



**The rise of the EU's economic government:  
Proposals on the table and what has already been  
achieved**

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## KEY POINTS

- The eurozone is now a *de facto* debt union, with its members taking on the liabilities of each others' sovereign debts and with the European Central Bank financing states through its purchases of government bonds.
- The legality of the eurozone rescue packages, agreed in the spring, is dubious since they are inconsistent with the 'no bailout' clauses in the EU Treaties. The €60 billion stabilisation fund, for which British taxpayers are liable for around €8 billion, is particularly questionable on legal grounds - and would most likely not survive a test in a non-politicised court. Crucially, it transfers both powers and potentially more taxpayers' money to the EU - both of which the UK Coalition Government has said it opposes.
- At the summit, EU leaders will discuss a proposal requiring member states to submit their national budgets to the Commission and other finance ministers before sending them to national parliaments. The UK Government opposes this, but according to the Commission has no veto over the proposal.
- German Chancellor Angela Merkel, and now French President Nicolas Sarkozy, have said that a change to the EU Treaties might be necessary to achieve stronger economic governance, including tougher sanctions for member states that violate the bloc's budget rules. A Treaty change is likely to come up against resistance but is not off the cards if Angela Merkel spends the political capital needed to push it through.
- UK Prime Minister David Cameron has said he will veto any Treaty change that transfers more powers from Westminster to Brussels. However, rather than being on the defensive, Cameron could work with Angela Merkel and other partners to achieve Treaty changes – but ask for substantial EU reforms in return, including the repatriation of powers back to the UK.
- The nature of the negotiations is likely to depend on the contrasting Franco-German visions of how to deal with the current economic problems.
- France, on the one hand, hopes to move a step closer to its long-held desire for economic government of the eurozone, including the greater harmonisation of all economic policy across its 16 members.
- Germany, on the other hand, is pushing for much tougher budgetary rules for the eurozone, backed by sanctions, but fears the politicisation of economic policy. It therefore wants to water down the French plans for economic government by more loosely applying aspects of them to the entire 27 member states rather than focussing them more tightly on the eurozone members.

## 1. THEY SAID IT...

*"We are clearly confronted with a tension within the system, the ill-famous dilemma of being a monetary union and not a full-fledged economic and political union. This tension has been there since the single currency was created. However, the general public was not really made aware of it."*

- European Council President, Herman Van Rompuy, 25 May 2010

*"I am sure the euro will oblige us to introduce a new set of economic policy instruments. It is politically impossible to propose that now. But some day there will be a crisis and new instruments will be created"*

- Then European Commission President, Romano Prodi, 2001<sup>1</sup>

*"The single currency is the greatest abandonment of sovereignty since the foundation of the European Community... the decision is of an essentially political nature."*

- Former Spanish Prime Minister Felipe González, 1998<sup>2</sup>

*"The introduction of the Euro is probably the most important integrating step since the beginning of the unification process. It is certain that the times of individual national efforts regarding employment policies, social and tax policies are definitely over. This will require finally burying some erroneous ideas of national sovereignty"*

- Then German Chancellor Gerhard Schröder, 1999<sup>3</sup>

*"The process of monetary union goes hand in hand with political integration and ultimately political union. EMU is, and was always meant to be, a stepping stone on the way to a united Europe"*

- Then President of the European Central Bank, Wim Duisenberg, 2001.<sup>4</sup>

*"The European currency will lead to member nations transferring their sovereignty over financial and wage policies as well as monetary affairs. It is an illusion to think that states can hold on to their autonomy over taxation policies"*

- Former President of the German Bundesbank, Prof. Hans Tietmeyer<sup>5</sup>.

*"There is no example in history of a lasting monetary union that was not linked to one state"*

- Member of the ECB Executive Board, Otmar Issing, 1991<sup>6</sup>.

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<sup>1</sup> Quoted on the *FT Alphaville* blog, 'It is relatively clear that (in economic terms) the Euro does not work', 25 February 2010; <http://ftalphaville.ft.com/blog/2010/02/25/158731/%E2%80%98it-is-relatively-clear-that-in-economic-terms-the-euro-does-not-work/>

<sup>2</sup> Quoted in the *Guardian*, 'Britons deceived; We can vote out Tony Blair when we get fed up with him but not the president of the European bank', 6 January 1999

<sup>3</sup> <http://www.liebreich.com/LDC/HTML/Europe/08-Euro.html>

<sup>4</sup> Quoted in Parliament, 5 Dec 2001 : Column 402; <http://www.parliament.the-stationery-office.co.uk/pa/cm200102/cmhansrd/vo011205/debtext/11205-23.htm>

<sup>5</sup> <http://www.liebreich.com/LDC/HTML/Europe/08-Euro.html> - the date of the quote is uncertain

<sup>6</sup> <http://www.liebreich.com/LDC/HTML/Europe/08-Euro.html>

## **2. A UNION OF DEBT**

EU leaders have agreed a three-pronged bailout package in a bid to help individual eurozone countries that struggle to pay back their debts and following political pressure, the ECB has separately begun buying up eurozone government's debt. This package will for the first time effectively see sovereign debts transferred between member states within the EU – something which has previously been seen as legally impossible under the EU Treaties, and both economically and democratically undesirable.

The first part is a rescue package of €80 billion in bilateral loans (with an additional €30 billion from the IMF), specifically designed for Greece. The second and third parts are intended to provide credit lines to any eurozone country that cannot pay back their debts in what EU leaders describe as “a comprehensive package of measures to preserve financial stability in Europe (...) of up to EUR 500 billion”. This package consists of a stabilisation fund worth up to €60 billion, run by the European Commission, and a separate facility of bilateral loan guarantees, worth up to €440 billion (with an additional €250 billion potentially provided by the IMF).

### **A) The Greek bailout package**

On 2 May 2010, the eurozone countries and the International Monetary Fund agreed to a €110 billion rescue for Greece, conditioned on the country pursuing a series of reforms and austerity measures.<sup>7</sup>

Under the original package, Greece will receive up to €80 billion in bilateral loans – up to €30 billion will be made available in 2010. The loans will be paid out through state-owned development banks in the eurozone countries, at an interest rate of around 5 percent – well below the rates of 7 percent that Greece would have faced if it had raised its own funds from the markets.

