House of Commons
European Scrutiny Committee

Treaty on Stability, Coordination and Governance: impact on the eurozone and the rule of law

Sixty-second Report of Session 2010-12

Volume I: Report, together with formal minutes, oral and written evidence

Additional written evidence is contained in Volume II, available on the Committee website at www.parliament.uk/escom

Ordered by the House of Commons to be printed 27 March 2012
**European Scrutiny Committee**

The European Scrutiny Committee is appointed under Standing Order No.143 to examine European Union documents and—

a) to report its opinion on the legal and political importance of each such document and, where it considers appropriate, to report also on the reasons for its opinion and on any matters of principle, policy or law which may be affected;

b) to make recommendations for the further consideration of any such document pursuant to Standing Order No. 119 (European Committees); and

c) to consider any issue arising upon any such document or group of documents, or related matters.

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i) any proposal under the Community Treaties for legislation by the Council or the Council acting jointly with the European Parliament;

ii) any document which is published for submission to the European Council, the Council or the European Central Bank;

iii) any proposal for a common strategy, a joint action or a common position under Title V of the Treaty on European Union which is prepared for submission to the Council or to the European Council;

iv) any proposal for a common position, framework decision, decision or a convention under Title VI of the Treaty on European Union which is prepared for submission to the Council;

v) any document (not falling within (ii), (iii) or (iv) above) which is published by one Union institution for or with a view to submission to another Union institution and which does not relate exclusively to consideration of any proposal for legislation;

vi) any other document relating to European Union matters deposited in the House by a Minister of the Crown.

The Committee’s powers are set out in Standing Order No. 143.

The scrutiny reserve resolution, passed by the House, provides that Ministers should not give agreement to EU proposals which have not been cleared by the European Scrutiny Committee, or on which, when they have been recommended by the Committee for debate, the House has not yet agreed a resolution. The scrutiny reserve resolution is printed with the House’s Standing Orders, which are available at www.parliament.uk.

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Additional written evidence may be published on the internet only.

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1 Introduction

Background

Temporary stability measures

1. In May 2010 there was a first response to a gathering sovereign debt crisis in the eurozone, caused partly by a crisis in the banking sector. The main elements of this were the EU’s European Financial Stabilisation Mechanism (EFSM), established under Article 122 of the Treaty on the Functioning of the European Union (TFEU), and the European Financial Stabilisation Facility (EFSF), a special purpose vehicle established by an intergovernmental agreement between the eurozone Member States and funded by them.

2. The EFSM gives financial assistance to a Member State in the form of loans or credit lines raised from capital markets or financial institutions guaranteed by the EU Budget; the guarantee is up to a level of €60 billion (£50.64 billion). The continuing need for the EFSM is to be reviewed every six months, and it is to be discontinued once the exceptional circumstances cited as justification for it no longer exist.

3. The EFSF can issue bonds or other debt instruments on the markets to raise funds for loans to eurozone Member States. Bond issues are backed by guarantees, allowing a loan capacity of €440 billion (£371 billion), given by eurozone Member States in proportion to their share in the paid-up capital of the European Central Bank. The EFSF is to expire in June 2013.

4. Support for eurozone Member States in difficulties under these arrangements can be complemented by assistance from the International Monetary Fund (IMF).

5. To date Greece, Ireland and Portugal have received bailouts:

- Greece’s first, three year, bailout package, agreed in May 2010 (outside the EFSM and EFSM mechanisms), consisted of €80 billion in bilateral loans from eurozone Member States and €30 billion from the IMF;
- Greece’s recently agreed three-year bailout package includes €109.1 billion from the EFSF and €28 billion from the IMF (over four years);
- Ireland received a three-year loan package of €85 billion in November 2010, comprising €22.5 billion each from EFSM, EFSF and IMF, plus bilateral loans from Denmark, Sweden and the UK; and
- Portugal received a three-year loan package of €78 billion in May 2011, comprising €26 billion each from EFSM, EFSF and IMF.

A permanent stability measure

6. In October 2010 the European Council agreed that the EFSM and EFSF should be replaced by a European Stabilisation Mechanism (ESM), “a permanent crisis mechanism to
safeguard the financial stability of the euro area as a whole”,¹ to be established and financed by the eurozone Member States. It was also agreed that a limited revision of the EU Treaties would be necessary to bring the ESM into effect. Accordingly, in March 2011 the European Council adopted, under the simplified Treaty revision procedure,² a Decision amending Article 136 TFEU, which allows the eurozone Member States to establish by intergovernmental treaty a permanent stability mechanism (the ESM) “if indispensable to safeguard the stability of the euro area as a whole”.³ The Decision has still to be ratified by several Member States, including the UK, and is to come into effect on 1 January 2013.

7. During 2011 the eurozone Member States only agreed an intergovernmental treaty to establish the ESM. This was to come into effect on 1 January 2013 but, because of the scale of the crisis, was subsequently amended to come into effect in July 2012.⁴ The ESM will have an effective lending capacity of €500 billion (a figure it has recently suggested should be increased), but it will also seek to supplement its lending capacity through the participation of the IMF in financial assistance operations. In his evidence to us on 14 March, the Financial Secretary to the Treasury described the ESM as “a firewall, with €500 billion of funds there to act as a brake and prevent contagion from spreading. It is a helpful way of trying to resolve the crisis in the eurozone, and one to which we do not have to contribute”.⁵

A “Six Pack” of legislative proposals

8. In parallel to these support measures, the EU adopted the so-called “Six Pack” of EU legislation on economic governance in October 2011. This package of legislation, based on existing provisions in the EU Treaties, is intended to strengthen the fiscal stability of Member States and introduced measures for the surveillance and correction of macroeconomic imbalances similar to those applying to fiscal deficits in the EU’s Stability and Growth Pact. And, like the coercive measures in the Stability and Growth Pact’s excessive deficit procedure, the “Six Pack” provides for coercive measures in an excessive macroeconomic imbalance procedure to be applied to eurozone Member States.

An intergovernmental agreement on fiscal discipline and economic integration

9. By Autumn 2011 there was renewed pressure on the eurozone to come up with further responses to contain the financial crisis. The absence of enforceable measures to improve fiscal discipline and economic integration prompted the Euro Summit in October 2011 to call for the first time for the possibility of “limited Treaty changes”⁶ to be explored in time

² The simplified revision procedures are set out in Article 48(6) of the Treaty on European Union.
⁵ Q 203
for the December 2011 European Council. Germany in particular wanted fiscal discipline to be enforceable through the Court of Justice. At the European Council on 9 December the eurozone Heads of State or Government accordingly proposed new rules on a “fiscal compact” and strengthened economic policy coordination. As was widely reported, the UK exercised its veto at that meeting to prevent the EU Treaties and institutions being used to this end. This is recorded in the Statement of the eurozone Heads of State or Government as follows:

Some of the measures […] can be decided through secondary legislation. The euro area Heads of State or Government consider that other measures should be contained in primary legislation [the EU Treaties]. Considering the absence of unanimity among EU Member States, they decided to adopt them through an international agreement to be signed in March or at an earlier date. The objective remains to incorporate these provisions into the treaties of the Union as soon as possible.\(^7\)

10. On 2 March 2012, 25 Member States signed a non-EU intergovernmental Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (the SCG Treaty). The contents of the SCG Treaty are summarised in the box following this chapter. In outline its purpose is to further strengthen the fiscal and economic discipline of the Stability and Growth Pact and the “Six Pack” legislation. For eurozone Member States access to the ESM will be dependent on compliance with the SCG Treaty.

The inquiry

11. On 19 December 2011 we announced our inquiry into possibilities for reinforcing the eurozone following the December 2011 European Council. In calling for evidence we said that we intended to examine:

- how the resolution of the eurozone crisis was developing and the possible consequences for the UK;
- how to reconcile monetary and fiscal policies within the eurozone, based initially on the Statement of 9 December 2011 by the eurozone Heads of State or Government, with the legal and institutional constraints; and
- the Government’s position on such monetary and fiscal policies within the potential confines of an intergovernmental agreement.

We received 16 written submissions and took oral evidence on four occasions. Those who helped us as witnesses were: Professor Paul Craig, University of Oxford, and Professor Simon Hix, London School of Economics; Charles Grant, Director, Centre for Economic Reform; Professor Michael Dougan, Liverpool Law School, and Martin Howe QC; Wolfgang Münchau, President, Eurointelligence ASBL and Associate Editor of the Financial Times, Douglas McWilliams, Chief Executive, Centre for Economic and Business Research, and Roger Bootle, Managing Director, Capital Economics; Mr David Lidington

MP, Minister for Europe, Foreign and Commonwealth Office, and Mr Mark Hoban MP, Financial Secretary to the Treasury, together with their officials. We are grateful to all who assisted us in our inquiry, although we were hindered by the refusal of the Foreign Secretary and the Chancellor of the Exchequer to do so.

12. During the inquiry we looked at seven broad questions. Two were primarily legal:
   - whether the SCG Treaty was compatible with the EU Treaties, particularly in relation to the roles conferred on the Commission and the Court of Justice; and
   - what were the dangers for the UK in the SCG Treaty’s encouragement of enhanced cooperation, particularly with regard to taxation measures?

Three were primarily economic:
   - whether the SCG Treaty would work, in terms of ending the eurozone crisis;
   - what it implied for Member States with severe fiscal difficulties; and
   - if the SCG Treaty did not work, what the consequences might be for the eurozone, the UK and the wider world?

And two were primarily political:
   - what the consequences might have been for the UK in ratifying the SCG Treaty; and
   - what might they be in standing aside from that Treaty?

Additionally, late in the inquiry our attention was drawn to a question as to whether amendment of Article 136 TFEU was a necessary precursor to setting up the ESM.
Summary of the SCG Treaty

Treaty provisions

Article 1 concerns purpose and scope, which are to strengthen the economic pillar of the economic and monetary union (EMU) by fostering budgetary discipline through a fiscal compact; to strengthen the coordination of economic policies; and to improve the governance of the eurozone, “thereby supporting the achievement of the European Union’s objectives for sustainable growth, employment, competitiveness and social cohesion”.

Article 2 requires that the SCG Treaty be interpreted and applied in conformity with the EU Treaties, with reference made to the principle of sincere cooperation laid down in Article 4(3) TEU, and with EU law (secondary legislation, decisions of the Court of Justice of the European Union), and that the EU Treaties and EU law take precedence in the event of a conflict.

Articles 3 and 4 establish the balanced budget rules for the “fiscal compact, namely that:

- national budgets should be balanced or in surplus, with the annual structural deficit (the balance between government tax receipts and current expenditure, adjusted for change in the business cycle) at the country-specific medium-term objective being no greater than 0.5% for contracting States that have a debt-to-GDP ratio of over 60%, and no greater than 1% for contracting States whose debt is below this mark;
- contracting States may temporarily deviate from their medium-term objectives only in exceptional circumstances, defined as:
  - an unusual event outside the control of the Contracting Party concerned which has a major impact on the financial position of the general government or to periods of severe economic downturn as set out in the revised Stability and Growth Pact;\(^8\)
  - there must be a correction mechanism triggered automatically in the event of significant deviations from the medium-term objective or the adjustment path towards it; and
  - when the ratio of a government’s debt to GDP exceeds 60%, it must reduce it by one twentieth of the difference between the present ratio and the 60% target each year.

Article 3(2) requires contracting States within a year of the SCG Treaty coming into force to put in place the rules in the above paragraph (with the exception of the last) “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.”

Article 3(2) further provides that the automatic correction mechanism is to be implemented nationally “on the basis of common principles to be proposed by the European Commission”.

Article 5 requires a contracting State subject to an excessive deficit procedure under the EU Treaties to put in place a “budgetary and economic partnership programme”, containing a detailed description of the structural reforms to be followed. The content and format of such programmes will be set out in EU legislation, and they are to be monitored by the Council and the Commission.

\(^8\) See Article 3(3)(b), http://european-council.europa.eu/media/639235/st00tscg26_en12.pdf.
Article 6 requires contracting States to report ex-ante to the Council and Commission their borrowing (public debt issuance) plans.

Article 7 commits eurozone States to voting in the Council in support of the Commission’s recommendations against a eurozone State which it considers to be in breach of the deficit criterion in the framework of an excessive deficit procedure, unless a qualified majority is against the recommendation (a “reverse qualified majority”).

Article 8(1) and (2) set out the enforcement mechanism for Article 3(2):

- the Commission will issue a report to each contracting State assessing whether it has fully transposed Article 3(2);
- if the Commission, after having given the State concerned the opportunity to submit its observations, concludes in its report that a State has failed to comply with Article 3(2), the matter will be brought to the Court of Justice by one or more of the contracting States;
- in addition, where a contracting State considers, independently of the Commission’s report, that another State has failed to comply with Article 3(2), it may also bring the matter to the Court of Justice;
- in both cases, the judgment of the Court of Justice shall be binding on the parties in the procedure;
- in addition the complainant contracting State may request that the Court of Justice impose financial penalties on the State in breach of Article 3(2), in line with the powers of the Commission under Article 260 TFEU; and
- the Court of Justice may fine a State in breach of Article 3(2) if it concludes that the State concerned has not complied with its judgment. The maximum fine is 0.1% of the State’s GDP, which shall be paid into the ESM for eurozone States and the EU Budget for non-eurozone States.

Article 8(3) states that Article 8 constitutes “a special agreement between the Contracting Parties within the meaning of Article 273 of the Treaty on the Functioning of the European Union”.

Articles 9 to 11 concern economic policy coordination and convergence. Under Article 9 contracting States undertake to “work jointly towards an economic policy that fosters the proper functioning of the economic and monetary union and economic growth through enhanced convergence and competitiveness”, with the objectives of “fostering competitiveness, promoting employment, contributing further to the sustainability of public finances and reinforcing financial stability.”

Under Article 10 the contracting States:

stand ready to make active use, whenever appropriate and necessary, of measures specific to those Member States whose currency is the euro, as provided for in Article 136 of the Treaty on the Functioning of the European Union, and of enhanced cooperation, as provided for in Article 20 of the Treaty on European Union and in Articles 326 to 334 of the Treaty on the Functioning of the European Union on matters that are essential for the proper functioning of the euro area, without undermining the internal market.

Article 11 requires the contracting States to ensure that all major economic policy reforms that they plan to undertake are discussed ex-ante and, where appropriate, coordinated among themselves. “Such coordination shall involve the institutions of the European Union as required by European Union law.”

Articles 12 and 13 concern governance of the eurozone. Article 12 contains provisions for informal meetings of heads of State or Government and the President of the Commission
in the newly created “Euro Summit”, and for the appointment of its President. The Euro Summit will meet at least twice a year to consider issues arising from the single currency, and “other issues concerning the governance of the euro area and the rules that apply to it, and strategic orientations for the conduct of economic policies to increase convergence in the euro area”. The Euro Group will be responsible for preparing Euro Summits, and implementing their conclusions. The President is to keep other Member States (including the UK) and the European Parliament informed of the outcome of Euro Summit meetings.

Article 13 states that, “as provided for in Title II of Protocol (No 1) on the role of national Parliaments in the European Union”, the European Parliament and national Parliaments “will together determine the organisation and promotion of a conference of representatives of the relevant committees of the national Parliaments and of the European Parliament “in order to discuss budgetary policies and other issues covered by this Treaty.”

Articles 14-16 (Title VI) concern general and final provisions. Article 14 states that the agreement will enter into force on 1 January 2013 if 12 eurozone States ratify it, or the first day of the month after the 12th ratification if earlier. Article 15 states that non-eurozone States can ratify the agreement. Article 16 states that “steps shall be taken” to incorporate the agreement into the legal framework of the EU within five years at most.

**Arrangements for bringing a case to the Court of Justice under Article 8**

Annexed to the Minutes of the signing of the SCG Treaty on 2 March was a document entitled “Arrangements Agreed by the Contracting Parties at the time of signature concerning Article 8 of the Treaty”.\(^9\) It has not been published on the Council’s website, nor made available by the Government. It lays down the following procedure:

- the Trio of Presidencies (the previous, current and subsequent presidency Member States) will lodge an application with the Court of Justice for a declaration that a contracting State has failed to comply with Article 3(2) within three months of the receipt of the Commission’s report to that effect;
- so long as i) the Trio States have not been found to be in breach of their obligations under Article 3(2) of the Treaty by a Commission report, ii) they are not otherwise the subject of proceedings before the Court of Justice under Article 8(1) or (2) of the SCG Treaty, and iii) they are not unable to act on other justifiable grounds of an overarching nature, in accordance with the general principles of international law;
- if none of the three States concerned meets these criteria, the duty to bring the matter to the Court of Justice will be assumed by the members of the former Trio of Presidencies, under the same conditions.\(^10\)

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\(^10\) The Government said these arrangements were a political agreement, which did not have the force of international law. By contrast, Professors Craig, Dougan and Peers thought they were drafted to create legally binding obligations.
2 The legal issues—the evidence

The Government’s view

The Prime Minister’s statements after the European Council of 9 December

13. The Prime Minister said that the UK wielded its veto in the European Council on 9 December:

- because other Member States would not agree to including safeguards on the internal market and financial services within the EU Treaties; and

- to stop EU institutions being used under the EU Treaties for the benefit of the eurozone without the safeguards above.

14. On the latter points, the Prime Minister said in his press conference after the European Council meeting:

[...] there are also risks with others going off and forming a separate treaty; and we should acknowledge that. So we will insist that the EU institutions—the Court, the Commission—that they work for all 27 nations of the European Union.

Indeed, those institutions are established by the Treaty and that Treaty is still protected.11

In his statement to the House on 12 December, the Prime Minister said this:

I understand why they would want to use EU institutions—but this is new territory and does raise important issues that we will want to explore with the euro-plus countries. So in the months to come we will be vigorously engaged in the debate about how institutions built for 27 should continue to operate fairly for all member states, Britain included. The UK is supportive of the role of the institutions, not least because of the role they play in safeguarding the single market, so we will look constructively at any proposals with an open mind. But let us be clear about one thing: if Britain had agreed treaty change without safeguards, there would be no discussion. Britain would not have proper protection.12

Correspondence with the Government during the negotiation of the SCG Treaty

15. The negotiations on the draft SCG Treaty took place within the Ad Hoc Working Group on the Fiscal Stability Union, which met on 20 December 2011, 6 January and 12 January. The draft Treaty was also discussed at a Eurogroup-plus meeting on 23 January and at a Sherpa meeting on Friday 27 January. The UK Government was present at each

12 HC Deb, 12 December 2011, col 521
such meeting. There was also a meeting on the 10 February to discuss the arrangements for the operation of Article 8 of the Treaty.

16. Several iterations of the draft were made public over the course of the negotiations. In the light of these, we wrote to the Minister for Europe on 12 January asking that he send us the latest draft of the SCG Treaty, together with a commentary on it, in time for our last meeting before the European Council on 31 January. We were becoming increasingly concerned about the legality of the proposed roles of the Court of Justice and the Commission:

The role of the latter as foreseen in Article 8 of the 10 January version of the agreement strikes us as particularly problematic. We say this in view of the fact that the Commission is an EU institution with no inherent jurisdiction; as such its competence to act in new fields, and the cost of so doing, have to be agreed to by all 27 EU Member States; and in view of the prohibition of infringement proceedings in Article 126(10) TFEU, to which the objective and procedures in Article 8 bear close resemblance.\(^\text{13}\)

17. We also had reservations about the encouragement in Article 10 of the draft Treaty for contracting States to use enhanced cooperation, also a mechanism the scope of whose use had been agreed to by 27 EU Member States, to ensure the proper functioning of the eurozone. We asked of the Minister:

\[\ldots\] whether the Government thinks reference to its use in a non-EU Treaty is appropriate; whether encouraging its use “whenever appropriate and necessary” is consistent with the EU Treaty requirement that it be used “as a last resort” (Article 20(2) TEU); and what safeguards the UK thinks will be necessary to ensure that greater use of enhanced cooperation does not undermine the internal market or economic cohesion in the EU, does not create barriers or discrimination in trade within the EU, and does not distort competition within the EU, all of which prohibitions are required by Article 326 TFEU.\(^\text{14}\)

18. The Minister’s reply of 24 January\(^\text{15}\) addressed enhanced cooperation—“[\ldots] the use of enhanced cooperation envisaged will be under the EU Treaties and thus will be compliant with all the safeguards and procedural steps provided in the EU Treaties”—but did not provide a response on the use of the institutions. This is perhaps the more surprising, in terms of genuine engagement with the Committee, in light of the fact that the Prime Minister and Foreign Secretary after the 31 January European Council both stated that there were real concerns about the use of the institutions.\(^\text{16}\) These concerns were more formally expressed in a letter of 22 February from the UK’s Permanent Representative to

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\(^{13}\) Ev 71

\(^{14}\) Ev 71

\(^{15}\) Ev 73

\(^{16}\) On 30 January in an interview on BBC Radio 4’s Today programme, the Foreign Secretary said that there were “some real legal concerns” about the use of the Court of Justice; that the UK could not veto its use as this was a (non-EU) intergovernmental treaty; but that it could take legal action if necessary. And in the press conference after the European Council Summit, the Prime Minister said that “there are a number of legal concerns on the use of EU institutions”; that the UK did not want to stand in the way of the draft treaty, but that it could “take action if […] national interests are threatened.”
the EU, Sir John Cunliffe, to the Secretary-General of the Council, Mr Uwe Corsepius, in which he stated that:

- to avoid the SCG Treaty setting objectionable precedents, “[…] the EU institutions must only be used outside the EU Treaties with the consent of all Member States”;
- that the SCG treaty “[…] should not undermine the operation of the single market or otherwise infringe on areas of policy that are properly for discussion by all member States in the EU context”; and
- the UK had previously raised these issues in the negotiations, and in writing, and in view of its “continuing concerns” on the above 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.”

The Minister for Europe’s evidence to the Committee on 23 February

The scrutiny process

19. We first of all asked the Minister to explain why his reply to our letter of 12 January had failed to respond to our questions about the safeguards which the Government had been seeking at the European Council meeting of 8-9 December 2011, and about the legality of the use of proposed EU institutions in the draft SCG Treaty. The Minister replied that the Government had recently decided to release greater detail of the UK’s approach to the December European Council negotiations; but that it could not be expected to give a “running commentary” on the negotiation of the draft SCG Treaty, which were confidential and in which the UK was not a participant; and that it did not come to a formal view on the use of the institutions until the European Council on 31 January, although it had communicated its concerns informally throughout the negotiations. Our concern was not, however, to inquire into the negotiations, but rather to know what safeguards the UK had demanded before agreeing to a revision of the Treaties, and to know the Government’s views on the use of the EU institutions and of enhanced cooperation in the draft Treaty. Our views are well summarised in a point made to the Minister by Mr Clappison:

[…] that was an excellent answer, which was very comprehensive and showed tremendous grasp of the details but, as the Chairman has just said, we would have appreciated that before we embarked on our inquiry, not least because it would have given us the opportunity to ask some of the expert witnesses we have had along to

17 Ev 74
18 Ev 73
19 Ev 71
20 Qq 125, 136, 137
21 Q 125. This information was set out in a letter to the Chairman of the Foreign Affairs Committee, and published on its website: http://www.parliament.uk/business/committees/committees-a-z/commons-select/foreign-affairs-committee/news/publication-of-letter-from-fs-dec-2011-euro-council/
22 Qq 130, 137
23 Q 136
the inquiry about the points that you have just very properly made in your answer now. The answer to the Chairman’s letter, which you gave us back in January, was very short; it was not much more than a page long. It looks like an answer to a question that was not asked, and no answers to the questions that were asked.\textsuperscript{24}

\textbf{The Government’s legal concerns with the SCG Treaty}

20. We asked the Minister to explain the Government’s legal concerns with the SCG Treaty, in the light of the Prime Minister’s comments after the European Council on 31 January and of Sir John Cunliffe’s letter of 22 February. He said that there were elements of the SCG Treaty that gave the Government “some concern, lest they be used in the future either to set unwelcome precedents or to impinge upon the integrity of European law and the arrangements set out in the European treaties”.\textsuperscript{25} We pressed him for detail of what this actually meant. He replied as follows:

In respect of Article 7, first of all, on the reverse qualified majority voting mechanism, our concern is less with the content of this particular case, because we are not in the euro and, by virtue of our protocol, we are exempt from penalties and sanctions under the Stability and Growth Pact or excessive deficit procedures, than the potential this might have for a precedent possibly being set for the use of this mechanism in other areas of the European Union treaties.

In Article 8, our concerns centre on the possible role both of the Commission and of the European Court of Justice. Here we are talking about the role of the Commission to judge national budgets. The principle that we continue to assert is that we think EU institutions should only be used outside the EU treaties with the consent of all Member States, and any such use must respect the treaties, because it is the treaties that have primacy in any clash. With regard to the role of the European Court of Justice under Article 8, in part the answer there is the same as I have just given in respect of the Commission’s role under Article 8; it is about everybody having to agree to the institution operating outside the scope of the treaties, and that action in respect of the treaties, at all times.

Article 273 allows Member States to 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. There is nothing in the treaties that provides for a state’s obligation to write a deficit break into its law or constitution, so the question in our minds is if that takes the Court into new territory.\textsuperscript{26}

But the Minister was reluctant to elaborate much further. When asked about Article 7, he said that he thought it was possible for a non-EU Treaty to stipulate voting procedures, such as reverse qualified majority, in an EU institution, which would appear to ignore the Government’s concerns about the precedent this might set for other areas of the EU treaties.

\textsuperscript{24} Q 127
\textsuperscript{25} Q 134; see also Q 135
\textsuperscript{26} Q 142
21. On Article 8, it appeared the Government’s concern was whether the Court of Justice’s jurisdiction over a contracting State’s compliance with Article 3(2), in other words over its balanced budget rules, was consistent with the Court’s jurisdiction under Article 273 TFEU, and whether the Commission’s role was provided for in the existing Treaties. However, the basis for the latter concern was harder to discern. When asked whether the Commission had de facto infringement powers, in that the trigger for the legal proceedings was a negative Commission report which meant that the matter “will be brought to the Court of Justice by one or more of the Contracting Parties”, the Minister and his legal adviser disagreed. The reasons they gave were that Article 8(1) did not impose an obligation on a contracting State because: “will”, as opposed to “shall”, was not mandatory Treaty language—“It is because the Treaty does not say that they must bring the action; it says they will bring the action”; there was no sanction against a State for failure to bring an action; and the provision was clear that it is the States which bring the action. When the Chairman sought simple clarification on whether the Government thought the role of the Commission in Article 8 was lawful in EU terms, the answer received was: “I think there is possibly a range of views on this issue” and the Government was “reserving [its] position”.

22. On the emphasis on enhanced cooperation in Article 10, the Minister’s answers were clearer. First, even though the Treaty placed an emphasis on enhanced cooperation, it could only be applied in accordance with the procedures and limitations set out in the EU Treaties:

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: the rule that it must be used as a “last resort”; that it must “not undermine the [single] market or economic, social and territorial cohesion; … it [must] not [constitute] a barrier to or discrimination in trade between Member States; [it must not] distort competition between [Member States]” and it must “respect the competences, rights and obligations of those Member States [that] do not participate in [a specific enhanced cooperation initiative]”. 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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27 Article 273 TFEU gives the Court “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.” A recital confirms this is what the intergovernmental agreement relies upon to invoke the jurisdiction of the Court of Justice.

28 Qq 163, 164 and 180
29 Q 156; see also Qq 153 and 155
30 Q 154
31 Qq 158, 160 and 161
32 Q 165
33 Q 166-168
34 Q 182
These considerations would apply, for example, to the recent application to proceed by way of enhanced cooperation on the financial transaction tax proposal.\textsuperscript{35}

23. Secondly, the risk of caucusing within the eurozone or among the contracting State was overstated:

Also, one ignores the reality I observe in the EU week by week, in which the 17, let alone the 25 parties of this treaty, simply do not act as a cohesive bloc but pursue alliances with other countries, including us, on a whole range of issues. 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.\textsuperscript{36}

\textbf{What are the consequences of the Government’s legal concerns?}

24. We pushed the Minister to answer this question. There seemed to us an inherent contradiction in the Government’s stance towards the SCG Treaty, which the Minister summarised as follows:

[...] while we do not want to block our partners from undertaking these economic and political tasks, we also reserve our legal position very clearly in respect of certain aspects of this Treaty, particularly in regard to the proposed use of the institutions in certain Articles.\textsuperscript{37}

Our concern was that the Government’s legal reservations did not appear to be premised upon the possibility of misuse, or even abuse, of the powers given to the EU institutions under Articles 3(2) and 8; rather to relate to the consistency of such powers with the EU Treaties and to their use without the consent of all 27 Member States.\textsuperscript{38} We pressed the Minister on this, asking him to say whether the Government was concerned with the way the SCG Treaty was drafted or might be applied. “We have had concerns about both” was his reply.\textsuperscript{39} This prompted a question asking the Minister to confirm whether the Government had given its consent for the use of the EU institutions, to which he replied: “We have not been asked and we have not volunteered it. At the moment, it is a hypothetical question.” The Minister refused to accept that the absence of the UK’s consent to the use of the EU institutions in the SCG Treaty must mean that the Treaty was unlawful \textit{per se}:

\textit{Mr Clappison:} [...] if we have not given our consent, it is not lawful […].

\textit{Mr Lidington:} The Intergovernmental Treaty itself says that, if there is any conflict between it and the EU treaties, it is the EU treaties that shall prevail.

\textsuperscript{35} Qq 185 and 186
\textsuperscript{36} Q 184; see also the last paragraph of Q 182
\textsuperscript{37} Q 138
\textsuperscript{38} See the answer to Q 142, cited above, and the letter from Sir John Cunliffe, Ev 74.
\textsuperscript{39} Q 173
Mr Clappison: I am not asking that question. I am asking, quite simply, if we have given our consent to the use of the EU treaties. If your answer is we have not been asked to do it, we have not given our consent. We would agree with that.

Mr Lidington: That is right.

Mr Clappison: In the terms of this letter, if we have not given our consent, then the use is not lawful.

Mr Lidington: I think that is taking it a step further [...].

The view of the expert legal witnesses

Value of an intergovernmental treaty

25. The idea of enshrining balanced budget rules and a concomitant enforcement mechanism in the EU Treaties was thought to have been an initiative principally of the French and Germans. The Foreign Secretary’s letter to the Chairman of the Foreign Affairs Committee confirms this to be the case: “On 7 December, Angela Merkel and Nicolas Sarkozy sent a further letter to Mr. van Rompuy with a different set of ideas. They made clear that they were seeking change to the EU treaties [...] Their proposals were not discussed [...] in advance of the European Council.”41 Professors Craig and Dougan thought the ultimate objective was to give the balanced budget rules a more elevated status and greater legitimacy than would have been the case if they had been proposed in EU secondary legislation—EU Treaty revisions require ratification through national parliaments and so engage the attention of the public more. So when the UK vetoed a revision of the EU Treaties, a non-EU treaty was preferred to a Directive. One of the paradoxes of this, according to Professor Craig, was that legal force of the SCG Treaty was “almost certain to be less peremptory than it would have been if the same rules had been embodied in ordinary EU legislation.”42 Professor Dougan agreed that a treaty, be it in the context of the EU or public international law (non-EU), was a political necessity for Germany, but the SCG Treaty was not a legal necessity for the eurozone43—many of its provisions were aspirations rather than obligations.44

26. A concern shared by several of the legal experts was that the considerable legislative overlap between the SCG Treaty and current or proposed EU secondary legislation—the innovations of the Treaty were limited to a) the domestic implementation of b) stricter balanced budget rules and c) their enforcement by the Commission and Court of Justice in Articles 2(3) and 8, and d) the voting obligations on the excessive deficit procedure in Article 7—made the framework of eurozone rules less transparent and even harder to comprehend.45

40 Qq 177-179
41 See footnote 21
42 Q 6
43 Q 62
44 Q 61
45 Qq 2, 64 and 67
The rule of law – a principle infringed?

27. Professor Craig argued that what had been agreed at the December European Council and in the negotiation of the SCG Treaty should raise a concern over the application of the rule of law in the EU. He characterised it as follows: presented with a veto on changing the EU’s competence over eurozone States through a revision of the EU Treaties, the EU 25 had proceeded to achieve the same ends through a non-EU treaty in circumstances where EU rules on how change should occur had been blocked:

[...] the question you raised is a question that has been nagging at many commentators or observers. It is the question I addressed in the first part of the paper, which I called the background principle. I think that, whichever way you look at it, the bottom line is that you have a decisional rule-you have a rule about how decisions are meant to be made—that is embodied within the Lisbon Treaty. It is a rule about how change should occur, and it is a rule that says you should undertake change if there is unanimity. It also contains quite sophisticated rules for further change to be able to take place through enhanced co-operation within the framework of the Lisbon Treaty. Whatever one believes about its desirability or not, this new treaty does raise an issue of principle, which you can call a rule-of-law issue of principle, that is concerned with whether we should bear with equanimity the idea of those decision-making rules being circumvented by a treaty outside the fabric of the Lisbon Treaty in circumstances where the rules as to how change should be undertaken within the Lisbon Treaty are not capable of being met, particularly given that the SCG treaty can only work through the participation of the EU institutions in the way that is written into that treaty. That does raise an issue of principle, which is a rule-of-law issue.46

28. We asked Professor Craig about the legality of giving new powers, through a non-EU intergovernmental treaty, to the EU institutions. He replied that, unequivocally, new powers could not (lawfully) be given to the institutions through a treaty of this kind.47 The more equivocal issue was whether a similar point of principle arose in the instance of EU institutions using existing powers under the SCG Treaty. In other words, cutting and pasting existing institutional powers under EU primary and secondary law into the SCG Treaty. Though tempted at first to distinguish this use of the EU institutions as unproblematic, on reflection he had revised his opinion: “It is not that straightforward because to say that there is an existing power to do X, whatever X is, under the Stability and Growth Pact, does not per se legitimate the use of that very same power in the context of a different treaty.”48

29. When asked whether the approach taken at the December European Council and in the negotiation of the SCG Treaty set a new precedent, Professor Craig replied that:

There is absolutely no doubt that, if this is ratified, it will be a precedent in the sense that it will be a solid piece of evidence that the EU as a whole, having been blocked or
stopped from achieving its goals through the normal methods of treaty revision, will have recourse to a treaty of this kind outside the existing Lisbon Treaty, and that EU institutions will be involved in it. That is a precedent. 49

30. Professor Dougan took a different view: 50

[...] I do not see the same type of issues, particularly as regards the principle of whether member states, having failed to achieve a treaty amendment so as to pursue an objective that they want to achieve, can then pursue that objective outside the EU framework by means of ordinary international law. That is one issue that Professor Craig flagged up, and it is one that I would disagree with.

31. For Professor Dougan, the real question was not the principle of whether a non-EU treaty could confer functions on the EU institutions—it could: it was the conditions under which those functions were conferred. For authority he relied on two cases—the Bangladesh case 51 and the Lomé Convention case 52—in which the Court of Justice recognised the principle that the Member States could draw upon the EU institutions for non-EU purposes, but he agreed with Martin Howe that in those cases all Member States had agreed to the proposals. 53 However:

[...] in both cases—Advocate-General Jacobs, as he then was—dealt more with the possibility that there could be situations where individual member states or even external organisations such as the UN might ask the Commission to carry out certain delegated functions on their behalf. The test that the advocate-general proposed in those cases is probably a very sensible one. The question is: is it incompatible with its obligations under the treaties? If, for example, 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. If they are not asking the Commission to behave in that way, however, it does not seem objectionable. 54

32. On the question of whether all Member States needed to consent, Professor Dougan thought that an analogy could be made with enhanced cooperation, in which fewer than the EU 27 could use the EU institutions to legislate:

It is perfectly possible within the treaties to make use of the institutions for the interests of certain member states against the opposition of others. That is within the scope of the treaties, so obviously it is not a direct analogy, but it is a useful indication that, as a point of principle, it may be possible. The real question is whether that would make the Commission behave in a way that would be incompatible with its

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49 Q 17
50 Q 66
51 C-181/91 and C-248/91 European Parliament v Council and Commission, 30 June 1993
52 Case C-316/91 European Parliament v Commission, 2 March 1994
53 Q 66
54 Q 78
duty of impartiality. If it would, that is a real problem, but if it would not, it should not be.55

33. Martin Howe was not so sure:

[...] that the existence of the enhanced co-operation procedure actually assists the argument that the Commission can act privately for a sub-group of member states. What one can draw from that is a contrary argument, which is that the treaty authorises the institutions to act under certain defined conditions on behalf of sub-groups of member states who wish to engage in enhanced co-operation. Hence, the argument would go that, in general, a sub-group of member states that wants to get together outside the authorised framework of enhanced co-operation cannot hijack—to use a pejorative word—the institutions for its private purposes.56

34. Professor Peers referred also to the Bangladesh and Lomé Convention cases:

In the debate on the draft REU treaty, it has often been assumed that giving any role to an EU institution outside the scope of its current powers under EU law would be legally questionable. However, the case law of the Court of Justice of the EU has not ruled this out in all cases. In particular, the Court of Justice has ruled that Member States can act collectively outside the framework of the EU Treaties in areas where the EU and Member States share a parallel competence, and in that context can confer powers to act upon the EU institutions: see Case C-316/91 EP v Council and C-181/91 and C-248/91 EP v Council and Commission. These cases involved collective action by all Member States, although the Court did not refer to this factor expressly in its judgment. So the question remains open whether or not it would be legal in principle for some Member States to confer additional power upon the EU institutions by means of an international treaty outside the EU framework. If this is legal in principle, there would probably be conditions upon the use of those institutions, in particular a requirement of compliance with EU law.57

35. Professor Peers’ conclusions were less conclusive than those of Professor Dougan:

Article 14(2) includes a target date of entry into force, but this does not really have any legal relevance, as the treaty will still enter into force one month after it has sufficient ratifications, whether that takes place before or after the target date. The bigger issue is the number of ratifications—originally nine eurozone States, then fifteen, and now twelve (2/3 of the eurozone States). This provision fails to provide for the legal position if fewer than twelve eurozone States have ratified the treaty before 1 January 2013; this issue ought to be clarified.58

55 Q 78
56 Q 79
57 Para 2, Ev w3
58 Para 30, Ev w3
**Voting obligations in Article 7**

36. Article 7 “commits” contracting States to supporting the Commission’s recommendations in the Council in relation to the excessive deficit procedure in Article 126 TFEU, unless there is a (reverse) qualified majority against. We asked Professor Dougan and Martin Howe whether they thought it was possible for a non-EU treaty to stipulate voting procedures in an EU institution. Professor Dougan replied that:

- although there was a commitment to vote presumptively in favour of a Commission proposal, it was not an absolute commitment. Contracting States could decide to change their minds: none of them is bound to follow the Commission proposal;\(^59\)

- reverse qualified majority voting was not unique to the SCG Treaty. It was a feature—a central feature some would say—of the Six Pack of legislative measures. Its role precisely was to try to increase the automatic nature of sanctions against Member States that are incurring excessive deficits. It was not unique in that regard, even if still relatively unusual.\(^60\)

37. Professor Peers took the same view:

Article 7 only specifies that Member States “commit” to apply it; this falls short of a fully-fledged legal obligation. It leaves open the possibility that Member States might decide not to support the Commission’s proposals or recommendations. Since this Article does not amend the role of the Commission or the Council as such, it would not breach any rule (if there is one) that a group of Member States cannot confer new powers upon the EU institutions. To some extent this reverse voting rule is already set out in EU legislation, for instance in Articles 5(2) and 6(2) of Reg. 1173/2011, concerning the enforcement of the excessive deficit rules as regards the imposition of fines on eurozone Member States.\(^61\)

**Role of the Commission in Article 8**

38. Professor Craig thought that the Commission had de facto infringement powers in Article 8: it was the trigger for legal proceedings because the contracting States were under a “mandatory obligation” to bring an action in the event of a negative report from the Commission. This was “simply a legal contrivance” to try to circumvent the injunction on the Commission from bringing an action in its own name when the jurisdiction of the Court of Justice was premised on Article 273 TFEU.\(^62\) There was a further conflict with the EU Treaties: the Commission was prevented by Article 126(10) TFEU from bringing infringement proceedings in the context of the excessive deficit procedures in Article 126 (1)-(9) TFEU. Martin Howe agreed with these views.\(^63\)

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\(^{59}\) Q 73

\(^{60}\) Q 74

\(^{61}\) Para 21, Ev w3

\(^{62}\) Q 21

\(^{63}\) Qq 86 and 87
39. Professor Peers thought Article 8 conferred significant powers on the Commission in a procedure similar to the pre-judicial stage of the infringement procedure:

On the other hand, the option to invite the European Commission to give its opinion on whether a Member State has complied with the debt brake rule, the Commission’s role in a procedure similar to the pre-judicial stages of the infringement procedure in such a case, and the subsequent obligation to bring an action against a Member State which has breached the debt brake rule, in the Commission’s view, would all confer significant additional powers upon that institution. Article 8 should also be clarified to make clear that the Member State which has allegedly breached Article 3(2) would be joining in the action against itself.64

40. For Professor Dougan the key consideration in assessing the legality of the role of the Commission was that the contracting States had ceded jurisdiction over Article 8 to the Court of Justice by voluntary agreement.65 In light of this, a wide margin of discretion should be given to the contracting States “subject to EU law and not breaching the treaties directly, to design the type of enforcement system they want to have imposed upon themselves.”66 It was not therefore a question of whether the Commission’s role was new, but whether its role infringed the existing Treaties. As the Commission had no formal role in bringing proceedings under Article 8, its role was not problematic. Further, it could be said to be analogous with the monitoring role of the Commission elsewhere under the Treaties.67

**Does Article 8(1) place legally binding obligations on contracting States?**

41. We asked Professors Craig, Dougan and Peers to comment on the Government’s assertion that the use of “will” in Article 8(1)—“the matter will be brought to the Court of Justice of the European Union by one or more Contracting Parties”—meant that States were not under a mandatory obligation to bring proceedings, so could elect not to. None agreed.68

**Jurisdiction of the Court of Justice in Article 8**

42. Professor Craig thought that whether what was presently contained in Article 8 was lawful or not would ultimately depend on the interpretation by the Court of Justice of the meaning and scope of Article 273 TFEU; this in turn would depend upon whether the Court, if the question were put to it, found that the present mechanism whereby the Commission, in effect, triggers the action was lawful under the Article 273.69 The prohibition on the Commission bringing enforcement action under Article 126(1-9) in his view reinforced “very considerably” the conclusion that to construe Article 273 as allowing

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64 Para 23, Ev w3
65 Qq 80 and 87
66 Q 80
67 Q 83
68 See Ev 83, 84 and 85
69 Q 26
de facto a Commission enforcement action for breach of the self-same rules "looks very odd indeed". 

43. When pressed to give a best guess on whether the Court of Justice would find in favour of jurisdiction to hear proceedings brought under Article 8, Professor Craig thought with some certainty that it would in the case of inter-State proceedings, because these were “a special agreement for the purposes of coming within Article 273”, but that these would be very rare indeed. But in the case of proceedings triggered by a negative report from the Commission, he was less sure:

I simply do not know what they will do about the first half of Article 8. I find that one more difficult to guess. There will be a temptation to validate it, to legitimate it, and say that the Commission is not formally bringing the action and that is good enough and therefore you can use 273. The problem with that conclusion is that it looks pretty artificial and, as I intimated in my paper in the evidence I gave, on many occasions in the past where member states have tried through various contrivances to get round a rule in the treaty by factually organising their behaviour in such a way as to minimise the likelihood of engagement with a particular treaty Article, the Court of Justice and the Commission legal service and the Council legal service have quite rightly said, “No, we are not going to allow that to happen. We will look at the substance.”

44. Professor Peers thought that Article 8 related “to the subject matter of the Treaties” and was confident that it did not exceed the scope of Article 8:

According to the preamble to the draft treaty, Article 8 is based on Article 273 TFEU, which provides that:

“The Court of Justice shall have 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.”

Therefore it cannot be objected that this provision *per se* is in breach of EU law. Although it has been argued that Article 8 exceeds the scope of Article 273 TFEU, since the 0.5% debt brake rule is new to EU law, and is therefore outside the “subject-matter” of the Treaties, this argument is not convincing. Article 344 TFEU subjects all disputes concerning the “interpretation or application” of the Treaties to the exclusive jurisdiction of the Court of Justice. Since Article 273 provides for only *optional* jurisdiction of the Court of Justice, the two provisions cannot overlap. So Article 273 cannot apply to EU law as such, since Article 344 applies to EU law; it follows that Article 273 applies (only) to disputes regarding measures which are not...
part of EU law as such, but which are connected to the “subject-matter” of the Treaties. Obviously the debt-brake rule meets that criterion. 74

45. Professor Hix and Martin Howe thought the Court would take an expedient approach to its jurisdiction under Article 273 TFEU, in reflection of the ultimate political objective: “where there’s a political will, the EU will find a way around this”; 75 and, in the case of Martin Howe:

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. 76

46. Professor Dougan’s views were consistent with his answers on the Commission’s role under Article 8, which he did not consider to be legally objectionable. He also thought that the enforcement mechanism under Article 8 could amount to a “special arrangement” for the purposes of Article 273 TFEU, and prayed in aid to this end the published legal advice of the Council legal service. 77

Enhanced cooperation

47. None of the expert witnesses thought that the reference to “mak[ing] active use” of enhanced cooperation “whenever appropriate and necessary” in Article 10 was legally significant. The reference was merely declaratory of powers that already existed in the EU Treaties, the procedures for which took precedence over the SCG Treaty. Additionally, Article 10 made explicit mention to the relevant Treaty provisions. 78

48. Professors Hix 79 and Dougan agreed that Article 10 was more significant as a declaration of political intent, enhanced cooperation only having been used on two previous occasions. 80 Professor Craig, like the Minister for Europe, was more sanguine about the prospect of unity among the eurozone or EU 25. 81

74 Para 22, Ev w3
75 Q 44
76 Q 65; see also Q 88
77 Q 88
78 Qq 35, 42, 89, 92
79 Professor Hix did not think enhanced cooperation could be used for EU policies such as taxation which required unanimity, the financial transaction tax being a specific example (see Qq 40 and 43). We do not think that is correct, and, indeed, the Minister for Europe confirmed that an application from nine Member States to proceed with the financial transaction tax proposal by means of enhanced cooperation had been lodged (see para 22 above).
80 Qq 36-39, 89, 94-95
81 Q 41
Was the UK right to exercise its veto and what are the consequences?

49. Both Professor Hix and Craig questioned whether the UK would have vetoed the provisions contained in the SCG Treaty, had they been known at the December European Council. The SCG Treaty was a significantly watered down version of the tougher language used in the Statement of the eurozone Heads of State or Government at the December European Council. The substance of the SCG Treaty over and beyond existing EU obligations was minimal; even the balanced budget rules in Article 3(2), when examined closely, no longer had to be enshrined in a constitutional or statutory rule.

50. Professor Hix thought that veto had not achieved anything in the short-term; in the long-term he was concerned that it may well lead to a growing separation of European integration into two tracks.

51. Professor Dougan thought the EU 25 had pretty much achieved the fiscal compact they had hoped for in a revision of the EU Treaties. What was important was not the form the implementation of the balanced budget rules would take, it was the fact that the substantive obligation goes further than what already existed under EU law—the lower limit of the structural deficit being 0.5% (as opposed to 1%). He concluded that the Government’s veto was, accordingly, of little positive consequence for the UK, and that it had forfeited some of its natural leadership in single market integration and liberalisation policies.

3 The economic and political issues—the evidence

52. To our surprise there was no fundamental difference of view between our economic commentator witnesses, Mr Bootle, Mr McWilliams and Mr Münchau, as to whether the SCG Treaty will work, in terms of ending the eurozone crisis. Their view is exemplified by Mr Bootle’s comments:

I don’t think it will contribute a great deal, no. I consider it to be essentially motherhood and apple pie. There are a number of different issues. One of course concerns the enforceability of the fiscal compact, and I see nothing in what I have read to make it credible […]

There is that problem but, more fundamentally, there is an issue about the nature of the problem that is facing the eurozone countries […] In my view, the fiscal problem is one aspect of the various difficulties facing the eurozone, but it is not even the most important one. The most important is the lack of competitiveness in the periphery.
and the failure of the eurozone as a group to generate significant rates of economic growth. Without solving those two problems, the objectives of the fiscal compact will be impossible to achieve.\textsuperscript{86}

Whilst seconding the overall view of the other two witnesses, Mr McWilliams did attribute some value to the perception the SCG Treaty creates:

\begin{quote}
It is not a treaty that makes any difference, but that does not fully take into account the way that such things are perceived. The first is that the treaty is seen as a step in the direction of fiscal co-operation [...]. The second, which is rather more important, is that it has acted as a fig leaf that has enabled the ECB to pump a lot of money into the banking system in Europe, which has actually rather transformed the state of the world economy on a temporary basis.\textsuperscript{87}
\end{quote}

The only other possible benefit of the SCG Treaty drawn to our attention, in addition to a signal it might send to the markets about the eurozone’s intentions for fiscal coordination,\textsuperscript{88} is the comfort it might give to Germany in relation to a relaxation of its views on the size of bail-out funds and on Eurobonds.\textsuperscript{89}

53. The Minister for Europe did not dissent from the view that it was improbable that the SCG Treaty would do much to resolve the eurozone crisis, commenting that:

\begin{quote}
I have never thought that new treaties were likely to be a silver bullet in solving the eurozone crisis.\textsuperscript{90}
\end{quote}

But the Financial Secretary to the Treasury nuanced that position, saying:

\begin{quote}
Given that [the Government] would agree that an effective monetary union should be underpinned by closer fiscal integration, clearly the intergovernmental treaty has a role to play in tightening that fiscal co-ordination.

It is a necessary step, but I do not think it is sufficient to resolve the situation. There are broader economic issues that need to be tackled within Europe to put the European economies on a much more stable long-term footing, as well as putting their fiscal position on a long-term footing.\textsuperscript{91}
\end{quote}

54. We also heard some comment as to the practical difficulties of implementing the SCG Treaty.\textsuperscript{92} Professor Hix said:

\begin{flushleft}
\textsuperscript{86} Q 107
\textsuperscript{87} Q 110
\textsuperscript{88} Q 108
\textsuperscript{89} Q 51
\textsuperscript{90} Q 144
\textsuperscript{91} Q 207
\textsuperscript{92} Ev w3, para 7
\end{flushleft}
If Governments are faced by a public and economic situation that demand they do not run a balanced budget, I can see them being under intense domestic pressure, and in that situation I just don’t see Governments willing to give in to the will of either the Commission, ECOFIN or the ECJ. I can see this being a recipe for real political conflict within the eurozone.93

And Mr Bootle, in relation to assessing and judging a structural deficit commented:

[…] I think that it is difficult to believe that the sanctions will be imposed. There could be quite legitimate reasons for questioning whether the deficit in question was structural or not.94

55. It was also apparent from various comments made to us that the SCG Treaty seems to shut off the possibility of better fiscal discipline being combined with other economic policies to stabilise the eurozone. As Mr Grant put it:

I am worried about the economic implications of the Fiscal Compact. Clearly, I go along with the view of many analysts […] that fiscal discipline alone will not solve the eurozone’s ailments and that there is a problem of a lack of growth and a lack of demand in southern Europe. This Fiscal Compact seems to essentially outlaw Keynesianism, which is not to say that fiscal discipline is not needed, but you need fiscal discipline plus efforts to promote growth.95

However the Financial Secretary to the Treasury thought that growth enhancing policies were possible despite the SCG Treaty. He said that:

There needs to be a twin-track approach. Those countries with fiscal problems need to tackle them, but all countries across the eurozone and across the European Union should identify pro-growth policies. Those do not need to be policies that involve the spending of more taxpayers’ money. It could be regulatory reforms; planning reforms; changing labour market laws; reprioritising spending on more productive areas of the economy; or tax reforms that favour enterprise.96

56. As to what might result from the eurozone crisis if the SCG Treaty were ineffective Mr Bootle presented starkly contrasting alternatives—breakup of the eurozone or full fiscal union underwritten by a full political union.97 Mr McWilliams, however, illustrated the large fiscal transfers between Member States a fiscal union might imply, with obvious political difficulties in gaining acceptance of such a consequence.98 On the other hand Mr Münchau suggested that a fiscal and political union might not be necessary to solve the eurozone crisis. He commented that:
It may be sufficient to Europeanise the banking sector of the eurozone states—it is not necessary for the non-eurozone states—to have a common deposit insurance system, a common supervisory system and, in particular, a common bank resolution system whereby a central authority could close down banks, merge banks, impose regulation. That may help stabilise the system.

