Analysis

Draft Agreement on Reinforced Economic Union (REU Treaty)

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The issue of the legality of any use of the EU institutions… has been avoided by the Treaty drafters.

Legally it does not add very much to the obligations which are already present in EU law…Put another way, the EU has already done enough (and arguably more than enough)… to address the fiscal discipline of its eurozone States

there is clear evidence that austerity policies (both inside and outside the eurozone) usually fail in their own terms (leaving aside their social cost), by reducing economic growth and therefore increasing government debt and deficit further.

the EU's economic governance rules fail the test of transparency, because of their near-total complexity and unreadability, scattered across a dozen primary, secondary and soft-law sources, with more to come… the basic rules on the EU's coordination and control of fundamental national economic decisions are essentially unintelligible.

Introduction

This analysis sets out the text of the draft international agreement on a reinforced economic union (REU Treaty), as circulated to Member States on December 17, 2011, annotated with legal comments. This is the first draft of the international treaty which the eurozone Member States agreed in principle to draw up on 9 December 2011, when the United Kingdom did not agree to a fully-fledged amendment of the EU's Treaties to incorporate new provisions on economic governance of the eurozone Member States, in order to reinforce the EU's economic and monetary union (EMU). The substance of the treaty is largely based on the conclusions of the eurozone Member States' heads of state of government of 9 December 2011 (the 'December 2011 conclusions'; see more detailed discussion below). The December 2011 conclusions referred to a 'fiscal stability union' and a 'new fiscal compact', but these terms do not appear in the draft REU treaty.

This draft treaty has apparently been drawn up by the legal service of the EU Council (of Member States' ministers) and/or the staff of the President of the European Council (the summit meetings of Member States' heads of state or government). The intention is that the treaty should be signed by March 2012 at the latest, according to the conclusions of the eurozone Member States' heads of state of government of 9 December 2011. It is possible, however, that the treaty could be signed earlier, and indeed an informal summit of all Member States' heads of state of government will be held in late January or early February 2012. This will likely be an opportunity to discuss the draft agreement, and possibly even to agree on the text in principle or to sign it.

According to press reports, the draft text will be discussed by a 'forum' of delegates of all Member States (including the UK), which will comprise three delegates from each Member State as well as the European Parliament (EP) and the Commission. There could be some amendments to the text before

it is signed. As discussed further below, Art. 14 of the draft treaty states that it will come into force when ratified by nine eurozone Member States.

The substance of the draft Treaty is very closely related to the existing and proposed EU legislation on economic governance, which comprises:

a) Article 122 of the Treaty on the Functioning of the European Union (TFEU), which sets out the basic rules on surveillance of Member States' economic policies;
b) Article 126 TFEU, and Protocol 12 attached to the TFEU and the Treaty on European Union (TEU), which set out the basic rules on the 'excessive deficit procedure';
c) the EU legislation further implementing Article 121 TFEU to establish a multilateral surveillance procedure, as originally adopted in 1997, and amended in 2005 and 2011; another EU Regulation, adopted in 2011, sets out a new procedure regarding 'macroeconomic imbalances';
d) the EU legislation further implementing Article 126 TFEU (known as the 'Stability and Growth Pact'), as originally adopted in 1997, and amended in 2005 and 2011;
e) the special rules as regards the multilateral surveillance procedure, the macroeconomic imbalances procedure, and the excessive deficit procedure, applicable to the eurozone Member States only, as adopted in 2011; and
f) two further proposals, submitted by the Commission in November 2011, which would set out further rules on economic governance specific to the eurozone Member States only; the December conclusions of the eurozone Member States set out an aim to adopt this legislation by March 2012.

It should also be noted that the eurozone Member States have already ratified a treaty creating a European Financial Stability Facility (EFSF), which entered into force in 2010, and was amended in 2011, to provide temporary financial assistance to eurozone Member States.

The eurozone Member States have also agreed on a treaty to create a European Stabilization Mechanism (ESM), in order to provide for permanent financial assistance to eurozone Member States. The ESM treaty was opened for signature in July 2011 but has not yet been ratified by any Member State; the December 2011 conclusions of the eurozone Member States include some agreed amendments to the text of this treaty, and an amended text of that treaty will likely be signed in the near future. The intention is for that treaty to enter into force in mid-2012; it will needs ratifications from Member States holding 90% of ESM capital to do so. This will mean the ratifications of Germany, France, Spain and Italy (which hold 75% of the capital between them), as well as a number (but not necessarily all) of the smaller eurozone Member States.

DRAFT
INTERNATIONAL AGREEMENT ON A REINFORCED ECONOMIC UNION

THE CONTRACTING PARTIES……….

CONSCIOUS of the obligation of the Contracting Parties, as Member States of the European Union, to regard their economic policies as a matter of common concern,

DESIRING to promote conditions for stronger economic growth in the European Union and, to that end, to develop ever-closer coordination of economic policies within the euro area,

BEARING IN MIND that the coordination of the economic policies of the Contracting Parties, as Member States of the European Union, is based on the objective of sound and sustainable government finances as a means of strengthening the conditions for price stability and for strong sustainable growth underpinned by financial stability, thereby supporting the achievement of the Union's objectives for sustainable growth and employment,

BEARING IN MIND that the need for governments to prevent a government deficit becoming excessive is of an essential importance to safeguard the stability of the euro area as a whole, and accordingly requires the introduction of specific rules to address this need, including the need to take necessary corrective action,

CONSCIOUS of the need to ensure that their deficits remain below 3 % of their gross domestic product at market prices and that government debt is below, or sufficiently declining towards, 60 % of their gross domestic product at market prices,

RECALLING that the Contracting Parties, as Member States of the European Union, should refrain from adopting any measure which could jeopardise the attainment of the Union's objectives in the framework of the economic union, notably the practice of accumulating debt outside the general government accounts,

BEARING IN MIND that the Heads of State or Government of the euro area Member States agreed on 9 December 2011 on a reinforced architecture for Economic and Monetary Union, building upon the European Treaties and facilitating the

implementation of measures taken on the basis of Articles 121, 126 and 136 of the Treaty on the Functioning of the European Union,

BEARING IN MIND that the objective of the Heads of State or Government of the euro area Member States and of other Member States of the European Union remains to incorporate the provisions of this Agreement as soon as possible into the Treaties on which the European Union is founded,

