# <u>Saving the British economy for the British people</u>

*Bill Cash MP*

1. Given that the leaders of France and Germany have now called for a Competitiveness Pact, whilst setting out proposals on how to establish a permanent financial mechanism, it is time for the Coalition Government to set out how it intends to deal with the prospect of the British economic policy being firmly directed by a European economic government – by responding to whether they will finally give the British people a referendum on this crucial issue in deciding how they are to be governed.

2. The eurozone's response to the Greek crisis has exposed its weakness. In fact, the EU leaders were unable to react to it, and when the ship was on the brink of sinking, they decided, through back door meetings – in order to save the euro – to break every Treaty rule, which explicitly states that no Member State is liable for the debts of another. Since then, Brussels has been seeking greater coordination and enhanced surveillance of economic policies in the EU and economic and monetary union (EMU) to reinforce so-called economic governance.

3. The informal meeting of the Heads of State or Government of the Euro area, which takes place on 11 March, aims to discuss the strengthening of the coordination of national economic policies in the Euro area. Experience tell us that the eurozone leaders agree among themselves with what is at the table and present the outcome of their agreement to the European Council as a given fact. That was what happened last May when they agreed to establish a "*European Stabilisation Mechanism*" based on Article 122.2 TFEU and on *"an intergovernmental agreement of euro area Member States*." What happened in May is set to happen again – particularly as EU leaders are in a rush to adopt the treaty amendment.

4. David Cameron needs to put his foot down and influence as early as possible eurozone decisions. The Competitiveness Pact might not apply directly to the UK but it will be subject to the side effects of it. David Cameron will be in Brussels for the European Council extraordinary meeting on Libya. He must make clear to his European partners that the UK rejects the Treaty amendment as well as the Competitiveness Pact. He should recall his pledge that any transfers of competences to Brussels would be subject to a referendum in the UK.

5. Last May, in order to respond to escalating concerns on financial markets, the eurozone leaders agreed to establish a European stabilization mechanism to prevent the Greek debt crisis from spreading to other countries. The Extraordinary Economic and Financial Affairs Council on 9 May agreed to establish a European Stabilisation Mechanism worth €60 billion based on Article 122.2

TFEU. Fearing that such financial facility would not be enough to prevent further eurozone debt crisis contagion, the eurozone Member States also agreed to provide assistance *“through a Special Purpose Vehicle*” based on an intergovernmental agreement between euro are Member States and worth €440 billion - *European Financial Stability Facility*.

6. Last October, EU leaders agreed to amend the Treaty providing it is a “limited” change in order to allow the creation of a permanent crisis mechanism that will replace the 440-billion-euro *European Financial Stability Facility*. On 16 December, the EU leaders agreed, therefore, on the text of a draft decision amending Article 136 TFEU, so that “*Member States whose currency is the euro may establish a stability mechanism to be activated if indispensable to safeguard the stability of the euro area as a whole.”* It is specified, “*The granting of any required financial assistance under the mechanism will be made subject to strict conditionality*.” The permanent European Stability Mechanism will replace *the European Financial Stability Facility (worth €440bn) and the European Financial Stabilisation Mechanism (worth €60 billion), which will remain in force until June 2013.* The EU budget would no longer be used to guarantee loans.

7. As expected, the European Council launched the simplified revision procedure provided for in Article 48(6) TEU. It was therefore able to avoid long negotiations between the Member States and with the European Parliament. It was a *sine qua non condition* to the Member States to amend the treaty without convening an intergovernmental conference. Article 48 (6) allows Treaty amendments to be made, within the TFEU Part III “*on internal policies and actions of the Union”* solely by European Council, as long as there is unanimity and the amendments do not extend the competences of the European Union. The European Council’s decision amending the Treaty cannot enter into force until all Member States in accordance with their respective constitutional requirements approve it. All 27 Member States must transpose the Treaty’s amendment into national law. It does not require ratification in some Member States and it will be possible to avoid referenda. In fact, the main reason for the so called “*limited treaty amendment*” is to avoid referenda in certain Member States, particularly in Ireland.

8. Under the existing treaties there is no such mechanism to help out a eurozone Member State through loans and grants. Therefore they must amend the treaties if they want to legally bailout eurozone countries. However, it is difficult to understand how they are intending to create a permanent crisis mechanism “*to safeguard the financial stability of the euro area as a whole*” without amending the bailout rule. Hence, any amendment to the treaty intending to create a permanent crisis mechanism is incompatible with Article 125 and with the principles of the EMU.

9. It is important to stress that simplified revision procedures are only possible if the European Council decision to amend the treaty does not "*increase the competences conferred on the Union in the treaties*." According to the President of the European Council "*This amendment will not increase the competence of the Union and only affect the members of the Eurozone themselves."* The precise details of a permanent crisis mechanism have not been agreed yet but it is hard to believe that such a mechanism would not further increase the Union competences. It seems obvious that such a mechanism would entail further transfer of powers to Brussels, namely further political and fiscal cooperation. Such a mechanism would entail a loss of sovereignty. Hence, if there is a transfer of powers from Member States to the EU, the so-called "*limited treaty amendment*" cannot be adopted under Article 48 (6). Consequently, such an amendment cannot be introduced without approval in a national referendum in certain Member States.

