HOUSE OF LORDS

European Union Committee

10th Report of Session 2010–11

# Amending Article 136 of the Treaty on the Functioning of the European Union

Report

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## *The European Union Committee*

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The Members of the Sub-Committee which conducted this inquiry are listed in Appendix 1.

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## *General Information*

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## *Sub-Committee Staff*

The current staff of the Sub-Committee are Antony Willott (Clerk), Laura Bonacorsi-Macleod (Policy Analyst) and Hadia Choudhury (Committee Assistant).

## *Contacts for the European Union Committee*

Contact details for individual Sub-Committees are given on the website.
General correspondence should be addressed to the Clerk of the European Union Committee, Committee Office, House of Lords, London, SW1A 0PW
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# Amending Article 136 of the Treaty on the Functioning of the European Union

## Introduction

1. The European Council recently proposed to amend the Treaties governing the European Union to establish a permanent crisis resolution mechanism for euro area Member States. The Government will be asking the two Houses of Parliament to enable them to agree to this amendment by tabling approval motions for debate in each chamber. This debate will take place in the House on 21 March.

2. The Economic and Financial Affairs and International Trade Sub-Committee of the European Union Select Committee has scrutinised this proposal and lifted the scrutiny reserve on the proposed Treaty amendment.[1] This short report aims to inform the House of some of the circumstances surrounding this proposal, to explain the process by which the amendment will be made, and to give the Sub-Committee's assessment of the Government's stance. **We make this report to inform the House for the debate on 21 March; we do not expect a Government response.**

## Background

3. In response to the financial crisis in Greece, two emergency funds were established in May 2010 to provide loans for Member States experiencing financial difficulties. These were:
   - The European Financial Stability Facility (EFSF)—a €440 billion intergovernmental fund established and financed by euro area Member States with voluntary contributions from Sweden and Poland. It was set up with a three-year lifespan and will expire in June 2013.
   - The European Financial Stabilisation Mechanism (EFSM)—a €60bn facility created by a Council Regulation and guaranteed by the EU budget. The EFSM is reviewed every six months to determine whether circumstances still justify its existence.

4. The EFSF is available only to Member States of the euro area. The UK does not contribute to this fund. The EFSM, by contrast, is available to all Member States of the EU. When a decision is reached to activate this mechanism, the Commission borrows money from the capital markets and lends it to the Member State receiving assistance. Since these loans are guaranteed by the EU Budget, all Member States share in the risk that they are not repaid.

5. The EFSM was established under Article 122(2) of the Treaty on the Functioning of the European Union (TFEU)[2] which provides for EU financial assistance to be granted to a Member State where the state "is in difficulties or is seriously threatened with severe difficulties caused by natural disasters or exceptional occurrences beyond its control". The EFSM was

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1 The scrutiny reserve was lifted on 1 February 2011 in a letter from Lord Roper, Chairman of the EU Select Committee, to David Lidington MP, Minister for Europe. This letter is printed in Appendix 3.

2 The EU is founded on two core Treaties: the Treaty on European Union (TEU) and the Treaty on the Functioning of the European Union (TFEU).

created in the light of "exceptional occurrences" in the international economic and financial environment, and doubts have been expressed (notably in Germany) about whether Article 122(2) provides a sound legal basis for this mechanism.

6. We have previously corresponded with the Government on this issue,[3] and have questioned whether the use of this Article in this manner conflicts with the "no bail-out" provisions of Article 125.[4] The Government's view was that the EFSM provided loans; it did not "bail-out" countries by assuming responsibility for their debts. They argued, therefore, that Article 125 had not been breached. This view was supported by the majority of witnesses who gave evidence to the Committee for its current inquiry on the future of economic governance in the EU.[5]

### A permanent crisis resolution mechanism

7. In October 2010 the European Council agreed on "the need for Member States to establish a permanent crisis mechanism to safeguard the financial stability of the euro area as a whole". This permanent mechanism would replace both the EFSM and the EFSF.[6] It asked the President of the European Council, Herman van Rompuy, to undertake consultations on a limited Treaty change required to that effect.

