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European Union (Approval of Treaty Amendment Decision) Bill

Bill 57 of 2012-13

RESEARCH PAPER 12/47 30 August 2012

This Bill enables the UK to ratify an amendment to Article 136 of the *Treaty on the Functioning of the European Union*. The amendment will give legal basis to the creation of a permanent European Stability Mechanism (ESM). The ESM itself is established in a separate treaty between the 17 eurozone Member States. It will provide financial assistance to eurozone States, up to a limit of €500bn, in order to safeguard the economic stability of the eurozone. Because the UK is not participating in the ESM, and Article 136 applies to eurozone States only, the Government has stated that the change should not trigger a national referendum under the *European Union Act 2011*.

Gavin Thompson
Vaughne Miller

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Research Paper 12/47

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Summary

This Bill enables the UK to ratify an amendment to Article 136 of the Treaty on the Functioning of the European Union. Primary legislation is necessitated by Section 3 of the European Union Act 2011, which requires such amendments to be approved by an Act of Parliament before they can be ratified. The Government has stated that the change should not trigger a national referendum under the European Union Act because it affects eurozone Member States only.

The amendment to Article 136 will give legal basis to the creation of a permanent European Stability Mechanism (ESM) to provide financial assistance to eurozone states in order to safeguard the stability of the eurozone as a whole. The ESM itself is established by a separate treaty between the 17 eurozone members, which details the financial structure, mandate and arrangements for lending under the mechanism. Against guarantees and paid-in capital from eurozone states totalling €700bn, the ESM will be able to lend up to €500bn to eurozone governments in difficulty 'if indispensable to safeguard the financial stability of the euro area'. As well as lending funds as part of a formal 'bailout' agreement, it will also be able to buy sovereign debt directly from governments and from investors in the secondary market; to make 'precautionary' loans to governments in anticipation of a sovereign debt crisis; and to make loans via governments to finance recapitalisation of banks.[1]

The ESM will replace two existing mechanisms, the European Financial Stability Facility (EFSF) and the European Financial Stabilisation Mechanism (EFSM), both created in May 2010. The EFSM, which can lend up to €60bn to Member States by borrowing against the EU Budget, was established under Article 122(2), which allows financial assistance to be granted to Member States facing difficulties 'caused by natural disasters or exceptional occurrences beyond its control' to be granted financial assistance. The EFSF, which can lend up to €440bn against the guarantees of eurozone countries, does not have a particular legal basis in EU treaties, but was instead created under an intergovernmental agreement between the eurozone states as a Special Purpose Vehicle.

The ESM has its origins in a European Council meeting of 28-29 October 2010, though the agreement to amend Article 136 was not adopted by the European Council until March 2011, and the final version of the Treaty Establishing the European Stability Mechanism was not signed by eurozone finance ministers until February 2012. The intention is that the ESM will enter into force by the end of July 2012.

Under an agreement reached by EU finance ministers in January 2012, the EFSM will cease to be active in all *new* lending arrangements once the ESM is established, while the EFSF will not be used in new lending from July 2013. These facilities will, however, continue to lend to countries to which funds have already been committed; in the case of the EFSM, €48.5bn has been committed to Ireland and Portugal, of which €40.8bn has thus far been disbursed. The liability for borrowing under the EFSF and EFSM will continue well into the future: the longest-dating bond issued to date under the EFSM matures in 2042.

[1] Following an agreement in principle by eurozone leaders on 28/29 June, the ESM may, in the future, be able to finance bank recapitalisation directly.

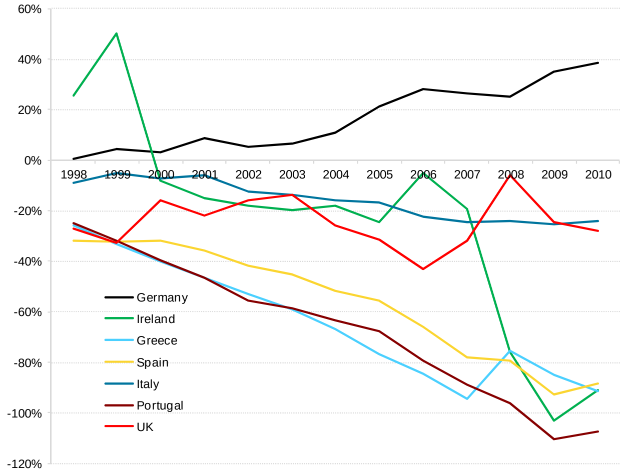
1 Background

1.1 A short history of the eurozone crisis

For many of the peripheral eurozone countries, joining the single currency resulted in lower private and sovereign borrowing costs. For governments, this was reflected in the convergence of government borrowing costs towards the low rates enjoyed by Germany; in the private sector, it was signalled by a similar convergence in the rates at which banks lent money to each other, rates which were then passed on to individuals and businesses in the form of cheaper loans. These developments enabled governments, individuals and banks to borrow more cheaply than they had in the past.

At the same time, there is much evidence to show that productivity and competitiveness in the periphery declined relative to the eurozone as a whole from 1999. Across the periphery, consumer prices and wages rose as a result of the economic boom these countries experienced on entry to the eurozone. Over time, this rendered them less price- and cost-competitive than their neighbours. In Germany, by contrast, unit labour costs and relative prices declined, partly thanks to concerted policy efforts to restrain wage growth. Rising wages in the periphery, together with the inflation this generated, drove up the relative price of goods produced there, making them less competitive on export markets. Outside a currency union, a situation of falling export demand would be mitigated by currency depreciation (i.e. a fall in the exchange rate) and a natural boost to competitiveness (since exports become relatively cheaper); but inside a currency union, this cannot occur.

Net international investment position (stock of external assets minus stock of external debts),
Selected EU economies, 1998-2010, % GDP



Source: IMF *Principal Global Indicators*

The situation in the periphery of rising consumer demand and falling exports, together with higher levels of private and public borrowing fuelled by cheap credit from abroad, was reflected in rapidly rising ratios of private and/or public debt to GDP. The effects of this are illustrated in the chart above, which shows selected countries' net international investment position, i.e. the difference between foreign assets and foreign liabilities. It shows that, since joining the euro, the periphery was accumulating liabilities to the rest of the world that were financed predominantly through debt issuance. As their ability to repay this debt began to be called into question, a process that did not begin until early 2010, they suffered an abrupt withdrawal of finance: this was reflected in governments facing prohibitively high borrowing costs, and banks being shut out of wholesale funding markets.

These crises of private and sovereign debt have led to some countries (namely, Greece, Ireland, Portugal, Cyprus and Spain) being forced to request loans assistance (commonly known as 'bailouts') from the EU and IMF. The Treaty change ratified by this Bill gives legal basis for the creation of the European Stability Mechanism, a permanent fund to provide financial assistance to countries facing such difficulties in the future.

1.2 The crisis response and the creation of the EFSF and EFSM

Though eurozone Member States and EU institutions are often charged with failing to respond convincingly to the crisis, a large number of measures have been undertaken with the aim of stabilising the situation. The European Central Bank (ECB) has engaged in ‘unconventional’ monetary policy measures, including buying up sovereign debt from investors in an effort to keep government borrowing costs down; lending to banks in unlimited quantities and against ever lower-quality collateral; and opening up credit lines with the US Federal Reserve to provide financial institutions with easy access to lending in dollars.

More relevant to this Bill, however, is the creation of loans facilities that provide crisis-stricken governments with access to finance when borrowing on the open market becomes prohibitively costly. The European Financial Stability Facility (EFSF) and the European Financial Stabilisation Mechanism (EFSM) were both established after an extraordinary meeting of the Economic and Financial Affairs Council (ECOFIN) on 9 May 2010, as part of a comprehensive package of measures to help maintain financial stability in Europe. The meeting took place against the backdrop of considerable uncertainty about eurozone economic stability, sparked by the sovereign debt crisis in Greece. In response to problems there, eurozone states had agreed the previous week to provide ad hoc bilateral loans to Greece to supplement assistance from the IMF. A key objective of the ECOFIN meeting was to calm market tensions by formalising arrangements for providing loans to beleaguered Member States, hence the creation of the EFSF and EFSM.

The EFSF

The EFSF was initially intended to provide up to €440bn of loans to crisis-stricken eurozone states, backed by unconditional and irrevocable bilateral guarantees from the 16 eurozone governments.[2] Initially, the size of the guarantees was proportional to countries’ paid-up capital in the European Central Bank, which in turn is a function of their GDP and population share within the EU.