10. The European Council will formally adopt the decision on 24 March 2011 and it is expecting Member States to complete the procedures "*for the approval of this Decision in accordance with their respective constitutional requirements"* by the end of 2012 so that the Decision can enter into force on 1 January 2013.

11. According to the European Council's Conclusions, the European Stability Mechanism is only for eurozone Member States and therefore the UK will not participate. David Cameron said "Both the Council conclusions and the decision that introduces the treaty change state in black and white the clear and unanimous agreement that from 2013 Britain will not be dragged into bailing out the eurozone.*"* At the UK's request, the EU leaders agreed that Article 122 (2) (provision on natural disasters), once the new mechanism enters into force, would no longer be needed to safeguard the financial stability of the euro area. However, the future crisis mechanism will only be effective from 2013, so consequently, and until this happens, the UK will contribute to any Eurozone bailout through the *European financial stabilization mechanism.*

12. Mr David Lidington, the Minister for Europe, reiterated to the European Scrutiny Committee what David Cameron said on 20 December 2010, *"the Government wants to see financial stability return to the eurozone, since it is clearly in the UK's national interest that it is stable and prosperous; the Government is prepared, therefore, subject to approval by Parliament, to amend the TFEU to make it clear that eurozone Member States can establish a permanent ESM."* Under the EU Bill, a treaty or Article 48(6) decision would not be subject to a referendum if it involves "*the making of any provision that applies only to member States other than the United Kingdom."* Therefore, the new EU Bill expressly excludes the possibility for a referendum of the present treaty amendment. In fact, David Lidington has already said that the Bill's referendum provisions will not be implemented during this Parliament.

13. However, one could wonder whether a decision amending the treaty stating it won't have impact in the UK would be enough to protect British national interests. I previously stressed "*There is no doubt about what they want or what they intend, which is effectively a twin-track treaty, which is a treaty entered into between us and the rest of the European Union-that is, with all 27 Member States, in order to legitimise it within the framework of the treaty arrangements-so that, on the one hand, they get their treaty, and, within that treaty, an arrangement specifically designed to exclude the United Kingdom, even though we would be gravely affected by it.*" That was the reason why I tabled an amendment to the exemption provision as mentioned above to be taken out of the Bill.

14. The Council established the European financial stabilisation mechanism through a Regulation, adopted last May, based on Article 122 (2) TFEU. Using Article 122 to set up the European stabilisation mechanism meant that Britain was unable to veto such proposal as Qualified Majority Voting decided it. In fact, the UK had no say in the creation of such a mechanism as it was discussed one day before, behind closed doors, at the eurozone leader meeting. Former Chancellor of the Exchequer, Alistair Darling, who, one could argue, had no mandate for it, represented the UK.

15. Under Article 122 (2) TFEU, Union financial assistance may be granted when "*a Member State is in difficulties or is seriously threatened with severe difficulties caused by natural disasters or exceptional occurrences beyond its control"* This provision has been broadly interpreted so that Member State's difficulties can also be caused "*by a serious deterioration in the international economic and financial environment."* It is ludicrous to say that a debt crisis is beyond a Member State's control. Natural disasters are unforeseeable but we cannot say the same of debit crisis. It is hard to understand how the Greek, the Irish, or the Portuguese crisis has been caused by *"…exceptional occurrences beyond [their] control …".* Such a broad interpretation breaches the spirit of the Maastricht treaty. This provision can be ultimately interpreted by the ECJ.

16. Brussels went beyond the powers conferred by the Treaties to provide a legal basis for emergency funding. Such a mechanism ignores the "no bailout" clause – Article 125 TFEU that forbids Member States for being liable for the debts of another. The European stabilisation mechanism is therefore a violation of the non-bail out clause and a misuse of Article 122 (2), which is intended for national disasters.

17. The European Commission "*is empowered on behalf of the European Union to contract borrowings on the capital markets*" of up to €60 billion, using the EU's annual budget as collateral. The plan has fiscal implications for all EU countries, including the UK. Such a facility is guaranteed by the EU budget and all EU Member States, including the UK, are jointly liable for any payments due. Hence, if a beneficiary

country fails to pay back the loan, all 27 EU Member States would have to pay into the EU budget to cover the default. According to the Government, the UK's contribution to the 2010 Budget is currently estimated at 13.8%.

18. The Council, acting by a qualified majority on a proposal from the Commission, can decide to grant financial assistance under the European financial stabilization mechanism. Hence, the emergency funds from the €60 billion pot are easier to release as only QMV is required. On the other hand, in order to release funds from the European financial stability facility, a unanimous decision by the eurozone Member States is required. Moreover, each eurozone Member State is only responsible for its share of the guarantee and are not jointly liable as in the other facility. The EU financial assistance to Ireland comes from the European financial stabilization mechanism (€22.5bn) and from the European financial stability facility (€17.7bn) and €4.8bn from bilateral loans from the UK, Sweden and Denmark.

