Amending the EU Treaty: the European Stability Mechanism

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Section IADS

On 17 December 2010 the European Council agreed to establish a permanent financial crisis mechanism called the "European Stability Mechanism" (ESM) by means of an amendment to the *Treaty on the Functioning of the European Union*. This Note looks at the likely ratification path in the UK of the proposed amendment to Article 136 TFEU, as set out in the draft European Council decision of 17 December 2010.

Contents

1 European Council Agreement

On 16-17 December 2010 the European Council, comprising the 27 Heads of State and Government, agreed to amend Article 36 of the *Treaty on the Functioning of the European Union* (TFEU) to establish a permanent European Stability Mechanism (ESM) to provide financial assistance to eurozone States if indispensible in order to safeguard the stability of the euro area as a whole. This permanent mechanism will replace the European Financial Stability Facility (EFSF, the EU-IMF mechanism), when the EFSF expires in mid-2013. The smaller European Financial Stability Mechanism (EFSM) will be absorbed into the ESM.

Article 136 TFEU is in Chapter 4, “Provisions specific to Member States whose currency is the euro”, from which the UK has a derogation. The Article 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:
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> (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.
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> 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.
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> A qualified majority of the said members shall be defined in accordance with Article 238(3)(a).

The draft decision agreed by the European Council would add paragraph 3, as follows:

> "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".[1]

The European Policy Centre (EPC) commented:

> Compared to earlier versions, the first of the two additional sentences added to this paragraph now clearly states that the permanent stability mechanism would only "be activated if indispensable" – a concession to the German government, which is keen to send a clear message to the Karlsruhe court [see below] that the mechanism will only be employed as an *ultima ratio* in the event that the euro's stability is endangered.[2]

The European Council also agreed that Article 122(2) *Treaty on the Functioning of the European Union* (TFEU), which was used as the basis for the emergency European Financial and Stability Mechanism (EFSM), would not be the appropriate Treaty Article for the permanent European Stability Mechanism (ESM) and that the **Simplified Revision Procedure** under Article 48(6) should be used to amend Article 136 TFEU.

Open Europe reported on the negotiations on the new mechanism in a briefing on 14 December 2010, maintaining that "Non-eurozone countries will be "associated" with the plans, with voluntary contributions from Britain, Denmark and Sweden remaining a possibility". However, there is no evidence in the proposed text that this will be the case.

2 The Article 48(6) TFEU procedure

Article 48(6) provides a simplified way of changing Treaty provisions in the main areas of Union policy set out in Part Three of the TFEU. Either Member State governments or the EP or the Commission may submit to the European Council proposals for changes to these policies. For the proposals to be adopted the European Council must first consult the EP and the Commission and the European Central Bank if the proposals are for institutional changes in the monetary area, and then it must act by unanimity.

The text of the amendment agreed by EU leaders will now go to the European Parliament, the Commission and the European Central Bank. The three institutions must give their opinion on the proposal, although their views do not bind the European Council. It is expected that the Treaty change will be approved at the European Council in March 2011.

This procedure is simple and less time-consuming than the Ordinary Revision Procedure. There is no need for an Intergovernmental Conference or a Convention. The decision thus adopted must be "approved by the Member States in accordance with their respective constitutional requirements." This is not the same thing as treaty ratification, but it creates a possibility for national input and a national veto.
The aim is to complete ratification by 1 January 2013 with the mechanism coming into force in June that year. The Cypriot EU Presidency in the second half of 2012 will oversee the completion of the ratification process.

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1 European Council Conclusions, 17 December 2010

2 "Adding pieces to the European economic governance puzzle", Janis A. Emmanouilidis, Senior Policy Analyst, European Policy Centre, 20 December 2010

3 The UK ratification procedure

Even though the UK is not in the euro area, Treaty changes must be approved by all Member States and the UK must therefore ratify this decision in accordance with constitutional requirements. The current requirements for parliamentary approval under the *European Union (Amendment) Act 2008* are that each House agrees a motion approving the Government's intention to vote for or support the adoption of a specified draft decision under Article 48(6) TFEU.