In addition, the IMF reached an agreement with the Greek authorities to support this program with a stand-by arrangement of about €30 billion, bringing the joint commitment to a total financing of €110 billion.<sup>8</sup>

### ***Is it legal?***

The EU Treaties explicitly prohibit bailouts and for governments to take on the debt liabilities of another country. EU governments insist that the Greek bailout does not constitute a violation of this rule since the loans are bilateral and come with interest. Luxembourg PM Jean-Claude Juncker has said that “it is not a violation of the no-bailout clause since the loans are repayable and contain no element of subsidy.”<sup>9</sup> However, the bailout is currently subject to a legal challenge in the German Constitutional Court over a possible violation of the EU Treaties. German think tank Centrum für Europäische Politik has said that the subsidised loan rates are a clear violation of EU rules, and that an action against the loans in the Court would have “promising” chances of success.<sup>10</sup>

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<sup>7</sup> *Bloomberg*, 3 May 2010 <http://www.bloomberg.com/apps/news?pid=20601087&sid=a9f8X9yDMcdl&pos=1> Also see: [http://www.consilium.europa.eu/uedocs/cms\\_data/docs/pressdata/en/ec/114128.pdf](http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/114128.pdf) and [http://www.consilium.europa.eu/uedocs/cms\\_data/docs/pressdata/en/ec/114295.pdf](http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/114295.pdf)

<sup>8</sup> <http://www.consilium.europa.eu/showPage.aspx?id=1826&lang=en> and [http://ec.europa.eu/economy\\_finance/articles/eu\\_economic\\_situation/2010-05-03-statement-commissioner-rehn-imf-on-greece\\_en.htm](http://ec.europa.eu/economy_finance/articles/eu_economic_situation/2010-05-03-statement-commissioner-rehn-imf-on-greece_en.htm)

<sup>9</sup> <http://www.guardian.co.uk/world/2010/apr/11/eu-greece-bailout-terms>

<sup>10</sup> <http://www.taz.de/1/zukunft/wirtschaft/artikel/1/milliardenhilfe-fuer-griechenland/>

The aid package has two potential 'exit' clauses. If a constitutional court in any eurozone country considers the aid package to be illegal, then the country may refuse to take part in the bailout. The second exit clause states that if a donor country must itself take out a loan to help Greece, and the interest rate is greater than that at which it will lend the money to Greece, the donor country is able to obtain the difference from other eurozone countries. If the eurozone countries refuse, donor countries can refuse to participate.<sup>11</sup>

### **B) Euro aid package part I: The “European Stabilisation Mechanism” – a first step towards a common EU bond?**

This package is designed for any eurozone country which finds itself unable to pay back loans. Under this mechanism, the European Commission will be allowed to raise up to €60 billion on markets at low interest rates by issuing bonds, using the EU's roughly €140 billion annual budget as collateral. It will then lend the money to euro-area states that are struggling to meet their debt obligations.<sup>12</sup> In this way, the Commission can lend at much lower rates than which struggling eurozone countries could have done individually. The decision on who will qualify for the loans will be made by Qualified Majority Voting, on a proposal by the Commission, meaning that no individual member state has a veto.

Since the EU budget is used as collateral, every member state in the EU contributes to this fund. No country would be required to provide more money upfront. However, should a country that has received loans default on them, every EU state is required to cover that default by contributing extra money to the EU, corresponding to its share of the total contributions to the EU budget. This means that UK taxpayers are potentially liable for some €8 billion in eurozone loans (corresponding to the UK's 13.6% share of the EU budget).

Since the fund involves the EU borrowing collectively using its budget as collateral, it has been likened to a common EU bond – such a bond is hugely controversial as it is transferring borrowing powers from national governments to Brussels and is seen as opening the door to fiscal federalism.

Prominent German liberal MEP Wolf Klinz has called the fund “a first step towards Eurobonds”, adding “Personally I am against eurobonds to finance member-state debts”.<sup>13</sup> When asked about the nature of the mechanism, Euro Group chairman and Luxembourg PM Jean-Claude Juncker said: “Is it a Eurobond? If I said Yes, everything would be done to prevent the birth of the instrument”.<sup>14</sup>

#### ***Is it legal?***

The legality of this fund is very dubious on several grounds.

As noted, the EU Treaties explicitly ban providing credit lines to other member states to ease their sovereign debt burdens. According to the ministers' official declaration, the legal base for this fund is article 122 of the EU Treaties – intended to provide assistance to EU states in the event of natural disasters or sudden energy blackouts.<sup>15</sup> Using the article in this way involves a heroic legal interpretation. Article 122.2 states:

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<sup>11</sup> *Die Welt*, 24 May 2010 [http://www.welt.de/wirtschaft/article7767343/Ausstiegsklausel-im-Vertrag-mit-Griechenland.html#vote\\_7766764](http://www.welt.de/wirtschaft/article7767343/Ausstiegsklausel-im-Vertrag-mit-Griechenland.html#vote_7766764) and <http://www.openeurope.org.uk/media-centre/summary.aspx?id=1108>

<sup>12</sup> *EUobserver*, 11 May 2010 <http://euobserver.com/9/30060>

<sup>13</sup> *EUobserver*, 11 May 2010 <http://euobserver.com/9/30060>

<sup>14</sup> *Les Echos*, 7 June 2010 <http://www.lesechos.fr/info/inter/020586129328-paris-et-berlin-trouvent-un-accord-sur-les-modalites-du-plan-de-soutien-a-l-euro.htm>

<sup>15</sup> [http://www.consilium.europa.eu/uedocs/cms\\_data/docs/pressdata/en/ecofin/114324.pdf](http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/114324.pdf)

*Where a Member State is in difficulties or is seriously threatened with severe difficulties caused by natural disasters or exceptional occurrences beyond its control, the Council, on a proposal from the Commission, may grant, under certain conditions, Union financial assistance to the Member State concerned. The President of the Council shall inform the European Parliament of the decision taken.*<sup>16</sup>

The European Council has previously said that Article 122 must be compatible with the “no bail-out clause” in the Treaties<sup>17</sup>, but ministers now claim that “we are facing such exceptional circumstance today and the mechanism will stay in place as long as needed to safeguard financial stability.”<sup>18</sup> A similar facility, set up to provide loans to non-eurozone countries hit particularly bad by the economic crisis (Hungary, Latvia and Romania) was based on a different article in the Treaties (Article 119) – an article which cannot be used legally for eurozone states.

Naturally, this has not gone down well in all quarters, including in Germany. Werner Langen, a German MEP for the Christian Democrats, has said that the stabilisation fund is a clear breach of the EU Treaties, as “the article which is being used is actually meant for natural disasters and unique emergency situations and not for saving countries from a debt crisis for which they are responsible themselves.”<sup>19</sup>

Likewise, Polish MEP Sidonia Elzbieta Jedrzejewska, who drafted a report on the European Parliament’s negotiating mandate on the 2011 budget, said: “We have this treaty provision that makes it possible to use the EU budget as a guarantee only in cases of calamities or a force majeure. I don’t think the economic crisis fits this definition.”<sup>20</sup>

But it also involves a legal stretch for a different reason: the decision to establish the stabilisation fund was taken by majority vote (as stipulated by Article 122). However, the EU Treaties clearly specify that any decision that involves the EU’s budget must be taken by unanimity, meaning that individual member states have a veto over any agreement. The stabilisation fund clearly does involve the EU budget, as the loans are backed by the budget and any defaults will be covered by the budget (there are even specific budget lines in the EU budget for the fund) – and yet it was decided by majority vote.

Irrespective of the benefits of establishing this fund – and there are benefits – it is hard to see how the use of the Article 122 and QMV in this way would survive a legal test in any non-politicised court.

