



The EU in 2007

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1) Key EU events in 2007

1 January - Germany takes over EU Presidency, Romania and Bulgaria join the EU

26 January - 'Friends of the EU Constitution' summit

27 February - Summit for those that have not ratified the Constitution

8/9 March - EU Council - 'Social Model' summit

21 March - 3 day celebration of the Treaty of Rome, Florence

25 March - 'Berlin Declaration' on the Future of the EU

22 April - First round French presidential elections

May - Turkish presidential election

May - Irish legislative elections

3 May - UK local elections, Scottish Parliament, Welsh Assembly elections

6 May - 2nd round French presidential elections

9 May - EU's 50th anniversary, 'Europe Day'

10 June - First round French legislative elections

17 June - Second round French legislative elections

21/22 June - EU summit on the 'Future of the EU Constitution'

May/June - Elections in Belgium

1 July - Portugal takes over EU Presidency

Early July - Most likely date for Gordon Brown to take over from Tony Blair

Autumn - Review of the Emissions Trading Scheme

31 December - Deadline for economic partnership agreements

2) The return of the EU Constitution

Background

Angela Merkel has already made clear that the number one priority of the German Presidency of the EU (January-June 2007) will be re-launching the European Constitution. Angela Merkel told the Bundestag in December that she “would consider it an historical failure if we do not succeed in working out the substance of the Constitutional Treaty by the time the next European elections take place” in 2009.

At the European Council in June 2006 EU leaders agreed that Germany would present a report on the future of the Constitution in the first half of 2007, and that agreement on how to proceed with it would be reached before the end of 2008.

Germany, along with the other 17 countries which have ratified the Treaty, is adamant that the Constitution should eventually be implemented in the same form as originally agreed, or at least stay as close as possible to the current text.

The German Presidency is aiming to prepare the ground early, by arranging two extraordinary summits in January and February - one for the 18 countries that have ratified the Constitution and another for those that have not.

Factors to watch:

1. **The French elections:** it is unlikely that any real decisions will be made until the result of the French Presidential election is known. Nicolas Sarkozy and Ségolène Royal have radically different approaches to the Constitution: he favours agreeing a “mini-treaty” quickly, while she wants to kick the issue into the long grass by negotiating a whole new Constitution.
2. **When does Brown take over?** A lot might turn on whether Brown becomes PM early, and can steer negotiations himself, or arrives later in the year, and potentially finds himself confronted with a *fait accompli* negotiated by Tony Blair.
3. **The quid pro quo:** what kind of side deals might oil the wheels of an agreement on a new version of the Constitution? Could Brown be offered CAP reform in return for signing up? Could French voters be placated with some kind of “social” agreement?
4. **UK politics and referendums:** How will any deal fit in with the UK’s own political schedule? If a deal is done, how much pressure might Brown come under for a referendum? Could he make it an election issue? If a deal is done will there be pressure for referendums elsewhere in Europe?

1. The French Presidential elections

Polls suggest 71% of French people are interested in the election - with good reason. Ségolène Royal on the left and Nicolas Sarkozy on the right are currently neck-and-neck in the polls (on around 30% each). Indeed, as the last presidential election in 2002 revealed, anything is possible.

Ségolène Royal has already been named the official Socialist Party candidate. Nicolas Sarkozy is the clear favourite for the governing UMP party, but Defence Minister Michèle Alliot-Marie may yet launch a bid, as might the beleaguered Prime Minister Dominique de Villepin, possibly independently of the UMP. As things stand in the polls at the moment 82% of UMP voters prefer Sarkozy, 34% Alliot-Marie and 23% Villepin.

Even Jacques Chirac seems to be harbouring some hope of standing again - he told a newspaper that what was needed to counteract the 'mother' figure of Royal is a 'grandfather' such as himself. Outside of the two main parties, UDF leader François Bayrou is on around 8%, and National Front leader Jean-Marie Le Pen is on around 16%. Le Pen, the surprise runner-up last time round, is convinced he will be running the country this time next year.

The first round of the election will take place on 22 April, and the second on 6 May. Legislative elections will follow in June.

Europe will not be one of the big themes in the presidential election - both the leading contenders are in favour of further integration and the EU Constitution. However, each candidate is keen to be seen to be offering something different from the other, and the outcome of the election will have a big impact on how EU discussions 'on the future of Europe' pan out over 2007.

If Sarkozy wins the election...

The leading centre-right contender for the French Presidency, Nicolas Sarkozy, has already spelt out in considerable detail how he will attempt to reform the EU's institutions if he wins the election. His proposal - a new "mini-treaty" - would include the parts of the Constitution which Sarkozy claims are "uncontroversial".

Sarkozy's mini-treaty would incorporate the institutional changes envisioned in the European Constitution, which are deemed imperative by most in Brussels, but would attempt to leave aside the policy issues which many blame for the rejection of the Constitution in France in June 2005. It would abolish national vetoes in key areas, create an EU President, and an EU Foreign Minister.

The central point of the mini-treaty proposal is that it should seem sufficiently different to avoid the need for a second referendum. Sarkozy has been explicit about the need to pass it through parliament, and not by referendum.

Sarkozy's adviser on EU issues, MEP Alain Lamassoure, has said that the thinking behind Sarkozy's approach is that any attempt to re-launch the Constitution "could not be allowed to fail". Lamassoure has said that this means that EU leaders have to agree

not to hold referendums, except in Ireland. He has made it clear that the text would not be renegotiated as such and that there would be an agreement to retain the "heart of the Constitution" on which, according to Lamassoure, there had been a strong consensus. He argued that as this would only be an ordinary treaty, there would be no need to "annoy the people" with another referendum.