19. The UK is not part of the eurozone but even so it is trapped in the European financial stabilization mechanism, as it is required to contribute to it. Having Article 122(2) as the legal basis, the UK would be required to contribute to a eurozone bailout on the basis of the qualified majority voting system. British taxpayers might be asked to pay for other eurozone bailouts. That is the reason why I tabled an amendment to the EU Bill whereby *any decision implementing the Regulation based on Article 122 extending the use of the European Financial Stability Mechanism to any Member State other than the Republic of Ireland would be made subject to both an Act of Parliament and a referendum*. The permanent European Stability Mechanism will be in place in 2013 but eurozone Member States in serious difficulties will not wait for 2013. Portugal is under pressure by other eurozone countries to seek financial aid from the EU. Portuguese Prime Minister José Sócrates has been denying that Portugal needs outside assistance. However, it seems it is just a matter of weeks before Portugal requests an EU bailout. The UK should not be forced into paying for any eurozone bailout.

20. It is well known that Article 122(2) TFEU is not an appropriate legal base for the European Financial Stabilisation Mechanism. The EU had no power to establish the EFSM under this provision. The financial mechanism is, therefore, unlawful. As I previously said "*because of the failure of the legal base, the whole deal is vitiated.*"

21. The German Constitutional Court is presently analysing the Greek bailout as well as whether the financial facility mechanisms comply with the German Constitution and EU treaties. Moreover, it is important to mention that last June Thomas Ax (Germany) brought an action for annulment of the Council Regulation establishing a European financial stabilisation mechanism before the ECJ (Case T-259/10). According to the applicant "*the aid released by the contested regulation would*

*infringe the prohibition under Article 125 TFEU on undertaking liability for or assuming the commitments of other Member States*." Moreover, the applicant argued, "*that the Member States affected by speculative attacks have not been seriously threatened with severe difficulties*" within the meaning of Article 122 and that such difficulties arising "*are not caused by exceptional occurrences beyond the control of the Member States concerned*." Under the Lisbon Treaty natural or legal persons may challenge any legal act addressed to them or which is of direct and individual concern to them. The Court has strictly interpreted the criteria of the "individual concern". Therefore, the ECJ might not consider the merit of this case, as it is very likely it will held that there is no *locus standi*.

22. The UK government should endeavour to avoid becoming liable for any eminent bailout. Such agreement, which, as I previously said "*cannot be justified by the legal base, has exposed the British taxpayer to a very significant sum of money*" – £8 billion. The regulation is not correctly based on the treaties and therefore the UK could challenge the mechanism, bringing an *action for annulment* before the European Court of Justice. However, Mark Hoban in a written answer to me said "*that the Government believe that EU Council Regulation No. 407/2010, establishing the European Financial Stabilisation Mechanism, is consistent with the Treaty on the Functioning of the European Union. The Government are not aware of a significant body of legal opinion supporting the opposite view."*

23. The EU Leaders have set the European Council on 24/25 March as a deadline to agree on a comprehensive package of measures to ensure the stability of the euro. The March European Council will also adopt the final decision on the limited treaty change to set up the European Stability Mechanism. The informal meeting of eurozone leaders on 11 March is intend to reach a consensus on that package, including expanding the size and scope of the EFSF, finalising details of the ESM (permanent crisis mechanism), as well as possible modifications to the terms of bail-outs for Ireland and Greece and, obviously the so called Competitiveness Pact. This is so that the European Council on March 24-25 can rubber stamp the agreement reached by the eurozone leaders.

24. The European Financial Stability Facility (EFSF) is a temporary instrument established last May 2010 to provide financial support to eurozone countries having difficulties refinancing their debts. The EFSF takes the form of a limited liability company under Luxembourg law. The ESFS provides assistance in the form of loans to euro area Member States only. It sells bonds and other debt instruments on the open market, which are secured against guarantees from eurozone states. The value of these guarantees is proportional to the value of each country's capital subscription to the European Central Bank. The eurozone Member States "*provide guarantees for EFSF issuance up to a total of € 440 billion on a pro rata basis."* The eurozone finance

Ministers agreed on several measures aimed at ensuring the best possible credit rating for the debt instruments issued by EFSF (triple A credit rating for the EFSF bonds), "*a 120% guarantee of each Member State's pro rata share for each individual bond issue"* as well as "*the constitution, when loans are made, of a cash reserve to provide an additional cushion or cash buffer for the operation of the EFSF.*"

25. Doubts have been already raised whether this fund is enough to save the more vulnerable eurozone Member States. There are fears that the current amount would not be sufficient if both Portugal and Spain applied for financing assistance. The eurozone finance ministers have been discussing possible changes to the eurozone's emergency bail-out fund. The European Commission as well as the European Central Bank have urged changes in order to strengthen the European Financial Stability Facility's lending capacity and extend its remit.

26. Eurozone leaders are now contemplating changes to the rescue fund. They are considering increasing its effective lending capacity and giving it new powers to buy bonds directly. The European Commission and the European Central Bank have also called for the EFSF to be allowed to buy sovereign bonds in the secondary market as well as issuing short-term loans to Member States temporarily unable to raise money on the financial markets. Another idea is to enable the EFSF to buy back eurozone sovereign bonds.