Although the size of the EFSF was originally presented as €440bn, this figure actually corresponds to the size of the total initial guarantees. Removing those countries which received loans assistance (Greece, Ireland and Portugal) takes the size of these guarantees down to €410bn. Moreover, in order to retain a triple-A credit rating, any EFSF borrowing has to be backed by guarantees worth 120% of the loan value and supported by cash reserves. It has been estimated that, taken together, these restrictions reduced the EFSF’s true lending capacity to below €250bn.

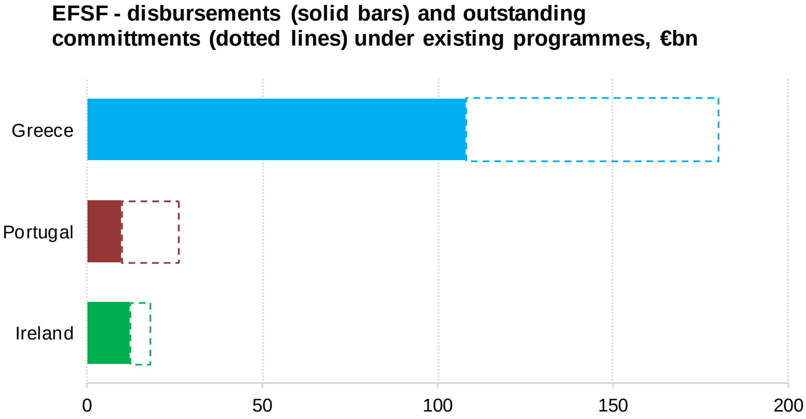
Following a meeting of eurozone Heads of State on 11 March 2011, it was decided that EFSF’s effective lending capacity would be raised back to €440bn. It was also agreed at this summit, and at another on 22 July 2011, to increase the flexibility and scope of the EFSF so that in addition in providing ‘bailout’ loans to countries unable to borrow on the open market, it could:

- buy sovereign debt in primary and secondary markets (i.e. directly from governments, and from investors)
- make ‘precautionary’ loans to governments in anticipation of a sovereign debt crisis

[2] Initially, Sweden and Poland also asked to contribute to the EFSF, but are not doing so.

- make loans to governments to finance recapitalisation of banks

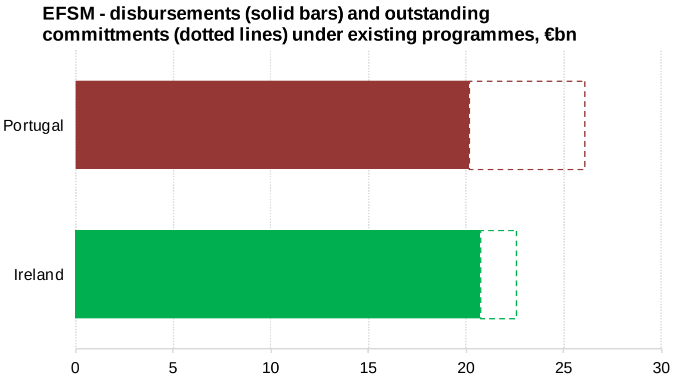
Both the expansion in size and increase in flexibility of the EFSF were finally approved on 13 October 2011.



Since coming into force, the EFSF has provided loans worth €130bn to Greece, Ireland and Portugal, as illustrated in the chart on the right. The amounts provided to the Spanish and Cypriot Governments for the recapitalisation of their banks are likely to be around €100bn and €10bn respectively, but the balance provided by the EFSF and the ESM was not clear at the time of writing.[3]

To obtain assistance from the EFSF and EFSM, Member States are required to agree to policy conditions contained in a Memorandum of Understanding between the Member State and the Commission. In practice, these conditions have included specific fiscal measures and targets, together with commitments to undertake labour market reform, privatisation of public assets and state-owned companies, and restructuring of the financial sector.

The EFSM



The EFSM is a €60bn facility financed by borrowing against the EU Budget. It was conceived as a counterpart to the EFSF, and the two have been used in conjunction with each other, to provide loans to Ireland and Portugal. Unlike the EFSF, there have been no proposals for an expansion in the size or scope of the EFSM. More details on the financing and liabilities arising from the mechanism can be found in Library Standard Note SN/EP/5973. More on the legal basis for the establishment of the EFSM can be found in Library Standard Note SN/IA/5800 and the following section.

To date, the EFSM has provided loans worth €40.8bn to Ireland and Portugal, as illustrated in the chart above. Total EFSM commitments under the Irish and Portuguese programmes are €48.5bn.

[3] See, for instance, Eurogroup statement on Spain, 9 Jun 2012. No funds to Spain will be provided through the EFSM.

1.3 The need for a permanent loans facility and a change to the Treaty on the Functioning of the European Union (TFEU)

The EFSM and EFSF, always intended to be temporary facilities, were legally controversial, and it was soon recognised that any permanent financial assistance mechanism would require an amendment to the TFEU.[4]

In particular, the stated legal basis for the provision of loans under the EFSM is Article 122(2) of the TFEU. This allows EU financial assistance to be granted to a Member State facing 'severe difficulties caused by natural disasters or exceptional occurrences beyond its control'. The 'exceptional occurrence' in this case was the international financial crisis, although doubts were expressed about whether the debt crises of Member States were indeed beyond their control. It was also suggested that the EFSM conflicts with Article 125, which prohibits the EU and individual Member States from 'assum[ing] the commitments of central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of any Member State' (the no bailout clause).

The EFSF, which does not have a basis in EU Treaties, but was rather created as a separate Special Purpose Vehicle, was the subject of a legal challenge to the German Constitutional Court launched on 21 May 2010 on the grounds that, among other things, it breached Article 125. More details on this can be found in Library Standard Note SN/IA/6062.

From October 2010, it was acknowledged that any permanent loans facility should be placed on a sound legal footing through a revision to the TFEU.[5] On 16-17 December 2010 the European Council, comprising the 27 Heads of State and Government, agreed to amend Article 136 of the *Treaty on the Functioning of the European Union* (TFEU) to establish a permanent **European Stability Mechanism** (ESM).[6]

The proposed amendment went to the European Parliament, the Commission and the ECB in early 2011. The three institutions gave a non-binding opinion on the proposal.[7] The Treaty change was approved in European Council decision 2011/199/EU on 25 March 2011 and published in the EU Official Journal on 6 April 2011. The details are discussed below.

2 Bringing the ESM into force

2.1 Amendment of Article 136 TFEU and the use of the simplified revision procedure

As discussed above, an amendment to the TFEU is being made to give legal basis to the ESM. This is being done under the 'simplified revision procedure', which provides a quicker way of changing Treaty provisions in the main areas of EU policy set out in Part Three of the TFEU. In contrast to the 'ordinary revision procedure', there is no need for an Intergovernmental Conference or a Convention to reach political agreement on the content of the Treaty amendment. However, the amendment must still be 'approved by the Member

[4] See Standard Note 6062, Germany and the Euro Rescue Agreements; Standard Note 5800, "Article 122(2) TFEU as Treaty Base for Financial Stability Mechanism", 14. December 2010, and Research paper 10/ 82, Loans to Ireland Bill. [Bill 125 of 2010-11], 13 December 2010

[5] European Council Conclusions , 28/29 October 2010

[6] European Council Conclusions, 16/17 December 2010

[7] EP Opinion of 23 March 2011, see also summary of EP Opinion; Commission Opinion of 15 February 2011; ECB Opinion of 17 March 2011.

States in accordance with their respective constitutional requirements'. More details on the use of the simplified revision procedure in the context of establishing the ESM can be found in Library Standard Note SN/IA/5812.

This amendment to Article 136 TFEU must therefore be approved by all EU Member States, including the UK. Article 136 is in Chapter 4 of the TFEU, "Provisions specific to Member States whose currency is the euro", from which the UK, as a non-eurozone State, has a derogation (i.e. it does not apply specifically to the UK). The Article currently states:-

> 1. In order to ensure the proper functioning of economic and monetary union, and in accordance with the relevant provisions of the Treaties, the Council shall, in accordance with the relevant procedure from among those referred to in Articles 121 and 126, with the exception of the procedure set out in Article 126(14), adopt measures specific to those Member States whose currency is the euro:
>
> (a) to strengthen the coordination and surveillance of their budgetary discipline;
>
> (b) to set out economic policy guidelines for them, while ensuring that they are compatible with those adopted for the whole of the Union and are kept under surveillance.
>
> 2. For those measures set out in paragraph 1, only members of the Council representing Member States whose currency is the euro shall take part in the vote.
>
> A qualified majority of the said members shall be defined in accordance with Article 238(3)(a).