Sarkozy's plan is not universally popular, not least with the countries which have already ratified the text. According to French reports, Germany is particularly keen to stick as much as possible to the original text, and Foreign Minister Frank-Walter Steinmeier has indicated that he hopes to be able to convince Nicolas Sarkozy and others to scrap any ideas for a "mini-treaty", saying "Those countries which rejected the Constitution seem ready to negotiate." While accepting that neither Sarkozy nor Royal can be regarded as "definitive partners" until after the French election, he has said that he will pursue efforts to "convince" them both even before the vote.

The mini-treaty plan appears to be dividing the UK Government. Lamassoure told a newspaper that Tony Blair had received the idea "with interest", reflecting strong previous indications that the Foreign Office and Downing Street are keen on the plan.

In November the Guardian reported that Geoff Hoon had given a private speech in which he set out "plans for the European Union which are certain to weaken the UK's right of veto. Ministers want to streamline decision making while rejecting plans to revive the EU Constitution." It went on - "The statement is likely to reflect ideas put forward by the French interior minister, Nicolas Sarkozy, for a mini-treaty to streamline European institutions". The Telegraph reported that Hoon's aides had "insisted" that the speech had received clearance from Number 10, and that the Government had explicitly acknowledged that it was rowing in behind Sarkozy's plans for a "mini-treaty".

However, according to Alain Lamassoure, talks with Gordon Brown on the mini-treaty plan have been "more complex", meaning that Sarkozy et al are keen to get the process well underway before Brown moves into office.

If Royal wins...

The star of the Socialist Party Ségolène Royal is equally well placed to take over from Jacques Chirac. Royal has been quieter than Sarkozy on Europe but appears to be in favour of making more wide-ranging revisions to the Constitution than her rival envisions in his "mini-treaty".

Royal has argued that the Constitution is not "dead", but is "null and void". She has dismissed the mini-treaty idea, arguing instead that proof of a "Europe of results", and a "re-launch of common policies" is more important than rushing ahead with institutional reform in the immediate future. She thinks Europe needs "new functioning rules," but that these will not be accepted by the French people in a referendum until Europe can prove its worth by helping to reduce unemployment among other things.

Royal thinks the French presidency of the EU should launch a new convention in 2008 to draw up a new text which would be "put to the people" on the same day across

Europe, and, ambiguously, "following the procedure chosen by each country" - implying that all countries would in fact be free to ratify in parliament, if they wished.

One of the primary motivations for Royal in calling for a more extensive and long-winded process is to kick the issue into the long grass. While 63 % of UMP voters back the Constitution and 33% are opposed, Socialist voters are more likely to oppose the party line, with 40% of their voters in favour of the Constitution and 54% against.

The polls suggest that Royal has a very good chance of winning the election, particularly since her recent electoral pact with Jean-Pierre Chevènement, leader of the left-wing no campaign, which has removed him from the contest (last time round he received more than 5% of the vote, taking a key constituency from then Socialist candidate Lionel Jospin). In addition, the small far-left parties have so far failed to agree on a common candidate, a situation which might work in Royal's favour.

It's not clear exactly what the pact with Chevènement involved, but if his views on the EU Constitution were to have any influence on Royal it would almost certainly make her more cautious, perhaps preferring to delay the German timetable which envisages a quick ratification. Given the splits in the Socialist Party caused by the Constitution during the referendum campaign, she is unlikely to want to open up these divisions again so soon into her Presidency.

Accordingly Royal has been suitably vague about what a new treaty might look like. Why, ask some, would the end result of Royal's convention be unlikely to look all that different to the Constitution? The Socialist Party manifesto clearly advocates "the elaboration of a strictly institutional Treaty", although according to Royal's spokesperson, Gilles Savary, the new treaty would include increased protectionism, an EU Foreign Minister, harmonised tax rates and moves to create a European army. Savary has also suggested that Royal would try to agree a new treaty with other key powers such as Spain, Italy and Germany should Britain reject the new deal.

If there is any deal under Royal it is likely to require the inclusion of a new "social charter" in the Constitution. Angela Merkel has also come out in favour of this idea. However, it would be *likely* to be resisted by the UK Government (and some of the new member states) unless it were made voluntary in some way.

In the short term, a victory for Royal would be likely to lead to stalemate on the Constitution at the European Council in June, especially if Blair or Brown chose to resist moves towards a more "social treaty". This would suit the UK Government well. However, in the longer term, Merkel would be likely to "call out" Royal on her support for a full Constitution - potentially leading to a bigger deal at a later stage.

2. When does Brown take over, and how much influence will he have beforehand?

Tony Blair has been generally regarded amongst other EU leaders as the most europhile British Prime Minister since Edward Heath. In contrast, Gordon Brown's prickly stance in ECOFIN meetings and often confrontational approach towards Brussels are well documented. In 2003 Brown advocated the repatriation of EU regional spending. During the debate about the European Constitution the Treasury made several critical interventions from the sidelines, particularly a series of critical

comments from unnamed treasury officials which appeared in the press in November 2003. Having positioned himself in the press as more sceptical than Blair, Brown is not going to be keen to be seen to be giving up further powers immediately on taking office.

In contrast, even after its rejection by French and Dutch voters Blair said that the Constitution was a "sensible set of rules" and will "have to be revisited". As noted above, Downing Street has backed Geoff Hoon's endorsement of Sarkozy's mini-treaty idea.

However, such unwavering support for the Constitution from the Prime Minister could put his successor in a difficult position. One possibility is that Brown might inherit a constitution process, the terms of which have already been agreed before he takes office.

It seems almost certain that Brown will be PM. However, the *timing* of the handover will become crucial.