### ***Where does this leave the UK?***

As noted, the UK is taking part in this fund via its contributions to the EU budget.<sup>21</sup> In a rather extraordinary coincidence, the stabilisation fund (and the additional €440 billion rescue package) was agreed the weekend following the UK general elections when Britain only had a caretaker government in place. It was therefore former Chancellor Alistair Darling who finally signed up to the deal, half-heartedly defending the measure and saying that he had “limited” the exposure of British taxpayers. In reality, Darling had little choice as the decision

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<sup>16</sup> Treaty of the Functioning of the European Union, see <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2008:115:0047:0199:EN:PDF>

<sup>17</sup> Written answer to written answer to former MEP Kathy Sinnott, 7 May 2009, see <http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+CRE+20090507+ANN-01+DOC+XML+V0//EN&query=QUESTION&detail=H-2009-0237&language=EN>

<sup>18</sup> Reuters, 8 June 2010 <http://www.reuters.com/article/idUSLDE65718H20100608>

<sup>19</sup> Reuters, 12 May 2010 <http://de.reuters.com/article/topNews/idDEBEE64B04120100512>

<sup>20</sup> European Voice, 10 June 2010 <http://www.europeanvoice.com/article/imported/meps-protest-at-council%27s-use-of-2011-budget-as-eurozone-collateral/68180.aspx>

<sup>21</sup> Guardian, 10 May 2010 <http://www.guardian.co.uk/business/2010/may/10/eu-rescue-package-q-a>

was made by QMV and the UK would not have been able to muster a blocking minority against the eurozone bloc in any case.

The Coalition Government – probably very relieved that the agreement was made one day before it took office – has said that it will respect the deal, but it will not be adding any additional support.<sup>22</sup> However, although largely unnoticed in the British media, the fund could still create a very awkward situation for the Coalition. This is because the establishment of the fund gives more powers to the EU (by moving a decision from unanimity to QMV and by giving the Commission new borrowing powers) and by potentially requiring Britain to pay in more money to the EU budget – both of which the Coalition Government has clearly said it opposes.

Should a country default on its loans from this fund, and British taxpayers be forced to pay in extra money to the EU budget to cover the default, the Coalition could come under significant pressure to challenge the whole arrangement in the courts. This issue could prove explosive.

### **C) Euro aid package part II: the €440 billion “Special Purpose Vehicle”**

If the €60 billion stability fund runs dry, the eurozone countries, also with the voluntary participation of Poland and Sweden, has established a second mechanism, worth a staggering €440 billion in loans and guarantees (the “European Financial Stability Facility”).<sup>23</sup> The UK has declined to take part in this scheme.

Under this mechanism, the eurozone countries will establish a so-called Special Purpose Vehicle (SPV) which can issue bonds, totalling up to €440 billion and then forward these as loans to struggling eurozone member states.<sup>24</sup> The IMF has committed an additional €250 billion.<sup>25</sup>

The SPV was set up on 7 June 2010 and is registered in Luxembourg and backed by individual guarantees provided by all 16 members of the eurozone, based on their shares in the ECB. Member states have also committed to guarantee an extra 20% beyond their ECB share, in case some countries are unable to provide financial guarantees due to economic difficulties of their own.

The SPV will be operational once 90 percent of countries participating in it have ratified the plan in their respective parliaments. Rather strangely, it will be a limited liability company, operating under Luxembourg law, run by a board of directors appointed by eurozone members. Crucially, national parliaments will not be given veto power over future activation of the mechanism, in spite of the strong demands for that from Germany, Austria, the Netherlands and Finland. Decisions will instead be taken by eurozone finance ministers alone – bringing the EU’s infamous ‘democratic deficit’ to new levels.

The interest rates will be modelled on the mark-up charged by the IMF and similar to the one that Greece was charged (around 5 percent). Although the agreement in May mentioned that the SPV would “expire after three years”<sup>26</sup>, only a couple of weeks later its duration was prolonged to five or six years, following concerns that recipient countries would need longer

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<sup>22</sup> *Le Figaro*, 7 June 2010 <http://www.openeurope.org.uk/media-centre/summary.aspx?id=1116>

<sup>23</sup> [http://www.consilium.europa.eu/uedocs/cms\\_data/docs/pressdata/en/ecofin/114324.pdf](http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/114324.pdf) Also see Reuters, 8 June 2010 <http://www.reuters.com/article/idUSLDE65718H20100608> and

[http://www.consilium.europa.eu/uedocs/cms\\_data/docs/pressdata/en/misc/114977.pdf](http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/misc/114977.pdf)

<sup>24</sup> <http://www.openeurope.org.uk/media-centre/summary.aspx?id=1116>

<sup>25</sup> [http://www.consilium.europa.eu/uedocs/cms\\_data/docs/pressdata/en/ecofin/114324.pdf](http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/114324.pdf)

<sup>26</sup> [http://www.consilium.europa.eu/uedocs/cms\\_data/docs/pressdata/en/ecofin/114324.pdf](http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/114324.pdf)

to pay back the loans.<sup>27</sup> As with the €60 billion stabilisation fund, no money will be spent upfront by member states but, if the country which receives the assistance defaults, eurozone members will have to provide cash to cover the default.<sup>28</sup> This means that European taxpayers are potentially liable for an enormous amount of money, with the Germans leading the league table, being on the hook for a record €120 billion.

There has been some criticism of the UK's decision not to participate in the package, with former French Europe Minister Jean-Pierre Jouyet saying "the English are very certainly going to be targeted given the political difficulties they have. Help yourself and heaven will help you."<sup>29</sup>

### ***Is it legal?***

As with the rescue package for Greece, EU leaders claim that this mechanism does not violate the 'no bail-out' clause in the EU Treaties, as it does not constitute a bail-out (since it is voluntary and bilateral). However, the legal reasoning remains shady and the same caveats as with the Greek bail-out apply. A handful of challenges have been filed in Germany's Constitutional Court against both parts of the euro bailout package. The Court is currently considering a temporary injunction against Germany's contribution to the package – if it rules to issue the injunction, it could temporarily ban the German government from activating credit guarantees, until the court can rule on their legality.<sup>30</sup>

### **D) An activist European Central Bank**

Arguably one of the most significant developments in eurozone governance during this crisis has been the ECB's decision to start buying government debt – effectively meaning that it is now financing individual states. The EU Treaties explicitly prohibit the ECB from buying government debt directly, but the Bank circumvented this ban by buying bonds from banks on the secondary market.<sup>31</sup> This was widely seen as a blow to the ECB's political independence, and a step towards a French-style monetary policy in which the central bank plays an active role in underwriting and financing a government's economic policies.

The decision was met with alarm in Germany and the two German members of the ECB were outvoted<sup>32</sup> - something which would have been unthinkable only a few months ago.

Bundesbank President Axel Weber openly criticised the move saying, "The purchase of sovereign bonds poses severe risks to political stability, and I therefore view this part of the decision of the ECB Board, even in this unusual situation, critically."<sup>33</sup> And on May 11, Die Welt wrote that "What was carved in stone the day before no longer has any validity. And nothing symbolises this more than the [ECB's] loss of independence. The separation of powers between monetary and fiscal policy in Europe now belongs to the past".<sup>34</sup>

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<sup>27</sup> <http://www.openeurope.org.uk/media-centre/summary.aspx?id=1114> and Handelsblatt, 7 June 2010 <http://www.wirtschaftspresse.biz/psepp/fn/pcc/sfn/showedetail/DocID/1055692/EditionID/4/SectionID/155/PageID/1055684/pDay/07.06.2010%2000:00:00/showtyp/1/SH/47a5023b9958d07f4379fd2a1694c0/index.html>

<sup>28</sup> Reuters, 8 June 2010 <http://www.reuters.com/article/idUSLDE65718H20100608> and [http://www.consilium.europa.eu/uedocs/cms\\_data/docs/pressdata/en/misc/114977.pdf](http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/misc/114977.pdf)

