



# Why treaty change matters for business and for Britain

*By Hugo Brady and Charles Grant*

- ★ The German presidency of the EU hopes that the Brussels summit on June 21<sup>st</sup>-22<sup>nd</sup> will approve its plans for a new treaty. This would amend the existing treaties and be much more modest in scope than the constitutional treaty defeated in the French and Dutch referendums in 2005.
- ★ The constitutional treaty would have changed little in the way the EU makes economic policy, and the new treaty, if approved, will change even less. It would probably improve the process of decision-making, but would not transfer substantive powers to the EU.
- ★ The arrival of 12 new members in the EU since 2004 has not stopped it taking decisions, for example on the single market. But EU institutions and procedures work poorly in two areas: foreign policy, and justice and home affairs.
- ★ Most EU governments believe that the EU's 'deepening', the building of stronger institutions, and 'widening', the entry of new members, have to go together. This means that without a new treaty to prepare the EU institutions for a wider Europe, enlargement will stop.
- ★ With a new generation of reform-minded leaders in charge of France, Germany and the Commission, Britain has an opportunity to help lead the EU towards a more pragmatic, economically liberal future. But if Britain blocks an agreement on a new treaty, its voice in future negotiations – such as those on the budget and farm policy – will count for less. An EU riven by internal conflict would become more introspective and less able to forge coherent policies on climate change, Russia, the Middle East and much else.

Businesses should feel broadly satisfied with the way the EU is developing. The Union's enlargement has extended the single market to some 500 million people. The market is still deepening in areas such as energy, capital markets and postal services. The current German chancellor and the new French president have more sympathy for economic liberalism than their predecessors, while in the European Commission the key jobs – the president and the commissioners for the single market, competition and trade – are held by liberals. Before proposing new laws, the Commission now consults widely and carries out impact assessments. Under the so-called Hampton Court agenda – named after a meeting during the 2005 British presidency – the EU has tried to shift its focus towards issues that matter

for the citizens of Europe, like climate change, energy security, and research and development.

Yet the German presidency of the EU has put treaty change back on the agenda. The Brussels air is thick with talk of institutions, inter-governmental conferences, variable geometry and other such exceedingly dull concepts. To many observers, especially in Britain, the EU is once again shooting itself in the foot, preparing for another round of navel-gazing, when all around it the world is full of challenges and problems that need tackling.

However, treaty change is not an unnecessary distraction. Businesses in general, and the British in particular, have a strong interest in Angela Merkel,

the German chancellor, striking a deal on a new treaty at the Brussels summit on June 22<sup>nd</sup> 2007. The purpose of this policy brief is to explain why a failure to agree on a new treaty would be bad for business, bad for Britain and bad for Europe.

## The German plan

The constitutional treaty, agreed by the EU heads of government in June 2004, was killed off by the French and the Dutch voting No in referendums.<sup>1</sup> Eighteen member-states have now ratified the text but all 27

<sup>1</sup> For an analysis of the constitutional treaty's contents, see 'The CER guide to the constitutional treaty', CER policy brief, July 2004.

would have to do so before it became law. Given that there is no chance of Britain, the Czech Republic, France, the Netherlands or Poland ratifying the document, it cannot be revived.

At the June summit, Merkel will seek to persuade the heads of government to support her proposal for a new treaty that would amend the existing treaties. She wants them to commit to a timetable for an inter-governmental conference in the autumn, which would allow the new treaty to be ratified in 2008, in time for the European Parliament elections in 2009. She also wants all 27 to agree, in broad terms, to the contents of the new treaty.

Merkel needs to strike a delicate balance between the 'minimalists', the five countries mentioned above that will reject anything resembling the constitutional treaty; and the 'maximalists', most of the other member-states, which want to keep as much of the treaty as possible. The plan is for most governments to ratify by parliamentary vote rather than referendum, though the Irish will in any case put the treaty to the people. The greater the number of countries holding referendums, the greater the risk that one country cannot ratify, which would send the EU back to square one.