A lot turns on whether there is a leadership contest. An "orderly transition" from Tony Blair to Gordon Brown certainly looks like the most likely outcome at the time of writing. His most credible rival - Education Secretary Alan Johnson - appears to have ruled himself out. The only other potential heavyweight challenger, John Reid, while being careful not to give away his intentions, seems increasingly unlikely to stand. If one of the left-wing 'outsider' candidates - John McDonnell or former Environment Minister Michael Meacher - drops out early, the other might just scrape enough nominations from the parliamentary Labour party to trigger a leadership election, delaying the handover to Brown until after a series of key EU meetings.

The conferences of EU leaders in January and February will have a major role in shaping the debate on the EU Constitution. The European Council on 8-9 March will probably draw up the Berlin Declaration on the future of Europe (to be proclaimed on 25 March) which will further frame the debate. The process will then accelerate quickly after the French Presidential elections on 6 May, and meetings around the 50th anniversary of the EU (9 May) will probably drive this on. It is possible that an outline agreement will be hammered out at the European Council on 21-22 June.

At what point in this series of events does Brown take over?

One widely spoken of handover scenario is that Blair might announce his plans to step down in March (in order to give Labour a boost in the Scottish, Welsh and local elections on 3 May). He would then step down as party leader (though not PM) in May. There would then be a leadership and deputy leadership election. This would be likely to last 10-12 weeks: 3-5 weeks for candidates to get nominations, followed by roughly 7 weeks for a postal ballot. This would mean Brown might not take over until July - after the French elections and the crucial June summit.

Alternatively, with no leadership election, Brown might take over unopposed at the end of May. However, if Brown was going to be present for earlier discussions on the EU Constitution, he would need Blair to stand down *as PM* at the beginning of March or earlier.

On the one hand Brown would be expected to have influence on the UK Government's negotiating position during these discussions. On the other hand it could be argued that Blair is to a certain degree free to agree to the new plan knowing that he won't be the one who comes under huge political pressure to hold a referendum on it.

Blair could then leave office happy that he has secured his "European legacy" (previously denied him by Brown's five euro tests) by agreeing to a new treaty which will, in his eyes, help to reform the EU. Indeed, some people would argue that Blair might take some degree of pleasure in leaving the problem to the man who forced him to leave office in 2007. It would be Blair's treaty but Brown's problem.

Of course, even if the process leading to a new treaty is well underway it is unlikely that Tony Blair would actually have *signed* a new treaty by the time he hands over the reins of power. Potentially therefore, Brown could simply throw out the outline deal and refuse to sign up to any agreement set up by Tony Blair. However, there would be considerable pressure from the Foreign Office not to do this if it involved overturning a seemingly "done deal". Blocking a new treaty would be a bold move for Brown. Blocking one which was thought to be agreed would be even bolder.

3. A quid pro quo?

There have been suggestions that Berlin is hoping Brown's support for a new version of the Constitution might be bought with a deal involving a package of CAP reform and cuts to the UK's EU budget contributions.

Writing in the FT in October, George Parker commented that Gordon Brown, while being sceptical of any moves towards reviving the Constitution is "passionate" about reform of the EU budget and the CAP, and suggested that there are plans afoot to use these concessions as "bait to entice a Prime Minister Brown to sign up to the Constitution".

He revealed that when Brown met German Chancellor Merkel in Berlin earlier in the year, "her aides started speaking of a possible broader deal: in exchange for signing up to a revised Constitution, Mr Brown could demand a modernisation of the EU budget, reform of farm support and regional aid for innovation and research." The article concluded that EU Commission President Barroso and Angela Merkel "plainly think Mr Brown might accept a new treaty updating the EU's institutions if he could present it as part of a package embracing enlargement, a 21st-century budget and a new mandate for the free-market."

If Merkel were to offer to accept significant CAP reform and a "mini-treaty", neither of which Germany is particularly keen on, this gesture of goodwill from the EU's biggest power might persuade the UK and France to meet her halfway. There would certainly be some resistance to this, not least from countries such as Spain and Ireland, but if the "big three" are in agreement, and if EU leaders think two of the most problematic countries will actually ratify the document, they might well fall in line.

Obviously the main stumbling block to this plan would be France. Although Sarkozy has, interestingly, said recently that he wants to “put the question of CAP reform on the table at the European Council” before the current deadline of 2013, he would be loathe to take on the vociferous French farming lobby so early in his Presidency, (especially since the current Agriculture Minister, Dominique Bussereau, is dead against any reform, even *after* 2013). Any attempts to push through a revised version of the Constitution are guaranteed to be unpopular in France, let alone a Constitution linked to significant cuts to French farmers’ subsidies. However, Sarkozy could at least claim that his vision of the future of Europe - the mini treaty - had won the day.

Such a deal would allow Brown to portray the new treaty as a real modernisation, not just a bureaucratic “tidying up exercise” that ordinary people would find difficult to relate to. It might also make it much more difficult for opponents in the UK to fight the new Constitution.

Brown might have an incentive to pursue such an outcome anyway. If Brown suggests that he would offer his support for a mini-treaty to a new Constitution if he gets CAP reform, but the French refuse, it could be quite useful for him both in blocking the treaty and positioning France as the “problem” within the EU. He would be able to kick the Constitution into the long grass thus preventing it becoming an issue in the next general election.

4. UK politics and referendums

Brown’s personal scepticism on Europe is one thing, but it is still far from certain how he will deal with the Constitution when it (sooner or later) comes back on the agenda. Both of the main opposition parties are pre-committed to calling for a referendum on a new version of the Constitution.