These constitutional requirements will change as and when the present European Union Bill is passed. Under the EU Bill the ESM decision would require a **statement** to be laid before Parliament as to whether the decision falls within section 4 of the Bill and why (see more on this below), and an **Act of Parliament**.

Clause 4 of the Bill sets out a number of scenarios which could trigger a referendum,[3] but the referendum exemption would apply (i.e. that "the Act providing for the approval of the decision states that the decision does not fall within section 4"). The permanent mechanism is aimed at euro area States only, and does not involve a new power or competence or 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.

In this particular case, Clause 4(4)(b) would apply. This states:

> A Treaty or Article 46(6) decision does not fall within this section merely because it involves one or more of the following:
>
> (b) the making of any provision that applies only to member States other than the United Kingdom;

The Prime Minister, David Cameron, told the House of Commons on 20 December:

> 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 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.
>
> Secondly, on the issue of liability for any potential bail-out of the eurozone in future, Britain is not in the euro and we are not going to join the euro, and that is why we should not have any liability for bailing out the eurozone when the new permanent arrangements come into effect in 2013. In the current emergency arrangements established under article 122 of the treaty, we do have such a liability. That was a decision taken by the previous Government, and it is a decision that we disagreed with at the time. We are stuck with it for the duration of the emergency mechanism, but I have been determined to ensure that when the permanent mechanism starts, Britain's liability should end, and that is exactly what we agreed at the European Council.

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[3] See Research Paper 10/79, *European Union Bill* [HC Bill 106 of 2010-11], 2 December 2010 for more detailed information on these scenarios.

The Council conclusions state that this will be a "stability mechanism" for

> "member States whose currency is the euro".

This means it is a mechanism established by eurozone countries for eurozone countries.

Britain will not be part of it. Crucially, we have also ensured that the current emergency arrangements are closed off when the new mechanism comes into effect in 2013. Both the Council conclusions and the introduction to the decision to change the treaty itself-the actual document that will be presented to this Parliament for its assent-are clear that article 122

> "will no longer be needed for such purposes"

and that

> "Heads of State or Government therefore agreed that it should not be used for such purposes."

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.[4]

4 Ratification in other Member States

It is not clear yet which Member States, if any, will need to ratify the decision by means of a referendum. The European Council President, Herman Van Rompuy, was reported to have said that to his knowledge, no referendum was needed. A report in *EurActiv* on 16 December thought Member states would be able to avoid ratification by public referenda because the Treaty change is considered "limited".

4.1 Germany

An agreement between France and Germany in Deauville in October 2010 was a major impetus towards the Treaty. Germany's Constitutional Court has yet to rule on the legality of the 'bailout' of Greece earlier this year, and *Der Spiegel* online reported on 17 December 2010 that "Merkel had insisted on the treaty amendment in part to avoid a scenario in which future bailouts could be challenged in German courts". The report continued:

> Merkel did her best to generate enthusiasm for the crisis mechanism. She called it a "major element of solidarity among member states." In reality, however, it is a minimalist solution that will hardly be enough to provide lasting stability for the euro. The drastic austerity measures that many indebted countries in the euro zone have implemented may expose the common currency zone to further risks.

4 HC Deb 20 December 2010 cc 1187-8

Another *Spiegel* commentary maintained "Political resistance to the plan, in Germany, is mainly restricted to members of the market-friendly Free Democrats (FDP), who govern in coalition with Merkel's conservatives in Berlin".[5]

Katinka Barysch, the Deputy Director of the Centre for European Reform, gave evidence on 7 December 2010 to the House of Lords Select Committee on the European Union, Economic and Financial Affairs, and International Trade (Sub-Committee A) Inquiry on the Future of Economic Governance. She talked about the German position:

> I read in the *Irish Times* the other day a scenario in which the constitutional court declares that Germany is no longer allowed to continue with any bailouts and the eurozone breaks apart immediately. I do not think that is plausible, because the court is aware of the impact that it has on politics and now also on European economics.
>
> Having said that, because the court has made its position quite clear that a permanent crisis management mechanism that involves transferring money from one sovereign country to another cannot be set up unless there is a solid treaty base for it, this is what the Germans think they need to do. That's a political imperative as much as a legal one, because no German politician can be seen to be acting in contravention of the court.

