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## The UK's EU Renegotiation: Placing the Economic Governance Measures in Context

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*Following the conclusion of the UK's renegotiation of its EU membership, David Howarth analyses the provisions on economic governance. He argues that, while most of measures change relatively little, the relationship between euro and non-euro states in the EU is a crucial issue for the UK, particularly given its large financial services industry and the importance it places on the single market.*

There were quite a few controversial points about the financial impact of Brexit made by Bank of England Governor Mark Carney in his [appearance](#) on 8 March before the Treasury Committee of the House of Commons. Of course, it falls within the Bank's remit to assess how the vote on EU membership will affect Britain's financial stability and the City institutions it regulates.

However, one point that Carney made is particularly problematic and goes well beyond any financial stability mandate of the Bank. He [argued](#) that the UK's renegotiation deal from February – which will come into effect only if the UK votes to remain in the EU – ‘delivers a number of protections and additional tools that will help safeguard the Bank's ability to continue to achieve its statutory objectives’.

Carney argued that the European Council agreement ‘explicitly recognises the needs of the UK to supervise its financial stability, while not impeding the implementation of necessary, further integration among members of the euro area’. He noted the added value that the agreement provides in making ‘a legally binding commitment to ensure non-discrimination in the single market on the basis of currency’.

Andrew Tyrie, the Chair of the Treasury Committee, responded to Carney by questioning the significance of the so-called safeguards in the February agreement. Tyrie noted: ‘I would not want to rely on [them] on a dark night’.

My own argument aligns neither with the positive claims of Carney nor with the negative views of Tyrie. Rather, I would argue that safeguards for the UK largely already exist in EU law and that the agreement adds only marginally to these safeguards. However, I do accept that there is a very valid political logic to introducing at least some of these provisions, because they respond to reasonable fears in the UK about efforts that might discriminate against non-euro area Member States. Each of the five main clauses of the Economic Governance section of the UK-EU [agreement](#) is taken in turn (all emphasis added).

Clause 1 – Currency

*Discrimination between natural or legal persons based on the official currency of the Member State, or, as the case may be, the currency that has legal tender in the Member State, where they are established is prohibited. Any difference of treatment must be based on objective reasons.*

*Legal acts, including intergovernmental agreements between Member States, directly linked to the functioning of the euro area **shall respect the internal market**, as well as economic and social and territorial cohesion, and shall not constitute a barrier to or discrimination in trade between Member States. These acts shall respect the competences, rights and obligations of Member States whose currency is not the euro. [...]*

This is already the case *de jure* and *de facto*. The principal concern this clause addresses is the impact of British non-membership of the euro upon the UK economy, notably financial services.

There is a very clear political logic for including this clause, because of previous efforts by the European Central Bank (ECB) and some Member States which have, on arguments of financial stability, in effect worked to undermine the internal market. However, rulings from the Court of Justice of the EU (CJEU) to date have undermined such efforts by the ECB. One notable case is that of euro clearing.

In January 2009, then-French Finance Minister Christine Lagarde referred to the need for ‘euro area clearing’. That February, a 26-page confidential memo by the Bank of France was leaked. The memo [advocated](#) the creation of a Paris-based clearing house for credit default swaps, with the explicit aim of preventing London from dominating the business.

Christian Noyer, then the Governor of the Bank of France, publicly [confirmed](#) the longstanding French position in a December 2012 interview with the *Financial Times*: ‘Most of the euro business should be done inside the euro area. It’s linked to the capacity of the central bank to provide liquidity and ensure oversight of its own currency.’

The French position also reflected a longstanding ECB preference on the location of euro-derivatives clearing, stated as early as 2001. The ECB [recommended](#) enshrining this preference for the first time in 2011, calling for legislation requiring clearing houses to be based in the euro area if they handled ‘sizeable amounts’ (more than 5 per cent of the clearer’s total business) of euro-denominated financial products.

This recommendation came in the context of a long-standing debate over the control and authorisation of clearinghouses in the [European Markets Infrastructure Regulation](#). The UK government later won an important concession, prohibiting the discrimination against any Member State as a venue for clearing services.

In September 2011, the UK government took the ECB to court on the grounds that the ECB’s policy recommendation would restrict the free movement of capital and

infringe the freedom of establishment.

The UK government argued that the ECB's move would disadvantage financial services in the UK and could force one of the world's largest clearing houses – LCH.Clearnet, which far exceeded the 5 per cent threshold – to move much of its euro operations to the euro area. At the end of 2012, over 40 per cent of euro-denominated transactions took place in London – more than the entire euro area combined.

The ECB responded to these valid concerns by clarifying its clearinghouse location policy in a November 2011 document. In February 2012, the UK government launched a second 'technical' legal challenge. In March 2015, the CJEU [ruled](#) that the ECB was acting beyond its competence by attempting to direct clearing of euro-denominated financial products to the euro area.

While the ruling clarified the illegality of the ECB's efforts, the CJEU did not decide on the question of whether financial stability outweighs the internal market. The possibility remains therefore that concerns for the former could trump efforts to preserve the latter.