<sup>29</sup> 11 May 2010 <http://euobserver.com/9/30060>

<sup>30</sup> See <http://www.spiegel.de/international/germany/0,1518,699471,00.html>

<sup>31</sup> BBC, 10 May 2010 <http://news.bbc.co.uk/2/hi/business/10104140.stm> and ECB Press Release: <http://www.ecb.int/press/pr/date/2010/html/pr100510.en.html>

<sup>32</sup> Telegraph, 11 May 2010 <http://www.telegraph.co.uk/finance/financetopics/financialcrisis/7707775/ECB-risks-its-reputation-and-a-German-backlash-over-mass-bond-purchases.html>

<sup>33</sup> Bloomberg, 10 May 2010 [http://www.bloomberg.com/apps/news?pid=20601087&sid=a83PaKeT\\_tF0&pos=4](http://www.bloomberg.com/apps/news?pid=20601087&sid=a83PaKeT_tF0&pos=4)

<sup>34</sup> Die Welt, 'Das Ende unserer Stabilitätskultur', 11 May 2010 <http://www.welt.de/die-welt/politik/article7574091/Das-Ende-unserer-Stabilitaetskultur.html>

At first the ECB refused to publish details about its bond purchases<sup>35</sup> but has subsequently revealed that, as of 4 June, it had bought €40.5 billion worth of bonds. The ECB has attempted to calm inflation fears in Germany by claiming that there would be "sterilisation" of the money, but to what extent this has any real impact is far from clear.<sup>36</sup> The sterilisation involves the ECB effectively giving banks the option to re-borrow the money later, by using the weekly deposits as collateral in its lending operations. However, ING analyst Carsten Brzeski has said that "With one hand you give and with the other you take, it's not possible [to sterilize]...the result is still that the liquidity is there."

If Greece, Ireland, Portugal (the countries the ECB has primarily bought bonds from so far) default on their debts, the ECB will take a very large loss, which will have to be financed through increases in the financial contributions to the ECB by member states, notably from Germany, or through printing more money. Most likely is some combination of the two, but that would mean inflationary pressures are likely to increase.

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<sup>35</sup> *Business Week*, 14 May 2010 <http://www.businessweek.com/news/2010-05-14/ecb-keeps-markets-in-the-dark-about-government-bond-purchases.html>

<sup>36</sup> See: FT Alphaville, 17 May 2010 <http://ftalphaville.ft.com/blog/2010/05/17/233291/ecb-puts-a-figure-on-its-bond-buying/> and *Wirtschaftspresse*, 18 May 2010 <http://www.wirtschaftspresse.biz/psepp/fn/pcc/sfn/showedetail/DocID/1049141/EditionID/4/SectionID/2/PageID/1049129/pDay/18.05.2010%2000:00:00/showtyp/1/SH/4711223074e870422491242315f607/index.html>

### **3. AN ECONOMIC GOVERNMENT FOR THE EU**

The European Council conclusions of 25 March 2010 stated<sup>37</sup> that “the European Council must improve the economic governance of the European Union and we propose to increase its role in economic coordination and the definition of the European Union growth strategy.”<sup>38</sup> However, the French translation of the Council conclusions used the original words “*le gouvernement économique*” to describe the arrangement – which had been deleted from the English version since it was deemed too controversial.

The Council asked the European Council President Herman Van Rompuy to establish a “task force” together with the Commission to work out the details of the new *gouvernement économique*. On 17 and 18 June, the European Council will be discussing a report from Van Rompuy’s economic taskforce. Separately, the Commission had also tabled a report<sup>39</sup> on the subject with some overlapping and some new proposals. Van Rompuy has already announced what the taskforce has agreed on so far<sup>40</sup> and below we set out the options currently on the table.

#### **A) Is the Franco-German axis cracking?**

Debates surrounding EU economic government continue to reveal the deep, contrasting Franco-German visions of how best to deal with the current economic problems.

“Economic government” has been a long-standing French ambition for the eurozone, resisted by a Germany that cherishes ECB independence and fears political interference in economic policy more generally. France has consistently argued for greater economic and political coordination of the eurozone in order to reduce the imbalances in economic competitiveness between eurozone members. A French official revealed the government’s aim: “We need at least a minimum of harmonization of labour costs and taxes in the euro zone. We will also have to address social policy one day.”<sup>41</sup>

President Sarkozy recently proposed a ‘eurozone council’ with regular meetings of the 16 eurozone leaders<sup>42</sup>. The long-term aim would be to coordinate economic decisions across the eurozone as a whole, for example, putting pressure on Germany to increase domestic demand for products and services from the weaker eurozone economies in the south. French Finance Minister Christine Lagarde has said proposals to modify the Stability and Growth Pact “should contain additional elements, especially a thorough examination of the states’ competitiveness, as well as the differences in the levels of competitiveness.”<sup>43</sup>

Former UK Europe Minister Peter Hain tried three times to remove Article 136 of the Lisbon Treaty – the article that provides the legal basis for more-co-ordinated Eurozone economic governance – during the negotiations in the Convention on the European Constitution. He argued that it would create an unfair system by which euro members could vote on laws that affect the UK, whilst the UK would be unable to vote on measures affecting them. He wrote:

*Formalisation of the Eurogroup and strengthening the powers of the “ins” is inappropriate ... We have always recognised that the “ins” will want to meet to discuss issues to do with sharing a currency, but greater powers for the Eurogroup to decide*

<sup>37</sup> [http://www.consilium.europa.eu/uedocs/cms\\_data/docs/pressdata/en/ec/113563.pdf](http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/113563.pdf)

<sup>38</sup> European Council Conclusions 25 March 2010, see

[http://www.consilium.europa.eu/uedocs/cms\\_data/docs/pressdata/en/ec/113563.pdf](http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/113563.pdf)

<sup>39</sup> [http://ec.europa.eu/economy\\_finance/articles/euro/documents/2010-05-12-com\(2010\)250\\_final.pdf](http://ec.europa.eu/economy_finance/articles/euro/documents/2010-05-12-com(2010)250_final.pdf)

<sup>40</sup> [http://www.consilium.europa.eu/uedocs/cms\\_data/docs/pressdata/en/ec/114979.pdf](http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/114979.pdf)

<sup>41</sup> Reuters, 14 June 2010; <http://uk.reuters.com/article/idUKTRE65D0TO20100614>

<sup>42</sup> Sunday Times, 23 May 2010; <http://times.cluster.newsint.co.uk/tol/news/politics/article7133980.ece>

<sup>43</sup> *Seuddeutsche Zeitung*, 14 June 2010

*on the Broad Economic Policy Guidelines or excessive deficits of Euro-ins will create an asymmetry, whereby the outs will vote only on outs' issues, while ins will vote on ins and outs.*<sup>44</sup>

Nonetheless the UK eventually allowed it to go ahead.