If the new text is close to the original, Brown will be in a difficult position and all the options become harder. If it is a mini-treaty he might be better placed to avoid a referendum where it would still be likely to be defeated, but this would depend on the political climate at the time. If he manages to persuade others to agree to major reforms, like a real revision of the CAP, his task would be made considerably easier and his chances of achieving ratification in parliament or in a referendum would be greater.

Could Brown accept a new treaty and refuse a referendum?

It would probably be more difficult to avoid a referendum on a new document than the first time round for several reasons:

- Blair has already set a precedent by calling a referendum on the first version of the Constitution, and the referendums (and no votes) in other member states would give further ammunition to those calling for a referendum.
- Labour are currently behind in the polls - up to 8% behind the Conservatives compared to an average lead of 5% in 2004.

- Brown will be fighting to define himself in the first months of his premiership. Trying to force through an unpopular agreement in the face of calls for a referendum is the last thing he is likely to want. Given his previous positioning as sceptical, he would face accusations of a u-turn.
- Even if the new treaty is slimmed down, enough of the controversial elements of the Constitution are likely to still be in place to make calls for a referendum seem credible. Two of the easiest-to-understand changes in the Constitution (the EU President and EU Foreign Minister) are certain to be in any mini-treaty.
- Ratification of a new agreement is likely to take place in either 2008 or 2009, around the expected time of the next UK elections. Labour MPs will be very anxious to avoid being forced to vote for an extremely unpopular EU treaty so soon before they ask their constituents to re-elect them, especially as polls found that Labour voters were the largest group that was opposed to the old EU Constitution. The last thing they want is a hugely publicised vote - similar to the ratification of the Maastricht Treaty - before the election is held.

Could Brown make it an election issue?

If Brown enjoys a honeymoon period once he comes into office there is a distinct possibility that he might choose to hold a snap election in early 2008 (before the public spending slowdown really begins to bite). If he is feeling really bold he might calculate that the best way to deal with the EU Constitution is to tackle it head on, by making it a centrepiece of this election.

This could be a more attractive option than it might first seem (particularly if there was some sort of guaranteed CAP reform). He might judge that the Conservatives would be reluctant to make Europe the centrepiece of yet another general election, particularly at a time when they are attempting to get away from "banging on about Europe". He could also quite persuasively argue that there would be no appetite among EU member states to revisit the Constitution for a third time and stress that as the text would be ratified by parliaments in most other countries, voting in the Conservatives could lead to the UK being forced to leave the EU, or at the very least become completely isolated.

By making it an election issue Brown would also allow the newspapers to return to one of their favourite themes, "Tory splits on Europe". He would however run the risk of the same being written about his own party. There would be a sizeable group of Labour MPs who would be reluctant to toe the party line on the EU Constitution, particularly if they believe it would result in the loss of their seat.

The obvious advantage of this approach would be that if he wins the election he could claim to have a mandate on the Constitution and would be able to pass it through parliament with a minimum of fuss - earning the praise of his fellow EU leaders.

The obvious risk Brown runs is that this issue could cause him to lose office. The Conservatives would almost certainly be reluctant to conduct another "Who runs Britain?" election campaign, but they might be quite happy to make opposition to the

unpopular Constitution one of many manifesto commitments or to campaign on the offer of a referendum.

Could Brown promise a referendum - and hope another country votes no first?

One solution if Brown is unable to delay a new treaty, and chooses not to block it, would be to promise a vote - perhaps delayed to some point after the general election. As well as delaying solving the problem until after the election, Brown might also hope that another no vote in another country might get him off the hook. Approval of a Treaty could be problematic in France and the Netherlands, and also Poland, the Czech Republic, Denmark, Sweden and Ireland. Denmark and Ireland would be required to hold referendums, and a mini-treaty would be likely to need a referendum in the Netherlands. Brown might realistically hope for the same lucky break as Tony Blair.

3) What to expect from the German Presidency

1. Berlin Declaration

The Berlin Declaration on 25 March will be the symbolic centrepiece of the German Presidency which is expected to act as a catalyst to the discussions on bringing back the EU Constitution. Each EU leader will be expected to sign up to the statement which will "reaffirm the Union's values" and will commit them to finding a solution to the European Constitutional problem.

Jose Barroso told the Bundestag, "I expect much from it. Firstly, as a symbolic act: Berlin is the symbol of our reunited Europe... How far do the Member States want to go? That is the question. Personally, I am confident. I believe that the Member States will see this Declaration as a unique opportunity to state clearly how they see their future together... This Berlin Declaration is therefore a key piece in the jigsaw puzzle that will gradually be assembled to settle the institutional question. The European Commission, and I personally, fully support the principles, the values and the substance of the Constitutional Treaty. I recall that I have said many times that Nice is not enough. We are ready to support Member States' efforts to find a way to solve the challenge at the heart of the institutional question."

2. EU Constitution

The Berlin Declaration will represent a symbolic commitment of all EU leaders to the EU Constitution but the real work will be done at the summit on 21 and 22 June which we are told will focus on "the future of the Treaty Establishing a Constitution for Europe". In many ways, EU leaders know that they need to wait until the next French President enters office before any real decisions can be made. Nevertheless the German Presidency will hold a "friends of the Constitution" summit on 26 January, which will gather together all the countries that have already ratified the Constitution. Then on 27 February they will get together all the countries that have so far failed to ratify to attempt to pressure them into finding a way forward for the Treaty. There will also continue to be individual meetings with officials from each country throughout the six months.

The German government's Presidency Programme, "Europe - succeeding together" states:

"The draft of a European Constitutional Treaty provides for the internal reforms needed to ensure the viability of the enlarged European Union. The German Presidency will hold in-depth consultations with all EU partners and institutions and make a concerted effort to drive forward the EU reform process in line with the decisions taken at European level."