8. At its meeting on 16–17 December 2010 the European Council agreed that the Treaties should be amended to allow the establishment of a permanent mechanism, to be called the European Stability Mechanism (ESM), which would come into existence on 1 January 2013.[7] It also agreed that Article 122(2) TFEU (see paragraph 5 above) would in future no longer be used for the purpose of safeguarding financial stability.

9. The proposed amendment would add a paragraph to Article 136 TFEU, as follows:

> "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".[8]

10. Article 136 is one of three articles of the TFEU in a chapter entitled "Provisions specific to Member States whose currency is the euro". The articles provide for action by the EU but specify that, when the Council of Ministers takes decisions, only those states in the euro area may vote.

### Amending the Treaties—the process

11. The draft European Council Decision setting out the Treaty change is based on Article 48(6) of the Treaty on European Union (TEU) which provides for

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3 *Correspondence with Ministers May 2010–December 2010* (http://www.parliament.uk/documents/lords-committees/eu-sub-com-a/CWM/CwMSubAMay-Oct10.pdf).

4 Article 125 states that "The Union shall not be liable for or assume the commitments of central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of any Member State". It goes on to state that no Member State shall do so either.

5 The report from the European Union Select Committee, *The Future of Economic Governance in the European Union*, will be published in late March 2011.

6 European Council, *28–29 October 2010 Conclusions* (EUCO 25/1/10).

7 European Council, *16–17 December 2010 Conclusions* (EUCO 30/10).

8 European Council, *16–17 December 2010 Conclusions* (EUCO 30/10), Annex 1.

amendments to be made to Part III TFEU (which includes Article 136) by the "simplified revision procedure". This would be the first use of that procedure, under which:

- a proposed amendment may be agreed by the European Council, without either an inter-governmental conference or a convention of national parliaments, governments, the European Parliament and the Commission;
- the European Council must consult the European Parliament, the Commission and (because of the subject matter in this case) the European Central Bank (these consultations are currently under way); and
- the amendment cannot come into force until it has been ratified by all the Member States in accordance with their national constitutions.

12. In the UK, under the law as it currently stands, parliamentary approval must be obtained before the Government may vote for an amendment in the European Council under the simplified revision procedure (section 6 of the European Union (Amendment) Act 2008). This involves a separate motion in each House, thus giving each House a veto. Following the adoption of the Treaty amendment in Council, it must then be ratified by each Member State in the usual way.

13. Under the provisions of the European Union Bill, currently passing through the House of Commons, the Government would not need to obtain parliamentary approval before voting for a Treaty amendment in the European Council. However, the following requirements would apply following a Council Decision to amend a Treaty:

- a Minister must lay before Parliament a statement whether, in his opinion, the amendment involves the kind of change which, under Clause 4 of the Bill, should attract a referendum because it would involve a transfer of competence or other powers to the EU; and
- the Decision to amend the Treaty must be approved by Act of Parliament.

14. While the European Union Bill provides for a referendum to be held in most cases where Treaty amendment is proposed, it is expected that no referendum would be required in relation to the amendment to Article 136 on the grounds that it does not fall within Clause 4. In that case, the Act approving the amendment must state that Clause 4 does not apply.

## The Government's view

15. The Government state in their Explanatory Memorandum[9] that, while financial problems within the euro area should be primarily resolved by euro area Member States, it is in the interests of all Member States to support a stable euro area.

16. They note that the ESM will not apply to non-euro area Member States, and will not create any liability on the EU Budget or on Member States outside the euro.

17. Finally, they refer to the Coalition Agreement which promised that there would be no Treaty change which transfers competence or powers from the

[9] Explanatory Memorandum EUCO 33/10 on a *Draft European Council Decision amending Article 136 of the Treaty on the Functioning of the European Union with regard to a stability mechanism for Member States whose currency is the euro*, 10 January 2011. This document is printed in Appendix 2.

