Andrew Duff

ON GOVERNING EUROPE

policy network

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The Alliance of Liberals and Democrats for Europe (ALDE) is the third largest political group in the European Parliament, comprising Members of the European Parliament (MEPs) from European political parties right across the continent. It is a strong centre force with a pro-European political agenda. *www.alde.eu*

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Preface

Since the Treaty of Lisbon was signed in December 2007, much has happened to change the European Union. The financial crisis and economic turmoil has exposed a weakness of governance which must be overcome if economic recovery is to be assured. Many measures are being taken by the EU by way of crisis management. But the creation of a federal economic government of a fiscal union requires a long-term constitutional settlement.

Meanwhile, the coalition government in the UK has decided not to take part in this federal process which it cannot stop even if it wanted to. The pace of European integration is now rapid and its destination much clearer than it has been for many years. As the British government and parliament will not share that destiny, alternative arrangements have to be made for the UK. Pro-Europeans in Britain must not abandon the battlefield. We should work to ensure the ultimate success of Europe's federal union even if the UK takes another stage or two to get there.

It struck me that few outside a rather small circle in Brussels have been able to follow closely the unfolding events that shape the quickly emerging federal union. I have written this short book in August 2012 to try to piece together what is going on. I hope it is instructive, and that it might influence the important decisions which have to be taken in the next weeks and months if the future of the European Union is to be bright.

A short bibliography at the back includes helpful recent publications from the rich world of European think-tanks. I have kept footnotes to a minimum, only citing treaty articles and Commission documents relevant to the story I tell. Readers will surely be able to follow up references in the text to EU laws on the europa website.

My thanks go to a number of people who have read a draft of the text or who have otherwise fed me good ideas, including Iain Begg, Graham Bishop, Sharon Bowles, Richard Corbett, Sylvie Goulard, Sony Kapoor, Roger Liddle, Guillaume McLaughlin, Wolfgang Münchau, Harald Stieber and Anthony Teasdale. My parliamentary assistants Sietse Wijnsma and Maxime Rolland-Calligaro have been as helpful as only they can. Most mistakes will still be mine.

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Duff was a member of the Convention on the Charter of Fundamental Rights (1999-2000) and of the constitutional Convention on the Future of Europe (2002-03). He represented the European Parliament in the intergovernmental conference which concluded the Treaty of Lisbon. Previous to his election as Liberal Democrat Member of the European Parliament for the East of England in 1999, Duff was Director of the Federal Trust for Education and Research in London.

Among his several publications are:

- Federal Union Now (2011)
- Post-national democracy and the reform of the European Parliament (2010)
- Making the Difference - Essays in honour of Shirley Williams (2010)
- Saving the European Union the Logic of the Lisbon Treaty (2009)
- The Struggle for Europe's Constitution (2005)

Executive summary

Europe's on-going financial crisis reveals what many suspected: that the governance of the EU's political economy is too weak. Executive authority is dispersed among different and fairly obscure institutions, and democratic accountability is thin.

Since the crisis broke in 2008, the Union has strengthened the regulatory framework for the financial sector and introduced new supervisory authorities. Few aspects of financial services have been left untouched by a raft of EU secondary legislation.

Three bail-out mechanisms have been created (EFSM, EFSF and ESM). There has been one change to the Treaty of Lisbon and two intergovernmental treaties on fiscal discipline agreed for the eurozone. National budgets are subject to EU surveillance under a European semester. The Stability and Growth Pact has been strengthened and a new procedure to identify macro-economic imbalances introduced. The decision-making procedures for the prevention and correction of excessive deficits have been improved, so that proposals of the Commission stand unless blocked by a qualified majority in the Council. The legislative process continues, helped by the energetic participation of the European Parliament.

The European Council has committed the states to a programme of productive investment to boost economic recovery. But the states still block the reform of the financial system of the Union. The Commission, meanwhile, has sparked debates on the mutualisation of sovereign debt through the issuance of eurobonds, and has proposed to introduce a financial transaction tax at EU level.

Greece, Ireland and Portugal are in receipt of eurozone bail-outs, and Hungary, Latvia and Romania have benefitted from emergency financial aid. In 2012, Spain was granted substantial assistance to repair its banking sector, Cyprus requested assistance in July, while Hungary made a new request only months after the previous assistance expired. The European Central Bank has engaged in 'non-standard measures' to bolster the liquidity of the banking system. Doubts remain about the capacity of the EU's crisis management measures, extensive as they are, to save Spain and Italy should they prove unable to convince the markets of their own creditworthiness.

Aware of the inadequacy of the crisis management measures to restore market confidence and democratic trust, the President of the European Council has launched an initiative to build integrated financial, budgetary and economic policy frameworks. Plans are being worked up for a banking union, fiscal union and political union and the completion of the internal market. Although these proposals will command a large majority in Parliament, they will divide the Council. As the euro heads of government themselves suggested, extensive use of enhanced cooperation, allowing a core group of like-minded integrationist states to go forward, is therefore essential.

The crisis is shaping the design of the new polity. A federal economic government is needed to run the fiscal union in the interests of its member states and citizens. The ECB and the Commission need fresh powers. The job of EU treasury secretary has to be created. The Eurogroup should be made a formal part of the new system of governance of the Union, which must then be entrenched in a proper federal constitution.

A constitutional Convention, involving national as well as European parliamentarians, should begin work early in 2015 to draft the necessary treaty amendments. These will be focussed mainly on building a genuine economic and monetary union, but should include other items as well to boost the legitimacy and ensure the future of a more united Europe.

The United Kingdom has decided it will not be part of the federal union. So a new form of associate membership of the EU will have to be devised to suit the British, but also to prevent a British veto of the constitutional evolution needed and desired by its partners. Associate membership may also cater for the needs of other countries.

On Governing Europe

As parliaments go, the European Parliament is a good parliament. It is necessarily large and complicated, but it works hard and well. It is serious about its law making and its budgetary responsibilities. It is fairly open to the public, with a lively petitions culture. It has a large international operation, fostering relations with other parliamentary assemblies across the globe. Of course, the European Parliament is not faultless and has sometimes struggled to reform its own internal affairs. It is prone to voting somewhat footling, dare one say academic resolutions about matters on which it has no significant influence. The reason for this, and the curious thing about the European Parliament, is that it has no government to lead it and, having no government to sustain, it has no need to form a controlling majority.

In historic terms, parliamentary democracy in Europe emerged as an expression of popular sovereignty to challenge autocratic government. For the European Parliament, without a credible European government to oppose it has been difficult to command the genuine loyalty of the citizens it represents.

The closest thing the European Union has to government is the multi-party European Commission which is appointed jointly by the Parliament and European Council once every five years, and can be sacked en bloc by the Parliament. But the survival of the Commission, barring accidents and scandals, is not reliant on the day-to-day support of a majority of deputies. And the Commission itself has to share executive authority with the Council, representing the twenty-seven member states of the Union, in a number of important areas, including economic and foreign policy. That 'Council' is of three types: the European Council of heads of state of government, the Council of Ministers which meets in various sectoral formations, and the Eurogroup, which is an informal meeting of the finance ministers of the seventeen states which have adopted the euro. The Council of Ministers doubles as the second chamber of the legislature, and there is now very little EU law that does not have to pass through both Houses. Parliament is not only busy as co-legislator but also has its work cut out to hold the Commission to account and to scrutinise the executive activities of the Council.

If this seems complicated to the European Union citizen, it is. The European Union citizen as national citizen has grown accustomed to orderly states which are presidential or parliamentary democracies with a government and opposition. The government rules through ministers and officials; it has constitutional instruments of executive authority (which are broadly trusted even if they are neither transparent nor understood) for so long as it can maintain the support of a democratic majority. The competences of the state are classic and its territory well defined. The contrast between the old states and the new European Union is self-evident.

When things go well, strong government seems less important. Lack of government begins to matter more in bad times. Democrats have the right to know who to blame and, importantly, who can put things right. For many years, the beneficence of the European Union could more or less be taken for granted. European integration produced real public goods in terms of peace, prosperity and rights. Its inner workings, clearly mysterious, were not a matter of general concern – a stable situation which aggravated equally militant federalists, who wanted more Europe, and militant nationalists, who wanted less.

Then came the financial crash and economic recession. This essay is about how this current, protracted crisis is changing

the governance of the European Union. It looks in particular at the arrangements for the economic and monetary union which spawned the euro, at the efforts at crisis management which have been made since 2008, and at how the Union should adapt to a more federal system of government which has the best chance of resolving the crisis. In other words, how might the more united Europe we need best be governed? The essay concludes with a proposal on how to cater for states which do not wish to participate themselves in the fiscal and political union but which accept the federalist logic advanced by their partners.

Economic and monetary union

The basic arrangements for economic and monetary union were laid down in the Treaty of Maastricht, signed in February 1992. The Treaty of Lisbon, signed in December 2007, clarifies rather than revises those arrangements substantively. The well-known disjunction between integration in the economic and monetary fields persists. While monetary policy is the exclusive competence of the Union, the member states are only required to 'regard their economic policies as a matter of common concern and … coordinate them within the Council'.[1] The European Council, acting on a report from the Council of Economic and Finance Ministers (Ecofin), which itself acts on a recommendation from the Commission, draws conclusions on broad macro-economic policy guidelines. Ecofin then adopts a recommendation. The Council and Commission monitor progress on the basis of information supplied by the states. The Commission may warn a state if its economic performance is not consistent with the guidelines or where the proper functioning of the monetary union is put in jeopardy. On a further recommendation of the Commission, Ecofin may turn that warning into a recommendation, and make it public. The Council acts by qualified majority vote (QMV) without the vote of the state concerned. Parliament is kept informed at all stages by Commission and Council.

In addition to this convoluted multilateral surveillance procedure, Maastricht also installed an excessive deficit procedure.[2] The Commission monitors whether the actual or planned government deficit exceeds 3 per cent of GDP and whether its debt exceeds 60 per cent of GDP. The Commission may address an opinion to the state concerned. On a proposal from the Commission, Ecofin decides whether an excessive deficit exists and then, on a Commission draft, may issue a private recommendation to the errant state. If no effective action is taken the recommendation may be made public. Persistent failure can cause the Council to 'give notice' of remedial measures which, if still ignored, may lead to fines and all-round embarrassment.

The Article 121 and Article 126 procedures apply to all EU states, although only partially to the UK.[3] As we will see, one important consequence of the crisis has been to reverse the decision-making process in the Council so that instead of having to approve Commission proposals by QMV, Commission proposals will stand unless blocked by QMV.