4.2 Ireland

It has been reported that Ireland, which has held a referendum on almost every Treaty change since 1987, will not hold one on this amendment. The Taoiseach, Brian Cowen, does not believe the proposed change would be a change of competence or a transfer of competence, so it would be compatible with the Irish Constitution.[6] The *Irish Times* reported that "Mr Cowen expressed confidence to reporters that any decision not to call a referendum would withstand legal challenge", continuing:

> "Obviously we'll examine the final wording when the decision is taken. Based on the drafts that we've been seeing thus far I think it's unlikely that we would have to have a referendum because it's a limited treaty change under an existing revision procedure in the treaty," he said.
>
> Asked if he was confident such a stance would survive a challenge in the Supreme Court, he said: "Yes. Obviously we will take the advice of the Attorney General and the Government will take its decisions based on what the constitutional requirements dictate." There was no question of personal preference in this matter, the Taoiseach said.
>
> "The question is what is our constitutional requirement ... and whatever those are they will be abided by and pursued. It would appear to us as things stand that it's highly unlikely a referendum would be required for the very limited treaty change that's envisaged in the decision that's expected today."[7]

However, the EPC thought a referendum might still be on the cards:

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5 *Der Spiegel online international* 17 December 2010

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

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

According to the Irish Supreme Court, the legal trigger for a referendum relates to whether a treaty reform alters the "essential scope and objectives" of the Union. Now, from a legal perspective one could argue that the proposed amendment will not transfer additional competences from the national to the Union level, especially as the permanent stability mechanism will be based on an intergovernmental construction, but past decisions in Ireland to hold a referendum have not been taken solely on legal grounds.

There are two potential lines of political reasoning which could be used to argue for a referendum. First, Irish governments have in the past 'voluntarily' opted to hold a popular vote to avoid the risk of being 'asked' to do so by the courts; and second, some might argue that national sovereignty is (strongly) affected, especially if a country has to seek shelter under the European rescue umbrella. National decision-makers then have not only to accept the strict conditionality attached to the mechanism, but their room of manoeuvre is also limited by the fact that national reform and austerity programmes are subject to tight surveillance by the Commission, the International Monetary Fund (IMF) and the ECB. Popular support for such arguments is likely to increase if the economic, political and social situation in Ireland deteriorates.[8]

4.3 Czech Republic

The Czech Foreign Affairs Minister, Karel Schwarzenberg, was reported to have said in early November that he was against reopening the Treaty to include a new financial aid mechanism.[9]

Prague Post reported that Czech ratification of the Treaty changes will require the signature of President Václav Klaus, "who has been a vocal opponent of the Lisbon Treaty and government bailouts in general".[10]

Appendix Draft decision on the ESM

European Council Conclusions, 17 December 2010

DRAFT EUROPEAN COUNCIL DECISION

of …

amending Article 136 of the Treaty on the Functioning of the European Union with regard to a stability mechanism for Member States whose currency is the euro

THE EUROPEAN COUNCIL,

Having regard to the Treaty on European Union, and in particular Article 48(6) thereof,

Having regard to the proposal for revising Article 136 of the Treaty on the Functioning of the European Union submitted to the European Council by the Belgian Government on 16 December 2010,

[8] EPC "Adding pieces to the European economic governance puzzle", 20 December 2010
[9] *Prague Post* "EU will reopen Lisbon Treaty Eurozone crisis prompts Franco-German push for bailout mechanism", 3 November 2010
[10] *Prague Post* "EU leaders strike permanent bailout deal: The Czech Republic must approve Lisbon amendments as part of eurozone crisis mechanism", 22 December 2010

[Having regard to the opinion of the European Parliament,[1]]

[Having regard to the opinion of the European Commission,[2]]

[After obtaining the opinion of the European Central Bank,[3]]

Whereas:

(1) Article 48(6) of the Treaty on European Union (TEU) allows the European Council, acting by unanimity after consulting the European Parliament, the Commission and, in certain cases, the European Central Bank, to adopt a decision amending all or part of the provisions of Part Three of the Treaty on the Functioning of the European Union (TFEU). Such a decision may not increase the competences conferred on the Union in the Treaties and its entry into force is conditional upon its subsequent approval by the Member States in accordance with their respective constitutional requirements.