The amendment will add a new paragraph 3:-

> The 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. The granting of any required financial assistance under the mechanism will be made subject to strict conditionality.

The specific legislative requirements to approve the Treaty amendment in the UK, including the Bill before Parliament, are discussed in Section 3.

2.2 Ratification of the ESM Treaty

While the amendment to Article 136 gives legal basis to the ESM, the mechanism itself is established in a separate intergovernmental Treaty between the eurozone Member States made under public international law.[8]

The first text of the Treaty was signed by the finance ministers of the 17 eurozone states on 11 July. The Treaty was subsequently modified to incorporate decisions taken by eurozone leaders on 21 July and 9 December 2011, which aimed to broaden the mandate of the mechanism and to establish the ESM earlier than initially proposed (by July 2012, rather than July 2013).[9] On 23 January 2012 an intergovernmental ministerial meeting chaired by the

[8] Treaty establishing the European Stability Mechanism

[9] See Factsheet on Treaty establishing the European Stability Mechanism, 2 February 2012. The broadening in the mandate of the ESM reflects the increase in the flexibility and scope of the EFSF agreed in July 2011.

Eurogroup President, Jean-Claude Juncker, reached agreement on the revised text, which eurozone Permanent Representatives signed on 2 February 2012.

The Treaty now has to be ratified by eurozone Member States in accordance with their constitutional requirements. Provided ratification is received by countries representing at least 90% of total capital subscriptions (see below), the ESM can enter force.

3 Ratification by the UK

3.1 UK legislative requirements

The European Council Decision to amend Article 136 TFEU was approved before the *European Union Act 2011* had come into force, and has been subject to procedures under both old and new UK legislation. Initially, the Government's support for the decision in the EU Council had to conform with Section 6 of the *European Union Act 2008 Act*, which required that the draft decision be submitted for approval by both Houses of Parliament by an affirmative resolution. The Commons debated the draft decision on 16 March 2011 and the Lords on 21 March 2011.[10] In each House the motion to approve was agreed to without amendment. During the debate on 16 March 2011 the Minister for Europe announced that the draft decision would also be subject to the provisions of the then draft EU bill once it had entered into force.[11]

This was a test of the so-called 'referendum lock' under the *European Union Act 2011*, which came into force on 19 August 2011. Section 3 of the Act requires a Decision of this kind to be approved by an Act of Parliament before it can be ratified. Under Section 5 of the 2011 Act, a statement had to be laid before Parliament as to whether the ESM Decision fell within Section 4 of the Act (cases where a treaty Article decision or an amendment using the simplified revision procedure attracts a referendum), and why.[12] The Foreign Secretary laid a statement before Parliament on 13 October 2011 to the effect that, in his opinion, the permanent mechanism is aimed at eurozone States only and does not involve a new power or competence, an extension of a power or competence affecting the UK, or a power to impose sanctions or to remove a limitation of sanctions on the UK. The referendum exemption under Section 4(4)(b) would therefore apply in this case.

3.2 The UK's obligation to ratify the Decision

Even though the UK is not in the eurozone, the European Council Decision amends the EU Treaty and changes to the EU Treaty must be approved by all Member States in accordance with their constitutional requirements.

The Prime Minister, David Cameron, supported the Decision, as he told the House of Commons on 20 December 2010:

> Enabling eurozone countries to establish such a mechanism is in our interests, but how that mechanism is brought about is equally important. After the October Council I made it very clear to the House that any possible future

[10] For information on the debates in both Houses, see House of Lords Library Note, European Union (Approval of Treaty Amendment Decision) Bill (HL Bill 3 of 2012–13), 16 May 2012.

[11] HC Deb 16 March 2011 c 424. See also Explanatory Notes to 2011 EU Act.

[12] See Research Paper 10/79, *European Union Bill* [HC Bill 106 of 2010-11], 2 December 2010, for detailed information on the scenarios which might fall within section 4.

> treaty change would not affect the UK, and that I would not agree to it if it did. I also said that no powers would be transferred from Westminster to Brussels. At the Council we agreed the establishment of a permanent mechanism with a proposed very limited treaty change. This change does not affect the UK, and it does not transfer any powers from Britain to the European Union. [13]

He did not believe the permanent mechanism would result in the UK having "any liability for any potential bailout of the eurozone", as it did under the current Article 122 provisions and assured the Commons that Parliament would be asked to approve the amendment:

> 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. Before the Government agree to this treaty change, Parliament must, of course, give its approval-and if this treaty change is agreed by all member states, its ratification in this country will be subject to the terms of our EU Bill, and so will be subject to primary legislation.[14]

4 The 2012 Bill

4.1 What it does

The *European Union (Approval of Treaty Amendment Decision) Bill 2012* was introduced in the House of Lords on 10 May 2012 and had its Second Reading on 23 May 2012. It is a short Bill with two clauses and it aims to provide for the Parliamentary approval of European Council Decision 2011/199/EU of 25 March 2011 ("the Treaty amendment Decision"), amending Article 136 of the *Treaty on the Functioning of the European Union* (TFEU) with regard to a stability mechanism for Member States whose currency is the euro. The Bill, if passed, will enable the UK to ratify the Treaty amendment Decision.

Clause 1(2) provides for the approval of the Treaty amendment Decision for the purposes of Section 3 of the European Union Act 2011 and **Clause 1(3)** provides, for the purposes of section 3(3) of the 2011 Act, that the Treaty amendment Decision does not fall within section 4 of that Act.

Clause 2 extends the bill to the whole of the UK and provides for it to come into force with Royal Assent.

The Foreign Office Minister, Lord Howell, said of the Bill:

> A stable and healthy eurozone is important for the UK's long-term growth and prosperity. This treaty change is firmly in the UK's national interest, since it makes explicit the ability of eurozone countries to set up a permanent European Stability Mechanism to support other eurozone countries in financial trouble. This will be a fund by the eurozone, for the eurozone, and, unlike the situation this Government inherited, the UK will not be liable through the EU budget for any future eurozone bailouts. This treaty change will help eurozone

[13] HC Deb 20 December 2010 c 1187

[14] Ibid, c 1188

> countries take forward a key aspect of their plan to resolve the crisis and secure financial stability.[15]

4.2 Associated issues

Is a Treaty change strictly necessary? Consideration by the European Scrutiny Committee

The Commons European Scrutiny Committee (ESC) considered the proposed Treaty change on 12 and 26 January 2011, recommending further debate on the Floor of the House and presuming that it would in any case be debated under Section 6 of the *European Union (Amendment) Act 2008*. The ESC's criticisms in both its reports centred on the appropriateness of using Article 122(2) as a legal base for the EFSM, and the Government's views on this:

> ... it strained credibility to say that Article 122(2) TFEU was an appropriate legal base for the European Financial Stabilisation Mechanism (EFSM). Article 122(2) provides for a Member State being given financial assistance when it "is in difficulties or is seriously threatened with severe difficulties caused by natural disasters or exceptional occurrences beyond its control". This did not, patently in our view, give the EU power to set up the EFSM.

This criticism was not directly relevant to the ESM, which does not use Article 122(2) as a legal base. However, the ESC believed that accepting Article 122(2) as an appropriate basis for the EFSM called into question the necessity for a Treaty amendment to give legal basis for the ESM:

> The Minister's comments on the use of Article 122 TFEU as the legal base for the European Financial Stabilisation Mechanism... do not appear to countenance any doubt about the lawfulness of the legal base; indeed, he says the EFSM is compatible with the TFEU. This seems to us surprising, for Article 122 TFEU is intended to give financial assistance to a Member State which "is in difficulties or is seriously threatened with severe difficulties caused by natural disasters or exceptional occurrences beyond its control". We do wonder if this was really intended to establish a bailout mechanism for the eurozone, however temporary; and if it were, why there is a need to amend Article 136 TFEU by the simplified revision procedure to set up a permanent bailout mechanism.