The programme reminds readers that the German Presidency was tasked with "holding in-depth consultations with the EU member states in the first half of 2007". The Presidency will then report back to the June Council which will "serve as a basis for decisions on how to continue the reform process".

3. Justice and Home Affairs

One of the key portfolios on which the German Presidency will be attempting to make progress is Justice and Home Affairs. As this is such a sensitive area of national policy it always has the potential for major disagreements as was seen with the Finnish attempt to use the *passerelle* clause. There are several areas where the German Presidency is committed to pushing forward integration which are likely to be resisted by the UK Government and others.

Europol. The Germans have said that a "priority of the Presidency is to strengthen Europol". They intend to do this through improving practical cooperation, developing the legal framework for the institution so that it comes within the EC treaty structure, and most importantly "*extending the scope of the organisation's responsibilities*".

The Commission wants to extend Europol's competences by allowing it to begin working on all "serious" cross-border crimes (it is currently restricted to dealing only with "organised crime"). It will also be allowed to begin coordinating security for major international events such as sporting events.

At the moment Europol's role is largely restricted to helping member states share evidence and intelligence but there is a consensus among many of the member states in favour of giving Europol a greater operational role. This includes allowing it to conduct investigations on the ground. In evidence to the Commons Home Affairs Committee recently, Jonathan Faull, Director-General of the European Commission's Justice and Home Affairs department said that "Europol is designed to co-ordinate, and perhaps one day actually to run, investigations itself".

The Austrian Presidency drew up a discussion paper in the summer which suggested allowing Europol to take on a more investigatory role in countering counterfeiting, as well as other undefined "EU crimes". They also wanted to allow Europol to access EC databases with personal information which are not designed for police purposes. The British government was opposed to this extension of Europol's powers as they want to resist Europol being established as an EU version of the FBI. If the Germans take up these ideas from the Austrians we can expect to see the UK fighting them to limit Europol's powers.

The German government has also signalled that it wants to get agreement on several contentious proposals in the criminal justice sphere. One proposed measure attempts to **harmonise rights for suspects in custody** across the EU.¹ If passed, every suspect across Europe would be handed a 'Letter of Rights' once arrested, which they are granted by "European Union law". The House of Lords EU Select Committee has warned that if this proposal is passed it could become impossible to stop the "creeping competence" of the Commission, and could lead to the "incremental unification of criminal procedure throughout the EU."

¹ Framework decision on certain procedural rights in criminal proceedings throughout the European Union

The UK Government originally gave the proposal lukewarm support, but since the proposal ran into stalemate in the Council of Ministers it has announced that it is “not needed as the proposal offers no new benefits to citizens over what the ECHR already guarantees”. The Germans have said that their “goal is to conclude these negotiations”; if they are to do so they will have to persuade the UK among others not to veto it. If the UK Government does give way it will be a significant reversal of policy with considerable consequences, setting a precedent which would allow the EU to begin harmonising standards across the criminal justice field. In particular there would be pressure to harmonise concepts such as the right to silence and the right to bail – moves which are extremely problematic for common law countries and are not looked on favourably by the UK Government.

Another proposed measure which the German Presidency wants to conclude is a proposal to **harmonise crimes of racism and xenophobia across the EU**. The proposal is sensitive from a UK perspective because it could overturn amendments made to the recent act on Religious Hatred. After a campaign led by the comedian Rowan Atkinson, an amendment was passed which safeguarded comedians from prosecution for insulting behaviour. The EU Commission’s proposal could overturn this amendment because it outlaws “public insults”. If the amendments were overturned it would also be likely to cause considerable consternation among religious groups in the UK.

Other measures the Germans are likely to focus on in this field include:

- **Extending the “right of hot pursuit”**. This would update the laws which allow police forces to chase criminals across borders. The UK could be included in this proposal for the first time. The Germans are also keen to take this further. For example, they want the Dutch authorities to allow German police to operate within the Netherlands to combat drug smuggling back into Germany.
- They have said that they want to “drive forward **harmonisation in the use of biometric data** for visas as well as for residence permits, passports and ID cards”.
- “Community-wide regulations in the field of **legal migration**”. This would include the EU Justice Commissioner Franco Frattini’s proposal for a “green card” system which could allow the EU to begin controlling the levels of migrants member states are allowed to admit through quotas.
- They also want to “work to strengthen the European External Borders Agency **FRONTEX**”. They call for member states to provide enough personnel so that there can be almost permanently deployed teams at “illegal migration hotspots and all major border crossings... A pool of border police experts is to be formed at FRONTEX, and officers from other Member States are to be granted executive powers for joint border controls.”

4. Economic reform

One of the more welcome parts of the Presidency's programme for the first half of 2007 is the focus they want to place on economic reform and in particular deregulation. The German government "wants to see the introduction of concrete reduction targets" for levels of regulation. The need for this is not in doubt; EU Industry Commissioner Gunter Verheugen revealed recently that EU regulations cost the European economy something like €600 billion a year. The Commission is also expected to present an interim report on its review of the Single Market before the March 2007 European Council.

Unfortunately the German Presidency merely plans to follow the Dutch approach of cutting the administrative burdens of regulation, leaving alone the actual cost of having to implement and abide by regulations. In other words they want to reduce by 25% the amount of paperwork businesses and charities have to plough through each year because of EU regulations. While this is clearly a step in the right direction, it is just that, a first step. It represents a tinkering at the edges which is not commensurate to the scale of the challenge that EU over-regulation poses. If the German Presidency wants to begin making a real difference it needs to start by scrapping controversial and burdensome measures such as the Working Time Directive.

Despite this fine-sounding talk of deregulation, British business will be extremely worried about the effort the German government says it will make to help further the cause of a "social Europe". It has committed itself to "further developing the European Social Model" and "the European Social Agenda".