At the time of writing, in May 2007, most governments seem likely to back the German plans. But the Germans worry about Poland, because Lech and Jaroslaw Kaczynski, respectively president and prime minister, are unpredictable and have eurosceptic leanings. And they worry about Britain. The Germans are confident that Tony Blair, the outgoing prime minister, will support their plan, but fear that Gordon Brown – who will become prime minister a few days after the summit – may not.

If Brown supports a deal on treaty change, the issue will shoot up the British political agenda. Eurosceptics and Conservatives will accuse the government of signing up to a federal EU, and demand a referendum on the treaty. In other countries, too, there may be pressure for a referendum, though President Nicolas Sarkozy's promise to ratify through the French parliament will diminish that pressure.

The eurosceptics will portray the new treaty as an attempt to salvage the constitutional treaty 'by the

back door'. To what extent would that be true? In May 2007 we cannot describe the exact contents of the amending treaty. But from conversations with those working on the document, we can make some informed guesses.

The constitutional treaty has four parts. The first is a short description of the EU's aims and institutions. The second, 'the charter of fundamental rights', sets out the rights and principles that the EU stands for. The long third part is mostly a consolidation of the existing treaties, modified to allow for the implementation of the institutional reforms covered in part one. The short part four covers the provisions for ratifying the treaty.

The Germans will drop those bits of part one that seem 'constitutional': not only references to an EU flag and anthem, but also, perhaps, the lists of legal competences, explaining which powers are for the EU, which are for the states, and which are shared; the article giving the EU a full legal personality, so that it can join international organisations in its own right; and the reference to the supremacy of EU law, which was in any case established by the European Court of Justice (ECJ) in the 1960s. Part two would go altogether or be consigned to a protocol. Part three would be cut, except for the articles required to make the new institutional provisions work.

So what would be left for the amending treaty? Our guess is that the new treaty would consist of the basic institutional innovations that went into part one of the constitutional treaty. These include a full-time president to chair the European Council (the regular meetings of the heads of government), in place of the rotating presidency; a new and simpler set of rules on voting, known as 'double majority'; new rules for choosing commissioners, so that there would be fewer than one per member-state; the creation of a 'foreign minister', merging the jobs currently done by Javier Solana, the Council's High Representative for foreign policy, and Benita Ferrero-Waldner, the commissioner for external relations (though the job title will be changed, to make clear that the post does not supplant national foreign ministers, whose powers will remain unchanged); a new 'external action service' to assist the foreign minister; and an exit clause that allows a country to leave the Union. In addition, several other provisions from the constitutional treaty that were not particularly controversial may appear in the new document (some of these are discussed below).

The constitutional treaty introduced qualified majority voting (QMV), meaning the abolition of the national veto, on 39 subjects. The argument over QMV in the new treaty will be bitter. About half of the 39 concern areas that are already largely covered by majority voting, like transport policy, or deal with procedural matters, like regulations affecting EU employees. The significant extensions were for rules on social security for migrant workers, and for legislation on justice and

home affairs (JHA) – though in both those areas, the UK negotiated an ‘emergency brake’, a complex procedure that would allow it to block decisions (leaving others free to go ahead without it). Germany and many other countries will fight to retain the extensions of QMV, pointing out that during the negotiation of the constitutional treaty, Britain protected its ‘red lines’ by excluding QMV from sensitive areas like tax, employment, the EU budget, foreign policy and defence. The British response will be that the world has changed, and that if the new treaty transferred substantive new powers to the EU, they would be obliged to hold a referendum on it.

The new treaty is likely to be a small fraction of the length of the 500-page document agreed in 2004. But it will probably contain additional wording on a few subjects that have become politically salient over the past three years. The constitutional treaty said little about issues such as energy security or climate change, and added nothing to what previous treaties had said on enlargement. The Germans will not propose new powers for the EU to enhance energy security or tackle climate change, but may add words that define them as EU priorities. And as a token to keep enlargement sceptics happy, the new treaty may spell out the ‘Copenhagen criteria’ for assessing a candidate’s readiness for membership (adopted by the EU in 1993, these say that candidates must respect the rule of law, minorities and human rights; have a functioning market economy; be able to cope with the competitive pressures of the single market; and be capable of implementing the EU’s rulebook).