TAKING NOTE, in this context, of the intention of the European Commission to present further legislative proposals within the framework of the Union Treaties regarding a mechanism of ex ante reporting of debt issuance plans of the Member States of the European Union, a procedure of economic partnership programmes detailing structural reforms for euro area Member States in excessive deficit procedure as well as a new coordination procedure at the level of the euro area for major economic policy reform plans,

TAKING NOTE that, when reviewing and monitoring the budgetary commitments under this Agreement, the European Commission will act within the framework of its powers as provided by the Treaty on the functioning of the European Union, in particular Articles 121, 126 and 136 thereof,

NOTING in particular that, for the application of the budgetary "Balanced Budget Rule" described in Article 3 of this Agreement, this monitoring will be made through the setting up of country specific reference values and of calendars of convergence, as appropriate, for each Contracting Party,

NOTING that compliance with the obligation to transpose the "Balanced Budget Rule" into national legal systems at constitutional or equivalent level should be subject to the jurisdiction of the Court of Justice of the European Union, in accordance with Article 273 of the Treaty on the Functioning of the European Union,

RECALLING the need to facilitate the adoption of measures under the excessive deficit procedure of the European Union for euro area Contracting Parties whose planned or actual government deficit to gross domestic product exceeds 3%, whilst strongly reinforcing the objective of that procedure, namely to encourage and, if necessary, compel the Member State concerned to reduce a deficit which might be identified,

RECALLING the need for those Contracting Parties whose government debt exceeds the 60 % reference value to reduce it at an average rate of one twentieth per year as a benchmark,

RECALLING the agreement of the Heads of State or Government of the euro area Member States on 26 October 2011 to improve the governance of the euro area, including the holding of at least two Euro Summit meetings per year, as well as the endorsement of the Euro Plus Pact by the Heads of State or Government of the euro area Member States and of other Member States of the European Union on 25 March 2011,

STRESSING the importance of the Treaty establishing the European Stability Mechanism as an element of a global strategy to strengthen the Economic and Monetary Union,

HAVE AGREED UPON the following provisions,

Comment: the preamble is unusually long for international treaties, but not that long compared to much EU legislation. It largely sets out the economic, legal and political context, without adding any detailed interpretation of the treaty text.

TITLE I

PURPOSE AND SCOPE

Article 1

1. By this Agreement, the Contracting Parties, which are Member States of the European Union, agree to strengthen their budgetary discipline and to reinforce their economic policy coordination and governance.

2. The provisions of this Agreement shall apply to the Contracting Parties whose currency is the euro. They may also apply to the other Contracting Parties, under the conditions set out in Article 14.

Comment: Article 1(1) sets out the purpose of the treaty; it is basically straightforward. As for the (territorial) scope of the treaty (Article 1(2)), see further the comments on Article 14 below.

TITLE II

CONSISTENCY AND RELATIONSHIP WITH THE LAW OF THE UNION

Article 2

1. This Agreement shall be applied by the

Contracting Parties in conformity with the Treaties on which the European Union is founded, in particular Article 4(3) of the Treaty on European Union, and with European Union law.

2. The provisions of this Agreement shall apply insofar as they are compatible with the Treaties on which the Union is founded and with European Union law. They shall not encroach upon the competences of the Union to act in the area of the economic union. In accordance with the case law of the Court of Justice of the European Union, European Union law has precedence over the provisions of this Agreement.

Comment: these provisions ensure that in the event of any conflict between this treaty and EU law, EU law prevails (first and third sentences, Article 2(2)). The EU is not stripped of any of its existing competence to coordinate Member States' economic policies, as set out in Articles 2 and 5 TFEU (Article 2(2), second sentence). More generally, Member States must apply the treaty consistently with EU law, including the principle of 'loyalty' or 'sincere cooperation' set out in Article 4(3) TEU (Article 2(1)). Also, a number of the specific provisions of the draft treaty give precedence to EU law.

TITLE III

BUDGETARY DISCIPLINE

Article 3

1. The Contracting Parties shall apply the following rules, in addition to and without prejudice to the obligations derived from Union Law:

a) Revenues and expenditures of the general government budgets shall be balanced or in surplus. The Contracting Parties may temporarily incur deficits only to take into account the budgetary impact of the economic cycle and, beyond such impact, in case of exceptional economic circumstances, or in periods of a severe economic downturn, provided that this does not endanger budgetary sustainability in medium term.

b) The rule under point a) above shall be deemed to be respected if the annual structural deficit of the general government does not exceed a country-specific reference value, which ensures an adequate safety margin with respect to the 3 % reference value mentioned under Article 1 of the Protocol (No 12) on the excessive deficit procedure annexed to the Treaty on European Union and to the TFEU (hereinafter 'Protocol No 12') as well as rapid progress towards sustainability, also taking into account the budgetary impact of ageing. The Contracting Parties shall ensure convergence towards their respective country-specific reference value. As a rule, the country specific reference value shall not exceed 0.5 % of nominal GDP.

c) Where the debt level is significantly below the 60 % reference value mentioned under Article 1 of Protocol No 12, the country-specific reference value for the annual structural net deficit may take a higher value than specified under point b).

2. The rules mentioned under paragraph 1 shall be introduced in national binding provisions of a constitutional or equivalent nature. The Contracting Parties shall in particular put in place a correction mechanism to be triggered automatically in the event of significant deviations from the reference value or the adjustment path towards it. This mechanism shall be defined at national level, on the basis of commonly agreed principles. It shall include the obligation of the Contracting Parties to present a programme to correct the deviations over a defined period of time. It shall fully respect responsibilities of national Parliaments.

3. For the purposes of this Article, definitions set out in Article 2 of Protocol No 12 shall apply. In addition, the following definitions shall apply:

- "annual structural deficit of the general government" means the annual cyclically-adjusted deficit net of one-off and temporary measures;

- "exceptional economic circumstances" means an unusual event outside the control of the Contracting Party concerned, which has a major impact on the financial position of the government.

Comment: the 'Balanced Budget Rule' (as the preamble to the REU Treaty calls it) is the heart of this Treaty, comprising the single most important binding provision of it. The rule therefore needs to be examined in detail.

First of all, the 'chapeau' (opening words) of Article 3(1) require the Member States to comply with Art. 3(1) absolutely (not simply to 'undertake' to comply with it, as in Art. 4 and a number of other provisions); they also make clear that the rules in this treaty do not subtract from the obligations imposed by EU law, but rather add to them.

