Shortcut to euro or dead end?

Reflections on the (im)possibility of changing the Maastricht criteria and the consequences of unilateral euroisation

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Disclaimers:

- *These are personal views only*
- *The issue is looked upon from legal and decision making perspectives, although it is by and large economic in its nature.*

Introduction:

'*In a way, the euro can be linked to the armours worn by knits during the Middle Ages. Of course, an armour provides a shield against external hits. However, an armour can also limit the freedom of action and restrain flexibility. It can also give a false sense of security*'.

Quotation from speech by Jürgen Stark, Member of the Executive Board of the ECB delivered at the Icelandic Chamber of Commerce, Reykjavik, 13 February 2008

➢ Who already uses the euro as the (sole) official currency?

- 16 euro area Member States: (11 'original' plus 4 'new' Member States (Slovenia as of 2007, Cyprus and Malta as of 2008 and Slovakia as of 2009) in accordance with the EC Treaty provisions on the introduction of the euro, including compliance with Maastricht or convergence criteria
- Vatican City (previously Italian lira), San Marino (previously Italian lira), Monaco (previously French franc) use the euro as their official currency on the basis of Monetary Agreements with the Community and issue their own coins (Article 111(3) of the EC Treaty); Andorra (previously French francs and Spanish pesetas) uses the euro as its official currency and is in the process of negotiating the Monetary Agreement with the Community
- French overseas territories (which are not part of the European Union) of Mayotte and Saint-Pierre-and-Miquelon use the euro as their official currency on the basis of a Council Decision
- Montenegro and Kosovo as a result of unilateral euroisation. In case of Kosovo imposed by the international community (UNMIK Special Representative)

➢ Who in the EU does not use the euro and why?

- UK and Denmark have negotiated opt-outs (Protocols annexed to the Maastricht Treaty)
- Sweden and all new Member States are 'Member States with a derogation' for the purposes of the monetary union' and hence under the obligation to introduced the euro as soon as they comply with the convergence criteria

What are Maastricht convergence criteria and where are they set?

- the ratio of government deficit to gross domestic product must not exceed 3% and the ratio of government debt to gross domestic product must not exceed 60%;
- there must be a sustainable degree of price stability and an average inflation rate, observed over a period of one year before the examination, which does not exceed by more than one and a half percentage points that of the three best performing Member States in terms of price stability;
- there must be a long-term nominal interest rate which does not exceed by more than two percentage points that of the three best performing Member States in terms of price stability;
- the normal fluctuation margins provided for by the exchange-rate mechanism must be respected without severe tensions for at least the last two years before the examination;
- legal convergence – independence of the central bank and adaptations of the national central bank statutes

- The convergence criteria are set in the Maastricht Treaty and in the Protocols (on on the convergence criteria referred to in Article 121 of the Treaty establishing the European Community and in the Protocol on the excessive deficit procedure) = in the primary law of the EU and hence can be amended only by the IGC and subsequent Treaty amendments, that would have to be ratified in accordance with the national constitutional requirements and traditions.

Who interprets the convergence criteria and can this be done differently?

- The European Central Bank (ECB) and the Commission (independently) adopt a Convergence Report at least once in two years or upon a request from a Member State with a derogation;
- The Council decides which Member States with a derogation fulfil the necessary conditions on the basis of the criteria set out in Article 121(1), and abrogate the derogations of the Member States concerned (acting on a proposal from the Commission acting by the qualified majority);
- A lot of criticism, especially after the downturn of the Lithuanian application for the euro area membership, was directed towards the Maastricht criteria and their application. Arguably the most 'outdated' criterion is the inflation criterion, because it takes as the reference value the 'three best performing Member States in terms of price stability' and not three best performing euro area Member States. Besides, it should be noted that in accordance with Article 105(1) of the EC Treaty the price stability is the primary objective of the ECB. Hence the ECB's Governing Council has defined the prices stability as 'a year-on – year increase in the Harmonized Index of Consumer Prices (HICP) for the euro area of below 2% '. The Governing Council has officially stated that, in pursuit of price stability, it aims to maintain inflation rates below, but close to, 2% over the medium term. Interestingly though, the Treaty of Lisbon, however, has not corrected this 'out-datedness'.

Any chance for a fast-track procedure on the account of the crisis? Not really..

- The ECB keeps emphasizing that convergence must be achieved on a lasting basis and not just at a given point in time. And that premature introduction of the euro may harm country in many ways (because monetary policy decisions in the EMU are taken in the light of economic conditions prevailing in the euro area as a whole, consequently differences in business cycles could lead to 'sub-optimal' interest rates; that competitiveness problems could no longer be solved through exchange-rate adjustments.
- On 30 March 2009 Jean-Claude Trichet, the President of the ECB made his introductory remarks at the hearing before the Economic and Monetary Affairs Committee of the

European Parliament, stating, *inter alia*, that '*Some central and Eastern European countries have also been hit [by the crisis] hard, thus highlighting previous vulnerabilities. These weaknesses relate in particular to domestic and external imbalances, unsound fiscal policies, and domestic and external debt positions. Overall, the financial crisis has highlighted the importance of macroeconomic imbalances and following a sustainable growth path supported by a sufficient degree of structural reform. This is particularly true for 'catching-up' economies, which have to balance the desire for swift changeover with the need for the sustainability of the convergence process. The adoption of the euro can not be a substitute for the need of domestic policy adjustment. This would go against the economic logic which underlines the convergence process in Europe. [..] Thus, euro adoption cannot take place until major imbalances in the country have been eliminated and provided appropriate sustainable convergence has been achieved as required by the Treaty*.'

- The EU, however, will have to cross the bridge of altering the convergence criteria upon the conclusion of accession Treaty with Montenegro and eventually Kosovo.

➢ Is there a way around or should one listen to the IMF's suggestions to euroise unilaterally?

- Already in November 2000, the ECOFIN Council (EU ministers of Economic and Finance) formally adopted a position that unilateral euroisation is not compatible with the Treaty and cannot be a way to bypass the convergence process foreseen by the Treaty for the adoption of the euro. The ECB has always fully subscribed under this conclusion
- What is the motivation for this rigidity? Legally, seen from Community law perspective, such position is justified because (a) the Treaty provides for a specific, well detailed step-by-step procedure how the euro should be introduced as the currency of the EU Member States, (b) the unilateral euroisation would render the application of some convergence criteria impossible (2 years in ERMII respecting normal fluctuation margins, long term interest rates); (c) it would breach the principle of equal treatment; (d) a sustainable convergence that is conductive to the maintenance of price stability (primary objective of the ECB) and the coherence of the euro area may be undermined.
- Can the IMF's advice always be taken at the face value? In 1992 the IMF advised the Baltic States not rushing to leave the Russian rouble area[i]...
- The issue is open also from the public international law perspective – no case law (yet?) as to whether a country may give up its own currency and introduce another currency without the consent of the 'mother' country. USA does not object the dollarization by Panama etc.

➢ What would be the (direct) legal consequences of a decision to euroise unilaterally?

- No seat at the Governing Council of the ECB (the highest decision making body that defines the monetary policy of the euro area);
- No share of the seignorage (profits) of the ECB;
- No access to the ESCB resources by domestic banks for LOLR (lender of last resort) operations;
- Where to get the euro banknotes (from private sector, e.i. commercial banks) and how to handle them.

➢ Partial unilateral euroisation? Does it solve anything?

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[i] Knöbl, Adalbert and Haas, Richard D, 'IMF and the Baltics: A Decade of Cooperation', *IMF WorkingPaper* WP/03/241