### **What will the new treaty mean for business?**

British businesses have a clear interest in efficient EU institutions and procedures. Previous treaties laid down the rules on how the EU makes law to liberalise markets, limits state aid, ensures open public procurement, curbs cartels, regulates mergers and decides international trade policy. The treaties set the framework through which the EU pursues broader objectives such as economic reform, or action to reduce greenhouse gas emissions. They protect existing economic achievements, like the single market, against the protectionist instincts of some governments.

Most business leaders have – very understandably – taken little interest in the issue of treaty change. It has not seemed pertinent to what they do. And in one sense they are right. The constitutional treaty would not have changed much in the way the EU regulates and sets rules for businesses. And the new amending treaty, if agreed, will have many fewer clauses and thus change even less. For example, most areas of EU economic policy, such as the single market and trade, are already subject to QMV, and the new treaty will not extend it into other areas of economic policy-making.

However, given the passions that treaty change will excite among some British politicians, we shall examine briefly the articles in the constitutional treaty

that are relevant for business. We shall focus in particular on those articles that may be transferred to the amending treaty.

The new treaty could strengthen the Euro Group, the committee of eurozone finance ministers that now meets only informally. The constitutional treaty would have given the Euro Group legal status and enabled its president to represent the eurozone in international financial institutions. This is not of great relevance to Britain, so long as it shuns the euro.

The constitutional treaty would also have improved the way the EU budget is negotiated and spent. The European Parliament would have gained modest powers to influence spending on the common agricultural policy (CAP) – it has long enjoyed the power to influence other parts of the EU budget. To judge from its past behaviour, the Parliament would be likely to use such powers to promote a slimmer and reformed CAP. The new rules would also have tightened budget discipline by setting annual caps on the spending of each EU institution.

The constitutional treaty would have given the EU, for the first time, a specific competence to promote an internal energy market. But in practice this would have changed virtually nothing, for the EU has legislated to liberalise energy markets on the basis of single market competences. The treaty confirmed each member-state’s right to control its own energy resources, restated that decisions on energy taxation would require unanimity, and proclaimed the goals of promoting energy efficiency and renewable energy.

In international trade negotiations, the constitutional treaty would have extended the exclusive competence of the Union’s common commercial policy, which already covers trade in goods. The policy would cover trade in services, the commercial aspects of intellectual property, and foreign direct investment, thus enabling the Commission to negotiate for the EU on those subjects. Given the evident benefits of the EU negotiating as a bloc, rather than as 27 separate nations, and given the Commission’s strong commitment to open markets, Britain would benefit if these provisions were added to the amending treaty.

In the area of social policy, the EU already requires its members to protect certain minimum rights, such as non-discrimination between men and women. The Council of Ministers has long been able to adopt some minimum standards, such as those on health and safety, and on consultation in pan-European companies, by QMV. The constitutional treaty would not have changed the EU’s role on social policy, leaving most decisions on social security and workers’ rights subject to unanimity. It would have shifted decisions on social security for migrant workers and their families, where decisions would not fundamentally affect national systems, to QMV – though Britain negotiated an ‘emergency brake’ on that issue. If Ségolène Royal had won the French

presidency, she would have tried to give the new treaty a more 'social' flavour. In her absence, the cause of social Europe will lack a strong advocate.

### The charter of fundamental rights

During the negotiation of the constitutional treaty, some British business leaders fretted that the charter of fundamental rights would give the EU new powers over social legislation, and damage Britain's liberal labour market. The purpose of the charter, initially signed by EU governments in 2000 as a non-binding document, is to highlight the Union's commitment to the protection of rights. The convention on the future of Europe added the charter to the constitutional treaty that it drafted. EU governments kept the charter in the legally-binding treaty they negotiated in 2004.