In its Report on the *Treaty on Stability, Coordination and Governance: impact on the eurozone and the rule of law* (the fiscal compact treaty) in April 2012, the ESC noted continued ambivalence over the requirement for Treaty change:

> Recitals 2 and 3 of the Decision strongly suggest that the Treaty amendment is a necessary precursor of the Treaty establishing the ESM. This suggestion is reinforced by the European Council Conclusions of October 2010 (paragraph 2), December 2010 (paragraph 1) and March 2011 (paragraph 16). And it is further reinforced by the Prime Minister's statements to the House following the October and December 2010 European Council 112 and comments by the Minister for Europe in the House's debate on the proposed amendment to Article 136 TFEU. 113
>
> So we were extremely surprised by the Financial Secretary to the Treasury's comment, in his letter to us of 13 March, responding to our enquiry as to

[15] FCO website, 10 May 2012

> whether, as the ESM was now to come into force in July, ratification of the Treaty amendment would be brought forward, that:
>
> “It is not legally necessary for the Article 136 Treaty change to have been made before the ESM can come into force.” [114]
>
> **Footnotes**:
>
> 112 HC Deb, 1 November 2010, especially cols. 615, 621 and 624, and 20 December 2010, especially cols 1187 and 1195.
>
> 113 HC Deb, 16 March 2011, especially cols 421, 427 and 431.
>
> 114 Ev 74

Giving evidence to the ESC, the Financial Secretary to the Treasury (Mark Hoban), conceded that Treaty change was not, in the opinion of the Government, strictly necessary:[16]

> ...we do not believe that it is legally necessary for the Article 136 change to be made before the ESM comes into force. It is desirable, but I do not think that it is necessary.

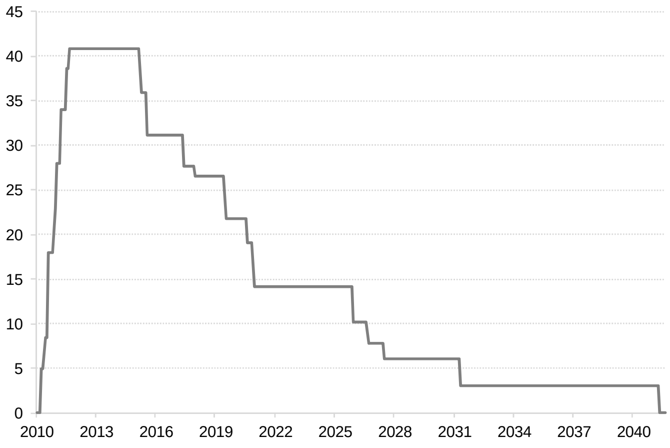
But went on to add that the German Constitutional Court was instrumental in requiring a Treaty change to give a legal basis to the ESM:

> ...from the perspective of at least one member state, it is important, or they believe it to be important, that the treaty change comes into force before the ESM came into force. That was the requirement, apparently, by the German Constitutional Court that sought legal certainty. [...]Our understanding, and what we believe to be the case, is that, for the purposes of the German Constitutional Court, they do require the treaty change to be made prior to the ESM coming into force. That does not apply to our position.

A Bill to block bailouts?

After the Queen’s Speech on 9 May, the Bill was widely characterised in the press as legislation that blocked or exempted the UK from further EU bailouts.[17] This is not the formal purpose or the direct effect of the Bill. The European Council did decide in December 2010 that that Article 122(2) will no longer be used for safeguarding the financial stability of the eurozone;[18] and the Government has received assurances that the EFSM be used in any *new* lending to eurozone countries once the ESM is established.[19] However, these agreements are incidental to the Bill itself, which does nothing but ratify a Treaty change that gives legal basis to the ESM.

Outstanding borrowing under the EFSM based on lending up to end June 2012
€bn, 2010-42



[16] Uncorrected transcript of oral evidence to the European Scrutiny Committee, 14 Mar 2012 (see in particular Q196-7)

[17] See, for instance, BBC News *Queen’s Speech: plans to withdraw UK from bailouts*, 9 May 2012

[18] European Council Conclusions, 16/17 December 2010

[19] See, for instance, HC Deb 1 Feb c63WS

Nor do the agreements (or the Bill itself) enable the UK to veto *any* future use of Article 122. Borrowing against the EU Budget for purposes other than 'to safeguard the financial stability of the eurozone as a whole' will continue to be decided under qualified majority voting.

Finally, the UK will remain indirectly liable, along with the 26 other EU Member States, for EFSM borrowing to finance existing programmes. The Commission will continue to issue bonds under the EFSM to Ireland as late as end 2013 and to Portugal as late as mid-2014. Meanwhile, the longest-dated bond issued under the EFSM so far matures in April 2042, so technically the UK's 'liability' through the EFSM will continue at least until this point (see chart). It is only correct to say that no *new* liabilities will be incurred under the EFSM once the ESM is established.

5 Lords scrutiny

Summary of Lords scrutiny

Stage	Date	Length of debate	Number of contributors	Amendments moved	Amendments agreed	Text of debate
First Reading	10-May-12	n/a	n/a	n/a	n/a	[link]
Second Reading	23-May-12	3h 43m	22	n/a	n/a	[link]
Committee	13-Jun-12	0h 59m	8	2	0	[link]
Report	27-Jun-12	0h 04m	2	0	0	[link]
Third Reading	04-Jul-12	0h 06m	6	0	0	[link]

5.1 Second Reading

Introducing the Bill, Lord Howell of Guildford described it as 'simple and straightforward'. As Mark Hoban had done in the European Scrutiny Committee, Lord Howell stopped short of claiming that the Treaty change was necessary precursor to the creation of the ESM, saying instead that the change 'made explicit the ability of eurozone countries to set up a financial assistance mechanism'. He went on to note that the ESM could be established without Treaty amendment ('the two things are not ultimately dependent'), but that the change would 'give comfort, support... and legal reassurance to the eurozone members so that they can go ahead'. A failure to ratify the Treaty change would, he warned, generate 'uncertainty about the eurozone's ability to establish a permanent support mechanism'.

Lord Howell described the context of the decision to establish the ESM and its predecessors, the EFSF and EFSM. He noted the agreement secured at the Economic and Financial Affairs Council on 24 January that the EFSM would no longer be used in new lending programmes once the ESM was established.

Most speakers expressed support for the Bill at Second Reading, and much of the debate concerned broader issues, such as the causes, consequences and response to the euro crisis, and the future of European integration. Common themes included the consequences of Greece leaving the euro and further economic turbulence in the region; possible reforms to enhance economic union and foster stability in the eurozone, through project bonds, Eurobonds and more extensive lender of last resort activity by the ECB; the responsibility of Germany to make adjustments and promote domestic demand through wage growth; the fact that the ESM, if necessary, was not sufficient to resolve the euro crisis; the need to achieve an appropriate balance between austerity and growth; and what some saw as the underlying flaws of the European monetary union (EMU) as established.

The vested economic and political interest of the UK in the success of the eurozone were noted by a number of participants, as was the importance of the Government maintaining its influence in the debate over the crisis response, especially after its decision not to be part of the 'fiscal compact'. Lord Radice pointed out that one means of establishing influence would be a 'purely voluntary financial contribution from the UK as a symbol of our solidarity with our European partners'. Lord Clinton-Davies spoke of a 'duty on all members of the European Union, including ourselves, to rescue [it]... from its present plight', and Lord Hannay argued for the importance of solidarity, describing the Bill as a 'modest contribution' towards that end. Were the eurozone to move towards greater integration, Lord Giddens argued that the rest of the Union would be carried towards a more 'federal' structure; in such a situation, he argued, the case for an 'in-out' referendum would become overwhelming because Britain would 'no longer have the option of semi-detached membership'. Lord Stoddart argued that UK influence was necessary in order to stem the tide of political union and counter 'the shadowy group of Foreign Ministers...calling for complete political integration under a European government.'

Lord Lamont questioned the extent to which the UK would be exempted from future financial assistance, given that Article 122, under which the EFSM was established, was not being amended. He also expressed scepticism at the structure of the ESM, whereby countries collectively 'guarantee[d] their own finances' (also see Section 6.2). Describing the euro as a 'disastrous experiment' that had bred 'acrimony and xenophobia', he cautioned against the Government attempting to secure greater influence in Europe if this meant supporting inappropriate policies. Lord Lawson raised similar questions about whether the eurozone's success really was in the UK's interest; rather, he argued, the UK's interest was in the success of the European economy more generally, success which was not furthered 'as long as the eurozone staggers on'. He went on to argue that establishing monetary union as a precursor, rather than a successor to political union had left the single currency with fundamental design flaws and that 'orderly dissolution' was the 'least bad' option for the 'Doomsday machine' of EMU. Given that the euro appeared to be thus ill-fated, he argued that the Treaty change under discussion was 'supremely irrelevant'.