27. Germany has been putting its foot down over increasing the size of the European Financial Stability Facility. The EFSF borrows money on markets with eurozone government guarantees of up to 440 billion euros. Presently, in order to maintain its AAA credit rating only €250bn of the EFSF can be used as loans as the rest of the money has to be kept in a cash reserve. The fund cannot lend, therefore, more than €250bn. The European Commission wants to increase the effective lending capacity of the eurozone rescue fund, so it can provide a full €440bn. Some eurozone Member States favour a hike in the effective lending capacity to the full €440 billion, whereas others such as Belgium are seeking to double the fund. Obviously, any changes in this regard would put a bigger burden on the triple A countries, such as Germany, France, the Netherlands, Austria, Luxembourg and Finland, as it would require further credit guarantees from them. They already contribute over 60 percent of the rescue funding.

28. It seems that there is an agreement to increase the €440bn bail-out fund's lending capacity, but there is no agreement yet on how this will be achieved. All of these issues, unsurprisingly, have been debated behind closed doors. The overhaul of the fund is part of the broad package of reforms to tackle the debt crisis and to ensure the euro credibility. Obviously the eurozone triple A countries, particularly Germany, want something in return for enhancing the actual lending capacity of the 440-billion euro fund. Particularly, Angela Merkel may well be open to the idea of increasing the fund's lending capacity, but

she wants tougher economic and budgetary surveillance. Angela Merkel wants her Competitiveness Pact in exchange.

*29.* The revamping the European financial stability facility is expected to be decided at the eurozone summit on 11 March, and then presented as a given fact to the European Council on 25 March. The UK would have an interest in influencing this decision because if the lending capacity of the fund is not increased more finance is likely to be drawn from the 60 billion euros fund, increasing, therefore, the UK liability. If the eurozone leaders are considering revamping the fund as well renegotiating the bailout with Greece and Ireland, and if this would be decided at the Eurosummit, David Cameron should have a say. David Cameron should endeavour to urge for new arrangements to be decided so that Article 122 is no longer used and UK would no longer be liable. As I previously said "*the bailout negotiations by the EU as a whole, including the UK, were based on an unlawful use of Article 122, Ireland and only the eurozone should cancel these unlawful arrangements and now renegotiate a new deal, excluding the UK and other non-eurozone countries."*

30. Greece and Ireland are seeking to renegotiate their bailout terms. A possible extension of the term of the European Union's bail-out of the Greek economy as well as changing the terms of the Irish bail-out are part of the abovementioned comprehensive package of measures. Not all Member States are willing to change the terms of the Irish bail-out, but, obviously, there would be compromises.

31. Ireland has agreed to pay on average 5.8 percent for its €67.5-billion bailout in December. Ireland's new Coalition Government has recently decided to seek a re-negotiation of its loan terms, particularly the rate of interest. The Economy and monetary affairs commissioner Olli Rehn has said *"I see a danger that we might overburden both countries with overly strict credit conditions*," However, Germany has been eager to introduce high interest rate attached to EU loans. Obviously, Germany may only accept to renegotiate the interest rate attached to Ireland's loan in exchange for something, such as support for the competitiveness pact, or an increase in Ireland's 12.5% corporation tax.

32. There is widespread opinion that Greece's default on its debt is inevitable which might not have been the case if it were not in the eurozone, as Greece could have devaluated its own currency whilst tightening fiscal policy. The Greek government is seeking for the repayment deadlines for its €110 billion loan to be extended to make it easier to meet its repayments as well as a reduction of interest rates. Angela Merkel is considering an extension of the payment period of the country's €110 billion bail-out, amid concerns that the country could not avoid a sovereign default. One could wonder what she will ask in return. It has been reported that Greece is one step closer to debt restructuring. Prime Minister, George Papandreou, has asked EU

partners to consider using the €440bn European financial stability facility to lend money to Greece to allow the government to buy back a portion of its outstanding debt.

33. It is also on the agenda of the eurozone summit changes to the EU treaty so that the temporary ESFS can become a permanent crisis fund when it expires in 2013. It is very likely that an agreement on the future permanent European Stability Mechanism (ESM) would be reached on 11 March.

34. According to the Eurogroup statement of last November, the participation of private sector creditors on any future eurozone bailout would be decided on "a case by case" basis. If a Member State has a liquidity problem, ESM support will be subject to an *"adjustment programme and private creditors will be encouraged to maintain their exposure*," In the other hand, if a country is considered to be insolvent by the Commission, the IMF and the ECB would have "*to negotiate a comprehensive restructuring plan with its private sector creditors, in line with IMF practices with a view to restoring debt sustainability."* Then, "*If debt sustainability can be reached through these measures, the ESM may provide liquidity assistance."* Private creditors would participate in future eurozone debt restructuring by collective action clauses annexed to eurozone government bonds issued after 2013.

35. On 14 February the eurozone finance ministers agreed, in principle, that the European Stability Mechanism will have an effective lending capacity of €500 billion. There is no agreement yet on the structure of the new fund and how it achieves its effective €500bn lending capacity.

36. It seems that the Eurozone leaders are seeking a greater involvement of the private sector and IMF in the new permanent crisis mechanism – nevertheless Member States would still contribute to the costs of sovereign debt rescheduling. The eurozone is also expecting voluntary contributions from non-eurozone EU Member States.