The Treaties make special provision under Article 136 for those states which have adopted the euro to take further measures with the aim of strengthening budgetary discipline. Ministers of finance of the eurozone states meet informally in the Eurogroup, along with the Commissioner responsible for economic and monetary affairs and the euro and the President of the European Central Bank, in meetings prepared by a Eurogroup Working Group of finance officials.[4]

What went wrong

The arrangements put in place for economic and monetary union at Maastricht have been tested harshly and found wanting. The presumption at Maastricht, held commonly but not universally, was that the introduction of the euro would lead automatically to deeper economic integration. That presumption has been confounded. Instead of convergence, there has been a steadily widening gap between the wealth and competitivity of the stronger and weaker members of the eurozone. The financial markets fuelled the peripheral economies with cheap euro debt, but vital structural reforms were neglected. The national regulatory authorities were too weak and uncoordinated to correct the deteriorating situation. The eurozone had not developed effective instruments for crisis management when the inevitable asymmetric shocks came – and they came in seismic portions. The need for much stricter budgetary rectitude within the European Union was obvious the moment Europe's banking sector hit the liquidity crisis. When that crisis transmuted into the turmoil of sovereign debt, the future of the single currency itself was put at risk.

The seat of the problem is that the Maastricht treaty established a monetary union without putting in place a decent system to govern the political economy. Pascal Lamy rightly describes the set up of economic and monetary union as 'actually highly monetary and hardly economic at all'. This lapse allowed individual members of the eurozone to pursue their own distinctly national policies while they only paid lip-service to the broad EU framework of macro-economic policy guidelines. Ill-discipline went largely unchallenged by the European Commission and wholly uncorrected by pressure from the financial markets whose understanding of the dynamics of monetary union proved dismal. The constitutional Convention of 2002-03, under the presidency of Valéry Giscard d'Estaing, had the occasion to act to remedy the weaknesses of the Maastricht system. Nevertheless, after deliberation, and fearing to interfere so early in the life of the euro, the Convention decided not to touch the existing treaty provisions for economic and monetary union: in that sense, the Convention was a missed opportunity.

As early as 2003, however, Germany and France breached the Council's code of fiscal discipline called the Stability and Growth Pact. In 2005 they were able to build the necessary qualified majority in Ecofin to loosen the Pact to accommodate their lapse from fiscal rectitude by making the criteria more subjective. Things went on their merry way until the first cracks appeared in the solidity of the banks. The US sub-prime mortgage market was in deep trouble by 2007, escalating through 2008, until the US government, in flight from moral hazard, let Lehman Brothers go under in September to the tune of over $600 bn. Contagion spread far and deep inside Europe's banking system, hitting Iceland and Ireland first.

Did Lisbon help?

As the crisis unfolded, the disarray of the European Union institutions was palpable. Nobody could say for certain who was in charge. Various bodies among whom the European Central Bank, the European Council, Ecofin, the European Commission and the Eurogroup vied for attention. Eventually, the IMF and the financial markets, most notably the credit rating agencies, vented their frustration at the weakness of the EU's economic governance. The European Parliament added to the cacophony.

One is led to ask if the Treaty of Lisbon, which came into force on 1 December 2009, actually made things worse. The main institutional innovation of that treaty was to install the European Council of heads of state or government at the top of a formal hierarchy of EU institutions. In part this was a mere codification of what had developed since 1974, when President Giscard, with the blessing of Jean Monnet, established the European Council. But the Lisbon treaty up-graded the status of the European Council, not least in the field of international affairs. It grounded the body in the Treaties and gave it a standing president. Again, the timing was unfortunate: the Lisbon treaty was completed, late, just as Europe was hit by the financial storm. How to improve the management of the economy of the EU was not central to the preoccupation of those responsible for the final version of Lisbon.

The remit of the European Council, according to Lisbon, is to 'provide the Union with the necessary impetus for its development and [to] define the general political directions and priorities thereof'.[5] It is not to govern the Union. Indeed, the European Council has no legislative functions and few executive ones. Its new-style President is empowered to 'chair it and drive forward its work; [to] ensure the preparation and continuity of the work …; [to] endeavour to facilitate cohesion and consensus; [to] report to the European Parliament'. He also has a specific diplomatic job: 'The President of the European Council shall, at his level and in that capacity, ensure the external representation of the Union on issues concerning its common foreign and security policy'.[6]

It mattered (and is a good thing) that the first President of the European Council, Herman Van Rompuy, is by training an applied economist. Yet it would have been impossible for any incumbent of that post in its first years to have failed to give full and undivided attention to the unfolding financial and economic crisis. Economic historians will analyse the performance of the European Council in these matters. But there are systemic issues here which constitutionalists should not ignore. First, the upgrading of the European Council perforce downgraded the respective roles of the European Commission and the rotating presidency of the Council of Ministers. Second, the formal exclusion of the European Council from EU law making means that some of its members can live in ignorance of and largely untroubled by the ordinary legislative process of the Council of Ministers and European Parliament. Such dislocation has become evident during the recent phase of intensive crisis management when the legislative decisions to strengthen the regulatory framework in financial services at EU level, and to enhance EU surveillance and supervision of national economic policies involving controversial changes to decision-making procedures in the field of economic governance – took some time to be fully assimilated at the level of heads of government.

So it is that notwithstanding the raft of new laws initiated by the Commission and passed (with political difficulty in all cases) by Council and Parliament, the European Council tends to act in a semi-detached manner. Many of its members make ex cathedra statements, relentlessly unhelpful, about the reform of the EU budget; some file off in smaller groups to undermine the collective effort to reform the system of economic governance; others (especially the French and German leaders) tend to exacerbate divisions between larger and smaller states, and between older and newer members. In short, the Lisbon style European Council is proving to be something of a volatile and unpredictable player in the running of the EU. Whatever it is, it is not, at least on its own, the economic government which the Union so badly needs.

So what are the alternatives? The traditional federalist response to the search for government would put every egg in the basket of the European Commission. But here too there are limitations on the Commission's role imposed by the Treaties which it would be difficult to lift. Article 17(1) TEU mandates the Commission to 'promote the general interest of the Union and take appropriate initiatives to that end'. It oversees the application of the Treaties and of EU law under the control of the Court of Justice. It executes the budget, manages programmes and exercises 'coordinating, executive and management functions'. Famously, EU law (with very few exceptions) may only be adopted on the basis of a Commission proposal. Clearly the college of Commissioners and its services will always form an indispensable part of the government of a federal union, but it will not do so on its own. The Commission is precluded from leading on foreign and security policy, which constraint led to the foundation under the Treaty of Lisbon of the External Action Service, a mixed administration drawn from the Commission, the Council and states' diplomatic services under the leadership of a hybrid Vice-President of the Commission who doubles as the Council's High Representative for foreign policy and chairs the Council of Ministers of Foreign Affairs.

Likewise, and significantly for the point of view of this discussion, the Commission has to share executive power in economic affairs with Ecofin which is itself empowered to 'carry out policy-making and coordinating functions' – which it does, in the manner of a cabinet of a national government.[7] For example, it falls to the Council, albeit on proposals from the Commission, to 'determine the guidelines and conditions necessary to ensure balanced progress' in the internal market.[8] The Commission's task in these matters is complicated by the fact that although the euro is the currency of the Union, only seventeen of the twenty-seven member states have as yet met the convergence criteria to join it, and two of the non-eurozone states, Denmark and the UK, have separate (and different) derogations from the single currency.[9] In constructing an economic government for the eurozone, the Commission will be a central participant but not an exclusive player. Moreover, the reputation of the Commission has in recent years lost some of its earlier lustre, not least because it tends to be treated, especially by France, as being merely the secretariat of the European Council. Any proposal to radically boost the Commission's powers to the detriment of the Council will provoke a difficult debate about the inter-institutional balance of power. Yet it is a debate the EU has to have. For it is certain that as the Union moves through a process of fiscal integration towards political union a new form of federal economic government will need to be established and that will involve, in one way or another, an enhanced role for the Commission. The manner in which the EU has managed the financial and economic crisis since 2008 will prove to have shaped decisively what comes next.

The crisis breaks

When did it all begin? There had been much academic literature and earnest political debate about the capacity of economic and monetary union to resist occasional asymmetric shocks which were, after all, expected to befall the project. Very few, however, had anticipated the massive and all-encompassing financial blow which befell the world economy on the back of the failure of the Western banking system in 2007-08.

My first-hand shock took place one Saturday morning in September 2007 when I was astonished to see a long queue of fellow Cambridge citizens form outside the city's branch of Northern Rock, a former building society turned bank in trouble in the short-term money markets. I had never seen a bank run before, and immediately recalled the photographs of the queues of Viennese outside Creditanstalt in 1931. Had I not heard the chair of the Treasury Select Committee of the House of Commons tell BBC Radio 4 that morning: "I don't think customers of Northern Rock should be worried about their current accounts or mortgages"? In any case, having no savings in Northern Rock, I did not have to join the Cambridge run. On the Monday (17 September) the Bank of England, as lender of last resort, began to bail out Northern Rock to the eventual tune of some £25 bn. In February 2008, Northern Rock was nationalised by the British government – in the process thereby pushing the UK's Public Sector Borrowing Requirement way over prime minister Gordon Brown's famous 'golden rule' of 40 per cent of GDP. The collapse of Northern Rock also exposed the feebleness of the Financial Services Authority which had been set up in 1997 as the lynch pin of the UK's newly liberalised, soft-touch financial regulatory system.

First steps in crisis management

The EU's initial response to the risk of financial instability was to agree a 'roadmap' in October 2007 focussing on improving transparency in the financial sector. Only when Lehman Brothers collapsed on 15 September 2008 were the EU institutions galvanised into a round of hectic activity aimed, first, at preventing a rash of uncoordinated actions by member states seeking to protect their national banks and, second, at assembling a coherent EU approach to the international talks which culminated at a meeting of G20 in Washington in mid-November. This meeting was preceded by a meeting of Nicolas Sarkozy, as President-in-office of the European Council, and José Manuel Durao Barroso, President of the European Commission, with US President Bush in New York.

On 12 October the first summit meeting of the eurozone heads of government took place, with Jean-Claude Trichet, President of the European Central Bank in attendance, to prepare for the full European Council on 15-16 October. Concretely, the Commission launched a revision of the capital requirements directive aimed at strengthening the management of liquidity risk and improving the quality of capital.[10] It proposed a new regulation on credit rating agencies which sought to improve external surveillance.[11] And it set up a working party under the chairmanship of Jacques de Larosière to study how to bolster cooperation between international and national supervisors of the financial markets. As a crisis measure, national regulatory supervisors were enjoined to meet monthly to strengthen oversight of the EU's financial sector. Minimum deposit guarantees were increased five-fold from €20,000, and state aid rules were temporarily relaxed, as they can be in 'exceptional circumstances'.[12] The EU's special assistance fund for non-eurozone countries with liquidity crises was raised from €12 bn to €25 bn.[13] Hungary, Latvia and Romania availed themselves of such aid. Finally, the December European Council adopted an economic recovery programme of the Commission which proposed to inject €200 bn into the European economies (1.5 per cent GDP) on a coordinated basis while respecting the constraints of the Stability and Growth Pact.[14] €30 bn of that injection would be found from the EU budget, the rest by the states.