In contrast to the French vision, the German response to the current crisis has been to emphasise tougher budget supervision and greater austerity from EU member states and Chancellor Merkel has said she will only agree to 'economic government' at the level of all 27 EU members rather than eurozone countries. This would have the effect of watering down any attempts to harmonise economic policy. Chancellor Merkel has said, "The members of the EU have to look at themselves as a kind of economic government. We must not create the members of the first and second class."<sup>45</sup>

Polish PM Donald Tusk has supported the German position, warning that steps to improve the economic governance of the eurozone should not lead to a 'two-speed EU'. He said, "As a country that is aspiring to join the eurozone, we would like the eurozone to be a leader but not an exclusive elite within the EU." Adding, "Common standards for everyone [are] the essence of the European Union."<sup>46</sup>

If that were to be the case and the German view were to prevail, the UK might get caught in the Franco-German crossfire and be pressured further into an EU-wide economic government that is essentially supposed to solve the problems of the eurozone. But the UK could also decide to work with Merkel, supporting her vision of strengthened governance – including a Treaty change – in return for EU reforms, such as the repatriation of powers back to Westminster.

Sarkozy and Merkel seem to have reached an uneasy compromise, with Sarkozy this week saying, "The natural frame for economic governance is at 27...More than ever, Germany and France are determined to speak with one voice".<sup>47</sup> However, Germany remains isolated in its opposition to an EU role in fostering greater economic and political coordination across the eurozone, with 13 of the 16 eurozone reportedly backing Sarkozy over Merkel on this issue.<sup>48</sup> These divisions are unlikely to disappear and as Sarkozy has said himself, "A few months ago, it was difficult to even pronounce the words 'economic government' inside the euro zone."<sup>49</sup> The speed and extent of the current crisis has shifted the parameters to such an extent that nothing should be taken for granted.

### **B) More powers to monitor national budgets (for all EU member states)**

The EU wants to gain more powers to supervise national budgets to strengthen the bloc's so-called "Stability and Growth Pact". The objective is to avoid member states running excessive deficits or unsustainable economic policies and a repeat of the sovereign debt crisis.

Under the plan, national governments will have to submit their budgets both to the Commission, and to other national finance ministers for peer review, before they are sent to

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<sup>44</sup> See *Open Europe*, 'Guide to the Constitutional Treaty', February 2008; <http://www.openeurope.org.uk/research/guide.pdf>

<sup>45</sup> *FT Deutschland*, 15 June 2010; <http://www.ftd.de/politik/international/berlin-und-paris-fuer-eu-wirtschaftsregierung/50127760.html>

<sup>46</sup> *FT*, 10 June 2010 <http://www.ft.com/cms/s/0/9c404652-73d6-11df-87f5-00144feabdc0.html>

<sup>47</sup> *FT Deutschland*, 15 June 2010; <http://www.ftd.de/politik/international/berlin-und-paris-fuer-eu-wirtschaftsregierung/50127760.html>

<sup>48</sup> *Die Welt*, 14 June 2010 <http://www.welt.de/wirtschaft/article8029222/Merkel-und-Sarkozy-liefern-sich-das-naechste-Gefecht.html>

<sup>49</sup> *Reuters*, 14 June 2010; <http://uk.reuters.com/article/idUKTRE65D0TO20100614>

national parliaments – during a so-called ‘European semester’, most likely in the Spring.<sup>50</sup> The European Council’s draft conclusions state that member states will be required to present “to the Commission in the spring Stability and Convergence Programmes including budgetary plans for the upcoming years, taking account of national budgetary procedures.”<sup>51</sup>

Although the details are still not decided the idea would be that key budgetary information such as total revenues, total spending and deficit targets would be given to European finance ministers and officials. Van Rompuy then envisions that peer and market pressure would require a country to adjust the plans, if they were deemed profligate or unsustainable, before the final budget is presented to the national parliament. However, it remains unclear how binding any possible objections to a country’s budget would be beyond peer pressure.<sup>52</sup>

Although most countries appear to agree on the principle of “peer review”, some have expressed concerns over the loss of economic and parliamentary sovereignty. The UK, for example, has said that it will not allow anyone to see the full budget before it is sent to Parliament, with the UK Financial Secretary to the Treasury Mark Hoban saying that, “The Budget will be presented to Parliament first. There is no question of anyone other than MPs seeing it first.”<sup>53</sup>

However, according to some reports, the Commission insists that the decision will be taken by QMV, and not unanimity, meaning that the UK could be outvoted.<sup>54</sup> When challenged about the prospect of being outvoted, Foreign Secretary William Hague responded that the Government’s position would be “trenchant” on the issue.<sup>55</sup> A key question is whether the UK’s pre-budget report – which is presented in December and is public information – will be enough to satisfy the budget semester or whether content from the full budget will have to be revealed.

Regarding possible UK opposition to the plans, French Finance Minister Christine Lagarde has said: “You know the devil is in the details. If we play the game of a club, we have to play by the rules of a club. To share and agree upon the macroeconomic data and forecasts, and to share the common basic principles as well as the expected balance, I don’t see that as a major obstacle – but we’re going to have to discuss that in detail.”<sup>56</sup>

### **C) Macro-economic supervision and monitoring competitiveness**

The Commission has said that it wants to “expand economic surveillance beyond the budgetary dimension to address other macroeconomic imbalances, including competitiveness developments and underlying structural challenges.”<sup>57</sup> This is close to what France has long been calling for: greater supervision of economic policies across the entire eurozone, which take into account indicators of economic competitiveness, such as costs and wages.

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<sup>50</sup> [http://www.consilium.europa.eu/uedocs/cms\\_data/docs/pressdata/en/ec/114979.pdf](http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/114979.pdf)

<sup>51</sup> Draft Conclusions available through the Danish Parliament’s website, see <http://www.eu-ophlysnigen.dk/upload/application/pdf/154cfe7a/Raad170610bilag-5.pdf>

<sup>52</sup> Handelsblatt and Die Welt, 7 June 2010

<http://www.wirtschaftspresse.biz/psepp/fn/pcc/sfn/showedetail/DocID/1055781/EditionID/4/SectionID/2/PageID/1055773/pDay/07.06.2010%2000:00:00/showtyp/1/SH/47a5023b9958d07f4379fd2a1694c0/index.html> and <http://www.welt.de/wirtschaft/article7929642/EU-will-Stabilitaetspakt-schon-bis-Herbst-reformieren.html>

<sup>53</sup> <http://www.openeurope.org.uk/media-centre/summary.aspx?id=1117>

<sup>54</sup> PA, 8 June 2010 and <http://imarketnews.com/node/14800>

<sup>55</sup> Telegraph, 12 June 2010 <http://www.telegraph.co.uk/news/worldnews/europe/eu/7821393/Britain-could-be-forced-to-accept-EU-vetting-of-budget.html>

<sup>56</sup> BBC Today, 14 June 2010 <http://www.openeurope.org.uk/media-centre/summary.aspx?id=1120>

<sup>57</sup> Commission, ‘Reinforcing economic policy coordination’, 12 May 2010, p6;

[http://ec.europa.eu/economy\\_finance/articles/euro/documents/2010-05-12-com%282010%29250\\_final.pdf](http://ec.europa.eu/economy_finance/articles/euro/documents/2010-05-12-com%282010%29250_final.pdf)

The Commission has said that,

*Looking at the euro area as a whole and on a country-by-country basis, the Commission would assess the risk of all possible forms of macroeconomic imbalances that jeopardise the proper functioning of the euro area... The Council, with only euro-area Members voting, would invite the Member State(s) concerned to take the necessary action to remedy the situation. Should the Member State(s), within a stipulated time frame fail to take the appropriate measures to correct the excessive imbalance, the Council, with a view to ensure the proper functioning of EMU, could step up the surveillance for the Member State concerned and decide, on a proposal by the Commission, to issue precise economic policy recommendations. Where necessary, the Commission would use its possibility to issue early warnings directly to a euro-area Member State.<sup>58</sup>*

German fears about this essentially are that the German government could potentially be told, 'you are too competitive for the good of the rest of the eurozone'. French Finance Minister Christine Lagarde has said as much in recent months:

*Clearly Germany has done an awfully good job in the last 10 years or so improving competitiveness. When you look at unit labour costs, they have done a tremendous job in that respect. I'm not sure it is a sustainable model for the long term and for the whole of the group. Clearly we need better convergence. While we need to make an effort, it takes two to tango.<sup>59</sup>*

Germany is therefore likely to oppose moves to strengthen economic governance in this area but many member states share the belief that economic imbalances across the eurozone are not purely the fault of profligacy in Mediterranean states but also lie with Germany's economic policies.