37. Angela Merkel has always been in favour of the permanent mechanism to be funded through contributions of private creditors. And now it seems that the ESM would entail further burdens for Germany. Wolfgang Schäuble has said *"Indeed, our total contribution would need to become a lot higher."* One could wonder what Merkel will get in return for supporting such measures, such as closer surveillance and co-ordination of policies to promote competitiveness and sustainable economic growth.

38. According to the Commission, as well as some EU countries, including Portugal, the ESM should be allowed to buy state bonds and to grant short-term loans, so it would be easier for eurozone Member States to obtain credit. However, Germany has been against these proposals.

39. All these issues are part of the package expected to be agreed by 11 March so that the European Council on 24 March simply agrees the final details. Obviously, this would entail further transfer of powers to Brussels namely further political and fiscal cooperation. According to David Cameron "*A strong and successful eurozone is in Britain's interests. We want the countries of the eurozone to sort out the difficulties they have and we won't stand in the way as we do that*." Moreover, he said "*that does not mean that Britain should be drawn into new mechanisms or new procedures or have to give up new powers."* But this is just an assumption that it might not affect the UK. I have stressed that "*A massive juggernaut would be created, through a form of extremely enhanced co-operation between those Member States, that would have an enormous impact on the United Kingdom."*

40. The treaty amendment is presently exempt from the EU Bill's referendum requirements even though it would have a considerable impact on the UK. That is the reason why I tabled an amendment whereby any treaty amendment, which "*substantially affects all or any of the political, economic, fiscal, social or constitutional relationship between the United Kingdom and other Member States of the European Union"* would be subject to a referendum.

41. The Euro and the EMU represent a serious limitation to the sovereignty of the States of the eurozone which have been ceded to the EU's monetary and exchange policy, and put in because of a prerogative of a sovereign state along with taxes on the capacity to print money. The governments have lost the capacity to use the exchange rate policies to answer to external shocks or to control the trade balance and they have lost seigniorage rights. Because they are stuck in the euro those Member States can no longer deal with economic imbalances by means of devaluation.

42. The EMU has now proven to be a failure. The SGP does not work, the bail out clause has been breached. Indeed, the crisis has exposed that the whole system of EU government is not working, is far too expensive and bureaucratic. However, Brussels' reaction to the failure of EU integration is to introduce further EU integration.

43. The eurozone crisis has provided for an opportunity for closer political integration in the European Union. The sovereign debt crisis has opened the door for further economic and fiscal policy integration. If the Member States are already in a straightjacket, the situation is set to get worse as their flexibility will be further reduced, particularly with a strengthened stability pact and budgetary surveillance. It is now clear that Member States economic and fiscal policies will be further co-ordinated at EU level. National governments would no longer be responsible for a great range of domestic economic policies. The EU is therefore moving towards a single economic policy. If we move towards a more centralized economy, having Brussels exercising total control

over the financial and economic affairs of Member States this is what "economic government" is about.

44. On 29 September, the European Commission presented legislative proposals on so-called Economic Governance in the EU and EMU. The Commission proposed broader and enhanced surveillance of fiscal policies as well as macroeconomic policies and structural reforms. Member States will be monitored not just for excessive deficits and debts, but also for imbalances and falling competitiveness. Although the UK would not be subject to sanctions, the Commission's proposals on economic coordination and surveillance would also apply to it, which is unacceptable. David Cameron has no assurance that Brussels will not interfere with British economic affairs.

45. The Commission presented a proposal for a regulation *on the prevention and correction of macroeconomic imbalances* based on Article 121(6) (multilateral surveillance procedure), which is going through the ordinary legislative procedure and QMV is required at the Council. The Commission has proposed a "*new element of the economic surveillance process"* the so-called Excessive Imbalance Procedure (EIP), which comprises a regular assessment of risks of imbalances, including an alert mechanism. The EIP will apply to every Member State, including the UK.

46. In this way Brussels would be able to interfere on Member States' tax policies and demand tax increases to avoid and correct *"macroeconomic imbalance*s" and to achieve the targets of the 2020 strategy. It seems this might goes beyond the "*recommendations*" foreseen in the treaty. It is important to stress that although the UK will not be subject to sanctions, it will be subject to the Council policy recommendations and might be placed in the Excessive Imbalance procedure and it would be subject to burdensome reporting requirements as well as surveillance missions from the Commission. Such measures would give Brussels the power to tell Member States how to run their economies and penalise them if they refuse to do it.

*47.* I have stated previously that "*one of the reasons why the eurozone is imploding is the vast amount of social and employment legislation, the over-regulation and burdens on business …*" I also said the British economy cannot be restored without repatriating powers from Brussels as "*If that does not happen we will not have jobs, growth or enterprise, nor will we be able to reduce the debt or pay for public services where necessary."* It should be bear in mind that the majority of the economic proposals are subject to majority voting. The Coalition Government should say NO to the European Economic Governance proposals. My United Kingdom Parliamentary Sovereignty Bill would provide the template to repatriate powers where there is a conflict between the EU Treaties and Westminster legislation.