Much of the charter covers the basic human rights that are included in the European Convention on the Protection of Human Rights (ECHR), which dates back to 1950. But the charter also adds 'social rights', such as the right to strike and to have decent housing. The basic rights in the charter effectively have legal backing through the ECHR. But there is no legal basis to enforce the charter's social articles, such as the right to social security, job training or protection against wrongful dismissal. EU governments consider such rights to be merely non-binding principles, and included them in the charter to express their general commitment to social justice.

The constitutional treaty includes a set of explanations, detailing the legal force of each charter article, and specifying how the European Court of Justice should interpret them. The charter's rights are guaranteed only "in accordance with Union law and national laws and practices". Thus a worker can rely on the charter's right to strike only insofar as that right already exists in his or her country.

The charter is addressed to EU institutions, bodies and agencies, but the treaty articles that govern its application state that nothing in the text can be interpreted as extending, modifying or creating new powers or tasks for the Union. Furthermore, the articles state that the charter does not apply to national governments, parliaments or courts when they enact, implement or interpret national law. Laws in most of the areas that British policy-makers and businesses worry about, such as social and employment legislation, are usually made at national rather than EU level.

Notwithstanding these multiple legal safeguards, the charter is likely to be dropped from the new treaty. Many governments, including Germany, think the charter would make the EU more citizen-friendly. But the British government views the charter as having a quasi-constitutional character, and believes that its inclusion would strengthen the hand of those demanding a referendum on a new treaty. The charter may be dropped altogether or turned into a special protocol (that governments might choose not to sign).

### Better leadership and accountability

The presidency of the European Council – and of all the various councils of ministers, such as the finance ministers, the farm ministers, and so on – shifts from one member-state to another every six months. This rotating presidency is a very inefficient system: each country uses its stint in the chair to promote its own pet projects, while countries outside the EU find the constant change in leadership confusing. Some of the smaller and newer member-states lack the resources to manage an EU presidency competently. The rotation of the presidency has contributed to the EU's leadership deficit, and impaired its ability to achieve ambitious policy goals.

The constitutional treaty proposed that an individual, rather than a country, should chair the European Council. The heads of government would elect a full-time president for a renewable term of two-and-a-half years. The president's main task would be to "drive forward" the work of the European Council, "ensuring proper preparation and continuity" and "cohesion and consensus" within it. The president would have no executive powers – so would succeed or fail according to his or her ability to think strategically and to motivate, persuade and cajole the heads of government.

According to the constitutional treaty, most of the councils of ministers would be chaired by a 'team presidency' – three countries, working together for an 18-month period. This would be an improvement on the current system, as would be the full-time president of the European Council. If, as is likely, these provisions become part of the amending treaty, businesses – which generally understand the need for clear lines of authority and continuity of leadership – should be content.

EU governments may decide to keep the treaty provisions that enhance transparency and the involvement of national parliaments in EU decision-making. The treaty would have opened the Council of Ministers to the public when it debated legislation, and required EU institutions to send draft laws to national parliaments at an early stage in the law-making process. It would have also established the 'yellow card procedure': if a third of national parliaments voted that a Commission proposal violated subsidiarity (the idea that decisions should be taken at the lowest appropriate level of government), the Commission would be obliged to pause and explain why the measure was needed.

The governments may salvage another provision, which would have given member-states, national parliaments, regions and individuals the right to ask the ECJ to rule on whether an EU law breached subsidiarity. Businesses should argue strongly in favour of having such measures in the new treaty, for they would help to check any possible future tendency of the Commission towards excessive regulation.

During the negotiation of the constitutional treaty, the arguments over the voting system for the Council

of Ministers proved particularly fraught. The current system of qualified majority voting is extremely complicated and discriminates unfairly against large countries, giving them fewer votes than their populations merit. The new system of 'double majority' voting has the merit of simplicity: a measure would pass only if 55 per cent of member-states voted for it, so long as they represented at least 65 per cent of the EU's population.

This system would boost Britain's share of the votes in the Council from 8.4 to 12.2 per cent – increasing Britain's voting power by about 45 per cent. Only Poland objects to double majority voting, for two reasons. First, Poland did very well from the previous voting rules, negotiated at Nice in 2000, which gave it almost as many votes as the countries with much larger populations. Second, double majority voting would give Germany twice as many votes as Poland, since it has twice as many people – and that touches raw historical nerves among some Poles.