#### **D) More and stronger sanctions**

Van Rompuy has also said that that he wants to strengthen the Stability and Growth Pact by introducing a 'progressive traffic light' system of sanctions for countries that not only break the budget rules but also for member states that ignore warnings they may break the rules in the future:

*We will also improve the Pact by creating more sanctions earlier on. Sanctions could already kick in before the 3 percent threshold for the annual deficit is exceeded, for instance if warnings have been neglected, or if the level of debt rises too quickly. To use the traffic light image: until now, you only got fined when driving through the red light of the 3 percent; from now on, you could also be in trouble when crossing the orange light.<sup>60</sup>*

In a further move, likely to be resisted strongly by Germany, Van Rompuy has suggested that "corrective measures" be applied to member states that do not do enough to reduce "economic imbalances" across the eurozone<sup>61</sup>.

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<sup>58</sup> Commission, 'Reinforcing economic policy coordination', 12 May 2010, p7;

[http://ec.europa.eu/economy\\_finance/articles/euro/documents/2010-05-12-com%282010%29250\\_final.pdf](http://ec.europa.eu/economy_finance/articles/euro/documents/2010-05-12-com%282010%29250_final.pdf)

<sup>59</sup> Telegraph, 17 March 2010;

[http://www.telegraph.co.uk/finance/comment/ambroseevans\\_pritchard/7467198/Angela-Merkel-defies-IMF-and-France-as-anger-rises-over-export-surplus.html](http://www.telegraph.co.uk/finance/comment/ambroseevans_pritchard/7467198/Angela-Merkel-defies-IMF-and-France-as-anger-rises-over-export-surplus.html)

<sup>60</sup> [http://www.consilium.europa.eu/uedocs/cms\\_data/docs/pressdata/en/ec/114979.pdf](http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/114979.pdf), p2

<sup>61</sup> [http://www.consilium.europa.eu/uedocs/cms\\_data/docs/pressdata/en/ec/114979.pdf](http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/114979.pdf), p3

In a recent interview, EU Economic and Monetary Affairs Commissioner Olli Rehn hinted at a potential role for the Commission as 'referee' in deciding on when and upon whom to impose sanctions. He said the Commission's powers should be similar to its role in competition policy where it is empowered to levy big fines, and that he wants a "rules-based" system that would make the penalties almost automatic. "An effective way of reinforcing independence is to apply the model of competition policy to budgetary surveillance," he said.<sup>62</sup>

While many member states, including France and Germany, advocate the use of sanctions, they are likely to resist giving too much power to the Commission to set automatic financial sanctions over the heads of national finance ministers. The details remain unclear as to what specific sanctions will be agreed upon but there are a number of different options currently being considered.

### ***Extending the existing system of fines***

The Commission already has the power to levy fines against member states that break the Stability and Growth Pact's three percent budget deficit rule. However, the Commission has stated that the existing so-called 'excessive deficit procedure' "comes into play too late to provide the right incentives for Member States to tackle emerging fiscal imbalances."<sup>63</sup>

The Commission, in a similar vein to Van Rompuy's 'traffic light' system, has therefore proposed to "speed up" the use of fines in order to act as an earlier incentive for member states to avoid breaking the deficit rules.

The Commission has also proposed to strengthen the link between overall national debt and budget deficits when it looks at countries' balance sheets and it proposes taking a tougher line on those countries that do not have a credible plan to reduce their overall level of national debt, which is supposed to be capped at 60 percent of GDP under the existing rules. This would include assumptions about governments' explicit and implicit liabilities, including future public pension payments, for example.

### ***Suspension of voting rights***

One of the proposals backed strongly by Germany, but which is likely to require treaty change, is to suspend the EU voting rights of member states that break the rules. Chancellor Merkel has recently said that she has convinced President Sarkozy of the need to change the treaties to impose tough sanctions:

*We agree to change the Treaties. Germany and France will soon make proposals and, for example, will remove the voting rights of the countries that do not meet the deficit criteria and the Stability Pact. It is important for us because we need the Treaties to support a culture of stability and growth.*<sup>64</sup>

### ***Suspending EU funds***

The Commission has also suggested the "broader and more timely use of EU budget expenditure as an incentive for compliance." This could include introducing "conditionality" to EU budget payments to member states and a proposal that "a more rigorous and rules-based application of the existing suspension clause for Cohesion fund commitments should

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<sup>62</sup> *Guardian*, 11 June 2010; <http://www.guardian.co.uk/uk/2010/jun/11/budget-george-osborne-european-union>

<sup>63</sup> *Commission*, 'Reinforcing economic policy coordination', 12 May 2010, p5;

[http://ec.europa.eu/economy\\_finance/articles/euro/documents/2010-05-12-com%282010%29250\\_final.pdf](http://ec.europa.eu/economy_finance/articles/euro/documents/2010-05-12-com%282010%29250_final.pdf)

<sup>64</sup> *Euronews*, 15 June 2010; <http://fr.euronews.net/2010/06/15/paris-et-berlin-a-l-heure-de-la-reconciliation/>

be pursued in case of recurrent breaches of the Pact.”<sup>65</sup> In this scenario, member states would see the suspension of payments from the EU budget if they fail to meet the agreed criteria.

This proposal is also backed by the German Finance Ministry which, in a recent policy paper, wrote, “The payment of European funds would be made conditional on a solid financial policy.”<sup>66</sup>

### ***Fees to a country resolution fund***

Another idea is for member states to be forced to “redirect funds” into an “interest-bearing deposit” if they are in breach of “their budgetary Medium-Term-Objectives in good economic times”<sup>67</sup>. The aim of this would be to ensure governments accumulate adequate buffers when their economies are growing. There are no details about how such a one-size-fits-all approach would work given the differences present in EU economies and whether these budgetary targets would be universal or country-specific.

### ***Kicking countries out***

The ultimate sanction, proposed by Chancellor Merkel at the height of the Greek crisis, is to have a mechanism by which a member state could be ejected from the eurozone. “In the future, we need an entry in the [Lisbon] Treaty that would make it possible, as a last resort, to exclude a country from the eurozone if the conditions are not fulfilled again and again over the long term,” Chancellor Merkel said in a speech to the German parliament.<sup>68</sup>

## **E) Statistical supervision**

Following the revelations that Greece had manipulated its economic data in order to gain entry into the eurozone, the March European Council conclusions stated that, “Ensuring the quality, reliability and timeliness of statistical data provided by national statistical offices will be central in ensuring credible and effective monitoring. Rapid decision is required on the Commission's proposals in this field”<sup>69</sup>.