[...]

A Eurobond is possibly necessary, and common labour market rules to facilitate adjustment to make sure that labour markets respond in a very similar way may be necessary.\(^9\)

57. Although these witnesses did not think that the SCG Treaty had much relevance for the resolution of the eurozone crisis, they were clear that the immediate economic future for Greece, and to varying degrees for other peripheral eurozone Member States, is bleak. As for the eurozone as a whole, they saw its breakup as entirely possible. Mr Bootle took an optimistic view of this possibility:

> What would be the consequence of the break-up of the euro? I can answer with a single word: prosperity.\(^{100}\)

Mr Münchau was more pessimistic, describing, by way of example, what he envisaged as consequences for Germany.\(^{101}\) Mr McWilliams took a view of an initial severe downside, with recovery taking more time the longer breakdown was postponed. He opined that:

> Keeping the eurozone together compared with breaking it up seems to me to be a slightly false choice, because I think it will break up one way or another, eventually. So you will probably get two lots of costs. At least if you take the pain early, you have the prospect of trying to reform and trying to organise things for the future.”\(^{102}\)

In terms of wider consequences Mr Münchau suggested that a breakdown of the eurozone could mean a threat to maintaining the single market.\(^{103}\) And the Financial Secretary to the Treasury simply said:

> I do not think any country would particularly benefit from the destruction of the euro.\(^{104}\)

58. It is possible that had the UK not objected, rather than the SCG Treaty, there would have been amendments to the TFEU to incorporate the requirements and sanctions of the SCG Treaty. So there would have been limitations on the fiscal freedom of the UK. Alternatively, if the Government had wished the UK to accede to the SCG Treaty, there would also have been limitations on the fiscal freedom of the country. However, neither of these scenarios is the case. So our concern is only with the consequences for the UK of not

\(^9\) Q 119
\(^{100}\) Q 124
\(^{101}\) Q 124
\(^{102}\) Q 124
\(^{103}\) Q 124
\(^{104}\) Q 223
allowing TFEU amendment and not being party to the SCG Treaty. In particular: has the 
UK’s negotiating weight in the EU been lessened; is there a danger of the participants in the 
SCG Treaty caucusing in considering draft EU legislation to the UK’s disadvantage; and is 
there a danger that the SCG Treaty’s advocacy of enhanced cooperation might expand the 
use of enhanced cooperation, again to the UK’s disadvantage?

59. We heard quite differing points of view on the first of these issues. On the one hand the 
European Movement UK and Professor Hix did see a threat of caucusing.\textsuperscript{105} And Mr Grant 
clearly thought there is a problem:

   The big danger […] is, if the British are not in the room when decisions are taken on 
economic policy, or even when discussions happen on economic policy, we will be 
unable to influence the discussions and unable to steer the argument.\textsuperscript{106}

On the other hand the Financial Secretary to the Treasury was dismissive of this fear, 
noting, in relation to a recent European Council that:

   […] member states from north and south, large member states and smaller member 
states, and states from Eastern Europe and Western Europe […] were brought 
together by a shared view about the way Europe’s economy should develop.

   and commenting:

   I think that the philosophies that underpin the governments and cultures in [the] 17 
member states do vary […] just because someone is in the euro does not mean they 
have to share the same view […].\textsuperscript{107}

60. On the possibility of a reference in the SCG Treaty to enhanced cooperation creating a 
danger to the UK, Professor Hix explained why it is a major concern for him.\textsuperscript{108} However, 
the Minister for Europe argued strongly that the danger did not exist, holding that the 
TFEU rules on enhanced cooperation were paramount.\textsuperscript{109} And his view was seconded by 
the Financial Secretary to the Treasury.\textsuperscript{110}

4 Article 136 TFEU and the European 
Stability Mechanism—the evidence

61. In October 2010 the European Council agreed on the need for a permanent crisis 
mechanism, which became the ESM. In preparation for an agreement to establish the ESM, 
on 25 March 2011 the European Council adopted a Decision amending Article 136

\textsuperscript{105} Ev w1 and Qq 35-38 \hfill \textsuperscript{106} Q 50

\textsuperscript{107} Qq 236 and 237 \hfill \textsuperscript{108} Qq 36-39

\textsuperscript{109} Qq 182-186 \hfill \textsuperscript{110} Q 248
Recitals 2 and 3 of the Decision strongly suggest that the Treaty amendment is a necessary precursor of the Treaty establishing the ESM. This suggestion is reinforced by the European Council Conclusions of October 2010 (paragraph 2), December 2010 (paragraph 1) and March 2011 (paragraph 16). And it is further reinforced by the Prime Minister’s statements to the House following the October and December 2010 European Council and comments by the Minister for Europe in the House’s debate on the proposed amendment to Article 136 TFEU.

62. So we were extremely surprised by the Financial Secretary to the Treasury’s comment, in his letter to us of 13 March, responding to our enquiry as to whether, as the ESM was now to come into force in July, ratification of the Treaty amendment would be brought forward, that:

It is not legally necessary for the Article 136 Treaty change to have been made before the ESM can come into force.

When we questioned the Minister about this he reiterated that:

It [the Treaty amendment] is desirable, but I do not think that it is necessary.

5 Conclusions

63. It is clear to us that the SCG Treaty does little towards solving the eurozone crisis, other perhaps than providing some comfort to international markets. Moreover it is possible that the Treaty will prove to be politically impossible to enforce. As undesirable as it may be, some form of breakdown of the eurozone clearly remains possible.

64. It seems to us that on balance the UK is better off with this SCG Treaty than with amendments to the TFEU of similar content. This is because insofar as actions under the SCG Treaty might disadvantage the UK, for instance in relation to the single market, they could be challenged in the Court of Justice as incompatible with the TFEU. Whereas if those actions derived from an amended TFEU they might be less easy to challenge. Fears about threats to the UK from agreement on the SCG Treaty, particularly to the UK’s negotiating weight, appear unsubstantiated. The Financial Secretary to the Treasury demonstrated, with his references to the Prime Minister’s joint letter before the March 2012 European Council and to current negotiations on budgetary matters and financial services regulation, that the Government has had some success on matters of importance to the UK.

112 HC Deb, 1 November 2010, especially cols. 615, 621 and 624, and 20 December 2010, especially cols 1187 and 1195.
113 HC Deb, 16 March 2011, especially cols 421, 427 and 431.
114 Ev 74
115 Q 196
116 Q 252
65. Whether or not the amendment to Article 136 TFEU is a necessary or a desirable precursor to the ESM may be open to debate. But it does raise the question as to why if it is not necessary the European Council clearly suggested it is. More importantly for Parliament why, until very recently, did the Government also suggest that the amendment is necessary?

66. The Foreign and Commonwealth Office was less than cooperative in helping us to scrutinise the draft SCG Treaty on behalf of the House. Our letter of 12 January, and the Minister’s reply of 24 January, are the clearest evidence of this. The Minister for Europe defended his Department’s approach by relying on the confidentiality of negotiations and the inappropriateness of providing running commentaries. This was not what we asked: as the relevant Select Committee of the House, we wanted to know what safeguards the Government had sought at the December 2011 European Council, and what its views, whether formal or informal, were on the proposed use of the institutions in the draft SCG Treaty, revisions of which were put in the public domain. On the former we were rebuffed, on the latter ignored. By 10 January it was, however, clear that the Government did have concerns about the use of EU institutions, although it chose not to apprise us, and thereby the House, of them. We strongly deplore the Government’s failure to respect the principle of accountability.

67. We agree, for the reasons enumerated by Professor Craig, that the approach taken to proceed with the fiscal compact by way of an intergovernmental agreement when a revision of the EU Treaties had been blocked raises a fundamental question about the application of the rule of law within the EU. We conclude that the SCG Treaty would have been an EU treaty but for the veto and that the veto therefore was a real veto. However, we also conclude that the EU institutions and the governments of the 25 Member States who have signed the Treaty, subject of course to its successful ratification, have embarked on a dangerous precedent in seeking to attain their political objectives irrespective of the rule of law in the EU.

68. The approach taken is also likely to render the foundation for the use of the EU institutions in the resulting SCG Treaty legally unsound. We consider that all Member States should have to agree to the new powers given to the Commission in Articles 3(2) and 8; that, unless Article 126(10) TFEU is amended, the de facto infringement powers of the Commission in Article 8(1) will in any event conflict with that provision of the TFEU; that the mechanism in Article 8(1) is a contrivance to avoid a conflict with the Court of Justice’s jurisdiction in Article 273 TFEU; and that, as such, the Court should refuse jurisdiction to hear an application brought by a contracting State pursuant to a negative report of the Commission under Article 8(1) of the SCG Treaty.

69. We have looked carefully at the counter-argument of Professor Dougan. Without further authority, we are not convinced by the argument that Member States should be given a wide margin of discretion to use the institutions as they choose where voluntary jurisdiction is given to the Court of Justice. We also find the distinction between all

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117 Ev 71
118 Ev 73
119 See the final para of Sir John Cunliffe’s letter of 22 February (Ev 74).
Member States giving their consent to the use of the institutions (the Bangladesh and Lomé Convention cases) and only 25 giving their consent significant, and not answered by Professor Dougan’s analogy with enhanced cooperation, or with the residual monitoring functions of the Commission under the EU Treaties. We note his emphasis on the key criterion for conferral of power by non-EU agreements to EU institutions being consistent with the EU Treaties. As we conclude that the Commission’s powers in Article 8(1) were de facto in violation of Article 126(10) TFEU, we think this criterion is not met.

70. We note that that the Legal Service of the Council published its advice on the compatibility of the Article 8 of the SCG Treaty with EU law. This was contrary to normal practice on the disclosure of its legal opinions and no doubt intended to dispel doubt among Member States. We asked Professor Craig to comment on the advice. He described it as a “best shot”, which he did not mean pejoratively.\footnote{Q 28} Martin Howe had more forthright views, describing the advice as “tortured”, in other words:

\[\ldots\] to achieve the end result that political imperatives imposed. I did think that it was particularly remarkable, in that final paragraph, as to why the intention that was expressed by these particular states to incorporate the material into the EU treaties was at all relevant to the question of whether or not it complies with article 273 in the first place.\footnote{Q 106}

We agree with these views. We were also perturbed to read in the final paragraph of the expectation, rather than the possibility, that the SCG Treaty will be incorporated into the EU Treaties:

It is again to be noted that that the substance of the draft Treaty is intended to be incorporated into the law of the Union following steps to be taken “within five years at most of the entry into force”. \textit{When this happens [...]}.\footnote{Final para of the Opinion of the Legal Service of the Council of 26 January 2012: Article 8 of the draft Treaty on Stability, Coordination and Governance in the Economic and Monetary Union – Opinion on its compatibility with European Union law.}

For this to happen the UK would have to give its consent, but this has been assumed by the Council Legal Service. We consider that that this legal advice has been manipulated to achieve the political result that the European establishment desires, particularly at the expense of the breach of EU law which they hold up as inviolate.

71. Given the views we express above, we understand why Sir John Cunliffe was asked to take the unusual step of writing to the Secretary-General of the Council on 22 February reserving the Government’s position on the use of the institutions in Article 3(2) and 8. However, the Government’s evidence on the consequence of the letter was inherently contradictory, and inconsistent with the letter itself. The tenor of it was that the Government does not want to stand in the way of 25 States reinforcing the eurozone, but the use of the institutions outside the EU Treaties without the consent of 27 Member States is unlawful. This to us suggested a conclusion that the SCG Treaty as agreed on 31 January must be unlawful in the Government’s view. The Minister accepted that the Government’s
concerns were related to both how the Treaty was drafted and might be applied, but to suggest it was unlawful was “taking it a step further”.\(^\text{123}\) When pressed on whether it thought the role of the Commission in Article 8 gave it de facto infringement powers, the Government disagreed, or demurred, telling us the use of “will” as opposed to “shall” meant there was not a mandatory obligation on the contracting States to bring proceedings in the event of a negative report from the Commission. We could see no contextual basis for this surprising opinion, nor could Professors Craig, Dougan and Peers.\(^\text{124}\) The Government’s reticence does, however, raise serious questions as to whether the letter of 22 February is a serious expression of intent.

72. The Government has made clear that it has reservations about the legality of what has been done, but the question of what it intends to do remains unsatisfactorily unresolved. Politically and legally, it is profoundly unwise to suggest taking action, and then not to explain how it intends to carry it through, or what concessions are now being sought and achieved.

73. We agree with Professors Dougan and Peers that the reference to Council voting procedures in Article 7 is not binding on contracting States, and with all the experts that the reference to enhanced cooperation in Article 10 cannot change the way it is applied under the EU Treaties. We do think, however, that referring to EU procedures in a non-EU treaty runs the risk of them no longer being considered exclusive to the EU—Professor Dougan’s reference to enhanced cooperation as support for the use of the institutions in the (non-EU) SCG Treaty with the agreement of 25 Member States being a case in point.\(^\text{125}\) It also runs the risk that EU procedures will be used more often than intended, a particular concern of Professor Hix in relation to enhanced cooperation.

74. Finally, although questions have been raised as to what the UK achieved by the use of its veto, we conclude that the veto was justified because of the very real concerns about a breach of EU law, even if this was not the reason given exclusively for the use of the veto in the first place. We note that there is an increasing tendency for the EU to propound the virtues of the rule of law but not to apply it in practice. For example, the Stability and Growth Pact was violated without further action being taken. Furthermore, we reported in January 2011 that the EFSM could not be justified under Article 122 TFEU.\(^\text{126}\) In our view, the approach to this SCG Treaty provides further and ever more disturbing evidence of the European Union dangerously ignoring its own precepts for political ends. We therefore recommend that the Government clearly states as soon as possible what action it now intends to take on the SCG Treaty.

\(^\text{123}\) Q 179
\(^\text{124}\) Ev 83, 84 and 85
\(^\text{125}\) Q 78.
\(^\text{126}\) See HC 428-xii (2010-11), chapter 2, para 12 (12 January 2011)
Formal Minutes

Tuesday 27 March 2012

Members present:

Mr William Cash, in the Chair
Mr James Clappison
Mr Michael Connarty
Chris Heaton-Harris
Kelvin Hopkins
Stephen Phillips
Penny Mordaunt

Draft Report (Treaty on Stability, Coordination and Governance: impact on the eurozone and the rule of law) proposed by the Chair, brought up and read.

Ordered, That the Chair’s draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 6 read and agreed to.
Paragraph 7 read, amended and agreed to.
Paragraphs 8 to 12 read and agreed to.
Box containing Summary of the SCG Treaty read and agreed to.
Paragraph 13 read and agreed to.
Paragraph 14 read, amended and agreed to.
Paragraph 15 read and agreed to.
Paragraph 16 read, amended and agreed to.
Paragraphs 17 to 23 read and agreed to.
Paragraph 24 read, amended and agreed to.
Paragraphs 25 to 27 read and agreed to.
Paragraph 28 read, amended and agreed to.
Paragraphs 29 to 35 read and agreed to.
Paragraph 36 read, amended and agreed to.
Paragraphs 37 to 62 read and agreed to.

Paragraphs 63 to 65 read and agreed to.

Paragraph 66 read.

Amendment proposed, in line 11, after the word “institutions” to insert the words “to enforce the eurozone budgetary regime”.—(Michael Connarty.)

Question put, That the Amendment be made.

The Committee divided.

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Paragraph agreed to.

Paragraph 67 read.

Amendment proposed, in line 9, at end to add the words “by making arrangements to act together outwith the formal arrangements set out in the EU Treaties.”.—(Michael Connarty.)

Question put, That the Amendment be made.

The Committee divided.

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Paragraph agreed to.

Paragraphs 68 to 70 read and agreed to.

Paragraph 71 read, amended and agreed to.

Paragraphs 72 and 73 read and agreed to.

Paragraph 74 read.
Amendment proposed, in line 3, after the word “law” to insert the words “but was not effective in preventing an arrangement being put in place leave that makes use of the EU institutions to create a Treaty outwith the EU Treaties”.—(Michael Connarty.).

The Committee divided.

Ayes, 1
Michael Connarty

Noes, 5
James Clappison
Chris Heaton-Harris
Kelvin Hopkins
Penny Mordaunt
Stephen Phillips

Paragraph agreed to.

Ordered, That the Report be the Sixty–second Report of the Committee to the House.

Ordered, That the Chair make the Report to the House.

Ordered, That embargoed copies of the Report be made available, in accordance with the provisions of Standing Order No.134.

Written evidence was ordered to be reported to the House for printing with the Report in addition to that ordered to be reported for publishing on 18 January, 25 January, 1 February, 7 February and 8 February.

[Adjourned till Wednesday 18 April at 2.00 pm.]
Witnesses

Tuesday 7 February 2012

**Professor Paul Craig**, Professional Fellow in English Law, University of Oxford, and **Professor Simon Hix**, Professor of European and Comparative Politics, London School of Economics

Ev 1

**Charles Grant**, Director, Centre for Economic Reform

Ev 11

Wednesday 8 February 2012

**Professor Michael Dougan**, Liverpool Law School, and **Martin Howe QC**

Ev 16

**Wolfgang Münchau**, President, Eurointelligence ASBL and Associate Editor of the Financial Times, **Douglas McWilliams**, Chief Executive, Centre for Economic and Business Research, and **Roger Bootle**, Managing Director, Capital Economics

Ev 25

Thursday 23 February 2012

**Rt Hon David Lidington**, Minister for Europe, **Ivan Smyth**, Legal Counsellor, **Marc Holland**, Deputy Head, Europe Directorate, Future of Europe, and **Thomas Barry**, Acting Head, Europe Directorate, Future of Europe, Foreign and Commonwealth Office

Ev 34

Wednesday 14 March 2012

**Rt Hon Mark Hoban MP**, Financial Secretary to the Treasury, and **Peter Curwen**, HM Treasury

Ev 47

List of printed written evidence

1. Professor Simon Hix, London School of Economics Ev 58
2. Professor Michael Dougan and Dr Michael Gordon, University of Liverpool Ev 60
3. Rt Hon David Lidington MP, Minister for Europe, Foreign and Commonwealth Office Ev 70; Ev 73; Ev 74; Ev 86
4. Letters to the Rt Hon David Lidington MP, Minister for Europe, Foreign and Commonwealth Office, from the Chairman of the Committee Ev 71; Ev 87
5. Roger Bootle, Managing Director, Capital Economics Ev 72
6. Rt Hon Mark Hoban MP, Financial Secretary to the Treasury, HM Treasury Ev 74
7. Professor Paul Craig, Professional Fellow in English Law, University of Oxford Ev 75
8. Martin Howe QC Ev 80
9. Further questions to Professors Craig, Dougan and Peers Ev 82
10. Response from Professor Craig Ev 83
11. Response from Professor Dougan Ev 84
12. Response from Professor Peers, University of Essex Ev 85
## List of additional written evidence

(published in Volume II on the Committee’s website www.parliament.uk/escom)

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<td>Professor Steve Peers, University of Essex</td>
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<td>3</td>
<td>British Bankers’ Association</td>
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<td>4</td>
<td>Professor Jagjit S. Chadha, University of Kent</td>
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Oral evidence

Taken before the European Scrutiny Committee on Tuesday 7 February 2012

Members present:
Mr William Cash (Chair)
Mr James Clappison
Michael Connarty
Chris Heaton-Harris
Kelvin Hopkins

Chris Kelly
Stephen Phillips
Jacob Rees-Mogg

Examination of Witnesses

Witnesses: Professor Paul Craig. Professional Fellow in English Law, University of Oxford, and Professor Simon Hix, Professor of European and Comparative Politics, London School of Economics, gave evidence.

Q1 Chair: Gentlemen, thank you very much indeed for coming. Of course, the Maastricht Treaty, on which many of these questions turn, was in fact signed on this very day 20 years ago. The question that we are going to be looking at, to some extent, is whether the issues that are before us and this new treaty that is proposed will in fact remedy deficiencies that have occurred in relation to the question of the convergence criteria and the deficit. At the root of all this it is not just a legal question; it is also a very political question, and the eurozone crisis speaks for itself. One or two other questions are, of course, whether or not this is an EU treaty—there are those who have suggested already on the floor of the House that it is an EU treaty and others have said it is not. The other question might be whether or not this was a veto, and that is also being debated in the public domain. There is the question of whether or not there should be a legal challenge. There is also the fundamental question about the rule of law, and whether the use of these mechanisms, which are there in this treaty entitled Treaty on Stability, Co-ordination and Governance in the EU, is justified. Will it work? Why is there no reference to an override of Article 126(10) in relation to the question of the prohibition on bailouts? We have a lot of important questions that are extremely relevant to the future conduct of the economy of the European Union and, though the UK has vetoed the treaty, there is still an impact upon us as well.

I just thought I would present that, because we have some detailed questions. I would like to thank both of you very much for the extremely comprehensive and detailed evidence that you have given. If I may say to Professor Craig, it was a virtuoso piece of analysis, if I can put it that way round, and we are deeply grateful to you. We will now move on to the questions themselves. The first question I will put is as follows: to what extent does this agreement increase the existing obligations on eurozone states that are not already contained in existing or draft EU rules? Professor Craig.

Professor Craig: In answering that question, one needs to look at the detail of the existing obligations. The detail of the existing obligations is contained not only in the Lisbon Treaty rules, but in the Stability and Growth Pact and, in particular, the upgrading of the relevant rules in the Stability and Growth Pact from December 2011 in the revised regulations. My own view in the light of that material is that, although there is some difference in the nature of the obligations that exist on states under the SCG—the Stability, Co-ordination and Governance treaty—and the obligations presently applicable to member states under the Lisbon Treaty and under the Stability and Growth Pact, it is not very much.

The devil is always in the detail. If you look at the detail, what you find is that, although we have a rule about balanced budgets, the detailed definition of what constitutes a balanced budget—which is the plus or minus 0.5% rule—differs not very greatly from the detailed obligations specified in the Stability and Growth Pact as revised in 2011, which is plus or minus 1%. Professor Hix knows more about this than I do, but it does seem to me that, given some of the difficulties in the actual computation of budgets, surpluses or deficits, 0.5% one way or the other is not going to be of tremendous significance. In my view, the fiscal stringency introduced by the SCG treaty, in terms of what it does over and beyond what was there before, has been overrated.

Q2 Chair: Could I ask you another question following up from that? Do you regard the legislative overlap as necessary, or do you think that there might be adverse consequences?

Professor Craig: The legislative overlap between what is there in the new “treaty” and what is there in the existing provisions of the Lisbon Treaty?

Chair: Yes, this is raised by Professor Peers.

Professor Craig: I agree with Professor Peers in that respect: I think it is a problem. In effect, even before we had this new treaty, we had what one might call a veritable wedding cake of regulatory provisions, starting off, we had the Lisbon Treaty rules; we had the broad economic policy guidelines; and then we had the legislation made pursuant to that, some of which was applicable to all states, and some of which was also applicable over and beyond that to the eurozone countries.

The existing framework is still law and it has not been altered by the new treaty, and indeed the new treaty
cannot alter those previous provisions. What we have now are those pre-existing provisions overlaid by this new set of rules, and the new set of rules draws in part from the previous set of rules, though the way in which it does so is rather complicated, as I tried to explain in the written brief that I presented. It does seem to me that there are going to be real problems about transparency and clarity of the legal provisions that are going to be applicable in any particular instance.

Q3 Chair: Just before we move on to Professor Hix, I would like to ask a very simple question, which is something I mentioned in my opening. Just to get it completely out of the way, that question is: is this an EU treaty?

Professor Craig: No, it is not an EU treaty. It is not an EU treaty in the sense that it does not in any legal way modify the primary rules presently contained in the Lisbon Treaty. Unanimity is required for that and there is not unanimity. In that sense, while one might debate in rather different ways whether the veto was a veto, it was unequivocally and unreservedly a veto in the sense that the rules contained in this treaty are not and do not alter the formal rules in the Lisbon Treaty that previously existed. In that sense it is not an EU treaty.

Q4 Chair: Could I therefore ask Professor Hix to perhaps comment on some of those questions before I move on to specific questions to him?

Professor Hix: From a political point of view, there is one thing I would comment on in this new treaty versus the existing legislative rules as set out in the Six-Pack, for example, of the economic governance legislation. What we have to understand are the incentives of why Heads of Government would want a treaty and want a treaty basis. This is because they see that, to make economic governance and to make these fiscal constraints work, they need to have some legitimacy that is different from the legitimacy you would get from just a piece of EU legislation. That is really behind why there is this treaty. Treaties require transposition and ratification in national Parliaments, and we may see demands for referendums. In fact, we are already seeing that in some states, like Ireland. Therefore, I think if this is ratified—and that is quite a big if—it does have a different level of legitimacy and credibility from the current legislative rules. I can then comment more on whether I think it is sufficient or not.

I just had one comment: I wrote the evidence I submitted before we actually saw the text. I have now seen the final text in detail.

Q5 Chair: When we get on to the questions that we want to put to you, we will be referring to the text rather than to your previous evidence. However, I do get the impression that you are somewhat concerned about the extent to which devices are used in order to get around the difficulties inherent in the failure of the compliance with the existing EU treaty arrangements. Is that about it?

Professor Hix: Yes. Part of the problem goes back to Maastricht, the first version of the Stability and Growth Pact, the second version of the Stability and Growth Pact, the rules in the Six-Pack economic governance legislation, and now even the rules in this treaty. A common thread I see through this is: how do you design a set of procedures to make a credible commitment to balance budgets? That goes all the way back to Maastricht and all the bells and whistles that have been added on ever since then. In a sense, this is adding something completely new, which is the quasi-judicial enforcement of a balanced budget rate. We have the most restrictive balanced budget rules that you can possibly envisage and some quasi-judicial enforcement of those, but I still do not think that is credible, no matter how much you add. I still do not see any evidence anywhere in the world in democracies where courts are able to force governments to meet budgetary commitments and say, “All right, we’ll achieve the same ends through EU legislation.” But my strong sense is that they were not inclined to do that; that would have...
been a loss of face politically, and they still believed in the enshrining of this precept in something at least analogous—or the closest thing they could get—to primary treaty law, which ended up as the SCG treaty. I do think it is paradoxical, though, that having gone down that route, the legal force of this will almost certainly be less peremptory than it would have been if the same rules had been embodied in ordinary EU legislation. That’s the first part of the answer.

Coming very briefly on to the second part, if the exact form of this had been enshrined in a Schengen-type modification to the EU treaties, my own view is that would still have required ratification, and the consequences of ratification, by the UK. There are certain provisions of the SCG treaty that do, albeit to a relatively minor extent, modify the pre-existing obligations. In that sense, it would have to be ratified.

Q7 Kelvin Hopkins: I have a small group of questions for Professor Hix. In a sense, the first two you have answered already, but I will ask them formally in any case. In your written evidence you questioned the credibility of the enforcement mechanisms. Now we have the Fiscal Compact, are your reservations confirmed?

Professor Hix: Yes, my reservations are confirmed. If Governments are faced by a public and economic situation that demand they do not run a balanced budget, I can see them being under intense domestic pressure, and in that situation I just don’t see Governments willing to give in to the will of either the Commission, Ecofin or the ECJ. I can see this being a recipe for real political conflict within the eurozone. One thing that really surprised me in the final text, given what they said in the statement of the Heads of Government of the eurozone states in December, was my understanding that there was a quid pro quo. The quid pro quo would be these fiscal constraint rules in return for the big bazooka—the big bailout fund: the significant increase in the EFSF and ESM—and this would be constitutionalised by putting this in the treaty parallel to the fiscal rules.

We have the fiscal rules, but I don’t see any evidence of the other side of this. I thought that was what the quid pro quo was going to be, and that was, in a sense, saying to states, “Politically, you are pre-committing to have balanced budgets in return for us pre-committing to have, essentially, a bailout fund that is going to help you through this.” Without that pre-commitment, I just don’t see, politically, how this is enforceable.

Q8 Kelvin Hopkins: So it is no more credible than the Stability and Growth Pact?

Professor Hix: I don’t think so.

Q9 Kelvin Hopkins: You also referred to the lack of democratic legitimacy of the proposals. Do Articles 12.5 and 13, the Fiscal Compact, do anything to meet concerns in this regard?

Professor Hix: No. I don’t think so. I share the views of a colleague of mine at LSE, Charles Goodhart, who has written on this. I just don’t see there being a sufficient political mandate for the Commission to act in this way. The Commission has a sufficient political mandate to oversee the implementation of EU legislation; it has a sufficient political mandate to initiate legislation. I don’t see it having a sufficient mandate to pass judgment on national budgets. To be able to do that, I think you would have to upgrade the Commission’s democratic political legitimacy.

To be fair to the German CDU, this is exactly what they were saying. They were saying that what they actually wanted, from their Congress in November, was a more democratically accountable Commission. From their logic, this makes sense. If we are going to take a major step forward in fiscal integration, we need to take a major step forward in political integration to match that. They have had that line consistently. My understanding is that it was France that blocked that, because Sarkozy did not want a more democratically accountable Commission.

Q10 Kelvin Hopkins: Do you remain of the view that the only effective and legitimate solution to the eurozone crisis is some form of fiscal union? Essentially, you have answered that, but if you take that view still, isn’t there one other alternative that is more likely—the at least partial dismantling of the eurozone?

Professor Hix: We can follow this logic, but I am always wary of the fact that I should not underestimate the EU’s ability to find a way to muddle through. It might be quite a long time before it all unravels and before we really do see some of the internal inconsistencies within the current design. The bond markets might get bored with Europe and focus their attention somewhere else, but I still think it is not clear to me how this fiscal austerity union being set up really resolves some of the major structural problems within the EMU. It does not resolve the problem that several of the periphery states are uncompetitive at the current locked-in exchange rates that they have. It does not resolve the fact that Germany is essentially exporting to these states and then lending money to the banks in these states. It does not add up from a political economy point of view, and I see this very much as driven by an incentive, essentially, to appease the German Supreme Court and to appease German banking opinion. I don’t think that is sufficient to make this work.

Q11 Chair: But isn’t it perhaps dangerous to do something for political purposes that purports to be within the framework of the rule of law, which is what the European treaties are meant to be all about, and then simply to use a series of devices to achieve a political solution? Does this not raise the rather difficult question about whether or not there is an integrity in the system that is actually represented by a proper rule of law rather than a purported one? Perhaps Professor Craig might like to answer that as well.

Professor Hix: I can comment from a political point of view. I don’t want to be particularly critical of Germany on this, because I can see the logic from their point of view. You have to see the difference between a German constitutional tradition and a British or a French constitutional tradition. The German constitutional tradition is very much the idea...
that you can write down within a constitutional framework a set of political objectives, that will constrain politicians to achieve those objectives. We don’t operate within that sort of framework, so it looks rather odd from our perspective. But from the German perspective, it is quite consistent within their constitutional tradition.

Q12 Chair: Professor Craig, would you like to comment on that last point before we move on?

Professor Craig: When you say, yes, that’s fine, and I simply don’t want to take the Committee’s time, would be that I think the question you raised is a question that has been naggng at many commentators or observers. It is the question I addressed in the first part of the paper, which I called the background principle. I think that, whichever way you look at it, the bottom line is that you have a decisional rule—you have a rule about how decisions are meant to be made—that is embodied within the Lisbon Treaty. It is a rule about how change should occur, and it is a rule that says you should undertake change if there is unanimity. It also contains quite sophisticated rules for further change to be able to take place through enhanced co-operation within the framework of the Lisbon Treaty. Whatever one believes about its desirability or not, this new treaty does raise an issue of principle, which you can call a rule-of-law issue of principle, that is concerned with whether we should bear with equanimity the idea of those decision-making rules being circumvented by a treaty outside the fabric of the Lisbon Treaty in circumstances where the rules as to how change should be undertaken within the Lisbon Treaty are not capable of being met, particularly given that the SCG treaty can only work through the participation of the EU institutions in the way that is written into that treaty. That does raise an issue of principle, which is a rule-of-law issue.

Q13 Michael Connarty: Could I ask Professor Hix to expand a little on the reservations about the actual enforcement mechanism? The point you made was that when a court strikes down a law, the law ceases, but if you strike down a budget, budgeting goes on—income and expenditure continue to flow. Have you thought through how it might work out should the ECJ ever be called to judge on this?

Professor Hix: There is an inherent contradiction in it, because on the one hand the requirement is for the member states of the eurozone to incorporate it into their domestic primary constitutional law or, if not possible, in some secondary instrument. The idea there is that presumably domestic courts would have access to this, so the first port of call would be a domestic court enforcing these primary rules. Then there is a belt and braces, which is that the Commission could then refer it to the ECJ.

Q14 Michael Connarty: I understand from reading the treaty that it has to be another partner, so it has to be another country that basically shops an errant country to the ECJ, having read the Commissioner’s report.

Professor Hix: Presumably, if it is part of domestic constitutional law, any citizen of that state could take it to the domestic court and enforce it, or a domestic party who has recourse to a court could enforce it. My first analysis was the idea that it is a domestic court ruling on whether or not a national budget is in breach of the balanced budget rule. In that situation, I would reiterate the point: what happens if a court strikes down a budget? The Government still has to carry on running; the Government still has to carry on spending money. Presumably you would go back to the previous year’s budget, which just rolls over, and that may well be in breach of the plus or minus 0.5% rule anyway. It is not as simple as saying you give a court judicial review over legislation. It is not so straightforward.

Q15 Mr Clappison: Can I ask Professor Craig a few questions, following on from what he has said to the Chairman already, about the way in which the EU does things generally—the general framework, and acting outside that framework, which requires unanimity—and what has happened here? Is there a doubt in your mind as to the legality of giving powers, through a non-EU intergovernmental treaty, to the EU institutions whose powers have not been conferred on them by EU treaties?

Professor Craig: Yes, there is a doubt. There is no doubt that I have doubts about that. I tried to set out my thinking about this as clearly as I could at the time in the evidence I submitted, because it does seem to me that lawyers have duties as well as rights. One of the duties they have is to try to be as clear as possible about important things of this kind. My own view is unequivocally that you cannot give, through a treaty of this kind, new powers to the institutions. That is point one. That still leaves open an arguing point about whether there are new powers, and that is an issue on which people might disagree. But on the point of principle, I am absolutely clear in my mind that you cannot confer new powers on institutions, and I have set out the argument in the evidence I gave. The perhaps more interesting point in practical terms is whether there are problems about the EU institutions using existing powers under the SCG treaty. I must admit, when I first looked at this and I read material on it out there from commentators, most people were regarding this as unproblematic. Part of the reason why they were regarding it as unproblematic is of course the very nature of the language. There is an existing power, so you think, “All right, there’s not a problem then; they are just using an existing power, so there’s no legal problem.” It was only when I started just turning this over in my mind, started talking to a colleague and started probing it further that I thought, “No, this is not that straightforward.” It is not that straightforward because to say that there is an existing power to do X, whatever X is, under the Stability and Growth Pact, does not per se legitimate the use of that very same power in the context of a different treaty.

Professor Hix: Do you see the powers as fundamentally different here from what is set out in the legislation that has been passed already?
**Professor Craig:** It does not matter whether they are different or not—it actually fundamentally does not matter whether the powers are different. What you are trying to do, and what you still need to do, is find a legal foundation for the use of those powers. The legal foundation logically has to come from one of two roots. You either say that the reference in the Stability and Growth Pact or the reference in provisions of the SCG treaty to provisions in the Stability and Growth Pact means that the provisions of the Stability and Growth Pact can be applied in this context. That is fine; you might make that argument, and that is the framing of some of these provisions of this treaty. But the fact that they are framed in that way—and my point is simply one of principle—cannot prove that the provisions of the Stability and Growth Pact can be used in that way. Whether they can be used depends upon an interpretation of those very provisions themselves.

**Q16 Mr Clappison:** Is part of the problem here that the Stability and Growth Pact came about within the accepted way of making and conferring powers within the EU and not this new way?

**Professor Craig:** Exactly, yes.

**Q17 Mr Clappison:** You use in your paper the image of cut and paste, which rather captures it in a layman’s way, for me anyway. Regarding these member states of the EU who are party to this new treaty, and perhaps the Commission as well, which rather captures it in a layman’s way as well, do you think there is something new here in the way in which things are developing? Is this a precedent—a new development?

**Professor Craig:** Can I just ask for a little clarification? Do I think that the very existence of the SCG treaty outside the existing framework is a precedent?

**Mr Clappison:** Yes, this is a new development where EU states have come together when they have not been able to go along the traditional route, the accepted legal framework, and they have said, "Very well, we’ll go our own way and go down this route."

**Professor Craig:** There is absolutely no doubt that, if this is ratified, it will be a precedent in the sense that it will be a solid piece of evidence that the EU as a whole, having been blocked or stopped from achieving its goals through the normal methods of treaty revision, will have recourse to a treaty of this kind outside the existing Lisbon Treaty, and that EU institutions will be involved in it. That is a precedent.

**Q18 Mr Clappison:** Thank you for that. In this context then, can I ask you about Article 16, which I think you might be familiar with? It contains a commitment, it seems to me, reading it as a layman, to bring this into the legal framework of the European Union within five years. This is a commitment that these particular states who have entered into this treaty have agreed between themselves, but it will affect the whole European Union. Not being a constitutional lawyer and without knowing the exact legal constitutional effect, what it seems to be saying to me, as a layman, is: “We are agreeing amongst ourselves that we are going to go ahead down our own route. At the end of five years, everyone is going to get it anyway, even if they did not want it in the first place.”

**Professor Craig:** I don’t think Article 16 can be read in that way, even if that is what they want.

**Q19 Mr Clappison:** What is the legal effect?

**Professor Craig:** In strict legal terms, the position on that is straightforward. Article 16 contains a commitment by the existing 25 who signed up to this treaty that they will, at least by the end of five years, try to incorporate these provisions into the ordinary primary law, which is the Lisbon Treaty. It is a commitment to try to achieve that. They cannot achieve it unless there is unanimity, so it depends on what the UK and the Czech Governments decide in five years’ time. If they decide that they don’t want these changes brought into the Lisbon Treaty, you don’t have unanimity and they cannot be brought in. I should also add that, of course, it would be open to one of the existing 25 to say, “Actually, we really don’t like the experience from the last five years, and we don’t want these rolled into the primary treaty. We don’t think this was a good idea and, therefore, we, even though we were party to this treaty, are not going to agree to the revision of the Lisbon Treaty to allow this to be folded into the Lisbon Treaty.”

**Q20 Mr Clappison:** I take your point about the two non-member states retaining their legal rights of veto and so forth, but this is an expression of political will, none the less, which may contain some implications for the future.

**Professor Hix:** If I may come in on that point, I read this the other way round, which is as security for the UK. There is an intent that this is largely temporary and their hope is this could be part of the treaties. At that point, the other member states who are not signatories—currently the UK and the Czech Republic, but there may be others who do not ratify this, by the way—are in a position at that point to then exercise a veto on whether they want this to be part of the treaties or not, and can make a judgment on how this has operated vis-à-vis the other member states. In a sense, I read this as a security device for the others as much as it is a political commitment. This goes to your first question about precedent. The one thing that worries me more than anything else, rather than the legal precedent, is the political precedent of what this means for the EU operating a sort of super club of the eurozone member states, particularly at the level of the Heads of Government in the eurozone summit and what this means for Finance Ministers. I worry politically and symbolically about the situation of the eurozone Heads of Government meeting, with the British Prime Minister and the Czech Prime Minister waiting outside the door to be called in once they have already decided, and then going through the charade of pretending that they are now discussing things with these other member states, when actually all the signatories of these states already have a qualified majority. If they can come to an agreement amongst themselves, they will have a qualified majority.
Almost all single market legislation requires a qualified majority, and the Eurozone states constitute a qualified majority, so this sets the precedent of allowing these states to get together in a room and to come to an agreement. They can conceivably have an agreement that relates to single market legislation, even though, of course, it is not mentioned here. There is nothing to stop them, saying, “We can talk about single market legislation at a meeting of Heads of Government or a meeting of eurozone Finance Ministers without the British representatives being in the room.” That sets a really dangerous precedent from the point of view of the UK.

Chair: We move on to Chris Kelly, and I think your question is addressed to Professor Craig.

Q21 Chris Kelly: Do you agree that the Commission has de facto infringement powers in Article 8? In other words, the trigger for legal proceedings is the Commission, and the member states are obliged to carry out its recommendations?

Professor Craig: Yes, I do. There is no doubt in my mind that, under Article 273—and the Council legal service agrees with me—the Commission does not have an independent right to bring suit in its own name. For that very reason, the Council legal service devised the wording that is presently contained in Article 8. I do not believe that this is sustainable legally—that is my view. It does not mean that, if it were tested before the ECJ, they would not take a contrary view; they might. I believe that as a matter of principle it would be wrong to do so, for the very reason that you have mentioned. If there is an injunction under Article 273 and if 273 cannot be used by the Commission as prosecuting authority in its own right, what we have in the first half of Article 8 is simply a legal contrivance to try to circumvent that injunction.

It really is not open to question that this is just a way of trying to get round the fact that the Commission cannot bring the action in its own name. Once the Commission has delivered a negative report on the particular state for being in breach of Article 3(2), the legal reality is there is a mandatory obligation on one or more of the other contracting states to sue the recalcitrant state. Not only is there a mandatory obligation, there is no doubt whatsoever that the substance of the legal argument would be the negative report by the Commission. So, it seems to me from every perspective this is de facto still the Commission bringing the suit.

Q22 Chris Kelly: Thank you. Further to that, is the role of the Commission in Article 8 provided for in the existing European Union treaties?

Professor Craig: There is no provision for the Commission to bring an action under 273 of the TFEU. Indeed, so far as there is anything in the existing treaties, what is in the existing treaties points in the other direction, because the Commission is not able to use the ordinary enforcement mechanism under Articles 258 to 260 of the TFEU in relation to matters covered by Article 126, paragraphs 1 to 9, of the TFEU. Basically, if you have an excessive deficit issue under Article 126, paragraphs 1 to 9, then what the treaty says is that the Commission cannot use its ordinary enforcement mechanism in those circumstances.

Could I just add one thing in this respect, going back to something that Professor Hix said a moment ago about how this kind of case might get to the European Court? One of the initial versions of this treaty did contain an express provision whereby national courts could check whether a member state was in compliance with the correction mechanisms demanded by Article 3(2). That has been stripped out; that has been removed. Professor Hix, none the less, is still right. It could be possible in principle, even though that has been removed, for a national court to be seized of the dispute, but it is more difficult. This is because of other changes to Article 8 and Article 3(2), because the obligation on member states at the beginning was to enshrine the balanced budget principles in rules of a constitutional nature, which would at least allow a national court, if a case could come before it, something to bite on. It could look at a provision of a constitutional nature. That has been very significantly watered down now.

There is now no obligation to have a balanced budget rule to be enshrined in a rule of a constitutional nature or, indeed, even of a statutory nature.

Professor Hix: I disagree with that. The wording of Article 3(2) still says “through provisions of binding force and permanent character, preferably constitutional”. That is the text that I have of 31 January, although it does keep changing.

Professor Craig: What it says in Article 3(2) is “through provisions of binding force and permanent character, preferably constitutional or otherwise guaranteed to be fully respected”. That change was a change expressly made by version four.

Professor Hix: No, I agree.

Professor Craig: If you look back at version four, the wording was expressly changed. Prior to version four, it said “through provisions of binding force and permanent character, preferably constitutional, that are guaranteed to be fully respected” etc. It was an express change of wording from “that are guaranteed” to “or otherwise”. It seems to me unimaginable that the substitution of “or otherwise” for “that are guaranteed” was fortuitous, chance or happenstance. It is a watering down. What it now says is that you can have “provisions of binding force and permanent character, preferably constitutional or otherwise guaranteed”. I cannot see how you could read it otherwise.

Professor Hix: I agree, yet “preferably constitutional” I assume means that certain member states will make this constitutional, and there is still an expectation that it should have permanent binding force. If it is constitutional as part of domestic constitutions, by definition there will be recourse to domestic courts.

Professor Craig: On the version of Article 3(2) as we have it at present, it seems to me impossible to read it otherwise than to say that, if a particular state were sued by the Commission or if a suit was brought pursuant to Article 8 saying, “You do not have a proper correction mechanism,” and if the Commission in its report said, “You don’t have something in a permanent statutory form or in a permanent
Professor Craig: I think the alternative scenario of inter-state suits without the Commission holding the gun, as it were, is almost non-existent. It is simply not going to happen. Member states are not going to sue each other for breach of their respective balanced budget rules.

Q27 Chair: At least not any more than they took action under the old Stability and Growth Pact, which comes back to Professor Hix. Lastly on this section: do you see a conflict between the role of the Commission in Article 8 and the prohibition against it bringing infringement proceedings in the context of the excessive deficit rules under Article 126(10) of the TFEU?

Professor Craig: I think the very fact that you have the prohibition on the Commission bringing enforcement action under Article 126, 1 to 9, which is the prohibition contained in Article 126(10), reinforces very considerably the conclusion that to construe Article 273 as allowing de facto a Commission enforcement action for breach of the self-same rules looks very odd indeed, which is why I said in my paper that to construe the rules under 8(2) as lawful runs the risk of coming into significant tension with the present rule in Article 126(10).

Q28 Chair: So you are not really happy with the advice of the legal adviser to the European Council?

Professor Craig: Let me just say in that respect: the Council legal service is giving something its best shot. If Government lawyers in any country are asked, “Give us a view about whether this will withstand scrutiny or not,” they are going to give you the best shot they can, and I do not mean that at all pejoratively.

Chair: It did take 10 pages.

Professor Craig: Yes, and I think part of the reason they went through 10 pages is that they wanted to try to give it as good a shot as they could. Even the Council’s legal service in that document does admit that the Commission has “a very decisive role within Article 273 as it is presently formulated under Article 8”.

Q29 Stephen Phillips: If I may, Professor Craig, I am going to begin by asking you to give something else your best shot. What do you think the ECJ will say in relation to Article 273 as to the legality of this proposed treaty if and when it comes before it?

Professor Craig: If or when the issue comes before the ECJ, I would think that they will, with some certainty, say that Article 273 can, in principle, be used in inter-state suits. Pure inter-state suits—where Germany sues Greece, or something of that kind, and the Commission is not involved—are a special agreement for the purposes of coming within Article 273. In that sense they will legitimate the use of 273. I simply do not know what they will do about the first half of Article 8. I find that one more difficult to guess. There will be a temptation to validate it, to legitimate it, and say that the Commission is not formally bringing the action and that is good enough and therefore you can use 273. The problem with that conclusion is that it looks pretty artificial and, as I
intimated in my paper in the evidence I gave, on many occasions in the past where member states have tried through various contrivances to get round a rule in the treaty by factually organising their behaviour in such a way as to minimise the likelihood of engagement with a particular treaty Article, the Court of Justice and the Commission legal service and the Council legal service have quite rightly said, “No, we are not going to allow that to happen. We will look at the substance.”

Q30 Stephen Phillips: I suspect we can at least agree on this: there is at least the potential that the European Court of Justice would, effectively, strike down this treaty by saying that, in relation to the enforcement mechanisms and possibly the Commission’s role as well, “The Commission can have no role, and we have no jurisdiction.”

Professor Craig: I don’t think they would say, “We have no jurisdiction,” because it will still leave pure interstate suits intact. Even if they did find against what is, in effect, the first half of Article 8, I don’t think it would lead to the striking down of the entire treaty. I think they would merely say that provision is ineffective as it presently stands and that the rest can remain.

Chair: We find your answers, both of you, extremely helpful. I would like to move on now to Michael Connarty.

Q31 Michael Connarty: Article 10 refers to enhanced co-operation within the eurozone. Is it talking about enhanced co-operation by the eurozone, in other words, acting as a bloc in some way?

Professor Craig: I think that is what it is envisaging, yes. I think that is what it is envisaging in Article 10.

Q32 Michael Connarty: Within the eurozone, or acting as a bloc as the eurozone?

Professor Craig: I had imagined that this was an encouragement for those countries to make use of the rules of enhanced co-operation as they presently exist within the Lisbon Treaty.

Q33 Michael Connarty: Which was among themselves?

Professor Craig: Yes.

Q34 Michael Connarty: There are clearly ongoing and parallel debates about whether the EU will act as a bloc, and vote as a bloc, if it signs up to the European Convention on Human Rights and becomes a member. The question is, does this then impact on those people who are not in the eurozone, such as the UK, in a negative way? How do you think Article 10 is to be interpreted? Do you think it is only those within the eurozone acting among themselves—in other words adhering to the rules within the eurozone?

Professor Hix: No. I read this as a way of meeting the demands of, primarily, the French Government but also the concerns of the German Government that this Fiscal Compact is not going to be enough and there is going to need to be some harmonisation of other public policies as part of macro-economic integration. This goes along with the discussions of what was an intergovernmental agreement of the Euro Plus Pact. If they decide that the elements of that Euro Plus Pact aiming to harmonise pension provisions, retirement ages and these sorts of things are not working through purely intergovernmental co-ordination, they could try to do this through enhanced co-operation through the EU treaties. That is how I read this, and I read then the last sub-sentence there, “without undermining the internal market,” as a way of appeasing the UK, who are concerned that any enhanced co-operation as a result of this would not relate to the single market. I primarily see this as enhanced co-operation relating to macro-economic policy co-ordination and not to the single market.

Professor Craig: I do not disagree with that.

Q35 Michael Connarty: Obviously you do not see the danger signals that I see, when you get people acting in a bloc, for the people outside the interests of that bloc, given—you would have heard earlier when I asked Professor Craig—that Germany was keen to have something that was even supra-treaty have control over the budgets of all of the 27 EU member states. If you have got somebody not co-operating and you are acting as a bloc—it may be a political science rather than a legal question—you use that bloc as a wedge or a battering ram or a pressure point on those who are outside to make them comply. That would be the history of how power blocs operate. That is a danger I see in Article 10: that “without undermining the internal market” is the only thing in there that you seem to be hanging your more positive analysis on.

Professor Hix: No. I think it is right that we have to consider the political as well as the legal elements of this. Legally this commits the member states who have signed up to this and who are part of the eurozone to try to use other mechanisms in a treaty that would enhance this treaty agreement. This commits them to think about the possibility of whether they do actually need enhanced co-operation, but they could do that anyway. They do not actually need this Article to do that. They could do that anyway within the rules of the treaty. In a sense this Article is largely moribund.

Professor Craig: Could I just reinforce that? I do not see Article 10 as particularly significant in that respect, just because it is merely declaratory of powers that already exist. If a group of states wish to use the rules on enhanced co-operation—and I agree with Professor Hix as to why they may wish to do so—they may wish to make more detailed rules that are formally legally binding within EU terms to carry forward the type of endeavour that they have outlined in this treaty, though that leads to complexities in and of itself. So it is merely declaratory of powers that already exist. I don’t think it is constitutive or creative of any new powers that are not already there.

Q36 Michael Connarty: Some people on either side of this argument—and I just identified myself—might harbour suspicions that having this new bloc with this new arrangement will in fact begin to impact on those people who are not in the eurozone, particularly countries like the UK that have not signed up to this
agreement. You did refer earlier, Professor Craig, to some small impacts it might have on the UK.

Professor Hix: That is a major concern that I have. Without a shadow of a doubt, we are now entering a fundamentally new phase of European integration. I see this as a qualitatively different project. I want to think of it as not two tiers, but two tracks. If we recognise it as two tracks, we have a set of states that are committing themselves to deeper fiscal integration through a set of fiscal rules and, in parallel to this, some other arrangements. Ultimately, I think they will have to discuss the issue of whether there should be EU bonds, they will have to discuss the issue of the exact rules and procedures for the allocation of bailout funds, and they will have to move on to thinking about how they have more quasi-judicial or constitutional rules governing co-ordination of other areas of macro-economic policy. All of this inevitably leads to deeper economic and fiscal integration.

Q37 Michael Connarty: So, they start to act like a bloc in reality.

Professor Hix: Inevitably they will. I think this will inevitably have an impact on a range of other issues in the internal market, and this is going to be a big tension and I see this as a major concern for the position of the UK.

Q38 Michael Connarty: Is it security enough to have that statement, “without undermining the internal market”, when what you seem to have indicated is that inevitably it will begin to impact on the internal market? We are not in the eurozone; we are not in this treaty; but we are in the internal market. It could be to the detriment of this country.

Professor Hix: There is nothing you can write down in law that could stop a political agreement amongst states acting together in the Council. A group of Governments can get together in the Council behind the scenes and say, “We agree that this is what we would like to happen in EU legislation”—this happens on legislation all the time.

Q39 Michael Connarty: The countries might say, “The Brits won’t like it—well, that’s tough.”