UK to the EU during this Parliament. They emphasise that this amendment to the Treaty does not involve any increase of the EU's competences, adding that the Treaties specifically forbid the use of the simplified revision procedure if it would "increase the competences conferred on the Union in the Treaties", and that as the ESM will not apply to the UK it cannot involve a transfer of powers from the UK.

## The Committee's assessment and conclusions

### *The use of the Simplified Revision Procedure*

18. Article 48(6) TEU restricts the use of the simplified revision procedure to amendments to Part III of the TFEU which do not increase the competences of the EU. Article 136 TFEU is within Part III. Indeed, the amendment does not refer to the Union; it provides for action by the Member States in the euro area.

19. By the same token, the amendment does not appear to us to fall within the classes of amendment which, under Clause 4 of the European Union Bill, would trigger a requirement for a referendum. Clause 4 applies (broadly speaking) where an amendment would add to EU competences or remove Treaty safeguards for Member States.

### *The mechanism*

20. The new paragraph (see paragraph 9 above) to be added to Article 136 TFEU would provide a legal basis for the proposed permanent mechanism to be established for the euro area by its members. The mechanism itself would be set up by agreement among the euro area states, not by the EU. The wording of the new paragraph might be seen as granting a necessary permission to the euro area states to set up the new mechanism. However, it appears to us that the text is only intended to express a power for the states concerned without any suggestion that the EU Treaty would otherwise prevent the establishment of the mechanism. It is commonly assumed that the German government was anxious to have a clear Treaty basis for action in order to forestall any adverse judgment of the German Constitutional Court.[10]

21. The second sentence of the new provision is not expressed in what, in English law, would be regarded as mandatory terms but the intention of the European Council is that the new mechanism will contain "strict conditionality" in return for assistance to a euro area state.

### *Impact on the UK*

22. The Explanatory Memorandum notes that the Government intend to participate in the work of designing the new mechanism, though the UK will not be part of it and will not, therefore, have any financial exposure in relation to the operation of the mechanism, either directly or through the EU budget.

23. **We agree with the Government's view that it is in the UK's interests to support a stable and prosperous euro area. The UK will not be part**

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[10] See, for example: Financial Times, *An EU Treaty change is necessary but hazardous*, Wolfgang Münchau, 31 October 2010; and, EuropeanVoice.com, *Merkel garners support for Treaty change*, Simon Taylor, 4 November 2010.

**of the new permanent crisis resolution mechanism. We note, however, that participating Member States have decided that such a mechanism is necessary to safeguard the stability of the euro area.**

24. **The proposed Treaty amendment will not transfer any powers from the UK to the EU, or result in any financial implications for the UK. We therefore support the Government's intention to vote in favour of this amendment in the European Council.**

## APPENDIX 1: EU SUB-COMMITTEE ON ECONOMIC AND FINANCIAL AFFAIRS AND INTERNATIONAL TRADE

The members of the Sub-Committee who conducted this inquiry were:

Lord Browne of Madingley
Lord Harrison (Chairman)
Lord Hamilton of Epsom
Lord Haskins
Baroness Hooper
Lord Jordan
Baroness Maddock
Lord Marlesford
Lord Moser
Lord Trefgarne
Lord Vallance of Tummel
Lord Woolmer of Leeds

### Declaration of Interests

No relevant interests were declared.

A full list of registered interests of Members of the House of Lords can be found at http://www.parliament.uk/mps-lords-and-offices/standards-and-interests/register-of-lords-interests/.

## APPENDIX 2: DRAFT EUROPEAN COUNCIL DECISION AMENDING ARTICLE 136: EXPLANATORY MEMORANDUM

### Explanatory Memorandum on the draft European Council Decision amending Article 136 of the Treaty on the Functioning of the European Union (Document EUCO 33/10)

**Submitted by the Foreign and Commonwealth Office on 10 January 2011**

### Subject matter

This draft European Council decision seeks to amend, using the simplified revision procedure, Article 136 of the Treaty on the Functioning of the European Union (TFEU) to enable Member States in the euro area to set up a permanent mechanism—the European Stability Mechanism or ESM—to safeguard the financial and economic stability of the euro area as a whole.