(2) At the meeting of the European Council of 28 and 29 October 2010, the Heads of State or Government agreed on the need for Member States to establish a permanent crisis mechanism to safeguard the financial stability of the euro area as a whole and invited the President of the European Council to undertake consultations with the members of the European Council on a limited treaty change required to that effect.

(3) On 16 December 2010, the Belgian Government submitted, in accordance with Article 48(6), first subparagraph, of the TEU, a proposal for revising Article 136 of the TFEU by adding a paragraph under which 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 and stating that the granting of any required financial assistance under the mechanism will be made subject to strict conditionality. At the same time, the European Council adopted conclusions about the future stability mechanism (paragraphs 1 to 4).

(4) The stability mechanism will provide the necessary tool for dealing with such cases of risk to the financial stability of the euro area as a whole as have been experienced in 2010, and hence help preserve the economic and financial stability of the Union itself. At its meeting of 16 and 17 December 2010, the European Council agreed that, as this mechanism is designed to safeguard the financial stability of the euro area as whole, Article 122(2) of the TFEU will no longer be needed for such purposes. The Heads of State or Government therefore agreed that it should not be used for such purposes.

(5) On 16 December 2010, the European Council decided to consult, in accordance with Article 48(6), second subparagraph, of the TEU, the European Parliament and the Commission, on the proposal. It also decided to consult the European Central Bank. [On […dates…], the European Parliament, the Commission and the European Central Bank, respectively, adopted opinions on the proposal.]

(6) The amendment concerns a provision contained in Part Three of the TFEU and it does not increase the competences conferred on the Union in the Treaties,

HAS ADOPTED THIS DECISION:

Article 1

The following paragraph shall be added to Article 136 of the Treaty on the Functioning of the European Union:

"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."

Article 2

Member States shall notify the Secretary-General of the Council without delay of the completion of the procedures for the approval of this Decision in accordance with their respective constitutional requirements.

This Decision shall enter into force on 1 January 2013, provided that all the notifications referred to in the first paragraph have been received, or, failing that, on the first day of the month following receipt of the last of the notifications referred to in the first paragraph.

Article 3

This Decision shall be published in the Official Journal of the European Union.

Done at,

For the European Council

The President

ANNEX II

GENERAL FEATURES OF THE FUTURE MECHANISM

EUROGROUP STATEMENT OF 28 NOVEMBER 2010

"The recent events have demonstrated that financial distress in one Member State can rapidly threaten macro-financial stability of the EU as a whole through various contagion channels. This is particularly true for the euro area where the economies, and the financial sectors in particular, are closely intertwined.

Throughout the current crisis, euro area Member States have demonstrated their determination to take decisive and coordinated action to safeguard financial stability in the euro area as a whole, if needed and return growth to a sustainable path.

In particular, the European Financial Stability Facility (EFSF) has been set up to provide for swift and effective liquidity assistance, together with the European Financial Stabilisation Mechanism (EFSM) and the International Monetary Fund, and on the basis of stringent programmes of economic and fiscal policy adjustments to be implemented by the affected Member State and ensuring debt sustainability.

On 28 - 29 October the European Council agreed on the need to set up a permanent crisis mechanism to safeguard the financial stability of the euro area as a whole. Eurogroup Ministers agreed that this European Stability Mechanism (ESM) will be based on the European Financial Stability Facility capable of providing financial assistance packages to euro area Member States under strict conditionality functioning according to the rules of the current EFSF.