Next, as regards Art. 3(1)(a), the first sentence is

based upon the first part of the first indent of paragraph 4 of the December 2011 conclusions. However, the second sentence of Art. 3(1)(a), providing for exceptions to the balanced budget rule, has been added. On the definition of the two key exceptions ('exceptional economic circumstances' and 'severe economic downturn'), see the comments on Art. 3(3) below; the treaty also does not define the 'budgetary impact of the economic cycle' or 'budgetary sustainability in the medium term'.

The basic concept set out in Art. 3(1)(a) already appears in the EU legislation concerning economic surveillance: Art. 2a of Reg. 1466/97, as amended by Reg. 1175/2011 (Art. 5(1), final paragraph, of that Reg. includes the same exceptions). However, the EU legislation requires Member States to set a 'medium-term budgetary objective' which they should make 'rapid progress' towards, rather than imposing an absolute rule. The EU legislation also states that such rapid progress should be made 'while allowing room for budgetary manoeuvre, considering in particular the need for public investment'.

As for Art. 3(1)(b) it is based upon the second part of the first indent, and the third indent, of paragraph 4 of the December 2011 conclusions. However, much of the detailed wording of the draft Treaty provision is derived from Art. 2a of Reg. 1466/97, as amended, which specifies that eurozone Member States should have a medium-term objective of no more than a 1% annual deficit. The draft treaty therefore is more stringent, by reducing that objective to 0.5% 'as a rule'. However, the obligation to 'ensure convergence' seems to suggest that the balanced budget rule does not always need to be met, even taking account of the exceptions to it, but rather (as in the EU legislation) worked towards. The reference to a convergence calendar proposed by the Commission, in the December 2011 conclusions, does not appear in the draft Treaty, perhaps because of a concern that it might breach EU law for the treaty to give specific new tasks to the EU institutions. It should also be noted that the EU legislation does not require convergence to be based on a calendar set by the Commission. A failure to ensure convergence under the EU legislation could, however, be punished by fines against eurozone Member States under certain conditions, whereas it is not clear who would assess compliance with Art. 3(1) of the treaty (but see the comments on Art. 8 below).

Art. 3(1)(c) preserves the possibility of a higher annual deficit than 0.5% for Member States that have less than 60% accumulated debt. However, this flexibility is limited by the EU legislation which still applies (see the chapeau of Art. 3(1)), so as to limit the annual deficit to no more than 1% (see the comments on Art. 3(1)(b)).

On an overall assessment, Art. 3(1) is not as dramatic at it might first appear, as compared to existing EU legal obligations. The apparently absolute obligation to balance the budget set out in Art. 3(1)(a) is subject to exceptions and is qualified to an obligation to 'converge' with the balanced budget rule in Art. 3(1)(b), and the rule itself is only slightly more stringent than the rule that the EU has already set. The EU has also established a procedure and penalties to ensure compliance with its rules, whereas the draft REU Treaty relies instead on the obligation to revise national law to this end pursuant to Art. 3(2).

As regards Art. 3(2), it should be noted that this provision, and by reference also Art. 3(1), can be enforced by the Court of Justice pursuant to Art. 8 (see further the discussion below). Art. 3(2) is based on the second indent of paragraph 4 of the December 2011 conclusions, with several amendments: it is specified that the national rules in question must be 'binding'; the correction mechanism only applies in the event of 'significant' deviations; there is now a reference to the 'adjustment path', indicating that the balanced budget rule is a target, not an absolute obligation (see the comments on Art. 3(1)); the reference to 'commonly agreed principles' for correction mechanisms has replaced a reference to 'principles proposed by the Commission' (presumably to avoid extending the role of the Commission in this agreement); and the final two sentences, concerning the presentation of the programme and the role of national parliaments, have been added.

Art. 3(2) is already partly addressed in EU legislation. There was an initial political commitment to a form of constitutional or equivalent fiscal rule in the 'Euro plus pact' (for the text, see Annex I to the March 2011 conclusions of the European Council), which is a political agreement among the eurozone Member States and six of the ten non-eurozone Member States (the non-participants are the UK, Sweden, Hungary and the Czech Republic) on the issues of competitiveness, public finance, employment and financial stability. However, the Euro plus pact refers on this point back to the obligations imposed by the EU's Stability Pact legislation as regards 'fiscal rules' generally, and provides for

more flexibility as to what the rule should address (it could for example, be a 'debt brake', or a rule concerning the primary budget balance or expenditure rules). The Commission was to be 'consulted, in full respect of the prerogatives of national parliaments', on the draft national rule before its adoption.

Next, one of the new measures on EU economic governance, Directive 2011/85, provides (in Arts. 5-7 of the Directive) that all Member States (except the UK: see Art. 8 of the Directive) must have 'fiscal rules' in place in national law which promote compliance with the EU's deficit and debt rules over a multiannual horizon. The national rules must specify their 'target definition and scope' and rules on compliance based on the analysis of independent bodies; they must also provide for 'consequences in the event of non-compliance'. Any 'escape clauses' must 'set out a limited number of specific circumstances consistent with' other EU rules. However, Member States do not have to comply with this Directive until the end of 2013.

Finally, one of the Commission proposals for new legislation concerning the eurozone Member States (COM (2011) 821) would require them to put in place binding national rules to implement their obligations under the EU's surveillance legislation (see comments on Art. 3(1)) as regards their medium-term budgetary balance, 'preferably' of a constitutional nature. Member States would have to comply with this rule six months after adoption of this legislation (see Art. 12(3) of the proposal); the December 2011 conclusions (see paragraph 6) refer to adoption of the proposal by the start of the next budget cycle, ie April 2012.

As for the two final sentences, the EU's surveillance legislation already provides for a detailed obligation to present a programme to correct deviations from the medium-term budgetary objective; but there is no definition of the role of national parliaments in EU legislation. Logically, national parliaments would be involved in enshrining the balanced budget rule in national law, but would not be able to rescind that rule without breaching this REU treaty or EU law; any amendments which national parliaments might wish to make to such rules would also be subject to this treaty and EU law. National parliaments' role would also be limited by the automatic 'correction mechanism' referred to in this treaty, which includes an obligation of the Member State to present a programme to correct budget deviations. Member States would be in breach of this treaty, and EU law, if their national parliaments prevent the adoption of measures which are necessary to comply with it. Art. 8 of the treaty makes clear that such breaches of this treaty will be subject to review in national courts. But national parliaments will retain flexibility to decide on exactly which (mix of) spending cuts or tax increases should be adopted to comply with this treaty or EU law.