At its meeting on 16–17 December 2010 the European Council discussed the proposed text of a draft decision to amend the Treaty (attached). The European Council agreed that the Treaty should be amended using the simplified revision procedure (SRP) provided for in Article 48(6) of the Treaty of the European Union (TEU) and decided to immediately launch that procedure. This is the first time that a change to the EU Treaties has been proposed using the SRP.

The European Council agreed that since the ESM is designed to safeguard the financial stability of the euro area as a whole, Article 122(2) TFEU will no longer be needed for such purposes. The Heads of State or Government of the Member States of the European Council also agreed that it should therefore not be used for such purposes.

The draft decision to introduce the Treaty change includes the proposed text to be added to Article 136 of the TFEU. The Recitals attached to the draft decision state that the amendment to the Treaty may not increase the competences conferred on the European Union through the Treaties, that the granting of financial assistance under the new mechanism will be subject to strict conditionality, and that the emergency mechanism provided for by Article 122(2) of the TFEU will no longer be needed or used to safeguard the financial stability of the euro area as a whole.

The Council Conclusions of the December European Council also set out the anticipated timeline for this Treaty change. The EU institutions concerned (the European Parliament, Commission and European Central Bank) will be consulted on the draft decision, with the aim of the decision being formally adopted at the Spring European Council in March 2011. After adoption by the European Council, the decision will be subject to approval by the Member States in accordance with their respective constitutional procedures before it can enter into force. The target date for the decision to enter into force is 1 January 2013.

### Scrutiny history

This is the first Explanatory Memorandum submitted to Parliament about this proposed change to the EU Treaty to establish the ESM. To date, the subject has been discussed on the Floor of the House on the occasion of the Prime Minister's statements after both the October and December European Councils on 1 November and 20 December 2010 respectively. It has also been discussed on the occasion of the Chancellor's statements on financial assistance to Ireland on 22 and 29 November 2010, and of the approval of the Loans to Ireland Bill. The issue has also been addressed in Committee on 21 December 2010 when the

Minister for Europe appeared as a witness before the House of Lords' Select Committee on the European Union during the Evidence Session covering both the October and December European Council meetings.

Explanatory Memorandum 9606/10 on the Council Regulation establishing a European Financial Stabilisation Mechanism was submitted by HM Treasury for Parliamentary Scrutiny on 15 July 2010. This document was subject to an override of scrutiny on 9 May 2010. Related Explanatory Memorandum 17211/10 on the Council Implementing Decision on granting Union financial assistance to Ireland was submitted by HM Treasury for Parliamentary Scrutiny on 20 December 2010, it has yet to be considered in either House.

## Ministerial responsibility

The Secretary of State for Foreign and Commonwealth Affairs with the Minister for Europe have overall responsibility for UK policy on EU Treaty change. The Chancellor of the Exchequer has responsibility for the content and technical aspects of the proposed European Stability Mechanism which will be established through this limited change to the Treaty.

## Interest of the devolved administrations

The UK's Foreign Affairs policy is a reserved matter under the UK's devolution settlements and no devolved administration interests arise. The devolved administrations have therefore not been consulted in the preparation of this EM.

## Policy implications

Our primary policy objective is to help ensure a stable and prosperous euro area. The Government believes that financial problems within the euro area should be primarily resolved by euro area Member States. However, it is in the interests of all Member States to support a stable and fully functioning euro area.

At the European Council of 28–29 October 2010, Heads of State or Government agreed on the need for Member States to establish a permanent crisis mechanism to safeguard the financial stability of the euro area as a whole. And at the European Council of 16–17 December 2010, it was agreed that the Treaty should be amended in order to allow euro area Member States to establish this permanent mechanism (the ESM). The European Council Conclusions of 17 December 2010 outlined proposed language for this Treaty amendment.

