27 member states.

4.2 Use of the EU institutions

Inter-governmental arrangements among EU Member States do not, strictly speaking, use the EU institutions or their mechanisms for making or monitoring rules, or imposing sanctions for breaches of these rules, because the EU institutions derive their power and authority only from the EU Treaties as conferred by the Member States. From the start of the Treaty negotiating process, Herman Van Rompuy and Commission President Barroso had proposed some EU institutional involvement for the arrangements agreed in the Fiscal Compact, not least for the Court of Justice, to enforce sanctions for breach of the agreement. The UK Government's view has been that "the EU institutions can only be used outside the EU treaties with the consent of all Member States, and must respect the EU treaties and the responsibilities and rights that all share under those treaties".[71]

David Lidington set out the Government's concerns about the legality of the use of the institutions:

- Article 3(2): the Commission's role in proposing the principles underpinning the automatic correction mechanism. Does this go further than the powers and duties given to the Commission under the existing EU Treaties?

- Article 7: the reverse QMV mechanism. Might this have the potential for a precedent being set for the use of this mechanism in other areas of the EU Treaties?

- Article 8:

  - the role of the Commission to judge national budgets. The principle the Government asserts is that the EU institutions should only be used outside the EU

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70 HL Deb 7 February 2012 c 125
71 David Lidington, evidence to ESC 23 February 2012

Treaties with the consent of all Member States, and any such use must respect the Treaties, because they have primacy in any conflict.
- the role of the Court of Justice. All Member States must agree to the institution operating outside the scope of the Treaties.

- Article 273 TFEU: Member States may ask the institutions to act on their behalf in matters beyond the Treaty, but on the subject matter that is dealt with by the Treaty. As there is nothing in the EU Treaties obliging a State to write a deficit brake into its law or constitution, does this take the Court into new territory?[72]

How this will work in practice, and whether the UK would challenge the Commission's role at the Court remains to be seen. Martin Howe implied that the UK would be unlikely to win if it did:

> The Court reflects political developments and the political ethos of the European Union in which it operates. One would be asking that Court, as it were, to ban the Commission from performing an activity that the Commission itself wants to perform and which the majority of member states want it to perform, in the face of the objection of maybe the United Kingdom and possibly one or two others. Unless the legal arguments are crystal clear, the prospects of winning that might not be too good.[73]

For the UK Government this has been one of the most controversial aspects of the new Treaty, although David Cameron admitted that the issue was "what the new organisation does, rather than necessarily what the institutions do".[74] He told *BBC Radio 4* on 6 January 2012 that there were "legal difficulties" in preventing the other Member States from using the EU institutions. He thought the legal position was unclear, but that the new "thing, whatever it is, can't do things that are the property of the European Union. [...] You can't have a treaty outside the European Union that starts doing what should be done within the European Union, and that goes back to the issue of safeguards".[75]

In the run-up to the agreement on the final treaty text on 30 January, the UK Government appeared to adopt a wait-and-see approach to the use of the institutions, and in the event did not block their limited use under the TSCG. In reply to a question in the Lords, Lord Howell said the Government did not want "to throw sand in the machine", continuing: "If some of them can usefully be used in the aim of building a better euro system, we will support them, but we are reserving our position on exactly which institutions should be used and how they should be used. Our general attitude is supportive and constructive ... .[76]

The Commission

Martin Howe QC was concerned about the provision in Article 3(2) for the Commission to propose "common principles" on the deficit correction mechanism. He was more worried about possible precedents than "actual effects", in that it would amount to using the Commission for "private consultancy work outside the framework of the EU Treaties for a sub-group of Member States". He continued:

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72 Evidence to ESC, 23 February 2012
73 Uncorrected Oral Evidence, 8 February 2012
74 HC Deb 12 December 2011, c 532
75 Reported in *EUObserver* 6 January 2012
76 HL Deb 30 January 2012 c 1327

> The principle of the Commission being co-opted to act in a private capacity without the consent of all Member States is worrying because, once established, its application could be greatly expanded in future. It is not so much the administrative costs that are the problem, but the risk of the Commission's mind-set being affected by carrying out significant tasks acting as the private servant of a sub-group of Member States.

Paul Craig pointed out that similar obligations to those in Article 3(2) are contained in existing EU legislation. For example, Articles 5 to 7 of Directive 2011/85 oblige all Member States except the UK to implement national numerical rules to promote compliance with EU Treaty obligations in the area of budgetary policy over a multiannual horizon. The rules include promoting compliance by the end of 2013 with reference values on deficit and debt set in accordance with the TFEU. However, this could not "per se legitimate use of an analogous power pursuant to a different Treaty". Craig maintained "It would have to be argued that an EU institution should be allowed to exercise powers in a non-EU context that are closely analogous to those that it exercises under the Lisbon Treaty/EU legislation" (see also the Council Legal Service's analysis in its Opinion on draft Article 8 of the TSCG, below).

The inclusion in the second draft of a role for the Commission in bringing an action to the Court of Justice against a Contracting Party for an alleged infringement of Title III would have been legally problematic. The Commission has no inherent jurisdiction and any new competence to act must be conferred on it by all 27 Member States through a Treaty amendment. Even if a particular Commission power is authorised in the EU Treaties or in EU law, it does not follow that the same power is legitimate in a different – in this case intergovernmental - institutional context. Paul Craig made this point clearly in his evidence to the ESC:

> The SCG Treaty cannot in itself legitimate use of a power given under the Lisbon Treaty/EU legislation. The SCG Treaty cannot pull itself up by its own bootstraps. If this were possible it would mean that an agreement/Treaty could be made outside the confines of the EU Treaty and the framers of the former could decide that institutional powers accorded under the EU Treaty/EU legislation could apply within the new Treaty ordering.

Article 126(10) TFEU prohibits the Commission from initiating infringement proceedings under Articles 258 and 259 TFEU.[77] Subsequent drafts of the TSCG removed this power, settling in the fourth text for a Commission role in reporting and assessing compliance with Article 3(2); it would be for another Contracting Party to initiate action at the Court of Justice. According to David Lidington, "it is possible for Member States to agree collectively to act in a certain manner. The existence of the Intergovernmental Treaty would provide a formal mechanism for that to happen, but there has been nothing to stop Member States from acting in such a fashion up to now, in any case".[78]

As to whether under Article 8 the Commission would have *de facto* infringement powers to take a State to the European Court, Ivan Smyth, the FCO Legal Counsellor, thought the Treaty language ("*Will* be brought to the Court of Justice" rather than "*shall* be brought") was

[77] These Articles set out the reasoned opinion procedure, whereby a Member State can be taken to the Court of Justice if it fails to comply with the opinion within a specified time period.

[78] Evidence to ESC, 23 February 2012

not "mandatory language" and that the TSCG made clear that it would be the Member States that took the action.[79]

The role of the Commission is of necessity weaker in an intergovernmental treaty than in an EU treaty, and its role in the TSCG was watered down between the first and fifth drafts. Some analysts have suggested that for the UK this was probably not beneficial, as the Commission has been a UK ally in promoting the extension of the single market into new areas. Notwithstanding the legal issues, Edward Carr, Foreign Editor of *The Economist*, thought the UK Government had come close to shooting itself in the foot by opposing a role for the Commission:

> I think that the pattern has been that the Commission has been excluded and then brought in at the last minute, partly to save face and partly because some of the smaller countries realised that the Commission is their ally. In this context of ins and outs—not eurozone but EU ins and outs—I think that it is very much in Britain's interest that the Commission is involved. The Commission will see the interests of the 27 rather than of the 17 so I think that there is quite a lot at stake. It slightly dismays me that Britain is not really backing or promoting the Commission, even though it is in its interests to do so.[80]

This view was shared by the European Movement.[81]

The Court of Justice

The TSCG gives the Court of Justice jurisdiction over the transposition of the balanced budget rule into national law and it may fine a State for not complying with a Court ruling if an alleged breach is brought by the Contracting Parties on the basis of a Commission assessment in accordance with Article 273 TFEU.

There is very little Court of Justice case law on the use of the EU institutions outside the EU Treaties, and what there is does not clarify the present situation. However, it is true to say that it would not be the first time the Court of Justice has been confirmed as the 'guardian' of a non-EU, European inter-governmental agreement at the request of the Member States. In Opinion 1/91 of 14 December 1991 and Opinion 1/00 of 18 April 2002 the Court of Justice considered whether jurisdiction could be granted outside the EU Treaties.[82] Professor Steve Peers referred to this Opinion in his written evidence to the ESC on 13 January 2012.

The question of whether the Court of Justice has pre-emptive jurisdiction to give an Opinion depends on whether this agreement is "an envisaged agreement" for the purposes of Article 218(11) TFEU. Under this Article "an envisaged agreement" is an international agreement to which the EU intends to be bound, rather than any international agreement, such as the TSCG. That would be consistent with Opinion 1/75, which appears to be the most relevant authority, in which the Court stated that the purpose of a predecessor of Article 218(11) (Article 228(1)TEC) is "to forestall complications which would result from legal disputes concerning the compatibility with the Treaty of international agreements binding on the Community". It would also be consistent with Article 218(11) being incorporated in the TFEU

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79 Evidence to ESC, 23 February 2012
80 Evidence to Lords EU Committee, 29 November 2011
81 Written Evidence to ESC para.19, February 2012
82 Court of Justice Opinion 1/09 8 March 2011

Article dealing with EU international agreements (Article 218), rather than in the provisions on the jurisdiction of the Court of Justice under Part Six, Title I TFEU ("Institutional and Financial Provisions"). So it is not clear whether, as has been rumoured, the UK could ask the Court of Justice to opine on the consistency of the TSCG with the EU Treaties.