New supervisory authorities

As the scale of the financial crisis continued to worsen, so the fiscal position of the states deteriorated and unemployment rose. The ECB was driven to 'non-standard measures' to inject liquidity into the banking system, which provoked well-justified fears that the banks were largely unsupervised at the EU level. On the basis of the De Larosière report, the Commission launched five reforms.[15] These were to create a supervisory framework to detect and negate risk; to join up EU and national frameworks; to improve the security of private investors; to strengthen risk management and limit excessive bonuses; and to impose effective sanctions against abuse. With commendable agility, the EU institutions moved to legislate for the setting up of a European Systemic Risk Board to be responsible for macro-prudential oversight, along with new bodies responsible for the three sectors of the financial markets: the European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA), and the European Securities and Markets Authority (ESMA).[16] The Systemic Risk Board is chaired by the President of the ECB. The three micro-economic surveillance bodies replace weak consultative committees and will focus on cross-border activities and on resolving disputes between national supervisors.

This intense legislative activity in 2009-10 was aimed to put in place a system which would prevent a crisis of the present magnitude from ever happening again: it did not, of course, resolve the current crisis. The European Parliament pointed out at the time that the powers of the new supervisory authorities were likely in the longer run to prove to be insufficient.

Concerned about coherence, MEPs also ridiculed the decision of the Council to disburse the location of these new bodies across several European cities. However, they were all ready to begin their work in January 2011, and the EBA, in London, immediately set about conducting its first stress tests on 90 banks in 21 countries.

Other relevant initiatives included a controversial draft directive on alternative investment fund managers, aimed at curbing the worst excesses of hedge funds and private equity operations which had escaped monitoring and risk supervision.[17] This was followed by a Commission proposal for a regulation on the complex global market in over-the-counter derivatives, requiring central clearing and controls on short-selling and credit default swaps.[18] President Barroso launched the 'Europe 2020' strategy aimed at boosting economic recovery, thus contributing a more optimistic tone to the otherwise depressing debate.[19] Five ambitious targets were proposed covering employment, research, greenhouse gas emissions, education and social inclusion.

Bail-out mechanisms

Nothing could stop the escalation of the financial crisis, however, which soon turned from a liquidity crisis for the banks into a sovereign debt crisis for the states. Greece was bailed out by eurozone states (via the Greek loan facility) and the IMF to the tune of €110 bn in May 2010 and for a second time in October 2012 with an aid programme of €100 bn which involved a 50 per cent 'haircut' for the private sector; in December 2010 Ireland was bailed out for €85 bn by the EU (EFSM share), the eurozone states (EFSF), Denmark, Sweden and the UK plus the IMF; and in May 2011 €78 bn was agreed for Portugal. Temporary instruments had to be created for this purpose. The first, the European Financial Stability Mechanism (EFSM), worth €60 bn, was established by stretching the meaning of Article 122(2) TFEU which allows financial assistance to be granted to an EU state which 'is in difficulties or is seriously threatened with severe difficulties caused by natural disasters or exceptional occurrences beyond its control'. It remains a moot point, of course, about whether the financial collapse of Greece and Ireland had been strictly speaking beyond their control. At any rate, in order to reassure the lawyers – as well as to placate the UK (of which more later) – a supplementary instrument was also created on a non-EU treaty basis, the European Financial Stability Fund (EFSF). This mechanism is a special purpose vehicle of €440 bn for the eurozone alone, with an additional bung of €250 bn from the IMF.

The EFSM makes use of the budget and borrowing capacity of the EU to raise loans for the beneficiary state under the joint and several liability of all member states. The EFSF issues its own debt to provide loans which will be guaranteed by all the eurozone countries and by prospective eurozone members Sweden and Poland. It is enabled to provide loans for the recapitalisation of financial institutions, and it can intervene in both the primary and secondary markets. Both bail-out mechanisms come with strict conditionality of fiscal rectitude and constant supervision by the Commission, the ECB and the IMF.

The crisis spawned the rapid realisation that the existing – and much abused conditions of the Stability and Growth Pact were in any case inadequate to the job of ensuring fiscal prudence not just in the Greek and Irish case but across the eurozone more generally. The spiralling of the sovereign debt crisis now put the euro itself at risk. By 2010, twenty four of the twenty-seven member states were subjected to the excessive deficit procedure. In recognition of the gravity of the situation, the European Council agreed in October 2010 to establish a permanent bail-out instrument, called the European Stability Mechanism (ESM). This involved a change in the Lisbon treaty, by way of an addition to Article 136 TFEU which provides for the member states of the eurozone to take specific measures. A new sub-paragraph reads:

> *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 ESM is intended to replace the EFSM and the EFSF in 2013, and is established by its own intergovernmental treaty, a first draft of which was signed in July 2011. At full capacity, the ESM will have an effective lending capacity of €500 bn.

European semester & Six Pack

To complement the EU's new bail-out instruments, whose setting up required both EU primary law revision and new intergovernmental accords, it was agreed to adopt by EU secondary legislation a package intended to strengthen both the preventive and enforcement arms of economic and monetary union. Since the 1990s, and on the legal bases of Article 121 TFEU (broad economic guidelines) and Article 148 (employment guidelines), states had been expected to deliver regular progress reports to the Commission. Now, stronger surveillance of national fiscal policies and greater coordination of growth policies by the EU involves a 'European semester'. Under the terms of the new European semester, national governments are obliged to present together for the inspection of the Commission both their national reform programmes (comprising structural policies on pensions, products and labour and capital market reforms) and their stability and convergence programmes (comprising budgetary projections). The cycle starts at the beginning of each year with an annual growth survey from the Commission which is discussed, possibly modified and agreed by the March meeting of the European Council. In April each government (excepting those countries already in a programme) publishes its reform programme and action plan in accordance with the EU orientation: these are assessed by the Commission and Council in time for the start of the annual round of national budget making.

How effective the European semester concept will prove to be in the longer term will depend on the close alignment of the macro-economic policy guidelines with the requirements of the Stability and Growth Pact. This approach effectively reverses the earlier policy, which had permitted the relaxation of the terms of the Pact to accommodate national foibles at a time of crisis. The semester, whose first full run took place in 2012, should also keep states on track towards the accomplishment of the Europe 2020 strategy. Greater involvement of both national parliaments, in quality control of the contribution of their own governments, and the European Parliament, in horizontal scrutiny, would help the European semester be a successful innovation.

In September 2010 the Commission published four proposals on fiscal matters which sought to toughen up the Stability and Growth Pact and impose sanctions against errant states. Two draft regulations were also drafted with the aim of detecting and correcting emerging macroeconomic imbalances. Together this package of legislation became known colloquially as the 'Six Pack', as follows:

1. Regulation to reinforce economic policy coordination through the Stability and Growth Pact, giving the Commission the power to issue preventive warnings against imprudent national budgetary decisions; introduces the European semester;[20]
2. Regulation to strengthen the corrective role of the Pact by opening the excessive deficit procedure if a state deviates from debt reduction below 60 per cent GDP at the defined rate of 1/20th per annum;[21]
3. Regulation setting terms and conditions for the levy of an interest-bearing deposit as a preventive measure and a non-interest bearing deposit of 0.2 per cent GDP as a corrective measure, possibly converted to a fine; introduces 'reverse QMV' so that a Commission proposal will be adopted unless blocked by a qualified majority of the Council;[22]
4. Directive to transpose Pact rules into national budgetary frameworks, including standard accounting systems and a common methodology for dealing with regional and local authorities;[23]
5. Regulation laying down rules for Commission surveillance and Council recommendations for states with excessive macroeconomic imbalances, including sanctions for states failing to take corrective action;[24]
6. Regulation to impose fines of 0.1 per cent GDP on any errant eurozone state by reverse QMV.[25]

The European semester process is designed to help EU states avoid the need for formal EU intervention of the type prescribed in the Six Pack. Moreover, it took immediate effect: Belgium and Holland, for example, were impelled to settle their domestic budgetary quarrels in 2012 as both peer and institutional pressure from the EU rose. The EBA reinforced its stress tests on the banks

in year two, and will do so again in year three. The Commission's annual reports on the macro-economic situation in each state are digested by the markets. So the package constitutes genuine innovation in the policymaking of the European Union; it succeeds in fleshing out and building on the summary provisions laid down in the Maastricht treaty for the economic governance of the monetary union. The addition of wider criteria than debt which now need to be assessed at the EU level, such as balance of payments, asset bubbles, job creation and unit labour costs, is especially important: in effect, a new macro-economic imbalances procedure is added to the classic Maastricht convergence criteria.

As had been expected, the Commission's draft package met some resistance in the Council of Ministers but the European Parliament, backed by the ECB, was able to insist on the core of the Commission's original proposals while making some significant improvements itself aimed at greater automaticity and transparency. The Six Pack eventually came into force in December 2011.

Euro Plus Pact

At the March 2011 European Council, in the course of the first European semester, 23 members of the European Council signed a new agreement proposed by the Commission called, rather oddly, the Euro Plus Pact. This committed the signatory governments to fostering convergence in the fields of competitiveness, employment, sustainability of public finances and financial stability. Presumably out of conviction, three eurosceptic conservative governments refused to join the Euro Plus Pact (the Czech Republic, Hungary and the UK);

Sweden declined to participate at that initial stage as a mark of annoyance at the imperious behaviour of the German Chancellor and French President, dubbed 'Merkozy'. Yet the Euro Plus Pact was a significant moment for the future economic governance of the Union in that a large majority of states showed themselves perfectly willing to go further and faster in the direction of integration than the British, notably, were prepared to tolerate. Moreover, the Pact emphasised the personal political responsibility of the heads of government to undertake 'concrete national commitments' – a welcome attempt to break away from the habitual practice of presidents and prime ministers who are always tempted to say one thing with their colleagues in Brussels and another to domestic audiences back home.

Two Pack

The momentum was kept up by the Commission, which in November 2011 put forward two new draft regulations on the legal basis of Article 136. The first would require every eurozone state to submit their draft national budgets (and not simply their pre-budgetary strategies) to the Commission for prior approval; this process would be public, and would require all the eurozone states to establish independent fiscal monitoring authorities (such as the UK's Office for Budget Responsibility).[26] The second law would enhance the Commission's powers to intervene in the fiscal policies of those countries officially under a bail-out programme.[27] Inevitably, this mini-package, currently under the ordinary legislative procedure, is dubbed the 'Two Pack'. Not the least significant aspect of the Two Pack is that it will link EU treaty-based surveillance to the intergovernmental bail-out mechanisms of the EFSF and ESM. The constitutional implications of the Two Pack should not be underestimated: in effect, the European Union becomes the external supervisor of national budget making.