Like Lord Lamont, Lord Flight raised issues about the UK's liability under the EFSM. He was concerned that new lending under the EFSM would only stop once Article 136 had been ratified, which though scheduled for July might not occur until January 2013. He also noted that the UK's liabilities under the EFSM would increase if other EU Member States did not 'honour their commitments'.

Drawing a comparison between pre-Nazi Germany and the current situation in Greece,[20] Lord Empey argued that the costs of failing to resolve the crisis extended beyond the purely economic. Lord Dobbs echoed these concerns over extremism, but did not agree that the EU was the only means of avoiding 'intolerant nationalism'. He drew a comparison between the exacting reparations demanded of Germany after World War I and the obligations being placed on the eurozone periphery today, and encouraged 'all authorities in Europe, and

[20] In the 17 June elections, the extreme right-wing party Golden Dawn won 18 of the 300 seats in the Greek parliament on a 6.9% vote share.

particularly those in Germany, to remember the lessons of the post-Versailles period rather than naively insisting that all financial obligations should be met, no matter what'.

5.2 Committee Stage

Two amendments were moved at Committee Stage, both by Lord Foulkes. Both were withdrawn.

The first amendment proposed that there should be a referendum before the treaty change could be approved (i.e. that the treaty change triggered a referendum under the European Union Act 2011). Lord Foulkes made clear at the outset that this was a probing amendment with which he did not agree. It was made, he said, to debate the circumstances in which a referendum might or might not take place. Unlike Lord Foulkes, Lord Stoddart supported the amendment and was concerned that the implications of the Bill were 'more important and far-ranging than some of us had believed'. Speaking for the Opposition, Lord Liddle reiterated Labour's position that 'referenda should take place only on issues of major constitutional significance'. Lord Howell, for the Government, pointed out that treaty changes under Article 48(6) (the simplified revision procedure) that did not apply to the UK were not subject to a referendum. He went on to point out that were this not to be the case, as Lord Stoddart argued, 'there would have been an opportunity for a judicial review, but no such review was brought forward.'

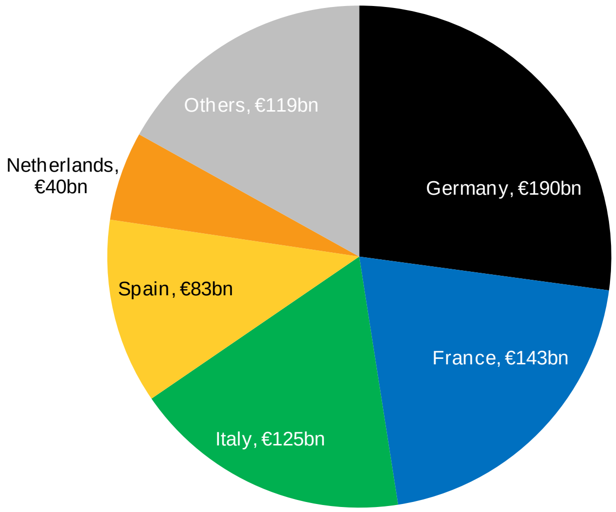
The remaining amendments delayed the entry into force of the Act until 1 January 2013 and then only if the membership of the eurozone remained the same as it is now. In particular, Lord Foulkes was concerned that Greece, Ireland or Spain would have been forced out of the eurozone by this point. If that were the case, he argued, 'why should a treaty which was drawn up at a time when they were members continue on that basis?' For the Government, Lord Howell argued that the ESM was an essential mechanism 'regardless of whether there is a change in member states whose currency is the euro', and that delaying the amendment decision risked further instability in the eurozone, with consequences for the UK economy.

6 The ESM and associated issues in detail

6.1 Structure and role

The ESM's structure is similar to that of the EFSF, with funds raised on the back of "irrevocable and unconditional" guarantees from participant States. It will have a maximum lending capacity of €500bn, equal to the existing combined lending limit of the EFSF and EFSM together.[21] Unlike the EFSF, however, the ESM will also have paid-in capital; that is, ready funds paid in by participants, as well as the 'promises to pay' (guarantees) on which the EFSF is based.[22] Of the €700bn in capital required to achieve its lending ceiling, €80bn will be paid-in capital, provided by eurozone states in five equal annual instalments through to 2017.[23]

Contributions to the ESM's capital
Selected Eurozone members



The ESM will also fulfil the same functions as the EFSF; namely, the provision of loans assistance to governments on a precautionary basis or in response to a crisis; intervention in sovereign debt markets; and the recapitalisation of financial institutions via lending to governments (see Section 6.3 for more on the ESM's proposed role in directly recapitalising financial institutions). The interest rate on loans under the ESM will not be pre-defined; rather, it is required under the Treaty that the ESM "aim[s] to fully cover its financing and operation costs and shall include an appropriate margin [i.e. an interest premium over and above its own funding costs]." The involvement of the 'troika' – the Commission, the European Central Bank and the IMF – in devising and monitoring the economic policy conditions attached to any loan is also made explicit in the Treaty.

Unlike the EFSF, the ESM will have explicit "preferred creditor status... while accepting the preferred creditor status of the IMF over the ESM." This means that in the event of default or restructuring of loans, the IMF will be paid back first, followed by the ESM, followed by other (private-sector) creditors. This preferred creditor status is also conferred in the Treaty on any country that makes bilateral loans alongside the ESM. However, changes have been made to this arrangement in the case of any ESM assistance that Spain receives; more details can be found in Section 6.2.

Decisions on financial assistance provided under the ESM are to be taken by its board of governors, consisting of the finance ministers of eurozone States. Unanimity is generally required, although assistance can be granted in certain circumstances by a qualified majority

[21] This limit was first agreed at the European Council summit of 24/25 March (see Conclusions).

[22] This structure is similar to that used to finance international lending institutions such as the International Bank for Reconstruction and Development, and the European Bank for Reconstruction and Development.

[23] Following an agreement reached by eurozone finance ministers on 30 March 2012, eurozone States have committed themselves to accelerating the provision of paid-in capital if necessary (i.e. if a country needs to call on the ESM for financial assistance) so as to maintain a minimum 15% ratio between paid-in capital and outstanding ESM borrowing.

of 85% of votes cast.[24] From March 2013, only those eurozone countries that have ratified the 'fiscal compact' will be eligible for support from the ESM.[25]

Finally, the ESM formalises to an extent the nature of private-sector involvement in any deal reached to provide loans assistance to a government facing a debt crisis. In particular, signatories to the ESM are required to insert *collective action clauses* (see box) in any new bonds with more than one year maturity issued after 1 January 2013. It also explicitly states that private-sector involvement will be considered as part of an ESM programme of loans assistance and macroeconomic adjustment 'in exceptional cases' and 'in accordance with IMF practice'.

Collective action clauses

Collective action clauses are conditions attached to a bond that can compel all holders to agree on a revision to the payment terms, provided a specified majority of holders agree to it. For example, a government facing difficulty repaying a bond might announce it would repay only 50%: provided a sufficient proportion of bondholders then consented, the conditions of the bond would change for *all* the bondholders (even if they were in the group who did not agree).

The rationale for CACs is that they facilitate debt restructuring, and prevent negotiations being held hostage to 'rogue' creditors who hope to receive better terms in subsequent offers. The "prisoners' dilemma" analogy is applicable here: individually, it may not be in bondholders' interest to co-operate, even though collectively it is. CACs thus ensure that the payoffs for non-co-operation are worse (or at least no better than) the payoffs for co-operation during debt restructuring negotiations.

6.2 Controversy over structure

The ESM shares many of the design features of the EFSF and much of the criticism related to the EFSF applies equally to the permanent facility. Firstly, some see the €500bn in lending capacity as too small to be effective, particularly if a large economy such as Italy required assistance. This is especially the case, it is argued, given that the ESM's mandate will be broader than was initially envisaged: like the EFSF, it be responsible for providing precautionary credit lines to governments, recapitalising banks (via loans to governments), and intervening in bond markets. Indeed, it is argued that the perception that the eurozone rescue funds could 'run out of money', and that insurance against the worst-case scenario is inadequate, in itself drives borrowing costs for the Italian and Spanish governments higher, and raises the likelihood of that very outcome.