48. It is well known that the EMU has been the product of negotiations between France and Germany. They have decided, last October, that the Treaty should be amended. And now, Angela Merkel and Sarkozy agreed on greater economic coordination to fight the sovereign debt crisis. The Commission proposals on Economic Governance are, obviously, not enough, for Nicolas Sarkozy and Angela Merkel. They agreed last December that steps towards political integration, including the harmonisation of tax and labour policies should be taken. The aim is to achieve greater economic convergence in the eurozone. However, each eurozone Member State faces different economic realities. Nevertheless, Germany and France want to have a say on how the other Member States run their economies.

*49.* Germany and France presented their plans for closer economic and fiscal coordination, arguing the crisis had exposed the necessity to complement monetary union with an economic union, at the European Council on 4 February. Their plan is, therefore, a form of "economic government." Merkel´s idea is to impose the German economic model on the rest of the eurozone. In their Pact for Competitiveness, Merkel and Sarkozy recall that the EU "*has already made the first important steps in view of maintaining financial stability and to promote a return to sustainable growth."* They want to go further than the proposals to tighten the SGP and to avoid and correct macro economic imbalances. The Pact is intend to "*increase of competitiveness of the states involved, in order to achieve stronger economic convergence",* which "*is to happen on the basis of concrete commitments-more ambitious and more biding ones than those already decided by the EU 27."*

50. The Pact would apply to eurozone Member States and would be opened to all EU members who want to join. The pact intends to harmonise areas that are national competences, such as tax, wages and social security policies. Under the Pact the participant Member States would have to agree to implement six policies to boost competitiveness, within one year, including: abolition of the automatic indexation of wages to inflation systems, Member States would have to recognise each other's education diplomas and vocational qualifications. Germany and France are seeking to harmonise corporation taxes, they are, therefore, calling for a common assessment basis for corporate income tax. The Pact also calls for "*Adjustment of the pension system to the demographic development (ie, average age of retirement*)", thus Germany is seeking a raise on retirement ages to take into account ageing populations. Moreover, Member States would be obliged to enshrine the debt alert mechanism into their respective constitutions. Member states would be, therefore, required to introduce ceilings on permissible national debts, as the Germany's "debt brake" law. Participants Member States would be also expect to establish a national crisis management regime for banks.

51. The Commission is invited to present within 12 months a report on the implementation of the six measures and to include its

recommendations. However, it is not clear how these measures would be implemented if the Pact is not meant to be voluntary and if it is not formally agreed under EU legislation. It might be a voluntary intergovernmental pact but experience tells us that its measures would eventually be implemented through community proposals. Moreover, the Pact states "*the introduction of a sanctions mechanism"* will be considered. Unsurprisingly, Germany is considering sanctions for Member States that breach the agreement but this can only be introduced through Article 136 TFEU. Therefore, no Member State should voluntarily agree to such a pact. It is important to recall that Article 136 just applies to eurozone countries and therefore, the non-eurozone Member States willing to participate in the so called "*enhanced economic policy coordination*" cannot be subject to measures based in this provision.

52. The Merkel/Sarkozy Pact has provoked strong opposition from other Member States at the summit. The proposals aimed at harmonising national policies on pensions, debt levels and wages policy, faced wide opposition from leaders from several Member States. In fact, all kinds of matters, including salary indexation, tax, social security and pension systems are matters for sovereign national states. According to *Euractiv* Viktor Orbán, Prime Minister of Hungary, the pact "*goes way beyond the package of six legislative proposals"* on economic governance. Ireland rejects the idea of harmonising the corporate tax base. Germany's idea of abolishing wage indexing is facing opposition from Belgium, Luxembourg, Portugal and Spain. According to Belgian Prime Minister, Yves Leterme "*There must be more economic cooperation, but Member States must be left the room to carry out their own policies*,". Luxembourg Prime Minister, Jean-Claude Juncker, said *"I can't really detect a reason why abolishing the indexation of wages should improve the competitivity of my country or of the euro area."* Greece and Italy are against the idea of being obliged to introduce debit ceilings in their constitutions. Non-eurozone Member States, particularly Poland are concerned over the Pact leading to a *"two-speed Europe."*

*53.* The pact is also facing opposition from the European Commission and the European Parliament because it is based on inter-governmental negotiation, rather than using the community method, involving the EU institutions, particularly involving the European Commission. José Manuel Barroso said to MEPs "*We have been in favour of more policy co-ordination and better economic governance but we have to do it in a way that is coherent and compatible with the treaties,*" Moreover, he said *"We would not further our cause if parallel structures were to work in an ultimately incoherent manner."*

54. On 4 February, the European Council welcomed the Statement by the Heads of State or government of the euro area and the EU institutions. The statement reads "*Building on the new economic governance framework, Heads of State or government will take further steps to*

*achieve a new quality of economic policy coordination in the euro area to improve competitiveness, thereby leading to a higher degree of convergence, without undermining the single market.*" President of the European Council, Herman Van Rompuy has been asked to prepare proposals to give the eurozone "stronger economic governance" beyond what has already been decided by his Task Force. Van Rompuy recalls "*At that time, we decided on far-reaching surveillance of the budgetary and macroeconomic developments in our 17 countries."* Moreover, he said "*Now we want to go even further, precisely to strengthen the competitiveness of each economy, so that each country in the Eurozone grows in the same direction."* Mark Hoban MP in a written answer to me had said "*This process will be taken forward through intergovernmental co-operation, which will be facilitated by the President of the European Council."* It is important to bear in mind that the "*far-reaching surveillance of the budgetary and macroeconomic developments"* also applies to no euro area countries, including the UK. Therefore it should be clarified how they intend to move forward without having an impact on non participating countries.