The Commission gets busy

As the crisis rolled on, the heads of government intensified their efforts to ensure the survival of the euro, meeting seven times as the European Council in 2011, with three summit meetings of the eurozone. The hard-pressed Commissioner for economic and financial affairs and the euro, Olli Rehn, was up-graded to be Vice-President of the Commission with special responsibilities for the coordination, surveillance and enforcement of the economic governance of the eurozone. At the same time, responsibility for European statistics was shifted to the Commissioner for Taxation and Customs Union, Audit and Anti-Fraud. This is the only mid-term reshuffle of the college made by President Barroso since his initial appointment in 2004.

In November Rehn and Barroso published a green paper on eurobonds which set out the arguments for and against their introduction and sparked a large debate on the several options available for complementing fiscal discipline with fiscal solidarity expressed either in pro rata or joint and several liability for the sovereign debt of the eurozone states.[28]

The decision of G20 to back the 'Basel III' agreement between national bank regulators led the Commission in July 2011 to propose a further regulation and directive on capital requirements in order to strengthen the resilience of the sector.[29] The indefatigable Commissioner responsible for financial markets, Michel Barnier, delivered another controversial draft directive on markets in financial instruments (Mifid) aimed at reducing volatility in commodity derivatives.[30] This was followed by a proposal for a regulation on insider dealing and market manipulation and a related directive on criminal sanctions against market abuse.[31] Credit rating agencies were not spared from a third round of legislation: the Commission proposes to try to inject greater transparency, diversity and accountability into the ratings business.[32] Likewise, auditors are to be the target of similar EU legislation in the field of accountancy.[33]

Running in parallel to the crisis management was the scheduled negotiations on the EU's new Multi-annual Financial Framework (MFF) for the expenditure period after 2013 and the related revenue issue of the reform of the own resources system.[34] Neither the Hungarians nor Poles, who held the rotating presidency of the Council of Ministers in 2011, had been able to make headway. The Commission had proposed a fairly ambitious package of budgetary reform which allowed for modest growth to meet the expanding work programme and contractual obligations of the Union. The very idea that there could be growth in spending at the EU level was enough to antagonise those national governments and parliaments which, mired in austerity, cared not to look deeper into the matter. Were they to do so, they would discover that it is only their national budgets and not the EU budget which are in deficit. They should also be reminded that EU spending represents only 2 per cent of their total public expenditure, amounting to little more than one per cent of EU GDP.

Undeterred, the Commission suddenly announced its proposal for a financial transaction tax, part of the proceeds of which was intended to become a new revenue stream to the EU budget.[35] Under the Commission's proposals, transactions in bonds and

shares would be taxed at 0.1 per cent, and derivatives at 0.01 per cent, raising approximately €57 bn a year. The motivation was two-fold: to levy the sector of the economy which had been so culpable in causing the recession, and to deepen the integration of the single market by complementing the regulatory measures in train. British government spokesmen had apoplexy.

The European Council in trouble

The European Commission, which goaded on by the European Parliament, was responsible for this frenetic level of political and legislative activity. It will take time for the real significance of the raft of fire-fighting measures to be accurately assessed. What was immediately clear, however, was that even the combination of the reforms we have outlined here plus the continual emphasis on the need to take deeper supply side measures was insufficient to restore the confidence of the financial markets in the long-term viability of the euro. Whereas the ECB won praise for quietly continuing its extensive liquidity operations (lending approximately €1 trillion), the impression grew that the EU's political leadership was behind the curve, doing too little too late. Criticism was levelled in particular at the European Council, many of whose members seemed strangely unaware of the complexity of the economic situation, out of touch with the legal realities, and unappreciative of the unfulfilled potential of the EU to address the crisis. Weighed against such criticism is the undeniable fact that the European Council has had to respond in unprecedented circumstances to a very rapidly changing situation in the markets while lacking the executive instruments common to economic government and, at the same time, teetering at the edge of the legal competence of the European Union. Herman Van Rompuy complained of the 'empty tool box' he discovered on taking up his appointment in late 2009 as the first permanent President of the institution.

Nevertheless, while Van Rompuy and Barroso could never be accused of a lack of diligence, they found it difficult to command the strategic high ground, especially when the French President and German Chancellor were seen to plot alone in bilateral meetings – notably at Deauville in October 2010 and to come up with proposals which were antithetic to the working method of the Union. 'Merkozy' were in something of their own predicament, however. Neither Gordon Brown nor David Cameron, eurosceptic British prime ministers, were credible interlocutors. And the Italian prime minister was a buffoon: the eventual replacement in November 2011 of Silvio Berlusconi by the economics professor (and former European Commissioner) Mario Monti was an invaluable contribution not only to Italy but to all Europe.

For the rest, the membership of the European Council is underwhelming. Trenchantly, but rather rudely, Jean-Claude Juncker described his colleagues as 'ungifted pragmatists'. The turnover in prime ministers during this period was fairly rapid, as one after the other lost office in the teeth of electoral unpopularity. By the time Nicolas Sarkozy departed the French presidency in May 2012, only Merkel, Juncker and Fredrik Reinfeldt remained from the leaders who had signed the Lisbon treaty in December 2007. In that sense, Van Rompuy and Barroso brought some sense of continuity to the affairs of government of the Union, but continuous reiteration of the same messages about fiscal solidarity and structural reform proved wearying for them and wearisome for onlookers – of whom the Brussels press corps and Members of the European Parliament are among the least cynical.

By the end of 2011, therefore, patience was running out and political trouble was brewing. The European Council meeting of 8-9 December promised to be particularly difficult as the leaders returned yet again to deliberate the crisis. The recent Commission initiatives on the financial transaction tax and stability bonds made the atmosphere even more charged than usual. The outcome, however, was spectacular: instead of more of the same, we got something completely different.

The analogous treaties

The financial and economic crisis has spawned two new treaties which work by analogy with the EU but are not of it. The first is the Treaty establishing the European Stability Mechanism and involves only the seventeen countries of the eurozone. The second is the portentously named Treaty on Stability, Coordination and Governance in the Economic and Monetary Union – or fiscal compact treaty – which sprang out of the historic meeting of the European Council in December 2011. Attracting the signatures of only twenty five of the twenty-seven member states of the EU, it has two functions. The first is to strengthen yet further fiscal discipline especially within the eurozone. The second and ultimately more important thing is to set in train separation proceedings between the United Kingdom and its partners.

The necessity to articulate the arrival of discernible economic governance in terms of primary law was made forcefully by Angela Merkel. The judges of the Bundesverfassungsgericht at Karlsruhe insist not only that further steps in European integration should enjoy legal certainty but also that every step will be accorded a fully democratic 'legitimacy guarantee'. This means treaty change at the European level, and, if necessary, a revision of German Basic Law too. In party political terms, Merkel has tricky coalition partners in the FDP and CSU who seem willing to risk euroscepticism, and an opposition which continues to makes gains in regional elections in the run up to the Bundestag election in the autumn of 2013. When it comes to EU constitutional matters, Germany has to be accommodated – and no advance towards fiscal solidarity is in any event possible without the consent of Europe's principal paymaster. With varying degrees of zeal, therefore, the euro summit meeting in October 2011 agreed to consider 'limited Treaty changes'. Mario Draghi, President of the ECB, told the European Parliament (1 December) that he wanted a 'new fiscal compact' which would be a 'fundamental restatement of the fiscal rules together with the mutual fiscal commitments that euro area governments have made', in order that those commitments should become 'fully credible, individually and collectively'.

European Council December 2011

So the European Council on 8-9 December tackled the question of how to represent the measures already agreed, and to reinforce them, in treaty form. Most governments would have preferred to revise Protocol 12 of the EU Treaties on the excessive deficit procedure, as Van Rompuy suggested. But the British refused to agree to opening up the Treaty of Lisbon for further amendment despite the fact that the UK would in any

circumstances keep its unique erogation from the euro.[36] Moreover, the use of Protocol 12 would have allowed Cameron to avoid a referendum as this is one of the items specifically mentioned in the EU Act of July 2011 as enjoying a derogation from the general contention that all major revisions to the EU treaties require a referendum in the UK. Cameron laboured the point that while he accepted the inexorable logic of fiscal union for the rest, for Britain the single market was sacred turf and that no eurozone activity should intrude upon it. Then, late into the summit, David Cameron waved a document at his colleagues containing seven demands, some of which, ironically, would require changes to primary law, some to secondary law and others which fenced at windmills. At the meeting, this sudden and inelegant British initiative was taken to mean that the UK wanted a general opt-out for the City of London from EU financial regulation. As the UK government must have known that such demands would be unacceptable to the rest of the EU, it is difficult to conclude other than that the British move was entirely spurious and, in fact, deliberate sabotage. It is also odd that the British government does not seem to understand that it cannot keep the UK's main export to the single market – financial services – if it does not apply the new single market rules for financial services. The notorious Cameron document is reproduced exactly in the boxes [PG40-41].

The real surprise, however, came when, under the guidance of Van Rompuy, the rest of the European Council did not succumb to Cameron's veto but decided instead to outflank the UK by agreeing to draft an entirely new intergovernmental treaty on fiscal integration. After a month of intensive drafting, to which the European Parliament sent observers, a final text was agreed.

On Governing Europe

THE UK'S DEMANDS ON THE EUROPEAN COUNCIL, 9 DECEMBER 2011

Annex: Financial Services – Explanatory note

1. Unanimity on:

i) Transfer of powers from national level to EU agencies

Explanation: this issue was debated at length before the European Council of June 2009. The June 2009 Ecofin agreed that 'national supervisors should remain responsible for the day-to-day supervision of individual firms'. The UK signed up to the Commission's proposals on the basis that the European Supervisory Authorities (ESAs) should have direct supervision powrers only in relation to credit rating agencies, which is what the Council Conclusions record. These restrictions are being tested routinely in new legislation seeking to extend the supervisory powers of the ESAs.

ii) Maximum harmonisation provisions that prevent member states imposing **additional** requirements

Explanation: member states may need to impose additional requirements on institutions within their own jurisdiction to reflect the nature of their financial sector – eg. the UK's decision to impose higher capital requirements on certain institutions to reflect the potential call on UK taxpayers of the UK's large and international financial sector. This does not affect other Member States or the ability of their financial sector institutions to compete in the single market.

iii) Fiscal interests of member states and imposition of taxes, levies etc.

Explanation: the June 2009 European Council agreed that 'decisions taken by the ESAs should not impinge in any way on the fiscal responsibilities of member States'. Furthermore, measures which entail very sizeable levies on the financial sector, such as the Deposit Guarantee Scheme Directive, are being pursued under QMV legal bases.

iv) The location of the European Supervisory Authorities

2. General provisions for:

i) Requirement for executive powers of ESAs to be clearly set out and not replace the exercise of discretion by member states' competent authorities

Explanation: this would have the effect of giving Treaty status to the ECJ Meroni judgement which prohibits discretionary powers from being imposed on EU agencies. This is consistent with the conclusions of the June 2009 Ecofin which agreed that 'the framework for the exercise of the [ESAs] competences should be specified exhaustively and in precise detail in the relevant sectoral legislation in parallel with the creation of the ESAs'.

ii) Ensuring that 3rd country financial institutions that operate only in one member state are authorised and supervised in that member state if they do not want a passport

Explanation: a number of third country institutions operate in UK as part of their international business. These institutions have no EU business and no requirement for a passport to provide services in other member States. This provision ensures that their authorisation and supervision would continue to be determined by the UK as no other member State is affected.

iii) No discrimination within the single market for financial services on the grounds of the member states in which an institution is established

Explanation: This addresses the issues which lie behind our challenge to the ECB's location policy.