Professor Hix: It is tough. If the rule says you can adopt legislation by qualified majority voting on the basis of a proposal from the Commission and, under co-decision, going through a majority in the European Parliament, and they decide that they want something in the internal market because they want some internal market legislation as part of fiscal integration, I think it would be very difficult for the UK to stop that.

Q40 Chair: Yes, but at the same time the question of the use of the institution still remains an obstacle to the question of whether or not it could be justified legitimately or legally.

Professor Hix: Can you clarify what you mean by that question?

Chair: Yes. If you are going to go down the pragmatic, de facto route that you have been mentioning, you still have to overcome the question of the use of the institution. If you are going to organise whatever it is that you wish to achieve within the framework of the rule of law, you have to ensure that it is justified in law, and the question of whether or not use of the institutions is a matter of law as respects the EU treaties still remains.

Professor Hix: The scenario that I am envisaging, which is purely hypothetical, is the situation where at some point the member states, as part of deeper macro-economic integration, decide they would like something as part of the internal market. People have discussed the issue of a financial transactions tax. A financial transactions tax actually requires unanimity, so it could be vetoed anyway. There may be other areas of the treaty that might relate to regulation of labour markets, for example—working time rules—and there are plenty of provisions within the treaties that allow labour markets to be regulated or de-regulated through normal legal mechanisms of the treaty. They could do that.

Q41 Michael Connarty: I think we are heading towards something. You mentioned one example. The reality is that in the EU treaty the requirement of enhanced co-operation was seen as a last resort. Article 20(2), I am concerned that this is a significant inconsistency that might change the way enhanced co-operation is used—in other words it becomes the normal way of behaving—from what was agreed in the treaties. You seem to say, “They can do it if they like,” but this is in a sense putting it in as almost the normal method of doing economic political business.

Professor Craig: If that happened, it would be a real sea change. I hear what Professor Hix is saying. I can see the force of it. I think I am just not quite as persuaded that we are going to have a core of 25 or 23 or whatever states that are really going to forge a different kind of economic and political union from the three or four other states outside, for a whole variety of reasons. One is that I don’t believe that there will be unity with those states. I think the tighter rules contained within the SCG treaty will do as much to tear them apart as they will to bring them together.

Professor Hix: That may well be the case.

Professor Craig: I don’t see that vision. In any event, just very briefly, to directly answer your question: if the rules on enhanced co-operation were used in a regular fashion, it would be a complete sea change. It does not mean it may not happen. They have been used once ever since they have been in the treaty.

Q42 Chair: Could I just butt in on that, because I want to ask a very important question relating to the use of enhanced co-operation? Article 10 encourages contracting states to use enhanced co-operation to ensure the smooth functioning of the euro area—and I am now quoting what they say—“whenever appropriate and necessary”. However, the EU treaty requirement is that it should be used—and I quote, again, from Article 22(2) of TEU—“as a last resort”. We are concerned that this is a significant inconsistency that might change the way enhanced co-operation is used from what was agreed in the treaties. The question is: are you?
**Professor Craig:** On that issue, Article 10 of this treaty cannot alter the meaning of Article 20 of the TEU or Articles 326 to 324 of the TFEU. Insofar as they lay down different criteria, and they do, the provisions in the TEU and the TFEU govern. So, if push comes to shove, as it were, or if legal push comes to legal shove, Article 10 of this treaty falls. Indeed, not only is there the inconsistency that you have pointed out; it is also the fact, as other people have pointed out, that the very last phrase, “without undermining the internal market”, is only one of the conditions in Article 20 of the TEU for the use of enhanced co-operation. There are other conditions—for example, that it should not discriminate between states, and about two or three other conditions that have to be met as well—and Article 10 cannot alter those conditions.

**Q43 Michael Connarty:** I come not as a legal person but as an economics graduate, and therefore I look at it politically and economically, but it seems to me that if you could talk about them doing things on working time and employment law, then obviously the temptation would be for some countries to move in that way in terms of taxation. Employment seems to be a very fundamental area of law, and taxation another.

**Professor Hix:** It is possible. The security for the UK, though, is that these provisions on taxation require unanimity. Whether it is harmonisation of tax bases or whether it is harmonisation of tax rates, these all require unanimity, so in that sense I don’t see this as necessarily threatening that particular issue.

**Q44 Chair:** It seems to me from some of the answers you have been giving that you have some grave reservations in general terms about the methodology that is being approached here, the objective and also the question of the legitimacy, if not the legality of it. Would you like to comment on that and also, lastly, what do you think overall the United Kingdom has achieved by exercising its veto?

**Professor Hix:** I am happy to go first. That is a very big question. I am less concerned legally by this, because I think where there is a political will, the EU will find a way around this. I would be very surprised if a challenge before the German constitutional court really threatened this new treaty. I would be very surprised if a challenge before the ECJ really threatened this new treaty. I am more concerned about whether or not the objectives in the treaty are actually achievable politically, and also whether or not the objectives set out in this treaty will actually resolve some of the structural problems within the eurozone. I am concerned about those two issues.

That then raises the question of what the fallout of that might be. The issue of whether the eurozone needs to take another major step forward to resolve its structural problems, and what that means for states that are not part of that the euro, will come very quickly on the horizon. For example: should there be EU bonds? That issue is not going to go away. I am sorry. What was the final part of your question?

**Q45 Chair:** What do you think the UK has achieved by exercising its veto?

**Professor Hix:** Having seen the text of the treaty, and having seen how the text changed quite significantly from what the text was expected to be on that night in December, I am not convinced that the UK could not have actually said, “I will agree to this on condition that I am happy with the final text that comes out.” At this point it would be interesting to know whether the UK Government would have vetoed this being part of the treaty, because this being part of the treaty would not have required a referendum in the UK, because it has no obligations for the UK. This is much more watered down than was the fear of the UK Government on that night in December. I am not sure really that the veto has achieved anything in the short term. In the long term, the veto may well have led to a growing separation of European integration into two tracks, and that I am concerned about.

**Q46 Chair:** Could I just put the simple question about the veto to you, Professor Craig? What do you overall think the UK achieved by exercising the veto?

**Professor Craig:** On that point, I echo the same thoughts as Professor Hix. When our Prime Minister exercised the veto back in December, he exercised the veto on the basis of the knowledge he had of the projected agreement at that time. That was six or seven paragraphs. Not only was it a very bare document, what was in the bare document looked a lot tougher than what we have now. It really did look like we were going to have automatic, constitutionally driven correction mechanisms with real force, monitored by the ECJ and by national courts. Now, not surprisingly, a lot of that has been watered down over the five versions of this treaty that have been written and amended between December and January 2012. Whether the UK Government would then feel inclined or less disinclined to veto this now, or whether it would feel inclined to take part in it now, is a political decision. But I repeat: in substance, the reality is what is contained in this treaty over and beyond existing obligations really is not very much, and therefore if one was concerned with substance in that sense, the fact that there is a balanced budget principle does not alter the fact that the devil is in the detail, and that means that you look to see what the definition of a balanced budget is, and that is not very different from the rules as they presently stand.

**Chair:** Thank you.
Examination of Witness

Witness: Charles Grant, Director, Centre for Economic Reform, gave evidence.

Q47 Chair: We are taking evidence from a number of lawyers as to the legal compatibility of the fiscal compact with EU treaties, but what, in your view, is its political compatibility? Is it evidence of an increasing trend to intergovernmentalism to a two- or multi-speed EU?

Charles Grant: I should start by saying that I do not have the legal and technical expertise that some of your previous witnesses have had. If I can add any value, it is probably on the political and economic context behind the treaty, and the general situation of the euro crisis.

I have certainly had a fear that this would turn out to be a very intergovernmental treaty. My own view is that there has been a long-term trend towards greater intergovernmentalism in the EU, for reasons we may wish to discuss, driven particularly at the moment by France and Germany having a very negative view of the Commission. Their belief, hard as it may be to imagine in this country, is that the Commission is pursuing Anglo-Saxon ultra-liberal interests. For various reasons, therefore, France and Germany have for several years wanted to turn the EU institutions in an intergovernmental direction. Their initial comments on this treaty before it was drafted implied that it would move in that direction, and you have seen that in the ESM treaty and the EFSF the Commission plays a relatively small role.

However, having seen the final treaty, people like me, who are worried about intergovernmentalism, are reassured to some degree, because the EU institutions, particularly the Commission and the Court, do play a significant role. I have to say the British debate on the use of institutions has been, in my analysis, completely wide of the mark. The Government has been criticised for allowing the other member states to use the EU institutions. My point would be that it is very much in the British national interest that the EU institutions should be involved. We are not going to be in the room when these people discuss economic policy, and the Commission has the task of making sure that the new arrangements are compatible with the existing treaties, and that the new arrangements do not disadvantage member states outside the room or damage the single market. I am personally delighted that the Commission seems to be playing, as far as I can see, rather a large role in the new setup.

Q48 Chair: But you would none the less be aware of the question of the rule of law and the question of whether an organisation or a treaty-based organisation operating outside the rule of law, if that were the case, would be a serious matter.

Charles Grant: Sorry, could you just repeat that, please?

Chair: We are talking about a treaty-based organisation, which is the European Union, which purports to operate according to the rule of law. Would you not be concerned if it were established that what they were seeking to do by an agreement between 25 member states—actually by use of institutions that belong to the other organisations—infringed the rule of law?

Charles Grant: Yes, that would be a concern. I think it is important that these new arrangements are totally compatible with the existing EU arrangements, and that there is a system of policing to make sure that they are, namely the involvement of the Commission and the Court.

Q49 Chair: What sort of agreement does this represent for the relationship between the very large member states, particularly Germany and France, and the smaller states? Can you see any question of difficulty that could arise between the bigger states and the smaller ones?

Charles Grant: There is obviously, as you rightly infer, a lot of tension between large and small. There has been a battle fought between the 9 December summit and the agreement on this agreement, treaty—whatever you want to call it—on this principle, which has been totally unreported by the British press; even the Financial Times has not referred to it. The French during the last six weeks have been trying very hard to intergovernmentalise it, which means giving a more important role to large countries, de facto—that is what it means. The smaller countries and the Commission, with some support from the Germans, have fought back. My analysis, from talking to some of the Ministers involved in the negotiations, is that the French have basically been defeated. They have lost a lot of the arguments, which is why the final result does not, as far as I can see, greatly skew the power relationship in favour of large countries against the small, but I believe the French tried very hard to do that.

Q50 Mr Clappison: What consequence from their position in the EU do you see for the UK and the Czech Republic in standing aside from the Fiscal Compact?

Charles Grant: The big danger—and I guess some of your previous witnesses have referred to it—is, if the British are not in the room when decisions are taken on economic policy, or even when discussions happen on economic policy, we will be unable to influence the discussions and unable to steer the argument. That is the big danger. I am afraid I am very traditional in these things. I go along with the old-fashioned Foreign Office view that Britain should be in the room when other Europeans discuss economic policy. There are of course safeguards in the treaty, and legally they are not allowed to talk about the single market, but I have talked to one Europe Minister of one large member state who is generally sympathetic to Britain, and he said, “That is not going to work in practice. In practice, if we are talking about the European economy, we will talk about the single market. We will not take decisions on it; that would not be possible legally, but we will talk about it and we may informally caucus on it.” That is the danger for Britain. I worry that with the arrival of these “twin tracks”, to quote Simon Hix, we will not be in the room when economic issues are discussed that are relevant to the UK.
Q51 Kelvin Hopkins: What consequences do you see if the Fiscal Compact fails in its aim of helping to solve the eurozone crisis?

Charles Grant: I am worried about the economic implications of the Fiscal Compact. Clearly, I go along with the view of many analysts in this country, the United States and France that fiscal discipline alone will not solve the eurozone’s ailments and that there is a problem of a lack of growth and a lack of demand in southern Europe. This Fiscal Compact seems to essentially outlaw Keynesianism, which is not to say that fiscal discipline is not needed, but you need fiscal discipline plus efforts to promote growth.

The only possible reason for having this Fiscal Compact is to make the Germans feel more relaxed that southern countries will not spend too much, and the Germans will then feel more relaxed about shifting their policies towards the eurozone, namely on the ECB, on the size of bailout funds, and on eubonds. I think there is some tentative evidence that the Germans are shifting their policies, at least on the first two things I mentioned. They are quite relaxed about the ECB’s more interventionist role; they are going to agree to a bigger bailout fund, namely that the ESM should exist at the same time as the EFSF. They are not really moving on eubonds, but that would take a long time anyway.

As far as I know, of the 25 countries involved, probably 24 of them think the Fiscal Compact is a pretty silly idea in itself. It is only relevant in the sense that it will persuade the Germans to shift their policies.

Q52 Chair: Before you came to the witness stand, you heard the discussion with Professor Craig and Professor Hix regarding enhanced co-operation. Did you form any sense of where you thought the question of enhanced co-operation was going? Did you have any sense that there were problems there that would concern you?

Charles Grant: I did hear some of that conversation. I am not too concerned, because I think I would agree with Professor Craig that the existing EU treaty’s rules on enhanced co-operation would still pertain, that they are quite strict about that and that they do not allow any kind of enhanced co-operation that could damage or impair the single market. I think he said it has been used once. I thought it had been used twice: once on family law and once on the patent. Perhaps the patent one has not been fully finalised, which is why he said once. It seems to me that the Commission has to approve enhanced co-operation before it can happen, and the Commission would not want enhanced co-operation to happen if it was creating obstacles to or impairing the operation of the single market, so I am relatively relaxed about that.

Q53 Michael Connarty: I had taken those questions to put to you as someone who is coming from an economic reform perspective. The point to be made is that the compact says to use enhanced co-operation “to ensure the smooth functioning of the euro area… whenever appropriate and necessary”, but the treaty and all of the references to the articles in the treaty say that the requirement is that it should be used “as a last resort”. Now, there has been a sea shift or they have crossed a Rubicon, it would appear to me, from where it is used only as a last resort—it is necessary—to where it has become the method of operation. In any economic arrangement, whether it is in the private sector between companies or institutions or whether it is between Governments as economic units, the people who are in the deal look to their interests first before they think about the consequence for those outside the deal. Given that most of the people who are now in the EU seem to be in the deal and the UK and others are outside it, that gives precedence and more power to the eurozone countries, clearly. It does seem to me that you are being optimistic that somehow the Commission will think always of the people who might be outside who would be affected by something that would help the eurozone. Clearly, they set out in this process to have a treaty governing all 27 countries. They did not get it, but continued with the project in a different form, even in a watered-down form, as has been said of this fifth version that we have before us now. But it does seem to me that the first consideration will be: “What is good for us inside the deal, other than that? You say the Commission will somehow be disciplined and always look at the interests of the internal market for the 27. If they think it is better for the internal market, for example, to have common tax bases or even common levels of taxation, including particular business taxes, then why should they not pursue that? Or employment decisions: we would see that as the interest of the internal market, even though it might not be what is wanted and would be resisted by those who are outside the eurozone. I would like you to expand on it. Do you have evidence that leads you to believe that the Commission will act in anything other than a single-minded, competence empowerment position, which it has always done in my view for the last 25 years?

Charles Grant: You make some fair points. The one area where perhaps I do see the kind of danger that you refer to is banking supervision—financial regulation—because arguably the interests of the eurozone countries there are to have a much more centralised system of supervision which probably would not be in the interest of Britain because we are outside the eurozone. One could conceive of the eurozone countries trying to have an enhanced co-operation on banking supervision, which would have implications in the UK, though it would not necessarily be damaging to us if we are not part of it. I have tried to think of other areas where this might happen. I have not thought of many other than banking supervision.

In general you are assuming, Mr Connarty, that the interests of the 25 or at least the 17 friends are coherent and cohesive and similar, which could be the case some of the time but, as one of your earlier witnesses said, they have very different views on many economic questions. It is not just the Irish who do not want to harmonise taxes, it is most of the Central Europeans as well, so there is a big split down the middle on that one. On the single market, the Swedes and the Danes, who will be inside this group, and most of the Central Europeans and the Italians, so
long as Monti is there, are passionate for the single market. We should not forget that Britain does have quite a lot of friends despite the fact that on the morning of 9 December we were isolated. Since then there has been a big effort to try to build bridges to us and work with us. A lot of people understand that an EU dominated by France and a few other protectionist countries would be disastrous and not in their interests. I see other countries going out of their way to try to not do things that would damage the market or damage British interests. As for the Commission just pursuing the interests of the majority, I agree that it could, perhaps. On an issue like financial regulation, if it thought that the interests of the fiscal compact countries were different from the British, it might well pursue their interests, but in general, I perhaps have a different view of the Commission. I think it is a stickler for the rules most of the time and does believe in the single market, and that puts it inherently in a more similar position to the British than the French on many issues, which is why if you ever go to Paris you will find that the Commission is hated there much more than it is hated in this town, and the same could apply to Berlin.

Q54 Chair: If we go back to your comments on the events of 9 December, those events could be seen as the example of political will coming into conflict with the community of law, and political will won the day. Where does this leave the ability of a single member state to rely on the use of institutions to be limited to what has been agreed in the EU treaties as a whole? Charles Grant: As I have already said, I think the new arrangements reassuringly seem to be based on very similar arrangements to the EU as a whole, with a strong role for EU institutions, which should ensure that the interests of all parties are protected. I accept that, because this is a more intergovernmental set of arrangements than the EU per se, there is a risk that the new arrangements will be driven more by political will than legal process, which is why, from my point of view, it is unfortunate that this has happened—that we have these twin tracks and that the UK is outside. What can one member state do to ensure process is defended? One thing we can do, obviously, is use the rules as they are. Enhanced co-operation, for example, cannot happen unless it happens under the EU’s own arrangements. The other thing we need to do is more political: we need to have friendships and alliances and people who agree with us. Under governments of the left and right in this country, we have not been very good at building friendships and winning allies. In practice, because the EU is about power as well as rules, what is needed to promote British interests in the EU is a network of friends and allies who will help us when we need help. That is what we have not been very good at doing.

Q55 Kelvin Hopkins: If I return to the Fiscal Compact and austerity being forced upon weaker nations and so on—your emphasis is economic like mine—isn’t the only real solution to allow states to leave the eurozone, recreate their own currencies and devalue to regain competitiveness, and to retain currency flexibility after that to survive? Austerity is just going to drive them into the dirt, isn’t it? Charles Grant: I think that is a very fair question, and with hindsight it is obvious that the southern European countries should not have joined the euro because they are not competitive, they are not flexible and they cannot adjust to the strains of being in the euro. But just because they should not have joined in the beginning, it does not mean it is necessarily right for them to leave now. My own view—and I have written this—is that probably Greece should leave, because Greece is a special case. It seems incapable of adjusting easily; the structural reforms that the EU has been asking for for the last two years have not been implemented. I am not sure about Portugal, and I think Spain and Italy are very different. They have quite considerable economic strengths as well as problems, and with a bit of good governance and good reform, they could do what is necessary to stay in the euro.

One key question is, of course, if Greece leaves the euro, does the whole pack of cards collapse? I have talked to some of the best economic experts on this and they do not agree. People think that, if Greece departed, it would lead to a kind of run, so that everybody in Spain and Italy would take their money out of their country, and the markets would lose confidence in the ability of the euro to survive. My own view is as long as the firewall is sufficiently large, the bailout funds are there and you have good policies in place, probably the eurozone could survive a departure of Greece. Nobody knows and the best experts disagree on that question, which is why everybody is keen to keep Greece in for now. In any case, the firewalls are not yet fully in place.

Q56 Michael Connarty: In the context of both what you heard and what you have said, what overall do you think the UK achieved by exercising its veto to prevent Greece leaving? Charles Grant: To be honest, I don’t believe it achieved very much at all. The request for a special case. It seems incapable of adjusting easily; the structural reforms that the EU has been asking for for the last two years have not been implemented. I am not sure about Portugal, and I think Spain and Italy are very different. They have quite considerable economic strengths as well as problems, and with a bit of good governance and good reform, they could do what is necessary to stay in the euro.

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no particular protection. I believe the main consequence of 9 December is that other countries will get together and discuss the European economy and economic policy and probably the single market, and we are not going to be in the room. That is potentially injurious to the British national interest.

Q57 Chair: If we were not to have exercised the veto and we were therefore party to all the rules set out in this Treaty on Stability, Co-ordination and Governance in the EU and it was actually an EU treaty, would you not accept that the consequence of that would be that we would have imposed upon us a series of rules relating to the question of the running of our economy and all the changes that are being made? We would then have less control as an independent nation state in this context. Would you agree that would be a big change of such a kind that would warrant the exercise of the veto, even though the reasons that were given were to protect the single market and the City of London?  

Charles Grant: I would not agree with that analysis, no. As far as I understand it, if Britain had been part of this treaty it would have been subject to the fiscal discipline—the particular rules that I think many of us agree are probably not desirable. In the past few days I have talked to a Swedish Minister who says that he has no desire to have these rules applying to Sweden, and he believes that as part of the treaty Sweden will not have to follow these particular rules and certainly would not face penalties for not following them. I think Britain could have been part of this treaty without losing its ability to run its own economy in the way it wished, so long as it did not want to join the euro.

Q58 Chair: That is the question, because under the arrangements of the Maastricht Treaty—and I hesitate to remind you that it was 20 years ago to the day that it was signed—the provisions relating to monetary union are described as irrevocable and, furthermore, although we have an opt-out from it, it does not mean to say that, short of a resolution in the House of Commons, we are not actually part of the framework. I am much more relaxed about that

Charles Grant: Yes, but I don’t see anything in the treaty agreed a few days ago that would impose extra constraints on the way Britain could run its economy. I don’t see any provisions that imply that.

Q59 Chris Heaton-Harris: I just wonder if you see any sort of danger for us in the extension of the competence of the institutions, or part of the institutions, in relation to the co-ordination of economic policy?  

Charles Grant: I think that was a contentious issue during the negotiation of this treaty, and I believe the French tried very hard to do so, even at one point saying that this article on co-ordination could include discussion of the single market. This was one of the battles I referred to earlier, whereby the French tried to push the treaty in an intergovernmental direction, in a broader direction, in a direction where they would like the new grouping to be able to talk about anything at all, and other people—the Commission, Britain’s friends, and the Germans—fought back and defeated the French on that point. As it is worded now, I think there is still a danger that they will talk about the single market. As I said, one Europe Minister of one large country who is a friend of Britain said to me, “We will talk about the single market, whatever the treaty says. What we cannot do, of course, is take decisions on it, but we will talk about it.” That is why this treaty in some ways could be bad news for Britain, because we will be less able to steer the discussion if we are not in the room. I regret very much that we don’t seem to have got any observer status. I don’t know why we have not demanded that. Perhaps we would not have got it, but it would have been a right to observe and even speak when our own interests are touched upon by these new arrangements.

Q60 Chair: Picking up the point that you have just made about the use of qualified majority voting in relation to the single market, you are obviously aware that there are, I think, 213 votes of those countries within the eurozone and 131 not in the eurozone. Prima facie, but not necessarily consistently, there is a union between the possibility of a union and the continuation of the use of qualified majority vote by those in the eurozone to ouvote the others. However, there is also the fact that there are certain member states not in the eurozone who have indicated that they would be inclined to vote with those in the eurozone on the single market questions. For practical purposes, cutting through all the opaque legal provisions, there appears to be a considerable number of states who would continue to use their voting arrangements in a way that could be inimical to British national interests. Are you familiar with the work of Professor Roland Vaubel, Professor of Economics at Münich University? He argues that there is a process of regulatory collusion that operates within the EU so that certain blocs of member states achieve their objectives. Do you ever feel that that is something that does happen, and that therefore, to protect the single market, you really do have to be extremely vigilant, and furthermore that the use of qualified majority vote could be, in certain circumstances, extremely disadvantageous to the UK under the arrangements prescribed by this treaty?

Charles Grant: I am much more relaxed about that than I was before the arrival of Monti. Now, Monti may not last forever. We have a large member state with a Prime Minister who is passionate about the single market and who wrote a report on the market a year before last, which is essential reading. He is an integrationist, yes, so not everybody in this country would agree with that side of his thinking, but he is passionate about the market. This has changed the balance of power hugely.

France is quite isolated now. There are discussions going on at the moment between the British Government, the German Government, the Italian Government, the Swedish Government and the Polish Government on how to revive the single market programme—how to push it into digital goods and
into services. The risk of us being outvoted on these issues now is significantly reduced. Now, if Berlusconi returned, that would change things a bit, but you have very few Governments now in the French camp of resisting liberalisation of services. Things will happen in the next year or two to promote the market, because Britain’s friends see this as a way to bring the British back on board.

I don’t see much danger of the eurozone countries colluding to push through anti-market measures. That is not the way the balance of power is shifting at the moment. Of course, things could change, but at the moment things are shifting rather in the opposite direction.

Chair: Does anybody else have any further questions? Thank you very much, Mr Grant.
Wednesday 8 February 2012

Members present:
Mr William Cash (Chair)
Mr James Clappison
Michael Connarty
Julie Elliott
Nia Griffith
Chris Heaton-Harris
Chris Kelly
Penny Mordaunt
Stephen Phillips
Jacob Rees-Mogg
Henry Smith

Witnesses: Professor Michael Dougan, Liverpool Law School, and Martin Howe QC gave evidence.

Q61 Chair: Thank you very much for coming, Professor Dougan and Martin Howe. The simplest thing is to get straight into the questions. Tomorrow the website will have the evidence that has already been taken and the written opinions that we have received from others so far. As far as you are concerned, what you are doing today will be up within 48 hours. I think that would be a fair comment. The first question is in regard to the obligations on eurozone states. Mr Howe, to what extent does the agreement increase the obligations on eurozone states that are not already contained in existing or draft EU rules?

Martin Howe: The increase in obligations on eurozone states includes first of all an obligation on them as to how they vote in the context of the excessive deficit procedure. They are required by this treaty to act as a voting bloc or caucus. Second is the obligation to incorporate internal mechanisms to secure a balanced budget in their domestic law or domestic constitution. Those are the principal additional obligations imposed on eurozone states.

Chair: Professor Dougan, what is your view about that?

Professor Dougan: I would agree with Martin on that point. The voting requirement and the balanced budget rule would seem to go beyond what already exists or what we know to be imminent in terms of Commission proposals that are expressly envisaged by the terms of the new treaty. Beyond that, it is probably worth noting that some of the obligations set out in the new treaty are really more in the character of aspirations for future EU action, rather than direct obligations for the member states involved, in the sense that they envisage or exhort the Commission to carry out forms of secondary action under the EU treaties, which it really is the prerogative of the Commission to decide to carry out for itself. Although they may well express the aspiration that they would like the Commission to do so, it is really not an obligation as such. It is merely an invitation to the Commission to behave in that way.

Q62 Chair: Do you regard this legislative overlap as necessary, or might there be adverse consequences?

Martin Howe: This is the legislative overlap between this treaty and the TFEU?

Chair: And the non-EU treaty.

Martin Howe: Let us take the balanced budget requirement. The TFEU itself requires member states to maintain their deficits within a band of—in normal circumstances—3%. This treaty, as it were, is not inconsistent with that. It imposes a tighter obligation. It overlaps by imposing a tighter obligation, but it is not inconsistent.

Chair: Professor Dougan, what is your view on that?

Professor Dougan: I would probably divide it between whether it is politically necessary and whether it is legally necessary. Politically, most people agree that certain member states, particularly Germany, felt that they needed an agreement of this sort at the level of primary law. Preferably, the Germans would have wanted an EU amending treaty, but as an alternative, they are happy for a public international law treaty. Politically, I think they needed that in order to feel that they could sell resolution of the eurozone crisis to their own population, and also perhaps persuade the European Central Bank to take some of the measures that are necessary in the short term to prop up some of the struggling economies. That is the political reason why it may well be necessary. Legally, it is probably not so necessary.

Q63 Chair: What do you mean by that?

Professor Dougan: Legally, it takes the form it does because of the UK veto in December. It could have been a very different type of treaty. There would still have been political pressure to have it, but legally it takes the form that it does because of the UK veto.

Q64 Chair: You obviously know Professor Paul Craig very well. Yesterday he was saying, in effect, that there were serious questions about the rule of law in relation to this entire operation. His evidence will speak for itself, but that is the thrust of it. I have another question on this: is there a danger that this overlap makes the rules for the eurozone more difficult to understand? There is also a question of complexity, which I think you dealt with in your evidence—actually, I think it was Professor Peers who dealt with the complexity question. What is your view about that? Do you think that there is a danger that this overlap makes the rules for the eurozone more difficult to understand?

Martin Howe: I think it does make them somewhat more difficult to understand, although they are rules that are primarily almost entirely directed to member states, rather than to the population at large. I am afraid I do not know what Professor Craig said to you yesterday at the evidence session, but I have read the paper he submitted. Personally, I share concerns about propriety in the rule of law, particularly in the context
of the use of the Commission and, to a lesser extent, the use of the Court—the use of the institutions—for the private purposes of this subgroup of member states, without any formal mechanism authorising use of the Commission under the EU treaties. However, I look at it, if you like, from a practitioner’s perspective. I find that what my clients are interested in is not my opinion of what I think is the right decision a court should make; it is my opinion of what decision the court that is going to hear a case will make.

If you look in practical terms at the use made of the institutions, what would happen supposing, hypothetically, that the United Kingdom were to mount some sort of challenge or some other member state were to mount some sort of challenge? While there are strong theoretical arguments that the Commission should not allow itself to be used in this way, the European Court of Justice is a court that is—put it this way—highly attuned to the political context in which it operates.

Q65 Chair: Is that a euphemism or a joke?
Professor Dougan: Take it whichever way. 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.

Q66 Chair: Professor Dougan, do you have anything to add to what Martin Howe said?
Professor Dougan: I think I could probably add quite a lot, if you would like me to. I had the advantage of reading Professor Craig’s written evidence, which was circulated on Monday, I think. I saw several points at which Professor Craig expressed the view that there were rule of law issues in relation to both the form and the content of the new intergovernmental treaty. I will say quite honestly that although I very much respect Professor Craig’s views and analysis, I certainly do not share them. I am not sure that I see the same types of issues. I can see issues, like Martin, but I do not see the same types of issues, particularly as regards the principle of whether member states, having failed to achieve a treaty amendment so as to pursue that objective outside the EU framework by means of ordinary international law. That is one issue that Professor Craig flagged up, and it is one that I would disagree with.

On the use of the EU institutions for a non-EU purpose, Dr Gordon and I indicated in our written evidence that there is relatively clear authority from the European Court of Justice that it is possible in principle for the EU institutions to be delegated non-EU functions by the member states. The real question is not the principle; it is the conditions under which that type of delegation can take place. There are lots of factors that could be used by analogy to try to figure out what those conditions might be, but on the point of principle I think it is possible. It is just a matter of trying to decide how and when that would be lawful.

Professor Dougan: Those cases are ones 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. There is a significant legal difference in an instance where not all member states have consented to the extension of the functions of the institutions beyond those under the treaty.

Q67 Chair: Lastly, before I bring in Michael Connarty, I just want to get this one question to Professor Dougan on the record. Would you like to comment on the danger that this overlap would make the rules for the eurozone more difficult to understand—the complexity question?
Professor Dougan: The rules on the single currency—on the eurozone—are difficult for any of us to understand at the best of times. I think this is an unhelpful degree of overlap, which makes the situation more complex.

Chair: That is what I needed to know.

Q68 Michael Connarty: Professor Dougan, you commented on Professor Craig’s written evidence. He and our other witness pointed out that they were dealing with a treaty that has since been amended again. We have the fifth version before us, from 27 January. Chapter 3, section 2, of the original draft stated, as Martin said, that there would be provisions of a binding force and permanent constitutional character. That has now been changed to “preferably constitutional, or otherwise guaranteed”, which both our witnesses said made it very much like it is at the moment. Basically, there has never been any infringement because those guarantees are so vague. Your stress on that as a second major change, which changes constitutional laws, seems to be so much euro-fudge at the moment. It is not likely to have any binding character at all, so in its present form in the fifth amendment it is not such a great threat as you put forward.

Martin Howe: I agree it has been weakened since its original draft.

Michael Connarty: Seriously.
Martin Howe: Yes. The legal test is still that it has to be of binding character. Internally, it seems to me that to satisfy a requirement of the treaty it must—

Q69 Michael Connarty: It is not what it was. It is not what the Germans and French were seeking—namely, binding constitutional changes in all countries that signed up to this. It has been watered down considerably. Do you agree?
Professor Dougan: I agree. Perhaps when we were talking about what is novel about this new treaty as compared with what exists already, it is partly the idea of the balanced budget as a substantive obligation. If we set aside the issue of the form that that guarantee takes, whether it is constitutional, equivalent to constitutional or merely of a binding character, it is the fact that the substantive obligation goes further than what exists already under EU law—the idea of the lower limit of the structural deficit being 0.5%. That is what is novel and significant, rather than necessarily the form it has to take.
Q70 Michael Connarty: It was not one of the things mentioned by Martin at the beginning. He mentioned two things: voting as a bloc and changes to constitutional law, and "changes to constitutional law" is not as strong as we wished for when they set out the first draft.

Martin Howe: I did say constitutional or other internal law. I think I said that. It has to be a law, it seems to me.

Q71 Michael Connarty: It does not say that. It just says, "otherwise guaranteed." It does not say law.

Martin Howe: "Binding force and permanent character," it says.


Chair: Henry, would you be kind enough to follow this up with your question to Martin Howe on article 7?

Q72 Henry Smith: Article 7 incorporates the mechanism for reverse qualified majority voting. In your opinion, is it possible for a non-EU treaty to stipulate voting procedures in an EU institution?

Martin Howe: It is not a question to which I can give you a certain answer, and I would rather not. There are other contexts where the answer would clearly be no. For example, to take an extreme case, members of the Commission owe duties as individuals under the treaties, and there is express provision in the treaty that they shall not take instructions from either their own or any other member state in how they perform their functions. The same rules apply explicitly to members of the Court of Justice, as one would expect. Here, we are talking about voting by representatives of member states within the Council of Ministers, and in general the treaty does not explicitly say that you cannot bind the way you vote. One would not expect there to be a general prohibition on doing political deals as to how member states’ representatives will vote in the Council of Ministers.

On the other hand, what we have in article 7 of this treaty is, if you like, a formal and binding-in-international-law obligation on the members of the contracting states of this treaty as to how their representatives shall vote. Furthermore, the context in which they are voting could be argued to have quasi-judicial characteristics, because the Council of Ministers is a political institution. It is made up of representatives of the national Governments, its responsibilities are essentially political and its accountability is also essentially political. There might be a danger in trying to juridify or legalise the operation of the Council by trying to impose such quasi-judicial obligations on it in a way that is not necessarily appropriate. I think therefore that there are three main characteristics of this article 7 procedure that we should bear in mind. First, the defendant member state—if you want to put it that way—still has the right to make its representations before any voting takes place, so it still has procedural rights, which the other member states have to respect. Secondly, although there is a commitment to vote presumptively in favour of a Commission proposal, it is not an absolute commitment. They can decide to change their minds, and if enough of them change their minds, none of them is bound by a member state—this is the characteristic of the framework. One might go further and say that they could simply breach this treaty because they are free in the Council to vote however they like, and if they want to breach their obligations under the treaty, there is no enforcement sanction that can be imposed upon them. They will incur a breach of international law, but there is nothing to stop them doing that if they so wish, and the sanctions are non-existent. Finally, at least in certain cases you can go to the European Court of Justice if you feel that your procedural rights under this excessive deficit procedure have not been followed. Particularly at the later stages of the procedure, the Court can judicially review the acts of the Council, if it feels that the Council has behaved in a procedurally unfair way.

Q73 Chair: And surely it is not just about the question of exercising a vote, as it were; it is about what they are dealing with, because this is about running the economy. It affects employment and the manner in which the economy functions, so from that point of view, it is not just a theoretical exercise. It is actually about practical questions that flow from whatever decisions are taken.

Martin Howe: Indeed, because what the Council will have to consider, if, for example, a member state is in breach of the excessive deficit criterion, is not merely a black and white economic question—is it in breach?—but how severe or acute the measures should be to get it back on track and balance what may be short-term damage to employment, and so forth, against other considerations.

Chair: Would you like to ask the same question of Professor Dougan, Henry?

Henry Smith: Yes, that would be useful.

Professor Dougan: I am grateful for the opportunity because I will disagree quite strongly with Martin. The language of a quasi-judicial character being imposed upon what are the 27 Governments of the EU is quite strong, and I think it should be used only in cases where it is really justified. I do not doubt that there are cases where the Council acts in a way that we would consider it to be bound by rules of natural justice, and it should not fetter its discretion in advance; for example, when it comes to imposing financial sanctions on suspected terrorists. That function of the Council clearly infringes the rights of individuals and it is right that the Council should act in a quasi-judicial or administrative way. However, I think that outside that type of particular context, we should bear in mind that the Council is essentially a political institution. It is made up of representatives of the national Governments, its responsibilities are essentially political and its accountability is also essentially political. There might be a danger in trying to juridify or legalise the operation of the Council by trying to impose such quasi-judicial obligations on it in a way that is not necessarily appropriate.

I think therefore that there are three main characteristics of this article 7 procedure that we should bear in mind. First, the defendant member state—if you want to put it that way—still has the right to make its representations before any voting takes place, so it still has procedural rights, which the other member states have to respect. Secondly, although there is a commitment to vote presumptively in favour of a Commission proposal, it is not an absolute commitment. They can decide to change their minds, and if enough of them change their minds, none of them is bound by a member state—this is the characteristic of the framework. One might go further and say that they could simply breach this treaty because they are free in the Council to vote however they like, and if they want to breach their obligations under the treaty, there is no enforcement sanction that can be imposed upon them. They will incur a breach of international law, but there is nothing to stop them doing that if they so wish, and the sanctions are non-existent. Finally, at least in certain cases you can go to the European Court of Justice if you feel that your procedural rights under this excessive deficit procedure have not been followed. Particularly at the later stages of the procedure, the Court can judicially review the acts of the Council, if it feels that the Council has behaved in a procedurally unfair way.

Q74 Mr Clappison: I am interested in what our eminent witnesses have said about this. Professor Dougan, you chose to highlight this in your evidence to us. You very academically set out the arguments
for and against, but it is something that I think caught your eye as being an important development in these terms. Looking at it politically, as a political procedure it seems to place an awful lot of power in the hands of the Commission and a potential blocking minority. Looking at it politically, it is the case with the procedure—described as “reverse qualified majority voting”—that if the Commission comes to its view, it can be stopped only if there is a sufficient number of states in a blocking minority. It could be the case, could it not, that after the Commission has come to its view on what to do, a majority of states might be against the Commission and in favour of whatever the offending country says, but nevertheless, there is not a sufficient majority, because there is a blocking minority, and the Commission therefore has to do what the minority wants? I take that as being put in as a sign of toughness towards any potential offending countries. Is that right?

**Professor Dougan:** I think that it is true that the influence and the role of the Commission are increased generally throughout most of the reforms taking place in relation to the eurozone crisis, including the Six Pack of legislation adopted last year. There are a couple of points to bear in mind in the light of what you said. First, recognise that reverse qualified majority voting is not unique to this new treaty. It is a feature—a central feature some would say—of the Six Pack of legislative measures. Its role precisely is to try to increase the automaticity of sanctions against member states that are incurring excessive deficits. It is not unique in that regard, even if it is relatively unusual.

**Q75 Mr Clappison:** Am I right in saying that it is a relatively recent development?

**Professor Dougan:** Sure. The second thing to bear in mind though is that, in a way, you could say that in the political realm this type of thing is relatively common in the way that the EU operates as a whole. Most of the Commission’s legislative proposals for example do not emanate from thin air; they come from a request by the European Council, the Council or through dialogue with the member states. They will very rarely appear from nowhere. Most of the time, when the Commission proposes to do X, we can identify the member states either largely or wholly in favour.

**Q76 Mr Clappison:** The concept of the qualified majority vote was brought in to prevent a single country from vetoing something unfairly to make progress on something like the single market, but it was designed to protect the rights of states. This is turning the thing on its head so the minority gets what it wants, not the majority. Put in legal terms, is it not a bit like an appeal coming to the Court of Appeal from a lower court, and one member of the Court of Appeal agreeing with the lower court and two being against, but the Court of Appeal having to do what the one member wants because he constitutes a blocking minority?

**Chair:** Henry, would you like to ask Professor Dougan a question?

**Q77 Henry Smith:** Yes, indeed. Could you outline your concern about the Commission’s role in proposing the principles underpinning the automatic correction mechanism in article 3(2)?

**Professor Dougan:** If we are talking specifically about the Commission’s role under article 3(2), it is interesting to note that compared with the earlier drafts of the treaty, which were very vague about the common principles that the Commission should take into account when it was going to elaborate its proposals, the final version is much more precise. It is interesting that the contracting parties have given the Commission quite a strong steer about the types of common principles that they want to see.

Beyond that, in terms of the more general concern that the Commission here is performing a role that is not laid out in the EU treaties and is additional to its functions under EU law, that would be a broader question about the conditions under which that is lawful. Martin and I alluded to those earlier. My concern is that we do not have any answers; we only have indications, ideas, analogies and equivalences. I can elaborate on those if you would like me to.

**Q78 Henry Smith:** Briefly, if I may ask you to do so.

**Professor Dougan:** There are a couple of things to bear in mind. First, recognise that reverse qualified majority voting is not unique to this new treaty. It is a feature—a central feature some would say—of the Six Pack of legislative measures. Its role precisely is to try to increase the automaticity of sanctions against member states that are incurring excessive deficits. It is not unique in that regard, even if it is relatively unusual. It is interesting that the advocate-general in both cases—Advocate-General Jacobs, as he then was—dealt more with the possibility that there could be situations where individual member states or even external organisations such as the UN might ask the Commission to carry out certain delegated functions on their behalf. The test that the advocate-general proposed in those cases is probably a very sensible one. The question is: is it incompatible with its obligations under the treaties? If, for example, the member states were asking the Commission to behave in a way that infringed its duty of impartiality or its duty of independence, would we all have a real problem. If they are not asking the Commission to behave in that way, however, it does not seem objectionable.

On the question of whether all the member states need consent, there is probably an interesting analogy to draw with the enhanced co-operation provisions because there we have sub-groups of member states acting within the treaties and using the Parliament, the Council, the Commission and the Court even in the face of the opposition of certain member states, because enhanced co-operation can be authorised by a qualified majority vote. It is perfectly possible within the treaties to make use of the institutions for the interests of certain member states against the opposition of others. That is within the scope of the treaties, so obviously it is not a direct analogy, but it is an useful indication that, as a point of principle, it may be possible. The real question is...
whether that would make the Commission behave in a way that would be incompatible with its duty of impartiality. If it would, that is a real problem, but if it would not, it should not be.

Q79 Chair: Martin Howe, do you have a view on that?

Martin Howe: Certainly if a group of member states set up EU treaties that required, or purported to require, the Commission to act in a way that was incompatible with its duties under the new treaty, it would clearly be unlawful for the Commission to act under that private treaty. I agree that if that condition is satisfied, the action by the Commission would certainly be unlawful under the treaties. The more difficult question, which genuinely has not been decided by the European Court, is whether that is a sufficient condition, and whether Advocate-General Jacobs was right to put that forward as a sufficient condition. I would also add that I am not sure that the existence of the enhanced co-operation procedure actually assists the argument that the Commission can act privately for a sub-group of member states. What one can draw from that is a contrary argument, which is that the treaty authorises the institutions to act under certain defined conditions on behalf of sub-groups of member states who wish to engage in enhanced co-operation. Hence, the argument would go that, in general, a sub-group of member states that wants to get together outside the authorised framework of enhanced co-operation cannot hijack—to use a pejorative word—the institutions for its private purposes.

Chair: I should like to move on to the legality of the role of the Commission under article 8. James, if you could tackle those questions. Against the background that a lot of this is legalese, if I can put it that way, but bearing in mind the impact it has on the people who have to bear the results and consequences of the decisions that are taken, sometimes one is left wondering how much of this they could possibly understand. James, would you start with those questions on article 8?

Q80 Mr Clappison: Perhaps I could start with Professor Dougan and ask him if he agrees that the Commission has de facto infringement powers under article 8, and what his view is of the legality of it.

Professor Dougan: The principle that would inform my answer to virtually any question to do with article 8—but that question in particular—is that this is a voluntary jurisdiction that the member states in question offer to the ECJ. In a way, the legal test I referred to earlier, which was suggested by Advocate General Jacobs, would be equally applicable here. The question is not, “Does this supplement the treaties? Does it go further than the treaties?” It has to; otherwise it has no purpose. Its purpose is to supplement and go further than the existing treaties. The question is, “Does it force an institution to do something that it is prohibited from doing under the treaties, or otherwise require them to act in breach of EU law?” Setting aside that test, I think this is a voluntary agreement between member states and we should recognise that they should have a wide margin of discretion, subject to EU law and not breaching the treaties directly, to design the type of enforcement system they want to have imposed upon themselves. It is a voluntary thing. From that point of view, I don’t necessarily find it problematic that they want to offer the Commission a role in this enforcement system. If they had decided, as an earlier draft suggested, that the Commission should be capable of acting directly as a party to bring the proceedings before the Court, that might have been more problematic, because the relevant treaty provision, article 273, specifically says that it is the member states that should be parties.

Q81 Mr Clappison: I will come to that point in a moment. Taking it as given, as you correctly say, that there may not be active contradiction of treaties, what is your view on the point that it may be something new as far as the Commission is concerned, even though it does not necessarily contradict what happens elsewhere?

Professor Dougan: I think it is new in the sense that the Commission is being asked to produce a report and it would therefore fall within our previous discussion: can the member states ask the Commission, or delegate to the Commission, certain functions that are not already envisaged in the treaty? That is why I would use the same test. Is it incompatible with the treaties for the Commission to behave in this way? In other words, would it breach its duty of impartiality and independence? I think the answer must be, no, because the Commission is being asked to produce a report on all the relevant contracting parties about whether they have complied with an obligation that is clearly set out in this new treaty.

Q82 Mr Clappison: Do you think the role of the Commission in article 8 is provided for in existing treaties?

Professor Dougan: In article 8?

Q83 Mr Clappison: Yes, the role of the Commission in preparing the report on whether a state is in breach of its commitments on its budget and so forth.

Professor Dougan: It is analogous to what the Commission does on virtually a daily basis under EU law, which is constantly to monitor whether the member states are complying with their obligations under the EU treaties. Of course, this is not an obligation under the EU treaties; it is an obligation under this new treaty. So it is not an obligation that you could say the Commission has under EU law, but it is certainly analogous to the type of functions that the Commission carries out all the time under EU law.

Q84 Mr Clappison: Can I ask Martin Howe whether he has any views on that?

Martin Howe: I agree with that answer. The function envisaged for the Commission under article 8 of the treaty is not part of its functions under the EU treaty, but it is closely analogous to the types of function that it regularly performs. For example, when a directive is passed, the Commission will then monitor the national laws of each member state to check whether national law has been passed that will comply with its provisions. Obviously, it has been intentionally framed in such a way as to make it closely analogous to those procedures.

Q85 Mr Clappison: I do not have it at my fingertips, but I understand that article 126, paragraph 10, of the
TFEU prohibits the Commission from bringing infringement proceedings in the context of excessive deficit rules at the moment.

**Chair:** This is the no bail-out provision.

**Mr Clappison:** Yes, that is what my briefing tells me. Do you think that article 8 is consistent with this? The Commission does not bring the infringement action itself to the European Court of Justice, but under article 8, if the Commission has produced a report, it is incumbent on one of the states to bring the infringement itself, acting as a sort of hit man for the Commission.

**Martin Howe:** There may be a bit of confusion here. I do not think that the task under article 8 is analogous to article 126 of the TFEU. That is the excessive deficit procedure. Paragraph 10 of article 126 excludes the jurisdiction of the European Court of Justice from application to the first part of the excessive deficit procedure, and it excludes its jurisdiction by reference to articles 258 and 259, so by reference to both Commission complaints and complaints by member states. That is a different point that perhaps requires separate discussion.

**Q86 Mr Clappison:** Looking at the generality of article 8, do you have any observations to make about the procedure of the Commission producing a report and then one of the states being obliged to take action as a result of it?

**Martin Howe:** They obviously realised that under this treaty, they could not authorise the Commission directly to take an action before the European Court under article 8, because there is simply no basis in the treaty to allow that, so they have to do something which at least arguably brings it into article 273 of the treaty. That door is open only to member states; hence, they have to frame it by way of saying that if the Commission says that one member state is in breach, they have to be able to co-opt another member state to initiate the action.

**Q87 Mr Clappison:** It looks, in a very basic way, like a bit of a device for getting around the problem of the Commission bringing a proceeding itself. Really, it is the Commission that is bringing a proceeding, because somebody else has been required to do that if the Commission produces its report.

**Martin Howe:** Indeed. It is a device to get around the lack of power for the Commission itself to bring the proceeding.

**Professor Dougan:** It is interesting to compare previous drafts with what we have ended up with. We can compare them in two respects. First of all, previous drafts envisaged that the enforcement proceedings in general under article 8 could be brought in respect of all the obligations contained in the treaty under title III. That would have raised problems with article 126, paragraph 10, because they would have envisaging the possibility of infringement proceedings by the Commission, which are expressly excluded by the treaty, but the final version does not do that; it does limit it to the balanced budget rule. I agree entirely with Martin that it is a separate issue and that it is not problematic. The other interesting thing is that the previous draft envisaged a direct enforcement role for the Commission. We can speculate that this is probably one point at which the UK’s position led to a tangible change in the text, because the UK insisted that the Commission’s role, if it had any at all, should be very limited. That is one area where the Commission’s role has been diluted compared with previous drafts.

In a broader sense, I come back to the idea that this is a voluntary agreement by the member states. If the member states devise a system with a margin of discretion to devise their own enforcement system, and they want to confer certain powers on the Commission in that and that is not incompatible with the treaties, it is not really objectionable. In a way, it has the same spirit as article 7. Both article 7 and article 8—the voting bloc rules and the article 8 role for the Commission—are seeking to give greater independent credibility to the obligations of the euro states; they are trying to make it less obviously a political bargaining chip between countries and give it greater credibility as an independent set of obligations that will be respected by Governments. They can both be seen in that light.

**Q88 Chris Kelly:** Given that the ECJ’s jurisdiction over this agreement derives from article 273 of the TFEU and that the UK is not a party to that agreement, what standing would the UK have to challenge it?

**Martin Howe:** I think the UK could in theory challenge the agreement. The thing about article 273 is that it is an article that explicitly provides that in some circumstances the services of the Court may be invoked by member states, on a private basis if you like. The question is how broad that power is and whether or not it covers this type of agreement. It would clearly cover a specific agreement relating to a specific dispute, as long as it is related to the subject matter of the EU treaties, but the real question is whether it is broad enough to cover a sort of standing arrangement that purports to confer a standing jurisdiction on the Court in future disputes.

I think there are strong theoretical arguments to say that article 273 is too narrow to do that but, realistically, I tend to think that if this were challenged in the Court of Justice, its past pattern of behaviour—in my written evidence, I used the word “avid”—to expand its jurisdiction rather points to the fact that it would come to a different result. In fact, on the first occasion when this process is invoked, the Court itself would need to consider, as a first step, whether or not a member state objected, the admissibility of the action; so the Court would, of its own motion, have to consider the compatibility of bringing the dispute in front of it under this treaty with article 273.

**Professor Dougan:** In a way, there are two separate issues, which I will deal with very briefly. The first issue is whether the UK would have standing to challenge this part of the new treaty as an article 273 agreement before the Court because it is believed to be unlawful. The answer is probably—clearly—yes: the UK has rights of standing before the ECJ. If the UK believes that other member states have acted in breach of their obligations under the EU treaties, it could bring an action under the existing treaties to challenge this part of the agreement, if it wished. In a way, Martin’s answer related to one of the potential grounds for challenging this treaty, which is the idea that it is not a special agreement and is not
envisaging a concrete dispute now between two member states, but is providing a system of dispute settlement and resolution for potential future disputes between member states.

**Chair:** I am sorry, someone has just popped out, so we are going to have to adjourn the proceedings for a few minutes. We will get him back in again, just hang on for a second. Perhaps it was a Michael Gove moment, I’m not sure.

**Q89 Michael Connarty:** Thank you. Chairman, I have been holding fire for this one. Article 10 refers to the contracting parties and talks about enhanced co-operation being essential for the smooth functioning of the euro area. Does article 10 refer to enhanced co-operation within the eurozone or the eurozone plus, or by the eurozone or the eurozone plus? Which is it?