The ESM will provide euro area countries with increased certainty and stability. We therefore support this draft proposal to amend the Treaty to make clear that the euro area Member States can establish a permanent ESM. The UK will directly benefit from increased stability of the euro area brought about by the ESM, without being part of the new mechanism or having any obligations under it.

The European Council Conclusions, draft decision and recitals meet the following Government policy objectives:

- The existing European Financial Stability Facility (EFSF) and European Financial Stabilisation Mechanism (EFSM) will be replaced by the European Stability Mechanism (ESM);
- Article 122(2) will no longer be used to safeguard the financial stability of the euro area as a whole;
- The establishment of the ESM does not result in any transfer of power or competence to the EU from the UK.

### *EFSF and EFSM*

These two emergency instruments were set up in May 2010 in response to the Greek financial crisis. The EFSF is an intergovernmental decision by euro area Member States to establish a temporary facility among euro area Member States to provide loans to euro area Member States in difficulty. It is a limited fund with a 3 year lifespan and is due to end in June 2013.

The EFSM was established by EU Regulation based on Article 122(2) of the TFEU which states that the Council may grant EU assistance to Member States "in difficulties or is seriously threatened with severe difficulties caused by natural disasters or exceptional occurrences beyond its control". The EFSM is available to any Member State and will remain in place until it is judged that the exceptional circumstances no longer exist (this is to be reviewed after 6 months, and every six months thereafter where appropriate). Under this mechanism EU borrowing to provide assistance is backed by the EU budget. Council approval for assistance is based on Qualified Majority Voting (QMV).

Paragraph 1 of the December European Council Conclusions (also referred to in the recitals to the draft decision) confirms that the ESM "will replace" both the EFSF and the EFSM, which will remain in force until June 2013.

### *Future use of Article 122(2)*

Both the Council Conclusions and the recitals to the draft decision that introduces the Treaty change confirm that, once the ESM mechanism is established to safeguard the financial stability of the euro area as a whole, Article 122(2) will no longer be needed for such purposes, and Heads of States or Government agreed that it should not be used for such purposes.

### *Future use of Article 136*

The text of the draft amendment to Article 136 of the TFEU states that "The Member States whose currency is the euro may establish a stability mechanism". The ESM will not apply to non-euro area Member States. It will be an intergovernmental body among euro area Member States (more akin to the EFSF than the EFSM) which does not create any liability on the EU budget or on non-euro Member States. Paragraph 3 of the December Council Conclusions calls for Finance Ministers of the euro area and the Commission to "finalise work on the intergovernmental arrangement setting up the future mechanism by March 2011".

Paragraph 4 of the Council Conclusions (also referred to in the recitals of the draft decision) states that "Member States whose currency is not the euro will, if they so wish, be involved in this work. They may decide to participate in operations conducted by the mechanism on an ad hoc basis." This means that that non-euro countries may, if they so wish, work with euro area countries on the design of the ESM. There are good, practical reasons for doing so, in order to ensure the ESM is as effective as possible. But this would be on an entirely voluntary basis. The Chancellor will write to the President of the Eurogroup, Jean-Claude Juncker, to confirm that the UK would like to participate in this work on the design of the ESM.

### *Transfer of competence and power*

The Coalition Agreement promised that there would be no Treaty change which transfers competence or power from the UK to the EU during this Parliament. And under the terms of the recently introduced EU Bill any future proposed transfer of competence or power to the EU would be subject to public approval in a national referendum.

The proposed, limited Treaty change set out in the draft decision to establish the ESM does not involve any transfer of competence from the UK to the EU. The simplified revision procedure could not be used to amend the Treaty if it were to involve an increase in EU competence. Article 48(6) of the TEU states that SRP "shall not increase the competences conferred on the Union in the Treaties". Paragraph 6 of the recitals to the draft decision explicitly sets out that the amendment "does not increase the competences conferred on the Union in the Treaties". It is clear in the Council Conclusions and the draft decision to amend the Treaty that this will be a "stability mechanism for Member States whose currency is the euro", established by euro area countries for euro area countries. The UK will not be part of the new mechanism. As the new mechanism only applies to euro area countries, it could not transfer any power away from the UK.