Fiscal compact treaty

The Treaty on Stability, Coordination and Governance in the Economic and Monetary Union was signed on 2 March 2012 by all the heads of government of the European Union except those of the Czech Republic and the United Kingdom. Ireland submitted the new agreement nervously but successfully to a referendum on 31 May; others ratify it through national parliaments. Free of the classical unanimity constraints of the EU treaties, the fiscal compact will enter into force once it is ratified by twelve of the seventeen eurozone states. A target date of 1 January 2013 was set for this event. In any case, signatory states of the fiscal compact are enjoined to transpose the rules on balanced budgets into national law 'through provisions of binding force and permanent character, preferably constitutional' within one year of its entry into force.[37]

What are the main features of this treaty to which the British government so strongly objected? The purpose of the signatory states is, simply, 'to strengthen the economic pillar of the economic and monetary union by adopting a set of rules intended to foster budgetary discipline through a fiscal compact, to strengthen the coordination of their economic policies and to improve the governance of the euro area'.[38] It will be applied in a way which fully respects the EU treaties and ordinary legislative procedure where secondary legislation is required; it will follow the conventional decision-making procedures as far as the European semester is concerned and in the case of excessive deficit, as embellished by the Six Pack (and prospectively by the Two Pack). The states commit themselves to maintaining the revised Stability and Growth Pact that is, with a lower limit of 0.5 per cent structural deficit over the medium term and to accept automatic correction in cases of serious deviation. That is the debt brake.

By way of a curious cartel agreement, the contracting parties agree to support the Commission's positions through the excessive deficit procedure. They stand ready to exploit the enhanced cooperation arrangements of the EU treaties 'on matters that are essential for the proper functioning of the euro area'.[39] And they promise to consult each other on all major economic reforms. The European Court of Justice will be used to settle disputes between the signatory states in accordance with Article 273 TFEU, an as yet unused provision of the original Treaty of Rome which, if used, would pitch the ECJ straight into the role of a federal supreme court.

With respect to governance methods, the treaty foresees regular euro summit meetings, including the Commission President, and establishes the office of a permanent chair. The non-eurozone signatory states will be invited to euro summits at least once a year. The president of the euro summits will report to the European Parliament after each meeting, to which the President of Parliament 'may be invited to be heard'.[40] The European Parliament and relevant national parliaments will be expected to cooperate with each other in the ordinary way in order to discuss the issues covered by the new treaty.

The sting comes in the tail. Article 16 says that 'within five years, at most, of the date of entry into force of this Treaty, on the basis of an assessment of the experience with its implementation, the necessary steps shall be taken … with the aim of incorporating the substance of this Treaty into the legal framework of the European Union'. This provision presupposes that the objections levelled at the fiscal compact treaty at its conception will have disappeared by 2017, for the revision of the EU treaties still requires the unanimous agreement of all member states. The Czech Republic may be expected to change its mind and join the fiscal compact once President Vaclav Klaus retires in 2013. For the British, there is a more fundamental choice.

Prime minister Cameron was received like a conquering hero on his return from Brussels after his vain veto. In the Commons, the Liberal Democrats were mute and Labour dissembling. Bizarre as it may seem, the likelihood is that the UK will never agree to the integration of the fiscal compact within the EU treaties. To make the point, the UK Permanent Representative to the EU, who is not a diplomat, wrote to the Council to 'reserve our position' on the fiscal compact.[41] The UK, he said, 'considers that it is important to ensure that no objectionable precedents are set. In this context, it notes that the EU institutions must only be used outside the EU Treaties with the consent of all Member States, and must respect the EU Treaties'. There may be litigation trouble ahead.

The fiscal compact treaty will only work by way of close analogy with the EU treaties. It cannot be implemented in any other way than through the good offices of the EU institutions, especially those of the Commission. It does not contradict the Six Pack but it goes further in that it insists on the establishment of debt brakes in national law. The European Parliament may seek to amend the Two Pack to insert a similar provision in EU law.

ESM Treaty

The other substantive innovation of the fiscal compact treaty was to make its ratification the condition for a state to access financial assistance from the European Stability Mechanism. A revised version of the ESM treaty was duly signed on 2 February 2012. The revisions were aimed at improving the flexibility of the mechanism, including urgency procedures, providing for the same financing tools as the EFSF, and linking the ESM to

the conditionality prescribed inter alia under the fiscal compact treaty.[42] As with the fiscal compact, the operation of the ESM relies on the work of the EU institutions: critically, a decision to grant stability support to a state will only be made by the board of governors of the ESM, acting by mutual agreement, on the assessment of the Commission and ECB. The ECJ will perform the same arbitration role in ESM disputes as it will under the fiscal compact treaty.[43] The ESM will enter into force once parties representing 90 per cent of the capital subscription have ratified it (effectively giving Germany a veto) – and, of course, once the enabling amendment to Article 136(3) TFEU has been ratified by all member states. Due to a certain dilatoriness among national parliaments as well as legal challenges in the German Federal Constitutional Court, the ESM will not be up and running as soon as was hoped.

Banking union, fiscal union, political union

By the start of 2013, the European Union will have managed to put in place the rules necessary to ensure that such a crisis from which we now suffer could not happen again. Some satisfaction can be drawn from that. Things that were unimaginable before the banking crash have now been agreed and put in place. The Maastricht system has been embellished and made operational. The Six Pack, Two Pack and the Fiscal Compact Treaty have left the Union's rule book for economic and monetary union in good order.

Yet two problems persist. The first is that the very rules-based nature of the improved system of governance, with its emphasis on automaticity and coercion, makes the EU even more technocratic and less political than it was before. The very strictness of the rules may prove to be something of a fiscal straitjacket, proving too inflexible to allow for unforeseen events. Politics are further attenuated, which might please the financial markets but which increases the distance between authorities and the real economy. Eurozone governments have strapped themselves into the vehicle and locked the doors, but they pile into the back seat. None can claim to be truly responsible for the speed or direction of travel. Rules are no substitute for leadership; market confidence is not democratic trust; and the citizen still waits for the answer from Europe to the question 'So, who's in charge?'.

The second problem is the continuing chronic imbalance in the eurozone, where weaker states are picked off one by one by the markets as their efforts to reduce current deficits serve only to increase their overall indebtedness. It is widely accepted that the firewall of the EFSF/ESM is not large enough to get Spain or Italy back to the marketplace should the price of their national bonds rise inexorably. There is one big thing that will be certain to bring the cost of borrowing down for the eurozone as a whole, and that is the pooling of risk through eurobonds. Eurobonds would create a large liquid market of global attraction akin to the US Treasury bond. They would require a single instrument which, unlike the ESM, will be jointly and severally guaranteed by all eurozone states.

Eurobonds

The EU will need to establish a treasury facility of its own to control the issuance of eurobonds and to set conditions to counter the risk of moral hazard. Such a treasury authority is conceived by some as a neutral EU debt agency, adding to the galère of remote technocratic bodies in Brussels, Luxembourg or Frankfurt. In my view, however, the EU treasury should be designed to eventually become a prominent and powerful part of the federal economic government. Its job is to provide a fiscal policy counterpoint to the monetary policy of the ECB, equipping the Bank, indeed, with an alternative source of advice to that from the ineluctably pro-cyclical credit rating agencies. The EU treasury needs to have the fiscal authority to be able to respond dynamically to social and economic policy dialogue; it must be accountable to the European Parliament. In its role as borrower the EU treasury would create a debt redemption fund; as lender, it should issue short-term T-bills and, ultimately, eurobonds where it would take sensitive decisions to vary the terms to one or other member state. Fiscal solidarity of this advanced type demands the growth of trust between the taxpayers of Europe. The design of the EU treasury, therefore, is a complex thing which we need to get right from the outset. More empirical development of the kind witnessed over four or five years as the EFSM transmuted to the EFSF and then to the ESM will not do. Fiscal union means big bang.

The European Commission's consultation paper on eurobonds of November 2011 pleased the federalist wing of the European Parliament, at least, which had been demanding action on the partial mutualisation of sovereign debt long before it had become an acceptable topic among consenting adults elsewhere. Its publication succeeded in exporting the rich academic discussion about options for eurobonds into the political marketplace, despite the apparent disapproval of Chancellor Merkel. The debate began to widen from a narrow focus on fiscal discipline to the broader question of fiscal solidarity.

'Towards a Genuine Economic and Monetary Union'

The next initiative was taken by Herman Van Rompuy in close collaboration with José Manuel Barroso, Jean-Claude Juncker and Mario Draghi. This was belated leadership. On 25 June the gang of four presidents published 'Towards a Genuine Economic and Monetary Union', and sent it to the European Council which was to meet three days later.[44] The report laid out four building blocks for an integrated financial framework, an integrated budgetary framework, an integrated economic policy framework, and improved democratic legitimation.

The challenge is to maintain 'an appropriate level of competitiveness, coordination and convergence to ensure sustainable growth without large imbalances'. Over the next decade the EU should build the following:

> *1. An integrated financial framework to ensure financial stability in particular in the euro area and minimise the cost of bank failures to European citizens. Such a framework elevates responsibility for supervision to the European level, and provides for common mechanisms to resolve banks and guarantee customer deposits.*

The report was frank about the 'structural shortcomings in the institutional framework for financial stability'. The integrated financial framework should involve a single European banking supervision system with ultimate authority resting at the EU level for the whole Union. Conferral of new powers on the ECB under Article 127(6) TFEU 'would be fully explored'. A European deposit insurance scheme would be introduced to re-insure national deposit guarantee schemes, and a European resolution scheme, funded by the banks, would oversee the winding down of non-viable institutions. A common resolution authority would control both these schemes, backed up, so far as the eurozone is concerned, by the 'fiscal backstop' of the ESM.

> *2. An integrated budgetary framework to ensure sound fiscal policy making at the national and European levels, encompassing coordination, joint decision-making, greater enforcement and commensurate steps towards common debt issuance. This framework could include also different forms of fiscal solidarity.*

Notwithstanding the agreements already reached in terms of strengthened economic governance for the eurozone, the report recommended a 'qualitative move towards a fiscal union'. In the short term this means the Two Pack. In the medium term, 'the issuance of common debt could be explored' involving 'the introduction of joint and several liabilities ... as long as a robust framework for budgetary discipline and competitiveness is in place to avoid moral hazard and foster responsibility and compliance'. Progress towards the issuance of common debt should be phased according to criteria. 'A fully-fledged fiscal union would imply the development of a stronger capacity at the European level, capable to manage economic interdependences, and ultimately the development at the euro area level of a fiscal body, such as a treasury office. In addition, the appropriate role and functions of a central budget, including its articulation with national budgets, will have to be defined.'