**Professor Dougan:** I interpret that text to mean not very much, in fact. What they say in article 10 is that they are ready to make active use of two types of flexibility arrangements that are provided for under the treaties. There are the provisions which are specific to the eurozone—that is article 136, which is the legal basis for a lot of the recent legislation on budgetary surveillance and excessive deficits. They then also refer very specifically to the enhanced co-operation system which is provided for under the treaties. What they are indicating is, I suppose, their political will to make greater use of that facility. Up till now, it has hardly ever been used—it has existed since the treaty of Amsterdam, but it has hardly ever been used. One of the questions that people like me have speculated a lot about is whether an event since Amsterdam would ever push the member states to break free of this real reluctance to make greater use of enhanced co-operation and see themselves as capable of forming ad hoc alliances to achieve certain policy objectives within the scope of EU law. Article 10 is a political indication that the contracting parties see themselves as politically able to do that. They have always been legally able to do it, but this is an indication of their political will to do it into the future.

**Martin Howe:** Just to make it clear, article 136 is on provisions which are specific to the euro—the member states that have adopted the euro. It envisages measures, first, to strengthen the co-ordination and surveillance of their budgetary discipline; and secondly, a much broader one, to set out economic policy guidelines for them—i.e. just for the euro states—while ensuring that they are compatible with those adopted for the whole of the Union and are kept under surveillance. There is the existing basis in the treaty for having specific economic policy guidelines that apply only to the euro members, and I think this is effectively a cross-reference back—a reminder to them that they can make use of those and a reminder to them that they can use, when appropriate, enhanced co-operation procedures—but it does not alter the conditions in the treaty under which those can be invoked.

**Q90 Michael Connarty:** Are you referring to enhanced co-operation by the 17 eurozone member states, or less than the 17 member states? The contracting parties to this treaty is everyone apart from the UK and the Czech Republic, so it could be 17, less than 17, or 25.

**Professor Dougan:** There is a minimum requirement in the treaties for how many member states participate in enhanced co-operation—I think it is currently nine. The “contracting parties” here clearly refers to the 25 states which have signed this treaty, but one of the fundamental principles of enhanced co-operation is that it is both voluntary—so if a contracting party decided it did not want to participate in an enhanced co-operation initiative, article 10 of the new treaty would not oblige it to—and, equally, open to all member states. If the UK or the Czech Republic were to decide that they wanted to participate in an enhanced co-operation initiative, they would be perfectly entitled to do so and there is nothing to stop it either in this treaty or the EU treaties themselves.

**Martin Howe:** I think the specific question you raised is whether the reference to the “contracting parties” in article 10 means all the contracting parties to this treaty including the non-euro states, or just the euro states. The combination of articles 10 and 14(5) effectively means that it will actually be only the euro states, because article 14(5) says: “This treaty shall apply to the contracting parties with a derogation”—that is, the non-euro states—“or with an exemption as defined in protocol 16”, that is Denmark with its opting out, “which have ratified it, as from the day when the decision abrogating that derogation or exemption takes effect, unless the contracting party concerned declares its intention to be bound at an earlier date by all or any part of the provisions in titles III and IV of this treaty.” The answer, I think, is that unless one or more of the non-euro contracting states make a declaration that they are to be bound by article 10, that article will not apply to them.

**Professor Dougan:** I do not disagree with Martin on the technical substance, but given that article 10 is...
merely an expression of political will—"We are happy to see the use of enhanced co-operation in EU treaties"—I do not think a contracting state needs to have opted in to article 10 in order to participate in an enhanced co-operation. The EU treaties give it a right to participate in enhanced co-operations completely independently of article 10.

Q91 Michael Connarty: I have one remark on the way it has been drafted, having been through the whole Lisbon treaty in detail. The word "will" is used—that was the subject of a great debate in relation to the Lisbon treaty—in the new amendment. Article 10 says that the contracting parties “will” make recourse; it does not say “may”. I will take you on to a different question, but I think that use of the word “will” in article 10 should be borne in mind.

Professor Dougan: In the final version? The version I have says that the contracting parties “stand ready to make active use of”.

Michael Connarty: No, “will make recourse”—that is in the 27 January version.

Professor Dougan: But in the final version of 31 January, they had changed the wording.

Michael Connarty: We have the 27 January version.

Martin Howe: I have the 31 January version and it says “stand ready”. One would probably need to look at the other language versions as well.

Q92 Michael Connarty: That is very useful—we have not been given the right one. I thought the one in the pack was the latest one. The question is still relevant, however. Article 10, even if the wording is “stand ready”, encourages contracting states to use enhanced co-operation to ensure the smooth functioning of the euro area, and then it says, “whenever appropriate and necessary”, whereas the requirement treaty of the European Union is that it be used as a “last resort”—that is in article 20(2). We can say that this is a significant inconsistency, which might change the way enhanced co-operation is used from that which was agreed in the original treaties. That leads to the second question: is there a danger that enhanced co-operation will become a default bloc position for the eurozone, if they cannot reach agreement in the Council?

Professor Dougan: I do not think I would read too much into the wording of article 10 in that regard. This new treaty says repeatedly that it is without prejudice to EU law, it is subject to EU law and, when secondary measures are required, they will be carried out under the procedures provided for under EU law, so I do not think there is anything in article 10 that can even purport to change the requirements for enhanced co-operation under the EU treaties. When the EU treaties say that enhanced co-operation is permissible only when it has been established in the Council that it is a last resort—because, for example, they could not meet the voting requirements necessary to pass an initiative in the Council—that will remain in place, and I do not think anything in this new treaty could even pretend to alter that obligation.

Chair: That may be the case, but I—

Q93 Michael Connarty: Let me pursue it to the end, Bill. Martin, do you agree with that?

Martin Howe: I think it is right that this cannot alter the requirements of the treaty on enhanced co-operation. I think one would say of the reference that the words “appropriate and necessary” may be a cross-reference to that, because it is not necessary to use enhanced co-operation unless and until the ordinary legislative means have failed; but I would say that it probably reflects a shift in the political willingness to use it. In other words, they may be more willing to say, “We have actually reached the last resort and we now want to go down this road.”

Q94 Michael Connarty: Are you saying that maybe we are over-suspicious, and some of our previous witnesses were over-suspicious when they suggested that states might wish to use enhanced co-operation in policy areas which would in fact be essential to the functioning of the euro area, as far as they were concerned—areas such as employment, bank regulation or even taxation? You think this is not just a Trojan horse inside the single market, used to push the eurozone’s interest by dealing with these very things? You think this is just a mild collection that will be used only when you cannot find agreement?

Professor Dougan: Not necessarily. One of the very interesting possibilities raised by this expression of political will in article 10 is that, so far, enhanced co-operation, if it has proposed or in the very rare cases where it has actually been authorised, has been for an ad hoc measure—just a single measure on a single issue where they could not reach agreement in the Council. One of the possibilities which was opened up by the Lisbon treaty, but which has not yet been made use of, is that enhanced co-operation could be authorised for an entire sector of activity. They could actually decide in advance that this group of member states, for the future, will enact additional measures across employment, banking or the environment. This could be an indication of political will, that that possibility becomes much more real in the future than it has been in the past. There is still the obligation, under the treaties, that enhanced co-operation cannot undermine the internal market, it cannot create a barrier to trade or discrimination between member states and it cannot distort competition between member states, but nobody quite knows what those concepts might mean in the context where a group of countries are trying to press ahead with closer cooperation across a sector of activity, because that would be a very different thing from what we are used to already.

Martin Howe: I agree with that answer. It seems to me that you could argue that, over and above the specific provisions in the treaty relating to the euro area, there might be arguments for more closely coordinating matters such as bank regulation, for example, within a single currency zone than the rules that are necessary across the European Union as a whole. That is the sort of argument that might be put forward to justify taking such measures.

Q95 Chair: Professor Dougan, there is something I would like you to clarify. Do you think that the UK can block enhanced co-operation on a taxation measure which had to be agreed by unanimity?

Professor Dougan: I think it would depend on the nature of the taxation measure. If it was a measure
where you could envisage that it would create a barrier to trade between member states, or a distortion of competition between member states, then either the enhanced co-operation authorisation should not be given or, if it was given, a non-participating state could challenge it before the European Court of Justice as being ultra vires the treaties. The real challenge for all of us now that enhanced co-operation could become a more regular phenomenon is to try to understand what these concepts mean in the context of enhanced co-operation. You could of course say that any regulation of anything creates additional regulatory costs for the undertakings in that territory, and that inevitably distorts competition because it artificially changes the way in which the competitive conditions operate between member states, so I do not think that we can take an extreme idea that any regulation which happens to increase costs for some companies will not be allowed. Equally, there will obviously be situations where if a group of member states were trying to exclude foreign competitors from their bit of the internal market that they regulated, that would clearly be unlawful. The difficulty is trying to find where that line is in between those two extremes.

Q96 Chair: But this is all part of the problem before this inquiry today, which is the impact that the complexity, the blurring of lines, the overlap and the question of the rule of law will have on the decision makers within the framework of voting arrangements and, at the same time, the impact that these decisions will have on ordinary citizens in the European Union when they are made. The question whether or not they are right or wrong, or whether they are even understood, seems to be a matter of some concern. You and other witnesses, from what I have seen so far, have all drawn attention to the complexity question. It is not just a theoretical argument, I hope you agree; it is really a matter of how on earth all this will actually work out in practice, given the crisis in the eurozone, which some would say is the result of the existing treaties.

Martín Howes: I agree with that point about complexity. It is really like a Russian doll. If you look at it at the global level, there are a number of principles under the WTO agreements which are binding on the European Union and the member states in terms of discrimination both in goods and services against imports. You then have European Union-level principles of the treaty involving the single market principles and non-discrimination; those bind the margin of discretion of member states. You can then envisage another Russian doll inside that: the sub-group of member states which act within the margin of discretion of member states under the EU treaties, but co-ordinate themselves more closely together in particular sectors. How a voter who dislikes one of these decisions can express that view at the ballot box in a way that can be understood, I do not know.

Q97 Chair: There is also, is there not, a problem relating to the manner in which the markets interpret all these different factors at work, which in itself is an economic question? We will be coming on to the economists in a moment, but the real question is: are we not faced with a blizzard of slightly contradictory inconsistencies—as you say in your evidence, Professor Dougan—and the possibility of inconsistencies arising between the terms of the draft treaty and the current and future state of Union law itself? This is part of the question that we will have to resolve.

Jacob, would you like to ask the next question?

Q98 Jacob Rees-Mogg: Thank you, Chairman. I am sorry that I had to pop off to the Procedure Committee halfway through. Looking at article 16, what legal or political obligations do you think that article places on the UK? Given that it directly affects the UK, should we have given consent to it?

Martín Howes: In my view, it imposes no legal obligations on the UK at all. What it imposes on, where it talks about necessary steps, is where the contracting parties are binding themselves together to seek to incorporate its provisions by amendment into the two EU treaties; but nothing in this weakens or removes the UK’s right to veto such a course being taken. That is the legal answer. At the political level, of course, it is sort of declaration of intent by the participants in this treaty that they are going to keep pushing at this door unless, or maybe they hope that at a point in the future, a Government in the UK come along who will allow them to open that door.

Q99 Chair: I take it you rather agreed with that in general, Professor Dougan.

Professor Dougan: With maybe one additional observation. I certainly agree that article 16, in a way, is a very good example of why so much of this treaty text is made up of a lot of nice ideas rather than very concrete things. It cannot change the requirement that unanimity among the member states and national ratification are required before anything in the EU treaties can be changed through the revision procedures.

For the UK, the interesting question is the interrelationship between a future article 16 initiative to try to incorporate this treaty into the EU treaties and the European Union Act. It is a question that Dr Gordon and I addressed at some length in our written evidence, so it is probably not necessary for me to say it now, but we think that there are interesting issues about the interrelationship between a future incorporation attempt for this new treaty and the way the UK would respond to it in terms of a referendum or parliamentary control. That is a much trickier question.

Q100 Chair: Could I bring this part of the inquiry to a conclusion by asking you what you think the United Kingdom achieved overall by exercising the veto? I ought to mention that I sense the Division bell is about to ring. In general, what do you think the UK achieved by exercising the veto?

Martín Howes: I think it makes it legally impossible for this treaty to amend or qualify the European Union treaties. This treaty has a subordinate status, because it will be entered into later than those anterior treaties to which all the members of this treaty are bound, so it cannot contradict or cut down them; whereas had it been incorporated or provisions similar to it had been
incorporated—at least in theory—there would be a possibility that it could modify the application of other provisions of the treaty by implication.

Q101 Chair: Because it has been raised elsewhere, and just to get it on the record, you take a view that this not an EU treaty—we collectively agree about that, do we? This is not an EU treaty.

Martin Howe: In the context of the European Union Act?

Q102 Chair: No, all together. This is simply not an EU treaty, full stop. Is that agreed?

Martin Howe: Yes.

Q103 Chair: Professor Dougan, would you like to answer the question about what you think the UK achieved by a veto?

Professor Dougan: I will be slightly more critical than Martin. I am not convinced at all that the UK veto achieved anything positive for us. It is quite clear that the other member states have gone ahead and had pretty much the same fiscal compact that they were going to try to have as part of the EU treaties, and now they have pretty much the same deal and substance as a matter of international law. Conversely the governance of the single market and in particular the issues about regulation of the financial sector remain exactly the same as they were before the December European Council.

In terms of positive outcomes, I do not think there is really much to show for the veto. What worried me about the veto was that, first of all, it meant that the UK was not at the table in any real effective sense for the negotiations on this fiscal compact. It exercised an influence in a negative sense by saying, “We don’t want this. We don’t like it,” as far as it could about the use of the institutions, but it wasn’t really a player in the negotiations. More worrying for us, but also for a lot of the member states, which look to the UK as being the natural leader of market integration, market liberalisation and of not having overtly protectionist policies or overly centralising policies, it puts them in a bit of a dilemma, because the UK has forfeited a little. I think, some of its natural leadership of that large group of member states, which would naturally look to the UK for those types of leads.

Q104 Chair: There is an expectation under article 16 that this treaty—to use the Deputy Prime Minister’s words—would be folded into the EU treaties. The legal adviser to the Council, in his evidence, which deals with the question of article 273, says that there are provisions for the folding in of the treaty within, at the most, five years. He then goes on to say quite baldly that when this happens—not if this happens—many of his arguments will seem then to have been realised. I am paraphrasing there. None the less, that seems to be quite an astonishing statement in terms of an opinion from somebody as eminent as the legal adviser to the Council. Do you not agree?

Professor Dougan: First, it is useful to clarify the position of article 16. There is no way that this treaty can be incorporated into EU law without the unanimous consent of all 27 member states. I read the legal opinion of the Council Legal Service as saying that the specific problems with the court’s jurisdiction over this treaty under article 273 of the TFEU would evaporate if and when—I know that he says it in less categorical terms—

Chair: He does not say if and when. He says when.

Professor Dougan: But I think that that is clearly the sense. He cannot suggest that this could happen without the unanimous consent of all 27 member states. By that time, we expect it to be 28.

Q105 Chair: This raises the real problem that we keep on coming up against, which is that there are these fuzzy lines, boundaries, uncertainties or questions of interpretation, and yet it is dealing with something that is critical to the whole future of the eurozone and the rest of the EU. It is the rule of law question in a broader sense. We will have to consider all that when we come to make a judgment. Thank you very much for coming. Did you want to say something else, Mr Howe?

Martin Howe: On that question of the legal advice from the Council, I just wanted to add that my own word that I brought to apply to this document was “tortured”.

Q106 Chair: Tortured?

Martin Howe: Tortured—to achieve the end result that political imperatives imposed. I did think that it was particularly remarkable, in that final paragraph, as to why the intention that was expressed by these particular states to incorporate the material into the EU treaties was at all relevant to the question of whether or not it complies with article 273 in the first place.

Chair: Thank you very much. We now have a Division, so we come to a natural break.

Examination of Witnesses

Witnesses: Wolfgang Münchau, President, Eurointelligence ASBL and Associate Editor of the Financial Times, Douglas McWilliams, Chief Executive, Centre for Economic and Business Research, and Roger Bootle, Capital Economics, gave evidence.

Q107 Chair: Thank you very much for coming. I will start the questioning. We have a number of questions and we have moved on to the economic front. Of course, feel free to comment on any of the legal questions that you feel need to be addressed, but we have had quite a lot of evidence from the lawyers, some of which you may have heard just now. Because there are three of you, we will ask the same questions, which you should answer as directly as possible. Then there will be some supplementaries. First, will the fiscal compact achieve its objective of helping to solve the immediate problems of the eurozone? I shall start with Roger Bootle and work down the line.

Roger Bootle: I don’t think it will contribute a great deal, no. I consider it to be essentially motherhood and apple pie. There are a number of different issues. One of course concerns the enforceability of the fiscal compact, and I see nothing in what I have read to
make it credible. Of course, the stability and growth pact itself was broken by France and Germany, no less, who did not seem to be subject to massive sanctions—certainly not sanctions that could change what they were going to do. Someone described this as the stability and growth pact on steroids. I think that that is not an inaccurate description.

There is that problem but, more fundamentally, there is an issue about the nature of the problem that is facing the eurozone countries. The fiscal compact, of course, is drawn up on the presumption that it is a fiscal problem. In my view, the fiscal problem is one aspect of the various difficulties facing the eurozone, but it is not even the most important one. The most important is the lack of competitiveness in the periphery and the failure of the eurozone as a group to generate significant rates of economic growth.

Without solving those two problems, the objectives of the fiscal compact will be impossible to achieve. If there is going to be a very weak economic outlook in the eurozone, which looks to me to be very likely, and then countries of the eurozone in pursuit of their objectives lay down the fiscal compact—cut their fiscal deficits to meet their objectives—what will result is, quite simply, even weaker economic growth, with hardly any impact on the deficits.

Q108 Chair: That could not be clearer, Mr Münchau. Wolfgang Münchau: I agree with Roger on the broad assessment. I am playing devil’s advocate, because I agree with Roger on the thing. Even Angela Merkel would not claim that the fiscal compact would resolve the eurozone crisis. The idea behind it was that it would bring out a strong statement of intent of fiscal co-ordination in the future, and that this strong statement that “We are staying together; we are sticking together; we are working together” would impress the financial markets. The markets are momentarily impressed, but this is more to do with the European Central Bank’s liquidity policies than with the fiscal compact, which is generally not of particular relevance to market actors.

To answer your question, the fiscal compact itself cannot solve the crisis, simply because, even if it was good, it will not come into effect for many years, so it will not have that effect. The problem that we have in the eurozone, and the fiscal compact does not help to deal with, is that that is not an inaccurate description.

Q109 Chair: Thank you. Professor McWilliams. Douglas McWilliams: First, I agree with everything said by both the previous speakers. Let me put this into a bit of context. The world is going through the biggest ever economic challenge, and the fundamental problem in the political debate—is what you could call the fiscalisation of the crisis. Roger was mentioning this: everything is reduced to fiscal policy. We are having a crisis of imbalances. You can see this on charts. If you look at the current account deficits and if you look at the budget deficits of eurozone member states since the beginning of the euro, you see that budget deficits have not converged but, relative to the ‘90s, they have converged, and that they are not as divergent as the current account deficits which have diverged incredibly. The difference between the two is, of course, the private sector. The eurozone is first, second and third a private sector crisis. It is a fiscal crisis in Greece. Clearly, it is a private sector crisis in Spain, Portugal and Ireland. It is partly a fiscal crisis in Italy, but that’s not really new; it’s an old one. The difference is that, now, market interest rates have risen, which raises questions about Italy’s solvency. In this complex web, you have a banking system that is largely dysfunctional and undercapitalised, and heavily influenced by the Governments. It is a very complex situation that cannot be addressed by fiscal policy. The pact—I am sure others have given evidence to this effect—will not create significantly new fiscal rules for the eurozone. The main fiscal rule is the 3% rule in the Maastricht Treaty. A much forgotten rule was in the Stability Pact. It says that countries should run a balanced budget over the cycle, or a surplus. Essentially, the new pact economically reinstates that rule. It makes it more specific: it says countries should have a structural deficit of no more than 0.5% of GDP over the cycle. The only addition it makes is that it establishes some mechanisms to ensure that you don’t reposition the cycle as you please. It is quite a sophisticated machinery. The Germans introduced that into their constitution a couple of years ago. The hope is that if everyone introduces the same rule, it will be better.

I don’t believe it’s a fiscal crisis, but even if you do believe it’s a fiscal crisis, I still don’t think the measure is going to work, because it has got the logic wrong. The German experience, which was the first thing, the monetary union in the beginning of the eurozone, was the introduction of fiscal consolidation. That’s why they put it in the constitution. They are likely to get it because they wanted it in the first place. As, in other countries where there isn’t the same political consensus behind it, it is imposed by treaty from the outside, the chances of it really happening are significantly lower, especially as there are ways around it. Even in Germany, there are ways around it. The Parliament has always reserved rights to declare a state of emergency, so there is a degree of leeway for national Parliaments to circumvent the rule. It’s not a key that you throw away.

My assessment is that it’s not necessary. It’s based on the wrong diagnosis of the crisis. It won’t solve the crisis. It might, for a short period, bring about some confidence among investors, but we have seen that investor sentiment is very fragile and volatile. It will not lead to greater fiscal discipline, either.
souvlaki. The Portuguese had a thriving business selling textiles, which has been largely wiped out by Chinese competition. So the effects are differential. You have three different problems. The West is uncompetitive against the East. On top of that is the differential competitiveness. Italy has lost 40% of its export market since it went into the euro, whereas Germany has gained 10% relative to its export markets. There is the problem that eastern industrialisation affects the European nations differentially. Not having the currency flexibility to cope with that enhances the scale of the difficulties that the different countries have, and basically has massively exacerbated the North versus South problem within Europe, essentially because southern Europe industrialised fairly late and so was very much in the industries that the Chinese got into first, whereas northern Europe industrialised a lot earlier and so still has some legacy advantages—in the case of countries such as Britain, brands and things like that; in the case of a country such as Germany, products that the Chinese still do not feel that they can make.

Q110 Chris Heaton-Harris: I was wondering, based on your remarks, whether what we have just gone through, the fiscal compact agreement and this treaty, is just no more than EU diplomatic bling—looks good, but actually has no value. Has this just been a waste of time?

Roger Bootle: Yes. To anyone trained in economics, with an eye to market fundamentals and market reactions, it is as though the people who put together this compact, and indeed EU treaties in general, simply live on another planet. They seem to think that economic progress is decided by committees in Brussels or Frankfurt. They seem to think that markets will be impressed by expressions of will. Neither of those two conditions, I’m afraid, is met in the world. The markets are very hard-nosed and, quite frankly, they see through this stuff and see it for what it is.

Wolfgang Münchau: It would have been different if this had been part of a process towards a fiscal union, which was debated ahead of the last summit—whether it should be a multi-stage process and you start off with a set of fiscal rules and that leads to an eventual adoption of a single bond. But it was clear that that was rejected by Germany. It is not rejected in principle; it is rejected as unsuitable as a crisis resolution mechanism and unsuited to the current debate. Should the eurozone ever develop into a proper political union, it would still be possible, but they certainly do not want the combination of a eurobond and no sovereign power transfer, so that every country is allowed to issue its own eurobond. That was a situation that was to be avoided, so they focused only on the fiscal discipline side. The result was—even especially now that this is a separate treaty and not a series of treaty amendments—that they struggled very hard to produce something that was very different from what they had. Also, if you are thinking of what they had, I think the legal interpretation is probably not really telling you the story of what happened with the stability pact. The stability pact had provisions for sanctions. It was not that these sanctions were difficult. Even if you had reversed the majority rule back in 2003 when Germany and France usurped the process and broke the rules, and even if you had to reverse the QMV thresholds, they would still have been able to break the rules, so it is not so simple that raising the threshold would protect you against rule-breaking by very large countries. These are always rules for very small countries.

I have no doubt that if Germany and France decide that they need to expand their budget policies, because they have different Governments in power, which is not a completely unrealistic prospect, certainly in the next five or 10 years, we could see a very different fiscal policy emerging. At best this treaty has no economic implication. At worst it leads us into more pro-cyclicality in the sense that maybe these automatic things do work, contrary to what I expect, but maybe they really believe in this and now basically just have an automatic rule-based fiscal policy. Ask yourselves about Spain. The Spanish private sector came out of this crisis with massive debts and an incredible housing bubble—much worse than anything you have seen in your country. Spanish house prices have adjusted, but not quite as much as they need to. Spanish debts have not adjusted. The Spanish private sector has to deleverage in a serious way. The Americans have done it, or they have gone through most of it. The Spanish have not even started. I do not see how the Spanish private sector can deleverage—reduce its debt—and the Spanish state also reduce the debt at the same time, without having an exchange rate and an interest rate that is a recipe for depression. So that is the worst outcome of this pact. Over the long term, it might give rise to a disastrous policy mix applied from the centre.

Douglas McWilliams: Can I give a slightly different answer? I do not think that I completely agree with either of the gentlemen on my right. If you read the treaty as written down, I would agree with them completely. It is not a treaty that makes any difference, but that does not fully take into account the way that such things are perceived. The first is that the treaty is seen as a step in the direction of fiscal co-operation. It is clearly a very small step, but it opens up the possibility of further co-operation, so it is seen as movement in a direction. The second, which is rather more important, is that it has acted as a fig leaf that has enabled the ECB to pump a lot of money into the banking system in Europe, which has actually rather transformed the state of the world economy on a temporary basis.

In the second half of last year, the United States suddenly got flush with funds on the basis of, first of all, QE, but, secondly, the unexpected thing was that, when US banks withdrew their money from Europe, they suddenly had a lot of extra money that they did not quite know what to do with. That created the most relaxed credit conditions in the United States since before 2007, and that has been a very important factor in the recovery of the US economy over the last few months.

At the same time, Europe has pumped in money. We have had, in effect, QE in Europe under the fig leaf of bailing out banks, which has been done against the background of this treaty, and it has temporarily...
stabilised the economic position and temporarily stabilised the position in the markets. All the confidence indicators are looking up, but for how long that can happen and what the limits are to the process are a bit unclear. In the short term, however, there has actually been a market reaction, and we all said, “Oh. The markets will react badly.” They did not, and then we said, “It’s just before Christmas. When they wake up from their new year hangovers, they will react badly.” Well, they have not. We just need to accept the fact that some of our initial analysis has been slightly disapproved by the fact that the pumping in of money has operated in the opposite direction, and we have to be prepared to admit that we got it wrong.

Chair: That brings us quite neatly to the next question, which is related to the European Central Bank.

Q111 Henry Smith: Yes. It is argued that were the European Central Bank able to operate like a sovereign central bank, that would be a way of helping to resolve the eurozone crisis. Do you think that the fiscal compact will help the ECB act more like a national central bank or not? Do you have any comments that you think are relevant?

Chair: Can we ask Mr Bootle first, and then work backwards to Professor McWilliams?

Roger Bootle: I think there are several barriers to the embracing of quantitative easing pure and simple, which is something that a sovereign bank can do and has done in the case of the United States and the United Kingdom. Some of them are ideological and political with regard to what will wash in Germany and what will not wash in Germany. Douglas McWilliams may well be right in suggesting that this pact has acted as a fig leaf, in which case it has had some sort of value, but it would be rather odd to attribute the effect to the fig leaf, rather than to the fundamental thing that it is somehow disguising, which is a change of policy by the ECB.

It is quite wrong to imagine that quantitative easing pure and simple, in what we have seen so far, has not been the straightforward version of quantitative easing. It has been really rather different. It has been the relief of a liquidity crisis faced by banks. It would be quite wrong to imagine that quantitative easing in and of itself could not just address one aspect of the problem. In the United States and the UK, there is obviously a debate going on, but it does not seem as though it is exactly the answer to a maiden’s prayer and for very good reasons. It did not appear to do an awful lot of good in Japan, and I do not believe that it would do an enormous amount of good in the eurozone. It could of course relieve pressure on the bond markets, but there would be an interesting question as to how the ECB would operate it. Would it buy different countries’ bonds in some rigid proportion according to GDP ratios or something, or would it buy those bonds that had just recently fallen and that the market did not apparently want?

Underlying all this, there is a question of the risk facing the ECB if one of the member countries were to default and/or leave the eurozone, which is not something that applies to either the US Federal Reserve or the Bank of England. The notion that the ECB could and should, without limit, buy the bonds of a country in a very difficult fiscal position, such as Greece, is pretty extraordinary. In the process, if it were to go on in that way, it would potentially lessen the pressures on that particular country to tackle its fundamental fiscal problems, which is one of the reasons why so much opinion in Germany is against the notion of quantitative easing.

Q112 Henry Smith: Do you think that the fiscal compact would make things more flexible for the ECB?

Roger Bootle: I don’t think so—not in substance. I largely agree with what Douglas McWilliams said about it at least providing some sort of fig leaf, and in that there may be some value.

Wolfgang Münchau: Let me answer that question directly. Given that the narrative of the crisis in continental Europe, especially in Germany, the Netherlands and the northern countries, is that the crisis was caused by fiscal indiscipline and that the ECB is hamstrung because of opposition, especially by the German central bank, to quantitative easing and the extension of liquidity policies, the fig leaf, as Roger was saying, of a fiscal compact that seems to address the deemed root cause of fiscal indiscipline in Europe would calm down German public opinion and give the ECB an excuse to run those policies. In that sense, there is a chain, and one should be careful of justifying something based on a mistaken narrative, but in the short-run it had that effect.

The effect of the liquidity policies has been significant in the short-run, which was underestimated. The eurozone was about to have a credit crunch in the last quarter, and there was evidence of credit crunches in various parts of the eurozone. The banking system completely seized up and the Government bond market was on course for major shocks. The massive injections of liquidity have addressed those three problems—they have not solved those problems, but they have addressed them—and buy more time. When I say that they buy time, they buy time to do what? To have a fiscal compact that is not solving the crisis? We are getting into a circular argument. If you believe, as we do but they don’t, that the crisis is rooted in internal imbalances that have built up and are now reflected in payment and system imbalances, which are probably all sorts of incentives that are likely to get worse over the next years, the fiscal compact and the ECB’s policies are obviously not going to help because an undercapitalised bank will be as undercapitalised in a year’s time as it is today. They will be in the same weak position and no one would want to lend to them when this programme expires, as it eventually will.

Q113 Chair: Professor McWilliams, would you like to make a brief comment?

Douglas McWilliams: Yes. I largely agree with what my two colleagues have just said. I think we have bought some time, but probably not very much time, for two different reasons. First, it is addressing one aspect of a multi-faceted crisis and the other aspects are not being touched. Secondly, the ECB is pretty close to the limits. I do not see any plausible way in which they could differentially buy the distressed bonds of the Governments in trouble, and if they did, I would argue that, during the present rather tense
We could easily see this policy, which has had temporary success, coming to an end within the next few weeks if the Greeks fail to reach an agreement, because I suspect that would probably mean: first, default; secondly, that they could not easily stay within the single currency in the circumstances; and, thirdly, a domino effect on other countries if Greece finds itself unable to pay its debts and to sustain its currency. So I would expect to see quite a rapid crisis emerging if that happens, and I do not see that as at all impossible. I think there is quite a decent chance that that might happen.

Chair: Jacob, would you like to ask the next question? I think you had something that you wanted to say before you started.

Q114 Jacob Rees-Mogg: Oh, yes, thank you for reminding me of that. I have an interest to declare, in that Mr Bootle’s company Capital Economics provides an excellent service to my company Somerset Capital Management. With that interest and a brief advert on the record, I will move on to the questions of the reality of the limits that have been set and the judgment of a structural deficit. Can Governments and commentators judge a structural deficit effectively or are they essentially just guessing?

Roger Bootle: They are guessing, but hopefully they are guessing in an educated way. You only have to look back a few years in this country to see how easy it is to get a completely erroneous picture of the structural position, because to judge what is structural and what is not structural you have to take a view on the fundamentals: both the cyclical position of the economy at that time and its prospective growth rate. Those things, of course, are not set in stone. You cannot establish them through incontrovertible scientific method. They have to be an act of judgment and, because they have to be an act of judgment, there is then a question not only about how you technically make that judgment, but on how you ensure that the judgment that is made is somehow or other insulated from political pressures, because we know from what happened in this country that there were definite political reasons why the technical judgments were made in the way that they were.

Q115 Jacob Rees-Mogg: But the treaty is aiming to enforce sanctions as a matter of rules on something that is essentially a matter of judgment. How do you square that circle?

Roger Bootle: I don’t. It is going to be extremely difficult. It is one of the reasons why I think that it is difficult to believe that the sanctions will be imposed. There could be quite legitimate reasons for questioning whether the deficit in question was structural or not. In those circumstances, perhaps under a condition where there had been a political change in one of the countries and there were serious domestic political difficulties, I find the notion that one of these countries will end up paying a large fine incredible.
Therefore think that what previously might have been assumed to be a cyclical deficit actually becomes, in effect, a structural deficit. In practical terms, that distinction no longer seems to be as relevant for an advanced western economy in these present circumstances, when we are going through something that is quite extraordinary. That is why I do not think this type of analysis is very helpful. I believe it is the reason for the OBR’s failure at economic forecasting. This attempt to try to make this false distinction between cyclical and structural that implies some kind of mean reversal—I just do not think that it washes in this modern world. Getting back to the mean would mean such a huge devaluation and would create so much instability, in practical terms, it is not going to happen, so they will not go back there.

Q117 Chair: If the fundamental problem for the eurozone is that it contains both surplus economies that are growing or that have prospects of doing so and deficit economies that are stalling or that are getting worse, how does the fiscal compact help in that respect?

Douglas McWilliams: It doesn’t help, except to the extent that ultimately deficit countries will not find that someone else will be prepared to pay their debts. The normal rules of everyday life mean that you cannot keep for ever borrowing. You have to stop borrowing at some point; people stop lending to you at some point. The deficit countries that expect people will continue to finance their debts are just overoptimistic. The real world will come in on them in one way or the other, and it will be incredibly painful when it happens.

Q118 Chair: To cut to the chase as it were—I would like all three of you to answer this question in turn—do you, in fact, think that the eurozone is unsustainable in its present form?

Roger Bootle: Yes. There is a question about what form of break-up there will be, but I personally think that it is more likely there will be a break-up than that the current membership will be sustained. When you ask whether it is unsustainable, there is some way in which it could be sustained: a progress to full fiscal union, a structural deficit, but you have to be essentially underwritten by a full political union. I would judge that to be pretty unlikely in current circumstances. Without that, I do not see how the current set-up can survive.

Q119 Chair: You know, for example—it is clear from statements already made—that the United Kingdom would not concede the possibility of a political union of the kind envisaged in what you have said. So that would be a unanimity issue for a start in any treaty change. Political union of that kind is off the agenda. Mr Münchau, on that basis what would you say about the sustainability of the eurozone in its present form?

Wolfgang Münchau: In its present form, the sustainability conditions are not given. A eurozone would have been sustainable among countries with very similar characteristics to Germany, like the Netherlands, Austria and Finland. Even with imperfections in the banking systems, it could have been made to work. Those countries have a history of very long exchange rate stabilities with Germany, and their labour markets function in a very similar form. There is already evidence that although France and Germany have stuck together for a very long time, they are diverging now, with France running increasing current account deficits inside the eurozone and against Germany in particular. The central axis is cracking. I am worried about Spain, whether Spain could maintain its membership. So, no, under present circumstances it is not possible. To make it sustainable you need a degree of centralised policy making that would address, in the first instance, the financial sector. That may already be sufficient, but it is certainly necessary.

One of the reasons we have fiscal crises in countries like Spain is because the Spanish Government is ultimately responsible for the liabilities of its banking sector. The banking sector is not a European sector or a eurozone-based sector, but a national sector. You may not need a political union, a single state or anything of that nature. It may be sufficient to Europeanise the banking sector of the eurozone states—it is not necessary for the non-eurozone states—to have a common deposit insurance system, a common supervisory system and, in particular, a common bank resolution system whereby a central authority could close down banks, merge banks, impose regulation. That may help stabilise the system. But without that it cannot be done. I also believe that a eurobond of some kind is necessary in the long run. It will not solve the crisis. I agree with Angela Merkel on that but it is necessary in the long run because we have seen what Charles Goodhart calls these sub-sovereign bond markets. We see countries being able to issue bonds but there is no central bank that backs them, no lender of last resort respective to their own sphere. That is ultimately not sustainable in the long run. The eurobond is necessary too, but in the first instance I would say that the Europeanisation of the banking sector is absolutely necessary. A eurobond is possibly necessary, and common labour market rules to facilitate adjustment to make sure that labour markets respond in a similar way may be necessary. If you are asking me whether this is realistic, I do not think that it is realistic now. I don’t know how future generations would answer the question: do we give up the euro or do this? But it is certainly a choice for people to make.

Q120 Chair: Do any of you have any further comments on that question?

Douglas McWilliams: I genuinely do not think that the euro can survive in its current form. How long it takes to break up is one of the things that is uncertain. Economists are much better at giving you a prediction than giving you a time. I’m afraid. I have gone on record as saying that I give it only a one in 100 chance of surviving the next 10 years.

Q121 Chair: Are there any of those you come across—you obviously meet a lot of economists from different quarters—who would simply disregard what you are saying and say that you are just wrong?

Douglas McWilliams: None to whose views I would give much credence.

Q122 Chair: That could be regarded as special pleading. On the other hand—

Chris Heaton-Harris: Talk about the others.
Douglas McWilliams: There are plenty. There are a lot of academics for a start and various other people who don’t run businesses that actually survive in the real world. Academics have all sorts of points of view. Some of them are sensible and some of them are not. So you have that kind of group. Can I just go back to the issue of fiscal union? There is a lot of rather loose talk about fiscal union. Actually people looked very much at the details. When I went into economics I was effectively apprenticed to man called Sir Donald MacDougall who had been the Government’s chief economic adviser under both the Labour Government and the Conservative Government before he stepped up to become the CBI’s chief economic adviser. I was fortunate enough to be his successor as the CBI’s chief economic adviser. He wrote the MacDougall report on European fiscal integration. It is a very complicated report but very worthwhile reading.

Chair: It was quite a long time ago. I think I remember reading it.

Douglas McWilliams: It was written in April 1977. I have a copy of it here. It is available on the internet. What he says there is that you really cannot have any serious fiscal integration without a minimum EU spending of about 10% of GDP, and probably you are thinking more about 20% to 25% of GDP EU competence if you want to have a fiscal union. He goes into a lot of detail about what is done in other federal unions, and so on, and comes to that conclusion. That gives an indication of the scale of the fiscal transfers that might be likely. I did a quick exercise last night just to look at the scale of the fiscal transfers within the UK, and it is quite interesting. London is a region that provides fiscal transfers, and £1 in £5 earned in London is used to subsidise other regions in the UK. In Northern Ireland, nearly £1 in £3 is received as a subsidy. In Wales, £1 in £4 is received as a subsidy, and in the north-east, about £1 in £5. That is the scale of the fiscal transfers that you tend to get in a fiscally integrated market. The idea that you could get political support for fiscal transfers between nation states on that scale—you are politicians and you will understand the prospects much better than I do, but they do not look to me to be very great.

Q123 Chair: Roger Bootle, what’s your assessment?

Roger Bootle: You asked if other people take a different view. I honestly think there are plenty, and plenty who would pass all the usual tests of respectability and competence. In particular, I do not think we should underestimate the divergence of views between London, if I may put it that way, and the continent. I speak a lot on the continent, in Frankfurt, Brussels, Paris and other centres, and I never cease to be amazed at the difference in the attitudes of people, many extremely well-qualified, to this question.

The alternative view to the ones that have been expressed pretty much by all three of us together would be along the lines that somehow or other, the euro will muddle through, through a combination of some of the things we have talked about; that is to say, eventually the ECB does QE, some form of eurobond is agreed, and there are bail-outs here and strengthening the banks there. There are two fundamental ideas underlying all that. First, politically and for the future of Europe, it is just unthinkable to give up the euro and secondly, some people believe that the direct economic costs of giving up the euro are enormous. There is the disaster view; the idea that if we lose the euro, we get some mega-disaster.

The balance of views has undoubtedly been changing. About two or three years ago, when I expressed the views that I still hold—I have not changed one jot—I was lucky to escape with my life in Paris. I was grateful that they had done away with the guillotine. There was no embrace whatsoever of the power of the economic thinking that all three of us have been talking about today—none whatsoever. I think there is still a very big divide between the way that people on the continent think about things and the way they are thought about in London.

Wolfgang Münchau: That is absolutely correct.

Chair: Chris, would you like to ask the last question?

Q124 Chris Heaton-Harris: I will put it in two parts, if I may. The question I have been asked to ask is one I think you have partially answered, certainly in articles that Mr Münchau has written: if there were a breakdown, either disorderly or orderly, of the eurozone, what consequences would you see for the UK, the EU, and the wider world economy? I would like to ask a question attached to that: is the fact that we are stringing out the slow death of the Greek economy for so long actually the factor that is killing—or chilling—the markets that we have now?

Would it not be better if Greece were just allowed to go at this point so that there is a definite bottom to the crisis and we could recover from it?

Roger Bootle: Obviously there is room for lots of different views on what the consequences would be, but the main point I want to make is that I think we are living through one of these periodic major misjudgments by the political and economic establishment about the significant economic issue of the day; that is to say the widespread, accepted view is that if the euro breaks up, it is a mega-disaster. I think that is fundamentally wrong. The euro is part of the problem, not the solution.

I find it very odd that, in particular in America, when people in the policy establishment think about the global situation, so many of them—I think correctly—identify the imbalances between East and West as being a significant problem; that is to say China, with an undervalued currency and a tendency to underspend, accumulating significant current account surpluses. They identify that as being a big problem and say it would be better for the world as a whole if China let her currency rise and expanded domestic demand. I agree. What they do not seem to perceive so often is that we in Europe have exactly the same problem, between Germany and the northern core on the one hand—I agree with Wolfgang, so many other countries are similar to Germany and are compatible with it—and the rest of the eurozone on the other.

Before the euro existed, many of the tendencies that we have talked about were already there—that is to say, the tendency towards competitive improvements in Germany and a very strong presence in manufacturing and exporting or, by contrast, the lax
control of both costs and financial balances in southern Europe. These have not suddenly emerged overnight, when the euro was formed; they were there all along. What was different was that the market had a way of adjusting to them, and that way was to send the Deutschmark higher and the Spanish peseta and the Italian lira lower, which then enabled these two very different groups of countries to co-exist in a state of reasonable prosperity. Of course with the German export surplus being continually attenuated by the rising currency, there would then be pressure on Germany to do something about the state of domestic demand.

So my fundamental answer to your question is completely at odds with the consensus. What would be the consequence of the break-up of the euro? I can answer with a single word: prosperity.

Wolfgang Münchau: I am not quite as optimistic as that. It would also depend on how the euro breaks up. There are different scenarios: you could start with a peripheral break-up, with just Greece leaving; you could have a slightly contagious break-up, with Greece, Portugal and maybe Spain leaving; you could have a much more contagious or third category, with Italy and perhaps France leaving as well; and then a category where the whole thing ends and everyone stops. I think it would be difficult to maintain the single market in such an environment, because countries will protect themselves or have an incentive to do so—they would obviously still be legally bound by it, but their political processes might enable them to withdraw from it or to leave the EU. So there is a risk that certain market integration processes might take a step back, and there is a risk—or an opportunity, as you might see it—of the EU breaking up too.

Then there is a cost if you split up a currency. Take the example of Germany, which has built up a surplus of about half a trillion euros in its target 2 payments balance, which is a kind of shadow of its current account surplus. That surplus is a claim that it has against the ECB. If that thing were to implode, half a trillion of German claims would not be met—that is about 20% of German GDP—so that is like a debt. We have to consider this carefully, because it is not as if we would all be going happily back to our currencies and trading with one another and prospering thereafter. There are break-up costs that one has to assess very carefully, and my sense is that those are not trivial.

On Greece, we are in year five of a recession. A new package is being negotiated right now—I am not sure whether an agreement has been reached, because I have not seen any news for the past hour or so. If it is agreed, it will prolong and deepen the recession, so we are looking at year six and year seven of that recession; there is no bottom-building. Government spending and the private sector are in freefall; there is no bottom-building. The strategy in place is based on forecasts that were made for normal times, but they do not incorporate the toxic interaction of austerity and growth, which is fairly extreme—not just a problem in Greece, I understand. However, Greece is not going to get out of this. This is a very long depression, much worse than the great depression that we had, which ended after a few years. This could well take 10 years.

So a kind of violent end is very likely. The question is whether Greece is going to default in the eurozone or outside it. We have to consider the structure of the Greek labour market, and its trade unions. If Greece were to leave the eurozone it would have a comparative advantage—it would increase competitiveness—but Greece does not have that many export industries to benefit from that. There are some manufacturing companies and there is tourism, of course, which would benefit from it. But in Greece the labour unions would negotiate that advantage away very quickly. You would want to reform your labour market before that happens, because it would probably take two years for them to have eradicated that competitive gain. If you gain a 50% comparative competitive advantage, you will have a 50% wage increase within two years, and that will then erode all the benefits.

The question is, I cannot see Greece wanting to leave the euro. The question is whether Greece might have no choice but to leave the euro, because its banking system would not get access to ECB funds if all Greek bonds were in default. That is the question. It simply needs to have its own currency in order to have a banking system—that is the answer. If the eurozone would help it in some way, it could stay inside, and it would be better for it to stay inside. The best thing would be, obviously, for it to reform and leave and devalue and benefit from the devaluation, but I cannot see it benefiting from the devaluation as more advanced economies would.

Douglas McWilliams: I think the outlook for Greece is that it leaves, fails to reform initially, then devalues again, and then the second time around probably gets round to reform. That is a long drawn out process. If it can get through it in 10 years, I would say that is a pretty optimistic outlook. It seems to me more like 20 to 25 years of depression that they are in for.

We are dealing with the consequences of one of the world’s greatest ever economic misjudgments. It makes Churchill’s return to the gold standard look really quite clever by comparison. This is a serious, grade one miscalculation. Whatever happens is going to be immensely painful. It seems to me that there are two possible outcomes. One is an early break-up, which will certainly be very painful when it happens. How long it will be painful for, I do not know. For example, I could easily imagine a loss of 50% of GDP for the first week afterwards—something as big as that—for the eurozone itself, but I would have expected that markets would come into operation and that follow-up arrangements would be made to try and mitigate the damage.

The alternative, I suspect, is a period of prolonged austerity and then it breaks up. So in a sense I do not think you actually gain that much by delaying. All you get is a longer period of delay, and possibly avoiding making some of the reforms that you need to make. Keeping the eurozone together compared with breaking it up seems to me to be a slightly false choice, because I think it will break up one way or another, eventually. So you will probably get two lots
of costs. At least if you take the pain early, you have the prospect of trying to reform and trying to organise things for the future.

**Chair:** Well, gentlemen, unless there are any further questions from the Committee I will say thank you for your evidence and we will have it out, hopefully, in 48 hours. Then we shall be seeing the Minister. At this juncture, as some people may know, we were hoping and requesting William Hague to come. Unfortunately, at this stage we have not yet been able to get him to come, which is a matter of concern to the Committee, but we will continue to have Mr Lidington. We feel that on a matter of this importance, the Secretary of State himself should come to give evidence to this Committee. We just want to get that on the record, as he was requested to let us know by 5 o’clock and we have not heard that he is coming. So that is the position as it stands.

Thank you very much indeed for your evidence and we will be reporting in due course. Thank you.
Thursday 23 February 2012

Members present:
Mr William Cash (Chair)
Mr James Clappison
Michael Connarty
Kelvin Hopkins
Chris Kelly
Penny Mordaunt
Jacob Rees-Mogg
Henry Smith

Examination of Witnesses


Q125 Chair: Minister, thank you very much for coming today. I would just like to make one brief comment before we begin. We have on a number of occasions asked the Foreign Secretary himself to come, without any disrespect to you; I hope you understand that, Minister. The request to have the Foreign Secretary come, because of the overarching importance of this: the precedent; the fact is that the veto has been used for the first time; and the enormous implications not only for the United Kingdom but also for Europe as a whole, in relation to the rule of law, some of which we will be examining as we go through the evidence and our cross-examination of you. We were disturbed, because it was a unanimous request from the Committee that the Foreign Secretary should come, and we remain concerned. We were glad to note that he was prepared to come on 27 March, albeit for a brief examination, but we do feel that the overarching question is of such importance, both legally and in terms of the impact politically on the United Kingdom, which after all is our function under the standing orders, that we really continue to believe that it would have been preferable, without any disrespect to you, for the Foreign Secretary to have come to enable us to ask him these questions. But we are very glad that you have come, and I will now move on to the first question.

We wrote to you on 12 January announcing that we would be opening an inquiry into the eurozone crisis. In that letter, we asked you to say what single market and financial services matters the Government was seeking to safeguard by exercising the veto. Your reply to us was, “I am afraid that we do not publish informal draft texts proposed during the negotiations.” Now, we did not ask for the draft texts; we asked what safeguards the Government was providing for the United Kingdom, which is quite a different question. Do you think that what you gave us was a helpful reply?

Mr Lidington: It was the reply that successive Governments have given with regard to negotiating texts, as you know. Chairman, before I start, I am not going to tell you about my officials. I should just, for the record, say I am accompanied by Mr Thomas Barry and Mr Marc Holland from our Europe Directorate, and by Ivan Smyth from our legal advisers.

To return to your question, Chairman, since that exchange of correspondence I am glad to say that there has been a discussion within the Government. I do not think I am breaking any great secrets to say this is partly because of the concerns and questions expressed both by this Committee and by a number of other Select Committees of both Houses of Parliament. The outcome of that discussion has been that Ministers have agreed to release greater detail of the details and what it was that the Prime Minister was seeking on 9 December. What we were seeking then were safeguards for the position of the United Kingdom, our interests and the interests in particular of the single European market, if the proposed new Treaty were incorporated as an addition to the Treaty of Lisbon.

To provide the Committee with a little bit more detail, 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 non-discrimination on the grounds of currency 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.

Q126 Chair: Of course you appreciate, Mr Lidington, that we wanted this answer in January. We are glad you have given it today, but we did not want it today; we wanted it in January. Can you explain why it is that you and the Foreign Office were not prepared to cooperate then?

Mr Lidington: I cannot go into detail, and the Committee would not expect me to be willing to go into detail, about internal discussions that took place within Government. The position that was expressed in the letter that I sent to you in January was the position of the Government at that time. As the Government reflected upon the representations made by a number of parliamentary Committees, the decision was taken, after collective discussion, that more information should be made available.

Chair: I think we have got the message.

Q127 Mr Clappison: Minister, thank you very much. I think that was an excellent answer, which was very comprehensive and showed tremendous grasp of the details but, as the Chairman has just said, we would have appreciated that before we embarked on our inquiry, not least because it would have given us the opportunity to ask some of the expert witnesses we have had along to the inquiry about the points that you have just very properly made in your answer now. The answer to the Chairman’s letter, which you gave us back in January, was very short; it was not much more than a page long. It looks like an answer to a question that was not asked, and no answers to the questions that were asked. I appreciate you have a lot on your plate, but do you think it would be possible to go back to your officials, who presumably wrote this letter, and for you to go through it with them? Could you possibly have a look at the answer you have given us now, go through it with them and see if they could be a bit more helpful in future, if this was to crop up again?

Mr Lidington: I appreciate both the tone in which Mr Clappison posed his question and his understandable wish for there to be more information made available on this and future occasions. I would say, while of course my officials as always are responsible for drafting letters to put before me, it is Ministers who take responsibility for what they sign and send out in their names. The decision to respond, not just to this Committee but to other Parliamentary inquiries, about the detail of what was sought on 9 December was a decision made collectively by Ministers in Government, not by officials. The change that has subsequently taken place was a consequence of decisions by Ministers after collective discussion, too.

Q128 Mr Clappison: None of that would preclude you from having a word with your officials.

Mr Lidington: I talk to my officials constantly, and I am sure we will bear closely in mind the comments Mr Clappison has made.

Chair: James, did you have another question that you wanted to ask relating to that same letter, regarding the commentary on the latest version of the draft?

Q129 Mr Clappison: Yes, we did ask you to provide a commentary on the latest version of the draft international agreement before our meeting on 25 January. Do you think that your reply of 24 January met our request?

Mr Lidington: We had concerns about the point at which it was right to disclose what were negotiating texts being negotiated by other parties—we were present at the meetings, but we had taken the decision to stay outside the negotiations—and which had been supplied to us in what were expressly termed confidential terms. Again, after discussion, the decision was taken that, particularly since versions of these documents had been put into the public domain—in Brussels and probably some other Member State capitals—it was frankly ludicrous for us to withhold them from our Committees. The decision was then taken to provide this and other Committees of the House with copies of the drafts, including the eventual final draft, when that came out.