The Court of Justice established an EU institutional role in an intergovernmental context in a decision in 1993 (*Parliament v Council and Commission*, Joined Cases C-181/91 and C-248/91 concerning international aid to Bangladesh). The EP had sought to annul budgetary implementation measures adopted by the Commission granting special aid to Bangladesh. The Council claimed that the Court should declare the application brought against it inadmissible on the ground that the contested act was adopted, not by the Council, but by the Member States - in this case *all* the Member States - and thus could not be the subject of an action for annulment under (former) Article 173 TEC (now Article 263 TFEU). The EP argued that the contested act constituted an act of the Council, and that, by adopting the act, the Council had infringed the prerogatives conferred on the EP by (former) Article 203 TEC in budgetary matters (now Article 314 TFEU). The EP also sought to annul measures adopted by the Commission to implement the contested act.

The Court stated (para. 14) that:

> ... it is not enough that an act should be described as a 'decision of the Member States' for it to be excluded from review under Article 173 of the Treaty. In order for such an act to be excluded from review, it must still be determined whether, having regard to its content and all the circumstances in which it was adopted, the act in question is not in reality a decision of the Council.

Martin Howe pointed out to the ESC that those Opinions concerned cases "in which all member states agreed to the Community institutions carrying out the additional tasks, in treaties to which the Community and all the member states were parties". The present scenario presented a "significant legal difference". Professor Dougan noted that in both the above cases, Advocate-General Jacobs had proposed that the test question should be: "is it incompatible with its obligations under the treaties?" With regard to the TSCG, he suggested that if the Member States "were asking the Commission to behave in a way that infringed its duty of impartiality or its duty of independence, we would all have a real problem", but that if not, "it does not seem objectionable".

In another ECJ case concerning the Lomé Convention,[83] the Court ruled that "No provision of the Treaty prevents Member States from using, outside its framework, procedural steps drawing on the rules applicable to Community expenditure and from associating the Community institutions with the procedure thus set up". However, as Paul Craig pointed out in evidence on 5 February 2012, "The reach of this authority is ... unclear", "distinguishable in several respects" from the new treaty, and would be a "very significant extension of the reasoning therein to apply it to the instant circumstance". On the role of the Commission in this particular inter-governmental arrangement, the Court pointed out that the fourth indent of (former) Article 155 TEC (now largely Article 17 TEU) "does not prevent the Member States from entrusting the Commission with the task of coordinating a collective action undertaken by them on the basis of an act of their representatives meeting in the Council". When the EP countered that under the contested act the special aid would be distributed among the Member States according to GNP, which, in its view, was a "typically Community concept",

[83] Case C-316/91 *EP v Council*, 2 March 1994

Article 273 TFEU: "the Court of Justice has jurisdiction "in any dispute between Member States which relates to the subject matter of the Treaties if the dispute is submitted to it under a special agreement between the parties".

the Court replied (para. 22) that "nothing in the Treaty precludes the Member States from making use outside the Community context of criteria taken from the budgetary provisions for allocating the financial obligations resulting from decisions taken by their representatives". The Court concluded (para. 25) that "the contested act is not an act of the Council but an act taken by the Member States collectively" and declared the application and that of the Commission inadmissible.

Opinion 1/00 in April 2002 concerned the compatibility with the provisions of the EC Treaty of a proposed agreement on the establishment of a European Common Aviation Area (the ECAA Agreement) between the EC and 12 non-EU "Associated States", and "particularly of the system of legal supervision provided for therein". The Court thought the system of legal supervision proposed by the Agreement on the establishment of an ECAA *was* compatible with the EC Treaty. In Opinion 1/09 in March 2011 on the creation of a European and Community Patent Court, the Court of Justice confirmed that it had accepted "that an international agreement may affect its own powers provided that the indispensable conditions for safeguarding the essential character of those powers are satisfied and that the autonomy of the European Union legal order is not adversely affected".

Articles 260 and 273 TFEU

Article 8 TSCG provides roles for the Commission and Court of Justice on the grounds that it is a "special agreement" within the meaning of Article 273 TFEU. The Preamble recalls Article 260 TFEU, which empowers the Court of Justice to impose a lump sum payment or penalty on a Member State for failing to comply with one of its judgments concerning a breach of the EU Treaties. Critics have argued that, as the incorporation of the balanced budget rule into domestic law is not an obligation under the EU Treaties, the meaning of Article 273 TFEU is being stretched and the Court of Justice would be exceeding its legal competence under Article 13(2) TEU[84] in enforcing incorporation. Others point out, however, that balanced budgets relate to the subject matter of EMU in a general way and that this is therefore a legitimate use of both Article 260 and 273 TFEU.

In evidence to the ESC, Steve Peers conceded that legal views would differ:

> ... for those who take the view that a group of Member States can *never* grant *any* new powers to the EU institutions outside the EU legal framework, such provisions will nevertheless violate EU law. On the other hand, for those who believe that it is legally open for a group of Member States to do this, there is no legal clarity on what the conditions on the grant of such powers are, and so it cannot be concluded in the abstract whether or not the draft treaty would violate such conditions.

Michael Dougan and Michael Gordon described some potentially problematic instances in which the EU institutions could be used for non-EU purposes. Martin Howe was also "doubtful whether Article 273 is sufficient to confer a general jurisdiction on the Court to deal with prospective disputes arising not under the EU treaties but under the provisions of a parallel treaty between a sub-group of EU Member States". However, he conceded that the

[84] Article 13(2) TFEU: "Each institution shall act within the limits of the powers conferred on it in the Treaties, and in conformity with the procedures, conditions and objectives set out in them".

predecessor to Article 273 TFEU (Article 239 TEC) had "been treated in the past as having a wider scope than its actual words suggest" and that, as the Court had generally expanded its own jurisdiction, it would probably find that it did "have jurisdiction to entertain actions in circumstances envisaged by Art 8 of the draft Treaty". Paul Craig questioned the *principle* of the use of the EU institutions:

> ... does it mean that if the Member States fail to attain unanimity for amendment, and do not seek or fail to attain their ends through enhanced cooperation, the 15, 21 etc states who wish to do so can make a Treaty to achieve the desired ends and the EU institutions can play a role therein, provided only that they use powers analogous to those under the existing Treaties?

Craig thought "it would be a very significant extension of the reasoning therein to apply it to the instant circumstance".

Council Legal Service Opinion

On 26 January 2012 the Council Legal Service issued an Opinion on the compatibility with EU law of draft Article 8 and related preamble recitals, based on the fourth treaty draft. The Legal Service answered four questions:

1. Can the procedure foreseen be described as a dispute settlement mechanism between Member States?

   A Member State considering that another Member State had not complied with mutually accepted treaty obligations "is enough to be regarded as a genuine dispute between them" if one takes action against the other. The initiators are Member States, not the Commission, and the Member States could be in breach of their obligations under international law if Court not seized. "There is no convincing reason not to regard Article 8 as a clause that aims at settling disputes between Contracting Parties, which are Member States of the European Union".

N.B. Paul Craig disagreed with the Legal Service view that the Commission was not directly involved in bringing an action before the Court. A negative report from the Commission would trigger a mandatory obligation on one/more Contracting Parties to bring the recalcitrant state to the Court: "The reality is therefore that the Commission is still 'bringing' the action".

2. Can the clause be regarded as a "special agreement"?

   Member States can establish in advance "a mechanism that may be made use of, in predetermined conditions, if a dispute happens" but only if the "speciality" criterion is fulfilled. Article 8 fulfils this criterion because it refers specifically to violation of Article 3(2). The Court is limited to reviewing the transposition only of the balanced budget rule, to be accomplished according to a defined legal framework and precise timetable. Therefore, Article 8 conforms to Article 273 TFEU because it "merely anticipates possible incidents of which the nature, the limits and the time of occurrence are known with a relatively high degree of precision at the time of its conclusion".

3. Do the issues to be brought to the Court relate to the subject matter of the Treaties?

The provisions Contracting Parties adopt must give legal effect to rules that apply within the framework of the "revised Stability and Growth Pact" (Council Reg. 1466/97, as amended by Reg. 1175/2011). This is in line with implementing EU policies, e.g. to strengthen EMU and "conceptually and practically inseparable" from EMU as established by the EU Treaties. "Therefore, although as such the control of the adequacy of national measures transposing rules established outside the Union is not an EU law issue, the assessments required would necessarily involve consideration of problems of EU law and must for this reason be regarded as 'related to the subject matter of the Treaties'".

4. Does the Court have jurisdiction to impose "sanctions" on Member States following an agreement between them to have recourse to Article 273 TFEU?

   Article 273TFEU does not exclude the capacity of the Court to impose penalties, but the capacity must be explicit in the dispute settlement clause as it cannot be presumed, as must the procedures, since they differ from Article 260 TFEU. Imposing financial penalties does not alter the nature of the Court's responsibilities because Article 260 TFEU empowers it to impose sanctions. Article 8(2) therefore does not introduce "an element alien to its existing practice". Although the violations here are not of EU law, they are closely related to EU law (see note 3 above). Also, it is the Member State(s), not the Commission, which asks the Court to impose penalties, which "does not significantly affect the conditions in which the case will be treated by the Court nor the exercise of its powers". Article 8 "broadly anticipates the framework that will apply to the norm" when the substance of the new treaty is incorporated into EU law within five years of entry into force, "while being entirely compatible with the legal basis of Article 273 TFEU" before that time.

Craig did not think the Legal Service opinion was the end of the story, as the questions of principle and legality remained unanswered:

> The issue of principle presented above nonetheless remains relevant, even if the consent to the use of the EU institutions by non-signatories to an agreement such as the SCG was unequivocal and even if there was no external pressure. This is because the issue of principle in paragraphs 1-6 above is not dependent on whether particular Member States at particular times are willing to allow it to be circumvented.

For Craig the proposition that institutional powers granted under the EU Treaties or EU law could simply be "cut and pasted" into a different, non-EU treaty was "not legally or politically tenable" and "The fact that an EU institution has power pursuant to the Lisbon Treaty or EU legislation to do certain things, cannot per se legitimate use of an analogous power pursuant to a different Treaty".