> *3. An integrated economic policy framework which has sufficient mechanisms to ensure that national and European policies are in place that promote sustainable growth, employment and competitiveness, and are compatible with the smooth functioning of EMU.*

Building on the European semester and Euro Plus Pact, the framework for policy coordination should be more enforceable, including in areas such as labour mobility and tax coordination, where common action against tax evasion is an urgent necessity.

> *4. Ensuring the necessary democratic legitimacy and accountability of decision-making within the EMU, based on the joint exercise of sovereignty for common policies and solidarity.*

'Decisions on national budgets are at the heart of Europe's parliamentary democracies. Moving towards more integrated fiscal and economic decision-making between countries will therefore require strong mechanisms for legitimate and accountable joint decision-making. Building public support for European-wide decisions with a far-reaching impact on the everyday lives of citizens is essential.'

The report was short (seven pages): the original version had apparently been longer and less cautious. Nevertheless, it succeeded in provoking a real debate at the level of the heads of government and in soliciting some serious decisions.

European Council June 2012

'Following an open exchange of views, where various opinions were expressed', the European Council of 28-29 June agreed to invite Van Rompuy, in collaboration with his three colleagues, to develop 'a specific and time-bound road map for the achievement of a genuine Economic and Monetary Union'. This will 'include concrete proposals on preserving the unity and integrity of the Single Market in financial services'. The road map will examine what can be done under the present treaties and what would require treaty change. 'In order to ensure their ownership,' – curious phrase – 'Member States will be closely associated to the

reflections and regularly consulted'. The European Parliament will also be consulted. An interim report is to be presented to the European Council on 18-19 October, with a final report in December.

The eurozone summit, which continued once David Cameron had gone to bed, was more decisive. It urged rapid progress to install centralised supervision of the eurozone's banks under the European Central Bank, accepting that this will weaken the power of the diverse national supervisory authorities. The European Bank Authority will continue to be responsible for stress testing the banking sector across the whole EU and for writing the common rule book for all twenty-seven states. The euro summit also agreed that once the ECB takes charge of supervision, the EFSF/ESM will be allowed to intervene directly to help ailing banks without the intervention of governments. This decision can be expected to boost the confidence of markets because it weakens the power of politicians and breaks the vicious circle between banks and sovereigns.

The ESM recapitalisation deal will apply in the first instance to Spanish banks (perhaps €100 bn) but also, if necessary, to Irish banks – helping Ireland to avoid a second bail-out. The burden of Spanish and Irish taxpayers is therefore shared with their fellow taxpayers across the eurozone. Eurozone bailouts lose their seniority, which helps private bondholders. Relief for Italy and Cyprus is less explicit but the ESM is empowered in general to buy sovereign bonds according to an EU programme based on existing austerity measures 'in a flexible and efficient manner'. Debt to GDP ratios will therefore be reduced for these countries, which should help to stabilise the euro in the currency markets.

The Board of Governors of the European Stability Mechanism – essentially the eurozone treasury ministers is set to become central to our story. The designated Managing Director is Klaus

Regling, who now heads the EFSF. The ESM board will have discretion under the terms of the founding statute, acting mainly by 'mutual agreement', to intervene in primary and secondary markets. In emergencies it may act by QMV weighted by shareholding. Bailing out banks, shrinking them or closing them down are not mere technical issues but have high political repercussions. The governors of the ECB and the ESM deserve now to come under closer scrutiny. This raises questions for the European Parliament: whereas the President of the ECB reports frequently to MEPs, there is no provision in the intergovernmental ESM treaty for any kind of parliamentary scrutiny. The incorporation, therefore, of the ESM treaty and the fiscal compact treaty within the EU framework proper as soon as possible – certainly within five years – becomes imperative.

The European Central Bank is also on the brink of important transformation when it assumes its new functions. The legal base for the banking union reform is Article 127(6) TFEU which allows the Council, acting unanimously on a proposal of the Commission, to confer specific tasks on the ECB relating to the prudential supervision of banks. Parliament and the ECB itself will be consulted. Other changes to the functions of the ECB, including market operations as lender of last resort to solvent but illiquid banks, can be made by way of the Statute of the Central Bank through the ordinary legislative procedure.[45]

Mario Draghi seems less reluctant than his illustrious predecessor Jean-Claude Trichet to allow a deeper reflection on the mandate of the ECB. Any radical widening of the powers of the ECB would require a change of political direction not least by Germany, which still vividly remembers the behaviour of the Reichsbank in the Weimar Republic. But other models of central banks exist to that of the Bundesbank, as in the Bank of England or the US Fed,

and these should inform the debate about the revised role of the ECB. It would surely be possible to revise the Bank's own decision-making bodies by weighting votes according to shareholding, as with the ESM. Both the ECB and the ESM, responsible for the Bank's technical operations, will need to engage with the new fiscal authority – the EU treasury – in order to impose credible variable conditions on their borrowers and to lessen the danger of moral hazard, so that being bailed out never becomes the easy option for weaker eurozone states. The ECB needs rapidly to acquire the expertise to wield its centralised powers to supervise all the systemically important banks in Europe. Lastly, to consolidate the financial position of the European Central Bank it may be necessary to raise the limit on EU borrowing above the current 1.23 per cent of GNP.[46]

Next steps

Encouraged to do so by new French President François Hollande, the June 2012 European Council agreed to the good yet long anticipated Compact for Growth and Jobs, mobilising investment of €120 bn in theory at least. However, the same meeting also had another difficult and inconclusive discussion on the Multi-Annual Financial Framework and the reform of the own resources system. Nor is there progress on the 2013 budget, where the Council proposes deep cuts for R&D and small businesses. MEPs were quick to point out the contradiction. President Barroso wrote to the European Council (25 July) to express his concern that the financial negotiations were undermining the spirit behind the Compact for Growth and Jobs. Cutting EU spending was, he warned, a false economy with serious consequences for economic recovery.

When he reported to the European Parliament (3 July) on the results of the summit, Barroso made it plain that he would have liked the European Council to go further in support of the gang of four's banking, fiscal and political union. 'While there was progress in recognition that there is a need for a stronger Europe,' he said, 'there was also very significant resistance to further steps forward, but there is a resistance precisely because there is movement.' It is clear that several conservative prime ministers, such as Mark Rutte, Fredrik Reinfeldt and Jyrki Katainen, have yet to be brought to accept the federalist logic which underlies the Van Rompuy report. With respect to banking union, the Czechs and Poles have worries about losing all control over their banks (which are wholly owned subsidiaries of eurozone banks). And as is well known, Merkel continues, at least in public, to insist on a commitment to political union as the absolute prerequisite of fiscal union. A large majority of the European Parliament, however, approved the outcome of the June summit – and, in passing, gave Barroso his warmest reception (not least because he let fly at the British Tories).

Fortunately, many of the immediate steps to create a banking union can be undertaken by secondary legislation, and here the European Parliament comes into its own. The ordinary legislative procedure might take more time than the quick fixes of the intergovernmental method, as with the Six Pack, but it does provide a serious legitimation of what is agreed, as well as performing a useful didactic purpose. The Parliament, on the whole, is having a good crisis, and will be determined to capitalise on its success at the next constitutional Convention especially once it is refreshed by the elections in 2014.

One needs always to recall that, whereas national vetoes may work at the level of the European Council to block or blunt the initiatives of the four presidents, in the Council of Ministers and

in the European Parliament, where the legislative work is to be done, the occurrence of such vetoes is much more rare. Moreover, even if a blocking minority exists in the Ecofin of twenty-seven states, it only takes nine eurozone states ready to move forward under Lisbon's enhanced cooperation provisions for progress to be made as long as such progress in not challenged by an outsider state as being detrimental to the functioning of the internal market.[47] Potentially, use of this facility brings the Union flexibility as to how it addresses its economic policy challenges: enhanced cooperation can be used experimentally, as a way to test-run ideas pitched to greater integration. It is doubtful whether the single market programme of the Commission can be completed at all if enhanced cooperation is not exploited. Moreover, fiscal and social security policies which are explicitly exempted from the single market programme are open to the use of enhanced cooperation as long as this does not impact negatively on the internal market.[48]

What all seem to agree, however, is that there will be no return to the previous situation in which the UK was allowed to veto deeper integration. Nobody evinces regret at the split that occurred at the December meeting of the European Council. It remains apparent that David Cameron cannot prevent whatever is about to happen: his bluff has been comprehensively called. Cameron boasted to the press after the meeting on 29 June: 'We won't be part of a banking union, fiscal union or political union'. This means that the UK is headed directly either for complete withdrawal from the EU or, more likely, for a formal second-class associate membership based essentially on those aspects of the single market which the British find palatable and its erstwhile partners tolerable. One notes the delicious irony of the situation in which, just as the UK government rejects the European banking union, many high priests of Anglo-Saxon capitalism residing in the City of London (itself a victim of light regulation) would prefer to participate in just such a centralised continental banking union at least in so far as their extensive euro dominated operations are concerned.

Formalisation of the historic divide between the UK and its EU partners will have to be negotiated in the context of a general revision of the EU treaties which will also serve to incorporate the fiscal compact and ESM treaties into the EU framework, to codify in terms of primary law the elements of economic governance agreed since 2008, to establish the conditions for a fiscal solidarity union (including modification of Article 125 TFEU, the famous no bail-out clause), to rectify some of the mistakes of the Treaty of Lisbon, and to adjust the conferral and delimitation of EU competences in a number of special cases. Therefore, the EU institutions, governments and political parties need now to begin to prepare for the opening of a new constitutional Convention in the spring of 2015, followed by multiple referendums.

At least today the Union has begun to think about longer term strategy and not just immediate crisis management. In this, the EU begins to copy what the financial markets do when they deal in ten year bonds. Yet much detailed legal and political work remains to be done, and rapidly, if the EU is ever to reach the land of banking union, fiscal union and political union.

Government for a new polity

If the euro survives this protracted crisis, the EU will deserve Olympic medals in crisis management. But it will also be necessary to replace ad hoc arrangements by permanent institutions which can manage affairs in a sustained way as befits a durable economic and monetary union with social objectives. Real

fiscal solidarity between EU citizens as tax-payers implies the formation of a genuine European polity. The new European fiscal union has to be representative of its citizens as well as its states, and must therefore acquire a proper federal economic government with powers to distribute resources and deliver public goods in a fair and efficient manner.

The European federal union which emerges has parallels with other federations, but also marked differences. The new union has to deliver a deep democracy; it must foster from the outset a sophisticated sense of European political citizenship with functional linkages, such as the media and political parties, connecting up the citizen with the supranational authorities. Europe's federal union cannot underestimate the powerful lasting legacy of Europe's nation states. So the different levels of federal government must be truly coordinate with each other: the subordination of any one level of government by the other must be resisted through a constitutional system of built-in checks and balances. Europe's federal democracy will only work if there is strong horizontal association among self-conscious European Union citizens of different nationalities as well as lively vertical liaison between the various levels of government.