Moreover, the ECB's actions left a nasty aftertaste in the UK and a very real (and valid) fear that some Member States and some EU institutions see the balance between concerns on financial stability and the need to respect the internal market very differently from the UK.

On this particular issue, the underlying concern that UK-located counterparty clearers might lack sufficient liquidity in a crisis has been resolved through swap arrangements between the ECB and the Bank of England.

Separately, it is also possible that pressure from convergence of bank supervisory standards within the [Single Supervisory Mechanism](#) (SSM) for the participating states could shape rules that apply to all EU Member States. This remains another important British preoccupation, and one which definitely is not unwarranted. However, important safeguards are already in place in this respect.

More generally, it is important to note that on nearly all internal market issues (and specifically on financial services) there is no clear euro area bloc. The coalitions of Member States on nearly all matters concerning financial services cut across euro area and non-euro area membership. For instance, the UK is regularly joined by the Netherlands, Ireland and Luxembourg on a range of financial services issues (from the financial transactions tax to [AIFMD](#)). This is not likely to change in the near future.

## Clause 2 – Banking Union

*Union law on the banking union conferring upon the European Central Bank, the Single Resolution Board or Union bodies exercising similar functions, authority over credit institutions is applicable only to credit institutions located in Member States whose currency is the euro or in Member States that have concluded with the European Central Bank a close cooperation*

*agreement on prudential supervision, in accordance with relevant EU rules and subject to the requirements of group and consolidated supervision and resolution.*

*The single rulebook is to be applied by all credit institutions and other financial institutions in order to ensure the level-playing field within the internal market. Substantive Union law to be applied by the European Central Bank in the exercise of its functions of single supervisor, or by the Single Resolution Board or Union bodies exercising similar functions, including the single rulebook as regards prudential requirements for credit institutions or other legislative measures to be adopted for the purpose of safeguarding financial stability, may need to be conceived in a more uniform manner than corresponding rules to be applied by national authorities of Member States that do not take part in the banking union. To this end, specific provisions within the single rulebook and other relevant instruments may be necessary, while preserving the level-playing field and contributing to financial stability.*

Once more, this is a restatement of current legal fact and the *de facto* reality. If anything, the text appears to exaggerate the singleness of the [Single Rulebook](#). It is important to note that, even in the Single Supervisory Mechanism – on the direct European supervision of the largest euro area banks – the ECB is obliged to operate supervision according to the national banking laws of the participating Member States transposing [CRD IV](#).

The ECB has counted around 150 options and national discretions in the application of EU rules on banks and their supervision. Of course, the ECB wants to reduce the scope of these options and discretions, but for many this will take a long time and in some areas convergence is very unlikely.

Non-[Banking Union](#) Member States (like the UK) are still subject to the EU-wide Single Rulebook and efforts at convergence and harmonisation. However, here the EU (through the European Banking Authority – EBA) has fewer powers than the ECB to bring about convergence in supervisory practice.

Another crucial point is that the SSM's supervisory manual and supervisory approach must conform to the EBA's binding technical standards and guidelines – not the other way around. This is because the SSM must respect the rules of the internal market.

The UK has more room to manoeuvre in the transposition and implementation of European standards than do the SSM national competent authorities (supervisors), which are under much more pressure from the ECB to modify a range of their distinctive national supervisory practices.

Another important feature of the EBA is its own specific Double Majority voting rule, which is unique in EU policymaking. This means that a UK vote on EBA decisions on supervisory policies is more heavily weighted than those of the members of the Banking Union. At present, a coalition of five out of the nine non-euro Member States can block EBA decisions. In contrast, it may take ten out of the nineteen euro area Member States to block decisions.

This of course is egregious, because it introduces a *de facto* qualified majority voting (QMV) which has no relationship to national population or size of the national economy. This definitely strengthens the UK's bargaining position at the EBA's Board of Supervisors. This unique Double Majority voting in the EBA will remain until the number of Member States outside the Banking Union drops to four.

In other words, we might well have a situation in the not-too-distant future where three Member States (regardless of their size) can block decisions supported by the other 25! This can legitimately be described as 'heavily' qualified majority voting!

### Clause 3 – Bailouts

*Emergency and crisis measures designed to safeguard the financial stability of the euro area will not entail budgetary responsibility for Member States whose currency is not the euro, or, as the case may be, for those not participating in the banking union.*

*Appropriate mechanisms to ensure full reimbursement will be established where the general budget of the Union supports costs, other than administrative costs, that derive from the emergency and crisis measures referred to in the first subparagraph.*

This is to a very large extent a restatement of the legal and *de facto* reality that exists today. However, one example from the recent past shows how the agreement might feasibly provide additional safeguards. This relates to the [European Financial Stability Mechanism](#) (EFSM).