Arrangements for legal procedures under Article 8 TSCG

At the signing ceremony on 2 March, signatories agreed an annex to be attached to the minutes of the signing ceremony on the arrangements for bringing a matter to the Court of Justice under Article 8(1) TSCG. The Annex clarifies that an application to the Court will be made by the Trio of Presidencies as set out in Annex I to Council Decision 2009/908/EU of 1 December 2009 (assuming there are no criteria which would exclude any of these three States, in which case the applicants will be the former Trio of Presidencies), in close cooperation with all Contracting Parties. Technical and logistical support and costs will be

> "... we are vigilant and ready to act, including by taking legal action in the European Court of Justice, if we believe that the EU institutions are being used in a way that is contrary to the provisions of the EU treaties and that harms our national interest".
>
> David Lidington, HC Deb 29 February 2012 c 346

provided by the Contracting Parties linked to the case in question. Sub-section 6 provides that, on the basis of the Commission's assessment that a State Party has failed to comply with the Court's judgment, "the Contracting Parties bound by Articles 3 and 8 of the Treaty state their intention to make full use of the procedure established by Article 8(2) to bring the case before the Court of Justice, building upon the arrangements agreed for the implementation of Article 8(1) of the Treaty".

The Government reserves its legal position

William Hague said in his letter to the Foreign Affairs Committee that the Court of Justice would not have jurisdiction *per se*, and that the Government's "clear view" was that the EU institutions were "obliged to act in the interests of, and on the instructions of, all 27 EU member states". The Government expected the institutions "to play their normal role" under the EU Treaties. However, David Lidington made clear the Government's concerns about the use of the EU institutions setting "unwelcome precedents" and impinging "on the integrity of EU law and the arrangements set out in the EU Treaties".[85] For this reason the Government had reserved its legal opinion but would act if necessary. He would not reveal the Government's legal analysis of Article 8, which might prejudice any future legal action concerning the TSCG.

The UK's Permanent Representative to the EU, Sir Jon Cunliffe, wrote to the Secretary-General of the EU Council on 22 February 2012, formally stating the Government's opinion that, in view of its "continuing concerns on these points we must reserve our position on the proposed treaty and its use of the institutions, in particular in Article 3 (2), Article 7 and Article 8".[86]

What will reserving a legal position mean in practice? The UK Government has not objected to the use of the EU institutions, but has not approved of it either. This position allowed the Treaty to be signed, but also left open the option of taking legal action if there was a perceived threat to the UK's vital interests. According to David Lidington:

> It means that we have concerns about certain aspects of the Treaty, in respect of the proposed use of the institutions, but we do not want to stop our partners from getting on with the immediate firefighting task in hand, and it is in our interest as well as theirs that they succeed. We will watch very carefully what happens from now on, and we are ready to act if we believe that the institutions are being used in a way that is improper and harms our national interest, either now or in the future.[87]

The Minister maintained that the Government had not given its consent to the use of the EU institutions because it had not been asked to do so, but that this did not mean the Treaty was unlawful. James Clappison was not convinced by what appeared to be government casuistry, concluding that "If the institutions are being used, unless and until we are giving our consent to that, then it is not lawful. I cannot see it could be more straightforward than that".

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85 Evidence to ESC, 23 February 2012.
86 Dep 2012, 327
87 Evidence to ESC, 23 February 2012

How successful would a challenge about the scope and meaning of Article 273 TFEU be at the European Court? Professor Craig thought it would hinge on whether the Court found the mechanism whereby the Commission triggers the action was lawful under Article 273. He believed the Court would say that Article 273 "can, in principle, be used in interstate suits" (for which the TSCG provides), and that, with regard to the Commission's role, "There will be a temptation to validate it, to legitimate it, and say that the Commission is not formally bringing the action…".[88]

In the evidence session on 23 February Bill Cash asked David Lidington whether the Government would go to the Court or not to establish the legality of the Treaty, but the Minister replied only that the option remained available. In reply to a similar question on 5 March, the Prime Minister reminded the House that the Treaty did not yet have the force of law and that a legal challenge "is a less good [path] than using our leverage and influence to ensure that the agreement sticks to fiscal union rather than gets into the single market. That is the right approach and the one we are pursuing".[89]

Jacob Rees-Mogg (Con) wanted to know whether the Government was reserving its position on the "current legality of the treaty, or how the treaty will be used in practice".[90] If the former, he, like Bill Cash, thought the Government should take pre-emptive action by going to the Court of Justice now (ibid c 333). He did not agree with Martin Horwood (LD) that reserving its position gave the Government a "tactical advantage by perhaps retaining the ability to challenge any future perceived breach" of the treaty, and he thought the distinction between "will" and "shall" made by the Government official, Ivan Smyth, before the ESC a few days earlier was "a pretty narrow basis for maintaining the legality of what the treaty requires the Commission to do" (c 333). Christopher Chope (Con) also urged the Government to challenge the use of the institutions sooner rather than later, because "If we wait for it to interpret the treaty, we will find that it does so in a purposive manner, in accordance with the principle that it is right and proper for the EU to have more and more power" (cc 341-2).

On the other hand, Neil Carmichael (Con) found two reasons for allowing the use of the EU institutions:

> first, to secure our reputation as a country that is involved, engaged and ready to contribute to the future of the EU; and secondly, to ensure that we can easily observe what is going on, because we have a clear and obvious interest in making sure that the EU treaties, such as the Lisbon treaty, are enforced and maintained as part of the governance of the EU. That is how we will be able to check the legality of the treaty we are talking about today. We will do that not by complaining about it or chucking grenades into the process, but by allowing it to happen and ensuring that we keep an eye on what is happening.[91]

Martin Horwood acknowledged the political and legal issues, but thought these were "dwarfed by the really big issue, which is the future of the European economy". His comments in the debate on 29 February implied that arguments about the use of the EU

88 Uncorrected oral evidence to ESC, 7 February 2012
89 HC Deb 5 March 2012 cc 574
90 HC Deb 29 February 2012 c 332
91 HC Deb 29 February 2012 cc 335-6

institutions were perhaps missing the point,[92] a view which Jacob Rees-Mogg, who held that the EU was breaching the rule of law, found shocking (c 332).

4.3 A two-speed Europe?

Will the Treaty, as and when it comes into force, represent a step towards a two-speed or two-tier Europe, in which some Member States press ahead of others with integration in fiscal as well as economic union, with France and Germany in the lead? The UK, Denmark, Ireland, Poland and other EU Member States have in the past negotiated opt-outs from EU Treaty amendments.[93] On each occasion such States have been cautioned about the risk of being left behind while others advanced using enhanced cooperation. A two-speed Europe has been viewed as the lesser of two evils, given the alternative of lengthy delays in agreeing amendments due to vetoes from one of two Member States.[94] However, some have argued that there is now perhaps more than the usual rhetoric, given the significance and urgency of the financial crisis which the new treaty aims to resolve.

It is likely that there will be some ratification problems and that the TSCG will come into force initially for some but not all of the 25 signatories. By mid-December 2011 some non-Euro States, including Denmark, and Eurozone Members Austria, Ireland and the Netherlands, were voicing doubts about prospects for national ratification. In Finland, France and Hungary political events loomed which threatened to delay ratification. Once the twelfth Member State has ratified, the treaty will apply among those 12 States, and to others as and when they ratify. While this provision (which is unlike the EU norm of universal ratification) anticipates the possibility of divisions within the Eurozone, it also appears to envisage a two-speed delivery of the Fiscal Compact. Lord Kerr of Kinlochard commented in the Lords debate on 16 February: "One could now envisage a member state-in this case hypothetically an Ireland unable to win a referendum, or a Hollande-led France talking of a renegotiation-stuck in a limbo, unwilling or unable to ratify but equally unable to prevent the convoy sailing on". He did not believe this would have been the entry-into-force provision if it had been an EU treaty, and concluded that the provision was a consequence of the position the UK took, and "Careful reflection is needed on whether that is a good or a bad thing" (c 989).

Some commentators think that UK and Czech non-participation has made it more difficult for the rest of the EU to reform the Eurozone because operating outside the EU Treaty framework will complicate and possibly delay their efforts. This might increase uncertainty in the financial markets and have a negative effect both on Eurozone and non-Eurozone States. Poul Skytte Christoffersen, a former Danish envoy to the EU, was concerned that the former Communist States could be among the first EU States to be relegated to a second tier, "losing results of the past ten years' work".[95]

The Italian Prime Minister, Mario Monti, addressing the EP on 15 February, condemned judgments of EU Member States as "goodies and baddies": "The eurozone crisis has given rise to too many resentments and re-created too many stereotypes, it has divided Europe into central countries and peripheral ones". In rejecting the popular division of the Eurozone

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92 HC Deb 29 February 2012 c 315

93 See Standard Note 4462 EU Treaty Opt-ins and Opt-outs 8 October 2007

94 E.g. Commissioner for Justice, Freedom and Security, Franco Frattini, after the failure to achieve universal ratification of the *Treaty Establishing a Constitution for Europe*, cited in *European Voice* 31 May – 6 June 2007

95 *EUObserver*, 11 January 2012

into virtuous northern States and profligate southern ones, he gave tacit credence to an existing two-tier or two-speed Europe.

Caucusing

John Baron (Con) asked the Government for "concrete and substantive guarantees" that would prevent the two-tier Europe created by the fiscal compact from acting against the UK's best interests.[96] David Lidington's response, which was not concrete or substantive, included an analysis of EU bloc mentality, which in his view was unpredictable: "Countries do not act as a predictable bloc or cohesive caucus because they happen to belong to the euro". He thought there were Eurozone States that would support the UK on budgetary discipline, while some net recipients and Eurozone Members wanted a larger EU budget. In evidence to the ESC he used the example of the joint letter from David Cameron and 11 other EU leaders to President Van Rompuy and President Barroso of 20 February 2012, suggesting priority areas for growth in Europe as "evidence that the pattern of alliances and partnerships within the EU is much more complex and fluid than one would think, if one assumes that the 25 or the 17 will always act as a bloc".