Q130 Chair: Of course you could have given us the answer you have just given at that time, but I think we will now move on to the next question relating to the same letter. We now move on to the question that we put asking for the commentary to include the Government’s views of the legality of the role of the European Court and the Commission in the agreement. Bearing in mind that this letter was sent well before the Council meeting on 31 January, why did you not comment on this when you were asked?

Mr Lidington: What was happening in January was a negotiation between a number of other countries, and it was the early stage of those negotiations. I do not think that it would be terribly helpful or sensible for British Ministers to offer a running commentary on a document that itself was the subject of negotiation and discussion among those countries that were aiming to be party to it. It is possible to have a slightly more considered conversation on the text that they finally agreed, although even there I would add the rider that this is not a treaty to which the United Kingdom is a party or which binds the United Kingdom in any way.

Q131 Chair: You are not suggesting it does not affect us?

Mr Lidington: It is designed to help bring about stability in the eurozone. Instability of the eurozone is something that affects us, yes, and so any measure that is aimed at restoring stability to the eurozone has
a potential impact upon the economy of the United Kingdom and, I would hope, a beneficial impact on the economy of the United Kingdom, but the Intergovernmental Treaty contains nothing within it that can bind the United Kingdom, because the United Kingdom is not a party to it.

Q132 Chair: On this legality issue, we know the Prime Minister has expressed his reservations with respect to its legality or legitimacy, particularly in the statement that he made when he came back from the Council meeting. Indeed, this is specifically referred to in the letter that you deposited in the library, I think last night, dated 22 February; it is Jon Cunliffe’s letter, which you arranged to be put in the library. It is addressed to Mr Corsepius, the Secretary-General of the Council of the European Union, from Jon Cunliffe. It says that the United Kingdom “notes that the EU institutions must only be used outside the EU treaties with the consent of all Member States, and must respect the EU treaties”. It then goes on to talk about matters that are “properly for discussion by all Member States in the EU context”. It also goes on to say, “In view of the United Kingdom’s continuing concerns on these points,” that is further to the letter of 10 January, “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.”

Now, given these reservations expressed repeatedly, both by the Prime Minister and in this letter, as regards your Department and the legal advice that you were receiving from that Department, it seems absolutely clear that you not only had severe reservations, but this matter would not have reached this pitch—this letter of 22 February being a most unusual letter, welcome as it may be—unprecedented I think in terms of the relationship between the UK and the EU in a matter of this kind. It is clear that you took very great steps to get the legal position properly examined and analysed. Furthermore, we had Professor Paul Craig, and you will have seen his evidence as well, one of the most pre-eminent lawyers in the country, as well as Martin Howe and others, who gave evidence to the Committee, all of which is on the website. There is a very clear picture, which is that there are very serious grounds of really disputing the basis on which this Treaty, this non-EU Treaty, has been composed. In those circumstances, it would not be surprising to discover that advice had been taken at the very highest level in the Government of the United Kingdom. Against that background, could you explain, and if necessary ask Mr Smyth to speak on behalf of the Department’s legal department, whether you believe, in line with what Professor Craig and others have said, that effectively this Treaty is in breach of the rule of law with respect to the EU as a whole, for reasons that we will be examining later, particularly with respect to the use of the institutions? We regard this as a very important question and, if you would rather Mr Smyth answer it after you have had a shot at it yourself, I would be happy to hear what he has to say. How would you like to play it?

Mr Lidington: I will answer first. If Mr Smyth feels he wants to add to what I have said, then he is free to do so. First of all, Chairman, I want to just take a step back and, for the record, note that of course this Treaty is not yet in force. It has been signed but it has still to be ratified by those 25 countries that are party to it. We know they intend to ratify it—that is the avowed intention of their governments—but we do not yet know whether sufficient of those 25 will complete ratification for it to come into force on those countries that have so ratified. There is that element of uncertainty still.

Secondly, of course we support as a Government the intended objectives of this Treaty, which are economic in character and about trying to restore some stability to the eurozone. The argument that the German Government in particular has always put forward is that, if you construct some binding rules for the long term, that will give the international markets greater assurance about your commitment to bring finances under control in the short term. There is a debate to be had about how strong that argument is, but that is an argument that the Government of Germany in particular argues very forcefully. We do not want to stop our friends and neighbours in the eurozone from taking the action that they need to do to restore stability. We have said consistently, for many months now, that we do believe that the economic logic of having a single currency monetary policy and interest rate is that you move towards greater fiscal and economic integration as well.

Q133 Chair: I am sorry, Minister, but you are giving me an answer about the policy, which relates to the economic arguments. I am asking a question about the legality of the agreement and the end does not justify the means.

Mr Lidington: I want to come on to that, but I wanted to make it clear first, because that is an important consideration when the Government comes to judge where the British national interest lies. Now, of course it is open to any sovereign countries, whether they are inside or outside the European Union, in principle, to enter into treaties with each other that they then accept as binding on themselves under international law. In the case of European Union countries, of course there is a limit that is imposed on that freedom by the European Union treaties.

Q134 Chair: You agree it is about the rule of law?

Mr Lidington: No EU Member State is free to bind itself to agreements that breach the European Union treaties, which all have signed. When we come then from that point to look at the detail of what is in the Intergovernmental Treaty, a great deal of it is a set of undertakings by the parties to support particular measures to be brought forward under the existing European treaties and in accordance, therefore, with the procedures and practices of the European Union. Those aspects of the Treaty, in the terms, Chairman, that you have described, are perfectly acceptable. One can argue about the politics of them, but they amount to a promise by 25 countries that they want to support doing certain things under the European treaties. In those cases, the use of the European institutions is, by definition, already authorised, because we will be talking about a piece of secondary legislation brought
forward in the normal manner by the Commission, under the European treaties, which would have to be agreed by all EU Member States under the appropriate voting procedures. The concerns that we have had, and the reason why we have reserved our legal position, are that there are elements of the Intergovernmental Treaty that give us some concern, lest they be used in the future either to set unwelcome precedents or to impinge upon the integrity of European law and the arrangements set out in the European treaties.

Q135 Chair: As it stands now, not just for the future? The future is important. But even in respect of this Treaty, would you not agree, in the light of what Professor Paul Craig has said, and in the light, no doubt, of the advice you have received, whether it is from the legal department or indeed from any other source, that there is a serious question to the point of your having to write a letter of such importance to the Secretary-General, or for Sir Jon Cunliffe, on behalf of the Government, to write to the Secretary-General of the Council in those terms?

Mr Lidington: The Cunliffe letter is the formal record of the position the Prime Minister made clear at the January European Council when the 25 countries signed the Intergovernmental Treaty. The Prime Minister said at that time that we were going to make clear our position in writing, and formally record that we were reserving our legal position then. He said at that time, in January, and in Jon Cunliffe’s letter repeats, 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. The Prime Minister said in January, and the letter now also reiterates, that the Treaty should not undermine the operation of the single market at 27. We said in January, and I would repeat again today, that we do not want to hold up the eurozone from fighting a fire, from doing what is necessary to solve the crisis, as long as it does not damage our national interest, and that includes, critically, respecting the integrity of the European Union treaties, especially—but not just—as regards the single market.

Chair: Basically you are saying that it should not infringe the rule of law in the European Union. I would like to ask Mr Smith if he would carry through the next question.

Q136 Henry Smith: Chairman, thank you very much indeed. Minister, it is the case that, at the 31 January informal meeting of the European Council, as you say, the Prime Minister and the Foreign Secretary did say they had “a number of legal concerns on the use of the institutions” and that the UK could take legal action “if national interests are threatened”. With that being the case, why did the Government not convey our legal position very clearly in respect of certain precedents or to impinge upon the integrity of European law and the arrangements set out in the European treaties?

Mr Lidington: We vetoed something different, which was an agreement on a European Union treaty, which would, at the point of ratification, then become binding on the United Kingdom and which would also, at that point, have begun over time to have influenced how the Commission and others set the priorities for the EU as a whole, balancing these new objectives of promoting the fiscal and economic integration of the eurozone against the previous Lisbon objectives, including the single market. It was having the importation of these new EU priorities into the treaties without the safeguards that we were seeking that led the Prime Minister to veto the proposal.

Q137 Henry Smith: How do you think that reflects, if I may, on the aim often stated by you and the Foreign and Commonwealth Office that they have a commitment to parliamentary scrutiny over EU matters and other related European matters?

Mr Lidington: We do not want to blow apart arrangements that are intended to have an economic effect that we believe would be beneficial for the United Kingdom, as well as for the European Union as a whole. We have therefore expressed our position in the way that we have now done, and said that, while we do not want to block our partners from undertaking these economic and political tasks, we also reserve our legal position very clearly in respect of certain aspects of this Treaty, particularly in regard to the proposed use of the institutions in certain Articles.

Q138 Jacob Rees-Mogg: I just wanted to come in on the question you raised about the Treaty only being at the pre-agreed stage and it has to go through the ratification procedures. I wonder when the Government thinks it would be most helpful to our European partners to point out to them that the Treaty was unlawful, if that were the case. Would it be best to do it at an early stage, before it is agreed, or, so to speak, to blow the Treaty apart after it has been through its full ratification procedures?

Mr Lidington: We do not want to blow apart arrangements that are intended to have an economic effect that we believe would be beneficial for the United Kingdom, as well as for the European Union as a whole. We have therefore expressed our position in the way that we have now done, and said that, while we do not want to block our partners from undertaking these economic and political tasks, we also reserve our legal position very clearly in respect of certain aspects of this Treaty, particularly in regard to the proposed use of the institutions in certain Articles.

Q139 Jacob Rees-Mogg: You want, Minister, to veto but not to block?

Mr Lidington: We vetoed something different, which was an agreement on a European Union treaty, which would, at the point of ratification, then become binding on the United Kingdom and which would also, at that point, have begun over time to have influenced how the Commission and others set the priorities for the EU as a whole, balancing these new objectives of promoting the fiscal and economic integration of the eurozone against the previous Lisbon objectives, including the single market. It was having the importation of these new EU priorities into the treaties without the safeguards that we were seeking that led the Prime Minister to veto the proposal.
Q140 Jacob Rees-Mogg: What does “reserve our position” mean in the letter that has been sent? 
Mr Lidington: It means what it says. 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 fire-fighting 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.

Q141 Jacob Rees-Mogg: In the interim, we would accept a treaty that is unlawful in EU law terms.
Mr Lidington: There is a treaty that 25 countries have chosen to sign and to agree among themselves. It has objectives that serve the United Kingdom’s national interests. We have the legal concerns that we have expressed; that is why we have reserved our position.

Q142 Michael Connarty: Minister, I think generally Mr Rees-Mogg is getting to the heart of the questions that would be asked by any sensible person outside of this arena, which does not necessarily accept the dances done by Ministers and Governments when they do not want to say what they really need to say. The question of whether this is an illegal arrangement or not is one that clearly is up for political debate. I would like to know how the Minister could expand on the question about reserving our position, the point made by Mr Rees-Mogg. Governments say, “We are doing this because we are doing it, because we think we should do it.” What is the logic behind it? What is the problem with Article 3(2), which I have read? What is the problem with Article 7? What is the problem with Article 8? Is it only that the institutions are being used, which should only be used under EU treaties, for what is clearly not an EU treaty? Is that the heart of it?
Mr Lidington: I completely understand the point. Let me deal with those three, because Mr Connarty has put his finger on the three elements of the proposed use of institutions in the Intergovernmental Treaty that do concern us. 

In respect of Article 7, first of all, we are talking here about the Commission’s role in proposing the principles underpinning the automatic correction mechanism. The question in our minds is if that takes the Court into new territory. Article 273 allows Member States to ask the institution operating outside the scope of the treaties, and that action in respect of the treaties, at all times. Article 273 allows Member States to 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 itself. That view will not come as a shock to any of my ministerial counterparts around the Council table, because I have been saying it at General Affairs Councils frequently. One has to respect the fact that the eurozone countries are most directly concerned. It is Germany that has felt most strongly that there is a need for a treaty change or a new treaty to give additional strength and an additional legal basis to the action to integrate the eurozone crisis. Since it is Germany that is having to underwrite a lot of the financial support being given to other countries, and Germany has political and constitutional concerns of its own, I understand and sympathise with where the German Government is coming from. I appreciate they have an interest here.

Our judgment is that the key things for the eurozone are that, first of all, they complete the deal that they announced, first in July and then in October, where they came to deals to sort out the Greek debt, to recapitalise banks across the European Union and to provide a firewall of sufficient size to prevent contagion from one country—and it is no secret it is Greece that is in the spotlight—from spreading to other potentially vulnerable countries in the eurozone. Since the July and October meetings of the eurozone countries, there has been progress but, even now, the final details have not been implemented on any of those three aspects. The longer that time elapses...
without those deals being completed, the more market confidence inevitably is sapped. That is why it is important that the programme does move rapidly forward to complete what they have previously agreed, and why the Prime Minister called again, the other day, for a firewall of sufficient size to be put in place as rapidly as possible.

I think that there is, then, an economic logic. It raises some political challenges for the eurozone countries in different ways, 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. That of course has political consequences in terms of accountability for major economic policy decisions, but that is one reason why I, as a Conservative politician, oppose the United Kingdom joining the euro because I always thought that economic logic was bound to apply.

Q145 Kelvin Hopkins: Dwelling on one point you made, there is increasing talk of a firewall, as if somehow Greece’s default and re-creation of the drachma is now becoming thought to be inevitable. I certainly think that myself. This talk of a firewall certainly seems to indicate to me that the rest of the European Union is moving in that direction—that Greece is now beyond the pale and has no chance of survival inside the eurozone. They want to protect other countries. Anyway, I have another question. Similarly, our witnesses held that the Treaty was likely, because of the difficulty of measuring observance of the criteria, to be no easier to enforce than the Stability and Growth Pact. What is your view on this?

Mr Lidington: I will just be brief on Greece and then I will come to Mr Hopkins’ question. I am an opponent of Britain joining the euro, but one has to respect the fact that the elected Greek Parliament by a massive majority, and, so far as one can tell from opinion polls, the overwhelming majority of the Greek electorate as well, have voted for Greece to stay within the eurozone. They want to protect other countries. Anyway, I have another question. Similarly, our witnesses held that the Treaty was likely, because of the difficulty of measuring observance of the criteria, to be no easier to enforce than the Stability and Growth Pact. What is your view on this?

Q146 Henry Smith: On that point, I am tempted to ask you this question, Minister, although it is probably better directed to the Financial Secretary next week, as you say. What contingency plans are being made by Her Majesty’s Government with regard to the possibility of there being a break-up of the eurozone, whether that is one country leaving or more?

Mr Lidington: I know Mr Smith would not expect me to go into detail. We do make contingency plans for all kinds of contingencies, in respect of every country in the world. Those plans are kept under regular review. They look obviously not just or primarily at the economic conditions in a country, I, from time to time, am dealing with advice on how our contingency plans might be affected by terrorist threats in a particular country, anywhere in the world. We do monitor our contingency plans right across the world, all the time. It is one of the core objectives set by the Foreign Secretary of the FCO after taking office that our purpose is to look after the security of British citizens overseas. That is something we always have in our minds.

Q147 Kelvin Hopkins: Minister, it is a point you have touched on already, but I would like you to go into more detail, if you will. Overall, the views of the witnesses who have come before us implied that the eurozone could only survive if there were some form of closer political and fiscal union. This view seems to echo earlier comments by Government Ministers. Would you like to expand on this view; and would you like to consider the possibility that countries such as Portugal, shall we say, Portugal and Germany can survive together in a disciplined fiscal and political union?

Mr Lidington: It is certainly possible for territories with very different economic performances to survive in a currency union. We see that within any almost any Member State, within any nation state, that has its own currency. We can look from opinion polls, the overwhelming majority of the Greek electorate as well, have voted for Greece to stay within the eurozone. They want to protect other countries. Anyway, I have another question. Similarly, our witnesses held that the Treaty was likely, because of the difficulty of measuring observance of the criteria, to be no easier to enforce than the Stability and Growth Pact. What is your view on this?

To come to Mr Hopkins’ question, he is tempting me to speculate on things that stem from the Treaty, to which this country is not a party. What is certainly true is that a great deal that is within the Intergovernmental Treaty now relies upon the continuing neutral commitment of its signatories to deliver on what they have promised. We shall have to see. It is an expression of political will, as much as anything else, but we hope that they do succeed in restoring political stability and economic growth. Getting political stability and getting finances under control is the first step. There is a much bigger question as to the measures that need to be taken, at both European and national level, to stimulate economic growth, which I would be happy for the Committee to explore with me, or you may want to address with the Financial Secretary next week. We want to support the eurozone countries in their judgments as to what they need to do to sort out the problems with their currency.
Q148 Kelvin Hopkins: Just to pursue that a little further, it is absolutely right that within a country that accepts itself as a polity, like Britain, rich people in the richer parts of the country pay taxes, and public expenditure is recycled to other parts of the country. We accept that because we are a nation. Are the Germans seriously going to accept a long-term arrangement where they sustain, for long periods, countries that are much less well off than they are?

Mr Lidington: I said earlier that the process of fiscal and economic integration raises important political challenges for countries around the eurozone, whether on the periphery or the northern eurozone countries, and those do include questions about how those responsible for making economic policy are to be held responsible if you are moving towards some kind of supranational arrangement for fiscal and economic policy. I have to say that, as someone who is not a fan of Britain joining the euro, in the UK we have frequently, in the last half century, underestimated the extent to which, in a great deal of Europe—not just among the political elites but among electorates as well—there is support for the principle of European integration. There are differences between the parties as to how that would be implemented, and those differences were expressed in the Intergovernmental Treaty. They are the same concerns that we have on the use of the institutions outwith the treaties.

Q149 Kelvin Hopkins: One more question: how likely is it that eurozone Member States and prospective eurozone Member States would and could move towards this prospect sufficiently quickly to contribute to a more solid resolution of the current eurozone crisis?

Mr Lidington: It has taken too long to deliver on the things that were agreed in July and October last year. There is limited value in British Ministers hectoring our eurozone friends in public about this. We want them to succeed. I certainly believe that the quicker that they go ahead with the immediate measures that they have already agreed to in principle, the better it would be for them. They then have to work out how to take forward their strategy for closer fiscal and economic integration in a fashion that their governments and voters will accept.

Q150 Chair: Minister, we are now going to move on to the legality questions in more detail. Mr Smyth was concerned that the approach taken in enhancing the eurozone through a non-EU Treaty did raise very profound questions regarding the rule of law. In fact, in answer to a question I put to him—it is question 12 in the transcript of evidence—he replied, “Whatever one believes about its desirability or not, this new treaty does raise an issue of principle, which you can call a rule-of-law issue of principle that is concerned with whether we should bear with equanimity the idea of those decision-making rules being circumvented by a treaty outside the fabric of the Lisbon Treaty in circumstances where the rules as to how change should be undertaken within the Lisbon Treaty are not capable of being met, particularly given that the Stability, Co-ordination and Governance Treaty can only work through the participation of the EU institutions in the way that is written into that treaty. That does,” he said, “raise an issue of principle, which is a rule-of-law issue.”

Before we look at the agreement in more detail, can you tell me, first of all, whether the Government sympathises with this view and, secondly, how far up the legal tree you have gone in obtaining advice, including the advice you have received from your legal department, in getting at what is quite clearly a very important question about the rule of law?

Mr Lidington: There has been advice from across Government that has informed the position the Prime Minister took at the January European Council, subsequently expressed in the letter from Sir Jon Cunliffe to Uwe Corsepius. I am not going to get drawn into a detailed discussion of what the Government’s own legal advice and legal analysis says, not least because reserving our position means that we might, at some stage in the future, wish to go down the path of legal action, but to say anything that prejudices or reveals a position that we might take in such circumstances. I think it is clear from what I have already said to the Committee that we have concerns about some elements of the Intergovernmental Treaty, insofar as the proposed use of institutions is concerned. That is why we have reserved our position, done so formally and have consistently reiterated our position that the use of the institutions outwith the treaties requires the agreement of all Member States and that, even then, the institutions must not act in a way that is contrary to their obligations to all Member States, set down in the treaties.

Q151 Chair: Of course, as a former Shadow Attorney-General myself, I am sure you would understand that I would expect that matters of this kind would be taken by the Attorney-General in terms of advice that he might give to the Government. I am simply asking you not to reveal that advice, but to indicate that the advice has indeed been given.

Mr Lidington: We have taken advice from across Government.

Chair: I think that is a moment when we will have to adjourn.

Sitting suspended for a Division in the House.

On resuming—

Chair: We are going to ask a number of questions now on, as I said, more detail in respect of the legal concerns that we have on the use of the institutions in the Intergovernmental Treaty. They are the same questions that we put to our expert legal witnesses and we would really be grateful if we could have some clear answers explaining the Government’s views. That is the idea. If you would be kind enough to refer to Mr Smyth at a given point in time, on some of the more detailed questions, that might be helpful, because there is a slight tendency to enlarge the issues, when we want to look at some of the more precise answers to the questions. Penny Mordaunt, would you like to ask the first question?
Q152 Penny Mordaunt: This is turning to Article 7, which incorporates the mechanism of reverse qualified majority voting. The question is: is it possible for a non-EU treaty to stipulate voting procedures in an EU institution?

Mr Lidington: There is nothing to stop a group of Member States either formally or informally from agreeing among themselves to vote in a particular way. What Article 7 does is require the contracting parties to support the Commission proposals under Article 126(6), and recommendations of the Council, unless there is a qualified majority not to do so. Yes, the straightforward answer is that 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.

Q153 Jacob Rees-Mogg: Coming on to Article 8, do you agree that the Commission, under Article 8, has de facto infringement powers? In other words, the trigger for legal proceedings is the Commission and Member States being obliged to carry out the recommendation. It may be helpful to read a bit of it, because it requires the Member States to ask the Commission. It does not say “the Member States may”: it says they will.

Mr Lidington: I will ask Mr Smyth to comment on that.

Ivan Smyth: “Will” is not, in treaty terms, mandatory language. If we were looking at this in treaty terms in the UK, if it was mandatory, we would be using “shall”. The point about this is it is the Member States that actually initiate the action, based on the opinion that they may receive from the Commission.

Q154 Jacob Rees-Mogg: If they are obliged to under the Treaty, or if they are under very strong pressure to from the treaty—the “will” rather than “shall” point—then de facto it is the Commission that is bringing it, because the Commission gives the report to the Member States. The Member States then go back to the Commission saying, “This is what you must do.” This is what the Treaty is requiring of the Commission.

Ivan Smyth: The Commission cannot compel the Member States to take that action. There is no sanction, if Member States decide, having read the opinion from the Commission, not to proceed with the matter.

Q155 Jacob Rees-Mogg: Just because there is no sanction, it does not mean that something is not an obligation.

Ivan Smyth: As I said, it is not a mandatory obligation on the states to do that.

Q156 Jacob Rees-Mogg: Is that only because there is no court that can enforce it?

Ivan Smyth: It is because the Treaty does not say that they must bring the action; it says they will bring the action.

Q157 Jacob Rees-Mogg: The only reason that the Commission is not, de facto, obliged to bring infringement cases is because it says “will” rather than “shall”.

Ivan Smyth: No, it is because the provision actually makes it clear that it is the Member States that take the action.

Q158 Jacob Rees-Mogg: It says the Member States will ask the Commission to bring the action.

Ivan Smyth: But it is the Member States that actually take the action to the court.

Q159 Jacob Rees-Mogg: Following the report of the Commission, and if “the European Commission, after having given the Contracting Party concerned the opportunity to submit its observations, concludes in its report that such Contracting Party has failed to comply … the matter will be brought to the Court of Justice … by one or more Contracting Parties”. If the Commission says it will be brought to the Court of Justice, it will be brought. It is the Commission that is saying to a Member State, “This is what you need to do.”

Ivan Smyth: If you actually read the text, there is the double thing here. One is if there is a report from the Commission, then the Member States may determine it, but the Member States, of their own volition, may also bring an action.

Q160 Jacob Rees-Mogg: Yes, that is perfectly true that the Member States can do it off their own bat, but that does not mean the Commission is not being placed under an obligation to bring infringement proceedings.

Ivan Smyth: I am sorry, but the Article is very clear that it is the Member State that brings the action.

Q161 Mr Clappison: Can I come in on this? I am sorry I missed the other part of this; I was still in the Division. This is Article 8, isn’t it? This is the sort of thing that gives the law a bad name, when it is trying to hide something like this. Can I just take you through it? The European Commission is invited to present a report on the provisions. Looking it through, “If the European Commission, after having given the Contracting Party concerned the opportunity to submit its observations, concludes in its report that such Contracting Party has failed to comply with Article 3(2), the matter will be brought to the Court of Justice.” It could not be clearer than that; it is the European Commission that is invited to present the report. It submits its observations and then there is a trigger for action through the Member States. Of course, as you say, the Member States could undertake this process of their own accord, but it is the Commission that is doing it, isn’t it?

Mr Lidington: With respect, Mr Clappison, if the countries concerned got to the stage that the Commission report had concluded that a Contracting Party had failed to comply with 3(2), then it is for one of the Contracting Parties, not the Commission, to bring the case to the ECJ. There has to be a separate decision by one or more of the Contracting Parties to take that further step and go to the ECJ.
Q162 Mr Clappison: It does not read like that, with respect, Minister, because it says the matter “will be brought to the Court of Justice of the European Union by one or more Contracting Parties”. What does the word “will” mean there?

Mr Lidington: That is a question for the countries that are signed up to the Treaty.

Q163 Mr Clappison: Isn’t this why we are objecting to it in our letter from Jon Cunliffe, which is a very good letter? This is what we are objecting to in regard to Article 8, as well as Article 7. It is the role of the Commission.

Mr Lidington: I think I said earlier in the Committee’s proceedings the two concerns we have about Article 8 are, on the one hand, the Commission and, on the other hand, the European Court of Justice might be used for things that go beyond the scope of their remit under the European Union treaties. That is a slightly different point from the one that has been the subject of the question so far.

Mr Clappison: I will have another question on this in due course.

Q164 Chair: Minister, put simply, is the role of the Commission in Article 8 provided for in the existing treaties?

Mr Lidington: I think there is a serious question about that. If I go back to the evidence that both Professor Dougan and Martin Howe gave to the Committee, the role of the Commission that is given here, under Article 8, is outside the EU treaties, but similar to the role it performs under the EU treaties. Our position as a Government is that the EU institutions, including the Commission but the Court too, must only be used outside the EU treaties with the consent of all Member States, and that any such action by the institutions must respect the EU treaties and not contravene them.

Q165 Chair: Let me put a question and answer that I derived from the evidence on page 10 of the transcript with Professor Paul Craig, where I put it to him “whether the role of the Commission in Article 8 was provided for in the existing … treaties”, the question I have just put to you. I asked him, “You have answered that, and I am now asking: in EU terms, therefore, is it lawful for this agreement to prescribe such a role to the Commission?” He just says “no”. Does Mr Smyth have a different view or does the Attorney-General have a different view?

Ivan Smyth: I think there is possibly a range of views on this issue.

Q166 Chair: There is a variety of views and it is a question of politically how you want to judge it. Is that more or less what you are saying?

Mr Lidington: We are reserving our position.

Q167 Chair: Is it the Government’s view? What is the Government’s view?

Mr Lidington: The Government’s view is that we are reserving our position on this. We have concerns about the proposed use of the institutions, as I have expressed already to the Committee. That is why we have taken the position we have.

Q168 Chair: Why do you disagree with Professor Craig?

Mr Lidington: I am not seeking to disagree with Professor Craig. What I am seeking to do is to explain what the Government’s position is: that we are reserving our legal position on this, because it is important that the principles that I have described, of institutions acting outside the treaties only with consent of all Member States and within the limits of action prescribed by the treaties, are upheld.

Q169 Chair: To go back to Mr Rees-Mogg’s question earlier, in the meantime, whether or not it is lawful is secondary to the question of whether it is expedient.

Mr Lidington: What also needs to be acknowledged, Chairman, is that the Intergovernmental Treaty itself says in terms that it is a treaty that is agreed with regard to all the obligations set out in the EU treaties, and the declared intent of the signatories of the Intergovernmental Treaty is that they shall act at all times within European law. What is also true is that, as a matter of legal fact, the primacy of European Union laws laid down in the treaties is not and cannot legally be affected by the drafting of an intergovernmental treaty binding, in international law, outside those European treaties. It is the express intention of the signatories that, if there is any conflict or overlap, the EU treaties should prevail.

Chair: I have a sense that somehow, one way or another, you will find yourselves on both sides of the equation. The political imperatives appear to be prevailing at the moment, as far as you are concerned. Could I ask Mr Rees-Mogg to ask the next question?

Q170 Jacob Rees-Mogg: One question to come back, if I may, to Mr Smyth: are the Contracting Parties able to refuse to act?

Ivan Smyth: As I have said before, there is nothing that compels the Contracting Parties here to take a case.

Q171 Jacob Rees-Mogg: So they can refuse to act. Okay, thank you. I now have my question; sorry, I am being rather greedy. To carry on, do you see, within Article 8, Minister or Mr Smyth, a conflict between the role of the Commission and the prohibition against it bringing infringement proceedings in the context of the excessive deficit rules in Article 126(10) TFEU?

Ivan Smyth: I think the jurisdiction of the court here is different, in a sense. What this is about is the requirement for Member States to enshrine, in their domestic law, an obligation to resort to the balanced budget rule. That is the obligation here and that is what the jurisdiction of the court attaches to.

Q172 Jacob Rees-Mogg: Article 126(10) says that the European Commission cannot bring infringement proceedings. Article 8 is getting them towards bringing infringement proceedings, unless the Contracting Parties refuse to act.

Ivan Smyth: As I have said before, in a sense this is not about infringement proceedings by the Commission. This is about Member States deciding to
take it to an action. This is not an infringement proceeding by the Commission.

Q173 Jacob Rees-Mogg: To come back to Mr Cunliffe’s letter and the “continuing concerns”, are those continuing concerns in relation to the way the Treaty is drafted and challenged on that basis, or are the continuing concerns in relation to how the Treaty might be applied in practice?

Mr Lidington: I think the trouble is Mr Rees-Mogg is asking us—I do not blame him—to come very close to going on to the detail of the legal advice the Government may have received, and I am not prepared to do that. We have had concerns about both. That is why we are reserving our position.

Q174 Jacob Rees-Mogg: The reason for my asking the question is that, if the Government has concerns about the way the Treaty is drafted currently, it would be important to bring those forward early because of the old legal maxim: he who is silent is seen to consent. If you allow time to go by on the drafting of the Treaty, your consent will have been implied. If it is on how it is applied in practice, then time is of course on your side. It seems to me it is crucial that, if you have these concerns with the current draft, something is done about it now.

Mr Lidington: I take that point seriously.

Chair: I am very glad to hear that.

Q175 Mr Clappison: I think that is a very helpful reply we have just had from the Minister. Very quickly on this point, going back to the Cunliffe letter, we say, “In this context, it notes that the EU institutions must only be used outside the EU treaties with the consent of all Member States, and must respect the EU treaties.” Can I ask if we have given our consent to the use of the EU institutions in this Treaty?

Mr Lidington: No, we have not been asked so do to.

Q176 Mr Clappison: Have we given that consent?

Mr Lidington: We have not been asked and we have not volunteered it. At the moment, it is a hypothetical question.

Q177 Mr Clappison: As it stands, if we have not given our consent, then what the EU is doing is not lawful, in our view. The two conditions that are set here are, for the EU’s action to be lawful, it could only be done with our consent and must respect the EU treaties. If we have not given our consent, it is not lawful.

Mr Lidington: The Intergovernmental Treaty itself says that, if there is any conflict between it and the EU treaties, it is the EU treaties that shall prevail.

Q178 Mr Clappison: I am not asking that question. I am asking, quite simply, if we have given our consent to the use of the EU treaties. If your answer is we have not been asked to do it, we have not given our consent. We would agree with that.

Mr Lidington: That is right.

Q179 Mr Clappison: In the terms of this letter, if we have not given our consent, then the use is not lawful.

Mr Lidington: I think that is taking it a step further. The Intergovernmental Treaty is designed expressly to be compliant with the European Union treaties. That is laid down in the language of the Intergovernmental Treaty itself. I have never denied that we have concerns about the proposed use of the institutions. That is why we take the position we do.

Mr Clappison: I am very heartened by what is says in the Cunliffe letter. 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.

Q180 Chair: Inevitably, we shall be moving on to the question of what you will be doing about it, but let us get through the next question first. The evidence we have received suggests that the jurisdiction of the European Court under Article 8 is consistent with Article 273 of the TFEU, but Article 273 emphatically does not permit the Commission to bring proceedings before the European Court. Given the position that it is the Commission that triggers the legal proceedings in Article 8, do you see a conflict between Article 8 of the agreement and Article 273 of the TFEU?

Mr Lidington: With respect, Chairman, there may be concerns about whether various items in the Intergovernmental Treaty are covered by Article 273. The particular point on which your question is based, I think, is at odds with what Article 8 actually says. Although it is true that Article 8 provides for the report on the failure of a state party to comply with 3(2) to be brought forward by the Commission, the responsibility and decision to go to the European Court of Justice lies expressly with one or more Member States and not with the Commission.

Chair: I would now like to move on Michael Connarty’s questions relating to enhanced cooperation.

Q181 Michael Connarty: Thank you very much, Chairman. We had a number of extended conversations, if you read the evidence, with our witnesses about what enhanced cooperation means. In your opinion, the same question, does Article 10 refer to enhanced cooperation within the eurozone or by the eurozone, within the wider context, do you think? In other words, does Article 10 envisage enhanced cooperation with less than the 17 eurozone states or the eurozone states acting as a bloc? Some of the witnesses had strong opinions about that problem.

Mr Lidington: Enhanced cooperation means enhanced cooperation as defined by the Treaty of the European Union and the Treaty on the Functioning of the European Union, with all the rules and safeguards laid down there, and the minimum number—at present nine—EU Member States that have to be party to any such enhanced cooperation initiative.

Q182 Michael Connarty: We noted through the amendments that had been coming through that Article 10 had become more squishy, shall we say, more what we would normally expect from euro-waffle. Rather than the word “will”, it became “stand ready”. Rather than “will”, it became “when appropriate”. It still has this problem. If Article 10
encourages use of enhanced cooperation by the eurozone as a bloc, is that consistent with the rules on the use of enhanced cooperation in the EU treaties? It does seem to take it further. Only nine states are required for enhanced cooperation, but this is a bloc of 17, or is it a bloc of 25, because is it expecting others to cooperate with the people now who have signed this, should they ratify this treaty, so they all act together as a bloc? It is very similar to the question that has been raised in the Council of Europe about whether the EU will act as a bloc should it sign up to the Convention.

Mr Lidington: Clearly what Mr Connarty is getting at is the risk of caucusing and, by inference, the risk of caucusing against our interests. 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: the rule that it must be used as a “last resort”; that it must “not undermine the [single] market or economic, social and territorial cohesion; … it [must] not [constitute] a barrier to or discrimination in trade between Member States; [it] must not [distort] competition between [Member States] or between the competences, rights and obligations of those Member States [that] do not participate in [a specific enhanced cooperation initiative]”. 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.

Having said that, and that is the formal position, I would add the rider that the history of enhanced cooperation so far is that it has been there in the EU treaties for a considerable length of time. There have been, to date, only two initiatives under enhanced cooperation: one on family law, I think, in which we did not participate; and one on the proposed European patent, which is very near but has not quite reached final agreement, in which we are a participant. I am not seeing evidence at the moment that what is here in the Intergovernmental Treaty is going to lead to some kind of caucus that is inimical to United Kingdom interests. If one looks at what has been happening elsewhere in the European Union this week, at the 11 other Heads of Government who join our Prime Minister in a joint letter about growth and competitiveness, mixing in almost equal numbers eurozone and non-eurozone countries, there is 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.

Q183 Michael Connarty: The reality is, if this treaty is ratified, that this is enhanced cooperation driven by the Commission, not driven by a group of countries. All of the rest of it talks about the Commission being given powers and having roles. It says quite specifically in this “whenever appropriate and necessary”. As you said, in Article 20(2) of the Treaty of the European Union, it says “as a last resort”. If someone is to read this evidence, it is as if you, Minister, have ignored the fact that this treaty is a different beast from something that is already in the Lisbon Treaty. It has a different purpose. It has clearly some matters in it you have as a Government said you have some concerns about, but surely this is not the same as enhanced cooperation as we know it. We are concerned that this is a significant inconsistency, which might change the way enhanced cooperation is used; and I am a bit concerned, because you are normally very perceptive in these matters, that you are not sharing that same concern.

Mr Lidington: I simply believe that Mr Connarty’s fears are not supported by what we have here, because the Intergovernmental Treaty does not erect some new structure for enhanced cooperation. Instead, it is a commitment by the signatories that they will, in an unspecified way, support in the future measures under the EU treaties for the use of enhanced cooperation. There is not a new procedure. The procedure to which Mr Connarty refers is the Intergovernmental Treaty procedure laid down in the EU treaties, which has already existed for many years and which has been limited in its use. It is also worth saying—and I think this perhaps helps to understand the EU political context for this—that in the discussions in various ministerial Council meetings last autumn, when ideas about treaty change surfaced in some countries but there were other proposals kicking around as to how the eurozone could look to move towards greater integration, 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.

Q184 Michael Connarty: Professor Hix was concerned—he expressed his fears in his evidence—that enhanced cooperation is becoming, let us say, used, “whenever appropriate and necessary” rather than “as a last resort”. The eurozone might use enhanced cooperation and let it spill over into matters that actually influence the votes on internal market measures. Do you not share that fear?

Mr Lidington: Not unless one assumes that our partners are going to ignore the commitment that they have entered into that this Intergovernmental Treaty should be compliant with EU law and that, where there is any overlap or conflict between the Intergovernmental Treaty and the EU treaties, it is the EU treaties and EU law that shall prevail. Also, one ignores the reality I observe in the EU week by week, in which the 17, let alone the 25 parties of this treaty, simply do not act as a cohesive bloc but pursue alliances with other countries, including us, on a
whole range of issues. 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.

Q185 Michael Connarty: One of the things we need clarifying, because there is conflicting evidence, is whether the UK could block a proposal to use enhanced cooperation when unanimity in the Council is required—for example, on the financial transaction tax, which was given as an example. Would the UK block that and how would it do so?

Mr Lidington: It would depend on whether such a proposal for enhanced cooperation respected all the requirements laid down in the treaties. As Mr Connarty knows, it is in the nature of enhanced cooperation procedure that those countries that are not participants nonetheless attend the negotiating meetings of the participant countries and can make comments and have full status, but not voting rights, in those meetings. In those hypothetical circumstances, UK could be vigilant to ensure that the rules laid down in the treaties—last resort, not distorting competition, so on and so forth—were all being observed. If, at the end of the day, we felt that they were not being observed, then we would be willing to use all the rights accorded to us under the EU treaties to challenge such use of enhanced cooperation.

Q186 Chair: Would you not agree, though, when you refer to the use of enhanced cooperation in the context of patents—where we are in the middle now of examining Baroness Wilcox on that—and also in relation to family law, that you are, effectively, by comparing that to this, engaged in a process of mixing apples and pears? After all, in the kind of context in which we have been discussing these questions, where enhanced cooperation has been agreed to in the past, it has been where all the Member States have agreed, by their own unanimity in relation to a European Treaty, that the procedure of enhanced cooperation will be employed. This is a different situation. This is what was agreed to out of the two but, nonetheless, no unanimity in agreement. That is precisely why this is not an EU treaty. I fear that you may be, and I would be grateful if you could comment on whether you agree with me or not, in danger or you are, in fact, mixing up a non-EU treaty situation with a Treaty situation.

Mr Lidington: No. The only provision for there to be enhanced cooperation is that laid down in the TEU and TFEU. No new system or process for enhanced cooperation is created by the Intergovernmental Treaty. What in effect we have in the Intergovernmental Treaty is an agreement by 25 countries that it would be rather a good thing if they could use enhanced cooperation from time to time. The implicit message is that this has been on the EU statute book for a while and we perhaps have not used it often enough. If I wanted to point again to a reason why I do not, at the moment, see evidence that I need to fear the consequences, Chairman, that you have foreseen, it is precisely on the issue of the financial transfer tax because, within the past couple of weeks, we have had a proposal from a number of Member States for an enhanced cooperation initiative on the FTT. That proposal was signed by nine Member States. It was not signed by every member of the eurozone, let alone by every party to the Intergovernmental Treaty. That in itself illustrates that countries are likely to go on making calculated judgments about their national interests, measure by measure, using the enhanced cooperation process set down in the EU treaties.

Q187 Chris Kelly: Minister, following on from Mr Connarty, Article 10 encourages Contracting States to use enhanced cooperation to ensure the smooth functioning of the euro area, which both you and I are thankful we are not a member of, “whenever appropriate and necessary”, whereas the EU Treaty requirement is that it be used “as a last resort”. This Committee is concerned that this is a significant inconsistency, which might change the way enhanced cooperation is used from what was agreed in the treaties. Are you also concerned?

Mr Lidington: The point about last resort is that is written into the European Union treaties. That principle, therefore, has primacy over anything that may be contained in the Intergovernmental Treaty. Article 2 of the Intergovernmental Treaty itself says at paragraph 1 that “this treaty,” the Intergovernmental Treaty, “shall be applied and interpreted in conformity with the treaties on which the European Union is founded.” It says at paragraph 2 that the provisions of this Intergovernmental Treaty “shall apply insofar as [they] are compatible with the treaties on which the … Union is founded and with European Union law. [They] will not encroach upon the competence of the Union to act in the area of the economic union.” There is an express limitation written into Article 2 of the Intergovernmental Treaty on the ability of this treaty to affect the primacy of EU law.

Q188 Chair: Do you see any particular obstacles to ratification in any of the Member States?

Mr Lidington: Chairman, all but two of our Member States are asking me to trespass on some quite sensitive political issues in a number of Member States. There are, I think, two distinct but related questions here. One is ratification of the Treaty, for which each country will have its own sovereign arrangements. The other is the writing into law, preferably constitutional law, the deficit rule that is an obligation under this treaty. In a number of countries, those require a two-thirds or other special majority within the national parliament. In some countries, there is provision in their constitutions for referendums in certain circumstances. The Irish Attorney-General has been asked by the Irish Government for his view on whether ratification of the Intergovernmental Treaty requires a referendum in Irish law. My understanding is that the Attorney-General of Ireland has yet to respond on that. Prime Minister Fillon of France has suggested that the ratification of the Intergovernmental Treaty would be made by a decision of the French
Q189 Kelvin Hopkins: We have heard today that Hungary is being punished, if you like, with a substantial fine for not having its budgetary arrangements in order. We have heard that the Czech Republic takes a dim view of what has been happening. We also understand from the Chairman and others that, although a number of countries’ leaders have signed up to this, there is actually a lot of disquiet about the whole thing in any case. What are the chances of the whole thing being derailed?

Mr Lidington: There is no doubt that, in the months leading up to the December European Council, there were a lot of countries in the EU that said that they would much prefer to avoid having treaty change. The decision having been taken in December, and then in January by the signatories, makes the question slightly different, because there is, from that point on, a certain measure of collective credibility tied up with delivering on a promise that people have entered into. I think that there will be a political determination by all 25 Governments that they should go ahead with this. Those Governments, in the conversations that I have had with Ministers, seem confident that they can deliver their necessary parliamentary approvals with the required majorities.

I said right at the beginning of the Committee’s proceedings that this treaty has not come into force. It has been signed but it has not yet been ratified. I think still, by anybody. My officials may correct me if I am wrong, but it has certainly not been ratified by the 12 countries that are needed for it to come into effect. It will be signed at the European Council on 1 March. I had better correct my words. The final text was agreed at the January European Council; it is going to be signed on 1 March in the margins of the European Council meeting. The ratification process then has to follow.

Q190 Chair: Very quickly—no, it is only an adjournment so we can continue—in that context you may know I raised this issue in Business Questions today, calling for a debate on the Floor of the House next week, in relation to the nature and lawfulness of this treaty, which of course is what we are examining now. Finally, I would like to ask two last questions. What overall do you think the United Kingdom achieved by exercising its veto? Secondly, in the light of all the legal advice and the evidence before this Committee, and I mean all the legal advice that you have received within your Department and, as you say, from across Government Departments and elsewhere, and bearing in mind that this is clearly not just a question of the single market and the City—although that was given as the main reason for exercising the veto—it is clear that this has now moved on and that we are now talking in the light of the evidence from legal advice and from Professor Craig, Martin Howe and others that there is an issue of the rule of law here as well. Do you not agree that there is a very profound case for going to the European Court and to take that step beyond the reservation, because this is clearly something of such importance that taking it to the European Court is required? In a nutshell, what do you think the UK achieved by exercising the veto? Are you proposing to go to the Court or not?

Mr Lidington: What we achieved by the Prime Minister’s exercise of the veto was to block a European Treaty that would, by definition, then be EU primary law, binding upon the United Kingdom. We did so because, while we were willing in principle to consent to such a treaty amendment, there was not agreement by some other countries to the safeguards that we regarded as essential for the single market and for financial services in particular. There are no obligations imposed on the United Kingdom. The Intergovernmental Treaty is not part of European law; it cannot in any way amend or supersede European law. The fact that it is intergovernmental means that we have avoided the importation without adequate safeguards into the EU treaties, and, therefore, the hard-wiring—the aims and objectives—of the European Union, of the priority to the fiscal and economic integration of the eurozone, which the Intergovernmental Treaty is intended to provide. Although we supported that objective politically, we regarded safeguards for the integrity of the single market and financial services as essential in order to ensure that those vital interests were not overridden as, over time, attention was given to these new EU priorities.

In response, Chairman, to your second question, on which I am just retrieving my train of thought—

Q191 Chair: Are you going to go to the Court or not?

Mr Lidington: We have not ruled it in or out. Our decision to reserve our legal position makes it clear that that option is one that is still available to us.

Chair: Minister, thank you very much indeed.
Wednesday 14 March 2012

Members present:

Michael Connarty
Julie Elliott
Nia Griffith
Chris Heaton-Harris

Kelvin Hopkins
Chris Kelly
Jacob Rees-Mogg
Henry Smith

Examination of Witnesses

Witnesses: Right Hon Mark Hoban MP, Financial Secretary to the Treasury and Official, and Peter Curwen, Director (Europe), HM Treasury, gave evidence.

Q190 Chair: Minister, thank you very much for coming this afternoon. I am sorry that the last occasion was displaced by other business, but I would say that we are very glad to have you. Before I come to the substance of the evidence session, I would like to ask you some questions about the attendance of Treasury Ministers before this Committee. Can you tell us the reason for the apparent reluctance of Treasury Ministers to give oral evidence to us about the significant economic policy developments in the EU?

Mark Hoban: Well, first of all, may I introduce Peter Curwen, who is Director, Europe, and who is with me today? Mr Cash, firstly, this is the first time I have been invited to give evidence, and I am always—I should choose my words carefully—very happy to give evidence. I take part in a large number of the debates that you elevate either to European Committee B or to the Floor of the House. I am always very willing to take part in these discussions if that would be helpful to the Committee.

Q193 Chair: I first wrote to the Chancellor himself inviting evidence on 14 December last year. Two further letters had to be sent before we elicited a response on 21 February. I would not describe this as a speedy response. Although you might say that you cannot speak for the Chancellor, those were the letters that were written. Is there something about the response to the eurozone crisis that, generically, the Treasury does not wish to discuss with the Select Committee charged with scrutinising European affairs?

Mark Hoban: No, we are always very happy to engage with the Committee, and I think sessions like this are very helpful. Clearly, the Chancellor has a busy diary in the run-up to the Budget, which makes his attendance problematic, but as the Minister who is most closely engaged with this, I am very happy to engage with the Committee.

Q194 Michael Connarty: Does the Minister accept that he is here to speak on behalf of the Treasury, or does he think he is here to give his personal opinion?

Mark Hoban: I am here to speak on behalf of the Government.

Q195 Michael Connarty: Excellent, as long as it is not your opinion as opposed to the Government’s position.

Mark Hoban: I only ever have the Government’s view these days.

Q196 Chair: I will turn now to your own letter, which is dated 13 March, which is only yesterday. Your letter says, in terms, that the amendment of Article 136 of the TFEU is not necessary for the euro member states to establish the European Stability Mechanism. This seems very much at odds with reasons for the amendment given or implied since it was first proposed in October 2010, so I am going to ask you the following question in relation to that letter. In your letter of 13 March you say the amendment to Article 136 is not necessary for the eurozone member states to have their treaty to establish the ESM. But by contrast the European Council conclusions, from 28 to 29 October and again 16 to 17 December 2010, and, yet again, the European Council decision on 24 March 2011 on the treaty amendment suggest that the amendment is indeed necessary. Furthermore, the Prime Minister’s statements to the House after those two European Councils, and the Minister for Europe’s speech in the debate to authorise the Government to agree to the European Council decision to amend Article 136 also strongly suggested that the amendment was a necessary precursor to the ESM Treaty. Now for those who may be inclined to think that the facts and the arguments are sometimes rearranged in the course of the development of policy to suit the circumstances of the present time, can you explain why the Government thinks this is the case, why it was not explained to Parliament from the very first, and, secondly, if the amendment to 136 does not have to come into force before the ESM Treaty can be adopted, why on earth has the European Union gone to such lengths to make the amendment?

Mark Hoban: I think our position is this: we do not believe that it is legally necessary for the Article 136 change to be made before the ESM comes into force. It is desirable, but I do not think that it is necessary. However, from the perspective of at least one member state, it is important, or they believe it to be important, that the treaty change comes into force before the ESM came into force. That was the requirement, apparently, by the German Constitutional Court that sought legal certainty. As far as I am concerned, it would be good but it is not necessary.

Chair: Your letter only arrived yesterday, so for practical purposes you can be assured that we will be
looking at this in detail in our report, because there does appear to be not only a change in tack but a change in principle in the attitude adopted by the Government. Of course, when those things happen, there are those who believe that this is done in order to circumvent the problems that might otherwise arise. It may be on ratification; it may be on other matters, but we will certainly be looking at that.

Q197 Michael Connarty: It does appear, Chairman, that what has been said is that this is just a larger example of enhanced co-operation, rather than anything unique. ESM is just an agreement to have enhanced co-operation in this field if it does not require an amendment.

Mark Hoban: Our understanding, and what we believe to be the case, is that, for the purposes of the German Constitutional Court, they do require the treaty change to be made prior to the ESM coming into force. That does not apply to our position. It was suggested to me I could send the letter this morning, but I thought it would be helpful to the Committee to send it yesterday, so the Committee had an opportunity to look at it.

Q198 Chair: I am not sure I would regard that, if I may say, as something that we would regard as a favour.

Mark Hoban: I was aiming to be helpful, Mr Cash, rather than unhelpful, and to at least be able to have a preliminary airing of the points today, and obviously look forward to the Committee’s report, and respond to it.

Chair: But you do get the burden of what I am saying, which is that there is a possibility, and we will be looking at this carefully, that the facts and the attitudes—contrary to previous statements, both of principle and of analysis, that have been put forward by the Government in the past—are now being rearranged to fit in to the desired framework. As far as we are concerned, I am quite sure that will be regarded as a matter for serious comment in our report, if that conclusion is arrived at.

Q199 Michael Connarty: The Minister has not really answered. If it does not require this amendment before the ESM comes into being, is it any more than just a very large enhanced co-operation? Basically, rather than having a minority of members involved for an enhanced co-operation, almost all the members are involved in an enhanced co-operation, apart from the UK and a few others.

Mark Hoban: There is an issue here, and clearly there is some difference of view about whether or not the treaty change is necessary. Because there is that difference of view, it is better that there be legal certainty. That is one of the reasons why it is proposed that the treaty amendment should go through, to find that legal certainty so that the ESM treaty can come into force. I do not see it as enhanced co-operation; it has not gone through that enhanced co-operation process. It is a separate treaty.

Q200 Michael Connarty: Let us be quite frank—the Prime Minister made a great song and dance about how he vetoed the treaty. What we are now saying, in fact, is that there was not really anything that he was required to veto. In a sense, you say it is not necessary to have a treaty amendment. Therefore, the whole point was that there was nothing to stop.

Mark Hoban: No, Mr Connarty, the treaty we are referring to is the one that set up the ESM, not the Fiscal Compact, which the Prime Minister did indeed veto.

Q201 Michael Connarty: Which he did not veto?

Mark Hoban: No. The Prime Minister vetoed the Fiscal Compact. What we are talking about here is the amendment to Article 136.