Under the new system, those opposing a law would find it slightly harder to block it. But that should not concern the UK or businesses, since most of the draft laws coming out of the Commission are liberalising measures. Britain should support a system that increases its voting strength in the Council of Ministers.

### Who needs treaties?

Not only eurosceptics, but also many others regard treaty change as a waste of time. They argue that, despite the accession of 12 new members since May 2004, the Union continues to function. The institutional framework of Council, Commission, Parliament and Court of Justice has not collapsed into chaos. Laws get passed and decisions get made.

Those opposed to treaty change have a point, particularly in the realm of economic policy-making. Close observers of the Council of Ministers report a decline in the quality of debate around the table. Council meetings take longer, because so many ministers want to have their say. More decisions are taken in small groups away from the table. The wording of decisions tends to be less clear, according to some. But these are the inevitable consequences of the growth in the number of participants. The institutional provisions of the constitutional treaty, if applied in full, would not fix these problems, except to the extent that more majority voting speeds up decision-making (even where QMV applies, votes are rare, but the prospect of a vote encourages recalcitrant governments to compromise). However, most laws on business regulation are already decided by majority vote. Thus the accession of new members has not necessarily made it harder to pass single market laws.

In two other areas, less relevant to business, provisions in the constitutional treaty would help decision-making. One is justice and home affairs. The treaty would have transformed this area, switching

most decisions to majority voting, and giving the Commission the power to ensure that agreements on policing and criminal justice co-operation are properly implemented.

Among the EU's interior ministries, there is a growing realisation that international co-operation is essential in the fight against organised crime, illegal immigration and terrorism.<sup>2</sup> But the EU governments usually take decisions on these issues by unanimity, and often very slowly. The final compromises are frequently of poor quality, and are seldom implemented on time. For example, the Council took several years to negotiate a law that should ensure the rapid sharing of criminal evidence between EU judicial systems, and national exceptions have harmed the law's effectiveness. Although 27 governments have signed up to the new system of JHA decision-making in the constitutional treaty, some interior ministries are having cold feet about aspects of it, and may call for more modest changes in the new treaty. However, the case for persevering with the introduction of majority voting remains compelling.

A second area where the existing institutions do not work well is the Common Foreign and Security Policy (CFSP).<sup>3</sup> The rotating presidency is particularly damaging to the EU's external representation. The split between the High Representative and his bureaucracy, and the commissioner for external relations and her bureaucracy – and the lack of communication between them – is very damaging. The inability of the EU to co-ordinate either its various external policies in Brussels, or the wide range of bodies, missions and agencies that act in its name in other countries, is embarrassing. The reforms promised by the constitutional treaty held out the prospect of a significant improvement to the CFSP. The new 'foreign minister' would have merged the jobs now performed by Solana and Ferrero-Waldner; a new external action service, consisting of Council, Commission and national officials, would provide the foreign minister with resources; and he or she would chair the meetings of foreign ministers, and represent the EU externally, in place of the rotating presidency. Such reforms would not shift powers to the EU – policy would still be decided by unanimity – but would create more efficient institutions. Therefore it would be desirable for the new treaty to adopt these provisions from the constitutional treaty.

### The strategic implications of treaty change

Despite the current problems in areas such as JHA and CFSP, which a new treaty could help to fix, there is a much stronger argument for the EU to adopt a new treaty. This is that without an agreement on treaty change, the EU is likely to suffer serious strategic damage, in three ways.

<sup>2</sup> Hugo Brady, 'The EU and the fight against organised crime', CER working paper, April 2007.

<sup>3</sup> Charles Grant and Mark Leonard, 'How to strengthen EU foreign policy', CER policy brief, May 2006.

The first is that treaty change and enlargement go hand in hand. The predominant view among leaders in many EU countries is that ‘deepening’, the development of stronger institutions, and ‘widening’, the admission of more members, should go together, or not at all. They think that more widening without deepening would weaken EU institutions and the sense of solidarity that binds the member-states together.