David Lidington acknowledged before the December European Council a small risk that an intergovernmental solution to the Eurozone crisis involving the 17 Eurozone States and others could have the effect of "caucusing on single market measures", presenting the UK with a "take it or leave it" option.[97] The Lords EU Committee was concerned "that euro area states meeting together might informally reach common views on matters which would then fall to be decided by the full European Council ("caucusing")".[98] The report noted that all three current holders of the key posts of President of the Euro Summit/European Council, the Commission President and the EP President were from Eurozone countries, adding "The question arises whether it might in practice prove difficult in future for the holder of any of these key posts to be nationals of non-euro area countries.[99]

Charles Grant described the possible consequences of a Eurozone core:

> To some degree there clearly will be a core, because the eurozone will have its own rules and procedures to a greater extent than it does today. The question is whether that there is the risk of a de facto or de jure core. That is up to the British. If the British are perceived as too difficult, that will provoke other eurozone countries to have their core of 17—or 17 plus a few others—which obviously, as I said before, would not be in the British interest.[...]
>
> The risk is that, whether it is de jure or de facto—we do not know what it will be—you will have a group dominated by relatively illiberal countries that will have a view of the single market that is not the British view. They will caucus and, by the time the British turn up, we may find that we still have a vote but can be outvoted by QMV. We will have lost the argument because we will not be in the room when they argue. Even if, technically, the treaty at 27 still applies and so single market rules have to be decided à vingt-sept—by the

96 HC Deb 29 February 2012 c 344
97 HC Deb 8 December 2011 c 197WH
98 The Euro Area Crisis February 2012
99 25th Report of Session 2010–2012, 14 February 2012

> 27—in practice, a whole group of countries will have got together first. This is a very serious risk to the single market.[100]

Angela Merkel, who has led the economic reform process, said in January 2012 that Germany remained committed to a dialogue with all Member States, whether inside or outside the euro, but added that the crisis was "forcing the 17 eurozone countries to take a step further by forging closer economic and political ties among themselves".[101]

More enhanced cooperation?

The EU Treaties already provide for a group of Member States to cooperate among themselves under 'enhanced cooperation' arrangements, allowing others to join later.[102] The TSCG provides for all Member States to join it at some time, and past experience has shown that this can happen – EU and non-EU States have continued to accede to Schengen, for example. Dougan and Gordon raised the matter of further integration by Eurozone States through enhanced cooperation:

> If put seriously into practice, increased recourse to enhanced cooperation on matters essential to the smooth functioning of the single currency could imply the emergence of a bifurcated Union in all manner of fields related to economic policy – not only the regulation of specific sectors or markets, but also employment protection, consumer rights, taxation and social security. That would pose novel and interesting legal questions about how far enhanced cooperation may properly proceed before its scope and scale begin to threaten the integrity of the single market. [38] But it also raises important political prospects: if the Eurozone were to break itself free from any sense of commitment to the pursuit of common Union policies in fields closely linked to the smooth functioning of the single currency, might it also begin to see the benefits of forging its own approach to more far-flung policy areas such as the environment, or discrimination, or public health? Whereas flexibility in fields such as EMU or the AFSJ was once seen as a temporary aberration or a minority fetish, the Eurozone crisis might yet provide the stimulus for flexibility to emerge as a much more entrenched and systematic phenomenon – with all the risks that implies for the legal coherence and political solidarity of the Union.[103]

David Lidington told the ESC on 23 February that "Nothing in the Intergovernmental Treaty can amend or set aside what is written down in the EU treaties about how enhanced cooperation has to operate", and that the UK could block such a move if it wished:

> Those rules all continue to apply, whether there is enhanced cooperation that springs from the Intergovernmental Treaty or springs from some other initiative among a variety of EU Member States. Clearly we could not block a proposal for enhanced cooperation that respected all those requirements. We would consider carefully whether to resist, including if necessary through challenge in the EU courts, any resort to enhanced cooperation that we considered did not satisfy all the conditions laid down in the treaties themselves for its use.

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100 Oral evidence, 29 November 2011
101 *Le Monde* 25 January 2012
102 One of the first examples is the unitary patent system, which 25 of the 27 Member States have joined. See Council press release 10 March 2011
103 Written evidence to ESC, January 2012

He used the recent suggestion that the Financial Transactions Tax (FTT) might become subject to enhanced cooperation as an example of States not acting as a bloc but "making calculated judgments about their national interest, measure by measure, using the enhanced cooperation process set down in the EU treaties".[104]

Different institutional structures

Charles Grant, of the Centre for European Reform (CER), thought "a two-speed EU with a separate treaty for Eurozone Members might work, but would undermine the European Commission in its basic tasks of protecting the interests of smaller Member States and launching EU-level legal proposals". He told the Lords EU Committee on 29 November 2011 that closer integration by some Member States had "potentially very damaging implications for the single market" and "implications for British influence in the EU". He pointed in particular to a weakening of the Commission, commenting that:

> ... the weaker the Commission becomes, the more we move towards President de Gaulle's Europe des patries—the Europe of fatherlands that he always wanted—and the less good for the single market. The weakness of the Commission is also very damaging to British interests.

In October 2011 the *European Affairs* writer, Kirsty Hughes, suggested there might even be a new EU presidency structure in the future: "For now, Herman van Rompuy will preside over both the euro and the EU summits but in future, the inner core may have a different, permanent president".[105]

4.4 UK isolation in Europe?

Just a theoretical risk

Is the UK's non-participation in the new Treaty an opt-out too far, which will damage irrevocably the UK's position in the EU?

On 8 December 2012 David Lidington acknowledged a "theoretical risk" of UK isolation but recalled how the UK had been given such warnings when it decided not to adopt the euro, and that "those dire warnings have not been justified by the events of the years since".[106] He named EU governments that would want to keep the UK on board (c 197WH):

> ... when I talk to Ministers from the other 26 member states, I find that neither the eurozone 17 nor the euro-out 10 are cohesive or monolithic blocs. Talking to Dutch, German—in particular—Finnish, Austrian or Irish Ministers, one finds that they all very much want the United Kingdom, with its championship of free and open markets and an outward-looking European Union, to be centrally involved in taking decisions.

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[104] Evidence to ESC, 23 February 2012
[105] BBC News, 28 October 2011
[106] HC Deb 8 December 2012, c197WH

Following the UK veto of the Fiscal Compact there was much speculation about the UK's future in Europe. Commission President Barroso, who had said that concessions to the UK would have damaged the single market, hoped nevertheless that the EU could "work constructively with the UK Government" to make sure that the Compact was in line with the EU Treaties.[107] There was no suggestion that the UK would be sidelined in drawing up the new treaty or after its implementation.

> "It does not leave us outside of anything we want to be in".
>
> William Hague to FAC, 8 March 2012

For other commentators the UK action typified the UK's relationship with continental Europe. The *Economist's* Charlemagne commented on 9 December 2011 in a post called "Europe's great divorce" on the UK's long-standing and geo-political separation from the rest of Europe by the English Channel. Charlemagne also thought that the Contracting States, even when they were divided among themselves, had a "habit of working together and cutting deals", which would "inevitably, begin to weigh against Britain over time". The following example was given:

> Britain may assume it will benefit from extra business for the City, should the euro zone ever pass a financial-transaction tax. But what if the new club starts imposing financial regulations among the 17 euro-zone members, or the 23 members of the euro-plus pact? That could begin to force euro-denominated transactions into the euro zone, say Paris or Frankfurt. Britain would, surely, have had more influence had the countries of the euro zone remained under an EU-wide system.

> "The European Union is an exercise in pooled sovereignty or it is nothing. If we are not prepared to join in and do our bit, we will ultimately make ourselves irrelevant. We cannot indefinitely achieve our objectives by staying out of the room when we do not like what is being discussed, and we cannot achieve them by opting out of so much that it begins to look as if we might as well not be in.
>
> We have to resolve this issue as a country: is our future European or not? That is the lead that we are looking for from the Government".
>
> Lord Liddle 16 February 2012

Loss of UK influence?

In the debate on 13 December 2011 David Lidington did not believe the UK would lose influence in the EU and gave examples of UK involvement in EU projects to which the Government did not directly subscribe and others in which it fully cooperates:

> The truth is that we have always had a Europe in which there have been multiple forms of co-operation. We are not in the euro and nor do we plan to be. It is good that we have our own economic policy, interest rates and ability to deal ourselves with the problems we face in our economy. The United Kingdom remains a key—indeed, a central—member of all initiatives on European foreign and defence policy co-operation, but we are not in the Schengen borders organisation. We are a key member of the single market, and in fact it is the UK that often drives change and improvement in the single market.

[107] EP Plenary, 13 December 2011

> On the other side of the equation, at the same time that the European Council was in progress, the British Government were working closely with EU partners to shape a successful negotiation on climate change this weekend in Durban. Our intention is to continue to work hard with our many allies in Europe to advance our interests. That is not isolation: it is defending Britain's national interest, and that is what the Government are going to continue to do. That does not mean, as some have said, pulling back from our relationship with the European Union. We remain a full member of the European Union, and that membership is vital to our national interest. Our national interest and the EU interest are not mutually exclusive; we have genuine common interests.[108]

Concluding for the Government, the FCO Minister, Henry Bellingham, insisted that the UK remained central to the EU and had neither abandoned it, nor been abandoned by it:

> The decision not to proceed with a treaty at 27 has no impact on our status in the European Union. Our role in the EU is safeguarded by the existing treaties. Britain remains a full member of the EU. Our membership is vital to our national interest. We are a great trading nation, and we need the single market for trade, investment and jobs.[109]

He reminded the House that the EU "is not a monolithic block, and it already contains flexible arrangements" (c 756) and other UK opt-outs from EU policies have "not prevented us from leading the way in the EU on a range of issues, from an activist foreign policy to the completion of the single market".[110] Others are confident that the EU needs the UK too much to marginalise it. John Redwood said of EU-UK trade that "The EU sells a lot more to us than we sell to them. They would not wish to risk that".[111]

Many commentators were not so confident. The *Economist's* Bagehot blog on 9 December was sceptical that David Cameron's veto would result in a defence of British national interests in the long-term:

> ... when one member of a club uses his veto, he blocks something from happening. Mr Cameron did not stop France, Germany and the other 15 members of the euro zone from going ahead with what they are proposing. He asked for safeguards for financial services and—as had been well trailed in advance—France and Germany said no. That's not wielding a veto, that's called losing.