EU finance ministers have therefore agreed to grant more powers to the Commission's statistics agency, Eurostat, to enable it to audit budget statistics from EU countries. Once the changes come into effect, Eurostat will be able to send officials to national capitals to investigate whether governments are accurately reporting data on their debt and deficits. Eurostat officials will have the right to see data from every level of government on the execution of national budgets. They will also have the right to see the accounts of “extra-budgetary bodies, corporations...non-profit institutions and other similar bodies that are part of the general government sector”<sup>70</sup>.

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<sup>65</sup> Commission, ‘Reinforcing economic policy coordination’, 12 May 2010, p6;

[http://ec.europa.eu/economy\\_finance/articles/euro/documents/2010-05-12-com%282010%29250\\_final.pdf](http://ec.europa.eu/economy_finance/articles/euro/documents/2010-05-12-com%282010%29250_final.pdf)

<sup>66</sup> Handelsblatt, 19 May 2010; <http://www.handelsblatt.com/politik/deutschland/strategiepapier-rettungsplan-fuer-den-euro;2583703>

<sup>67</sup> Commission, ‘Reinforcing economic policy coordination’, 12 May 2010, p4;

[http://ec.europa.eu/economy\\_finance/articles/euro/documents/2010-05-12-com%282010%29250\\_final.pdf](http://ec.europa.eu/economy_finance/articles/euro/documents/2010-05-12-com%282010%29250_final.pdf)

<sup>68</sup> EUobserver, 17 March 2010; <http://euobserver.com/9/29706>

<sup>69</sup> [http://www.consilium.europa.eu/uedocs/cms\\_data/docs/pressdata/en/ec/113591.pdf](http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/113591.pdf); see also European Council Conclusions 25 March 2010:

[http://www.consilium.europa.eu/uedocs/cms\\_data/docs/pressdata/en/ec/113563.pdf](http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/113563.pdf)

<sup>70</sup> European Voice, 8 June 2010; <http://www.europeanvoice.com/article/2010/06/eurostat-to-get-extended-auditing-powers-/68172.aspx>

## **F) Other possible talking points**

### **A bank levy**

There is an agreement on the principle of an EU-wide bank levy. The Commission proposal however foresees that the levy would be paid into a pot at the European level for collecting an insurance fund for future bailouts, which the UK is opposing. The draft Council conclusions state that:

*“The European Council agrees that a levy on financial institutions should be introduced to ensure that they contribute to the cost of crises. Such a levy should be part of a credible resolution framework. Further work is urgently required on its main features and issues of level playing field should be carefully assessed. The European Council invites the Council and the Commission to take this work forward and report back in October 2010.”<sup>71</sup>*

Britain wants to be free to decide how to spend the money and is opposed to the money being collected by the EU. Business Secretary Vince Cable has said,

*The one major reservation that we have about the [Commission] proposal as I have seen it is that it seems to suggest that the levy will be paid into a pot at the European level for collecting an insurance fund for future bailouts. That is not the way we saw the levy operating in London.<sup>72</sup>*

EU member states will press ahead with it at the 17 June summit with a view to adopting a proposal in October, with some arguing for its adoption irrespective of any agreement at the G20 level.<sup>73</sup>

### **An ‘orderly default procedure’**

German Chancellor Angela Merkel and her Finance Minister Wolfgang Schaeuble have both stressed the need for a mechanism by which eurozone states can default in an ‘orderly’ manner but remain with the eurozone. German Finance Minister Wolfgang Schaeuble has said,

*“We quite urgently need something for the members of European Monetary Union that we also didn’t have during the banking crisis two years ago. Namely the possibility of a restructuring procedure in the event of looming insolvency that helps prevent systemic contagion risks.”<sup>74</sup>*

Schaeuble has stated that an orderly insolvency procedure is not possible under the current treaties<sup>75</sup>.

### **A European Monetary Fund/country resolution fund**

Another option proposed by Chancellor Merkel is for the creation of an IMF-style European Monetary Fund (EMF) to help struggling eurozone countries. The idea, which was first floated by German Finance Minister Wolfgang Shaeuble in March, has not so far been

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<sup>71</sup> <http://www.eu-oplysningen.dk/upload/application/pdf/154cfe7a/Raad170610bilag-5.pdf>

<sup>72</sup> PA, 26 May 2010; <http://www.openeurope.org.uk/media-centre/summary.aspx?id=1107>

<sup>73</sup> AFP, 12 June 2010 <http://www.google.com/hostednews/afp/article/ALeqM5gHPjivy0tlufzvGfclfVT26JSGQ>

<sup>74</sup> Irish Times, 19 May 2010 <http://www.irishtimes.com/newspaper/breaking/2010/0519/breaking17.html>

<sup>75</sup> Dow Jones, 7 May 2010; <http://www.nasdaq.com/aspx/stock-market-news-story.aspx?storyid=201005070455dowjonesdjonline000375&title=german-ministtermust-set-up-orderly-sovereign-insolvency-procedure>

developed beyond the basic principle. Merkel has said, “Of course we are going to have to ask ourselves who will pay into it, how independent it will be from the European Commission,” adding that, “Without treaty changes we can't form such a fund.”<sup>76</sup>

Merkel said at the time, “We want to be able to solve our problems in the future without the IMF”. The appeal of an EMF would be that the eurozone, i.e. Germany, which would be the fund's biggest contributor, would be able to dictate extremely strong conditions to member states considering an EMF-bailout, which would act as a strong disincentive and reassert German leadership of the eurozone.

The proposal received a lukewarm response when first aired, with French Finance Minister Christine Lagarde suggesting “other avenues should be explored” in line with the existing treaties<sup>77</sup>.

### ***Direct financing of the EU budget***

The moves towards the creation of genuine economic government and political union are also likely to be used to create pressure for a more expansive EU budget – recent unprecedented developments mean that the budget can now be used as collateral to raise €60bn of loans on the financial markets.

Direct financing of the EU budget, through a tax for example, is not something that the EU will deal with in the coming months. However, several options for how it could be achieved have been touted by the Commission and Van Rompuy in recent months, with the latter saying, “the possibility of financial levies at European level needs to be seriously reviewed”<sup>78</sup>:

- *A Tobin tax*: one way to finance the EU budget, favoured by Budget Commissioner Janusz Lewandowski, is to introduce a levy on international financial transactions, with the revenue going to the EU budget.<sup>79</sup>
- *Proceeds for the EU through the Emissions Trading Scheme for CO2*: Belgian MEP Jean-Luc Dehaene, Vice-Chairman of the European Parliament's Budget Committee, has said that “we should open the discussion on direct funding for the EU”, suggesting that instruments to combat climate change present an opportunity to do that<sup>80</sup>.
- Other possibilities are a bigger share of VAT going to the EU or the proceeds of a direct carbon tax being used for the EU.