On an overall assessment, Art. 3(2) does not differ much from existing and proposed EU legal obligations, except for the minimum obligation that the balanced budget rule must be at least 'equivalent' to a constitutional obligation. To the extent that the 'correction mechanism' in the event of deviations from the budget rule is defined to include the presentation of an adjustment programme, there is no real difference from the EU's surveillance legislation.

As regards Art. 3(3), Protocol 12 attached to the EU Treaties also includes definitions of 'government', 'deficit', 'investment' and 'debt'; there are more elaborate definitions of these concepts in Reg. 479/2009. The source of the definition of 'annual structural deficit' is not known, but the definition of an 'exceptional economic circumstance' is the same as the definition in the EU's 'Stability Pact' legislation (Art. 2(1), first sub-paragraph, of Reg. 1467/97, as amended by Reg. 1177/2011). While the same provision of the EU's Stability Pact legislation refers to, but does not define, a 'severe economic downturn', which is a crucial exception to the balanced budget rule in Art. 3(1)(a) of the draft treaty, the June 1997 resolution of the European Council on the Stability and Growth Pact suggests a normal rule of an annual reduction of more than 0.75% in real GDP as a definition. It is odd that the definitions set out in, or referred to in, Art. 3(3) only apply to Art. 3, and not also to Arts. 4 or 6, which also include the terms 'government' and 'debt'.

Article 4

When the ratio of their government debt to gross domestic product exceeds the 60 % reference value mentioned under Article 1 of Protocol No 12, the Contracting Parties undertake to reduce it at an average rate of one twentieth per year as a benchmark.

Comment: This provision reflects the last sentence of paragraph 5 of the December 2011 conclusions. In international treaties, an

agreement to 'undertake' an act (as in Art. 4) is not fully legally binding on the State parties, but rather constitutes a 'best endeavours' clause, ie a political commitment. A very similar provision is already set out in EU legislation, namely Article 2(1a) of Reg. 1467/97 as amended recently by Reg. 1177/2011 (the 'Stability Pact' Regulation). The legislative rule, which applies to all Member States, provides that when the total accumulated government debt (as distinct from the annual government deficit) exceeds 60% of the economy as defined in Protocol 12, it shall be considered to be 'sufficiently diminishing' (a test set out in Art. 126(2) TFEU) if it is reduced by 1/20th of the <u>differential</u> between the 60% debt ceiling and the actual level of debt, averaged over a 3-year period (as further defined). There is also a transitional period to apply the new rule, and a requirement to take account of the economic cycle. None of this detail appears in Art. 4 of the draft treaty, and so it is not clear if the substance of the rule in the draft treaty is different from the substance of the rule in the legislation. In particular, does a Member State have to reduce 1/20th of its <u>total</u> debt yearly under the draft REU Treaty? This would mean that a Member State which has a debt equal to 100% of its economy would have to reduce the debt by <u>5% a year</u>, whereas it would only have to reduce that debt by <u>2% a year</u> (1/20th of 40%, rather than 1/20th of 100%) under the EU legislation. More generally, the EU legislation does not simply require Member States to reduce the debt ratio, but rather takes the reduction of the debt ratio into account as a factor when assessing whether an excessive annual deficit exists. Art. 4 of the treaty therefore obviously needs to be clarified.

Article 5

The Contracting Parties that are subject to an excessive deficit procedure under the Union Treaties shall put in place a budgetary and economic partnership programme with binding value including a detailed description of the structural reforms necessary to ensure an effectively durable correction of their excessive deficits. Such programmes shall be submitted to the European Commission and the Council.

Comment: this provision reflects paragraph 4, indent 4 of the December 2011 conclusions. It does not include the references to 'endorsement' and 'monitoring' of the programmes by the Commission and the Council which appear in the December 2011 conclusions. In the absences of such references, it is not clear what the Commission and Council will do with these programmes after they have been submitted to them. Presumably such wording has been omitted because of a concern that the REU Treaty could be challenged legally if it conferred specific tasks on those EU institutions. The reference to the EU excessive deficit procedure in the first sentence clearly does not intend to alter the application of that procedure as such.

As indicated in the preamble to the REU Treaty, the Commission is intending to make proposals on this issue. In fact, one of the proposals regarding economic governance submitted by the Commission in November 2011 (COM (2011) 821) already provides for detailed rules governing the same issue as Art. 5 of the REU Treaty (see Art. 7 of that proposal), albeit using different language to describe the process.

Article 6

The Contracting Parties shall improve the reporting of their national debt issuance. For that purpose, they shall report ex-ante on their national debt issuance plans to the European Commission and the Council.

Comment: this provision reflects paragraph 4, indent 5 of the December 2011 conclusions, except that the conclusions do not refer to the EU institutions. The preamble to the draft treaty indicates that the Commission intends to propose EU legislation on this issue, although there is no reference to its plans in its 2012 work programme (COM (2011) 777) or its recent Green Paper on Stability Bonds (COM (2011) 818). In the absence of EU legislation on this issue, it is not clear what the Commission and the Council will do with this information. The draft treaty does not bind the EU institutions as such, but merely refers to them as recipients of this information.

Article 7

While fully respecting the procedural requirements of the Union Treaties, the Contracting Parties whose currency is the euro undertake to support proposals or recommendations put forward by the European Commission where a Member State whose currency is the euro is recognised by the European Commission to be in breach of the 3 % ceiling in the framework of an excessive deficit procedure, unless a qualified majority of them is of another view. A qualified majority shall be defined by analogy with Article 238(3)(a) TFEU and with Article 3 of Protocol N° 36 to the EU Treaties on transitional provisions and without taking into account the position of the

Contracting Party concerned.