Q202 Michael Connarty: But had it been a treaty—

Mark Hoban: It is not a treaty, so we are where we are on that one. The point we are trying to link here is the amendment to Article 136 and the acceleration of the ratification of the treaty that sets up the ESM. Frankly, we have some interest in accelerating that ratification process, because it means that, once the treaty is in force, the facility that we contributed to can no longer be used for new contributions. We have an economic interest in this process happening on a timely basis.

Q203 Chris Heaton-Harris: Could it be said that the establishment of the ESM is an extension of the competence of the EU in the economic field?

Mark Hoban: We set out very clearly in our approach, or how we believe the response to the economic crisis in the eurozone should be established, that there are three things that are needed: one is the resolution of problems in Greece; one is the resolution of the problems of the banking system; and then a firewall. The ESM is a firewall, with €500 billion of funds there to act as a break and prevent contagion from spreading. It is a helpful way of trying to resolve the crisis in the eurozone, and one to which we do not have to contribute and one to which we will not contribute.

Q204 Chris Heaton-Harris: What I am after is whether this is an extension, albeit a small one, of economic co-ordination in the eurozone?

Mark Hoban: Clearly, in a way it is, because member states are contributing towards a bail-out fund, or a firewall. There is, in that sense, co-operation.

Q205 Chair: There are a whole series of statements—you are familiar with all of them, I know—made by various parties in relation to Article 136. There are speeches, there are statements; it was one of the issues that kept on coming up. We remember it very well from the time when the ESM was being discussed. You will understand our concern at this change. Can you explain why this change of position has occurred?

Mark Hoban: What has happened is a discussion of the ratification process. There was clearly originally intended to be a sequencing of events. You would have the Article 136 change, and then you would have the ESM coming into force. That change to Article 136 was seen by member states as a need to create
some legal certainty. However, as the crisis has developed, what we have seen is a recognition of a need to move from the existing bail-out fund to the ESM, and an appetite by those member states contributing to it to bring forward its establishment. The only way to do that is to bring forward the ratification of the ESM. Clearly, in the knowledge that Article 136 will be amended by treaty, there is a sense that that does create some legal certainty, but at the same time they wish to bring forward the creation of the ESM. It is in our interests for that to happen, given that it extinguishes our liability for future bail-outs through the existing mechanism.

**Chair:** I know the Government has taken as a matter of policy, of course, that it is in the interests of the EU as a whole to allow the UK in particular to engage in the bail-outs. Of course, the original EFSM was itself severely criticised by me, amongst many others, on the basis that it was not lawful in the first place, because it was using Article 122 for a purpose it did not appear to be designed for. You will understand that we have something of a concern that we are seeing some kind of repetition of this.

**Q206 Chris Heaton-Harris:** In one of the last paragraphs in your letter, you talk about the parliamentary process and timings on that. I wonder if you could be slightly more precise about the timetable for this House to have some sort of say, or approve of the action.

**Mark Hoban:** This is a Foreign Office matter, and I think the Minister for Europe has dealt with this before. It is a matter for the Foreign Office and the usual channels to bring forward the Bill.

**Q207 Kelvin Hopkins:** There has been surprising unanimity in the oral evidence we have taken from economic commentators about the improbability of the intergovernmental treaty doing much to resolve the eurozone crisis. The Minister for Europe, whom we saw last week, was somewhat sceptical about the immediate utility of the fiscal pact when he spoke to us. What is the Treasury view of the relevance of this treaty for the eurozone crisis?

**Mark Hoban:** There is clearly a range of interventions taking place to resolve issues in the eurozone; there are some short-term measures to tackle the immediate crisis—the Greek bail-out, reform and strengthening of the banking system, and creation of the firewall. Given that we would agree that an effective monetary union should be underpinned by closer fiscal integration, clearly the intergovernmental treaty has a role to play in tightening that fiscal co-ordination. It is a necessary step, but I do not think it is sufficient to resolve the situation. There are broader economic issues that need to be tackled within Europe to put the European economies on a much more stable footing, as well as putting their fiscal position on a long-term footing. What we are seeing is a process where you are looking at issues just beyond the narrow scope of fiscal matters, where eurozone states are looking much more carefully at some of their own balances, for example, and some of the issues that affect the stability of their economy, and tackling those. This is an important part, but, in itself, it is not enough.

**Q208 Kelvin Hopkins:** My thoughts are that even the second bail-out is an exercise in buying time for Greece, but that this will not, in the end, solve the crisis, but you may comment on that. You mentioned the term firewall, as the Minister for Europe did last week, and it occurs to me that the firewall might be drawn between Greece and other countries that have difficulties to stop the contagion spreading, or is this firewall genuinely intended to include Greece, and to protect Greece for the long term?

**Mark Hoban:** Some of the funding that will go to Greece comes from existing EU facilities, and in the long term will be replaced by the ESM, or supplemented by the ESM. It serves two purposes: one is to meet the needs of the eurozone member states in trouble, but also to provide reassurance to markets that there is sufficient capacity there to withstand problems in other European member states. It is there to provide some stability to the eurozone.

**Q209 Kelvin Hopkins:** So you reject my scepticism, and that of other Members of the Committee and commentators who have been to see us, about what is happening at the moment?

**Mark Hoban:** There has been a package agreed with Greece, if that is what you are referring to, of structural reforms and fiscal constraint, and the forecast indicates that debt sustainability will achieve an appropriate level in the medium to long term and a view that the package should work. In fact, it is in Europe’s interests for it to work, because we have seen what has happened over recent months, where continuing instability in the eurozone does have a chilling effect on economies not just in the eurozone but outside too. I am not limiting my remarks in that context particularly to the UK; when I meet international counterparts, the impact of the eurozone on the wider global economy is a factor that is mentioned often.

**Q210 Kelvin Hopkins:** I will not ask you to comment, but there has been a suggestion this week that youth unemployment rising to over 50% in Spain is increasingly likely to cause social unrest there, but that is another problem. Similarly, our witnesses held that, because of the difficulty of measuring observance of the criteria, the treaty was likely to be no easier to enforce than the Stability and Growth Pact. What is your view on that?

**Mark Hoban:** It cropped up at the meeting of ECOFIN I attended yesterday on behalf of the Chancellor. People understand the lesson that should be drawn from what has happened in the past. There is an appetite to put the eurozone’s public finances on a much more stable footing. That does require much greater surveillance, much greater scrutiny, not just of the fiscal position but also broader macro-economic indicators, and there is an appetite to do so. That struck me very strongly yesterday. I think member states in the eurozone recognise that, if they do not stick to this, there will be a price to pay in markets.
Q211 Kelvin Hopkins: There has been concern this week, certainly from me, that Hungary has been punished for fiscal laxity, if one likes, with fines, and they are not even a member of the eurozone. The Stability and Growth Pact is being applied to states outside the eurozone. Is this not something of great concern, given that we are outside the eurozone ourselves?

Mark Hoban: It does not apply to the UK, by virtue of the opt-outs we secured under the Maastricht Treaty, but it does apply to other member states, and the action taken against Hungary yesterday demonstrates a commitment to taking action. What is important is that member states are able to, and should take action to, tackle their structural deficit. Hungary has committed to bring forward measures to do so. The sanction that is in place is a suspension of its cohesion funds, rather than a fine in terms of taking money away from Hungary.

Q212 Kelvin Hopkins: It comes to the same thing in the end, though, doesn’t it?

Mark Hoban: If the Hungarians deliver, the suspension will be lifted. One of the positive outcomes from yesterday is a deadline by which the suspension will be reviewed, of 22 June, whereas before it was a rather open-ended process. Certainly the Hungarian Finance Minister was yesterday very positive about the actions they would take to tackle their structural problems. It was very clear from Commissioner Rehn that there are a number of other member states in the excessive deficit procedure who could be subject to sanction, both inside and outside the eurozone, if they have not resolved their problems by the time of the spring forecast. We will see a gathering momentum on this, and a recognition that Europe and those eurozone member states, and those subject to the sanctions regime, do need to get their house in order.

Q213 Michael Connarty: The Government’s position is that it reserved its position on three items: Article 3(2), Article 7, and Article 8. When pressed on it in evidence last week, the Minister concluded that the problem was that it was going to use the European Court of Justice as the court that would judge on the budgets of Governments, and that is why we reserved our positions. A court cannot really judge a question on a budget—you must continue to budget, unlike a criminal act; you can rule against someone committing a criminal act, or breaching a civil law, you cannot really rule on budgets. Apart from the very serious matter of committing a criminal act, or breaching a civil law, I do not think there is a question of the legality of the pact, whether it was not better to challenge it now, because of the legal maxim that he who is silent is seen to consent. Mr Lidington replied, “I take that point seriously,” which I was rather encouraged by. I wonder if this is a concern of yours—that by doing nothing, it may be that the status quo is inadvertently enhanced.

Mark Hoban: We have reserved our position on the use of European institutions in this process, so we will watch and see what happens.

Q214 Michael Connarty: Which part of the Government is right: the Treasury or the Foreign Office?

Mark Hoban: We share the same view.

Q216 Chair: Wearing the hat of the Treasury in this context, you will be conscious of the danger of delay in taking appropriate action, either in the Court or politically. That can boil down to whether or not the Court, if it got to the Court, might then at that stage say, “Well, you did not do anything about it when you had the opportunity to do so, and therefore you have not mitigated your concern”: that is one aspect. The other is crying wolf in saying that you have got reservations about the legality of something, which, to say the least, is pretty serious territory in the context of the European treaties, and the breaking of the rule of European law is not something to be done at all, let alone lightly. I would like to get it on record, from you as a Treasury Minister. We have heard from Mr Lidington—you have obviously read the transcript—and we have heard from the Prime Minister. Now I would like to just get it on the record from you: do you believe that this is a lawful exercise, this treaty, of the use of the mechanism that is being employed?

Mark Hoban: As I say, we have our reservations, and we have made that very clear, as the Minister for Europe did in his evidence before you.

Chair: Kelvin, have you got another question to ask? Jacob, you ask the next one.

Q217 Jacob Rees-Mogg: Can I continue with one final question on the treaty to see if you take, Minister, the same position, as I am sure you do, as the Minister for Europe? I asked him last week, on the question of the legality of the pact, whether it was not better to challenge it now, because of the legal maxim that he who is silent is seen to consent. Mr Lidington replied, “I take that point seriously,” which I was rather encouraged by. I wonder if this is a concern of yours—that by doing nothing, it may be that the status of the treaty is inadvertently enhanced.

Mark Hoban: We do take those matters seriously, which is why we have been very clear in stating our reservations about it.

Q218 Jacob Rees-Mogg: Thank you. Now on to the more substantial question: I think you said that the pact was necessary but not enough. I wonder if you
feel if it has failed its first test by allowing Spain to break though the limits that have been set and allowing it a higher budget deficit level at its first test. If you do think that it has not done very well at its first test, what do you think might be able to shore up the euro in its place?

Mark Hoban: The issue with Spain is slightly more complex than you suggest; the requirement for them to meet their Maastricht criteria is 2013, not 2012, so I would say that the glide path has been slightly softened but the runway has remained unchanged.

Q219 Jacob Rees-Mogg: To follow on: what do you think they need to do as the next steps to make a compact, treaty, or pact that would have more effect in supporting the member states in difficulties and shoring up the future of the euro?

Mark Hoban: Clearly there is a sanctions regime in place for breaches, but where the debate is heading to is much greater engagement and surveillance of individual member states’ economies and their fiscal position, and much greater engagement by the Council and the Commission. There is a much more intrusive regime in place, both in terms of monitoring and sanctions, than has been the case in the past. One of the comments that was made yesterday was that the most recent European Council was one, for the first time in 18 months, that focused on getting Europe moving again. There has been a lot of focus on the fiscal crisis, and what we need to do is see more emphasis on competitiveness, on growth, because we cannot solve these problems simply by tackling austerity, although tackling austerity is important. There is more that can be done at the European level.

I thought it was noteworthy that, in advance of the March Council, the Prime Minister, along with 11 other heads of state and government, signed a letter to Herman Van Rompuy setting out some positive agenda for growth. There were two aspects of that I thought were noteworthy: it included both the ins and the outs, but also included Spain and Italy among the signatories. That is a recognition across Europe of a need to drive economic growth and trying to look at some of the barriers to growth across Europe.

Q220 Michael Connarty: I love to hear a Government Minister speak about growth; I wish he could convince his Government to get some, instead of focusing on austerity all the time, which he seems to be critical of in the European context but not able to do anything about in the UK context. Moving back to the topic before us, the overall views of the witnesses implied that the eurozone could only survive through some form of closer fiscal and political union. This view seemed to echo earlier comments by Government Ministers, but the Minister for Europe was reluctant last week in his evidence to say so categorically. Does the Treasury believe that the eurozone does need closer fiscal and political union than it has at the moment?

Mark Hoban: We have said that there should be closer fiscal union, closer fiscal integration; that has been a position that we have been very clear about for some time now. The compact is a sign that the eurozone accepts that; they are moving closer in that direction. We still see the EU as being made up of 27 nation states, and the fiscal union is part of that, but I do not think that should equate with political union.

Q221 Michael Connarty: Politics is the use of power; if the power does not lie behind this fiscal union, is it any more than, as we have said, a set of urgings and target settings, because it would appear the evidence in Spain’s case is that maybe those targets do not mean anything unless you put political power behind it?

Mark Hoban: It is for your member states to exercise that political power. You can have a fiscal framework within which people operate, but the decisions about what sort of structural reform should take place, what sort of changes should take place to the tax system to encourage growth—we have taken measures in this country to encourage growth through tax reforms—and where your priorities lie in spending, and future spending commitments—we have chosen to invest quite heavily in increasing the number of apprenticeships—are political decisions that individual member states take, whether you are inside or outside of the eurozone. Members of the eurozone have signed up to a fiscal compact; that does not limit their ability to make decisions within those constraints that affect the direction of travel of their economies.

Q222 Michael Connarty: It looks like what happens is that a country has to get to the point where they are hanging over the precipice, and only being bailed out, as Greece has been, makes them do the things that are required to safeguard their economy in the long run, as well as the eurozone of which they are part. That does not seem to me like a formula for steady progress; it seems to be one where countries may all have to, one after the other, get to the precipice, fall over, and be hauled back, by bail-outs by the eurozone. That is hardly a prospect that is attractive to anyone in or outside the eurozone. Surely a consistent agreement on a political basis—we are outside, but those who are in and those who sign up to this compact must be more than just targets and urgings, and only being forced to do something when, in fact, they are about to cause a major crisis of default.

Mark Hoban: That would be a criticism that could be justifiably levelled at the European Union, and particularly the eurozone, if they had not done anything in response to the eurozone crisis other than simply bail out Greece. The fact that you have seen enhancements in economic governance and you have got the intergovernmental treaty means they are trying to learn some of the lessons by having sanctions in place at an earlier stage and having much greater surveillance of countries threatened with financial problems. Rather than simply waiting until the edge of the precipice, action is taken before they get to the precipice, and we then try to stop them from hurtling over the precipice.

There is a much more pre-emptive regime in place, and eurozone member states have learnt some hard lessons as a consequence of the failure to tackle some of these fiscal issues in the past, and they know that they need to demonstrate they are prepared to tackle
them now if they are going to maintain market credibility.

Mark Hoban: It is quite interesting; we were talking about the financial transaction tax yesterday, and it was very clear from the debate that, whether you were inside or outside the eurozone, a great deal of store was set by member states in having national sovereignty over taxes. That was a very clear message from a variety of member states. I do not think fiscal integration needs to mean taxes.

Q226 Kelvin Hopkins: May I take you up Minister on what you said a minute or two ago—that no country would benefit from the destruction or dismantling of the euro? Surely, if countries were allowed to develop a parity appropriate to their own currency, their own economy, and interest rates appropriate to their own economic performance, many of them could devalue and then reflate their economies behind that devaluation, and many countries would find the brakes suddenly taken off their economies simply because they are outside the euro. I personally would urge them to seek to withdraw from the euro and have the freedoms that we have to choose our own parity and our own interest rates.

Mark Hoban: Mr Hopkins, I think we were right to maintain those freedoms. I think it is a bigger challenge for those who are in the eurozone; there are quite significant economic and financial risks they would face from leaving, let alone the spillover effect on other eurozone member states. I am not as convinced as you are that the future would be rosy.

Q227 Kelvin Hopkins: Well, it is right for Britain, but not for Greece.

Mark Hoban: We are where we are.

Q228 Henry Smith: Minister, would you recognise that, if the very different economic situation in the so-called core northern member states was allowed to develop differently from the peripheral member states, it would be good for growth in both those so-called core northern states as well as the peripheral member states?

Mark Hoban: I think that across Europe there needs to be a focus on growth and productivity and competitiveness, and there are actions that individual member states should take and actions that Europe should take. I do believe that it is possible for all member states to engage in some structural reforms that will gradually lead to greater commonality in individual countries’ economies. It is a challenge to get there, and it is something that does need to be taken very seriously across Europe. I thought the March Council demonstrated it was beginning to happen.

Q229 Julie Elliott: Minister, getting back to closer fiscal and political union: how likely is it that eurozone member states, and prospective eurozone member states, would and could move towards this prospect sufficiently quickly to contribute to a more solid resolution of the eurozone crisis?

Mark Hoban: Clearly the intergovernmental treaty is a sign of commitment to closer fiscal integration, and while I expect we would all wish they got there faster
than they had, it is a good sign. What is important is that member states look quite carefully at some of their imbalances; we have got an excessive imbalance procedure now that looks at a dashboard of measures to look at some of the challenges in countries’ economies. Focusing on those imbalances will be helpful in moving economic growth forward, and trying to understand where individual countries have weaknesses and where they need to make progress. Whether it is people running a net trade deficit or running a persistent trade surplus, or whether it is level of private debt or public sector debt, there are measures people should be looking at to look at the imbalances in their economy and tackling those. That is nothing new: it is something that the IMF and the OECD do on a regular basis, but there is a particular focus now in the EU in doing that and trying to remove some of the differences that Mr Smith referred to.

Q230 Chair: Clearly there has been a bail-out deal agreed for Greece, but have you heard any suggestions that some pressure is being exerted on the statistical department of the Greek Government? I imagine that it is some form of ONS or equivalent. Have you come across any reference to the fact that there are pressures being brought to bear to produce results statistically that are also leading to disagreements within the framework of the Greek economy: the Greek Government; the Greek ONS officials, the equivalents; or their statisticians?

Mark Hoban: Not that I am aware of. I do not know whether Peter has.

Peter Curwen: I do not have anything particularly in reference to that. Of course, the Greek statistics were part of a problem that was identified.

Q231 Chair: There are rumours around, so I hear, that there are some suggestions of pressures being brought to bear to deal with some inconsistencies in some of the figures that have been put forward by different people in the framework of the Greek economy.

Peter Curwen: You could make the case that Eurostat should have been more diligent on Greek statistics earlier, but they are now completely on top of what is going on in Greece. The Greek statistical institution that you referred to, the equivalent of the ONS, is monitored regularly, and the independence of Greek statistics is now central to what Eurostat is looking at.

Q232 Chair: That is precisely why I asked the question, because if there was any suggestion of undue pressure being brought to bear to produce statistics that were not consistent with the Eurostat requirements, that would be something that obviously we would be wanting to look at as a Government as well. I assume.

Peter Curwen: Yes. Eurostat reports regularly to the Economic and Finance Committee of the European Union, on which I sit, and that feeds in reports to the Finance Ministers’ Meeting of ECOFIN on Greek statistics—indeed, on all statistics. I am not aware of the particular concerns you refer to.

Q233 Chair: Could you look into it? I was given some information a few days ago that suggested there were some difficulties around, but you are probably in a better position than we will be to find that out. Maybe the Minister could write to me about it.

Mark Hoban: Perhaps, Mr Cash, you could write to me with the information, suitably anonymised, and then we will pursue it.

Q234 Chair: I cannot give you a specific; I have said it was a rumour.

Mark Hoban: Right.

Chair: I said it was information that was provided to me, but it appeared to be from quite a good source.

Q235 Chris Heaton-Harris: Minster, if closer integration of the eurozone were in prospect, what would be the implications, even dangers, for member states outside the eurozone?

Mark Hoban: This goes back to the debate that took place at the December Council: that there is closer fiscal integration among a group of member states, those matters should be best dealt with by all 27 member states. Obviously competitiveness, productivity and the single market are part of that. That is the risk, as it were, but that is why the Prime Minister vetoed the treaty in December.

Q236 Chris Heaton-Harris: Does the Treasury have any worries about the potential for caucusing of votes at Council meetings in the future?

Mark Hoban: What I would say is reflected in a way in the letter from the 12 heads of state and government sent prior to the March ECOFIN, where you have member states from north and south, large member states and smaller member states, and states from Eastern Europe and Western Europe. They were brought together by a shared view about the way Europe’s economy should develop. I certainly found, both prior to the December Council and subsequently, that where member states share a similar economic philosophy, they want to co-operate and work together. Those member states that are trading nations, that are outward looking, that prefer liberal, open markets, do work together, whether inside or outside the eurozone.

Q237 Chris Heaton-Harris: That is the case now, but in this future Treasury world where we have fiscal integration, surely there are going to be some areas where you have 17 countries that have exactly the same idea as to in which direction they would like to go, and the voting weights in the next four years will change rather dramatically, and not necessarily in the favour of those outside the eurozone.

Mark Hoban: I think that the philosophies that underpin the governments and cultures in those 17 member states do vary, and you see it now; just because someone is in the euro does not mean they have to share the same view on CRD4, which we happened to be discussing this morning. There are differences of views, and I do not feel that that is likely to change; sometimes we are talking about quite deep-seated attitudes towards business and the economy.
Q238 Chair: Is there any formal or informal analysis within the Treasury about whether or not closer integration of the eurozone is in the interests of the UK, and could we have sight of it?  
Mark Hoban: The Chancellor has been clear that we think that closer fiscal integration is helpful for the eurozone, and has a beneficial impact on the UK economy. One just needs to look at the OBR forecasts last November, where, in providing explanations for its revision to the economic growth forecast, they cited three reasons: firstly, the size of the boom and subsequent bust; secondly, inflation driven by high commodity prices; and thirdly, the impact of events in the eurozone.

If we are able to have fiscal stability in the eurozone, that is to the benefit of the UK economy in the OBR’s forecasts. You can demonstrate that if you look at the forecasts from a number of business organisations; they highlighted that the downside risk comes from events in the eurozone, so clearly stability would be to the benefit of the UK economy.

Q239 Kelvin Hopkins: We now have a situation of severe austerity being inflicted on some countries and low growth; there is a kind of stability of the graveyard, which we could have to deal with if the economies collapse. Stability of itself is not necessarily a good thing. What we want is growth, and a rising level of demand for our exports. Surely releasing some countries from the vice of the eurozone, and allowing them to reflate their economies, would be much more beneficial for Britain than what is happening now.

Mark Hoban: There needs to be a twin-track approach. Those countries with fiscal problems need to tackle them, but all countries across the eurozone and across the European Union should identify pro-growth policies. Those do not need to be policies that involve the spending of more taxpayers’ money. It could be regulatory reforms; planning reforms; changing labour market laws; reprioritising spending on more productive areas of the economy; or tax reforms that favour enterprise.

There are a lot of measures out there you can do in a fiscally neutral way that promote growth, and if at this time the rules were relaxed I think there would be quite a negative market reaction. Look at the market rates of those countries that are not seen to have got ahead of the curve and tackled their financial problems; you see what would happen as a consequence of that type of policy.

Q240 Kelvin Hopkins: If you do not have fiscal reflation, you could have monetary reflation, but that means the ability to depreciate your currency and reduce your own interest rates, and they cannot do it.

Mark Hoban: The ECB is responsible for economic policy and monetary policy across Europe, and there are other means, not just around interest rates. We saw, both before Christmas and the end of last month, the ECB use its long-term repo operation to pump €1 trillion into bank balance sheets. You cannot underestimate the impact that has had in reducing stress on the eurozone banking system and providing a bit of stability. I do not think they are, to use the words of a former Chancellor, necessarily just a one-club golfer.

Q241 Kelvin Hopkins: I understand that some of these banks are taking the money from the ECB and then depositing, for safety, all their deposits back in the European Central Bank to protect their balances.

Mark Hoban: What they have been able to do, Mr Hopkins, is, through the LTRO, pre-fund some of their funding needs for 2012. In the absence of the LTRO, we would see continuing pressure on bank funding markets, and that would lead to a squeeze on lending to the rest of the economy. The steps that the ECB have taken to provide liquidity have been hugely helpful.

Q242 Henry Smith: You were speaking a few moments ago, Minister, about other ways to stimulate growth across member states, such as deregulation. Do you really see any evidence of a co-ordinated effort across member states to engage in deregulation? Obviously there will be some shining examples from some states, but perhaps others are less willing to reform in such as way.

Mark Hoban: Each member state will take their own actions, but one thing that we were keen to do through the letter that the Prime Minister signed along with 11 other heads of state and government was to get the EU itself to focus on barriers it puts in place to growth, and think about some of the regulatory challenges—think about the ways in which we can either kick-start the Doha trade round or sign bilateral free-trade agreements with other countries to free up world trade. If you talk to politicians from Spain and Italy, they will talk about some of the structural reforms that are happening there: labour market reform in Spain and the liberalisation of professions in Italy. They are big changes, but we need to ensure that not only member states do what they think is right but the European Union does what it thinks is right too.

Q243 Henry Smith: How optimistic are you that the institution, if I can put it like that, of the European Union is serious about reform in such a way? The Prime Minister is absolutely right, of course, but it is one thing to articulate that and it is another thing for the institution of the European Union to take that on board.

Mark Hoban: That is a fair comment. It does require a mind shift by the Commission. I saw Commissioner Barnier last week; he was talking about a second Single European Act to try to look at trade liberalisation. There is work going on in the European Commission at the moment thinking about the economic cost that comes from regulation, and what can be done to reverse that. I think there are some positive signs there. In the same way that member states look to the European Union to tackle its budget, because they are suffering from austerity at home, they are also looking to the Commission to find ways in which they can reduce the burden of red tape on businesses as they are doing in their own domestic economies too.
Q244 Chair: You have given us a fairly optimistic or, at any rate, a positive view of the impact of closer integration, and freedom of business practices and approaches to free trade, and things like that, that divide them. I do not necessarily see a bloc like that.

Mark Hoban: Does that include the danger of any one country, Germany in particular, being predominant in the eurozone? As they move further towards fiscal union, which is quite clearly the intention of Angela Merkel and others, the consequence would be, because of the dependence of some of the countries within the eurozone on Germany as well—in terms of export, import, and so forth, and politically—that this would create something much more in the nature of a German-driven economy in Europe as a whole. That would present a danger to other member states outside the eurozone, and perhaps the UK in particular. Our trade imbalance with Germany is notoriously huge, and I wonder whether you see that exacerbated.

Mark Hoban: One of the challenges for the eurozone is to look at a whole series of economic imbalances and try to tackle those, and that applies to deficit as well as surplus countries. There is a range of member states with strong voices in the eurozone. You have a number of larger countries, and you have blocs of smaller countries that co-operate well together. It would be wrong to present it as a monolithic organisation with a single view. From my own contacts with opposite numbers in member states inside the eurozone, that is clearly not their view.

Q245 Chair: Do you have any sense that there is a danger of any one country, Germany in particular, being predominant in the eurozone? As they move further towards fiscal union, which is quite clearly the intention of Angela Merkel and others, the consequence would be, because of the dependence of some of the countries within the eurozone on Germany as well—in terms of export, import, and so forth, and politically—that this would create something much more in the nature of a German-driven economy in Europe as a whole. That would present a danger to other member states outside the eurozone, and perhaps the UK in particular. Our trade imbalance with Germany is notoriously huge, and I wonder whether you see that exacerbated.

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On the issue of enhanced co-operation, this is covered in some detail in the treaty on the function of the European Union. Enhanced co-operation should be open to all member states, not just a particular pre-defined bloc. Of course, it cannot be used in a way that undermines the internal market, or economic, social, or territorial cohesion. Even within enhanced co-operation there are some constraints, even if a group of member states wanted to pursue that route.

Q249 Chris Kelly: Further to Mr Heaton-Harris’ follow-up question earlier, what about taxation?

Mark Hoban: Member states could use enhanced co-operation to deal with tax issues. I go back to the example of the FTT, which is famously mooted to be the answer to many of the world’s woes. It may be that a group of member states would want to use enhanced co-operation, but there are safeguards around that, and they have to get the permission of others to use that method.

Q250 Chris Kelly: Presumably we would not give such permission?

Mark Hoban: No one has approached us yet. Based on the questions at yesterday’s ECOFIN, which have been well documented in today’s Financial Times amongst others, it is hard to see quite where the European Union was going to go on the FTT.

Q251 Nia Griffith: Could I ask you a couple of questions, Minister, about the veto? First of all, please accept my apologies for not having been here at the beginning. What do you think the UK achieved overall by exercising its veto?

Mark Hoban: I think there was a risk that this would become a treaty of the European Union, where there was a risk that measures would be introduced into the way in which the European Union works that would affect the single market or competition issues. By exercising the veto, this treaty has been reached outside the European Union treaties.

Q252 Nia Griffith: Do you think it has had any adverse effect on the way the UK is perceived or the way that the UK can participate in negotiations on other issues, such as financial services or the multiannual financial framework?

Mark Hoban: It is a curious sort of thing, and I deal with both of those issues. We have a very good relationship with a number of member states on the European budget, including Germany and France. Our cooperation has remained as strong since December as it was before December. We are seen as a group of fiscal disciplinarians in European Union terms on financial services. We had a significant success on the regulation on European Market Infrastructure, where in the final stages we were not the member state that was isolated; it was a member of the eurozone that was isolated.

Look at the pattern of contacts between governments post the December treaty. The German Foreign Minister was across here very quickly after the December Council meeting. The Prime Minister has met a number of his opposite numbers, including the Prime Minister of Spain. The Chancellor has engaged in meetings with his opposite numbers. I have done a series of bilateral visits to member states. The example that demonstrates that we are not isolated is the letter of 12 that was signed prior to the March Council, where alongside the Prime Minister it was signed by the prime ministers of Italy, Spain, the Netherlands, Poland, and a range of member states. I do not think that our influence has been diminished as a consequence of the December meeting.

Q253 Nia Griffith: Do you see us then in some way, if you like, going along very much on the same track, but in a sort of parallel way?

Mark Hoban: In what way?

Q254 Nia Griffith: In the sense that in terms of a lot of what was put in place in order to make the eurozone more stable, if you like, we are complying with anyway in our own financial way. Does that make sense? As you say, we are being prudent, etc. We are travelling in the same direction.

Mark Hoban: The advantage we have is that we have the freedom not to. Obligations make best endeavours, and it has not always been the case the British Governments have sought to tackle their budget deficits.

Q255 Chair: To what extent do you think the eurozone’s preoccupation with this fiscal pact has detracted from attempts to address other policies that might lift member states out of the present economic difficulties?

Mark Hoban: I do not think we should underestimate the extent to which the fiscal crisis has dominated a number of European Council meetings, and led to more European Council meetings than would normally be the case. This is a big issue, and the impact it has had across Europe has been huge: I do not think we should underestimate it, and it was right to spend the time to do it. I do believe that there should be a twin-track approach; we should be tackling our fiscal problems, as we are here at home, and introducing growth measures, as we are here at home, but the European Union needs to focus on the growth agenda too.

One of the merits of the letter was to demonstrate that concerns we have are shared by a number of member states, and that is the direction in which the European Union should be going in the future. Certainly the conversation yesterday at ECOFIN was that we have spent, as a group of finance ministers, a lot of time talking about the financial crisis, but we need to do what we can to focus on growth at a European level, whether through specific initiatives, or through monitoring imbalances.

Q256 Chair: Growth is not an issue for the European Union in itself alone; it is also a question in relation to the individual domestic economies. The object of the exercise, one might imagine, would be to a member of the current European Union for the purposes of enhancing the national interest of the electors of this country as part of a process of increasing growth. Would that not be right?
Mark Hoban: I am fully signed up to that. I think we should be pursuing pro-growth measures within the European Union as well as at home. In areas such as trade the EU can lead, and can not only open up its own markets to trade from overseas but can work to open up overseas markets. That is a very constructive way in which the European Union can complement measures being taken nationally to promote growth.

Q257 Chair: Has the Treasury studied the question of the current account transactions as between the UK and the other 26 member states and, indeed, the interaction of the current account transactions, goods, and services between the member states themselves, and drawn any conclusions from that?
Mark Hoban: By and large we see our country’s future as being intimately bound up with economic growth, not just in the eurozone but elsewhere, because we are, by our nature, a trading nation. We have always thrived by being able to export: identifying what areas we are good at and how we exploit those international markets. I spoke at the launch of Mexico Week this week, and only 1% of our exports go to Mexico. That is one of the fastest growing economies, and we should be capitalising on that, and I think that we can. I think that there are huge volumes of trade out there, Mr Cash, that we should be capitalising on. I am sure you have heard me say this before, but perhaps I will repeat myself just this once: last year we exported more to Ireland than we did to Brazil, Russia, India, and China combined. That is not a healthy situation to be in, and we can do more.

Q258 Chair: Understood, but, at the same time, there are statistics from the ONS that demonstrate—to go back to my earlier question about the transactions on goods and services, import-export—that in 2009 our deficit with the other 26 member states was minus €14 billion, but by the end of 2010 it had gone up to minus €51 billion. That does not demonstrate an enormous amount of confidence in our ability to be able to use the European Union as a means of enhancing growth for the UK, because the trade deficit appears to be so absolutely vast. Is that improving, and are you going to be looking at that in the context of this treaty and also the impact that the fiscal union within the eurozone would have on this situation as regards the UK?
Mark Hoban: I do not think the fiscal compact will prevent us from exporting; it does not have an impact on the internal market. What I do think is this: economic stability within the eurozone would be hugely helpful, as it is one of our largest export markets. There is clearly more that we should be doing to promote exporting to not just the EU but elsewhere. I am hosting an event in my constituency next month to encourage SMEs to export more, not just in Europe but around the world. There is more we can do and should do, but I am not a defeatist Mr Cash. I think you said earlier I was optimistic; I am optimistic, and I do think we can raise our game and do more. One thing that Europe should be very cautious about is doing anything that would close the shutters around Europe.

Q259 Chair: You do appreciate that the imbalance, on the figures that the ONS have come up with, does suggest that within one year we went from minus €14 billion to minus €51 billion, and that does not bode very well if that were to be a continuing position.
Mark Hoban: I would look at it as we should be able to reverse the position; we should be able to go back to that lower deficit in 2010.

Q260 Chair: Well, I am very glad that Mr Curwen was able to give you some good advice on that point. I too am an optimist, but I also believe that trading, as you rightly suggested, elsewhere in the world is also highly advantageous, because of the enormous development potential. Mr Kelly would like to ask a final question.

Q261 Chris Kelly: Not so much a question, Mr Chairman, but I am pleased to hear that the Minister is involved in Mexico Week. He will be interested to learn that I took our right hon. Friend the Chancellor of the Exchequer to Bri-Mac Engineering in Dudley South in my constituency, which is an engineering business that exports high-quality bearing products to Mexico, a country with much lower labour costs than our own.
Mark Hoban: That is a perfect demonstration, Mr Cash, of why we should be optimistic, because it does demonstrate we can succeed in overseas markets. I do not see that our economic future is limited simply to the boundaries of Europe; we should be exporting to Europe and beyond to places like Mexico.
Chair: On that very encouraging note, I will bring the proceedings to a conclusion. Thank you.
Written evidence

Written evidence submitted by Simon Hix, Professor of European and Comparative Politics, London School of Economics and Political Science

1. It is difficult to assess the intergovernmental agreement on 9 December on economic governance of the Eurozone before the concrete details of the proposed “fiscal compact” have been defined and adopted. As a result, I restrict my evidence to the key elements of the agreement, as set out in the Statement by the Eurozone Heads of State or Government on 9 December, which I see as:

- a set of rules governing national budgetary discipline, which include the fact that government budgets must be balanced or in surplus, that an annual structural deficit may not exceed 0.5% of nominal GDP, and that a national legal or constitutional automatic correction mechanism must be introduced in every member state;

- a set of procedures for monitoring and enforcing of budgetary discipline, which include ex-ante reporting by member states on national debt issuance plans, and an automatic sanction mechanism if a Eurozone member state’s deficit exceeds 3% of GDP (unless a qualified majority of Euro area member states is opposed);

- stronger fiscal stabilisation tools, via a larger European Financial Stability Facility (EFSF) and a launch of a permanent, and treaty based, European Stability Mechanism (ESM) in July 2012, and closer coordination between EFSF/ESM lending and IMF lending to Eurozone states;

- an agreement not to make the European Central Bank the “lender of last resort”, but instead to allow the ECB to indirectly lend to governments, via loans to private banks to purchase government bonds; and

- an agreement not to introduce Eurozone bonds, such as the plan proposed by Commission President Barroso on 22 November 2011.

2. Also, I am a political scientist, not an economist or a legal scholar, and so my evidence focuses on what I believe are the two main political weaknesses of the package: (i) the lack of credibility of the enforcement mechanism, and (ii) the lack of democratic legitimacy of decisions which will have redistributive consequences. I leave the questions of whether the proposed plan will save the Euro or usher in a decade of deflation to academic economists, and the issue of the relationship between the intergovernmental agreement amongst the 26 and the EU treaties to academic lawyers.

Lack of Credibility of Enforcement Mechanisms

3. The first problem, as I see it, is that the national budgetary discipline rules lack political credibility. If the intergovernmental agreement is ratified, and if national constitutions or basic legal provisions could be amended to introduce balanced-budget provisions (and these are big “ifs”), I am not convinced that national electorates, governments, and spending ministries will abide by these rules. The expectation that annual structural deficits may not exceed 0.5% of nominal GDP is particularly questionable. 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.

4. Furthermore, even if a national court did strike down a budget as breaching a balanced-budget rule, it is not clear that this would have the desired aim. Budgets are different from individual pieces of legislation, which simply fail to enter into force if they are rejected by a court under judicial review. In contrast, if a court rejects a national budget on the grounds that it would breach a balanced-budget rule, presumably the previous year’s budget would continue until a new budget is adopted. And, given changes in economic circumstances, spending entitlements and tax revenues, the previous budget could well lead to a deficit of greater than 0.5% of GDP anyway.

5. A similar criticism can be levied at the proposed sanctioning mechanism if a Eurozone state’s budget exceeds 3% of GDP. For a start, for a fine to have force it would need to be substantial, such as a particular percentage of a state’s national budget. However, a substantial fine against a government which is running a deficit would be pro-cyclical, and lead to higher deficits in subsequent years.

6. In addition, the provision that a fine would be automatic unless a qualified-majority of Eurozone states vote against a proposal from the Commission means that a fine would not be automatic after all. Given the way the existing Excessive Deficit Procedure has been applied so far, and given the budgetary pressures on all the Eurozone states, I would expect a qualified-majority of states to vote not to levy a fine; and particularly if the first member state to breach the rule is one of the larger member states (who have most political weight and most numerical voting power under qualified majority voting). Then, once a fine has not been applied to one member state, the bond markets will expect the mechanism to never be applied.

Lack of Legitimacy of Decisions with Redistributive Consequences

7. An even greater concern, in my view, is the lack of political legitimacy of the whole “fiscal compact” package as it is currently designed. In a democratic society, any decision which has major redistributive
consequences requires significant political legitimacy for the decision to be accepted by the net losers of the outcome (what political scientists call “losers’ consent”). The problem for the Eurozone is that the proposed plan would have major redistributinal consequences, both within states and between states. On one side, the restrictions on national budgets will have redistributional consequences domestically, such as cuts in national spending plans and/or higher taxes. On the other side, the bailout provisions in the EFSF and ESM as well as the sheer amount of money involved in these funds, will lead to a significant redistribution of revenues from some states (such as Germany, the Netherlands, and Finland) to other states (such as Greece, Portugal, and Ireland), at least in the short term (until the loans are repaid).

8. As long as European integration was primarily a market regulation project—involving the creation and regulation of the continental scale single market—the question of weak political legitimacy of the project could be avoided, on the grounds that creating and regulating a market only has minor direct redistributional consequences. I have questioned this claim in much of my research and writing over the last 15 years, on the grounds that the redistributional consequences of the single market have often been underestimated. Nevertheless, no-one can doubt that the proposed fiscal compact would be a step-change for the EU in this regard, in that decisions at the European level will now have direct consequences on national taxing and spending policies, and the distribution of wealth between different groups in society and between member states. This consequently raises the issue of the lack of legitimacy of European integration to a new level.

8. As the agreement is currently designed, neither the new constraints on national budgets (via the balanced-budget rules, European level oversight, and European sanctioned fines) nor the rules governing the transfer of resources between member states would be accepted as legitimate by citizens and national parliaments in the member states involved.

9. Specifically, the EU Commission would have a role of oversight of national budgets and have the responsibility of proposing the imposition of fines. However, the Commission is only indirectly appointed, by the European Council and the European Parliament. Despite the new Commission appointment procedure in the Treaty of Lisbon (whereby the European Council must take account of European Parliament elections when nominating a candidate for Commission President), the appointment of the Commission President is currently more akin to choosing a Pope than electing a head of a political executive! Hence, the Commission does not have a sufficiently democratic mandate to pass judgement on national budgetary discipline.

10. Eurozone Finance Ministers will be responsible for making all key economic governance decisions under the proposed fiscal compact. Eurozone Finance Ministers are more democratically legitimate than the Commission, since they are members of national governments who have won national parliamentary elections. However, while each minister might be accountable to his or her own member state this does not make him or her either individually or collectively legitimate for the EU as a whole. Put another way, 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% budget deficit rule)?

11. EU legislation governing the single market must pass through the European Parliament as well as a qualified-majority in the EU Council. European Parliament elections are far from perfect, and the European Parliament is not as legitimate as most national parliaments. Nevertheless, Members of the European Parliament are independent from the Commission and national governments. As a result, EU legislation is on average more moderate and better because the European Parliament is an effective check on the other two institutions (as was seen in the passage of the so-called “six pack” of economic governance legislation through the European Parliament in 2011). However, the European Parliament is currently absent in the proposed intergovernmental structures for a fiscal compact for the Eurozone. If the European Parliament was given an oversight role of the Commission and the Eurozone Finance Ministers, this would at least add one democratic check in the proposed structure.

12. Similar criticisms can be levied at the lack of political legitimacy in the procedures for approving the transfer of funds from national treasures to the EFSF or the ESM. The current plans do not specify in any detail how national approval would work. Presumably it would be up to each member state to introduce procedures that allow for effective national parliamentary and public scrutiny of transfer of national revenues into these funds. However, it would be better—from the point of view of collective transparency and legitimacy—if the European level agreement set out in more detail the procedures that should be followed for the approval of the transfer of national revenues to the EU level. Without an agreement on at least a set of minimum procedures, there is a danger that some national governments will try to side-step national parliamentary approval of their contributions to the EFSF and ESM.

A Possible Solution

13. In general, the intergovernmental agreement of 9 December 2011 to establish a fiscal compact, a harmonization of national fiscal and other macro-economic policies, and a larger European stability mechanism might be workable from an economic point of view (although I doubt it will address the underlying uncompetitiveness of several of the periphery economies). From a political point of view, however, I believe the plan is neither credible nor legitimate. As a result, I am sceptical that it is workable or sustainable.

14. What the Eurozone needs is a proper “fiscal union”, meaning an EU treasury with resources equivalent to at least 2% of Eurozone GDP (for example, as proposed by Professor Charles Goodhart and several other
prominent economists), the European Central Bank as the unconstrained lender of last resort, and the ability to issue Eurozone bonds (for example, following the Barroso plan). With these institutions in place, Eurozone citizens, national governments and the bond and currency markets would be recognise that the Eurozone has the weapons in place to meet any major exogenous economic shocks.

15. However, such a “fiscal union” in the Eurozone would have to be balanced by far greater political integration and democratic accountability. For example, a fiscal union plan would need to be ratified in all participating member states, preferably by referendums. In addition, the EU would need a more democratically legitimate political leadership structure, such as a directly-elected Commission President (as the CDU proposed in November 2011) or rival candidates for the Commission President before European Parliament elections.

4 January 2012

Written evidence from Professor Michael Dougan and Dr Michael Gordon, Liverpool Law School, University of Liverpool

1. The European Scrutiny Committee’s call for evidence focuses on how the resolution of the Eurozone crisis is developing and the possible consequences for the UK; with particular emphasis on how to reconcile the policies agreed on 9 December 2011 by the Eurozone Heads of State or Government with the legal and institutional constraints.

2. This submission considers two main sets of legal issues, raised by the proposed treaty designed to implement the abovementioned policies, which seem directly relevant to the Committee’s inquiry:

   (a) the relationship between the proposed treaty and the legal order created by the EU Treaties (the TEU and TFEU), ie examining the legal and institutional constraints facing the new treaty from the perspective of EU law; and

   (b) the relationship between the proposed treaty and the system of control over various decisions relating to the EU contained in the European Union Act 2011, ie examining the legal and institutional constraints facing the UK’s own engagement with the new treaty under domestic law.

3. For those purposes, it should be made clear at the outset of this submission that our observations are based on the following sets of documentation:

   — the Statement by the Euro Area Heads of State or Government of 9 December 2011 (hereinafter: the December deal);
   — the draft “International Agreement on a Reinforced Economic Union” circulated by the President of the European Council on 16 December 2011 (hereinafter: the First Draft);
   — the draft “International Treaty on a Reinforced Economic Union” released on 4 January 2011 (hereinafter: the Second Draft); and
   — the draft “Treaty on Stability, Coordination and Governance in the Economic and Monetary Union” released on 10 January 2011 (hereinafter: the Third Draft).

4. At the time of writing, it is anticipated that the terms of the new treaty may well be finalised by the relevant Heads of State or Government at a European Council meeting scheduled for 30 January 2012. Given the Committee’s deadline for the submission of written evidence, we base our comments primarily on the text of the First Draft, with appropriate reference to significant amendments contained in the Second and/or Third Drafts, fully conscious that the text will continue to change (perhaps extensively so) over the course of the remaining negotiations.

A. RELATIONSHIP BETWEEN THE PROPOSED TREATY AND THE LEGAL ORDER CREATED BY THE EU TREATIES

5. On the relationship between the proposed treaty and the EU legal order, two main sub-issues warrant discussion: first, how far the proposed treaty might interfere with the Union’s own institutions, competences or procedures in a way which could run counter to the obligations of the Contracting Parties under EU law; and secondly, how far the proposed treaty further contributes to the emergence of a “two speed Europe” centred around a Eurozone core, which not only is more highly integrated in terms of substantive policy commitments, but also tends to dominate the EU’s agenda-setting potential more generally.

1. **How far the proposed treaty might interfere with the Union’s own institutions, competences or procedures**

6. The preamble to the First Draft expresses the intention of the Contracting Parties to incorporate its provisions, as soon as possible, into the EU legal order. The Second Draft goes even further: it promises, within five years of the treaty’s entry into force, an initiative aimed at incorporating the agreement’s substance into the Union legal order. In the meantime, the draft treaty is envisaged as an agreement concluded under ordinary international law and formally separate from the EU Treaties.

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1. See Art 14(6) of the Second Draft. That provision is retained (with minor amendments) as Art 16 of the Third Draft.
7. Nevertheless, given the very close relationship between its subject matter and a core part of Union business, there is inevitably a significant degree of overlap between the terms of the draft treaty and the EU's own competences—not only the primary provisions of the TEU and TFEU,6 but also secondary legislation such as the “Six-Pack” on improving economic governance which was adopted in November 2011,7 as well as the “Euro Plus Pact” signed in March 2011.4 Given such a degree of overlap, there are legitimate concerns about the need to prevent unhelpful duplication: many of the measures on budgetary discipline and economic convergence envisaged by Titles III and IV of the First Draft (respectively) could, and therefore should, be achieved through the medium of the existing Treaties.5 Beyond that, there are also worries about the possibility of inconsistencies arising between the terms of the draft treaty and the current/future state of Union law itself: it would surely do more harm than good if certain commitments accepted by the Contracting Parties under the draft treaty were to contradict their binding obligations under the Treaties.6

8. No doubt in response to those worries, the First Draft was already at pains to stress its own subservience: Title II alone, for example, proclaimed that the agreement will be applied in conformity with EU law, shall only apply insofar as compatible with EU law, shall not encroach upon the EU's own competences, and shall give way to the precedence of EU law.7 Again, the Second Draft goes one step further: many of its amendments seek to align (or even define) the commitments set out in the draft treaty with (or by reference to) those imposed under the Union law;8 and more generally, to reinforce the message that this new treaty complements and builds upon, rather than bypasses or challenges, the EU Treaties.9 The same is true to an even greater degree of the Third Draft: it continues the trend which has so far emerged during the negotiations, of tying the proposed treaty as closely as possible to the relevant substantive and procedural provisions of Union law.10

9. Although the risk of duplication or inconsistency with the EU Treaties may thus have been legally neutered, one can still anticipate the persistence of nagging doubts about the lawfulness of the draft treaty from the perspective of the Union legal order. We will consider two principal examples.

10. First, some commentators might question the propriety of Article 7 of the First Draft, whereby the Contracting Parties essentially agree to pre-structure the exercise of their voting rights in the Council, when dealing with Commission proposals or recommendations in respect of Eurozone countries subject to the excessive deficit procedure, on the grounds that that provision seeks effectively to reverse the voting requirements set out in the Treaties themselves.11 But perhaps one should not be too quick to condemn the Member States simply for agreeing to coordinate the casting of their votes in the Council on a given issue, when the building of policy alliances and determination of voting positions is part and parcel of the ordinary life of Union decision-making, and is nowhere prohibited by the Treaties. It is also worth observing that the phenomenon of “reverse qualified majority voting” is already provided for under Union secondary law itself;12 indeed, it is a centrepiece of the “Six Pack” plan to facilitate more efficient and effective economic governance by the Union institutions.12

11. Secondly, objections were raised, at the time of the December deal itself, to the prospect of using the Union institutions for the purposes of a non-Union agreement without the involvement, or at least the explicit consent, of all 27 Member States. Again, however, there is little in the actual text of the draft treaty to contradict the integrity of the Union’s institutional framework as provided for under Article 13 TEU. Indeed, save for a few exceptional cases which we will discuss in greater detail in paras 12–22 below, the text has been carefully designed so as to involve the Union institutions only in procedures and actions they would already participate in and undertake pursuant to the EU Treaties. Consider, in particular, the provisions concerning the submission by Contracting Parties subject to an excessive deficit procedure of economic partnership programmes,13 and the ex ante reporting by Contracting Parties of their national debt issuance plans,14 to the Commission and the Council. For those purposes, it is clear that the Union institutions are not being co-opted into a novel procedure or exercising new powers to be created by the draft treaty, but will continue to act within the existing parameters laid down for them in the relevant provisions of the TEU and TFEU.15 It is worth noting that the

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2 Especially Arts 3(1), 121, 126 and 136 TFEU; as well as Protocol No 12 on the Excessive Deficit Procedure.
5 Indeed, it is arguable that only the balanced central government budget rule, and the presumption of support for proposals/recommendations against Eurozone states under Art 126 TFEU, go beyond what is already possible under the TEU and TFEU.
6 Concerns raised especially by the relatively precise obligations set out in Arts 3 and 4 of the First Draft.
7 Though note the deletion of the reference to the precedence of EU law under Art 2(2) of the Third Draft.
8 Consider, in particular, the amendments contained in the Second Draft to Art 3(1)(b); Art 3(1)(c); Art 3(2); Art 4; and Art 5(1).
9 Consider, in particular, the amendments contained in the Second Draft to Art 9 and Art 10.
10 Consider, in particular, the amendments contained in the Third Draft to its Art 3(1)(b); Art 3(1)(c); Art 3(1)(d); Art 3(2); Art 5(1); Art 6; and Art 9. Certain amendments to the preamble of the Third Draft also tell a similar story.
11 Also Art 7 of the Second and Third Drafts.
13 See Art 5 of the (first and Second/Third) Draft.
14 See Art 6 of the First (and Second/Third) Draft.
15 In that regard, the preamble to the First (and Second/Third) Draft specifically refers to Arts 121, 126 and 136 TFEU.
preamble to the draft treaty specifically records the Commission’s intention to bring forward proposals for future Union legislation on precisely those issues.16

12. Against that background, we will now consider three situations where the various drafts of the new treaty seek to involve the Union institutions in a manner which might be seen as potentially more problematic.