In the immediate term, Bagehot thought Cameron "took the decision to reject a new EU treaty because he was not sure he could get it through the House of Commons" (This view was shared by several observers of UK and EU politics).

The *EUObserver*'s "Euro maverick blog" on 12 December 2011 thought the UK Government had "suffered a rare defeat" and "overplayed their hand", and that "the Europeans have called the British bluff". Commissioner Olli Rehn said the City of London could not avoid EU financial regulation as a result of the UK veto, and some analysts believed the UK's influence in the future shaping of such financial regulation would be significantly reduced as a result. Graham Bishop, an EU financial legislation expert, was reported to have warned that the

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[108] HC Deb 13 December 2011 c 719
[109] Ibid c 756
[110] Ibid c 757
[111] John Redwood's diary, 2 December 2011

UK's "antagonism" towards the other Member States would lead to it being "systematically out-voted on single market measures", particularly when the 2014 double majority voting mechanism comes into effect and the non-euro States can no longer form a blocking minority.[112] The Socialist leader in the EP, Martin Schulz, found Cameron's demands for the City unacceptable and accused "the speculators in the City of London" of having "driven us into the crisis".

Wolfgang Kaden commented on 12 December 2011 in *Der Spiegel* that the UK was "an EU member that never truly wanted to be part of the club. It was more of an observer than a contributor and it always had one eye on Washington"; also that "the political classes in Britain never fully shared the Continental conviction that the European Union was an absolute political necessity". The leader of the German Social Democrats and former foreign minister, Frank-Walther Steinmeier, told the *Rheinische Post* that he could foresee the day when the UK would leave the EU altogether. He was reported as saying "I fear that the decisive step for a British exit from the EU has already been accomplished".[113] Charles Grant (Centre for European Reform) told a meeting to celebrate the book launch of Jean Claude Piris's "The Future of Europe - Towards a Two-Speed EU?" that "it is quite likely Britain will leave the EU within 10 years".[114]

Sir Graham Watson, leader of the liberals in the EP, said in a written statement that David Cameron had "played his cards badly", continuing:

> He could have achieved the safeguards he sought and preserved the UK's influence in Europe by ensuring reform within the EU treaty framework. Instead he upset his counterparts by holding out against bank regulation, sidelined the European Commission and Parliament and left Britain in the EU but with much less sway over its decisions. Much work must now be done to stop a slide to an intergovernmental hegemony dominated by Germany and France.[115]

Benjamin Fox, a political advisor working for a Socialist MEP, raised the prospect of a UK-EU "Midlothian question",[116] asking whether British MEPs and Government ministers should be involved in decision-making affecting only the other 26 Member States. In his view "an EU version of 'West Lothian' has been a dirty, unspoken secret ever since the Maastricht Treaty", at which time the UK and Denmark did not sign up to the single currency, followed by subsequent UK opt-outs from Schengen and justice and home affairs policies. He concluded:

> Some MEPs already want to have sub-committees on policy areas where some Member States have opt-outs. What happens if they push to harmonise corporation tax and introduce a financial transactions tax? Will British MEPs be allowed to vote even if their ministers are locked out of the negotiations? Now that the fiscal union treaty defines a clear line between the EU-26 and Britain,

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[112] From November 2014, QMV will be calculated according to a double majority: 55% of EU Member States (15 Member States) and 65% of the EU's population. By 2014 the Eurozone will have a qualified majority.

[113] *EUObserver* 15 December 2011

[114] *EUObserver* 11 January 2012

[115] *EurActiv 12 December 2011*

[116] This refers to issues concerning the ability of MPs from constituencies in Northern Ireland, Scotland and Wales to vote on matters that only affect people living in England.

> it's time that the EU's barrack-room lawyers gather together to resolve our unspoken 'West Lothian'.[117]

In the debate on 29 February 2012, the Shadow Europe Minister, Emma Reynolds, painted a picture of UK in solitary confinement within the EU: "The UK will be barred from key meetings, rendering us voteless and voiceless in future negotiations. Without being in the room, we stand little chance of knowing—let alone influencing—whether eurozone Ministers will stray into areas of decision making that affect the 27".[118] She thought the UK had "never been so excluded from decisions affecting its vital national interests" (ibid, c 310).

Kirsty Hughes,[119] in a comment on 10 December, thought: "perhaps one positive outcome of the UK now having the weakest political influence, and most ineffective political strategy, of any point in time of its 38 years of EU membership, will be that we can now have a serious British debate about this".

Will the other EU Member States 'gang up on' the UK? Will the UK have to fight even harder to keep its EU budget rebate? The prospect of a 'vindictive Europe' (see comment by Nigel Dodds above) was evident in the EP debate on 13 December 2011, when Joseph Daul (European People's Party) linked the UK veto to the UK budget rebate: "If the UK's solidarity towards the other 26 is being abandoned, I do not see why the others should show solidarity to UK. Solidarity must work in both directions".[120] In evidence to the ESC, the European Movement thought the UK veto had "also created bad faith between Britain and some of its allies in the European Council of the EU. Member states like Poland are increasingly viewing Britain as an unreliable partner". Paul Craig differed, given the unlikelihood of the EU-25 sharing "a common vision that is distinct from the UK and Czech Republic". He envisaged a degree of animosity, not of 25 against 2 but *among* the EU-25, because of increased EU oversight over domestic economies and possible inter-state legal actions under Article 8.

David Cameron was reported to have contacted other potential Treaty doubters in the days following agreement on the Fiscal Compact, including the Czech Prime Minister, Petr Nečas, the Swedish Prime Minister, Fredrik Reinfeldt, and the Irish Prime Minister, Enda Kenny.[121] However, the Government has sought to quash any suggestion that the Prime Minister was desperately seeking allies in Europe.

Lord Kerr, speaking in the Lords debate on EU development on 16 February, thought the UK would be severely damaged by its position. Asking "Does our self-exclusion matter?", he answered his own question as follows:

> I fear so. I have argued previously in this House that leaving an empty chair is always unwise. The noble Lord, Lord Radice, must be right to say that it is easier to defend your interests if you are there. When the treaty becomes operational, our officials who helped in the drafting have to leave the room. Most of their colleagues from non-eurozone member states will be able to stick around. Are we sure that the Poles, the Danes and the Swedes have got this wrong and we have got this right? Why are we sure that they have got it

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117 *EUObserver* blog 4 February 2012. The Czech Republic had not yet announced its decision not to participate.
118 HC Deb 29 February 2012 c 308
119 Senior associate fellow, Centre for International Studies, Department of Politics and International Relations, Oxford University
120 EP Plenary, 13 December 2011
121 *EurActiv* 15 December 2011

> wrong? When this group meets at European Council-Heads of Government-level, 25 Governments will be represented. The others will be able to influence the thinking of the eurozone and what it decides to do. Why do we not want to do that? For all this talk of a veto, all we vetoed was our own attendance.

In the weeks after the January 2012 summit, David Cameron sought to engage bilaterally with other EU leaders. At the UK/France summit on 17 February in Paris (which followed the November 2010 summit at which two bilateral defence treaties were signed), Nicolas Sarkozy and Cameron issued joint declarations covering defence and security, energy and Syria. William Hague told the Commons on 20 February "The UK and France are committed to working together, for the security and the prosperity of both our nations". The Prime Minister also went to Stockholm "to cement ties with liberal-minded Nordic and Baltic states"[122] and on 21 February held talks with Mariano Rajoy, the centre-right Spanish leader, about the Eurozone crisis and the case for economic reform. David Cameron and eight other EU leaders also signed a joint letter calling for robust action by the March European Council to develop the single market in services, digital industries, energy and other sectors. The *Financial Times* commented:

> It will be seen as an attempt to promote a more red-blooded message of reform and liberalisation than that proposed by Nicolas Sarkozy, French president, and Angela Merkel, German chancellor, before an EU summit in January.
>
> However, even some of Mr Cameron's new allies believe his decision to block an EU treaty revision at a fractious summit at the end of last year weakened his ability to influence the economic debate.

Mark Hoban also emphasised in evidence to the ESC on 14 March 2012 the many bilateral meetings he had had recently with EU counterparts as evidence that "our influence has been diminished as a consequence of the December meeting". David Lidington was optimistic about the UK's relations with EU partners, telling the ESC in February 2012 that "Since the December European Council, many of the countries that have signed the Intergovernmental Treaty have been extremely eager to show that they want to work with us as a key partner on a whole range of measures, and especially the single market". William Hague affirmed that the Fiscal Compact issue had not spilled over into other policy areas and pointed to the recent UK initiative on growth and competitiveness which eleven other States had supported.[123] He was confident that not joining the new Treaty had "not affected the way we work together" and had had "no impact of any significance in the wider world".[124] He did not think UK leverage in the EU had been reduced on global issues or EU matters such as competitiveness.

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[122] *Financial Times* 21 February 2012

[123] See also Lord Howell's comments in his speech "Britain and the quest for influence in a re-shaped EU", 9 March 2012

[124] Evidence to Foreign Affairs Committee, 8 March 2012

Appendix I Summary of the TSCG

Article 1(1): the purpose of the Treaty:

> .. to strengthen the economic pillar of the Economic and Monetary Union by adopting a set of rules intended to foster budgetary discipline through a fiscal compact, to strengthen the coordination of economic policies and to improve the governance of the euro area, thereby supporting the achievement of the European Union's objectives for sustainable growth, employment, competitiveness and social cohesion.

Article 1(2): the Treaty applies to euro area states and (read with Article 14) to non-euro Contracting Parties when they adopt the euro. The latter may declare that they will be bound by its substantive provisions earlier.

Article 2: EU law takes precedence over the Treaty. Article 2(2) states that "The provisions of this Treaty shall apply insofar as they are compatible with the Treaties on which the Union is founded and with European Union law. They shall not encroach upon the competences of the Union to act in the area of the economic union".

Articles 3 and 4: the terms of the fiscal compact:

- government budgets shall be balanced or in surplus. The annual structural deficit shall not exceed 0.5% of GDP (unless government debt is very low, in which case the structural deficit can be up to 1%);
- there will be an automatic correction mechanism, triggered if the State deviates from a country-specific medium-term objective, or its adjustment path towards that objective;
- if the ratio of general government debt to GDP exceeds 60%, the difference between the actual ratio and 60% should be reduced by an average of one-twentieth per year.