55. Van Rompuy was given, therefore, a mandate by EU leaders to draft a competitiveness pact. The European Council President and José Manuel Barroso have drafted proposals for such a pact in an effort to ease disagreements over the German/French one. The Van Rompuy-Barroso pact was obtained and published by the FT. In fact, both pacts have not been published on the EU institutions websites and have been kept secret.

56. The non-eurozone Member States are invited to participate on a voluntary basis. The pact aims at deepening "*the economic pillar of the monetary union by fostering convergence among economies of the euro area*." According to both presidents "*That requires shift to a higher level of policy coordination, in particular in areas that fall under national competences to the extent that they are key for increasing competitiveness and avoiding harmful imbalances."* It seems that the participating Member States would be require to give away their national competences. The Pact stresses that "*In areas where the pact touches on EU competences that legislative and other procedures provided in the treaty will be fully respected."* Hence, the Pact is not outside the EU's existing legal framework. The Van Rompuy-Barroso Pact stresses that the pact should be in line with the EU economic governance rules, the EU2020, European semester, SGP and new macro-economic surveillance framework. The UK is subject to all this measures and it is far from clear how the pact would be link to them and to the existing report requirements.

57. The pact reads "*It should involve a special effort going beyond what already exists and include concrete commitments and actions that are more urgent, more ambitious than those already agreed, with a timetable for implementation."* But the Pact also stresses "*These new*

*commitments should therafter be included in the regular surveillance framework*" and "*The Commission will be fully involved."*

58. It would be focused on policy areas that are deemed as essential for fostering real convergence and competitiveness and that belong to Member States competences. The heads of state and government would, annually, agree to common objectives. Each country would be responsible for choosing the specific policy measures to be implemented, nevertheless the choice will be guided taking into account the issues mentioned below.

59. Such commitments will also be reflected in the national reform programmes and stability programmes submitted each year and will be assessed by the Commission in the context of the European semester. It is important to recall that the UK has to present national reform programmes and is subject to the European semester.

60. Within the Pact framework, Member States would have to commit to consult their partners each other on major economic reforms before their adoption.

61. The Pact is therefore based on participating Member States' commitment to achieve several commonly agreed goals in key policy areas and its implementation will be monitored on the basis of policy and quantitative indicators. Euro area Member States would be required to take all necessary measures to pursue the following objectives: *foster competitiveness, foster employment, contribute further to the sustainability of public finances, reinforce financial stability*.

62. The progress towards *fostering competitiveness* will be assessed on the basis of wage and productivity developments. A monitoring system would be introduced for wage and productivity levels. Member States would not be obliged to abolish the indexing of wages to inflation as proposed by Germany, but they must implement other measures to bring down wages. The pact reads "*Unit labour costs will be monitored over a period of time, by comparing with the developments in other euro area countries, and in the main trading partners."* Hence, it seems that wages should not be higher than those of a country's main trading partners. According to the pact "*Large and sustained increases may indicate the erosion of competitiveness*." It points out "*Countries facing major challenges in this respect should be identified and should commit to address these challenges in a given timeframe."* Hence, they would have to lower wages. According to the Pact each country will be responsible for choosing specific policy actions to achieve this objective, but attention should be given to reforms such as *"Ensuring wage restraint in the public sector."*

63. Participating Member States would have to introduce measures to reduce youth unemployment rates. Moreover, Member States are

asked to reform labour markets to promote *flexicurity* and introduce tax reforms, such as shifting taxes from labour to consumption through indirect taxation.

64. Moreover, participating Member States should enhance the sustainability of public finances. Governments would have to monitor their pension systems to ensure they are sustainable. There is no target to rise retirement ages, but "*Countries facing major challenges in this respect should be identified and should commit to address these challenges in a given timeframe."* Hence they should consider the necessary reforms to ensure the sustainability of pensions and social benefits such as "*Aligning the retirement age with life expectancy"* and "*Reducing early retirement schemes and using targeted incentives to employ older workers*." In practice, it would result in increasing retirement age. It is important to mention that under the Commission proposal for a regulation *on the prevention and correction of macroeconomic imbalances*, currently being negotiated, the Commission will draft a *"competitiveness scoreboard"*, which would consist of a set of economic and financial indicators, with corresponding indicative thresholds, aiming at identifying imbalances emerging in different parts of the economy. A scoreboard will rate therefore Member States' performance as regards economic stability and competitiveness, including current accounts and external debt, price or cost competitiveness as well as productivity, unit labour costs, public debt and private sector credit. Member States performance, including the UK, would be assessed against these indicators. The Commission will draft a report providing for an economic and financial assessment "*putting the movement of the indicators into perspective",* compiling, therefore, a list of Member States deemed at risk of imbalances. Based on the multilateral surveillance procedure and the alert mechanism, and taking account of the discussions in the Council and the Euro Group, the Commission will provide *country-specific in-depth reviews* for Member States where the alert mechanism indicates possible imbalances or a risk. The Commission will consider whether Member States have taken appropriate action in response to Council recommendations as well as the Member State policy intentions, as reflected in its Stability and Convergence Programme and National Reform Programme. An excessive imbalance procedure would be initiated if the in-depth review identified severe macroeconomic imbalances in Member State. The Council may recommend the Member State concerned to take corrective action within a specified deadline to remedy the situation. Such recommendations may address policy challenges across several policy areas such as fiscal and wage policies, product and services markets. One could wonder whether the Competitiveness Pact indicators and targets would no be taken into account for the launching of the excessive imbalance procedure. The UK is required to inform the Commission about economic policies measures and it will be subject to the Commission warnings and Council recommendations if its economic policy is not consistent with the broad economic guidelines. The UK would also be subject to the