The European Union has in place some but not all of the institutions which it needs to make the successful transition to federal union. Above all, as this essay has discussed, the present EU lacks a credible and discernible government of the political economy, and it is on this that the new polity must be based. At present, authority and responsibility for the many sensitive and sophisticated financial and economic decisions which ought to be taken is dispersed and obscure. If one could collect those who really mattered to the government of the economic and monetary union and put them in one room, at least nine chairs are needed for the President of the Commission and his Vice-President responsible for the euro, the President of the

European Council, the President of the European Central Bank, the rotating President of Ecofin, the President of the Eurogroup (Jean-Claude Juncker), the President of the Economic and Financial Committee and the Eurogroup Working Group (Thomas Wieser), and, last but not least, the Director of the EFSF/ESM (Klaus Regling). The ninth chair is still vacant but is designated for the EU's treasury secretary put in charge of the federal fiscal authority empowered to buy and hold state debt.

How to realise such an executive on a rational basis will be an early item on the agenda of the next Convention, which can be anticipated for spring 2015. Maybe the example of the High Representative responsible for foreign and security policy, in charge of the European External Action Service, sets a useful precedent. At the very least, these nine should make the time and space to dine together on a regular basis. (Dinner requires no treaty change.)

In addition, an early start could be made to make formal what is at present merely the informal structure of the Eurogroup.[49] Such informality already looks archaic in the face of embarrassing incoherence among eurozone prime ministers and ministers. Access to bail-outs, for example, must be subject to commonly agreed criteria strictly observed. Greater discipline inside the Eurogroup would eliminate the unfortunate practice of ministers going home from Brussels and, egged on by national parliaments, seeking extra collateral. In more general terms, Eurogroup ministers need more mental practice in thinking of the eurozone economy as one entity with a general interest in becoming competitive in global terms and sticking to a common policy for all international purposes, including within the IMF.

The decision to hold regular euro summit meetings is a step in the right direction. The up-grading of the Eurogroup suggests immediately the need for a stronger secretariat drawn from the

Commission and Council to service the chair, who is elected for two and a half years. Is Juncker's eventual successor the EU's pilot treasury secretary? The EU has a commendable history of being ingenious.

The wider institutional agenda

On the broader front, other institutional reforms are surely desirable. The European Commission would profit in terms of cost, coherence and authority if it were to follow the injunction of the Lisbon treaty and reduce in size to nineteen in 2014.[50] And measures should be taken to strengthen the connection between the appointment of the Commission with the elections to the European Parliament. Each political party should nominate its own candidate for the presidency of the Commission, and half the members of the new college should be drawn from newly elected MEPs. Both of those changes can be made in 2014 without treaty change. Nobody should underestimate the possibility that Parliament refuses to accept the nomination of a Commission it does not like.

As one of the treaty amendments proposed at the next Convention, the European Parliament should agree to its own dissolution should it ever sack the entire college, as is its right.[51] Parliament would also be well-advised to reform its own electoral procedure by installing a single pan-European constituency for the election of a certain number of its Members. Such a reform, long discussed, would galvanise the European political parties into becoming real campaigning organisations and add a European dimension to the Parliamentary elections which has, so far, been sadly missing.

There will be internal repercussions for the Parliament as and when the Eurogroup is formally established, as it surely will be, as the official legislative Council for fiscal matters. It will not be acceptable for MEPs from non-eurozone countries to vote to impose taxes on citizens who cannot vote for them. Eventually there may also be two budgets of the EU, one for the inner core and the other for the EU as a whole, which will suggest another division of responsibilities within the Parliament. The position of British MEPs is already becoming delicate as the UK government exploits to the full its multifarious opt-outs from mainstream mainland EU politics and legislation. Striking the right balance will not be easy in any of the institutions, including the Commission and the Court of Justice. But for the Parliament the problem of core and peripheral Europe is more acute. MEPs are elected as representatives of the Union's citizens who enjoy equal access to the EU's institutions regardless of nationality (or of the passing predilection of their national government). To date, single market legislation applies equally to everyone everywhere. Recourse to enhanced cooperation, which is stipulated as one of the means of implementing the fiscal compact, may complicate the situation for law makers. Authorising decisions on the choice of legal base – for example, to use enhanced cooperation (Article 329 TFEU) or to legislate only for the eurozone (Article 136) – must continue to be initiated by the whole Commission and voted on by the whole Council and the whole Parliament. Thereafter, the Treaties specify special qualified voting procedures only for the core group in the Council.[52] Parliament will have to make up its own rules.

That the processes which move the EU towards fiscal union and political union must be profoundly democratic should not go without saying. There is an eminent risk, as Jürgen Habermas has observed, of 'panic-stricken incrementalism' inducing a type of 'executive federalism', or directory, of national rulers (especially from the larger member states). We have already witnessed the unpalatable fruits of 'Merkozy'. Whatever emerges by way of European executive authority, it will deserve a strong democratic counterparty in the shape of the European Parliament. As fiscal integration takes hold, fewer choices on taxation and spending policy will be left wholly to the level of the state and national parliament. National parliaments therefore have a more important role to play than ever in holding to account the performance of their own national government in the European Council, Council of Ministers and Eurogroup. Few do this well at the moment. They should, for example, get plugged in formally to the process of the European semester, and their contribution in this regard should be recognised in the revised EU treaties.[53]

Equally, there is scope for improved cooperation between national parliaments and the European Parliament.[54] Interparliamentary cooperation between federal and state levels will be a unique feature of the European federal union as it has not been, for instance, in the USA. Each level must understand and respect the mandate of the other. The added value of European integration is more than a simple aggregation of national policies, which inevitably tends to slump to the lowest common denominator. Common economic policy and common budgetary policy is something qualitatively different to the individual national versions of the same. Economies of scale, cost efficiencies, interventions in the case of failure of the single market, all these are the objective products of an EU economy working well across the whole spectrum of a deeply integrated market. The crisis has given ample evidence (which was apparently needed) that uniform regulation at the EU level is usually better regulation than twenty-seven different sets of rules. Good collaboration between MEPs and MPs will result in better EU legislation and its more rigorous implementation within the states. Stronger European political parties also have an important role to play in facilitating interparliamentary cooperation.

Reform of certain aspects of the European Parliament and a larger role for national parliaments would go some way to stem the criticism of the German Federal Constitutional Court of the representative capability of the system of governance of the European Union. One need not follow the *obiter dicta* of the Karlsruhe court in all respects to heed its basic lesson, which is that a more federal EU will have to be grounded in the democratic constitutional norms of the German Federal Republic which, for obvious historic reasons, set the gold standard among the constitutional courts of the twenty-seven member states. We have not said much about the European Court of Justice in this pamphlet, but the implication of the federal surge which we propose for Europe is that the ECJ continues to evolve confidently into a federal supreme court which is respected even at arms' length by the state judiciaries. Reform of the statutes of the Court, and a necessary increase in the number of judges, is currently under way. No change needs to be made to its treaty mandate – which is, quite simply, to 'ensure that in the interpretation and application of the Treaties the law is observed'.[55] That is what it must continue to do.

An important element in this process is prescribed by the Lisbon treaty: the EU's accession to the European Convention on Human Rights which will allow the ECJ at Luxembourg to build up jurisprudence in the field of human rights, based on the EU's mandatory own Charter of Fundamental Rights, in partnership with the European Court of Human Rights at Strasbourg. (Somewhere in the middle of the triangle formed by the three elegant cities of Karlsruhe, Luxembourg and Strasbourg one will find Europe's judicial hot spot.) The 2015 Convention

must make its hallmark the recognition and advancement of the constitutional interdependence among the states, and between the states and the EU, which is imperative for the ultimate success of the federal project. Recent constitutional controversies in Hungary and Romania show how a very important facet of EU citizenship is to have faith in the independence of the courts and calibre of the judiciary across the EU as a whole.

The British problem again

Which talk of constitutions, brings us back again to the problem of how to deal with the Brits. Some explanation is needed about the European policy of the Conservative-led coalition government which took office during the euro crisis weekend of 9-10 May 2010. There are two main elements. The first is the European Union Act which was passed into law in July 2011. Its effect was to entrench inside Britain's fragile constitution the holding of referendums whenever there are to be major revisions of the EU treaties. Where the changes do not involve a transfer of competence to the Union or an increase of powers to the EU institutions there is provision for acts of parliament. All three British political parties had been tempted at some stage down the populist path to promise a referendum on one or other EU treaty: all three reneged on their promise. The EU Act ensures that there will have to be a referendum on the outcome of the next constitutional Convention. The state of British public opinion on any European matter has for a long time been unremittingly hostile. No political party would seem to have the wit or wherewithal to turn public opinion around to be well disposed to the UK's participation in a federal union. So the practical effect of the EU Act, which cannot be repealed without doing incalculable electoral damage to the party that tried it, is to place an unmoveable British veto on the future constitutional evolution of the European Union.

In July 2012 arch-eurosceptic and foreign secretary William Hague announced the government's plans to conduct a review of 'the balance of competences' between the European Union and the United Kingdom. Such a thing had also been presaged in the hasty coalition pact with the Liberal Democrats in order to placate the nationalist wing of the Tory party. More neutral observers at home and abroad may wonder why the UK has encumbered itself with such a complex, costly and challenging exercise bang in the middle of Europe's economic turmoil and Britain's own constitutional crisis over Scotland, the House of Lords and human rights.

For indeed this is to be no minor academic study. It has very political purposes. The pace of the review is not quick, and is not meant to conclude until the end of 2014 when the coalition government is in any case intended to fold. For Hague, the object of the review is to prepare the catalogue of demands which the UK will level at the rest of the EU at the next general revision of the EU's treaties anticipated for spring 2015. Although the final report will not be published until the end of 2014, the foreign secretary has arranged that interim conclusions will be published by each ministry as and when they complete their own assessment of the balance of competences. With as many as a dozen government departments affected, there will be much diversion over the next two years to whet the eurosceptic appetite.

However Hague weighs his words, he gives more than a glimpse of the kind of EU relationship he wants Britain to have

achieved after the renegotiation of its membership terms. He sees that relationship being rebuilt on two pillars of trade and security. In the variable geometry of the EU, he told the Commons (12 July), Britain would be in an outer layer comprising 'free trade, open markets and cooperation' involving 'less cost, less bureaucracy, and less meddling in the issues that belong to nation states'. The UK, he says, will continue to work to complete the single market and to support the further enlargement of the Union. Although Britain will be an 'active and activist member of a changing EU', it will play no part in deeper integration, will not agree to 'accruing greater power at the centre', will oppose a larger EU budget, and will neither join nor prepare to join the Schengen agreement and the euro. Hague boasts of the many successes of current UK policy on Europe, including self-exclusion from the impending banking union and refusal 'to allow a Fiscal Compact to be written into Treaty law without adequate safeguards for the single market'. The white paper speaks of building on national identities: while it may be logical for Britain's EU partners to pool sovereignty to salvage the euro, the British government is 'committed to playing a leading role in the EU and protecting the UK's sovereignty'. (Savour that one.)