Such fears are probably exaggerated: as already stated, the Union does work with 27 members. It is true that if the Union took in ever more members on the basis of the current treaties, it would become less effective in some areas. But that is not the real issue. What matters is that the Union cannot enlarge without the unanimous support of every member-state. And it is a fact that many governments – including France, Germany, Italy and Spain – believe in the link between deepening and widening, and will therefore block enlargement without a deal on institutional reform.

Croatia, which has already made good progress with its enlargement talks, may be an exception, and could join even without a new EU treaty. But the other Balkan states and Turkey would stand no chance. If the EU shuts the door on these countries, their leaders would find it much harder to press ahead with political and economic reform. An end to enlargement would bring harmful economic consequences not only to candidate countries, but also to member-states. Enlargement – and its boost to migration, investment and trade – has been a strong driver of economic growth in recent years.

The second strategic problem for the EU would be a loss of British influence. If Gordon Brown, or Brown and one or two other leaders, vetoed a deal on treaty change, the atmosphere among the governments would become rancorous. The Germans would not be amused that Britain had effectively destroyed what they hoped would be the crowning achievement of their EU presidency. Some governments would become less willing to do the British favours on issues that matter to the UK. In 2008, when the EU starts to review its budget and the CAP, Britain’s voice would carry less weight than it should – if Britain was perceived as the cause of an institutional crisis. And when it comes to promoting economic reform and more liberal markets, Britain might find fewer allies at its side than it would wish.

The more integrationist countries would start talking about ‘variable geometry’ – the creation of *avant-garde* groups that could move ahead in particular policy areas, without the British and perhaps some others. There may even be talk of a ‘core Europe’, an inner circle that integrates across a broad range of policies, within the wider EU. A core Europe is unlikely, but variable geometry is possible in areas such as justice and home affairs, economic co-operation among euro countries, and corporate taxation – and need not necessarily damage Britain.

However, with Britain marginalised, France and Germany would have little choice but to give the Union the leadership it would look for. The irony would be that both President Sarkozy and Chancellor Merkel are keen to work closely with Britain. They believe that the Union can benefit from a strong British contribution, particularly on the economic policy agenda, and would welcome close collaboration between Berlin, London and Paris. Neither Merkel nor Sarkozy is particularly keen on the sort of tight Franco-German alliance that operated in the days of Helmut Kohl and François Mitterrand. And yet, if Brown chose to block a new EU treaty – for whatever domestic political reasons – he would exclude himself from Europe’s leadership club. Merkel and Sarkozy would work with other leaders to pursue their goals. All this would extend French and German influence on EU policy-making. Notwithstanding the relatively liberal bent of Merkel and Sarkozy, this would not be good for the pragmatic and free-trading approach to Europe that Britain espouses.

The third strategic consequence of a blockage on treaty change would be that the Union became less capable of dealing with the many external challenges it faces. Politicians and officials would be busy with – and sometimes obsessed with – treaties, institutions and schemes for removing the blockage, for a prolonged period. The Union would become more introspective. It would have much less energy for trying to conclude the Doha round of trade talks, developing a common approach to energy security, forging a united response to the rise of Russian authoritarianism, or playing a constructive role in the Middle East peace process. And its chances of leading the world in building a new international mechanism for tackling climate change, to replace the Kyoto system that ends in 2012, would be greatly diminished.

So the Union needs to strike a compromise on treaty change, and then move on to deal with the issues that matter. It has spent far too much time talking about institutions and treaties over the past few years. Merkel has already shown herself to be a skilled negotiator with a knack for persuading other leaders to shift their positions. But she will find it very hard to broker a compromise among 27 governments. The Poles may be difficult. The British may oppose any treaty that transfers new powers to the EU. They may therefore reject significant extensions of majority voting, unless a formal opt-out is practicable, as it would be in sensitive areas like JHA and social security for migrant workers. The maximalists, like Belgium, Italy and Spain, will be very reluctant to accept the sort of treaty that Britain could swallow. But Merkel may persuade them that a small piece of cake is better than no cake at all. To move on, Europe needs a deal.

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