Sterner critics point towards what they see as a fundamental design flaw at the heart of the ESM that exists no matter how large it is; namely, the circularity of having the facility guaranteed by the same group of countries that might need to draw on it. The result of this structure is that, as countries face debt crisis and become ESM borrowers, rather than guarantors, the burden on the remaining countries increases, thereby increasing the likelihood that they too will face debt crisis.

The reliance of the ESM on the creditworthiness of *all* its guarantors also means that the triple-A credit rating it aims to achieve, and hence its low borrowing costs, hinge on a sufficiently large number of eurozone countries maintaining their own credit rating. The effect of ratings downgrades was illustrated when Standard and Poor's downgraded nine eurozone

[24] This procedure can be used where the Commission and ECB both conclude that failure to urgently adopt a decision might threaten the economic and financial sustainability of the eurozone.

[25] For more information on the fiscal compact, see Library Standard Note *In Brief: provisions of the eurozone fiscal compact* and Library Research Paper *The Treaty on Stability, Coordination and Governance in the Economic and Monetary Union: political issues.*

countries on 13 January 2012,[26] including France; it then followed logically that it would downgrade the EFSF too, which it duly did (to AA+) on 16 January.

Finally, the ESM's precedence over other creditors in the event of default or debt restructuring has been criticised for raising the borrowing costs of countries that might have to draw on it. This is because the higher the proportion of a country's debt held by 'official' creditors, such as the IMF and the ESM, the greater the loss that ordinary private sector creditors will bear in the event of default or debt restructuring. Eurozone leaders appear to have recognised this issue, agreeing at a summit on 28/29 June 2012 that 'financial support to Spain for recapitalisation of its banking sector... will be provided... without gaining seniority status'.[27]

6.3 Direct recapitalisation of financial institutions

As the banking crisis in Spain reached a climax in late June 2012, the government there was forced to formally request up to €100bn to support its financial system. The developments in Spain led to calls for the ESM, from which a significant proportion of the €100bn is set to come, to be empowered to lend directly to financial institutions in eurozone countries, rather than channelling funds through governments. This, it was argued, was essential to break the link between sovereigns and banks, whereby governments, by recapitalising struggling banks, increased their own debt burdens, damaged their own creditworthiness and suffered rising borrowing costs. These governments, in turn, become increasingly dependent on domestic banks, often the very lenders they are rescuing, to buy up their debt and fund their deficits.

At the European Council summit of 28/29 June 2012, eurozone leaders agreed in principle that changes to the ESM could be made to enable it to lend directly to financial institutions, thereby allowing banks to be recapitalised without sovereign debt burdens increasing. However, this will only happen once a single supervisory institution for banks in the eurozone is established. The Commission is in the process of drawing up proposals for how such a supervisory mechanism might work, and it will not be before the end of 2012 at the earliest that the ESM could acquire such powers.

6.4 Raising the firewall to €700bn and accelerating the ESM

At the Council summit of eurozone heads of state on 9 Dec 2011, an agreement was reached to accelerate the entry into force of the ESM from mid-2013 to July 2012.[28] At the end of March 2012, eurozone finance ministers further agreed to increase the total official lending capacity of the eurozone (the 'bailout funds') from €500bn to €700bn.[29] This will be done by adding around €200bn in commitments already made through the EFSF (the temporary lending facility which the ESM will replace) to the €500bn lending capacity envisaged for the ESM; previously, the plan was to subsume these commitments into the ESM. That gives total lending capacity (including existing arrangements) of €700bn and available lending capacity of €500bn (as opposed to €500bn total and €300bn available under the previous plans).

[26] Standard and Poor's press release *S&P takes various ratings action on 16 eurozone sovereign governments*, 13 Jan 2011

[27] Euro area summit statement, 29 June 2012

[28] European Council conclusions, 9 December 2011 (see esp. Paragraph 13)

[29] Statement of the Eurogroup, 30 March 2012

6.5 A banking licence for the ESM

Under current proposals, once the eurozone's permanent rescue fund, the European Stability Mechanism (ESM) is established, its lending capacity will be fixed at €500bn, a figure that is constrained by the amount of capital committed to the fund by each of the 17 eurozone states. Granting a banking licence to the ESM, thereby transforming it into a publicly-owned credit institution like the European Investment Bank, could expand this capacity to an unlimited level, since it would enable the ESM to borrow money from the ECB.

The idea of granting a banking licence to the ESM has been strongly resisted by governments in certain eurozone states (most notably Germany) and seen by some ECB officials as a thinly-disguised attempt to circumvent legal restrictions that prevent the ECB financing governments directly.[30] This is because, as well as providing loans to governments as part of formal agreements, the ESM can also purchase sovereign debt on the primary and secondary markets; that is, it *can* finance governments directly. Thus, with a banking licence, the ESM could simply act as an intermediary to channel ECB funds directly to governments.

On the other hand, Italian, Spanish and French governments have openly promoted the idea. The Italian Prime Minister, Mario Monti, went so far as to suggest that implementing the measure was a question of 'if' rather than 'when', saying that 'it will occur in due course'. The idea, however, was taken off the table by Mario Draghi for the time being after the ECB's Governing Council meeting on 2 August 2012. When asked about it in the subsequent press conference, Draghi replied:

> It is not up to us to issue a banking licence – this is a matter for the governments. What is up to us to decide is whether the ESM – even with a banking licence – can actually be a suitable counterparty that is eligible for central bank financing. And I have said at least twice – at a press conference, and on other occasions – that the current design of the ESM does not allow it to be recognised as a suitable counterparty. And we have a legal opinion of the ECB on this, which was issued the way back in March 2011[31]

The legal opinion in question recalls the prohibition on direct monetary financing of eurozone governments by the ECB, in effect asserting that granting a banking licence to the ESM would *not* circumvent this principle.

6.6 Expiry of the EFSF and EFSM

The EFSF will cease to be active in *new* lending programmes from July 2013, but will continue to exist to administer the disbursement and repayment of existing loans arrangements. Unlike the EFSF it does not exist as a legal entity (bond issues under the EFSM are administered by the European Commission). The EFSM will cease to be used in *new* lending programmes once the ESM enters into force (originally intended in July 2012). More details on the EFSM's expiry can be found in Section 6.2.

[30] This is prohibited by Article 123 TFEU, which states that *Overdraft facilities or any other type of credit facility with the European Central Bank or with the central banks of the Member States (hereinafter referred to as 'national central banks') in favour of Union institutions, bodies, offices or agencies, central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of Member States shall be prohibited, as shall the purchase directly from them by the European Central Bank or national central banks of debt instruments*

[31] ECB *Introductory statement to the press conference (with Q&A)*, 2 Aug 2012. The legal opinion in question is contained in Paragraph 9 of the opinion of the ECB on the Article 136 TFEU amendment (CON/2011/24)

7 Approving the Article 136 amendment and the ESM Treaty in other Member States

Approval of the Article 136 Treaty amending decision by all EU Member States, ratification of the ESM by eurozone States and ratification of the fiscal compact Treaty by both euro and non-euro States have become intertwined. Several Member States are debating and ratifying them concurrently. A summary of the position of EU countries with respect to the fiscal compact can be found in Standard Note 6285. An overview of the provisions and economic issues associated with the compact can be found in Standard Note 6274. The EP Directorate General for Internal Policies, Citizens' Rights and Constitutional Affairs has published a note on the ESM, Article 136 and fiscal compact ratification procedures in the EU Member States, together with a table summarising national requirements and the state of play, 27 August 2012.

As of 27 August 2012, 16 of the 27 EU Member States had completed ratification of the Article 136 amendment decision.[32]

Austria

The ESM, Article 136 and fiscal compact measures were all submitted to both parliamentary chambers, the *Nationalrat* and the *Bundesrat* in March 2012 and approved in both Chambers at the same time in early July. President Heinz Fischer signed all three instruments in July 2012, allowing them all to be ratified. However, three opposition parties (FPÖ, BZÖ and the Green Party) plan to launch a constitutional challenge against the fiscal compact Treaty, and the FPÖ has said it intends to challenge the ESM.

The Constitutional Court can only begin its review after the President has signed a treaty. According to the Constitutional Court President, Gerhart Holzinger, it could take three to six months for the Court to deliver a judgement.

Belgium

The Senate approved the Article 136 decision on 10 May 2012 and the Chamber of Representatives approved it on 14 June. The regional and community assemblies have yet to approve it. The Senate approved the ESM on 7 June 2012 and the Chamber of Representatives approved it on 14 June. Ratification was completed on 26 June 2012.