Excessive Imbalance Procedure, hence, one could ask which guarantees has the UK that it won't be affected by the Pact, if it is adopted.

65. Moreover, participating Member States would have to go "*beyond the directive on national fiscal framework that is part of the governance package Euro area Member States should take a more ambitious commitment to ensure full compliance with EU fiscal rules in the pact.*" Member states would not be obliged to adopted German's style rule, but, nevertheless, the pact would oblige eurozone Member States to make their own plan for not exceeding EU spending limits. Member States would be allowed to choose "*the specific national legal vehicle*." Each country will decide on the formulation of the rule limiting their debt levels, but it should have *"a sufficiently strong binding nature.*" The Commission would review the precise fiscal rules before their adoption to ensure they are compatible with the EU rules.

66. Obviously, the economic crisis is also being used as an excuse to harmonise Member States taxation policies. If there is greater economic integration that would lead to tax harmonization which will apply to the whole EU and not just the Eurozone. The government must, therefore, veto such proposals.

67. The Pact announces that the Commission intends to present a legislative proposal for a common consolidated corporate tax base in the coming weeks. Several Member States such as the UK and Ireland have been showing their opposition to such proposal. Even so, despite all the opposition towards this measure, the European Commission wants to proceed. Therefore, if a unanimous agreement will not be reached at the Council, Algirdas Šemeta will present the proposal under "*enhanced cooperation."*

68. The Eurozone has learnt the hard way that the Euro and the common monetary policy do not work. But the solution does not lie on more EU integration. The so-called Competitiveness Pact would be another failure like the SGP, the Lisbon strategy for growth and the stability and as it will be the "2020 Agenda". The Pact would reduce Member States ability to run their own economic or social policies without achieving competitiveness. In fact, one could wonder whether the Pact undermines the single market.

69. A compromise could be agreed at the summit of eurozone leaders on 11 March. The Merkel´s pact has been watered down. Would the German Bundestag and Bundesrat accept the water down version? Angela Merkel may back down on some of her demands, but not all. Angela Merkel will not agree to strengthen the European Financial Stability Facility as well as on charging lower rates to Ireland and Greece without an agreement on the Competitiveness Pact. A German government representative said to Euractiv "*No pact, no German money,"* For Angela Merkel the competitiveness pact is *condition sine*

*qua non*' for continuing to give financial aid to eurozone countries. It seems small Member States would be bullied to accept the pact otherwise there is no funds. The negotiations on 11 March will have implications to all Member States not just euroarea, therefore all Member States should participate in the discussion. But non eurozone countries have not been invited.

70. This so called informal meeting of the eurozone leaders will decide important measures that, in fact, may undermine the UK's ability to govern itself but David Cameron is happy so long as it says it "*won't apply to the UK*." The UK has veto power over any treaty amendment but David Cameron is not using its negotiating power effectively. The approach of saying it is between eurozone countries, the measures will not affect the UK, is not defending British national interests. As soon as there is going to be an overhaul of the European Financial Stability Facility, David Cameron should demand that any future bailout should use only eurozone finance and that Article 122 should not apply even before 2013.

71. It is not clear yet which legal basis it would be used for the "enhanced economic policy coordination in the eurozone" – the Competitiveness Pact. Brussels could use Article 136 TFEU but, taking into account that non eurozone Member States are also invited to participate, this provision is out of the question. Another option is Article 121 TFEU, which applies to all Member States, but what is referred in the Competitiveness Pact requires more powers than what is provided in this provision. It seems the most likely option is an intergovernmental agreement. In this case, if the UK does not participate it is out of the decision making because it does not have to agree to it, even so it would be indirectly affected. The Competitiveness Pact is set to have serious consequences to the UK. As I have stated previously, "*We must therefore veto any Treaty for economic governance, fiscal, social and similar policies. These will massively affect us even if the Treaty applies only to the eurozone,"* and I have stressed that the *Treaty for European economic governance* and the *competitiveness package* fall "*into the same category, the characteristic of both of which is to create, with the acquiescence of the Government, a two-tier Europe which would damage our own ability to compete because we would be parties to these arrangements even though we are not members of the eurozone*." Such arrangements should therefore be subject to a referendum.