The ESM will complement the new framework of reinforced economic governance, aiming at an effective and rigorous economic surveillance, which will focus on prevention and will substantially reduce the probability of a crisis arising in the future.

Rules will be adapted to provide for a case by case participation of private sector creditors, fully consistent with IMF policies. In all cases, in order to protect taxpayers' money, and to send a clear signal to private creditors that their claims are subordinated to those of the official sector, an ESM loan will enjoy preferred creditor status, junior only to the IMF loan.

Assistance provided to a euro area Member State will be based on a stringent programme of economic and fiscal adjustment and on a rigorous debt sustainability analysis conducted by the European Commission and the IMF, in liaison with the ECB.

On this basis, the Eurogroup Ministers will take a unanimous decision on providing assistance.

For countries considered solvent, on the basis of the debt sustainability analysis conducted by the Commission and the IMF, in liaison with the ECB, the private sector creditors would be encouraged to maintain their exposure according to international rules and fully in line with the IMF practices. In the unexpected event that a country would appear to be insolvent , the Member State has to negotiate a comprehensive restructuring plan with its private sector creditors, in line with IMF practices with a view to restoring debt sustainability. If debt sustainability can be reached through these measures, the ESM may provide liquidity assistance.

In order to facilitate this process, standardized and identical collective action clauses (CACs) will be included, in such a way as to preserve market liquidity, in the terms and conditions of all new euro area government bonds starting in June 2013. Those CACs would be consistent with those common under UK and US law after the G10 report on CACs, including aggregation clauses allowing all debt securities issued by a Member State to be considered together in negotiations. This would enable the creditors to pass a qualified majority decision agreeing a legally binding change to the terms of payment (standstill, extension of the maturity, interest-rate cut and/or haircut) in the event that the debtor is unable to pay.

Member States will strive to lengthen the maturities of their new bond emissions in the medium-term to avoid refinancing peaks.

The overall effectiveness of this framework will be evaluated in 2016 by the Commission, in liaison with the ECB.

We restate that any private sector involvement based on these terms and conditions would not be effective before mid-2013.

President of the European Council Herman Van Rompuy has indicated that his proposal on limited treaty change to the European Council at its next meeting will reflect today's decision."

ANNEX III

STATEMENT BY THE HEADS OF STATE OR GOVERNMENT OF THE EURO AREA AND THE EU INSTITUTIONS

The Heads of State or Government of the euro area and the EU institutions have made it clear, as set out below, that they stand ready to do whatever is required to ensure the stability of the euro area as a whole. The euro is and will remain a central part of European integration. In particular, the Heads called for determined action in the following areas:

a. Fully implementing existing programmes: we welcome the impressive progress made in implementing the Greek programme and the agreed adjustment programme for Ireland, including the adoption of the 2011 budget.

a. Keeping up fiscal responsibility: we are all committed to strictly implementing the budgetary policy recommendations, fully respecting the fiscal targets for 2010 and 2011 and to correcting excessive deficits within the agreed deadlines.

a. Stepping up growth enhancing structural reforms: we are determined to accelerate structural reforms to enhance growth.

a. Strengthening the Stability and Growth Pact and implementing a new macro-surveillance framework from summer 2011.

a. Ensuring the availability of adequate financial support through the EFSF pending the entry into force of the permanent mechanism: we note that only a very limited amount has been committed from the EFSF to support the Irish programme.
b. Further strengthening of the financial system both as regards the regulatory and supervisory frameworks and conducting new stress tests in the banking sector.

a. Expressing full support to ECB action: we support the ECB in its independent responsibility to ensure price stability, solidly anchor inflation expectations and thereby contribute to financial stability of the euro area. We are committed to ensuring the financial independence of the central banks of the Eurosystem.

Elements of this strategy will be further developed in the coming months as a comprehensive response to any challenges, as part of our new economic governance.

[1] : Opinion of … (not yet published in the Official Journal).

[2] : Opinion of … (not yet published in the Official Journal).

[3] : Opinion of … (not yet published in the Official Journal).