Article 3(2): the Contracting Parties must put into national law the balanced budget rule "through provisions of binding force and permanent character, preferably constitutional, or otherwise guaranteed to be fully respected and adhered to"; and also to transpose the automatic correction mechanism specified in Article 3.

Article 5: Parties in breach of the deficit criterion and subject to the excessive deficit procedure must put in place a programme of structural reforms to reduce the deficit. The form and content of such programmes will be defined in EU law.

Article 6: the Parties must report their borrowing plans *ex ante* to the Commission and the Council, in order to better coordinate debt issuance.

Article 7: the Parties undertake to support European Commission recommendations where a Eurozone State is in breach of the deficit criterion and subject to the excessive deficit procedure, unless a Qualified Majority of Eurozone States objects to the recommendation.

Article 8: the EU Court of Justice may rule on whether Parties have complied with the requirements of Article 3(2); and the Court may levy a fine of up to 0.1 per cent of GDP if its ruling is not complied with.

Articles 9 - 11: economic policy coordination. Under Article 9 the Parties "undertake to work jointly towards an economic policy fostering the smooth functioning of the Economic and Monetary Union and economic growth through enhanced convergence and competitiveness".

Article 10: the Parties should make use of existing procedures in the TFEU to take forward measures specific to Eurozone States (Article 136 TFEU regarding Eurozone and Articles 326 - 334 regarding enhanced cooperation).

Article 12: Euro Summit meetings will be held at least twice a year.

Article 13: there will be a conference of MEPs and States Parties' national parliamentarians.

Article 14: the Treaty will come into force when twelve Eurozone States have ratified it.

Article 15: after the Treaty comes into force it will remain open to other EU Member States.

Article 16: within five years the Treaty may be incorporated into the EU Treaty framework.

Appendix II Evolution of the TSCG

On 16 December 2011 the European Council's Legal Service approved the text of a draft intergovernmental agreement to implement the Fiscal Compact, which would be finalised by the end of January 2012 and submitted for signature at a summit on 1-2 March 2012. The first four drafts of the treaty were not published on the EU's *Europa* website, confirming its non-EU status, but perhaps at the expense of transparency. The drafts were published by other sources, as outlined below, and only the final text of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union was published on the European Council website.

The drafts made frequent, if qualified, reference to the role of the EU institutions in the new mechanisms. The language was sometimes vague, calling on Contracting Parties, for example, to "undertake" to support Commission proposals if they were in excessive deficit. However, both the Commission and the Court of Justice were given legal capacity, the later endorsement of which by the Council Legal Service (see below) was a setback for the UK Government.

An ad hoc working group was set up to discuss and negotiate the final text of the new treaty. It met on 20 December 2011 and 6 and 12 January 2012, and the draft treaty was also discussed at a Eurogroup-plus[125] meeting on 23 January 2012. The working group comprised three delegates from each of the Eurozone-plus group, three officials from the Commission, the European Central Bank and three Members of the European Parliament (Elmar Brok (EPP), Roberto Gualtieri (S&D) and Guy Verhofstadt (ALDE), with substitute Daniel Cohn-Bendit (Greens/EFA).[126] The Council provided 'technicians' to assist Herman Van Rompuy in the negotiations. UK officials from the FCO and the Treasury, as well as the UK Permanent Representative to the EU, attended the working group and Europlus meetings as observers.

The first draft agreement

The first draft agreement was circulated among Member States on 17 December 2011. This draft, as the basis for the final treaty, is considered in some detail below. Only amendments are considered subsequently, and there is a summary of the final text at the end of this section.

In preambular recitals, the draft referred to the relationship of the Fiscal Compact with the EU Treaties and its aim of helping to implement measures taken under EU Treaty Articles 121 (coordination of economic policies), 126 (avoidance of excessive government deficits) and 136 (strengthening budgetary discipline) of the *Treaty on the Functioning of the European Union* (TFEU). The draft took note of the role of the Commission in reviewing and monitoring budgetary commitments under powers provided by these EU Treaty Articles, and also noted that the transposition of the "Balanced Budget Rule" into national legal systems at constitutional or equivalent level should be subject to the jurisdiction of the Court of Justice under Article 273 TFEU.

[125] 17 Eurozone Members + six non-euro States

[126] Because of the intergovernmental nature of the proposed agreement, the EP had no formal role in its negotiations or future ratification processes. However, the EP was invited to participate in the working group and it debated progress in the negotiations.

Draft Article 1(2) (Title I: Purpose and Scope) stipulated that the Agreement would apply to Eurozone Members, but "may also apply to the other Contracting Parties" under conditions set out in Article 14.

Article 2 (Title 2: Consistency and Relationship with the Law of the Union), specified that the Agreement would be applied "in conformity with" the EU Treaties, EU law and Article 4(3) of the *Treaty on European Union* (TEU), which required "full mutual respect" and mutual assistance "in carrying out tasks which flow from the Treaties". Article 2(2) clarified that the Agreement provisions would apply "insofar as they are compatible with" the EU Treaties and with EU law, and not "encroach upon the competences of the Union to act in the area of the economic union"; also, EU law would take precedence over the provisions of the Agreement.

Articles 3 – 8 on Budgetary Discipline (Title III) gave the Commission and Council a role in receiving reports from the Contracting Parties on their national excessive deficit programmes. The text did not specify what these institutions would do with the programmes after submission.[127] Similarly, Article 6 did not bind the EU institutions but referred to them as recipients of information on Member States' national debt issuance.

Draft Article 7 obliged the Eurozone Contracting States to act as a coordinated voting bloc in supporting Commission proposals or recommendations against a Member State under the excessive deficit procedure for breach of the debt criterion, unless those States decided to oppose it by QMV ('reverse Qualified Majority Voting'). The QM was that stipulated in transitional provisions in Article 3 of Protocol 36, which is attached to the EU Treaty (it applies the same proportion of weighted votes among participating Council members as there would be if all States were participating), and Article 238 TFEU on the post-2014 period (at least 55% of participating Member States, comprising at least 65% of the population of these States). France and Germany together constitute a blocking minority of Eurozone States; thus, if they support a Commission proposal, Article 7 means that the other Eurozone States would have to as well – unless France or Germany were the subject of the proposal, in which case their position would not be taken into account (end of draft Article 7).

Draft Article 8 gave the Court of Justice jurisdiction in any dispute between Member States which related to the subject matter of the Treaties (inter-State disputes are rare in practice), if the dispute was submitted under a special agreement between the Parties. The draft did not provide for the Commission to sue Member States, so it did not conflict with Article 126 (1) TFEU, which rules out Court of Justice jurisdiction over "infringement actions" brought by Member States or the Commission regarding most of the excessive deficit rules.

Draft Article 11 (Title IV: Economic Convergence) required all Parties to "ensure that all major economic policy reforms that they plan to undertake" were discussed and coordinated among themselves and involved the EU institutions.

Draft Article 12 required the relevant economic and finance committees in the Member States to associate with their counterparts in the relevant EP committee.

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[127] Professor Steve Peers of *Statewatch* suggested the detail might have been omitted "because of a concern that the ... Treaty could be challenged legally if it conferred specific tasks on those EU institutions" *Statewatch Analysis*, "Draft Agreement on Reinforced Economic Union (REUTreaty), 21 December 2011.

Draft Article 13 (Title V: Euro Summit Meetings) established informal twice yearly (at least) meetings of Eurozone leaders to discuss:

- Questions related to the specific responsibilities those States share with regard to the single currency;
- Other issues concerning the governance of the Euro area and the rules that apply to it, particularly:
  - strategies for conducting economic policies and
  - improved competitiveness and increased convergence in the Euro area.

The summits would be prepared by a president appointed by the Eurozone leaders by a simple majority (draft Article 13(1)), in close cooperation with the Commission President and the Euro Group. The other EU Member States (including the UK) would be "closely informed of the preparation and outcome" of the summits and the EP would be informed of summit outcomes (draft Article 13(4)).

Under draft Article 14 (Title VI: General and Final Provisions), the Contracting Parties would ratify the Agreement "in accordance with their respective constitutional requirements" and it would enter into force following the deposit of the ninth instrument of ratification by a Eurozone Member.

Under draft Article 15(5), non-euro States who ratify the Agreement would be bound by it as soon as they adopted the Euro, but they could put in place some of the details immediately.

Comment

The working group met for the first time on 20 December 2011. Its three MEPs were not convinced a new treaty was needed and Roberto Gualtieri thought that most, if not everything, could have been done through EU secondary legislation.[128] Gualtieri and Guy Verhofstadt told EP colleagues that the legal services "could give no answer when specifically asked what in the draft pact could not be achieved under current EU law".[129]

Commentators pointed to similarities between, and at times conflicts with, the 'six-pack' measures, which significantly increased budgetary surveillance at EU level (although the UK is exempt from some of the sanctions that affect Eurozone states, the UK Government is required to submit its fiscal plans for EU surveillance). Elmar Brok thought the draft agreement required less than the six-pack,[130] while Gualtieri pointed to "overlapping rules and competences", and different percentage targets between the draft agreement and the 2010 legislation on economic convergence.

The group raised legal questions about the jurisdiction of the Court of Justice in an intergovernmental agreement, and criticised the draft Article on Contracting States policing each other's enforcement of the budget rules. The Treaties already provide for such inter-State surveillance, although this has been rarely used compared with cases initiated by the European Commission.

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[128] *EUObserver* 20 December 2011
[129] Ibid
[130] Ibid

When the EP Economic and Monetary Affairs Committee and the Constitutional Affairs Committee held a joint meeting to discuss the draft text on 20 December, Guy Verhofstadt disputed the use of the Court of Justice under Article 273 TFEU to enforce budget discipline, as this Article was intended to resolve *different interpretations* of the EU Treaties by Member States. He also noted that this provision had not been used in the last 60 years, suggesting that a better legal basis to ensure enforcement would be either Articles 259 TFEU (which had been used six times in the last 60 years) or Article 258 (which had been used more than 2,000 times). Verhofstadt wanted the Commission to have a stronger role in the proposed procedures and in enforcing the agreement. The roles of the Court and Commission under the proposed treaty were discussed intensively in the weeks that followed.