Bulgaria

The National Assembly approved the Article 136 decision on 13 July 2012. Ratification was completed on 27 July.

Cyprus

The House of Representatives approved the Article 136 decision and the ESM on 30 May 2012 and both completed ratification on 22 June 2012. Ratification of the fiscal compact Treaty was completed on 6 July 2012.

Czech Republic

The Article 136 decision was approved by the Senate on 25 April 2012 and by the Chamber on 5 June.

[32] See EU Council ratification list

Denmark

Denmark ratified the Article 136 decision on 7 May 2012. The fiscal compact bill was submitted to the *Folketinget* on 11 April 2012. The Ministry of Justice concluded that ratification of the treaty would not represent a transfer of sovereignty and that only a simple majority was required in the *Folketinget*. The bill was approved on 31 May 2012 by 80 votes to 27.

Estonia

Ratification of the ESM Treaty suffered a setback in Estonia. According to the opinion of the Estonian Chancellor of Justice, elements of the Treaty contradict the Estonian Constitution and thus cannot be ratified by the Parliament. The Chancellor of Justice has asked the Government to re-open negotiations on the Treaty. On 12 March 2012 the Chancellor of Justice submitted an application to the Estonian Supreme Court, challenging the constitutionality of the ESM Treaty provision on financial assistance to Member States on the basis of a qualified majority vote.[33] The Supreme Court issued an Opinion on 12 July 2012 which stated the ESM does not conflict with the Constitution. Even though it could restrict the Estonian Parliament's financial decision-making process and the sovereignty of Estonia, such a restriction would be justified in the circumstances.[34]

The Article 136 decision was approved by the *Riigikogu* on 2 August 2012 and ratification was completed on 16 August.

Finland

Both opposition parties, the True Finns and the Centre Party, oppose the ESM. For background to parliamentary consideration of the Treaty, see Statement of the Grand Committee 3/2011 (Draft Unofficial translation), "Revision of the EFSF and ESM Agreements", 2 September 2011. The Finnish parliament, the *Eduskunta*, approved the Article 136 decision on 29 May 2012 and the ESM bill on 21 June. Ratification of the ESM treaty was completed on 3 July 2012. The fiscal compact is due to come before Parliament in the autumn.

France

On 21 February 2012 the *Assemblée Nationale* voted by 254 to 44 in favour of the ESM Treaty, with 131 abstentions, and the *Sénat* approved it on 28 February by 169 to 35 with 138 abstentions. The Socialists and Communists did not back it.

However, France has not yet ratified the fiscal compact Treaty and one of the new French President, François Hollande's, key electoral pledges was to renegotiate the terms of the fiscal compact to place a greater emphasis on growth over austerity. The European Council agreement on 28-29 June 2012 was a sufficient guarantee for President Hollande to submit a draft law ratifying the fiscal compact Treaty. The draft law was transmitted to the *Conseil Constitutionnel*, which had a month in which to give its opinion.

On 9 August 2012 the *Conseil Constitutionel* Constitutional Council ruled that the EU's fiscal compact did not require a change to the Constitution.[35] President Hollande, who did not want to write a budgetary rule into the French Constitution, could now implement the pact in

[33] See Chancellor of Justice press release

[34] See *Estonian Review* 6-12 July 2012

[35] See EurActiv 10 August 2012

September by a simple majority of the Assembly (constitutional reform would have required a three-fifths majority in a special joint session of Parliament).

Germany

German ratification of the three measures is crucial to the success of attempts to solve the eurozone crisis. In mid-March 2012 the German Cabinet approved legislation to ratify the ESM Treaty and backed a bill authorising Germany to contribute to the ESM,[36] but the Government still needed *Bundestag* support for the fiscal compact in the face of opposition from the Social Democrats (SPD). Reports indicated that the ESM was not likely to be passed by the German Parliament, and Chancellor Merkel hoped to link it to a vote on the fiscal compact Treaty, which has cross-party support. Both the ESM and the fiscal compact needed the approval of two-thirds of the *Bundestag* and the *Bundesrat*, which meant the support of the SPD. In mid-April 2012 Dr Herta Däubler-Gmelin, the justice minister in the first cabinet of former SPD Chancellor, Gerhard Schröder, said she would take a complaint to the Constitutional Court in Karlsruhe unless voters were given the opportunity to vote on the issues in a referendum.

Angela Merkel suffered a setback in her aims on 16 May, when she dismissed her environment minister, Norbert Röttgen, and replaced him with her chief whip, Peter Altmaier, on whom she had been relying to gain parliamentary ratification of the fiscal compact Treaty before the summer recess. The planned date for the parliamentary vote, 25 May, was postponed until after the Greek parliamentary elections in June. The SPD signalled its willingness to back the ESM, and the SPD-dominated *Bundesrat*, representing the 16 states, also indicated its support. Opposition parties linked their support for the fiscal compact to Chancellor Merkel agreeing to a package of economic growth measures similar to those backed by François Hollande. President Joachim Gauck announced on 21 June 2012 that he would await the Constitutional Court's decision on the compatibility of the ESM and fiscal compact treaties with German law before signing them off.

The Bundestag approved the ESM and the fiscal compact legislation on 29 June 2012, the opposition parties supporting the Government in return for measures on growth and job creation. However, following six constitutional complaints about the ESM concerning alleged lack of democratic oversight and the undermining of parliamentary budgetary powers, the German President did not sign the new law. On 10 July the Constitutional Court considered whether to issue a temporary injunction against the two laws to stop them entering into force until the Court has addressed the main question of the constitutionality of the treaties. The German Finance Minister, Wolfgang Schäuble told the Court that any significant delay in approving the ESM and the fiscal compact Treaty could lead to turbulence in the financial market. The Constitutional Court is due to rule on 12 September, but this could be further delayed following an attempt on 13 August 2012 by *Europolis*, a eurosceptic think tank in Berlin, to further defer the Court's decision until the EU Court of Justice has ruled on the Pringle case (see Ireland, below).

[36] See Federal Ministry of Finance information, 14 March 2012

Greece

The Greek Parliament voted on all three measures in March 2012. The Article 136 amendment completed ratification on 17 April and the other two in May. Detailed information can be found on the parliamentary processes on the Greek Parliament website.

Hungary

Ratification of the Article 136 decision was completed on 19 April 2012.

Ireland

Ireland, which has held a referendum on almost every Treaty change since 1987, will not hold one on the ESM amendment, although Ireland ratified the fiscal compact Treaty by referendum on 31 May by 60.3% votes in favour to 39.7% against. The former Taoiseach, Brian Cowen, did not believe the proposed ESM change would be a change of competence or a transfer of competence, so it would be compatible with the Irish Constitution.[37] The *Irish Times* reported that "Mr Cowen expressed confidence to reporters that any decision not to call a referendum would withstand legal challenge."[38] However, the European Policy Centre (EPC) thought a referendum might still be on the cards.[39] The Independent MP, Thomas Pringle (Donegal South West) said in April 2012 that he would take the Government to the Constitutional Court claiming that ratification of the ESM Treaty, like that of the fiscal compact Treaty, should be by referendum rather than a vote in the *Oireachtas*.[40] Mr Pringle made five complaints about the ESM in the High Court:

- The 'sovereignty' claim. He submitted that the Irish Government's participation, on behalf of the State, in the proposed ratification of the ESM Treaty was contrary to the Irish Constitution. It was a delegation of state sovereignty, and an excessive exercise of the Government's executive powers in conducting the external relations of the State.

- The 'power transfer' claim. He argued that the legislative instrument which gives effect to the ESM Treaty in Ireland (the 2012 European Stability Mechanism Act), involved an impermissible transfer of power from the Irish Parliament to the Irish Minister for Finance.

- The 'ESM Treaty' claim. He claimed that by adopting the ESM Treaty, Ireland was taking upon itself obligations that were incompatible with the provisions in the TEU, and the TFEU concerning Economic and Monetary Policy – obligations which encroached on the exclusive competences of the Union in the matter of the euro and related policies.

- The 'Council Decision' claim. He argued that the Decision was not lawfully adopted. The Decision alters the competences of the Union contrary to the third paragraph of Article 48(6) TEU, which states: 'The decision … shall not increase the competences conferred on the Union in the Treaties'. Furthermore, the Decision was inconsistent with EU law.