Comment: this provision reflects the first three sentences of paragraph 5 of the December 2011 conclusions, with the addition of the references to the procedural requirements of EU law, a definition of qualified majority voting (QMV) by reference to the Treaties, less binding wording as regards the extent of the obligation to vote for the Commission's recommendation, and a focus on the obligations of the Member States rather than the outcome of the procedure. As noted above (see comments on Art. 4), an agreement to 'undertake' an act in an international treaty is not fully legally binding, but rather constitutes a political commitment. Note that Art. 7 only applies to the excessive deficit procedure, not to other aspects of EU economic governance (the surveillance procedure, the macroeconomic imbalances procedure, or fines for dishonest statistics). It should be noted that France and Germany constitute a blocking minority of Eurozone Member States – so if they support the Commission's view, then Art. 7 automatically means that the other eurozone Member States must do so also – unless France or Germany is itself the subject of the Commission's proposal or recommendation, in which case it cannot vote (see the final words of Art. 7). Since non-eurozone Member States cannot vote on the position of eurozone Member States (see Art. 139(2)(d) and (4) TFEU), this will mean that such measures must be adopted.

This provision does not affect the role of the Commission, and neither does it commit the Council as such; rather it commits the eurozone Member States which have ratified this treaty to vote a certain way in the Council – unless they decide otherwise by QMV. Also, it does not affect the definition of qualified majority voting in the Treaties. It should be noted that the recent amendments to the EU's economic governance legislation already enshrine in many cases the rule set out in Art. 7 of this treaty – known in practice as 'reverse QMV' – as a binding rule applicable (where relevant) to all euro-zone Member States, following the Commission's proposals or recommendations: see (as regards the excessive deficit procedure) Arts.5(2) and 6(2) of Reg. 1173/2011, concerning the enforcement of the excessive deficit rules as regards the imposition of fines on eurozone Member States. Presumably, the reference in Art. 7 to the procedural requirements of EU law is intended to take account of this. In fact, reverse QMV now also applies in other aspects of EU economic governance besides the excessive deficit procedure.

Art. 7 will therefore only be relevant to the extent that reverse QMV as regards the eurozone Member States is not already provided for in EU legislation, for instance as regards deciding on the existence of an excessive deficit in the first place.

Article 8

Any Contracting Party which considers that another Contracting Party has failed to comply with Article 3(2) may bring the matter before the Court of Justice of the European Union. The judgment of the Court of Justice of the European Union shall be binding on the parties in the procedure, which shall take the necessary measures to comply with the judgment within a period to be decided by said Court. The implementation of the rules put in place by the Contracting Parties to comply with Article 3(2) will be subject to the review of the national Courts of the Contracting Parties.

Comment: Art. 8 reflects paragraph 4, second indent, final sentence of the December 2011 conclusions. As indicated in the preamble to the REU Treaty, the jurisdiction of the Court is granted here pursuant to Article 273 TFEU, which provides that:

The Court of Justice shall have jurisdiction in any dispute between Member States which relates to the subject matter of the Treaties if the dispute is submitted to it under a special agreement between the parties.

In accordance with Article 273, the REU Treaty only provides for Member States to sue each other, not for the Commission to sue Member States. So the REU Treaty does not conflict with Art. 126(10) TFEU, which rules out jurisdiction for the Court of Justice over 'infringement actions' brought by Member States or the Commission as regards most of the excessive deficit rules. In any event, as discussed in the comments on Art. 3, the obligation in Art. 3(2) is not identical to the obligations to avoid excessive deficits imposed by EU law. A dispute brought pursuant to Art. 8 of the REU Treaty is similar to infringement actions in that a Member State is required to comply with the Court's judgment (compare to Art. 260(1) TFEU); but it is different in that the Commission does not have the power to ask the Court to impose fines for non-compliance with the prior judgment (compare to Art. 260(2) TFEU). Also the specific procedural rules set out in Art. 259 TFEU regarding infringement actions brought by one

Member State against each other will not apply. Presumably, however, if a Member State allegedly fails to comply with the ruling of the Court of Justice pursuant to Art. 8 of the REU Treaty by the required deadline, another Member State could again seize the Court with a complaint that the Member State in question is still in breach of Art. 3(2) of that treaty.

The second sentence of Art. 8 makes clear that the Court's ruling will be binding; this is not expressly specified in Article 273, but the Court's jurisprudence makes clear that its rulings must always be binding. Given the general wording of Article 273, and the close connection between the substance of Article 2(3) and the 'subject matter' of EU law, this provision does not violate the EU Treaties; and even if it did, it would simply be inapplicable (leaving the rest of the REU Treaty in force) pursuant to Art. 2 of the REU Treaty.

It must be noted that the Court's jurisdiction under Art. 8 of the draft REU Treaty only extends to Art. 3(2) of that treaty (and by extension, Art. 3(1)), and not to any other provision of that treaty. Of course, to the extent that any provision of the REU Treaty overlaps with obligations under EU law, the Court's normal jurisdiction pursuant to EU law - subject to any special rules such as Art. 126(10) TFEU - will apply.

Also, the final sentence of Art. 8 implicitly limits the Court's jurisdiction as regards Art. 3(2), conferring power on national courts as regards the 'implementation' of the rules to comply with Art. 3(2). In practice, this appears to mean that the Court of Justice has jurisdiction to verify whether: a) there are national provisions fully complying with Art. 3(1); b) those national provisions are binding, and of a constitutional or equivalent nature; c) there is a 'correction mechanism' which complies with Art. 3(2), second to fourth sentences; and d) that mechanism respects the responsibilities of national parliaments. It would make more sense to entrust point d) to the jurisdiction of national courts. National courts' power to rule on the 'implementation' of the national rules would entail, for instance, the power to rule on whether and how the correction mechanism must be invoked in particular cases. The wording of this sentence ('<u>will</u> be subject') makes clear that such powers <u>must</u> be conferred on national courts, but leaves great discretion as to Member States as to how to provide for this. Arguably, given the close connection between the REU Treaty and EU law, Member States have the same obligation that they have pursuant to EU law to ensure that the provisions on national judicial review are effective, but the Court of Justice will not have jurisdiction to rule on this point, since its powers will not extend to the interpretation of the third sentence of Art. 8, except to determine the distinction between its jurisdiction and that of national courts.

There is also provision for dispute settlement before the Court of Justice pursuant to Art. 273 TFEU in the EFSF and ESM treaties. These provisions have not been invoked in practice, and indeed Art. 273 (which has been in the Treaties since the original Treaty of Rome, without ever being amended substantively) has never been invoked at all. The only other known example of a reference to Art. 273 TFEU in a treaty is the German/Austrian treaty on double taxation disputes.