The UK Liberal Democrat MEP, Andrew Duff, believed that the prospect of the new treaty represented the greatest rupture the orthodox Community system had ever experienced. He said that the principle that Member States should try not to act outside of the EU framework had to be protected, but acknowledged that this arrangement was ultimately a pragmatic solution to the UK veto.

UK European Conservative and Reformist (ECR) MEPs objected to a role for the EU institutions in an intergovernmental treaty. Kay Swinburne (ECR) thought it was dangerous to adopt the treaty for political and symbolic reasons: just as global investors and markets were beginning to understand the implications and long-term effects of the 'six pack' and other economic governance measures, and were optimistic about what they might deliver, politicians were now risking confusing investors and increasing uncertainty by reopening the debate on economic governance.

Martin Howe QC was worried about the lawfulness and possible effects of draft Article 7, which remained in the final text, fearing that a precedent might be set for the States Parties to the new treaty to act as a coordinated voting bloc on other EU action, for example, single market measures which applied to the whole EU:

> ... if a formal voting bloc mechanism of this kind is left unchallenged, there is then a danger that it could be used as a precedent to justify, for example, a formal pact between euro area countries (or a large subset of them) under which they agree to coordinate their votes in the Council on matters which apply to all EU Members, such as EU legislation relating to financial services which is deemed to affect the eurozone.[131]

Second draft treaty

The Danish Minister for European Affairs, Nicolai Wammen, made available a more strongly worded second draft (now a 'treaty' rather than an 'agreement', giving it more political weight), on 5 January 2012.

Draft Article 1 was expanded to include "... a stronger coordination of economic policies, involving an enhanced governance to foster fiscal discipline and deeper integration in the internal market as well as stronger growth, enhanced competitiveness and social cohesion". Draft Article 3(b) referred specifically to EU Regulation 1466/97 as amended by Council Regulation 1177/2011, "on speeding up and clarifying the implementation of the excessive deficit procedure", as well as to the 3% reference value specified in the first draft.

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[131] Written evidence to the European Scrutiny Committee, 5 February 2012

Draft Article 2 referred to existing EU legal obligations that trigger sanctions in the event of significant deviations from the reference value, and required Contracting Parties to "implement a programme to correct the deviations", rather than just to "present" one.

Draft Article 5 specified that the content and format of the budgetary and economic partnership programmes "shall be defined in the law of the Union" their implementation "monitored by the Commission and Council". While the first draft required the programmes to be submitted to the Commission and Council, the revised text required these institutions to endorse and monitor them.

Revised Article 8 expanded on the first draft in two significant respects:

- the Commission, "on behalf of Contracting Parties" could also bring before the Court of Justice an action concerning a violation of the 'golden rule';

- the failure to comply concerned the whole of Title III, not just Article 3(2).

Under draft Article 9, in addition to States taking "all necessary actions" to improve EMU and economic growth, they had to pay particular attention to "all developments which, if allowed to persist, might threaten stability, competitiveness and future growth and job creation".

Article 14 raised the threshold of Member State ratifications necessary for entry into force from nine to 15, and a new sub-paragraph (6) specified that within five years of the treaty coming into force, if it was assessed as having been successful (there is no indication of how this assessment would be made or by whom, although presumably the Commission would have a role), an initiative would be launched under the EU Treaties to incorporate "the substance of this Treaty into the legal framework of the European Union". In other words, the intergovernmental arrangements would be merged with existing Treaty arrangements through a Treaty amendment. This Article could not itself effect a future Treaty change, but it would apparently have the authority to launch "an initiative" to do so. This would present the UK with another opportunity to negotiate "safeguards".

Comment

The three MEPs on the working group were critical of the revised text. Guy Verhofstadt had suggested to the Council Legal Service that everything in the proposed treaty could be introduced by secondary legislation using Articles 136 and 333-334 TFEU, and Protocol 12. The Council conceded that this was correct but said the treaty was necessary for political and symbolic reasons. Brok had sought two changes: more explicit reference to the EU treaties, to underline that the new treaty would be compatible with these; and a clause granting the leaders of the EP's main political groups the right to address Eurozone summits. A statement signed by Brok, Gualtieri, Verhofstadt and Cohn-Bendit found the latest text incompatible with the EU Treaties because it did not respect the "Community method"[132] of decision-making which ensured "proper democratic scrutiny and accountability".

[132] This is the EU's usual method of decision-making: the Commission makes a proposal to the Council and EP, which debate it, propose amendments and eventually adopt it as EU law, often having consulted other bodies such as the European Economic and Social Committee and the Committee of the Regions.

The *EUObserver* cited one diplomatic source who thought mandating the Commission to act "on behalf of" the Member States was a "legal trick to get around the issue" of using the EU institutions in an intergovernmental context. The author, Valentina Pop, also thought that raising the number of ratifications was "Germany's desire to have all southern Eurozone countries sign up to the 'golden rule' of a balanced budget before committing further bail-out money".

UK Conservatives welcomed the second draft because it reduced explicit references to the single market. However, disagreement remained over its provisions on future Eurozone summitry and the role of the EP, the Commission and non-euro States.

Third draft treaty

A third draft treaty was posted on the Open Europe website on 11 January 2012. It was for the most part a much 'softer' text than its predecessors, which commentators attributed to fears about ratification difficulties in some Member States.

Draft Article 1 removed the reference to "deeper integration in the internal market", which UK Conservatives welcomed, saying it reduced the role of EU institutions.[133]

Draft Article 2 omitted the provision that EU law has precedence over the new treaty provisions, but retained the guarantee of compatibility with the EU Treaties and non-encroachment on EU competences.

In Draft Article 3 the inclusion of the 'golden rule' on balanced budgets being incorporated into "national binding provisions of a constitutional or equivalent nature" was watered down, stating only that the provisions should have "binding force and permanent character, preferably constitutional". This was reported to stem from indications that several Eurozone and non-Eurozone States (e.g. Ireland and Finland, Denmark and Romania) would have to hold referendums in order to change their constitutions.[134]

Draft Article 8 reverts to restricting the Court's power of judicial review only to cover compliance with the obligation under Article 3(2), not under the whole of Title III, for Contracting Parties to enshrine the balanced budget rule into national law. As a result of French concerns about the Commission becoming too powerful, the Commission's role was weakened: it could, if asked by a Contracting Party, "issue a report" on the alleged failure of another Contracting Party to comply with Article 3(2). That State could submit its observations, but if the Commission confirmed non compliance in its report, the matter would be brought to the Court of Justice by the Contracting Parties. Also, sanctions for breaking rules on overall public debt were removed, and penalties were limited to breaches of budget deficits.

The wording in Article 9 on economic policy coordination was revised and generalised, stating only that Contracting Parties "shall take the necessary actions and measures in all the domains which are essential to the good functioning of the euro area, as mentioned in the Euro Plus Pact". According to a report in the *EUObserver*, "Opposing camps differ on whether to make mention of growth-enhancing measures and if so, on the nature of the reference".

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[133] *EurActiv* 12 January 2012
[134] *EUObserver* 11 January 2012

Article 14 reduced the number of ratifications necessary for the treaty to come into force from 15 in the second draft to 12 (it was 9 in the first draft). Germany was reported to want a high number "so that all struggling eurozone countries get on board".[135] There was a new Article 15 to allow other EU Member States to accede to the agreement at a later date by "common agreement" of the Contracting Parties. The third draft retained in draft Article 16 the "initiative" to be launched with the aim of incorporating the substance of the treaty into the EU Treaties within five years of its entry into force.

Comment

Reports on the third draft highlighted "clear concessions to Britain". Martin Callanan, the leader of the UK Conservatives in the EP, claimed the revisions showed that the UK was not isolated and that "Conservatives by their strong stance are directly influencing the shape and scope of this agreement. We are using that influence to benefit Britain".[136]

The EP criticised the new draft for undermining the EU institutions. On 16 January the EP's Economic and Monetary Affairs Committee and the Constitutional Affairs Committee held a second joint meeting to discuss the working group negotiations. Roberto Gualtieri had hoped for significant improvements in the third draft, which were unforthcoming: there was still no guarantee that a decision to implement the new treaty would be taken under existing EU Treaty procedures, thereby ensuring democratic scrutiny and accountability. He also wanted draft Article 13 to state that inter-parliamentary scrutiny of the economic and budgetary policies should be carried out within the framework of Protocol 1, Article 9, of the Lisbon Treaty.[137] MEPs raised continuing concerns about the proposed treaty's compatibility with EU law and hoped the next draft would contain provisions that the determination of the balanced budget rule in Article 3 would be incorporated into EU law by secondary legislation, which would ensure compatibility with the 'six-pack' of economic governance reforms.

On 18 January the EP plenary adopted by 521 to 124 with 50 abstentions a resolution on the December 2011 European Council conclusions. The resolution affirmed the EP's belief that an intergovernmental treaty was not necessary because its aims were achievable under EU law; that EMU's evolution into a true economic and fiscal union could only be via the Community method; that EU law had primacy over the new treaty; that the EP should participate in all aspects of economic coordination and governance and cooperate with national parliaments; that the treaty terms should be incorporated into the EU Treaties within five years; that the Commission should remember its duty as 'guardian of the Treaties', and that the treaty should include a commitment to implement the Financial Transactions Tax.

Professor Michael Dougan and Dr Michael Gordon noted the precise wording of revised draft Article 3(2), compared to the first two drafts, which appeared to propose "that certain Member States may make use of a Union institution for non-Treaty purposes".[138] They concluded that there were two situations in which the Commission would have a role for purposes outside the strict scope of EU law: "in assessing the need for possible judicial enforcement of national transposition of the balanced budget commitment; and in proposing

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135 *EUObserver* 17 January 2012

136 Ibid

137 The Protocol on the role of national parliaments in the EU, which states: "The European Parliament and national Parliaments shall together determine the organisation and promotion of effective and regular interparliamentary cooperation within the Union".