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<sup>76</sup> *EUobserver*, 16 June 2010; <http://euobserver.com/9/29633>

<sup>77</sup> *Market News*, 9 March 2010; <http://imarketnews.com/?q=node/9877>

<sup>78</sup> *Times*, 17 November 2009; <http://www.timesonline.co.uk/tol/news/world/europe/article6919380.ece>

<sup>79</sup> Lewandowski floated this idea during his hearing in the European Parliament on 11 January 2010, see [http://www.europarl.europa.eu/news/expert/infopress\\_page/008-66987-008-01-02-901-20100108IPR66980-08-01-2010-2010-false/default\\_en.htm](http://www.europarl.europa.eu/news/expert/infopress_page/008-66987-008-01-02-901-20100108IPR66980-08-01-2010-2010-false/default_en.htm)

<sup>80</sup> 2 March 2010 <http://www.openeurope.org.uk/media-centre/summary.aspx?id=1048>

## **4. WILL THESE PROPOSALS REQUIRE TREATY CHANGE?**

German Chancellor Angela Merkel has for some time indicated that she wants to see changes to the EU Treaties to strengthen the EU's budgetary rules and impose tougher sanctions on anyone that breaks the Growth and Stability Pact.<sup>81</sup> Following pressure from Merkel, French President Nicolas Sarkozy has pledged that "if a treaty change is needed we will propose it".

Which of the proposals would require Treaty change? Most of the proposals deal with the Stability and Growth Pact. On its website, the European Commission gives an overview of all the legal bases for the Pact.<sup>82</sup>

The fundamentals are provided by the Treaty (articles 121 and 126 of the TFEU) and a Protocol, which has equivalent legal status. Some arrangements are laid down in Council regulations. In any case the question of how much legal room the EU institutions have to modify the Stability pact has been subject to much discussion in the past<sup>83</sup> - and if possible, it is even more unclear now.

### ***What could the EU do without Treaty change?***

- **European Budget Semester (if voluntary)**  
National governments can decide a regulation under which they submit their budgets to the Commission, and to other national finance ministers for peer review, before they are sent to national parliaments. A different matter is whether a Member State can be *forced* to submit this information, which is relevant given the UK's opposition. It is also unclear whether objections by Commission to national budgets can be made binding under the current Treaties.
- **Taking into account the whole debt position of a country**  
This appears possible by merely amending the Council Regulation on the application of the Protocol on the excessive deficit procedure.<sup>84</sup>
- **More monitoring powers for the EU's statistics agency Eurostat: possible (if voluntary)**  
Also in this case it is up to the member states whether they allow an EU body to obtain information.
- **Suspending EU funds**  
The Commission sees the sanction as a "more conditional use of EU expenditure" and "more rigorous use of the Cohesion Fund Regulation". It notes that "currently, the suspension of the Cohesion fund, from which only a limited number of Member States is eligible, is only considered at a late stage of the Excessive Deficit Procedure (Article 126(8) of the TFEU)." There doesn't seem to be an obstacle in the Treaty against amending this, except perhaps when certain funds would be directed to member states as a result of Treaty provisions.<sup>85</sup>

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<sup>81</sup> [http://www.focus.de/politik/ausland/euro-krise-bruessel-greift-in-nationale-etatplanung-ein\\_aid\\_507711.html](http://www.focus.de/politik/ausland/euro-krise-bruessel-greift-in-nationale-etatplanung-ein_aid_507711.html)

<sup>82</sup> [http://ec.europa.eu/economy\\_finance/sgp/legal\\_texts/index\\_en.htm](http://ec.europa.eu/economy_finance/sgp/legal_texts/index_en.htm)

<sup>83</sup> See for example: "The stability and growth pact: experience and future aspects", 2007, by Fritz Breuss [http://books.google.com/books?id=T0CRrT1Js0C&printsec=frontcover&dq=The+Stability+and+Growth+Pact&hl=en&ei=-aEXTlv-OcyB\\_QbumviaDA&sa=X&oi=book\\_result&ct=book\\_thumbnail&resnum=1&ved=0CCYQ6wEwAA#v=onepage&q&f=false](http://books.google.com/books?id=T0CRrT1Js0C&printsec=frontcover&dq=The+Stability+and+Growth+Pact&hl=en&ei=-aEXTlv-OcyB_QbumviaDA&sa=X&oi=book_result&ct=book_thumbnail&resnum=1&ved=0CCYQ6wEwAA#v=onepage&q&f=false)

<sup>84</sup> <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:145:0001:0009:EN:PDF>

<sup>85</sup> The European Agricultural Guidance and Guarantee Fund, Guidance Section; European Social Fund and European Regional Development Fund are explicitly mentioned in the Treaty

- **Fees to a country resolution fund**

Currently, the Treaty mentions that Member States can be required “to make a non-interest-bearing deposit of an appropriate size with the Union until the excessive deficit has, in the view of the Council, been corrected.”<sup>86</sup> The EU’s plan is to “impose interest-bearing deposits when Member States make insufficient progress towards their budgetary Medium-Term-Objectives in good economic times”. The Commission claims in its 12 May Communication that “this would require a change in secondary legislation”, meaning not at the level of the Treaty. That seems correct as asking to hold interest-bearing deposits doesn’t seem to go further than non-interest-bearing deposits. However, Angela Merkel has previously said that the creation of a European Monetary Fund – which presumably will differ from a resolution fund since all member states, not only those running high deficits, will be asked to contribute – requires Treaty change.<sup>87</sup>

### ***What would require a Treaty change?***

- **Extending the existing system of fines**

This would entail making sanctions earlier and more automatic, which seems to be impossible without a Treaty change. The procedure was agreed after long negotiations in the 1990s. Back then, German Finance Minister Theo Waigel proposed the imposition of automatic sanctions for countries with excessive deficits, but this was met with resistance and the provision didn’t make it into the Pact, so it would be difficult to introduce it now through the back door.<sup>88</sup>

- **Suspension of voting rights**

Although French President Sarkozy claims that it is not absolutely clear that a treaty change would be needed to strip profligate governments of their vote in the Council, EU officials have said that there is no provision in the Treaties at the moment to allow for such punishment. Therefore, this would most likely require a Treaty change.<sup>89</sup>

Currently, Member states can lose their voting rights if the other EU countries find that they have breached human rights (the “values referred to in Article 2” TEU).<sup>90</sup> One would think that this cannot possibly serve as basis for suspending rights on budget grounds.

- **Kicking countries out**

This possibility is not provided in the current Treaty, as acknowledged by Angela Merkel.

- **Setting up of a whole new institution for the supervision of budgets (probably not possible)**

All legal documents clearly mention the specific institutions that are trusted with the task to follow up member states’ budgets. Therefore it should not be possible to outsource that responsibility without a legal basis.

- **Orderly default procedure**

There is no provision for such a procedure in the current Treaties, although it could conceivably be achieved through some sort of intergovernmental arrangement.

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<sup>86</sup> Article 126.11 TFEU

<sup>87</sup> <http://euobserver.com/9/29633>

<sup>88</sup> See: “The EU Stability Pact and the Case for European Monetary Union”, J. Peter Neary, 1997  
<http://www.economics.ox.ac.uk/members/peter.neary/writings/stabpact97.pdf>

<sup>89</sup> The Independent, 15 June 2010, <http://www.independent.co.uk/news/world/europe/eu-rulebreakers-should-lose-their-voting-rights-2000651.html>

<sup>90</sup> Article. 7 TEU and Art. 354 TFEU