TITLE IV

ECONOMIC CONVERGENCE

Article 9

Without prejudice to the economic policy coordination as defined in the Treaty on the Functioning of the European Union, the Contracting Parties undertake to work jointly towards an economic policy fostering growth through enhanced convergence and competitiveness and improving the functioning of the Economic and Monetary Union. To this aim, they will take all necessary actions, including through the Euro Plus Pact.

Comment: Art. 9, first sentence, reflects paragraph 9, first sentence, of the December 2011 conclusions, which states simply that the eurozone Member States 'are committed to working towards a common economic policy' ,without further elaboration. The more detailed reference to the objectives of growth, et al, reflect to some extent the 'Euro Plus Pact' (on this pact, see the comments on Art. 3(2)), which is referred to expressly in the second sentence of Art. 9.

As noted above (see comments on Art. 4), an agreement to 'undertake' an act in an international treaty is not fully legally binding, but rather constitutes a political commitment. However, the second sentence of Art. 9 states that the parties '<u>will</u> take all necessary actions'. While this language is more binding, the only specific commitment referred to (the Euro Plus Pact) is not itself binding; but this is a non-

exhaustive list of possible actions, as indicated by the word 'including'.

Note that this provision is expressly without prejudice to EU law measures on the coordination of economic policy, reiterating the general rule in Art. 2 of the draft REU Treaty.

Article 10

While fully respecting the procedural requirements of the Union Treaties, the Contracting Parties undertake to make recourse, whenever appropriate and necessary, to the enhanced cooperation on matters that are essential for the smooth functioning of the euro area, without undermining the internal market.

Comment: Art. 10 reflects paragraph 8 of the December 2011 conclusions. The reference to respecting the procedural requirements of the Treaties has been added; this would in any event follow from Art. 2 of the draft REU Treaty. The procedural requirements are (see Art. 20 TEU and Art. 329(1) TFEU): implicitly an initial proposal from the Commission and a block on that proposal in the Council, since enhanced cooperation must be a 'last resort'; a request from a group of Member States to the Commission (which must reply to the request, but is not required to reply positively); a proposal from the Commission to authorise enhanced cooperation; and authorisation by QMV in the Council on a vote of <u>all</u> Member States (note that the non-eurozone Member States have a blocking minority in the Council, if most or all of them vote against or abstain in a vote together); and consent from the EP (all MEPs could vote). The measure implementing enhanced cooperation would then be adopted by means of the usual decision-making procedure, but only the participating Member States would vote in the Council. The participating Member States could decide, by unanimous vote among themselves, to abolish any national vetoes which apply to the adoption of the legislation concerned (Art. 333 TFEU).

It is odd that only one of the substantive requirements for enhanced cooperation is mentioned here (Art. 326 TFEU states that enhanced cooperation 'shall not undermine the internal market'), but the other substantive requirements are not (Art. 326 TFEU also states, inter alia, that it shall not undermine 'economic, social and territorial cohesion', or 'constitute a barrier to or discrimination in trade between Member States' or 'distort competition between them'; see also Art. 327 TFEU). However, the other substantive requirements in the Treaties would still apply, in light of Art. 2 of the draft REU Treaty.

There is also no reference to the participation rules of enhanced cooperation (see Art. 20 TEU and Arts. 329 and 331 TFEU): a minimum of nine participants; only willing Member States participate; any Member States can join; new Member States are not obligated to join. Again, however, these rules would apply by virtue of Art. 2 of the REU Treaty. In principle, it seems that these rules would rule out the use of enhanced cooperation for <u>all</u> the eurozone Member States and <u>only</u> the eurozone Member States, unless it might possibly be argued that eurozone membership could be applied as a valid condition for participation in enhanced cooperation. Even in that case, it is hard to see how all eurozone Member States could be required to participate. Legally, a Member State which wishes to join the eurozone could not be required to participate in such legislation, since Art. 140 TFEU, which sets out the conditions for joining EMU, does not refer to such a requirement. However, in practice, the eurozone Member States (which have a 'blocking minority' vote on any extension of EMU to more Member States) might demand participation in such measures before a Member State joins EMU.

While, as noted already, Art. 2 of the REU Treaty ensures that all of the EU law rules regarding enhanced cooperation will prevail over Art. 10 of this treaty, it would be better to drop the word 'procedural' from Art. 10, to avoid any confusion.

The wording 'undertake to make recourse' replaces 'agree to make more active use' in the December 2011 conclusions, and the words 'whenever appropriate and necessary' have been added. As noted above (see the comments on Art. 4), an agreement to 'undertake' an act is not fully binding on the parties to a treaty.

Art. 10 would most likely be applied in practice as regards the adoption of legislation on a financial transactions tax and a common consolidated corporate tax base, which were both the subject of controversial proposals for EU legislation from the Commission in 2011. Some Member States have suggested that they might, if necessary, negotiate separate treaties on these issues. However, the scope of this Article is not limited to any particular issue.

Article 11

With a view to benchmarking best practices, the

Contracting Parties ensure that all major economic policy reforms that they plan to undertake will be discussed and coordinated among themselves. This coordination shall involve the institutions of the European Union as required by the law of the Union.

Comment: the first sentence of Art. 11 reflects the second sentence of paragraph 9 of the December 2011 conclusions. The second sentence of Art. 11 has been added; it does not appear to amend or even supplement EU law in this area, in particular as regards the role of the EU institutions, but simply refers back to EU law as it already exists (or will exist). Note that according to the preamble to the REU Treaty, the Commission plans to propose legislation on this issue, although this is not mentioned in the Commission's 2012 work programme (COM (2011) 777) or in its communication on the 'roadmap to stability and growth' (COM (2011) 669). It is not clear whether or how the discussion and coordination would take place if no EU legislation is yet in place.

Article 12

Representatives of the Committees in charge of economy and finance within the Parliaments of the Contracting Parties will be invited to meet regularly to discuss in particular the conduct of economic and budgetary policies, in close association with representatives of the relevant Committee of the European Parliament.