The Presidency's programme says, "The EU must do its part in safeguarding and developing the European way of life and identity and the values of a social order in the age of globalization and rapid demographic change. Intensifying their cooperation is the primary way in which the Member States and the EU must demonstrate their commitment to a social Europe. This is crucial if Europe's citizens are to accept the idea of integration."

The German government is clear that they intend to take action to achieve the dream of a "social Europe". They warn that "the debate on the European Social Model has to be fleshed out with concrete proposals". The importance attached by the German Government to this topic is underlined by the fact that it intends to dedicate the EU leaders' summit on 8 and 9 March to furthering social dimensions of the EU.

Another worry for business will be the Germans' determination to get an uncompromising deal on mobile roaming charges. The Germans have announced that they intend to go further than the EU Commission's proposal. The Commission wants to cap roaming charges at 30% above the price of domestic calls but the German government is insisting that it should be 20%. The Presidency would like to get a deal at the first reading in the European Parliament, which could be as early as May next year, but they are likely to face stiff opposition from both the UK and France who are opposed to setting any type of fixed cap on roaming charges. The UK in particular, is more in favour of persuading companies to slash roaming charges by threatening them

with future binding legislation unless they comply - thus maintaining an element of competition by allowing companies to adjust retail prices.

Other economic issues the German Presidency will focus on include:

- Continuing the evaluation of European directives on safety at work. "It must be clarified whether the goals of individual regulations have been wisely chosen, whether the tools employed in the regulations are suitable for attaining the positive impact desired in occupational practice and what steps, if any, must be taken to improve them."
- They aim to increase "convergence in supervisory practices" in financial services. Experts predict that this could set in motion moves towards an EU "super regulator" in financial services.
- "Last but not least, Germany believes that a single tax base for company taxation would go a long way to improving the competitive conditions for European enterprises". They hope to "gain further ground" on this during their Presidency.

5. Other priorities include:

- **The 'green agenda'**. The Germans want to achieve a common EU position on climate change for the post-Kyoto period, which would include involving "major greenhouse gas emitters" into a package with emissions reduction goals. They will also introduce the Commission proposal on integrating air transport into the European Emissions Trading Scheme.
- **Defence**. "The Presidency aims to take further steps towards military cooperation with the long-term goal of a common European defence."
- **Trade**. The German government aims to achieve a successful conclusion to the Doha Round and to the negotiations with Least Developed Countries over Economic Partnership Agreements. However it also stresses that it is keen to "strengthen trade protection instruments" - this is expected to be an attempt to toughen up the EU's anti-dumping regime.
- **Russia**. The Presidency aims to deepen relations with Russia - "particularly in the energy sector".
- **Transport**. Berlin aims to expand the responsibilities of the European Aviation Safety Agency, the body which the Commons Transport Committee described as "shambolic" and an "accident waiting to happen".²
- **Arms control**. According to the French press, the Germany Presidency hopes to agree stricter EU controls for arms exports, and include this objective in the Berlin Declaration.

² "EU airline safety agency attacked", BBC Online, 8 November 2006

4) Will the euro come under pressure?

Five years after euro notes and coins entered into circulation and eight years after its launch, the single currency seems to be the focus of a renewed wave of discussion - and indeed criticism from several unexpected quarters.

Scepticism in euroland...

Earlier this year, Paul de Grauwe, Jose Barroso's economics adviser, said that "the euro is a bad thing for the Italian economy. I'm afraid that Spain is also evolving in the same direction. If that happens, we are stuck with a big problem." He said that developing a "political union" is the only way to mitigate the problems created by the euro, saying "A political union is the logical end-point of a currency union. But if that political union fails to materialise, then in the long term the euro area cannot continue to exist." Public opinion in the eurozone's Germany seems to have turned against the euro - at the end of December a Forsa poll published in Stern magazine showed that 56% of Germans want to see the return of their former national currency, the mark.

In a recent pamphlet called "Will the eurozone crack?" Simon Tilford of the pro-euro think tank, the Centre for European Reform, discussed the lack of growth in the Italian economy since 1999 and predicted that if Italy does not improve its competitiveness, it could be forced to leave the eurozone. This in turn could force others to leave, and could even threaten the single market. He also argued that the zone as a whole has wider problems: "The scale of the eurozone's productivity problem should not be underestimated. Productivity growth, and especially growth in total factor productivity, has declined very sharply across the eurozone in recent years, a trend not mirrored in other EU-15 countries or in the OECD as a whole."

In a marked change of tone towards the end of the year, the previously pro-euro Financial Times argued that the UK's decision to stay out of the single currency is looking "sunder than ever," and has indeed been "vindicated". It argued that despite exchange rate stability being cited as a major boon of the euro, sterling has achieved stability outside the eurozone. It is also clear that trade has not been significantly affected by opting out of the euro, as non-eurozone countries (UK, Denmark and Sweden) increased their exports to the eurozone economies by 7%. Foreign direct investment has been "flooding into the UK", while Britain's financial services sector is "thriving", despite arguments in the past that these would be damaged by keeping the pound. The article concluded that the Bank of England, since it was given independence "is widely seen as more transparent and flexible than that of the European Central Bank. The UK fiscal rules, while not perfect, are superior to the eurozone's Stability and Growth Pact. For now, the Treasury's opposition to joining the euro has been vindicated."

And scepticism outside...

The Economist's The World in 2007 found that the average Briton is £2,200 better off because the UK did not join the single currency. Most of the ten new member states

have put back their expected dates for joining the currency, and a recent poll in Sweden found that the majority of Swedes are increasingly sceptical towards the euro, with a minority of only 34.7% in favour of joining the eurozone, compared with 38% in May. 51.5% are now against.