Last summer, the EFSM [provided](#) a bridging loan to Greece of €7 billion. The UK voted against using the EFSM but was outvoted in the Council — with all euro area states voting in favour. This was picked up — by the UK government, the softly Eurosceptic think tank Open Europe and various elements of the Brexit campaign — as a good example of Britain losing power to a bloc of euro area Member States (through QMV in the Council) and being potentially forced to pay to help euro area states in trouble.

Unlike the [European Stability Mechanism](#) (ESM) — the main funding mechanism of the euro area for both sovereigns and banks — the EFSM is an EU-wide mechanism that can raise up to €60 billion by issuing debt. These funds can be used to support any EU Member State (not just in the euro area).

The suggestion is therefore that British taxpayers, through the UK contribution to the EU budget, could be forced to provide financial support to the euro area. However, the reality is more complex.

First, the bulk of European financial support comes from the ESM, to which the UK does not contribute. Second, the EFSM raises funds on the markets. These funds are guaranteed by the European Commission using the EU budget as collateral. In theory, then, if a country failed to pay back the loans from this mechanism (offered at comparatively generous terms), it is the EU budget that would take the hit.

So the impact on the Member States would be limited to the contributions they already make to the EU budget. The necessary funds would have to be taken from other parts of the EU budget — the UK would not be expected to pay more. The impact on UK taxpayers would at worst be very minimal and indirect — beyond the fact such a situation would be very unlikely.

It is also worth noting that the bulk of the EFSM's total funding (€46.8 billion out of a possible €60 billion) has been lent to Ireland and Portugal, and these loans were supported by the UK government!

#### Clause 4 – Opt-In Provision

*The implementation of measures, including the supervision or resolution of financial institutions and markets, and macro-prudential responsibilities, to be taken in view of preserving the financial stability of Member States whose currency is not the euro is, subject to the requirements of group and consolidated supervision and resolution, a matter for their own authorities and own budgetary responsibility, unless such Member States wish to join common mechanisms open to their participation. [...]*

Again, this merely restates the existing situation in law and in practice.

#### Clause 5 – The Euro Group

*The informal meetings of the ministers of the Member States whose currency is the euro, as referred to in Protocol (No 14) on the Euro Group, shall respect the powers of the Council as an institution upon which the Treaties confer legislative functions and within which Member States coordinate their economic policies.*

*In accordance with the Treaties, all members of the Council participate in its deliberations, even where not all members have the right to vote. Informal discussions by a group of Member States shall respect the powers of the Council, as well as the prerogatives of the other EU institutions.*

This is a further restatement of the existing situation. If anything, the text might even exaggerate the importance of the Euro Group, which has no legal decision-making powers.

Much work has been done by political scientists on the role of the Euro Group as an informal decision-making body. However, yet again, it is crucial to remember that the euro area states have significant differences in views on most issues (such as fiscal policy). It is therefore unlikely that decisive agreements could be reached in Euro Group discussions on internal market matters which also affect non-euro area states.

#### The *Quid Pro Quo*

The European Council agreement on the UK's EU renegotiation should also not be

seen as reducing the UK government's power in economic governance policymaking.

On 10 March, pro-Brexit UK cabinet minister Chris Grayling [argued](#) that the provision that non-euro area member states will not “impede the implementation of legal acts directly linked to the functioning of the euro area” ... is a significant – and under-appreciated – loss of leverage’. He suggested that, with this provision, the UK government had ‘deprived itself of a key tool in preventing further EU integration’.

In full, the provision in question (Section A, Clause 1, Paragraph 3) reads:

*Member States whose currency is not the euro shall not impede the implementation of legal acts directly linked to the functioning of the euro area and shall refrain from measures which could jeopardise the attainment of the objectives of economic and monetary union.*

Grayling's argument is problematic because non-euro area states are already obliged not to impede the implementation of euro area legislation. Implementation is not about adopting new rules. However, ‘refraining from measures that could jeopardise the attainment of the objectives of Economic and Monetary Union’ might – potentially – be more significant. But there is considerable ambiguity on the matter.

Let us consider the creation of the European Stability Mechanism in 2012. The UK blocked change of the EU treaties to establish the mechanism. The ESM was nonetheless adopted, but by an intergovernmental treaty outside of EU law. With the provisions of this agreement, could the UK in future be unable to block bringing the ESM within the EU treaties? I have my doubts.

Earlier in the EU's history, during the ratification of the Maastricht Treaty, the Danish people rejected the treaty in a referendum in 1992. In response, the European Council delivered the Edinburgh Agreement, which gave certain concessions to Denmark, and the Danish people subsequently voted in favour of the treaty the second time around. Please see my article on this: ‘The Compromise on Denmark and the Treaty on European Union: A Legal and Political Analysis’, *Common Market Law Review*, 31, 1994, pp 765-805.

However, in reality, the agreement changed very little (if anything) on the provisions of the Maastricht Treaty protocols related to Denmark. I would [suggest](#) that the UK's EU renegotiation has a strong parallel in the Edinburgh Agreement. This is particularly the case for the economic governance provisions of the UK's deal.

*This article is based on a recent [presentation](#) by the author at the Jean Monnet Centre of Excellence at the University of Luxembourg.*

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