Comment: This provision is new as compared to the December 2011 conclusions. It appears to reflect, in simplified form, paras. 45-47 of the EP's resolution of 1 December 2011 on the European semester. It could be compared to Arts. 9 and 10 of the Protocol on national parliaments attached to the EU Treaties, which is the legal basis for the more general interparliamentary cooperation as regards EU law as a whole. Note that Art. 12 refers to the EP as a whole, but only to the national parliaments of the eurozone States. While the draft treaty only refers to an 'invitation' to meet, presumably a more formal system would be established by the EP and the national parliaments concerned. This provision falls far short of the recommendations to increase parliamentary control of EU economic governance in the Statewatch analysis on the democratic control of the eurozone.

TITLE V

EURO SUMMIT MEETINGS

Article 13

1. The Heads of State or Government of the Contracting Parties whose currency is the euro, (hereinafter "the euro area Heads of State or Government") and the president of the European Commission shall meet informally in Euro Summit meetings. The President of the European Central Bank shall be invited to take part in such meetings. The President of the Euro Summit shall be appointed by the euro area Heads of State or Government by simple majority at the same time the European Council elects its President and for the same term of office.

2. Euro Summit meetings shall take place, when necessary, and at least twice a year, to discuss questions related to the specific responsibilities those Member States share with regard to the single currency, other issues concerning the governance of the euro area and the rules that apply to it, and in particular strategic orientations for the conduct of economic policies and for improved competitiveness and increased convergence in the euro area.

3. Euro Summit meetings shall be prepared by the President of the Euro Summit, in close cooperation with the President of the European Commission, and by the Euro Group. The follow-up to the meetings shall be ensured in the same manner.

4. The President of the Euro Summit shall keep the other Member States of the European Union closely informed of the preparation and outcome of the Euro Summit meetings. The President will also inform the European Parliament of the outcome of the Euro Summit meetings.

Comment: this Article, which reflects paragraph 10 of the December 2011 conclusions, is closely based on points 1-4 of Annex I of the October 2011 conclusions of the eurozone heads of State and government, which set out ten new points regarding governance of the eurozone. This Article supplements the existing Protocol to the Treaties concerning the Eurogroup meetings of eurozone Member States' finance ministers. Points 5-10 of that Annex, which concerned the preparation of the various Eurozone meetings, are not reproduced. It should be noted that the Eurozone heads of state and government have already been meeting regularly since 2009, and have in practice taken the main political decisions relating to the eurozone's financial crisis. As regards Article 13(1), the eurozone Heads of State and Government have already appointed Herman van Rompuy, the President of the European

Council, to this post, for the remainder of his current term of office, which will expire on 1 June 2012.

TITLE VI

GENERAL AND FINAL PROVISIONS

Article 14

1. This Agreement shall be ratified by the Contracting Parties in accordance with their respective constitutional requirements. The instruments of ratification shall be deposited with the General Secretariat of the Council of the European Union.

2. This Agreement shall enter into force on the first day of the month following the deposit of the ninth instrument of ratification by a Contracting Party whose currency is the euro.

3. This Agreement shall apply as from the day of entry into force amongst the Contracting Parties whose currency is the euro and which have ratified it. It shall apply to the other Contracting Parties whose currency is the euro as from the first day of the month following the deposit of their respective instrument of ratification.

4. By derogation to Paragraph 3, Title V of this Agreement shall apply to all Contracting Parties whose currency is the euro as from the date of the entry into force of the Agreement.

5. This Agreement shall apply to the Contracting Parties with a derogation as defined in Article 139(1) of the Treaty on the Functioning of the European Union, or with an exemption as defined in Protocol No. 16 on certain provisions related to Denmark annexed to the Union Treaties, which have ratified it, as from the day when the decision abrogating that derogation or exemption takes effect, unless the Contracting Party concerned declares its intention to be bound at an earlier date by all or part of the provisions in Titles III and IV of this Agreement.

Comments: Paragraph 1 is a standard provision concerning the entry into force of treaties; the Council's General Secretariat is frequently the depositary for treaties linked to EU law. The progress of ratifications will be updated on the Council's website, 'agreements' section.

Paragraph 2 provides for great flexibility regarding the entry into force of the treaty - only nine eurozone states would need to ratify it, for it to enter into force (as regards those States only). If the ninth ratification were lodged in June 2012, the treaty would enter into force on 1 July 2012. Nine Member States is also the threshold for launching enhanced cooperation within the EU legal framework, as well as the threshold for entry into force of a draft treaty between Member States on a patent litigation treaty, which is likely to be signed soon. It also amounts to the majority of eurozone States. Note that the ESM treaty also has a flexible rule for entry into force, but a different one (it will enter into force when eurozone States with 90% of the capital have ratified it, meaning that the four biggest eurozone States have a veto on its entry into force).

Paragraph 3 provides for immediate application to the eurozone States that ratify the treaty, on the date of its entry into force. Eurozone States which ratify the treaty subsequently will be subject to the treaty shortly after. So if the treaty enters into force on 1 July 2012, a State which ratifies it in August 2012 would be subject to it as of 1 September 2012. If some eurozone States have not ratified the REU treaty, there is no provision in this treaty or in EU law for any sanctions against them, but it is possible that there will be political or economic consequences for non-ratification (for instance, the ECB or the EFSF or ESM might be reluctant to assist them, and the States concerned might to pay have a higher interest rate for their loans on the market or in the context of financial assistance. Or put the other way around, States which already receive financial assistance might be rewarded by lower interest rates by the EFSF or ESM, as an incentive to ratify it. States not receiving financial assistance could possibly be rewarded with lower interest rates de facto by financial markets.

Paragraph 4 means that Title V (the provisions on Euro-summit meetings) will apply to all Eurozone States when this treaty enters into force, even if they have not ratified this treaty.

Paragaph 5 provides for the possibility for non-eurozone States to ratify this treaty, but even if they ratify it, it will not in fact apply to them until they join the euro, unless they opt for all or part of Titles III and IV (on budgetary discipline and economic convergence) to apply earlier to them. Legally, ratification of this treaty cannot be a requirement for admission to monetary union, since the criteria for admission are set out in Article 140 TFEU, which has not been amended.

However, in practice, the eurozone Member States would be unwilling to accept a new eurozone member State which had not ratified this treaty (all Member States vote by QMV on enlargement of the eurozone, but the eurozone States, between them, have a blocking minority).