13. In the first place, consider the proposal under the First Draft to confer jurisdiction upon the Court of Justice of the European Union as regards compliance with the Contracting Parties’ obligation under Article 3(2) of the new treaty to enshrine the commitment to a balanced central government budget into national law at a constitutional or equivalent level.17 The preamble to the First Draft specifically states that that provision is based upon Article 273 TFEU, according to which the Court of Justice shall have 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 relevant provisions of the draft agreement do indeed relate to the subject matter of the Treaties, in the sense that they share a policy relationship with the system of economic coordination provided for under the TEU and TFEU (even if those provisions do not themselves have the character of Union law, and therefore cannot be considered to fall directly within the subject matter of the Treaties). That broad understanding of the scope of Article 273 TFEU follows the precedent already set by other international agreements where Member States have voluntarily accepted the Court’s jurisdiction.18

14. The involvement of the Court of Justice in enforcement of the new treaty was revisited under the Second Draft. The latter proposed to extend the Court’s jurisdiction so as to cover not only the Article 3(2) obligation to enshrine the balanced budget rule in constitutional or equivalent form, but indeed any failure by a Contracting Party to comply with the provisions contained in Title III on the “fiscal compact” more generally.19 How significant might such an extension prove to be? On the one hand, some of the commitments contained in Title III seem inherently ill-suited to judicial enforcement at all: for example, the undertaking to practise a form of “reverse qualified majority voting” in the Council as regards aspects of the excessive deficit procedure.20 On the other hand, it would be necessary to distinguish those obligations under Title III that are genuinely novel, in the sense that they are not already imposed under Union law:21 from those provisions under Title III which directly overlap with or are defined by reference to existing Union law.22 After all, insofar as the Court’s jurisdiction over a joint Title III-EU law issue already exists in the form of Article 259 TFEU enforcement proceedings, one would expect such jurisdiction to be exercised as such (rather than through the medium of the new intergovernmental treaty). By contrast, insofar as the exercise of the Court’s jurisdiction under Article 259 TFEU, in respect of a joint Title III-EU law issue, might be expressly excluded pursuant to the special provisions limiting judicial enforcement of the excessive deficit procedure contained in Article 126(10) TFEU,23 the idea of one Contracting Party nonetheless bringing proceedings against another, based upon the new treaty, would have to rely upon the argument that the relevant Member States’ voluntary conferment of jurisdiction upon the Court pursuant to Article 273 TFEU seeks positively to reinforce the enforcement mechanisms already provided for under Union law (rather than having the effect of contradicting an essential element in the scheme of the existing Treaties).

15. However, the issues thus raised by the Second Draft, about delimiting the precise extent of the Court’s jurisdiction over Title III as a whole, might well prove irrelevant to the final text of the new treaty. In particular, the Third Draft proposes once again to restrict the Court’s power of judicial review so as only to cover compliance with the obligation under Article 3(2) for Contracting Parties to enshrine the balanced budget rule into national law.24 As discussed above, Article 273 TFEU provides a sufficient legal basis for that arrangement as a matter of Union law.

16. In the second place, consider the proposal under the Second Draft whereby the Commission may, on behalf of Contracting Parties, bring an action for an alleged infringement of Title III on the “fiscal compact” before the Court of Justice of the European Union. At first glance, that amendment seems to go further than the terms allowed under Article 273 TFEU, which envisages only actions between Member States and might thus result, in particular, in the establishment of a possibility of standing, for other institutional actors; it also seems to furnish a concrete example of the Commission being called upon to participate in proceedings above and beyond those which already exist under the EU Treaties.

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16 As well as on the coordination between Eurozone states of major economic policy reform plans (an issue dealt with under Art 11 of the First (and Second/Third Draft)). Note also Commission participation in informal Euro Summit meetings (an issue dealt with under Art 13 of the First Draft/Art 12 of the Second/Third Draft); such meetings had already been agreed upon in principle by the relevant Member States on 26 October 2011.

17 See Art 8 of the First Draft; which also states that the actual implementation of the balanced budget commitment would be subject to the review of the domestic (not Union) courts.

18 Consider, eg the Protocol of 3 June 1971 on the interpretation by the Court of Justice of the Convention of 27 September 1968 on jurisdiction and the enforcement of judgments in civil and commercial matters. And more recently, eg the jurisdictional provisions of the European Financial Stability Facility Framework Agreement.

19 See Art 8 of the Second Draft; which nevertheless retains the qualification that implementation of the balanced budget commitment would be subject to review (only) by the national courts.

20 See Art 7 of the Second Draft.

21 Such as the counterparty rule contained in Art 3 of the Second Draft.

22 Such as the obligation to reduce the ratio of general government debt to GDP contained in Art 4 of the Second Draft.

23 The rights to bring actions provided for in Articles 258 and 259 may not be exercised within the framework of paragraphs 1 to 9 of this Article [126].”

24 See Art 8 of the Third Draft; further noting that that provision no longer contains any reference to the idea that implementation of the balanced budget commitment should be subject to review by the national courts.
17. However, greater nuance needs to be brought to bear upon that intuitive response. On the one hand, one should again separate out those provisions under Title III which directly overlap with or are defined by reference to existing Union law, and in respect of which the Commission’s competence to invoke the Court’s jurisdiction already exists in the form of Article 258 TFEU enforcement proceedings. In such situations, the proposal contained in the Second Draft actually adds nothing of significance. On the other hand, that leaves those obligations under Title III which either are genuinely novel as compared to existing Union law, or in respect of which the theoretical possibility of bringing Article 258 TFEU enforcement proceedings (based upon the corresponding substantive provisions of Union law per se) has been excluded in practice pursuant to Article 126(10) TFEU. In such situations, and those situations alone, the Second Draft would indeed involve certain Member States purporting to make use of a Union institution for non-Treaty purposes.25

18. Again, the revisions contained in the Third Draft would change the terms of this particular issue. Under the latest version of the new treaty, any Contracting Party which considers that another Contracting Party has failed to comply with the balanced budget rule under Article 3(2) may, instead of bringing its complaint to the Court of Justice directly, invite the Commission to issue a report on the matter. If the Commission’s report confirms the allegation of non-compliance, the Contracting Parties undertake to bring the matter before the Court for themselves. The Third Draft is therefore less far-reaching than the Second Draft to the extent that the Commission’s potential involvement in enforcement of the new treaty is both more limited in scope (ie only as regards Article 3(2), rather than Title III as a whole) and more indirect in nature (ie merely reporting its opinion on potential non-compliance, rather than enjoying any legal capacity to bring formal proceedings). But to that extent, the Third Draft still proposes that certain Member States may make use of a Union institution for non-Treaty purposes.

19. In the third place, consider the potential involvement of the Commission in devising the automatic correction mechanism which Contracting Parties should put in place as part of their national transposition of the balanced budget rule. Under the First and Second Drafts, Article 3(2) merely stated that the Contracting Parties should introduce the automatic correction mechanism on the basis of commonly agreed principles. Those drafts were thus rather vague: in particular, they failed to specify who should define the commonly agreed principles and within what timescale. Under the Third Draft, the text of Article 3(2) is considerably more precise: not only is it proposed that national implementation of the commitment to a balanced budget should be achieved within one year of the new treaty’s entry into force, but also that the principles underpinning the automatic correction mechanism should be agreed by the Contracting Parties “on a proposal from the…Commission”. Given that the commitment to a balanced budget is one of the few elements of the original deal which is genuinely novel as compared to the EU Treaties, it seems unlikely that the term “proposal” is being used in Article 3(2) of the Third Draft to mean an ordinary Commission proposal under Union law. Again, the Third Draft seems here to be proposing that certain Member States may make use of a Union institution for non-Treaty purposes.

20. Our analysis of the most recent version of the draft treaty therefore suggests that there are just two situations in which the Contracting Parties propose to make use of the Commission for purposes lying outside the strict scope of Union law: in assessing the need for possible judicial enforcement of national transposition of the balanced budget commitment; and in proposing the principles for the agreement of the Contracting Parties which will underpin national design of the automatic correction mechanism.

21. To that extent, the draft treaty raises the interesting legal question of whether, and under what conditions, certain Member States may indeed make use of the common institutions for extra-Union purposes. On the one hand, some might find it difficult to square the Commission’s extra-Union roles, as envisaged by the Third Draft, with the fundamental principle of conferred powers contained in Article 5(2) TEU. On the other hand, it should be recalled that the Court of Justice has explicitly recognised the right of Member States to associate the Union institutions with procedures established outside the framework of the Treaties.26 It is true that the precise conditions under which such an association will be judged compatible with Union law remain rather sketchy. In particular, the prospect of the UK formally objecting to any novel role for the Commission under the draft treaty has focused attention on the question of whether all the Member States must at least consent to the proposed association of a Union institution with procedures established outside the framework of the Treaties (even if it is not required that every country wish directly to participate in the relevant agreement).

22. Unfortunately, the current state of Union law offers no clear answer to that question. It would necessarily fall to the Court of Justice to identify the applicable legal criteria, seeking guidance from whatever provisions of the EU Treaties might seem relevant—including the duty of sincere cooperation imposed upon and between the Member States and the Union institutions by Article 4(3) TEU. Moreover, as in most situations where the Court is expected to develop a legal test which is not at all obvious from the text or scheme of the Treaties themselves, the process of identifying the applicable criteria would surely be influenced by the context and character of the concrete dispute in which the problem was actually being raised. In that regard, one might observe that the extra-Union roles envisaged for the Commission under the Third Draft are relatively narrow in scope and indirect in nature: they amount to little more than the provision of certain forms of assistance to

25 Though note that there would still be no possibility (when acting specifically under the jurisdiction recognised through Art 273 TFEU) of the Commission seeking the imposition upon a Contracting Party of fines/penalties pursuant to Art 260 TFEU.

the Contracting Parties, when it comes to the elaboration and/or the implementation of limited aspects of the new treaty. In such circumstances, one might find it difficult to understand how either the UK’s own national interests, or the autonomy and independence of the Union’s institutional system, could be adversely affected, in any direct or specific sense, by the relevant provisions of the Third Draft. Following as the duty of sincere cooperation under Article 4(3) TEU suggests any clear direction for the future development of Union law on this particular issue, it seems to counsel against the UK being entitled to block proposals for the Contracting Parties to associate the Commission to only a modest degree with the operation of the new treaty.

2. How far the proposed treaty further contributes to the emergence of a “two speed Europe” centred around a Eurozone core

23. The immediate aftermath of the December meeting of the European Council saw widespread speculation about the consequences of the choice to pursue extra-EU treaty-making, in particular, for the emergence of a “two speed Europe”. Doubts also quickly surfaced about whether the adoption of an intergovernmental agreement would avoid any of the ratification problems usually associated with amendments to the Union treaties themselves: on the contrary, several countries soon began to agonise over the need (whether legal or political) to ratify any new treaty by means of a popular referendum. Both sets of concerns were complicated by the swift realisation that not just the details but also some very fundamental questions about the terms of the December deal had been fudged by the relevant Heads of State or Government—not least the question of whether the non-Eurozone countries (apart from the UK) had merely pledged to support the changes and legal route agreed upon by the Eurozone states; or whether some or all of those non-Eurozone countries would also actively participate in some or all of the commitments and rules contained in the new intergovernmental agreement.

24. As for the challenge of securing national approval for the new treaty, in the face of strong parliamentary and potentially even popular opposition to the “fiscal compact” within several Member States, the First Draft deftly sought to neutralise the threat of non-ratification by various Contracting Parties: it provided that the agreement would enter into force after successful ratification by just nine Eurozone countries; from that time, the provisions relating to Euro Summit meetings would apply to all Eurozone states, while the remainder of the provisions would apply to Eurozone states as and from when they complete their own domestic ratification process.

25. That proposal nevertheless gave cause for concern that the price of driving forward with the “fiscal compact” might well be to dent the legal and political unity hitherto displayed by the Eurozone countries. It also ran the risk that a significant number of states, including several whose public finances were believed to pose the greatest dangers to the stability of the single currency, might fail to ratify the new treaty at all. Perhaps so as to reduce those dangers, the Second Draft suggested raising the threshold of successful ratifications required for the treaty to enter into force from nine up to 15 Eurozone countries—thus maximising the cohesion of the Eurozone, while still allowing for the risk that one or two countries might eventually reject the deal.27

26. However, the Third Draft envisions a different regime again: the agreement would enter into force on 1 January 2013 (or earlier, if possible) provided that 12 Eurozone countries have ratified it.28 Whether that change reflects the sense of urgency fuelling the negotiations, or worries that genuine obstacles to ratification might well arise in more than just one or two states, it anticipates and accommodates—one again under relatively generous terms—the possibility of divisions arising within the Eurozone itself.

27. As for the dangers facing the political cohesion of the EU as a whole, it should be recalled that flexible integration is far from a new phenomenon under EU law: EMU demonstrated that from its very outset, even besides other large scale manifestations of “variable geometry” in fields such as the AFSJ. Yet many observers sense that the Eurozone crisis has set us on the trajectory towards an altogether more significant division between “fast lane” versus “slow lane” Member States. True: it seems inevitable that new layers of substantive commitments for themselves. In that regard, the draft treaty provisions are marked by significant flexibility: it is envisaged that the new agreement would apply to the relevant non-Eurozone states which have successfully ratified it, only from the day when they join the single currency for themselves, unless they declare their

28. For example, much will depend upon the degree to which the relevant non-Eurozone countries merely express their political support for the terms of the December deal, which might also include putting their sovereign names to the draft treaty, or go further by actively participating in some or all of the new commitments for themselves. In that regard, the draft treaty provisions are marked by significant flexibility: it is envisaged that the new agreement would apply to the relevant non-Eurozone states which have successfully ratified it, only from the day when they join the single currency for themselves, unless they declare their

29. See Art 14 of the First Draft.
30. See Art 14(2) of the Second Draft.
31. See Art 14(2) of the Third Draft.
32. Even allowing for the possibility of limited divisions arising, under the new treaty, within the Eurozone itself: see the discussion above.
33. In which regard, consider the precedent already set by the “Euro Plus Pact” which was signed not only by the Eurozone countries but also by several other Member States as well (specifically: Bulgaria, Denmark, Latvia, Lithuania, Poland and Romania).
intention to be bound at an earlier date by all or part of the provisions contained in Title III (on the “fiscal compact”) and Title IV (on closer economic policy coordination).34

29. Moreover, the Third Draft introduces a novel provision into the negotiations: Article 15 would allow for accession to the new treaty by a Member State other than the original Contracting Parties.35 That provision could cover the scenario in which one or more of the 26 Member States which subscribed to the December deal did not eventually feel able to become a Contracting Party to the final version of the new treaty. But Article 15 of the Third Draft also leaves open the possibility that the UK itself might decide, in the future, to reverse the position it adopted at the European Council meeting in December 2011 and seek formally to become a party to the new treaty.36 We will discuss the legal implications of such a possibility, in terms of UK law, at paras 41–45 below.

30. Another important factor relates to just how far the Eurozone countries eventually seek to extend their broader and deeper policy coordination—not just via the legal basis for closer Eurozone cooperation contained in Article 136 TFEU, but also through the enhanced cooperation regime contained elsewhere in the EU Treaties.37 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.

B. RELATIONSHIP BETWEEN THE PROPOSED TREATY AND THE SYSTEM OF CONTROL OVER VARIOUS DECISIONS RELATING TO THE EU CONTAINED IN THE EUROPEAN UNION ACT 2011

31. As is well known, the UK Government does not intend to become a Contracting Party to the draft treaty, having exercised a much publicised “veto” over any direct changes to the EU Treaties during the negotiations in Brussels in December 2011. Consequently, the provisions of the future treaty, once it is finalised and enters into force, will have no application to the UK.

32. Nevertheless, it is worth exploring what impact the legal constraints contained in the recently enacted European Union Act 2011 (EUA) could have had on the position adopted by the Government during the Brussels negotiations. In particular, we will consider whether the Prime Minister’s decision to veto any potential amendment of the existing EU Treaties might be seen to have been affected or conditioned by the system of control over various decisions relating to the EU contained within the EUA.

33. We first assess the legal position: would the control mechanisms introduced in the EUA have been engaged had the UK Government indicated a willingness to ratify an amending treaty; and would those control mechanisms be triggered in the future, if the UK were eventually to agree to the incorporation of the provisions of the draft treaty into the EU Treaties? We secondly reflect on the political position: even if not formally engaged as a matter of law, is it possible to discern whether the controls introduced by the EUA have had an impact on the way in which the UK approaches negotiations which explore the viability of altering or augmenting the EU Treaties?

1. The Legal Relevance of the System of Controls Contained in the European Union Act 2011

34. The EUA introduced a range of legal mechanisms seeking to control the making of various decisions relating to the EU, including the requirement that certain categories of decision can only be made if affirmed by Act of Parliament,39 or if Parliamentary Approval has been received.40 Of direct relevance to the present discussion, however, are the EUA’s “referendum locks”, the most demanding form of control created by the Act.

35. The referendum locks contained in sections 2, 3 and 6 of the EUA are intended to ensure that, in the circumstances specified in the legislation, power or competence cannot be transferred from the UK to the EU by Act of Parliament unless approved of by a majority of the electorate voting in a referendum. Sections 2 and 3 of the EUA are of particular relevance for present purposes. By section 2, a treaty to amend or replace the existing EU Treaties must be approved at a referendum if it fulfils the criteria set out in section 4 of the EUA.

34 See Arts 1(2) and 14(5) of the First (and Second/Third) Draft.
35 Though the latter must unanimously approve the request.
36 Though occupying the same legal position as every other non-Eurozone country, ie of choosing voluntarily whether to be bound by all or part of the provisions contained in Titles III and IV.
37 Cf Art 10 of the Second (and Third) Draft.
38 Cf Art 10 of the First (and Second/Third) Draft; and also Art 326 TFEU.
39 See especially s.7 EUA.
40 See especially s.10 EUA.
Similarly, by section 3, a revision of the existing EU Treaties under the Article 48(6) TEU simplified revision procedure will attract a referendum if it falls within section 4. In principle, therefore, had the Prime Minister withheld his veto in Brussels, and had an agreement been reached to attempt to incorporate provisions of the sort now contained in the draft treaty into EU law via an amendment of the existing EU Treaties, whether through a new treaty or the simplified revision procedure, the EUA’s referendum locks might have been engaged.

36. Yet upon examination of the criteria set out in section 4, which determine whether a purported amendment of the existing EU Treaties would attract a referendum under the EUA, it becomes clear that provisions of the sort now contained in the draft treaty would not have required approval at a national plebiscite. To determine whether a provision falls within section 4 of the EUA, a two stage process is to be followed. First, it must be established whether a proposed provision satisfies any one of the criteria set out in section 4(1) of the EUA, which, in broad terms, is designed to catch an increase in the competence or power of the EU. Second, if a provision does satisfy the criteria set out in section 4(1), it must be considered whether that provision is nevertheless exempt from the requirement that a referendum be held in accordance with section 4(4). If the proposed amendment is to be carried out using the simplified revision procedure, by section 3(4) a further stage is added: if a provision falls within section 4 only because it is caught by subsection (1)(i) or (j), a referendum will not be required if the effect of that provision in relation to the UK is not significant.

37. Applying this process to the provisions contained in the Third Draft of the proposed treaty it is evident that the EUA’s referendum locks would not be engaged. Article 3 of the Third Draft, which imposes the balanced budget rule, comes closest to being caught by the criteria set out in section 4(1) of the EUA. In particular, it seems to be covered by section 4(1)(f)(i), which provides that “the extension of the competence of the EU in relation to the co-ordination of economic and employment policies” will attract a referendum. Nevertheless, when we look to section 4(4), it is apparent that Article 3 would be exempt from the requirement that a referendum be held in accordance with subsection (b). Article 3 would not engage the EUA’s referendum locks because it is a provision “that applies only to member States other than the United Kingdom”. As noted above, the provisions of the draft treaty will not apply automatically to non-Eurozone states like the UK, and as such, Article 3 would be exempt from the EUA’s referendum requirements.

38. Indeed, the exemption provided under section 4(4)(b) would also be applicable to all of the other substantive provisions contained in the draft treaty; each one would also, as with Article 3, be exempt from the requirement that a referendum be held because it “applies only to member States other than the United Kingdom”. Yet this is not the only reason that the other provisions of the draft treaty do not engage the EUA’s referendum locks, with one further potential exception. Article 8, at least as outlined in the Second Draft, might also have had to rely exclusively on the section 4(4)(b) exemption to avoid triggering a referendum, though even this would ultimately depend on how this draft of Article 8 is to be interpreted. If, as discussed in paras 13–15 above, Article 8 of the Second Draft were to be understood as extending the jurisdiction of the Court of Justice through a partial elimination of Article 126(10) TFEU, which otherwise operates to limit the judicial enforcement of the excessive deficit procedure, it is possible that this provision could satisfy the section 4(1) criteria. In particular, Article 8 of the Second Draft could potentially be caught by section 4(1)(i) if it were to be seen as a provision which removes a limitation on the power of an EU institution or body “to impose a requirement or obligation on the United Kingdom”. If such an understanding of Article 8 of the Second Draft were to be adopted, then the exemption under section 4(4)(b) would be necessary to negate the referendum requirement that would otherwise take effect. As with Article 3, if required, this exemption would be effective because, once again, Article 8 of the Second Draft would not be applicable to the UK. Nevertheless, Article 8 of the Third Draft avoids such problems, as the amended text of this provision limits the jurisdiction of the Court of Justice to matters related to Article 3(2) of the draft treaty alone. It thus cannot be contended that Article 8 of the Third Draft further extends the Court’s jurisdiction, with the consequence that section 4(1)(i) is not engaged.

39. Looking beyond Article 3, and the potential complications of the Second Draft of Article 8, while (in principle) all of the other substantive provisions contained in the Third Draft would also seem to be exempt under section 4(4)(b), they would also fail to attract a referendum under the EUA for a number of other reasons that can be briefly summarised:

— Article 4 would also be exempt in accordance with section 4(4)(a) of the EUA as it involves (at most) “the codification of practice under TEU or TFEU in relation to the previous exercise of an existing competence”.

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34 It should also be noted, that if the existing EU Treaties were to be amended to include the provision contained in Art 8 of the Second Draft using the simplified revision procedure, rather than via a new amending treaty, the significance condition set out in s. 3(4) EUA would also be potentially applicable. This is because Art 8 would only fall within the scope of s4(1) EUA via subsection (i). Consequently, in accordance with s3(4) EUA, if the change was deemed to be “not significant to the UK”, a referendum would also not be required on this basis. The significance test would not be relevant, however, in accordance with s2 EUA, if the change were to be made through a new amending treaty.
— Articles 5, 6 and 11 appear to be outside the scope of section 4(1), in so far as they do not confer any new competences on the EU. In addition, as the Preamble to the Third Draft states that the Commission intends to bring forward proposals for legislation within the framework of the EU Treaties in the areas covered by these Articles, in the future these provisions may also be exempt as a “codification of practice under TEU or TFEU in relation to the previous exercise of an existing competence” in accordance with section 4(4)(a) of the EUA.

— Article 9 appears to be outside the scope of section 4(1), as it does not confer any new competence on the EU.

— Articles 7, 10, 12 and 13 seem to be outside the scope of the EUA entirely, as they are not provisions the ratification or approval of which the Act seeks to control.

40. The overall position is therefore that nothing in the Third Draft of the proposed treaty, had it been conceived as an instrument to amend the EU Treaties themselves, would have engaged the referendum locks contained in the EUA. As a result, the UK Government could have lawfully agreed to ratify a treaty containing these provisions by way of amendment to the existing EU Treaties without having to seek the approval of the electorate at a national referendum. On this basis, it seems difficult to imagine that concerns that a referendum might be legally required under the EUA made a significant contribution to the Prime Minister’s decision to veto a change to the existing EU Treaties at the negotiations in Brussels.

41. A further legal issue relevant to the relationship between the draft treaty and the EUA must be addressed. If the UK were in the future to change its position in relation to the provisions contained in the draft treaty, would the control mechanisms contained in the EUA then be triggered? A change of the UK’s present position could involve simply acceding to the new treaty while its provisions remained outside the architecture of the EU Treaties, in accordance with Article 15 of the Third Draft. A change of position might also entail the UK declaring its intention to be directly bound by all or some of the provisions contained within the new treaty, again while outside the architecture of the EU legal order; a declaration which would be necessary under Article 14 of the Third Draft for the treaty’s provisions to be applicable to the UK. Finally, the UK might also change its position by agreeing to the incorporation of the new treaty into the EU Treaties, thus making the provisions set out in the Third Draft a part of EU primary law, as is envisaged in Article 16 of the Third Draft. When the potential ways in which the UK could change its position in relation to the draft treaty are combined, two problematic scenarios can be discerned.

42. First, consider if the UK agreed to the incorporation of the new treaty into the existing EU Treaties, when it had either not acceded to the new treaty at all, or had acceded but not declared its intention to be bound by the new treaty’s provisions. In such circumstances, at the point of the incorporation of the new treaty’s provisions into the EU Treaties, the EUA’s referendum locks would not be engaged. For, as discussed above, if the provisions were applicable only to Member States other than the UK, the section 4(4)(b) exemption would operate to ensure that a referendum was not required. Yet this creates a potential gap in the EUA’s system of control. For if a UK government subsequently agreed to be bound by the provisions contained in Title III (Fiscal Compact) of the Third Draft—which would now be incorporated into the EU Treaties—new competence would have been conferred on the EU through the UK’s acceptance of the rules contained in what is at present Article 3.42 And this could occur without a referendum being held to approve the changes, for these provisions would already have become part of EU law, and thus—even in relation to provisions which would otherwise fall within section 4—the referendum locks contained in sections 2 and 3 of the EUA would not bite.

43. The potential gap described above arises because the EUA is not as such structured to catch future hypothetical increases in EU competence; if an increase in competence is not applicable to the UK at the time of the treaty change, the EUA’s referendum locks will not be engaged. Only in certain explicitly listed situations does the Act make provision for referendums to be held if a future UK government were to seek to opt-in to existing areas of competence within the EU Treaties: for example, by joining the euro,43 or accepting the Schengen Protocol.44 To close this potential loophole, whereby EU competence could be increased without a referendum being held, section 6 of the EUA could be amended: for example, to require a decision for the UK to subscribe to the fiscal compact to be approved at a referendum. The continued existence of this gap in the coverage of the EUA could otherwise serve to undermine the overall coherence of the system of control put in place by the Act. Further, given the potential impact of the rules contained in the fiscal compact on the macro-economic autonomy of Member States, an acceptance to be bound by these provisions would appear to be a “trigger event” of at least equivalent significance to many others specifically covered by section 6 of the EUA. Consequently, the inconsistency created by the existence of this gap in the EUA’s scheme of referendum locks, when judged on its own terms, is difficult to justify.

44. The second problematic scenario created by a UK change of position in relation to the draft treaty is almost the inverse of the first. Consider now if the UK agreed to the incorporation of the new treaty into the existing EU Treaties, when it had already both acceded to the new treaty and declared its intention to be bound

42 Further, were the Second Draft of Art 8 to be reinstated, it is possible that a limitation on the power of an EU institution to impose obligations on the UK could also potentially have been removed, depending on how the Second Draft of Art 8 is to be interpreted; see the discussion in paras 13–15 above.

43 See s6(5)(e) EUA.

44 See s6(5)(k) EUA.
by the latter’s provisions. Upon declaring its intention to be bound by the new treaty, the UK would, in accordance with Article 3(2) of the Third Draft, be required to enact national provisions of “binding force and permanent character, preferably constitutional”, to give legal effect to the balanced budget rules set out in Article 3(1) of the Third Draft. In the UK, this would almost certainly need to be done by Act of Parliament. Yet even if the UK was in full compliance with its obligations under Article 3(2) of the Third Draft, and had put in place national legislation to give effect to the new treaty’s provisions in advance of their incorporation into the existing EU Treaties, at the point of incorporation a referendum could nevertheless be triggered under the EUA. For if, in accordance with section 4 of the EUA, new competence was in principle being transferred to the Union through a revision of the EU Treaties, a referendum would need to be held pursuant to section 2 or 3 of the EUA. And if a provision of the sort now contained in Article 3 of the Third Draft was incorporated into the existing EU Treaties, it would indeed fall within section 4 by virtue of subsection (1)(f)(i), and would not be exempt by section 4(4)(b), for the provision would be applicable to the UK.\footnote{Ibid.} Nor does it appear that such a change would be exempt under section 4(4)(a), because it could not be said to be a “codification of practice… in relation to the previous exercise of an existing competence”, since the EU would not possess an “existing competence” in relation to these matters.

45. Here then, rather than there being a gap in the EUA’s system of control, the problem is one of overprovision. In such circumstances, the EUA would require a referendum to be held to approve the granting of new competence to the EU even though the UK would already have agreed to be bound by the rules to be incorporated into the EU Treaties, and further, would already have passed national legislation to make such rules legally enforceable. The peculiarity of having to hold a referendum in such a situation—essentially to approve something already in place—is clear. And the consequences of a “no” vote would be significant and complex: the legal and political status of the national legislation implementing the relevant rules would be open to question. As with the first problematic scenario considered above, it is likely that the EUA would need to be amended, possibly on a one-off basis, to avoid such a situation occurring.

2. The Political Relevance of the System of Controls Contained in the European Union Act 2011

46. We concluded above that the referendum locks contained in the EUA would not have been applicable, as a matter of law, to provisions of the sort now contained in the draft treaty. It is therefore difficult to see that apprehension about the prospect of being legally required to hold a national referendum in the UK on the changes set out in the December deal could have been a factor which inhibited the Prime Minister from agreeing to ratify an amendment of the existing EU Treaties to this effect. Indeed, it was widely reported in advance of the Brussels summit that the Government’s position was that a referendum would not be held unless power or competence was transferred from the UK to the EU, with the Prime Minister himself stating, “I’m not intending to pass any powers from London to Brussels so I don’t think the issue will arise.”\footnote{Iain-Duncan-Smiths-demands.html} The Prime Minister thus appeared to be aware of the legal inapplicability of the EUA’s referendum locks prior to the December negotiations, and yet nonetheless decided to wield the British veto.

47. The position seemingly adopted by the Prime Minister in advance of the negotiations—that a referendum would likely be unnecessary—was not, however, unchallenged, both within and without the Government. A number of senior Conservatives argued publicly that a referendum might in fact be required to ratify any revising treaty agreed at the Brussels summit. The Work and Pensions Secretary, Iain Duncan Smith, called for a referendum to be held on any “major treaty change”.\footnote{Iain Duncan Smith calls for referendum on European ‘fiscal union’, The Daily Telegraph, 5 December 2011 (http://www.telegraph.co.uk/news/politics/conservative/8934746/Iain-Duncan-Smith-calls-for-referendum-on-European-fiscal-union.html).} The Northern Ireland Secretary, Owen Paterson, said that it was “inevitable” that a referendum would ultimately need to be held: “If there was a major fundamental change in our relationship, emerging from the creation of a new bloc, which would be effectively a new country from which we were excluded, then I think inevitably there would be huge pressure for a referendum.”\footnote{Tory minister breaks ranks with Cameron over Europe”, The Guardian, 7 December 2011 (http://www.guardian.co.uk/politics/2011/dec/07/tory-minister-cameron-europe).} Similarly, the mayor of London, Boris Johnson, argued that it was “absolutely clear to me that if there is a new treaty at 27—if there is a new EU treaty that creates a kind of fiscal union within the eurozone—then we would have absolutely no choice either to veto it or to put it to a referendum”\footnote{Ibid.}.

48. Such calls for a referendum clearly go beyond the strict scope of the EUA, and reveal two things. First, the political rhetoric surrounding the referendum locks has the potential de facto to extend the reach of the EUA. Second, the political rhetoric surrounding the referendum locks also has the potential de facto to entrench the EUA. The reach and applicability of the EUA may be extended in practice if it is argued that any major or fundamental change, either to the text of the EU Treaties or the UK’s relationship with the EU, should be subject to approval at a referendum. This is a strikingly broad proposition, and would cover a range of scenarios which would not otherwise fall within the EUA. When it is recalled that the system of referendum locks...
contained in the EUA is already very extensive, the idea that in practice this scheme could become all-embracing is a cause for concern. Furthermore, the EUA may be entrenched in practice if it becomes accepted that any major or fundamental change would need to be approved at a referendum to take effect. At present, it seems clear that a future government could seek to repeal or amend the referendum locks contained in the EUA, Parliament is sovereign, and its legally unlimited legislative power could be exercised to remove any or all of the referendum requirements which bind the Government at present. Yet if it becomes politically accepted that a referendum would always need to be held to affirm major changes, an entirely lawful repeal of the EUA might, in practice, be ineffective to release a government from these obligations. In addition to undermining the sovereignty of Parliament, such a development could unduly restrict the freedom of action of future governments.

49. It might be objected that the comments of the senior Conservatives set out above are not statements about the scope, reach or application of the EUA. Instead, it could be argued that they are simply political calls for a referendum to be held. Yet such calls must nevertheless be understood in the context of the EUA. This Act is the pre-eminent constitutional instrument which establishes the circumstances in which referendums will be required with respect to the UK’s relationship with the EU. It ought therefore to be seen as the yardstick against which calls for the imposition of further controls must be measured. In this sense, the EUA has had an important impact politically, as well as legally, on the question of whether it is necessary for a referendum to be held to approve any particular change to the structure, power or competence of the EU.

50. Two examples of the political effect of the EUA can be identified. First, the existence of the EUA seems to have reversed the political presumption that the holding of a referendum on changes to the UK-EU relationship will be an exceptional event, rather than an ordinary occurrence. The broad scope of the EUA’s referendum locks, which are triggered in an array of circumstances, gives the impression that the holding of a referendum to approve a change to the UK-EU relationship is the norm, and we might thus expect calls for referendums to be held, even where not required by the Act, to become regularised. Second, the EUA provides a barometer against which the significance of a change to the structure, power or competence of the EU can be measured, and thus offers a comparator which can be used to justify calls for referendums beyond the scope of the Act. So, it can be argued, if issue X is covered by the Act’s referendum locks, and issue Y is not, yet it is of equivalent (or greater) importance, why should we not also hold a referendum on issue Y, even though not required by law? Indeed, such an analogy will be even more potent when it is appreciated that the EUA could in principle operate to require a referendum to be held to approve changes which have already been implemented, a quirk of the Act identified in paras 44–45 above. On both counts, then, it appears that the introduction of the EUA has made it easier to make and sustain political calls for a referendum to be held even where it falls outside the scope of the legislation, and correspondingly more difficult for such calls to be convincingly rebutted.

51. As a result, while it is difficult to see that the EUA’s referendum locks had a legal impact on the decision of the Prime Minister to wield the British veto at the Brussels negotiations, due to their inapplicability to provisions of the sort now to be found in the draft treaty, the Act may nevertheless still have had a political affect on the Government’s negotiating position. Undoubtedly other factors played a role in motivating the Prime Minister to veto the negotiation of a revision of the existing EU Treaties, including a desire to protect the City of London from EU regulation,50 the absence of any repatriation of powers already passed to Brussels, and a need to assuage euro-sceptic members of the Conservative party. Nonetheless, in so far as the use of the veto was also intended to bypass calls for the holding of a referendum which would have been inconvenient, yet politically difficult to resist, it would also appear to have been conditioned in part by the referendum locks contained in the EUA. Moreover, it is likely that the EUA will continue to have an important influence, both legally and politically, on the way in which UK governments approach treaty negotiations on matters related to the EU in the future.

CONCLUDING SUMMARY

52. Our main findings may be summarised as follows:

1. No obvious legal problems are created by the relationship between the proposed intergovernmental treaty and the EU Treaties, so far as concerns preserving the integrity of the Union’s existing institutions, competences and procedures. Only one issue might potentially arise, ie concerning the suggestion (under the Third Draft) to associate the Commission with limited aspects of defining and enforcing the commitment of the Contracting Parties to maintaining a balanced government budget. In theory, the UK might object to the prospect of the Commission exercising functions beyond those assigned to that institution under the EU Treaties. However, it is far from clear that the UK would have any convincing basis under Union law for raising such an objection.

2. The referendum locks contained in the European Union Act 2011 should have had no legal bearing upon the negotiating position of the UK at the meeting of the European Council in December 2011. However, an analysis of its relationship to the proposed treaty seems to reveal certain shortcomings in the control system created under the Act: certain decisions relating to the UK’s position in Europe are not subject to any control, even though they seem comparable

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50 See the Prime Minister’s statement to the House of Commons; Hansard, HC Vol 537, col 519–555 (12 December 2011).
in importance to many of the decisions which would trigger a referendum under the Act; other decisions relating to reform of the EU Treaties could well trigger a plebiscite, even though they would carry little or no significance for the UK’s relationship to the Union. Furthermore, the experience of (and following) the December European Council suggests that the political impact of the Act may well be outpacing its true legal scope—in particular, by creating a political rhetoric which has the potential appreciably to affect both the nature of the UK’s public discourse, and its room for diplomatic manoeuvre, in relation to European affairs.

13 January 2012

Written evidence submitted by the Rt Hon David Lidington MP, Minister for Europe, Foreign and Commonwealth Office

It is in the UK’s national interest for the eurozone to sort out its problems and implement the necessary measures, including much tighter fiscal discipline, to help restore market confidence. Euro Summits are one mechanism that the eurozone is employing to coordinate better its economic policies and improve fiscal discipline in order to contribute to resolving the crisis.

Our position remains that in and of itself, a Euro Summit does not require a Treaty base since EU leaders are able to meet in a range of formats. In any event, Protocol No 14 to the Treaties already envisages meetings of the Ministers of the Member States whose currency is the Euro meeting informally. Actions that could affect the 27 Member States will continue to be taken at the level of 27 and therefore there is no reason to seek a revision of the EU Treaties. As outlined in the European Council Conclusions of 23 October 2011, “the European Commission has responsibility for ensuring compliance by all 27 Member States with EU legislation, including that relating to the internal market, and to safeguard a level playing field among all Member States, including those not participating in the euro.”

The proposed international agreement is in the early stages of discussion and we are reviewing its implications carefully.

The UK is participating in the Euro Group Working Group on the Fiscal Stability Union to discuss the proposed agreement. This means that we will be at the table when the use of the EU institutions are discussed, giving us the opportunity to raise any concerns and to support the role of the institutions in safeguarding the Single Market.

The Prime Minister in his post-European Council statement has explained the safeguards the UK was proposing. Those safeguards—on the single market and on financial services—were modest, reasonable and relevant. As the Prime Minister made clear in advance of the December European Council meeting, if the Eurozone countries wanted a treaty involving all 27 members of the European Union, we would insist on some safeguards for Britain to protect our own national interests.

The UK was not asking for an opt-out, special exemption or a generalised emergency brake on financial services legislation. They were safeguards sought for the EU as a whole. The UK was simply asking for 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. For example, we wanted assurances that the principle of non-discrimination would be respected in the single market and there would be a presumption in favour of openness in terms of free movement of capital.

Those satisfactory safeguards were not forthcoming, so the Prime Minister did not agree to the proposed treaty. The Government does not publish informal draft texts proposed during the course of negotiations.

There have been some baseless allegations that the UK’s position shows the UK is not serious about financial services reform, and could have undermined the single market. In fact, the opposite is true. The UK Government is already addressing the weaknesses which the crisis revealed in the existing system of financial regulation. One of our concerns is to ensure that the system of European regulation allows Member States to introduce more stringent regulations than the minimum levels agreed internationally. For example, the Independent Commission on Banking, chaired by Sir John Vickers, has recommended that banks be required to “ring-fence” certain vital banking activities and to increase their loss-absorbing capacity.

The Government will implement the recommendations of the Independent Commission on Banking in stages, with the full package of reforms completed by 2019. All necessary legislation will therefore be put in place by the end of this Parliament. The Government will publish a White Paper in spring 2012 setting out further detail on how the recommendations will be implemented.

The Government has also introduced a permanent bank levy which will raise £2.5 billion each and every year and is consulting on implementing the toughest and most transparent pay regime of any major financial centre in the world.

These reforms will strengthen the European single market. Since the onset of the crisis, European governments have provided over €500bn in direct support (including capital injections, asset purchases and loans) as well as extraordinary support in the form of guarantees and special central bank liquidity operations.
Today a major part of the European banking system remains dependent on official sector support and implicit taxpayer guarantees for its survival. These guarantees constitute a major distortion of the level playing field in the European single market. By taking radical steps to remove the implicit taxpayer guarantee for UK banks, the UK is contributing towards a more stable financial system and stronger single market for all European citizens.

I welcome your Committee’s decision to hold an inquiry on the Eurozone crisis and its possible consequences for the UK. I look forward also to meeting you separately for our planned discussion on scrutiny more generally.

10 January 2012

Letter to Rt Hon David Lidington MP, Minister for Europe, from the Chairman of the Committee

Thank you for your letter of 10 January about the December 2011 European Council. As you will realise both eurozone matters and the work of the European Scrutiny Committee have moved on since then—and we are now conducting an inquiry on how the resolution of the eurozone crisis is developing and the possible consequences for the UK.

Nevertheless the Committee should be grateful if you would expand on one aspect of your letter. But it would be extremely helpful to know what single market and financial services matters the Government was seeking to safeguard. The only one we can discern from the Prime Minister’s statement to the House after the European Council is in his passage about implementation of the Vickers Report, which we take to refer to the inadequate Commission proposal for implementation of Basel III.

This is relevant to one issue we will be looking at in our inquiry—the extent to which the planned intergovernmental agreement, rather than EU Treaty safeguards for UK interests in the single market and financial services, would worsen, if at all, the present situation.

More generally the Committee would like to have from the Government, in plenty of time for its meeting on 25 January, the latest draft of the “Treaty on stability, coordination and governance in the Economic and Monetary Union”, together with a Government commentary on it. This should be followed by an immediate readout, again in time for our meeting of 25 January, from the ECOFIN Council meeting of 24 January.

Our intention is that the commentary and the outcome of the 30 January European Council will form the background to the oral evidence we will be seeking from the Chancellor and the Foreign Secretary in early February, along with evidence from others outside government. In preparing the commentary you will wish to bear in mind that the main focus of our inquiry is how to reconcile the necessary monetary and fiscal policies of the eurozone with the legal and institutional constraints. We will be interested to know whether the Government thinks the intergovernmental agreement significantly helps to achieve this.

In terms of legal constraints, the Government’s commentary should cover the legality of the roles of the Court of Justice and the Commission. The role of the latter as foreseen in Article 8 of the 10 January version of the agreement strikes us as particularly problematic. We say this in view of the fact that the Commission is an EU institution with no inherent jurisdiction; as such its competence to act in new fields, and the cost of so doing, have to be agreed to by all 27 EU Member States; and in view of the prohibition of infringement proceedings in Article 126(10) TFEU, to which the objective and procedures in Article 8 bear close resemblance.

It should also cover the encouragement to use enhanced cooperation, also a mechanism the scope of whose use was agreed to by 27 EU Member States, to ensure the smooth functioning of the euro area in Article 10 of the intergovernmental agreement. We would be interested to know whether the Government thinks reference to its use in a non-EU Treaty is appropriate; whether encouraging its use “whenever appropriate and necessary” is consistent with the EU Treaty requirement that it be used “as a last resort” (Article 20(2) TEU); and what safeguards the UK thinks will be necessary to ensure that greater use of enhanced cooperation does not undermine the internal market or economic cohesion in the EU, does not create barriers or discrimination in trade within the EU, and does not distort competition within the EU, all of which prohibitions are required by Article 326 TFEU.

Finally, we look forward to full cooperation from Ministers in our efforts to report comprehensively and accurately to the House on these matters, which as the Government frequently reminds us, are so important to the UK national interest.

I am copying this letter to Lord Roper and Jake Vaughan in the Lords; to Les Saunders at the Cabinet Office; and to Sarah Winter, Scrutiny Co-ordinator, and David Slater, Select Committee Liaison Officer, in the FCO.

12 January 2012
Written evidence from Roger Btoole, Managing Director, Capital Economics

Brief for the House of Commons European Scrutiny Committee: Reinforcing the eurozone

What measures have been put in place by euro-zone policymakers?

1. In late October, euro-zone policymakers announced a comprehensive plan to try to bring an end to the euro-zone debt crisis to an end. The plan included three basic elements: a “voluntary” restructuring of Greek sovereign debt; a leveraging of the European Financial Stability Facility (EFSF); and moves to recapitalise Europe’s banks.

2. At the European Council Meeting on 9 December, euro-zone policymakers supplemented these measures by announcing a set of new fiscal rules and plans to strengthen economic coordination. EU governments also agreed to provide additional resources to the IMF of up to €200 billion. Moreover, policymakers announced that the European Stabilisation Mechanism (ESM), the successor to the EFSF, would be brought into operation by July 2012, a year earlier than initially planned, and that they would look into the possibility of increasing the size of these so-called bail-out funds.

3. Meanwhile, the ECB has stepped up its unconventional policy support for the banking system by providing unlimited three-year loans to the banking system. It has also relaxed the rules on collateral which should enable banks to borrow larger sums of money from the central bank.

Do these measures tackle the region’s problems?

4. In my view, each of the elements outlined above falls short of the action needed to solve the crisis. At the time of writing, talks between creditors and the Greek government are still continuing and a second bail-out package, which is conditional on a satisfactory private sector debt restructuring deal being agreed, has yet to be finalised. If the bail-out deal collapses, Greece would be unable to repay its creditors in Full. (Greece’s next major bond redemption is on 20 March.) Also, Greek banks’ access to the ECB would be in doubt.

5. Note too that the Greek deal is only designed to bring the debt to GDP ratio down to 120% of GDP by 2020. In other words, it would still leave Greek debt unsustainably high. What’s more, the debt ratio in 2020 will depend very heavily on the course of the economy between now and then. If Greece suffers a prolonged recession, as I expect, debt will no doubt be much higher than 120% of GDP in 2020. As a result, further Greek debt restructurings seem likely.

6. Plans to leverage the euro-zone bail-out funds are yet to come to much either. What’s more, the chances of the bailout funds increasing their effective lending capacity and being able to borrow money from the markets at low rates of interest have been further reduced following the decision by Standard and Poor’s to downgrade the French Government’s credit rating from AAA to AA+. Note too that the German Government appears unwilling to provide either bail-out fund with additional capital. Even factoring in increases in the size of the IMF’s lending capacity, doubts remain as to whether the euro-zone bail-out funds and IMF will have enough resources to prevent Italy and Spain from being dragged even deeper into the crisis.

7. The bank recapitalisation plans look unlikely to guarantee the stability of the euro-zone banking sector. After all, they make little or no allowance for sovereign defaults in Italy and Spain or the erosion of capital ratios likely to result from general economic weakness. And if banks raise their capital ratios by shrinking their loan books, this will have adverse consequences for the wider economy.

8. Meanwhile, as far as fiscal integration is concerned, there are major uncertainties over how far fiscal coordination and supervision proposals can go without necessitating time-consuming and politically awkward treaty changes which could trigger national parliamentary votes or even referendums. And even if such steps can be avoided, it is unclear just how much economic and fiscal sovereignty member states will be prepared to give up.

9. Admittedly, the expansion of the ECB’s unconventional policy measures is helpful. But given the stresses in the banking system, it is unlikely to prompt banks to lend more to the wider economy. Meanwhile, the ECB shows no sign of being willing to act as bond buyer of last resort.

10. More importantly, regardless of the effectiveness of these policies, they are either aimed at alleviating the symptoms of the current crisis or preventing the next crisis from taking place. These policies do nothing to address the deep-seated economic problems of the euro-zone: inadequate growth of domestic demand in the core countries and a fundamental lack of competitiveness in the southern euro-zone economies. Indeed, the only way to prevent the troubled economies from suffering years of pain within the euro-zone will be for the core economies to give them large and sustained fiscal transfers. Needless to say, widespread opposition to this in the core economies makes this unlikely. Meanwhile, the enforcement of yet more austerity in both the core and the peripheral countries threatens to make the economic environment worse.

What next for the euro-zone?

11. Given all this, and the mounting evidence that the region as a whole is on the brink of another deep recession, I think that some form of euro-zone break is likely sooner or later. This view has been bolstered further by the inadvertent acknowledgement by President Sarkozy and Chancellor Merkel that countries could...
leave the euro-zone. I suspect that Greece may leave the euro in 2012, with at least one further departure either this year or in 2013. And there is a clear risk of a bigger break-up, involving Italy and/or Spain.

12. A euro-zone break-up could well bring economic benefits over the long-run. But in the near term, it is likely to have severe adverse economic and financial consequences. I expect the euro-zone to contract by 1% this year and by 2.5% in 2013. This would give a total peak to trough fall in euro-zone output of some 5%, similar to that seen during the global credit crunch and recession of 2008–09, although I would expect the fall to be more gradual and drawn out. However, a bigger break-up—perhaps involving the exit of Italy—could cause much greater short-term economic damage.

The implications for the UK

13. Even a limited break-up of the euro-zone would have serious adverse effects on the UK economy. After all, the euro-zone is the destination for close to 50% of UK goods exports. The experience of 2009 suggests that, if our euro-zone forecasts are right, UK exports to the region might drop proportionately more than the fall in euro-zone GDP—perhaps by at least 10% over the next two years. That would knock about 1.5% off UK GDP.

14. The direct trade effects on the UK could be overwhelmed, however, by the financial ramifications of the euro-zone crisis, particularly those stemming from sovereign defaults. At first sight, the UK looks to be well insulated from these effects. UK banks’ direct exposure to the most troubled economies, such as Greece, is relatively low. But there are substantial indirect exposures via the UK’s links with other countries, notably France, which have much greater exposures to the periphery.

15. Perhaps more problematic for UK banks would be the general financial and market disruption caused by a further escalation of the euro-zone crisis. We know from the Lehman experience how uncertainties over the financial health of counterparties can lead to a general freezing up of interbank and wholesale funding markets and a tightening in banks’ credit standards. I suspect that even a limited euro-zone break-up would have similar sorts of effects.

16. Finally, the continuation or escalation of the euro-zone crisis is likely to have more general negative effects on both wealth and confidence in the UK.

17. Taking all these factors into account, we think that the euro-zone crisis could knock some 3–4% off UK GDP over the next two years. A bigger, messier break-up could substantially increase these negative effects.

20 January 2012

Further written evidence submitted by the Rt Hon David Lidington MP, Minister for Europe, Foreign and Commonwealth Office

Thank you for your letter of 12 January regarding the Eurozone crisis and the negotiations at the December European Council.

I welcome your Committee’s decision to hold an inquiry on the Eurozone crisis and its possible consequences for the UK.

Please find enclosed the latest draft of the “Treaty on the stability, coordination and governance in the Economic and Monetary Union”, published on 19 January. As I made clear in my letter dated 13 January, the drafts of the proposed Treaty are not of course covered by the scrutiny reserve resolution as it is not an EU document and in any case the UK will not be a signatory. Please be aware that all those participating in the Working Group considering this draft Treaty have been asked that, where it is national practice to transmit drafts to our national Parliaments, safeguards to ensure due confidentiality should be in place.

The UK has participated in the Ad Hoc Working Group meetings. This means that we were able to raise concerns and we have offered some observations on the earlier draft of the proposed Treaty; for example, we have stressed that it should not undermine the operation of the single market or otherwise infringe on areas of policy that are properly for the discussion of all Member States, and that nothing should be done which cuts across the provisions and procedures in the EU Treaties. However, as we are not negotiating the intergovernmental Treaty nor signing it, it would not be appropriate to give a detailed commentary on the drafts. So whilst I will endeavour to provide any further additional information of importance following the ECOFIN Council, there may be little to add at this stage.

You asked for more details on the single market and financial services matters that the Government sought to safeguard at the December 2011 European Council. I am afraid that we do not publish informal draft texts proposed during the course of negotiations.

You asked for our views on the references to the enhanced cooperation procedure. During the course of discussions in the Ad-Hoc Working Group our partners have made clear, and this is now reflected in the draft intergovernmental Treaty, that the use of enhanced cooperation envisaged will be under the EU Treaties and thus will be compliant with all the safeguards and procedural steps provided for in the EU Treaties. This includes Article 326 of the Treaty on the Functioning of the European Union (TFEU) that says that “Any
enhanced cooperation shall comply with the Treaties and Union law” and specifically, that “such cooperation shall not undermine the internal market or economic, social and territorial cohesion”.

Additionally, I have received the request from the Clerk’s office dated 20 January that relates to the letter from Rt Hon the Lord Roper and I will ensure that you are copied in on my reply to Rt Hon the Lord Roper.

24 January 2012

Letter to the Chairman from the Rt Hon David Lidington MP, Minister for Europe, Foreign and Commonwealth Office

Further to my letter of 15 January 2012 which enclosed the final copy of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, please find attached a letter from Jon Cunliffe, the UK’s Permanent Representative to the EU, to the European Council Secretariat. I am placing a copy of the letter in the libraries of both Houses.