138 Evidence to the ESC, 13 January 2012

the principles for the agreement of the Contracting Parties which will underpin national design of the automatic correction mechanism". How would this fit in with the fundamental principle of conferred powers contained in Article 5(2) TEU, which states that "The limits of Union competences are government by the principle of conferral" and that "the Union shall act only within the limits of the competences conferred upon it by the Member States in the Treaties to attain the objectives set out therein"; or Article 13((2), which stipulates that each EU institution must act within the limits of the powers conferred on it by the EU Treaties and in conformity with the procedures, conditions and objectives set out in them?

Fourth draft treaty

A fourth draft was circulated on 19 January 2012 and published by Open Europe. While it went some way towards meeting EP demands, it did not match those of UK Conservative MEPs. The fourth draft contained some key changes.

The preamble noted "the wish of the Contracting Parties to make more active use of enhanced cooperation" and made, as of 1 March 2013, the granting of assistance under the ESM conditional on ratification of the treaty.

Draft Article 2 referred explicitly to the primacy of EU law and to the use of EU law to implement provisions of the new treaty.

Draft Article 3(2) invited the Commission to report on each Contracting Party's adherence to Article 3(2), rather than the Commission being invited by a Member State to issue a report on the transposition of the balanced budget rule into national law.

In amended draft Article 8, if the Commission found that a State had failed to transpose the budget rules correctly, "the matter will be brought to the Court of Justice ... by one or more of the Contracting Parties". Further changes to draft Article 8 concerned the jurisdiction of the Court. If the Court confirmed that the Government concerned had ignored its previous ruling, it could impose a fine payable to the ESM of not more than 0.1% of that State's GDP. This provision was new in the treaty but not altogether new: the revised Stability and Growth Pact provides that fines imposed by the Council are paid to the ESM.

The fourth draft transferred from the Preamble to Article 8(3) the provision that Article 8 "constitutes a special agreement between the Contracting Parties within the meaning of Article 273" TFEU. The Open Europe blog on the fourth draft commented on 19 January that this "read like an insurance against any possible objections from the UK regarding the use of the ECJ outside the EU Treaties".

Perhaps in the light of reported threats from Poland that it would not sign up to the new treaty unless non-Eurozone Member States were invited to Euro summits,[139] draft Article 12(6) was amended and now invited non-euro States to the summits "at least once a year", but only if they have ratified the treaty and "declared their intention to be bound by some of its provisions". Professor Steve Peers asked if this meant a State like Poland could "comply only with a less significant provision of the treaty, such as Art. 6, 9, 10 or 11, in order to qualify for the right to be invited to meetings?" This condition appeared to exclude the UK, although there was no mention of an alternative status, such as that of observer, at such meetings.

[139] See EUObserver, 19 January 2012

Draft Article 13 incorporated the Lisbon Treaty Protocol 1, Article 9 (on inter-parliamentary cooperation), and stated that "The European Parliament and national Parliaments ... will together determine the organisation and promotion of a conference of the chairs of the budget committees of the national Parliaments and the chairs of the relevant committees of the European Parliament".

Comment

There were at this stage in the negotiations a number of outstanding issues:

1. Determining the link between the ESM and the new treaty. Responding to German demands, the granting of assistance under the ESM to Eurozone States was made conditional on ratification of the new treaty and compliance with Article 3(2). (An earlier draft had required Member States to comply with Article 3(2) in order to be granted ESM support, which assumed ratification of the treaty, whereas this draft made ratification explicit). Some working group delegations thought the two-step approach was too complicated, preferring a single cut-off date, after which conditionality would apply. (There were media reports around this time that Ireland had been floating the idea of "extending" the existing programme, although the Irish Finance Minister, Michael Noonan, said talk of a second bailout was "ludicrous").[140] *EurActiv* reported on 20 January: "The measure would apply added pressure to those eurozone states reliant on bailouts and under domestic pressure to hold referendums, and above all Ireland, where such a referendum would be close-fought".

1. Draft **Article 7**, on the commitment to support Commission proposals or recommendations where a Eurozone State is considered to be in breach of the deficit criterion, was agreed by the European Council on 9 December 2011 and supported by several working group delegations. However, others argued that the Excessive Deficit Procedure (EDP) is a unique procedure, whereby no distinction should be made between an EDP opened on the basis of the deficit or the debt criterion. On that basis, those delegations wanted Article 7 to apply to all EDP procedures, i.e. including those opened on the basis of a breach of the debt criterion.

2. Draft **Article 8**, allowing the Court of Justice to verify the transposition of the balanced budget rule at national level, gave the Court the authority to impose financial sanctions (not exceeding 0.1% of GDP) where it found a Contracting Party not to have taken the necessary measures to comply with its judgment.

3. Draft **Article 9** on economic policy coordination was consistent with the European Council statement of 9 December 2011. The working group had discussed the appropriate level of specificity for this Article, and the draft included four concrete objectives to ensure the good functioning of the Eurozone, in line with the four objectives of the Euro Plus Pact. However, some delegations wanted an explicit reference to the Euro Plus Pact in the treaty.

4. Draft **Article 12** on participation at Euro Summits was in line with working group views, and concerned the format of the summits beyond what was in the Eurozone statement of 26 October 2011, including the participation of the EP President in the Euro Summits and the meetings to discuss implementation of the current treaty.

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[140] *Business and Leadership* 11 January 2012

5. Draft **Article 14.2** on the entry into force of the treaty following ratification by at least twelve euro area Member States. Some delegations were concerned that entry into force before all euro area States had ratified might not contribute to reinforcing fiscal discipline within the euro area, by making it possible for some Member States not to participate, or to participate only at a later stage. Others thought that twelve was a reasonable compromise and some argued in favour of a lower threshold, to allow for earlier entry into force.

Fifth and final draft

> *"...* an electorate's ability to vote for a high spending Keynesian economic policy is effectively being removed from them".
>
> Martin Callanan MEP, Chairman of the European Conservatives and Reformists Group, 1 February 2012

Most of the outstanding issues were settled by a final meeting of the working group and then by the ECOFIN and Euro Group Ministers on 23-24 January. The two remaining issues were the application of reverse QMV in draft Article 7, which some delegations thought should apply to debt as well as deficit criteria within the Excessive Debt Procedure; and the arrangements for the participation of non-Eurozone States in Euro summits in draft Article 12.

The fifth draft of the *Treaty on Stability, Coordination and Governance in the Economic and Monetary Union* (TSCG) was issued on 27 January 2012, and 25 Member States (all but the UK and the Czech Republic) adopted it at the informal European Council on 30 January.

The final treaty text contained compromises that helped to bring on board potential doubters such as Poland. There is a lower annual structural deficit limit of 0.5% of the GDP at market prices in Article 3(1)(b), as opposed to the earlier wording specifying the annual structural deficit "not exceeding 0.5%", which Open Europe described on 30 January as a "watering down of the rules":

> We interpret this as meaning that the lowest the limit will be set for any country will be 0.5% (where as previously it could have been even stricter). Since the article still refers the Stability and Growth pact we can infer that the new balanced budget targets will probably fall somewhere between 0.5% of GDP and 3% GDP (the deficit limit in the treaties);

Access to ESM bail-out money will be conditional on signature and implementation of the treaty. The ESM will also run in parallel to the other bail-out fund, the EFSF, for six months, with a combined lending power of around €750 billion, after which the EFSF will be closed.

Article 8 specified that fines imposed by the Court of Justice will be paid into the ESM if they are imposed on Eurozone States, but fines imposed on non-Eurozone States will be paid into the EU's general budget. Bruno Waterfield commented in the *Telegraph blog* on 30 January: "This means Britain could be a beneficiary of fines under the fiscal pact as all EU surpluses at the end of the year, including fines, are given back to all 27 member states".

The treaty does not make clear how it will be decided which State(s) will start proceedings, but the annex to the minutes of the signing ceremony make clear that the applicants will be the Trio of Presidencies.

Under revised Article 12, non-Eurozone States will not have to agree to be bound by some of the treaty provisions in order to be invited to summit meetings, but they will have to have ratified the treaty.

Under revised Article 15, Member States wishing to sign up to the treaty will not have to wait for other Contracting Parties to "approve the application by common agreement", but will be able to accede as soon as they deposit the necessary instruments of accession (ratification of the fiscal treaty).

An Open Europe blog on 30 January thought that under the final text there is little or no incentive for non-Eurozone States to comply with the budget rules before adopting the euro:

> ... non-eurozone countries no longer need to incorporate any of the rules in order to be invited to attend future eurozone summits. In other words, non-euro countries would have no incentive to accept the rules set out in the 'fiscal treaty' before joining the single currency. What would they be fined for then? It seems very unlikely that non-eurozone countries would ever be fined and therefore that it could ever benefit the UK.

The Commission President announced that it had "successfully defended a series of principles" and had secured for itself "a central role in delivery of the Treaty objectives always in conformity with the Lisbon Treaty and the Community method".[141]

[141] Press release, José Manuel Barroso 30 January 2012

Appendix III Documentation and further reading

Standard Note 6160 In brief: Eurozone crisis documents 15 February 2012

House of Lords European Union Committee, "The future of economic governance in the EU" HL Paper 124-I, March 2011

House of Lords European Union Committee, "The euro area crisis", 14 February 2012 HL Paper 260, February 2012

German proposals for the EU Treaty change to deal with the Eurozone crisis, "The future of the EU: Necessary integration policies for progress towards establishing a Stability union"

European Commission, "What are the main features of the "six-pack" and the Treaty on Stability, Coordination and Governance (TSCG)?"

German proposals for treaty change

Parliamentary procedures for ratifying the TSCG in various EU Member States, FT blog, 14 December

European Foundation, 5 March 2012, Margarida Vasconcelos, "The Treaty on Stability, Co-ordination and Governance in the Economic and Monetary Union is unlawful"

EurActiv 8-9 December 2011: overview of the positions of nine EU Member States on key issues concerning the Fiscal Compact