[37] See *Independent.ie* 17 December 2010, "Cowen: We don't need referendum to set up bailout fund"

[38] *Irish Times* 17 December 2010*.* See also *Irish Times*, 14 December 2010 "Treaty referendum highly unlikely, but expect court challenge"

[39] EPC "Adding pieces to the European economic governance puzzle", 20 December 2010

[40] See *Irish Times* 17 April 2012

- The 'injunction' claim. He requested an injunction to restrain the Irish Government from ratifying the ESM Treaty before the ending of the legal proceedings.[41]

The ESM Bill was submitted to the *Dáil* on 3 May 2012 and approved by the Senate on 27 June 2012. The Article 136 amendment will be incorporated by a *European Communities (Amendment) Bill,* which was submitted to the *Dáil* on 4 May 2012. This too was approved by the Senate on 27 June.

On 31 July the Supreme Court rejected the Pringle claims that the ESM Treaty was unconstitutional and refused to grant Mr Pringle an injunction restraining the Government from ratifying the ESM treaty before its lawfulness had been decided. The Article 136 decision was approved on 1 August. However, the Supreme Court decided to refer questions to the EU Court of Justice with a request to deal with the reference under the accelerated procedure (Article 104a of the Court's Rules of Procedure). The questions referred were:

> Whether European Council Decision 2011/199/EU of 25th March 2011 is valid:
>
> - Having regard to the use of the simplified revision procedure pursuant to Article 48(6) TEU and, in particular, whether the proposed amendment to Article 136 TFEU involved an increase in the competences conferred on the Union in the Treaties;
>
> - Having regard to the content of the proposed amendment, in particular whether it involves any violation of the Treaties or of the general principles of law of the Union.
>
> (2) Having regard to
>
> - Articles 2 and 3 TEU and the provisions of Part Three, Title VIII TFEU, and in particular Articles 119, 120, 121, 122, 123, 125, 126, and 127 TFEU;
>
> - the exclusive competence of the Union in monetary policy as set out in Article 3(1)(c) TFEU and in concluding international agreements falling within the scope of Article 3(2) TFEU;
>
> - the competence of the Union in coordinating economic policy, in accordance with Article 2(3) TFEU and Part Three, Title VIII, TFEU;
>
> - the powers and functions of Union Institutions pursuant to principles set out in Article 13 TEU;
>
> - the principle of sincere cooperation laid down in Article 4(3) TEU;
>
> - the general principles of Union law including in particular the general principle of effective judicial protection and the right to an effective remedy as provided under Article 47 of the Charter of Fundamental Rights of the European Union and the general principle of legal certainty;
>
> is a Member State of the European Union whose currency is the euro entitled to enter into and ratify an international agreement such as the ESM Treaty?

[41] EUlawradar, 26 August 2012

> If the European Council Decision is held valid, is the entitlement of a Member State to enter into and ratify an international agreement such as the ESM Treaty subject to the entry into force of that Decision?[42]

The Court of Justice is due to hold an oral hearing on 23 October 2012, and requires written submissions from Thomas Pringle and the State's legal representatives by 14 September 2012.[43]

Italy

The Government presented draft bill N 3240 authorising the president to ratify the ESM treaty on 3 April 2012 and received final approval on 19 July. Draft bill N 2914 on the Article 136 amendment was submitted to the Senate on 19 September 2011 and the Senate Committee stage finished on 3 July 2012. All three measures received approval in the Senate on 12 July and the Chamber of Deputies on 19 July. The ESM Treaty received Presidential Assent in July 2012.

Latvia

The *Saeima* approved the Article 136 decision on 19 April 2012 and ratification was completed on 9 May 2012. The fiscal compact Treaty was approved on 31 May 2012 and completed ratification on 13 June 2012.

Lithuania

The Article 136 decision was approved by the *Seimas* on 12 June 2012 and ratification was completed on 6 July 2012. The *Seimas* adopted the fiscal compact Bill on 28 June 2012 by 80 votes in favour, 11 against and 21 abstentions. The Government might ask the Constitutional Court for an opinion on the treaty and the debt brake requirement.

Luxembourg

The Article 136 decision and the ESM treaty were approved by the Chamber at the first vote on 26 June 2012. They completed ratification on 5 July. Parliamentary proceedings on the fiscal compact have not yet started.

Malta

The Article 136 decision was submitted to Parliament on 2 July 2012 and the ESM treaty on 18 June 2012. The latter was approved on 6 July and ratification was completed on 17 July.

Netherlands

In April 2012 the Dutch Prime Minister, Mark Rutte, resigned after seven weeks of talks on budget cuts broke down. The far-right Party for Freedom (PVV), led by Geert Wilders, withdrew its support for the cuts and for the minority government. Early elections may be held in September. The Second Chamber, the *Tweedekamer*, debated and approved the Article 136 decision and the ESM on 24 May 2012. The *Eerste Kamer* approved them on 3 July 2012. The ESM completed ratification on 12 July. The fiscal compact Bill has yet to be submitted.

Poland

The Article 136 decision was approved by the *Sejm* on 11 May 2012 and by the Senate on 30 May. It received Presidential Assent on 28 May. The fiscal compact treaty might be approved by an act of government.

[42] EUlawradar, 26 August

[43] *Irish Times*, 15 August 2012

Portugal

The Article 136 decision completed ratification on 2 February 2012, the ESM on 19 June and the fiscal compact Treaty on 3 July.

Romania

The Romanian Senate and Chamber approved the Article 136 decision on 12 June 2012. It received Presidential Assent on 19 June and completed ratification on 22 June. The fiscal compact Treaty was adopted by the Chamber on 8 May 2012 and by the Senate on 21 May and completed ratification on 20 June.

Slovakia

The Article 136 decision was approved by the *Narodna Rada* on 15 May 2012 and ratification was completed on 13 June. The ESM Treaty was approved on 22 June 2012 and ratification completed upon signature by the Head of State on 28 June 2012. Ratification of the fiscal compact Treaty is likely to be completed later in the year, according to the Finance Minister, Peter Kažimír.[44]

Slovenia

The Article 136 decision completed ratification on 22 August 2011. Ratification of the ESM and the fiscal compact treaty was completed on 14 May 2012.

Spain

The Congress of Deputies approved the Article 136 decision and the ESM bill on 17 May 2012 and the Senate approved them on 6 June. Ratification was completed on 2 July 2012. The fiscal compact Treaty was approved by the Congress on 21 June 2012 and was debated in the Senate on 18 July 2012.

Sweden

The *Riksdag* approved the Article 136 decision on 30 May 2012 and it completed ratification on 19 June. The fiscal compact Bill will not be submitted to Parliament before autumn 2012 and the Government has not yet decided what kind of majority will be needed to approve it. The governing centre-right Alliance for Sweden supports the compact, but the opposition Left Party, Greens and Sweden Democrats are opposed. Support from the Social Democratic Party (SAP) was needed for a parliamentary majority. The SAP only supported the treaty after guarantees that the Swedish labour market would be maintained and that no decision-making powers would be transferred from the *Riksdag* to the EU institutions.

8 Further reading

House of Lords European Union Committee - Tenth Report, “Amending Article 136 of the Treaty on the Functioning of the European Union”, 8 March 2011

House of Lords Library Note, European Union (Approval of Treaty Amendment Decision) Bill (HL Bill 3 of 2012–13), 16 May 2012

European Council Factsheet, *Treaty establishing the European Stability Mechanism*, 2 February 2012

[44] *The Slovak Spectator*, 18 April 2012

FCO &Treasury Factsheet on the European Stability Mechanism

FCO Factsheet on what the bill does

ECB, "The European Stability Mechanism", July 2011

European Commission, Economic and Financial Affairs website

Open Europe briefing note, "European Council December 2010 – the questions that need answers", 14 December 2010

Statement by President Van Rompuy

Eurozone governance

Economic governance in graphs (Commission webpages)

Treaty on stability, coordination and governance

Lisbon
http://www.google.co.uk/url?q=http://www.lisboncouncil.net/component/downloads/%3Fid%3D626&sa=U&ei=_xG1T9LgBISq8QOtrYjQDw&ved=0CCkQFjAJOAo&usg=AFQjCNEk5Mqx7FNbnGynGuczdcoTNTPMwQCouncil Policy Brief, "Making the European Stability Mechanism Work", Alessandro Leipold

Centre for Studies on Federalism "The ESM Treaty: some critical remarks", Antonio Padoa-Schioppa

European Journal 26 April 2012, "The ESM is illegal, untransparent and unaccountable", Margarida Vasconcelos