### Subsidiarity

The draft decision under consideration is a proposal to amend the TFEU. This objective can only be achieved at the EU level. The European Council therefore agreed to launch the simplified revision procedure provided for in Article 48(6) of the TEU to bring about this Treaty change.

Establishment of the ESM through Treaty change will provide the necessary clarity to put the mechanism on a legal sustainable footing.

### Legal and procedural issues

Legal Basis: Simplified Revision Procedure provided for in Article 48(6) of the Treaty on European Union

Voting Procedures: Unanimity

Impact on UK Law: Adoption of the draft decision at the European Council has no impact on UK Law. In terms of Parliamentary procedure Section 6 of the EU (Amendment) Act 2008 requires that a motion must be introduced and passed by both Houses of Parliament without amendment before the Government can signal agreement to the adoption of the European Council draft decision.

Once the decision has been adopted, under the terms of the EU Bill an Act of Parliament must be passed before the draft Decision can enter force.

Application to Gibraltar: Yes.

Fundamental rights analysis: No fundamental rights issues apply.

### Application to the European Economic Area

None.

### Regulatory impact assessment

Not applicable.

### Financial implications

The ESM established by the proposed Treaty change will be set up by euro area countries for euro area countries with no financial liability on non-euro area Member States or the EU budget. There are therefore no direct financial implications associated with agreeing the draft decision to amend the TFEU to establish the ESM. Once in place, the ESM will potentially save the UK money as i) there will be no financial obligations on non-euro area Member States so no effect on UK contributions; ii) the EU budget, to which the UK contributes, will no longer be used to guarantee loans (as is the case with the existing EFSM); and

iii) the ESM aims to boost the economies of euro area Member States which will indirectly help the British economy.

## Timetable

The Council Conclusions of 17 December 2010 propose the adoption of the draft decision at the Spring European Council of 24/25 March 2011.

Before the draft decision can be adopted the European Council must consult the EU institutions concerned, the European Parliament, the European Commission and the European Central Bank, on the proposal.

Member States will consult nationally and gain approval in line with their own requirements. For the UK, under the current requirements in the EU (Amendment) Act 2008, this involves introduction of a motion for debate and a positive vote in both Houses.

Once the draft decision is adopted by the European Council, Article 48(6) requires that it must then be approved by each Member State in accordance with their own constitutional requirements before it can enter force. The anticipated date for the decision to enter force is 1 January 2013. In line with the provisions of the EU Bill this will involve primary legislation to enable the UK to approve the decision after it has been adopted by the European Council.

## Other observations

The European Council is currently consulting the EU institutions on this draft decision. The opinions of the European Parliament, the European Commission and the European Central Bank will be deposited with Parliament once received, in line with normal scrutiny procedures.

David Lidington MP

Minister for Europe

Foreign and Commonwealth Office

## APPENDIX 3: LETTER FROM RT HON LORD ROPER, CHAIRMAN OF THE HOUSE OF LORDS EUROPEAN UNION COMMITTEE, TO DAVID LIDINGTON MP, MINISTER FOR EUROPE, FOREIGN AND COMMONWEALTH OFFICE, 1 FEBRUARY 2011

Thank you for Explanatory Memorandum EUCO 33/10 on a Draft Council Decision on amending Article 136 of TFEU, and your letter, dated 22 December, on the same matter. The EU Sub-Committee on Economic and Financial Affairs and International Trade considered these documents at its meeting on 1 February.

We fully support your view that it is in the UK's interest to support a stable and prosperous Eurozone. Given that this Treaty amendment would not apply to, or have any financial risks for, the UK, we support your intention to vote in favour of this amendment. We have agreed to clear this document from scrutiny.