In an article in the *IHT* Robin Shepherd from the German Marshall Fund argued that it would not be in the interest of most of the new member states to join the eurozone. He said, "the stark reality [is] that the euro has provided no obvious benefits to the 12 countries that currently use it... The case in favour of adopting the single currency has too often been assumed rather than argued. When the European Commission next delivers a lecture about the euro, perhaps it should provide some hard, fact-based evidence explaining why there is such a rush and what precisely all the fuss is about."

Internal tensions

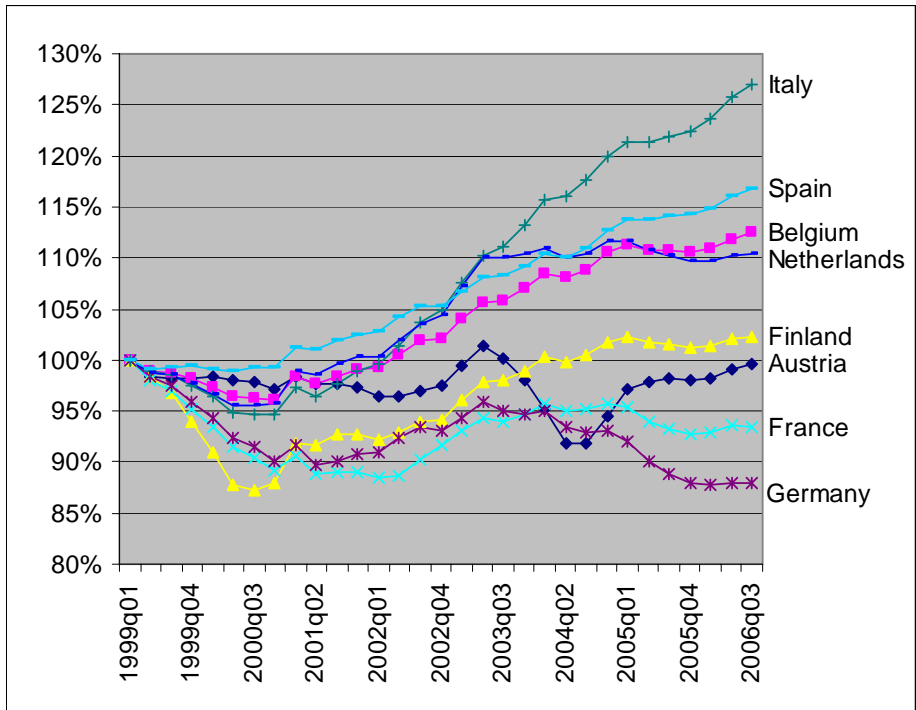
Cumulative differences in real exchange rates between euro members suggest that adjustment in the eurozone is more proving more difficult than some euro advocates had hoped. Real labour costs in Italy compared to Germany are now 40% higher compared to before the launch of the euro. In the absence of nominal exchange rate changes, cumulative differences in productivity growth and inflation rates can only slowly be ground out by comparative disinflation, meaning that regions and countries may face prolonged periods of higher unemployment.

The European Commission's "European Economy" report in November warned that "Continued subdued growth performance and persistent divergences in growth and inflation raise questions as to whether internal adjustment in the euro area is working smoothly." It concluded, "Such divergences, if they were to result in tensions, could weaken cohesion in the euro area, make policy co-ordination more difficult and complicate the task of the common monetary policy."

Fanning out: Real exchange rate changes since the launch of the euro

Comparative disinflation in Germany, compared to Italy causes tensions in itself. However, it is also likely to lead to further tensions over interest rates. A recent leader in the FT noted that, "Germany's record of competitive disinflation in recent years is formidable. But its prolonged economic stagnation did at least justify very low interest rates from the ECB. Now, as Germany's inflation rate is likely to rise towards the eurozone average, the ECB will have to hold down inflation elsewhere, if it is to hit its overall target. That ensures a durably tougher monetary environment for everybody else."

Underlying this tension is a difference in the industrial structure of the euro members. Germany is benefiting from a huge boom in capital goods exports to China and other emerging economies. With more of its economy in high value added goods it is likely to benefit from a higher exchange rate and lower input prices. Italy and Spain, on the other hand, are suffering from increased competition from China and other new producers of traditional lower value added goods (like shoes, clothes and textiles). A rising exchange rate is likely to bite harder for manufacturers of commodified, lower value added goods, who are less likely to be able to raise their prices.



Source: REER based on Labour costs, IMF International Financial Statistics 2006

2007: more rows over the 'strong euro'?

The rising strength of the euro against the dollar and the role of the European Central Bank have become what some have described as the "bête noire" of the French Presidential campaign, to such an extent that President Chirac was forced to call matters to order in the margins of December's EU summit. Prime Minister Dominique de Villepin suggested he wanted to "take back sovereignty" over exchange rate policy, and others including Ségolène Royal and Nicolas Sarkozy have argued that the strong euro is damaging French competitiveness, and that the independence of the ECB should be reconsidered. One presidential candidate, Nicolas Dupont-Aignan, has even called for a return to the franc.

US dollar / euro exchange rate



Several other leaders have called for strengthening of “economic governance” in the eurozone, and “a real economic government” in order to reap the benefits of the euro.

However, the Head of the ECB, Jean-Claude Trichet and others have hit back at the criticisms, recalling that France has voted for the independence of the ECB in the treaties, and saying the ECB shouldn't be a scapegoat for France's economic problems.