I am writing in similar terms to Rt Hon the Lord Roper, Chairman of the House of Lords European Union Committee and am copying this letter to the Chair of the Foreign Affairs Select Committee.

22 February 2012

Annex

LETTER TO UWE CORSEPIUS, SECRETARY-GENERAL OF THE COUNCIL OF THE EUROPEAN UNION, FROM JON CUNLIFFE CB, THE PERMANENT REPRESENTATIVE TO THE EUROPEAN UNION

I am writing to record the United Kingdom position which the Prime Minister set out at the European Council on 30 January 2012 on the Treaty of Stability, Coordination and Governance in the Economic and Monetary Union.

The United Kingdom considers that it is important to ensure that no objectionable precedents are set. In this context, it notes that the EU institutions must only be used outside the EU Treaties with the consent of all Member States, and must respect the EU Treaties.

The United Kingdom understands of course the need for the Euro-zone to have proper fiscal discipline, properly policed. However, it considers that the treaty, or actions taken under it, should not undermine the operation of the single market or otherwise infringe on areas of policy that are properly for discussion by all member States in the EU context.

The United Kingdom has raised these issues previously, during negotiations on the draft treaty and in writing on 10 January 2012. In view of the United Kingdom’s 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.

22 February 2012

Letter from Rt Hon Mark Hoban MP, Financial Secretary to the Treasury, to the Chairman of the Committee

EUROPEAN STABILITY MECHANISM

Thank you for your letter regarding the European Stability Mechanism (ESM).

A statement was released by euro area Member States on 9 December 2011 stating their intention to accelerate the entry into force of the ESM Treaty to July 2012. Euro area Member States signed the ESM Treaty on 2 February 2012. It states that the ESM Treaty will enter into force as soon as Member States representing 90% of the capital commitments have ratified it. The ESM Treaty is an intergovernmental agreement between euro area Member States; the UK is not a signatory and is not required to ratify it.

The proposed amendment to Article 136 TFEU recognises and clarifies the existing ability of euro area Member States to establish a financial stability mechanism. In doing so, it removes any doubt that might have existed as regards the legality of the euro area Member States acting in this respect, outside the framework of the EU Treaties. Let me be clear that the Government has no concerns about the legality of the ESM Treaty or its compatibility with the EU Treaties. It is not legally necessary for the Article 136 Treaty change to have been made before the ESM can come into force.

The December 2010 European Council agreed that the amendment to Article 136 TFEU, subject to ratification by all 27 Member States, should enter into force on 1 January 2013. This target date is included in the Decision itself and has not been amended as a result of euro area Member States’ agreement to bring forward the entry into force of the ESM Treaty. We are working to introduce the necessary legislation to gain Parliamentary approval of the Treaty amendment and deliver ratification by this deadline.
Written evidence received from Professor Paul Craig, University of Oxford

1. BACKGROUND PRINCIPLE

1. The Treaty on Stability, Coordination and Governance in the EU, hereafter the SCG Treaty, raises a number of issues. I begin with the question of principle raised by this development.

2. The Treaty provides clear rules as to its amendment in Article 48 TEU, with unanimity being required for change. There are in addition detailed Treaty rules concerning enhanced cooperation, which is regulated by its own procedures in Article 20 TEU and Articles 326–334 TFEU. These provisions contain the rules that have to be met if some but not all states wish to do certain things within the framework of the Lisbon Treaty rules. No attempt was made to use the rules on enhanced cooperation to attain the desired ends. The EU Summit in December 2011 attempted to change the primary Treaty, but failed because of the UK veto. It is perfectly possible for all Member States to agree to a Treaty amendment, which then only applies to some of them. This is in effect what occurred when, for example, the Schengen agreement was integrated in to the EU Treaty. This is in accord with the principle of unanimity, since all Member States agree to an amendment, the substance of which will henceforward only apply to some of them.

3. The Lisbon Treaty therefore embodies formal requirements before change can take place, viz the organization of the ordinary and the simplified revision procedure. These rules also have a substantive dimension. They enshrine the proposition that the rules of the game should not be altered unless all agree. They enshrine also substantive criteria as to what should happen when all do not agree, by offering the possibility for enhanced cooperation within the framework of the Lisbon Treaty. These amendment provisions might be different. They are not the only imaginable set of rules that could be devised for alteration of an international treaty, but it is common for such criteria to be applied and they are the criteria in the Lisbon Treaty.

4. The assumption underlying the SCG Treaty is that even though it has not been possible to attain unanimity, and even though the rules on enhanced cooperation have not been used, it is legitimate to attain the desired ends by a different route. A necessary condition for the legitimacy and legality of the SCG Treaty is that Member States retain inherent power to make international agreements that are consistent with the Lisbon Treaty. This may be a necessary condition for the legitimacy and legality of the SCG Treaty, but it is not a sufficient condition in this respect, since it still leaves open the issue as to whether, as a matter of principle, it is legitimate and lawful for EU institutions to be involved in such an agreement, provided only that it is carefully crafted so as to minimize the sense that new or modified functions are being conferred on those institutions.

5. It may well be possible to provide justificatory arguments to this end, but the desired conclusion cannot simply be assumed to be self-evident, nor can we assume that there is no issue of principle. The SCG Treaty is in effect seeking to do by a different route what it has not been possible to achieve by the normal methods of Treaty revision. It is of course true, as the framers of the SCG Treaty make clear, that it is not presently part of the Lisbon Treaty, and that the latter takes precedence. This does not however alter the point being made here.

6. The conclusion of the SCG Treaty therefore raises the following question of principle: 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?

7. There is some authority that the EU institutions can be used to assist the Member States in attaining their collective goals outside the strict confines of EU law (Cases C-181 and 248/91 European Parliament v Council and Commission [1993] ECR I-3685, [20] (aid to Bangladesh), “the fourth indent of Article 155 of the Treaty 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” and Case C-316/91 European Parliament v Council [1993] ECR I-653, Lome Convention, [41], “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.”). The reach of this authority is however unclear. These decisions are distinguishable in several respects from what is occurring pursuant to the SCG Treaty. Suffice it to say for the present that it would be a very significant extension of the reasoning therein to apply it to the instant circumstance.

8. I do not believe that the issue of principle presented in the preceding paragraphs is rendered moot by the fact that the UK latterly agreed not to object to use of EU institutions within the SCG. Space precludes detailed consideration of this issue. Suffice it to say the following for the present. I am not aware of the precise form of this UK acceptance, and there were clearly political pressures, internal and external, to reach this result. 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.

2. EU INSTITUTIONS: CONFESSION OF NEW FUNCTIONS

9. It is important to consider whether the SCG Treaty can confer new functions on the EU institutions. I believe that this would be contrary to the existing Lisbon Treaty and to legal principle. These will be considered in turn.

10. Article 13 TEU 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 therein. This is reinforced by Article 5(2) TEU, which provides that the EU must act within the limits of its competence, and that competence not conferred on the EU remains with the Member States. It would therefore be wrong if a Treaty other than the Lisbon Treaty could confer new powers or functions on the EU institutions.

11. This must also be correct when viewed from the broader perspective of legal principle. The contrary conclusion would entail the following proposition: it is open to a group of Member States outside the confines of the existing Treaties to decide in agreement with an EU institution that it should be empowered or mandated to perform certain tasks not specified in the existing Treaties. This conclusion is not tenable, and that is so irrespective of whether the relevant states are willing to pay for the “new function” from their own budgets, and irrespective of whether the EU institution agrees with the new power/duty. It cannot suffice to validate such a conferral that it relates in some way to existing institutional powers and duties under the Lisbon Treaty. Nor can it suffice in this respect that the Lisbon Treaty is accorded formal superiority over the other agreement.

12. The powers and functions of EU institutions are specified in the formal Treaties, after considerable deliberation between all states. The desirability of any addition to those functions is something on which all states might well have a view, and that is so irrespective of whether a particular state is party to an agreement made outside the formal confines of the Lisbon Treaty. Thus a state that is not party to an agreement outside the confines of the Lisbon Treaty may well believe that conferral of a new power on an EU institution might deleteriously affect the operation of the EU itself. The states might moreover differ as to whether they believe that an additional function is compatible with current powers and functions, and they might differ also as to whether they believe that the new function can be “hermetically sealed” from those functions performed by the institution within the formal roles assigned to it by the Lisbon Treaty.

13. The preceding analysis still leaves open the issue as to whether the SGC Treaty has conferred new functions/powers on the EU institutions. It may be contestable whether a function conferred by the SGC Treaty constitutes a new task or function for an EU institution. This is more especially so because institutional functions can be specified either in the Lisbon Treaty itself, or in EU legislation made pursuant thereto.

14. Consider for example SGC Article 3(2): The Contracting Parties must put in place at national level, “the correction mechanism mentioned in paragraph 1.c) on the basis of common principles to be proposed by the European Commission, concerning in particular the nature, the size and the time-frame of the corrective action to be undertaken and the role and independence of the institutions responsible at national level for monitoring the observance of the rules”. There are some obligations akin to those in Article 3(2) in existing EU legislation. Thus Directive 2011/85, Articles 5–7, contain obligations on all Member States, except the UK, to have numerical rules in place in their national law to promote compliance with its obligations deriving from the TFEU in the area of budgetary policy over a multiannual horizon. These rules should promote compliance inter alia with reference values on deficit and debt set in accordance with the TFEU. Member States must comply with the Directive by the end of 2013.

3. EU INSTITUTIONS: USE OF EXISTING POWERS

15. The analysis thus far still leaves open the issue as to whether there is any legal difficulty in EU institutions using their existing functions under the Lisbon Treaty and legislation made there under in the context of the SGC Treaty. The commentary on the SGC Treaty is often predicated on the assumption that this is not legally problematic. Thus on this view, provided that the SGC Treaty can be construed so as not to entail the grant of new functions/powers to EU institutions then it is not problematic in this respect. I do not share this assumption.

16. It is important to specify with greater precision what we mean by the EU institutions exercising existing powers within the confines of the SGC Treaty. This could bear three different meanings.

17. First, it could mean that the SGC Treaty simply takes cognizance of powers already contained in the Lisbon Treaty or legislation made there under. Secondly, it could mean that an EU institution, such as the Commission, will exercise existing power in the Lisbon Treaty/EU legislation in the context of the SGC Treaty. Thirdly, it might mean that an EU institution such as the Commission exercises a power under the SGC Treaty that is analogous to that which it possesses under the Lisbon Treaty/EU legislation.

18. The first interpretation captures the idea of the SGC Treaty making reference to the existing provisions of the Lisbon Treaty/EU legislation. Consider in this respect the references to existing provisions of EU law in Articles 9–11 of the SGC Treaty. This is not problematic legally.
19. The second interpretation connotes the idea that an EU institution, such as the Commission, will exercise existing power in the Lisbon Treaty/EU legislation in the context of the SCG Treaty. This is legally problematic for the following reason. The fact that a power is recognized in the Lisbon Treaty or EU legislation does not per se legitimate recognition and use of the same power in a different institutional context, viz. under the SCG Treaty. 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. Thus the statement in the Preamble to the SCG to the effect that when reviewing/monitoring the budgetary commitments under the SCG Treaty, the Commission will act within the framework of its powers as provided by Articles 121, 126, 136 TFEU, cannot in itself determine the issue of whether those Articles of the TFEU are indeed capable of being used in this way in the SCG Treaty.

20. Whether the same power can be used in a different institutional context must therefore as a matter of principle depend on interpretation of the Lisbon Treaty/EU legislation. It would have to be argued that the proper interpretation of the relevant institutional provisions of the Lisbon Treaty was such that the Treaty powers, and those in EU legislation, could also be used by the institutions pursuant to a different Treaty, and one which was not ratified by all Member States. It might be possible to reach this conclusion, but it is not self-evident or automatic. This is because the natural interpretation of EU legislation is that the institutional powers and duties contained therein apply in the legal context that is the EU. The Lisbon Treaty or EU legislation might of course empower an EU institution to take action outside the physical and legal confines of the EU. This does not however alter the point being made here, since in such circumstances the legal authority for an EU institution to act in this manner flows from the Treaty provision or EU legislation. The default assumption is that EU legislation and the powers accorded to the institutions apply and are intended to apply within the legal entity that is the EU. It would therefore have to be argued that an institutional power given under, for example, the Stability and Growth Pact could be interpreted to apply outside the legal entity that is the EU and be used in the context of the SCG Treaty. It may be possible to sustain such a conclusion, but the justificatory exercise has not to my knowledge been undertaken.

21. To reject the argument in the preceding paragraph would mean subscribing to the following proposition: institutional powers granted under the EU Treaty or EU legislation can be used, “cut and pasted”, to a different Treaty, which has not been ratified by all Member States. This proposition is not legally or politically tenable. Whether any particular power granted to an institution under the Lisbon Treaty or EU legislation can be used in a different Treaty context must depend on interpretation of the relevant EU Treaty provision or EU legislation to sustain the conclusion that it can be used in this manner.

22. The third interpretation of “existing power” is that an EU institution such as the Commission exercises a power under the SCG Treaty that is analogous to that which it possesses under the Lisbon Treaty/EU legislation. This is also legally problematic. 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. Thus to take an example, the fact that Articles 5–7 of Directive 2011/85 contain obligations on all Member States (except the UK) from 2013 to have numerical rules in place in their national law to promote compliance with obligations from the TFEU in the area of budgetary policy over a multiannual horizon, does not in itself legitimate use by the Commission of analogous powers pursuant to Article 3(2) of the SCG Treaty. The fact that a power under the SCG Treaty is analogous to a power that is exercised under EU legislation is just that: a fact. It cannot in itself cloak with legal legitimacy the exercise of an analogous power under the SCG Treaty. The legal legitimacy of such power can only be provided in the following manner. 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. This argument might be sustained. A moment’s reflection will make one realize that the argument is not however self-evident. It is certainly too broad to be sustainable in its present formulation, and it is not easy to narrow it down while retaining something that could still be regarded as a meaningful principle.

23. The actual wording of the SCG Treaty is mixed as between the second and third interpretations of “existing power”. Thus the wording of some provisions, such as Article 4 SCG, is framed clearly in terms of the relevant provisions of the Stability and Growth Pact and Article 126 TFEU, so in this context the idea of use of existing institutional power carries the second connotation: the Commission exercises the specific powers under the Stability and Growth Pact and Article 126 TFEU in the context of the SCG.

24. The wording of other provisions carries the third connotation. Article 3(2) SCG is framed in terms of the Commission devising principles concerning corrective action that may be analogous to those in EU legislation, but does not directly seek to use such powers, and thus in this context the idea of using existing institutional power carries the third connotation. Article 7 SCG is of the same genre. It imposes a reverse qualified majority voting requirement: contracting states prima facie commit to abide by the Commission’s decision, but they can decide not to do so by qualified majority. There are circumstances under the Lisbon Treaty and EU legislation where reverse QMV applies, but Article 7 is not expressly based on such provisions, nor would this have been straightforward in legal terms. Thus insofar as Article 7 can be regarded as use of “existing power”, it carries what I have termed the third interpretation: the SCG Treaty contains an institutional power that is analogous to that in the existing Lisbon Treaty/EU legislation.
25. The wording of yet other provisions, such as Article 3(1)(b) SCG, is ambiguous in this respect, since it is framed in terms of progress towards the medium term objective being decided “in line” with the provisions of the Stability and Growth Fact.

4. INSTITUTIONS: THE ECJ

26. Article 8 SCG provides for recourse to the ECJ via Article 273 TFEU, which provides that “The Court of Justice shall have 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”. There are a number of issues concerning use of this Treaty article.

27. First, there has been some political misapprehension about use of the ECJ. Thus there was much media coverage at the end of January asking whether the UK should veto use of Article 273, or something equivalent thereto. This was mistaken in the following sense. The UK could not prevent inclusion of Article 273 within the SCG Treaty because it was not a party to it. Nor could the UK “veto” recourse to Article 273 from Article 4(2) of the SCG Treaty, because the salient issue is the legitimate ambit of Article 273, and that is an issue on which the ECJ is ultimate authority. The most that the UK could do, if it was so minded, would be to challenge use of Article 273 before the ECJ and contend that it did not cover the circumstance of the SCG Treaty. It would then be for the ECJ to decide this issue.

28. Secondly, the Council Legal Service produced a paper defending the legitimacy of recourse to Article 273 TFEU. My view is that if the matter were tested before the ECJ it would uphold, at least in part, the legality of Article 8 SCG. This is because the SCG Treaty relates to the subject matter of the Lisbon Treaty, and there is a policy relationship with the system of economic coordination provided for under the TEU and TFEU.

29. Thirdly, I do not believe that Article 273 TFEU could have accommodated an action brought directly by the Commission under Article 273 TFEU, nor does the Council Legal Service. I also believe, contrary in this respect to the Council Legal Service, that the Commission’s role under Article 8 is still problematic. The reality is that Article 8 in its current formulation gives the Commission the “trigger” as to whether a legal action should be brought. The idea that the Commission is “invited” by the contracting states to present a report on their respective compliance with Article 3(2) SCG cannot conceal the reality, which is that Commission oversight of the balancing of budgets is central to the SCG schema. The requirement of an “invitation” is therefore purely formal, a sense which is heightened by the very fact that Article 8 is framed in terms of a collective invitation. If the Commission produces a negative report on a particular contracting state, this triggers a mandatory obligation on one or more of the other contracting parties to bring the recalcitrant state to the ECJ. The legal action will be argued on the basis of the Commission’s negative report. The reality is therefore that the Commission is still “bringing” the action. Insofar as this is so, there is moreover a tension between Article 8 SCG and Article 126(10), which precludes Commission enforcement actions under Articles 258–259, in relation to the subject matter of Articles 126(1+(9) TFEU. If a Member State attempted to structure its relations so as to avoid obligations contained under EU law, the ECJ backed by the Commission and Council Legal Service would rightly conclude that we should look to the substance and not the form when considering the legality of such practices. The same principle should apply in relation to powers of the EU institutions. If Article 273 cannot accommodate enforcement actions brought directly by the Commission, we should not allow this injunction to be circumvented by devices that render a contracting state the “formal plaintiff”, when the imperative to bring the action and the substance of the argument to be made are determined by the Commission.

30. Fourthly, there are further interesting questions as to how the “prosecuting” state should be chosen. It will almost certainly have to be via a taxi cab rule, since any other criteria would entail invidious discretion. This then generates a plethora of other difficulties, viz for example the unwillingness of a small state to be given this onerous responsibility against a much larger state.

31. Fifthly, the rationale for the wording of Article 8 is not hard to divine. The framers of the SCG Treaty implicitly acknowledged that contracting states would be reluctant to sue each other, which is the other option in Article 8. They have been very reluctant to use the analogous powers under the TFEU. If inter-state actions were the only way to invoke the ECJ’s jurisdiction under the SCG Treaty then it would in practice remain a dead letter. This explains the Commission’s role as defined in the first half of Article 8 and the efforts made by the drafters to square this with the precept that the Commission cannot itself bring a legal action under Article 273.

32. The final point that should be made about recourse to the ECJ is that Article 8 is dependent on proof of breach of Article 3(2). The success of any such legal action has however been made considerably more difficult, because Article 3(2) has been watered down significantly. This point will be developed below.

5. THE OBLIGATION TO BALANCE THE BUDGET

33. The obligation to balance the national budget is the core of the new SCG Treaty. This obligation is contained in Article 3(1)(a), and must be read with Article 3(1)(b), which defines its substance, and with Articles 3(1)(c)-(e) and Article 3(3), which qualify the basic obligation. The consequences of the new Treaty
34. First, as other commentators have pointed out, the SCG Treaty does not advance matters very much from the obligations contained in the EU Treaty and accompanying legislation. The EU rules relating to EMU are now found in the Lisbon Treaty provisions plus what is known as the “6 pack” of measures enacted in 2011 to bolster the rules on economic union. Some of these measures apply to the Euro zone countries, others apply to all Member States of the EU. The difference between the obligations imposed pursuant to these measures and those already contained in the EU Treaty plus the package of 2011 legislation is not very significant. Thus for example the 0.5% rule in Article 3(1)(a) SCG is different, but not very much from the rule in the revised Regulation 1466/97, Art 2a, as amended in 2011, where the deficit rule is 1%. The prima facie absolute obligation to balance the budget in Article 3(1)(a) is subject to exceptions and is further qualified by the fact that it is expressed in Article 3(1)(b) as an obligation to “converge” with the balanced budget rule.

35. Secondly, the extent of what might be achieved under the existing Treaty rules has not been fully tested. It is arguable that everything in the new Treaty might have been done under the existing Lisbon Treaty provisions, including those on enhanced cooperation. The pressure for revision to the primary Treaty came mainly from Germany, which wanted tighter rules of fiscal discipline embodied in the primary Treaty, not just in EU legislation. This does not mean that the substance of what is in the SCG Treaty might not have been accommodated in EU legislation. Given what has already been included in the 2011 measures the indications are that it could all have been done in this way. It should however also be noted in this context that Article 10 SCG as presently formulated is not consistent with the Lisbon Treaty. If the contracting states wish to make use of enhanced cooperation they have to comply with all the conditions in the Lisbon Treaty. Thus the enhanced cooperation must not undermine the internal market. It must also not undermine economic and social cohesion, constitute a barrier to or discriminate in trade between Member States, and it must not distort competition between them.

6. The Correction Mechanism

36. A novelty of the SCG Treaty is said to be the correction mechanism enshrined in Article 3(2), more especially because it is enforceable through the ECJ via Article 8 SCG considered above. It should be noted that Article 3(2) contains two related, but distinct, obligations. There is a general obligation for contracting states to ensure that the rules in Article 3(1) take effect in national law in one of the ways mentioned in the first sentence of Article 3(2). There is in addition an obligation on contracting states to have a correction mechanism in place in the event of deviation from the balanced budget criteria in Article 3(1). There are two points to be noted about the novelty and efficacy of Article 3(2).

37. First, in terms of novelty, it should be noted that existing EU rules contain some analogous rules. The issue of a debt brake in Article 3(2) SCG is already addressed in Directive 2011/85, Arts 5–7, although this does not apply to the UK because of Article 8. These rules provide that each Member State should have in place numerical fiscal rules which are specific to it and which effectively promote compliance with its obligations deriving from the TFEU in the area of budgetary policy over a multiannual horizon for the general government as a whole. Such rules shall promote in particular: compliance with the reference values on deficit and debt set in accordance with the TFEU; and the adoption of a multiannual fiscal planning horizon, including adherence to the Member State’s medium-term budgetary objective. These country-specific numerical fiscal rules must contain specifications as to the following elements: the target definition and scope of the rules; the effective and timely monitoring of compliance with the rules, based on reliable and independent analysis carried out by independent bodies or bodies endowed with functional autonomy vis-à-vis the fiscal authorities of the Member States; and the consequences in the event of non-compliance. If these numerical fiscal rules contain escape clauses, they must in effect be tightly drawn and there must be stringent procedures to determine when they can be applied. The difference between the SCG and the existing Treaty rules will be further reduced if and when COM(2011) 821 becomes law. Article 4 of this draft regulation, which is applicable to all Member States, provides that: Member States shall have in place numerical fiscal rules on the budget balance that implement in the national budgetary processes their medium-term budgetary objective as defined in Article 2a of Regulation (EC) No 1466/97. Such rules must cover the general government as a whole and be of binding, preferably constitutional, nature.

38. Secondly, the efficacy of Article 3(2) SCG can also be questioned, because it has been weakened through successive amendments to the SCG. The December 2011 version was framed in terms of a mandatory obligation to comply with the principles in Article 3(1) by enshrining this obligation in national binding provisions of a “constitutional or equivalent nature”. This was reinforced by the fact that Article 8 SCG mandated national courts to check that contracting states had put in place rules to comply with Article 3(2). The wording of Article 3(2) in version 3, 10 Jan 2012, was weaker: the rules in Article 3(1) were to be enforced through “provisions of binding force and permanent character, preferably constitutional, that are guaranteed to be respected throughout the national budgetary process”, and the national courts’ role of monitoring compliance with the rules was removed. Article 3(2) was further weakened by version 4 of 19 January. The current wording in the version of 31 January 2012 modified this slightly. It now provides that the 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”. A contracting state under the SCG can therefore argue that its ordinary budget processes contain in and of themselves sufficient controls to meet the demands of Article 3(1). To put the same point another way, 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. It suffices in this respect that they take effect in ordinary budgetary processes, which may often not be defined in statute at all.

7. A “DIVIDED” UNION

39. There was much talk at the time of the UK veto of the draft Treaty changes in December 2011 that it would lead to a radical division within the EU. The picture of a radically divided EU 25/2, with the majority subject to a plethora of rules not applicable to the UK is not borne out by the substance of the new Treaty. This is so for two reasons.

40. First, the SCG Treaty contains far less that goes over and beyond the obligations already contained in the Lisbon Treaty/EU legislation than was initially thought after the December summit. The SCG Treaty does not contain provisions that could be used for some radical closer political union, nor does it provide legal foundation for the enactment of provisions relating to, for example, financial transactions or the internal market.

41. Secondly, the image of a divided EU, split 25/2, is predicated, implicitly if not explicitly, on the assumption that the 25 will share a common vision that is distinct from the UK and Czech Republic. This is unlikely to be borne out in reality for a variety of reasons. If the precepts contained in the SCG are taken seriously it will lead to increased EU oversight over domestic economic affairs and it might well lead to inter-state legal actions mandated through Article 8 SCG. This is unlikely to generate inter-state harmony between the 25 signatories of the SCG. It is one thing to subscribe to the principles in the SCG, it is another to have them applied within one’s own domestic polity, and yet another to have them applied against one’s own state via legal means. It should perhaps not be forgotten in this respect that it was France and Germany that violated the rules of the Stability and Growth Pact as they existed in 2003–04, which ended up in legal action before the EU courts.

7 February 2012

Written evidence from Martin Howe QC

1. I have prepared this note on the basis of the draft of the proposed Treaty on Stability, Coordination and Governance dated 31 January 2012 (ie post-summit). I wish to record my gratitude for the extensive and comprehensive analysis already submitted as evidence by Prof Michael Dougan and Dr Michael Gordon of Liverpool Law School. This allows me to concentrate my own written evidence on what I see as the key points in the proposed Treaty which may potentially create problems with regard to its relationship with the EU treaties (TEU and TFEU), or for the United Kingdom in the future.

OBLIGATION TO ACT AS A VOTING BLOC

2. Article 7 of the draft Treaty obliges the Contracting States whose currency is the euro to act as a coordinated voting bloc in supporting proposals or recommendations of the Commission against a Member State under the excessive deficit procedure for breach of the debt criterion, unless those States decide to oppose it by QMV in an internal caucus vote involving only them. The purpose of Article 7 seems to be to secure the same functional result as if Article 126 TFEU had been amended to provide for “reverse QMV”, ie for Commission proposals to be carried unless there is a qualified majority against them.

3. When the Council takes decisions against a Member State under the excessive deficit procedure, it acts without the Member State concerned being allowed to vote (Art 126(13) TFEU, second sentence). Further, Member States which have not adopted the euro are excluded from voting in the Council on recommendations and “coercive” measures under Article 126 (see Art 139(4)). It follows that if all euro States do sign and ratify the draft Treaty, then Article 7 would achieve the same functional result as an amendment to Article 126 which provides for Commission proposals to be carried unless a qualified majority of euro States (excluding the alleged defaulter) vote against them.

4. I am seriously concerned about whether this “voting bloc” arrangement is lawful or compatible with the obligations owed by Member States under TFEU. I am also concerned about the effect of this provision as a precedent if it is left unchallenged: what if in future the States who become parties to this Treaty were to agree to act as a coordinated voting bloc in the Council of Ministers on eg single market measures such as those relating to financial services regulation which cover the whole EU?

5. The questionable consequences of Article 7 can be seen most clearly if one or more eurozone States (whether for constitutional or other reasons) do not participate in the draft Treaty. Since it will come into force on ratification by 12 euro States (see Article 14(2)), it is theoretically possible that up to five euro States might not be members of the new Treaty when it comes into force. Yet Article 7 would apply to proposed measures directed against any non-participating euro States as well as to sanctions directed against parties to the new Treaty. The States which have ratified the Treaty are required to band together in the Council and vote to impose coercive measures on that State if recommended by the Commission.
6. I agree with Prof Dougan and Dr Gordon that in general it cannot be contrary to the EU Treaties for Member States to exercise their votes in the Council on the basis of political agreements and horse-trading. However, I consider that it is strongly arguable that Article 126 TFEU obliges the representatives of the Member States on the Council to act in what amounts to a quasi-judicial capacity when a State is subject to the excessive deficit procedure. Art 126(6) explicitly requires the Council to consider “any observations which the Member State concerned may wish to make” before deciding that an excessive deficit exists. In my view this implicitly requires that each of the representatives of the Member States on the Council, and the Member States themselves in instructing their representatives, shall consider those representations fairly and vote in good faith having considered them. The arguments for the existence of such a duty are reinforced by the fact that the Member State “in the dock” is stripped of its own voting rights in this situation so cannot even vote in its own defence. I consider that it is strongly arguable that Article 7 of the draft Treaty, by fettering its Contracting States to vote in accordance with the bloc’s collective view under an internal “reverse QMV” vote among the caucus, is incompatible with such a duty.

7. It could be argued that it is unlikely that the United Kingdom could be adversely affected by Article 7 of the draft Treaty, except in the vanishingly unlikely event that it were to decide to join the euro. Accordingly it can be said that it is unlikely that the United Kingdom’s interests would be directly affected. However, 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.

8. It can also be seen that other provisions of the draft Treaty are structured to have a coercive effect on eurozone countries who do not ratify it. Article 12 provides that the President of the Euro Summit shall be appointed by the Contracting States whose currency is the euro, so excluding non-Contracting euro states from voting, and as far as I can see they would be excluded from participating in the Euro Summits as well.

USE OF EU INSTITUTIONS FOR PURPOSES OF THE DRAFT TREATY

9. The draft Treaty purports to co-opt the Court and the Commission to serve certain purposes under that Treaty which extend beyond their functions under the EU Treaties. Article 8 of the draft Treaty purports to confer jurisdiction on the Court under Article 273 TFEU, which reads:-

“The Court of Justice shall have 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.”

10. Starting from first principles, I would be 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. A “special agreement between the parties” would normally mean an ad hoc agreement relating to a particular dispute which had arisen, between the parties to that dispute. However, Prof Dougan and Dr Gordon rightly point out that the predecessor to Article 273 TFEU in the EC Treaty has been treated in the past as having a wider scope than its actual words suggest. Since the Court has generally been avid to expand its own jurisdiction, I would expect the Court to find that it does have jurisdiction to entertain actions in circumstances envisaged by Art 8 of the draft Treaty.

11. The draft Treaty co-opts the services of the European Commission to propose “common principles” for the deficit “correction mechanism” which each Contracting State is obliged to incorporate in its internal law under Art 3(1)(e), and to provide reports on the compliance by each Contracting State with the requirements of Art 3(2) on incorporating such a mechanism into national law. This function is analogous to the normal function performed by the Commission in relation to directives, first of proposing them and then of monitoring the internal laws of Member States to ensure that they have been transposed correctly.

12. I consider that these provisions are more troubling in terms of the precedent they set than in terms of their actual effects. It is hard to see how the United Kingdom is directly disadvantaged by the fact of the Commission performing these particular functions, which are essentially enforcement functions directed against the particular Member States who ratify the new Treaty. It could be argued that it is in the UK’s interests if excessive deficits by euro States are more effectively controlled. Although the time of Commission staff will be taken up with these tasks, any resource implications look to be very modest indeed compared with the Commission’s overall activities.

13. However, the Commission should be the equal servant of all Member States under the Treaties. This is fundamental to all aspects of its role and status. It is therefore troubling if it takes on what could be called private consultancy work outside the framework of the EU Treaties for a sub-group of Member States. 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.

51 Para 10 of their evidence.
52 Paras 13 and 15.
14. Prof Dougan and Dr Gordon point out that the Court has in two cases\(^{53}\) sanctioned the right of Member States to associate Community institutions with tasks outside the framework of the Treaties. However in both those cases, all the Member States were parties to the agreements which had effectively conferred additional tasks\(^{54}\) on the institutions. It does not follow that a sub-group of Member States is entitled to impose additional tasks or confer additional functions on EU institutions without the consent of all Member States. But I agree with Prof Dougan and Dr Gordon\(^{55}\) that EU law at present offers no clear answer to this question.

15. I suspect that in the present scenario the best course for the UK might be to indicate that it does not object to the Commission being involved with these particular tasks under the proposed Treaty because it wishes to assist the members of the eurozone putting their houses in order, but that in principle the UK believes that such a use of EU institutions requires the consent of all Member States and that it reserves the right to object to any similar arrangements in future which are entered into without its consent.

**COMPATIBILITY WITH THE SINGLE MARKET**

16. A broader question is the general compatibility of this draft Treaty with the rules of the single market under the EU treaties. As Prof Dougan and Dr Gordon have noted, the draft Treaty in formal terms is subject to the EU treaties including their single market provisions. In view of its status, it cannot be otherwise. In law, the parties to this treaty cannot cut down or alter the obligations which they owe under the anterior EU treaties. In this respect it differs from the situation which would have arisen if its provisions had been grafted on to the EU treaties by way of amendment, when in principle the amending provisions might have altered the scope or effect of other parts of TEU or TFEU.

17. I believe that any concern over the relationship between this Treaty and the single market is not so much over its formal terms, but rather over its encouraging patterns of behaviour which might spill over. 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?

18. This is a question which is difficult to answer. The prospect of euro area states acting as a more or less cohesive bloc within a wider Union which includes non-euro states is an intrinsic consequence of the structure, in combination with the general extension of QMV to single market measures which took place under the Single European Act. This is a fundamental problem which in my view needs to be solved in some way if it is not to call into question the sustainability of the UK’s continued membership of the EU under current arrangements.

5 February 2012

**Further questions asked to Professors Craig, Dougan and Peers, by the European Scrutiny Committee**

A couple of points have arisen since you submitted or gave evidence and on which your further evidence would be greatly appreciated.

The first is whether the Government is right in saying that the use of “will” instead of “shall” in Article 8 means that there is not a legal obligation placed on Contracting Parties. I attach the relevant transcript of evidence—see questions 153–156. Your evidence on this would be very useful.

The second is the annex to the Minutes of the signing of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, which concern the application of Article 8 (also attached). We are interested in the legal status of the annex—as above, does it create legal obligations for the Contracting States and should it be considered an international treaty?—and the plausibility/practicability of the agreed arrangements. We have asked the Government to comment on these issues and would be grateful if you were able to too.

14 March 2012

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\(^{53}\) In para 21 of their evidence; the two cases are referenced in their footnote 26.

\(^{54}\) The tasks were assisting with the payment (from funds provided by Member States outside the Community budget) and administration of overseas aid under agreements to which both the Community and the Member States were parties.

\(^{55}\) Their para 26.
Response from Professor Paul Craig, University of Oxford to supplementary questions

Question 1
1. The first question concerns the interpretation of Article 8 SCG. It was argued by the legal advisor to the FCO that Art 8 does not impose a binding obligation on the contracting states, the reason being that the wording is framed in terms of “will” not “shall”. I do not agree with this for the following reasons.

2. First, it is clear as a matter of first principle that the word “will” is fully capable of connoting an obligation. Thus to take but two simple examples, the following uses of that word would be accepted as entailing acceptance of an obligation: “If you supply me with 50 tons of wheat, I will pay you £1,000”; “I will pick up the children from school if you are unable to do so”. The first of these is clearly an enforceable legal obligation, the second almost certainly not, but the use of the word “will” nonetheless clearly connotes an obligation in both instances and would be read that way by all concerned.

3. Second, the fact that a duty or obligation is dependent on acceptance by the person so obliged is no barrier to the existence of the obligation. This axiomatic point is exemplified by contracts: the contracting parties are only under their respective contractual obligations if they agree to be so bound. Thus the fact that under the SCG Treaty the contracting states have consented to the obligation incumbent on them under Art 8 is no barrier to the recognition that the bringing of an action pursuant to a negative Commission report on a particular state is obligatory for the other contracting states.

4. Third, the fact that there may be difficulties in enforcing the contracting party’s obligations to bring the action under Art 8 is no reason in principle to deny the existence of the obligation. It is clear as a matter of principle that the existence of an obligation and practicalities as to its enforceability are separate conceptual issues, notwithstanding the fact that they are linked in terms of the efficacy of the particular regulatory schema. It should in any event be noted that the SCG Treaty constitutes an international Treaty and would therefore be subject in principle to the normal legal enforcement mechanisms for such international instruments, notwithstanding the fact that it is unlikely that the Commission would use such mechanisms if the contracting states did not fulfil their obligations under Art 8.

5. The final point concerns the overall structure of Art 8. It clearly distinguishes between the situation where there is an adverse report from the Commission and the situation where there is not. In the former scenario the contracting states “will” bring an action, in the latter a contracting state “may” do so. The former is therefore clearly intended to be more peremptory than the latter, and this is reinforced by the wording of the Annex, which determines the contracting states that must bring the action. The wording of paragraph 1 of this Annex makes clear that the negative Commission report immediately triggers the legal action by the contracting states: it must be brought within three months. If the interpretation given by the FCO is correct then the distinction within Art 8 fall away. On the FCO view the “will” in the first half of Art 8 appears to have no more force than the word “may” in the second half. It is a cardinal rule of Treaty interpretation that effect must be given to the Treaty words used in the particular context. I fail to see how the FCO interpretation achieves this.

Question 2

6. In my view the Annex constitutes a formal part of the SCG Treaty. There is nothing to prevent Treaties having annexes or appendices, and for them to be binding. This view is reinforced in the instant case by the way in which the Annex is drafted, the peremptory language and the express, formal agreement by all the contracting states.

7. In terms of practicality, the “solution” as to who brings the action seems sensible. By assigning the task to the trio of states that hold the Presidency it thereby avoids imposing an undue burden on any particular state. Moreover the trio of states that hold the Presidency for the relevant period know that they are “on duty” in a general sense of that term.

8. Two brief caveats to the previous paragraph. First, the very fact that the Annex draws on the institutional schema in the Lisbon Treaty nonetheless reinforces the more general unease about EU institutions and institutional mechanisms being used pursuant to a non-EU Treaty. Secondly, it is clear that the trio solution will have to be modified where the UK or the Czech Republic form part of the Presidency, although paragraph 2 of the Annex has sufficient flexibility to cope with this.

20 March 2012
Response from Professor Michael Dougan, Liverpool Law School to Further Queries from the European Scrutiny Committee Concerning Article 8 of the Treaty on Stability, Coordination and Governance

I am very happy to provide my views on two specific queries raised by the European Scrutiny Committee in relation to its public inquiry into developments in the Eurozone.

“The first is whether the Government is right in saying that the use of ‘will’ instead of ‘shall’ in Article 8 means that there is not a legal obligation placed on Contracting Parties. I attach the relevant transcript of evidence—see questions 153 -156. Your evidence on this would be very useful.”

There are two possible interpretations of the relevant provisions of Article 8(1) TSCG:

1. that “will” actually means “may”: the Contracting Parties still retain a legitimate political discretion about whether to bring proceedings before the ECJ even despite an adverse Commission report establishing non-compliance with Article 3(2) TSCG; or
2. that “will” actually means “shall”: the Contracting Parties are obliged under the TSCG to bring proceedings before the ECJ where the Commission’s report finds non-compliance with Article 3(2) TSCG.

Both of those approaches are plausible as a matter of legal interpretation—though one should of course stress the need to undertake a proper comparative analysis of the wording used in other authentic language versions of the TSCG (eg the French version states that “la Cour de justice de l’Union européenne sera saisie de la question par une ou plusieurs parties contractantes”; eg the Spanish version states that “el asunto será sometido al Tribunal de Justicia de la Unión Europea por una o más Partes Contratantes”).

On balance, however, interpretation 2) seems to me the more likely candidate, for the following reasons:

— “will” in English (and “sera” as used in the French version, or “será” as used in the Spanish version) naturally implies something closer to mandatory than to discretionary action;
— the “Arrangements Agreed by the Contracting Parties at the Time of Signature Concerning Article 8 of the Treaty” refer (in paragraph 2) to “the duty to bring the matter to the Court of Justice...”, ie providing evidence that the intention of the Contracting Parties was indeed to create an obligation (not confer a mere discretion);
— interpretation 2) fits better with the broader scheme of Article 8(1): the Contracting Parties already have a discretionary power, independently of the Commission’s report, to bring proceedings before the ECJ; it might therefore seem superfluous to say that the Contracting Parties have a discretionary power also consequent upon the Commission’s report, since that power would add nothing to what already exists under the Treaty; and
— interpretation 2) also fits better with the underlying purpose of Article 8(1) and indeed of the TSCG more generally: imposing an obligation upon the Contracting Parties to bring judicial proceedings in the event of a non-compliance reported by the Commission serves to enhance the credibility of the Treaty, and its new rules for budgetary discipline within the single currency, by increasing the automaticity of enforcement mechanisms against a recalcitrant Contracting Party, and by minimising the scope for (in)action motivated by extraneous political concerns.

However, even if interpretation 2) does indeed prove to be correct, one should bear in mind three important qualifications:

— first, as I pointed out in my oral evidence to the Committee, there is nothing inherently objectionable in the idea that the Contracting Parties have defined certain circumstances (an adverse report from the Commission) under which a discretion to commence legal proceedings before the ECJ will be transformed into an obligation to do so. Article 273 TFEU is a voluntary jurisdiction and the Contracting Parties which rely upon it should quite rightly be recognised as enjoying a broad discretion in designing an enforcement system which best suits their own preferences—provided only that those preferences do not come into conflict with the existing EU Treaties. That would be case, eg if the Commission were being asked to act in a manner incompatible with its duty of independence and impartiality; or if the Court were requested to exercise judicial powers not conferred upon it pursuant to EU law. However, there is no evidence of such a conflict in the design of Article 8(1) TSCG;
— secondly, even if brought as a matter of obligation rather than discretion, proceedings based upon Article 8(1) TSCG would remain proceedings brought by the Contracting Parties, not by the Commission itself. The Commission is in no way entitled to bring proceedings before the ECJ pursuant to the TSCG: Article 8(1) presupposes an intervening Member State act, after the Commission has produced its adverse report; in the absence of such Member State intervention, legal action cannot validly be commenced before the ECJ; and
— thirdly, as pointed out by Ivan Smyth in his oral evidence to the Committee, Article 8(1) TSCG has no enforcement mechanism or system of sanctions of its own: even if the Contracting Parties refused to respect their own obligation to bring proceedings before the ECJ, consequent upon an adverse Commission report, there is little that could actually be done about it.
“The second is the annex to the Minutes of the signing of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, which concern the application of Article 8 (also attached). We are interested in the legal status of the annex—as above, does it create legal obligations for the Contracting States and should it be considered an international treaty?—and the plausibility/practicability of the agreed arrangements. We have asked the Government to comment on these issues and would be grateful if you were able to too.”

On the question of the legal status of the Annex to the Minutes of the Signing of the TSCG, that is a matter of international law best addressed by specialists in international law. However, I would venture to offer a few relevant observations on the potential legal value of the Annex:

— the mere fact that the Annex is not contained in the main body of the final TSCG does not necessarily mean that it is devoid of legal effects, ie if there are indications that the Contracting Parties nevertheless intended to be bound by the terms of the Annex.

— in that regard, the arrangements concerning Article 8 TSCG are stated to have been “agreed” by the Contracting Parties (as opposed, eg to being merely declared or noted by those Member States).

— it is also significant that the arrangements are expressed in mandatory language (will, shall etc).

— the arrangements have also been drafted in relatively precise and detailed terms, eg including clear rules for identifying the Contracting Parties that shall be responsible for bringing legal proceedings under Article 8(1) TSCG; eg laying down clear timeframes for action required under the terms of the Annex.

Such factors might tend to support the conclusion that the Contracting Parties did indeed intend to be bound by the contents of the Annex, notwithstanding that the latter does not form an integral part of the text of the TSCG itself.

On the issue of the plausibility/practicability of the arrangements agreed under the Annex, one should bear in mind that an important element in the governance reforms contained in the TSCG lies precisely in their increased automaticity and greater independence from extraneous political influences. In particular, earlier drafts of what is now Article 8(1) TSCG were criticised on the grounds that enforcement proceedings were dependent upon voluntary action by the Contracting Parties, and thus vulnerable to direct or indirect political pressures that might render the possibility of judicial censure redundant in practice.

The arrangements set out in the Annex seek to overcome that potential deficiency by providing a system for identifying the Contracting Parties which will assume responsibility for initiating legal proceedings in the event of an adverse Commission report. The primary criterion (membership of the rotating trio presidencies within the Council) is entirely objective, so that the method for identifying Contracting Parties is, and is clearly understood to be, “depoliticised”. The objective nature of the enforcement system is reinforced (on the one hand) by the fact that the selected countries are expressed to be acting in the interests of all relevant Contracting Parties; and (on the other hand) by the possibility of exempting countries which might in practice have a compromising interest in the conduct or outcome of the forthcoming proceedings.

That is not to deny that the enforcement system contained in Article 8 TSCG, read together with the Annex, is relatively cumbersome. But the Contracting Parties do at least appear to have devised an enforcement system which overcomes the risk of judicial action being rendered entirely dependent upon political discretion. To that extent, almost regardless of whether or not it is ever actually put into practice, the Annex does contribute to the wider goal of bolstering the credibility of the “fiscal compact”—which is widely seen as vital not just for restoring market confidence, but also in persuading key institutional actors to support further interventions in favour of financially beleaguered Eurozone states.

20 March 2012

Response from Professor Steven Peers, Law School, University of Essex, to Further Queries from the European Scrutiny Committee Concerning Article 8 of the Treaty on Stability, Coordination and Governance

On the first point, my view is that first of all, it must be observed that the various language versions of the treaty are equally authentic (Article 16 of the treaty). A final view of the meaning of the word “will” would therefore depend on the interpretation of the relevant word in each of the other language versions, and whether this word is identical to the word “shall” in the relevant language or otherwise connotes a legally binding obligation.

Focussing only on the English-language version, the word “will” also occurs in the preamble and in Articles 3(1)(b), 4, 5(1), 5(2), 11, 12(3) and 13. In the case of Articles 4 and 5(1) in particular, it would make little sense in the overall context of the treaty if the word “will” did not connote a binding obligation. Looking at the wording of the rest of the treaty, it appears that when the contracting parties wanted to indicate that a particular provision was not binding, they used the word “may”—as in Articles 3(1)(c), 8(1) third sentence, 8(2), 12(4) and 12(5). The use of the word “may” instead of “will” in Articles 8(1) third sentence, and 8(2) is surely particularly relevant, since this can be immediately juxtaposed with the use of the word “will” in the second sentence of Article 8(1), which addresses the same subject-matter. Surely if the contracting parties
wished to indicate that the second sentence of Article 8(1) was not legally binding, they would simply have used the word “may”, as they did in the following sentence as regards the same issue. The use of different words in the same legal context clearly indicates a degree of obligation, in light also of the choice to provide for separate rules in the first place. Similarly, the word “will” can be compared with the word “may” in Articles 258 and 259 TFEU, which address a very similar legal issue. Also, it should be noted that even the word “commit” in the first sentence of Article 7 is described as an “obligation” in the second sentence of that Article, indicating that the contracting parties did not limit their intention to create obligations to cases where they used the word “shall”. Finally, there are clear indications that where the parties did not wish to create obligations, they used quite different wording, notably “is invited” (also in Article 8(1)), “undertake” (Article 9), and “stand ready” (Article 10).

On the second point, first of all the lack of transparency of these minutes should be criticised. The final signed version of the treaty has been made available to the public on the Council website without any indication that Member States have also agreed to these important arrangements. I have not seen these arrangements published anywhere else either.

On the substance of the issue, international law does not prescribe a particular legal form for treaties (ie “arrangements” or not), so the intention to create binding legal obligations depends on an interpretation of the substance of the measure in question. Interpreting the substance of this measure, the chapeau and the first five paras use the word “will”, while the sixth paragraph uses the phrase “state their intention”. The word “duty” in para 2 is surely also relevant. Taking the arrangements by themselves, it appears that the contracting parties have quite clearly distinguished between those paras which create obligations and those which do not.

Furthermore, if the arrangements are interpreted in light of the treaty as a whole, the interpretation of the word “will” in Article 8 discussed above logically applies also to the arrangements, given that the first five paras of the arrangements are intended to implement Article 8(1) in practice. Moreover, the distinction between the words “will” and “state their intention” in the arrangements further support the above interpretation of Article 8. More fundamentally, if there were no underlying obligation to bring proceedings, there would logically be no need to provide for a list of justifications for not bringing such proceedings in para 2.

As to the practicability of the arrangements, they should in principle be feasible in practice, although several possible issues of interpretation should be pointed out. First of all, no account is taken of cases (sure to be frequent) where some of the Member States in the Trio Presidency are not, for various reasons, bound by Articles 3 and 8 of the treaty (because they have not ratified the Treaty, or because they have ratified but are not eurozone States). Secondly, Article 3(2) in particular may apply at different times for different contracting parties, ie there may be contracting parties which ratify the treaty after it has already come into force, join the eurozone in future, or which otherwise decide to sign up to Articles 3 and 8 at a point after ratifying the treaty. Thirdly, the question may arise of the exact timing of when to determine which Trio Presidency states are covered by the rule (ie at the date of the report, when the subsequent three-month deadline applies, or some point in between), not only due to the second point but also due to the rotation of the trio presidency and the launch or termination of new proceedings or the issue of a new or revised Commission report. Also, what if the position changes while the proceedings are pending? Fourthly, there is no rule to determine what happens if some (but not all) of the Trio Presidency states are disqualified from acting for these reasons, or for the reasons expressly mentioned. Presumably, by a contrario reasoning from the second sentence in para 2, in this scenario the one or two Member States which have not been disqualified must still go ahead and bring proceedings. The treaty does not address what happens if no Member State in the prior Trio Presidency is able to bring proceedings, or indeed if no Member State at all is able to bring them. Finally, an important question of interpretation is the reference to “justifiable grounds of an overarching nature” as a ground to refuse to bring proceedings.

22 March 2012

Letter from the Rt Hon David Lidington MP, Minister for Europe, to the Chairman of the Committee

Thank you for your letter of 15 March regarding the Arrangements for Article 8 of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (“the Treaty”).

You asked whether this annex should be given the same legal status as the Treaty to which it refers, and whether it creates legal obligations for the Contracting States. The annex is a political arrangement between the Contracting Parties to the Treaty, and does not have the force of international law. The Arrangements were annexed to the Minutes of the meeting at which the Treaty was signed; they are not annexed to the Treaty itself. As with the Treaty, the Arrangements are not part of the EU Treaties, nor do they have the force of EU law. The fact that the Arrangements set out how Article 8 is intended to work in practice does not change the legal situation.

You also asked whether the government foresees any obstacles to the operation of these arrangements, or whether we see them as “plausible and practicable”. It is for those States who are parties to the Treaty to consider whether these arrangements are plausible and practicable. The UK is not party to the Treaty to which these arrangements relate and has reserved its position on the Treaty including the use of the EU Institutions under the Treaty.
I am copying this letter to Rt Hon the Lord Roper, Chairman of the House of Lords European Union Committee and to Richard Ottaway MP, Chair of the Foreign Affairs Select Committee.

The Rt Hon David Lidington MP
21 March 2012

Letter to the Rt Hon David Lidington MP, Minister for Europe from the Chairman of the Committee

ARRANGEMENTS CONCERNING ARTICLE 8 OF THE TREATY ON STABILITY, COORDINATION AND GOVERNANCE

I am writing with respect to the above arrangements, which I attach to this letter.56

For the purposes of our current inquiry, we will have to report on the legal status of this minuted annex, about which we were unaware at the time of our evidence session with you on 23 February. We are particularly interested to know a) whether this annex should be given the same legal status as the treaty to which it refers, and b) whether it creates legal obligations for the Contracting States.

In evidence on Article 8 of the treaty, the Government’s position was said to be that Article 8 did not create legal obligations for Member States (question 153 of the transcript) because “will” rather than “shall” was used. But we note that these arrangements, despite the use of “will”, purport to lay down binding obligations for the Trio States, referring to the effect of Article 8 as a “duty to bring the matter to the Court of Justice”.

We would be grateful for the Government’s replies to these questions.

In addition, we would like to know whether the Government foresees any obstacles to the operation of these arrangements or, conversely, sees them as plausible and practicable.

We intend to publish our report in the week beginning 26 March, so we ask that you reply to this letter by Wednesday of next week at the latest.

15 March 2012

56 Not printed.