General comments

Much of the commentary on this planned treaty has focussed on the legality of any use of the EU institutions by some (but not all) of the Member States, outside the framework of the EU Treaties. This issue has been avoided by the Treaty drafters, by refraining from providing for any new tasks for the Commission or Council, and by involving the Court of Justice only pursuant to Article 273 TFEU, which permits Member States to grant it jurisdiction over dispute settlement between them as regards the subject-matter of the Treaties. Any question of substantive violations of EU law is addressed sufficiently by Article 2 of the treaty, giving precedence to EU law generally, and by the many specific provisions of this treaty which defer to EU law more precisely.

In the absence of any serious legal problem with this draft treaty, it should be seen and assessed in its overall political and economic context, as part of a package of measures to ensure the survival of the EU's single currency, either with all of its current members or as many of them as possible. Given the widespread prediction that the collapse of the single currency would have huge negative economic consequences, with the obvious result of a massive increase in unemployment and huge human misery – both inside and outside the eurozone – it is obviously preferable to try to prevent its collapse, rather than applaud or facilitate it.

To what extent does this draft treaty help to prevent such a collapse? Legally, as discussed above, it does not add very much to the obligations which are already present in EU law, or which have been or will likely soon be proposed for adoption as EU law measures. If the draft treaty had taken the form of an amendment to the EU Treaties, it would be more effective, since it could be applied by the EU's institutions directly; but the underlying assessment would still not be different, given the substantive overlap between these measures and the existing or proposed EU law rules. Put another way, the EU has already done enough (and arguably *more* than enough), in the form of its recently adopted legislation and the two further measures to be adopted by April 2012, to address the fiscal discipline of its eurozone States, in particular as regards the enforcement of the excessive deficit rules, the possible build-up of excessive macroeconomic imbalances and the development of fiscal control rules in the law and administration of Member States. Indeed, there is clear evidence that austerity policies (both inside and outside the eurozone) usually fail in their own terms (leaving aside their social cost), by reducing economic growth and therefore increasing government debt and deficit further.

But the *political* assessment may be different – if, as some anticipate, the signature and ratification of this treaty might induce the German government and the European Central Bank to take much more significant steps to ensure the survival of the single currency, and/or encourage financial markets to reduce the interest rates demanded for the purchase of eurozone governments' bonds. If that happens, then the REU treaty will have served a its purpose; if not, then it will have served no earthly purpose whatsoever.

While the legality of such significant steps has been disputed, in light of the prohibitions on Member States taking over each others' debt (Article 122 TFEU) and on the European Central Bank purchasing Member States' government debt directly (Article 125 TFEU), this still leaves other measures which could legally be taken. But more fundamentally, this legal argument profoundly misses the point. There is no express provision in the EU Treaties providing for the collapse of the single currency, or the departure of Member States from it (other than implicitly, by means of leaving the EU); and therefore there is nothing to provide expressly for addressing the legal consequences of collapse. The EU Treaty (Article 3(4)) provides for an obligation for the EU to establish the single currency, and the drafters of the Maastricht Treaty stated in a Protocol that the creation of the single currency was 'irrevocable'. So the real choice may ultimately be between taking illegal actions to rescue the single currency, and the more fundamental illegality of *failing* to take such action, if that omission results in the collapse of the single currency. Similarly the real choice may ultimately be between the cost to German taxpayers of more significant actions to help other Member States, and the cost to the German economy of the collapse of the single currency. In light of the human cost of that collapse, it is obvious which is the 'least bad option' in each case.

Finally, the transparency and democratic legitimacy of the draft treaty should be assessed. As regards transparency, the public release of the draft treaty is obviously welcome, and it can only be hoped that the entire process is equally public. A website dedicated to the negotiations, with all relevant

documents and the chance for the public and civil society to submit comments, should be set up.

But in a different sense, the EU's economic governance rules fail the test of transparency, because of their near-total complexity and unreadability, scattered across a dozen primary, secondary and soft-law sources, with more to come. This might be justifiable if the subject-matter of these rules were a technical issue like chemicals regulation, but it is hardly acceptable that the basic rules on the EU's coordination and control of fundamental national economic decisions are essentially unintelligible.

The best way forward would be to replace all the secondary measures and the key soft-law measures (such as the definition of 'severe economic downturn') with only two Regulations: one setting out all of the economic governance rules applicable to the eurozone States, and one setting out all of the economic governance rules applicable to the non-eurozone States. Ideally, following the example of the Council's rules of procedure, the relevant Treaty provisions should also be set out in the secondary legislation (without affecting their legal character as Treaty provisions), to aid the reader's comprehension. A simplified (non-binding) guide to each set of rules should also be produced for the general public.

As for democratic accountability, it is striking that the draft REU Treaty would impact significantly upon the highly nuanced and detailed legislation that the EP jointly and painstakingly negotiated with the Council over a period of many months. While national parliaments would of course have a key role in deciding whether to ratify this treaty or not, the treaty could end up unnecessarily restricting the flexibility which the EU legislation currently allows to national governments (and therefore national parliaments) as regards the different techniques for ensuring fiscal discipline.

References

- Articles 122 and 126 TFEU, Protocol on eurogroup and Protocol 12 on excessive deficit procedure can be found in the Treaty.

- Regulation 1466/97 on multilateral surveillance, as amended in 2005
- Regulation 1175/2011, amending Regulation 1466/97
- Regulation 1467/97 on the excessive deficit procedure, as amended in 2005
- Regulation 1177/2011, amending Regulation 1467/97
- Regulation 1173/2011, on enforcement of the economic governance rules in the eurozone

2011 measures:

http://eur-lex.europa.eu/JOHtml.do?uri=OJ:L:2011:306:SOM:EN:HTML
prior legislation, consolidated:

http://eur-lex.europa.eu/LexUriServ/site/en/consleg/1997/R/01997R1467-20050727-en.pdf
http://eur-lex.europa.eu/LexUriServ/site/en/consleg/1997/R/01997R1466-20050727-en.pdf

- COM (2011) 821, proposal on economic governance of the eurozone
http://ec.europa.eu/commission_2010-2014/president/news/documents/pdf/regulation_1_en.pdf

- December 2011 conclusions of euro-zone states summit
http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/126658.pdf

- October 2011 conclusions of euro-zone summit
http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/125644.pdf

- March 2011 conclusions of euro-zone summit
http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/119809.pdf

- Statewatch analysis of democratic control of economic governance:
http://www.statewatch.org/analyses/no-155-econ-governance.pdf

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