The value of the euro, currently near its all time high against the dollar, is already causing difficulties for several high profile firms, including Airbus, which this year reported that the strong euro has put it at a competitive disadvantage over Boeing of the US. Nicolas Sarkozy has warned, "If we carry on like this, we won't be able to manufacture Airbus in Europe. The dollar will have become so cheap that we will have to go and make Airbus in the US."

According to an analyst quoted in Le Figaro, “Airbus manufactures in the eurozone, but sells in dollars. In 2005, its profits fell by 670 million euros for this reason alone.” In November Fedex became the first customer to cancel its order for Airbus' giant A380 jet. French Prime Minister Dominique de Villepin subsequently announced that €145m of state aid would be unblocked to help Airbus, because it is going through “a difficult period”.

The euro could easily go higher still against the dollar during 2007. In a series of influential papers the economists Dooley, Folkerts Landau and Garber have characterised the current international financial architecture as a kind of “Bretton

Woods 2". China is currently sustaining a very large US current account deficit by running up very large holdings of dollars while maintaining an artificially low exchange rate against the dollar. This means that the burden of adjustment has to flow through other non-fixed exchange rates, including the euro-dollar rate. Many see this arrangement as unsustainable.

For the time being, it seems likely that the ECB will continue to ignore pressure from member states. However, a sharp rise in the euro exchange rate would probably increase such pressure dramatically. Because there has not yet been a major recession during the period while the euro has been up and running, it is difficult to guess what might happen when the euro system comes under greater political pressure.

The euro: helping or hindering reform?

Even advocates of the euro have argued that without economic reform, the single currency will not be a success. However, so far it appears that the euro is doing more to blunt pressure for reform than to drive reform.

The French Prime Minister's *Conseil d'Analyse Economique* this year gave what The Business magazine called "the most damning indictment of the European economic policy ever produced." The report found that "Economic integration has stagnated and no longer promotes growth. The euro's creation has not produced the knock-on benefits expected. The increase in trade has been relatively modest and financial and credit markets remain segmented."

The report argued that "the single currency even seems to have had a "numbing" effect on the EU members, which no longer need to protect against a foreign-exchange crisis and have become complacent in their efforts to control spending and make structural reforms. Moreover, the euro area's macroeconomic framework has become obsolete." It also found that price convergence "did not occur". The report concluded that "the situation is perilous: the inability of the EU to revive the economy turns investment away from the continent; persistent under-employment and anaemic growth undermine social provision and the combination of agonising economic problems, poorly-managed enlargement and a manifest exhaustion with community procedures all threaten to trigger a vicious circle which will unravel the *acquis communautaire*."

5) Other issues to look out for

Some of the other EU initiatives and issues to look out for in the coming year include:

- **Economic migration.** As noted above EU Justice Commissioner Franco Frattini has called for an EU “green card” system to be set up. He believes it will help Europe compete with the US in attracting highly-skilled migrants. In addition the Commission will also put forward a directive to harmonise the rights of these immigrants, particularly in regards to their rights of entry and the length of stay necessary to qualify for citizenship. It will be interesting to see whether the UK Government signs up to these measures as until now it has opted out of all legal migration decisions. One thing the British will not be able to opt-out of is the proposals to create EU wide criminal offence and penalty for employing illegal immigrants. A controversial court ruling in September 2005 means that this measure will be decided under the first pillar of the EU’s treaty structure rather than under the inter-governmental pillar, which is subject to vetoes. The Government will be unable to block the move unless it can find support among other EU member states.
- **EU embassies.** The Commission will make a proposal aimed at strengthening diplomatic and consular protection. This follows an earlier Communication appearing in December which suggested the EU is taking the first steps towards fully-fledged EU embassies, as it proposed the “sharing” of consular tasks between member states and the establishment of “common offices” located either in member states’ embassies or in Commission representations.
- **Defence.** The Commission will make a proposal for a regulation on the transfer of defence products. Defence industries have so far been kept out of the implementation of the internal market, with member states maintaining national control over defence equipment markets and related industries. The proposal, according to the Commission, would aim to decrease fragmentation in the market brought about by national controls, to help in turn reduce fragmentation of research efforts and industrial bases. Also envisaged is a proposal for a directive on the coordination of procedures for award of public contracts in the defence sector. The Commission pre-empted these moves in December in an “interpretative communication”, reported on by the FT.
- **Emissions Trading.** 2007 will see the EU attempt to agree the next phase of its beleaguered Emissions Trading Scheme (ETS). One thing to watch out for will be the ongoing disagreements between member states and the Commission over the number of permits that will be issued for the second phase of the scheme. The Commission is attempting to limit the number of permits in order to force through an actual reduction in emissions, but many of the member states - France and Germany in particular - are resisting. The Commission has also just announced its plans to include the aviation sector in the ETS from 2011. This decision is already coming under fire from industry, the US - which is threatening legal action, and environmental campaigners who point out that the proposals would achieve a delay of only three to six months in the growth in aviation emissions by 2050 and that airlines could make huge profits from

the scheme. This is likely to come to a head in the autumn during the Commission's formal ETS review.

- **Healthcare.** When the European Court of Justice ruled that the NHS should pay for 75-year-old Yvonne Watts' hip replacement surgery which she had done in France it alarmed many in the UK who saw it simultaneously as the first major step in the birth of an EU healthcare system and another nail in the coffin of a nationalised UK health service. EU ministers and the Commission will attempt to accommodate this ruling through legislation in 2007. The EU Commission will put forward a proposal to "establish a Community framework for safe, high-quality and efficient health services to ensure patient safety wherever healthcare is provided throughout the Community" and "address uncertainties over application of Community law to health services that create obstacles to cross-border healthcare". Any encroachment by the EU into this sensitive area of national policy is guaranteed to generate a significant amount of column inches.