Despite protestations that Britain should retain membership of the EU is some form, the white paper poses fundamental questions about the Union's legitimacy. 'What value has it added and can it add in the future, above action at the national or more local level, in promoting Europe's prosperity and security and increasing the influence of Europe's voice in the world?'.

The review is intended to go far beyond an analysis of the competences conferred officially on the Union by the member states. The government gives its own much broader definition of competence: 'Put simply,' it says, 'competence is about everything deriving from EU law that affects what happens in the UK'. Called into question are all the legislative and executive powers of the EU institutions and their decision-making procedures, as well as the alleged federalist bias of the case law of the European Court of Justice. Specific targets are the EU's provisions on state aids and free movement (presumably of persons), the working time directive, and the use of Article 352 TFEU which, according to the white paper, constitutes a 'general power to adopt legislation to pursue the Community's objectives when there is no specific legal base'.

The white paper is mercifully silent on the EU's growing competence in human rights, presumably because the status of the EU's Charter of Fundamental Rights is currently under discussion by a dedicated special Commission on a [British] Bill of Rights, and because the EU's controversial accession to the European Convention on Human Rights will in due course have to be ratified by the Westminster parliament.

In short, the review is large scale and its scope wide. It is also uniquely British: although the foreign secretary says he welcomes submissions of evidence from his EU counterparts, it is impossible to envisage a comparable review being launched in any other country. What would be left of the Union, indeed, if every member state were to embark unilaterally on such an exercise?

One hopes, nevertheless, that the European Commission will remind the British government of the political context in which competences have been conferred by treaty on the Union. President Barroso should spell out again for the tone deaf

British what the Lisbon treaty lays down as the objectives of the EU (Article 3 TEU). He should also explain why the rest of the Union is now preparing to enhance the competences of the Union and to strengthen its capacity to act – in fact, going in exactly the opposite direction to the British.

However William Hague may pretend otherwise, his review of competences will be seen elsewhere in the EU as disingenuous. He needs to be told that it is fundamentally contradictory for the UK to claim a senior role in the EU without making the perceived sacrifices in terms of national sovereignty that its partners are at long last ready to make. It does not look well for British ministers to preach the 'remorseless logic' of fiscal union to their EU colleagues, as they do, while refusing to make concessions in a federal direction themselves. For Liberal Democrats, ostensibly Britain's federalist party, it is ironic that during its time in government, the UK is setting its face firmly against a federal Europe.

Yet the Hague strategy is an accident waiting to happen even for the Tories. He appears to be trying to shape the British debate as a choice between, on the one hand, a new relationship with the EU having repatriated some competences in an outer tier (something slightly stronger than Turkey's customs association or Norway's European economic area status) and, on the other hand, the hard core secessionist position of UKIP. There are at least three reasons why this is a flawed policy. First, it does not guarantee Hague's bottom line, which is UK influence in the single market which, for the sake of the country's own economic recovery, the British need to become more deeply integrated. Second, it will diminish British influence in the wider world which cannot understand why so many Brits do not see Europe as their natural destiny. And third, being wholly unsatisfactory both to the nationalists and the federalists, it cannot be a stable position in the long run.

Associate membership

The immediate problem for Britain's EU partners, however, is to present a package at the 2015 Convention which will circumvent the British veto and allow the large majority of states which will by then wish to take the federal route to do so. British pro-Europeans must help to make the federated EU work as well as possible so that the option of becoming full members of it remains open for the UK. In the shorter term, the UK needs the option of a parking place short of the federal destination. The inevitable British referendum, therefore, will proffer a two-tier federal package. Without the option of becoming more clearly detached from the federal core, the British voter, in my view, is certain to answer No.

Article 49 of the Treaty on European Union lays down the procedure and criteria for any European state to join the Union. The Lisbon treaty inserted a new clause, Article 50, which provides that any member state may secede from the EU in a reasonably orderly fashion. The next treaty revision needs an Article 49a which may go like this:

> *1.Any Member State which continues to respect the values referred to in Article 2 and is committed to promoting them may notify the European Council of its intention to become an associate member of the Union. The negotiations shall be conducted by the Commission on the basis of a mandate agreed by the Council, after consulting the Parliament.*

> *2. The conditions of associate membership and the adjustments to the Treaties on which the Union is founded shall be the subject of an agreement between the Member States and the Associate Member State. The agreement shall be concluded on behalf of the Union by the Council, acting by a qualified majority, after consulting the Commission and after obtaining the consent of the European Parliament. The agreement will enter into force once it has been approved by the Member States and the Associate Member State in accordance with their respective constitutional requirements.*

Such an associate membership requires fidelity to the values and principles of the Union but not adherence to all its political objectives as laid down in Article 3 TEU (which include the euro) nor, of course, the duty to engage in all its activities. Participation in the EU institutions would be limited. In the case that the UK opts for associate membership based on trade and the single market, retention of a British judge at the Court would be eminently sensible, but the case for a British Commissioner would be less convincing. As for MEPs, those Brits who manage to get elected in 2014 would surely be the last: one might envisage instead twice yearly meetings of a joint parliamentary committee of the European and Westminster parliaments.

Should the UK ever stumble into associate membership of the EU, one would hope that it would be a temporary sabbatical from full membership rather than permanent relegation. However, Article 49a could prove to be an attractive spring-board to full membership for other countries in the European neighbourhood, such as Serbia, as well as a satisfactory permanent accommodation for others, such as Turkey. In its drafting, the Convention would be wise to admit all these possibilities – and to deal with this issue as an early item of its business.

Once it is agreed to install a form of intermediate membership of the Union, the door will be open to making more flexible the procedures to change the Treaties. Following the welcome precedent of the analogous treaties, the Convention should relax the entry into force provisions for any future constitutional amendments. While retaining the practice of consensus in the Convention and unanimity at the intergovernmental conference, so that all EU institutions and every state government have to agree the package deal, Article 48(4) TEU should be revised to read:

> *4. A conference of representatives of the governments of the Member States shall be convened by the President of the Council for the purpose of determining by common accord the amendments to be made to the Treaties.*
>
> *The amendments shall enter into force after being ratified by four fifths of the Member States in accordance with their respective constitutional requirements.*[56]

Such a modification would relieve the Union of the risk of being trapped by the refusal of one national parliament or one referendum vote to accept the constitutional evolution desired and needed by everyone else. The Treaties of Maastricht, Nice and Lisbon were all delayed unconscionably by just such recalcitrance. The combination of the right to opt for second-class membership or to secede entirely from the Union will give any state a *voie de détresse* on the way home from the federal summit.

The thing about democracy

It is said, by way of cliché, that in a democracy people get the government they deserve. Conversely, the European Union will not be truly democratic until it gets a government. Now is the time to make the step change. There are some important decisions to be taken and implemented if the euro is to be saved and the Union as a whole is to be set back on its beneficial course. The present inter-institutional mix of hybrid executive and opaque democracy is not proving capable of taking and implementing those decisions. Trial and error in the eye of a storm is not the best way to rule. Government should be able to plan strategically and ensure continuity; and it should have the robustness to tackle the unintended consequences of its actions. For example, the rigour of the technocratic troika against the corruption of the Greek state is all very well, but the burden this imposes on the Greek people is hardly edifying for those who believe in the European ideal. EU governance needs more ways and means of advancing the common good, and of encouraging the development of a sense of solidarity and communication among the fellow-strangers who make up the EU's citizenship of some 505 million. Post-national Europe needs a federal economic government that can be held up to scrutiny and trusted by both the political and financial representatives of the people.

A new European polity is emerging from the crisis. Its system of governance must be clearer than what the EU has now, and stronger. Where Europe's national states fail, as they do, the EU must be there to provide decent representative government to work for the public good. This government must be defined in a federal constitution so as to resist the temptation to transmute into an over-centralised super-state. The legal order will assert the primacy of the federal government but resist its supremacy.

And it must obtain the essential sinews of democracy, such as political parties, to connect its representative institutions with its sovereign people. Europeans have rich experience of governance bad and good, over many centuries: we need to draw on that experience now.

The elections to the German Bundestag will be out of the way in October 2013. The elections to the European Parliament and the election of the next European Commission will be completed a year later. William Hague will have completed his shopping list. At that stage, the new constitutional Convention should open strictly according to the procedure laid down in the Lisbon treaty in order to guarantee the integrity and legitimacy of the constitutive process.[57]

Preparations for that Convention can begin now. Indeed, in December the European Council which will receive the Van Rompuy report on political union should publicly commit itself to just such a procedure and schedule. The European Parliament should also encourage a ferment of constitution mongering, not least to weed out simplistic ideas, which will help the European political parties prepare their electoral platforms for 2014. Essays like this one may also help - even from England.

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Endnotes

1 Article 121(1) TFEU.
2 Article 126 TFEU.
3 Under Protocol No 15, the UK derogates from Article 121(2) and Article 126 (1), (9) & (11).
4 Article 137 TFEU & Protocol No 14.
5 Article 15(1) TEU.
6 Article 15(5) TEU.
7 Article 16(1) TEU.
8 Article 26(3) TFEU.
9 Protocol Nos 16 & 15, respectively.
10 COM(2008) 602.
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12 Article 108(3) TFEU.
13 Article 143 TFEU.
14 COM(2008) 800.
15 COM(2009) 114.
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34 Articles 312 & 311 TFEU, respectively.
35 COM(2011) 594.
36 Protocol No 15.
37 Article 3(2) Fiscal Compact.
38 Article 1(1) Fiscal Compact.
39 Article 10 Fiscal Compact.
40 Article 12(5) Fiscal Compact.
41 Letter from Sir Jon Cunliffe to Uwe Corsepius, Secretary-General of the Council of the EU, 22 February 2012. See also House of Commons European Scrutiny Committee 62nd Report of Session 2010-12, March 2012.
42 Conditionality is settled in a Memorandum of Understanding negotiated and monitored by the Commission.
43 Article 273 TFEU.
44 http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/131201.pdfhttp://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/131201.pdf
45 Article 129(3) TFEU.
46 Article 311 TFEU; the figure is given in the Financing Decision of 2007.
47 Articles 20 TEU & 326-334 TFEU.
48 Article 114(2) TFEU.
49 Protocol No 14.
50 Article 17(5) TEU. That is, two-thirds of the number of 28 member states.
51 Article 17(8) TEU.
52 Article 238 TFEU.
53 Article 12 TEU.
54 Protocol No 1.
55 Article 19(1) TEU.
56 Article 48(5) would therefore be deleted.
57 Article 48(2-4) TEU.