EUROPEAN UNION MEMBER STATES OUTSIDE THE EURO AREA: THEIR LEGAL STATUS AND APPROACH TOWARDS THE EURO

Eva Indruchová*

Abstract: This article provides an overview of the legal status of the European Union Member States outside the euro area. It analyses the differences between Member States with derogation and Member States with opt-outs. The article also deals with the strict interpretation of the Maastricht convergence criteria when assessing new applicant countries. A discrepancy was noted when comparing the so called “first-wave” Member States and the newcomers – Lithuania is taken as a case study Member State for this purpose. This raises the question of the “principle of equal treatment”. A closer look is dedicated to Sweden, having a controversial and unique position within the group of Member States with derogation. More attention is given also to the United Kingdom as a traditional euro-sceptic country.

Keywords: Euro area, ERM II, Member States with a derogation, convergence criteria, referendum, European Monetary Union, lex imperfecta, principle of equal treatment, opt-out, Protocol, economic tests

1. INTRODUCTION

Amid the turmoil of financial crisis and heated political discussions about the future of a single European currency, the fact that over one-third of European Union (EU) Member States remain outside of the euro area has acquired momentum and deserves a closer look, in particular from the legal point of view.

The present euro area consists of 17 European Union Member States. Out of the total of 27 Member States which form the European Union, there are thus 10 Member States which at present remain outside the euro area. They may be divided into two main groups:

The first group is formed by eight countries, all of which have an obligation to adopt the euro as soon as they satisfy the required convergence criteria: Sweden, Latvia, Romania, Bulgaria, Czech Republic, Hungary, Poland and Lithuania. Except for Sweden, these countries all joined the European Union after the euro was already launched. Interestingly Lithuania is the only Member State that already tried to join the euro area, but was unsuccessful (details are given below). The group includes one old Member State, namely Sweden, but this Member State has a “sui generis” position – it has rejected entering the euro area for the time being – and therefore it will be examined separately.

The second group encompasses two countries: the United Kingdom and Denmark. These countries have special status as they negotiated opt-outs, meaning that they are not under the obligation to adopt the euro and join the euro area. However both Denmark and United Kingdom may join anytime in the future – providing, of course, that they meet...
the convergence criteria. The probability of Denmark and United Kingdom joining the euro area remains uncertain so far.²

2. MEMBER STATES WITH A DEROGATION

European Union membership does not automatically imply participation in the euro area – it requires fulfilment of the Maastricht Criteria as well as of the legal convergence criteria. The Maastricht Criteria consists of five convergence criteria, namely price stability, sound public finances, sustainable public finances, durability of convergence and exchange rate stability based on the participation in the Exchange Rate Mechanism II (ERM II) for at least 2 years without severe tensions.³

EU countries not participating in the euro area are – according to Art. 139 of the Treaty on the functioning of the European Union (formerly Art. 122 (1) of the Treaty establishing the European Community) – “Member States with a derogation”, which is of a temporary character.⁴ They do not belong to the euro area and they retain their monetary sovereignty.⁵ They are however committed to the objective of the introduction of a single currency as stated in Article 119 of the Treaty on the functioning of the European Union (formerly Art. 4 (2) of the Treaty establishing the European Community) and are under the obligation to achieve economic and legal convergence as a precondition for future adoption of the euro.⁶ Other provisions of the Title VIII Economic and Monetary Policy are applicable as governed by Art. 139(2), including for example Art. 130 that regulates the independence of national banks.

Even though belonging to the same category of “Member States with derogation”, the approach of these Member States remains varied, ranging from cautious to pro-active towards the euro.

The latter is valid for both Latvia and Lithuania. After joining the European Union in 2004, Latvia and Lithuania decided on a strategy of adopting the euro as soon as possible.⁷ Both countries quickly joined ERM II. Lithuania entered in June 2004 and Latvia followed in May 2005.⁸

Lithuania even applied to join the euro area as of 2007 but was rejected due to a narrow failure to meet the inflation criterion.⁹ The European Commission assessed, at the request of the Lithuanian authorities, whether Lithuania was ready to adopt the euro and it concluded that Lithuania met all the convergence criteria except the one on inflation and therefore the status of Lithuania as a Member State with a derogation should not be
changed.\textsuperscript{10} It has to be reminded however that the average rate of inflation was only a mere 0.1\% above the reference value.\textsuperscript{11} From an economical point of view it is important to note that the rate was “significantly below a seven-year average inflation rate of five member countries of the Eurozone”.\textsuperscript{12} While Lithuania could have been accepted from the economic perspective, from the legal point of view we have to agree that the provisions of the Treaty must be obeyed. Nevertheless this example demonstrates how the European authorities apply a strict interpretation of the Maastricht convergence criteria when assessing new applicant countries, contrary to the procedure used for the so called “first-wave” Member States, where a number of deficiencies have been tolerated.\textsuperscript{13} Just to mention a blatant example: “…at the start of the Eurozone quite a lot of the member countries did not satisfy one or more of the convergence criteria stipulated in the same Treaty. The debt levels of Belgium, Italy and Greece exceeded 100\% and were moving downwards exceedingly slowly. There was no way one could argue that these countries satisfied the Treaty provisions.”\textsuperscript{14} In the case of assessing the independence of national banks, France, for example, did not have an independent national bank at the time.\textsuperscript{15}

In this regard criticism has been repeatedly expressed on the uncertainties and conflicting views in the interpretation of the convergence rules as well as lack of consistency.\textsuperscript{16} Since the Treaty does not indicate whether the convergence rules should be subject to a strict or liberal interpretation and due to lack of coherence between the Treaty and Protocols, a shadow of legal uncertainty has been cast on the precise scope of the application.\textsuperscript{17} In the past the topic of ERM was raised regarding whether it was mandatory for a currency to be pegged to the ERM for at least two years. It should be noted that during the evaluation of other entrant countries, like Finland and Italy, neither were in the ERM for two full years.\textsuperscript{18}

However the situation has to be regarded from the legal point of view, meaning that if such differences were made possible in accordance with the Community legislation while applying different interpretation, the Community law (resp. nowadays the Law of the European Union) in this area may be considered as “lex imperfecta”.\textsuperscript{19} This was stressed many times also in connection with the fact that the Treaty establishing the European Community stipulated relatively detailed rules on entry requirements into the euro area, but did not provide enough detailed conditions and requirements to be complied with after accession to the euro area\textsuperscript{20} to ensure continuous and sustainable fulfilment of the economic criteria after adoption of the euro.

\textsuperscript{12} GRAUWE, P. Economics of monetary union. OUP Oxford, 2009, p. 155.
\textsuperscript{13} ČNB/ Vláda ČR. Společný dokument vlády ČR a ČNB: Aktualizovaná strategie přistoupení ČR k Eurozoně, 2007, p. 5.
\textsuperscript{14} GRAUWE, P. Economics of monetary union. OUP Oxford, 2009, p. 156.
\textsuperscript{15} Ibid.
\textsuperscript{17} Ibid.
\textsuperscript{18} Ibid.
\textsuperscript{20} Ibid.
According to certain experts, “a single currency project was frequently presented as a purely economic strategy, whereas it is clearly a political project, put forward by France and Germany.”21 Some stress that the euro was only a pretext for future possible integration in the area of economic policy and political centralisation and grasp of power.22 “The Euro is about European Union and political order rather than only lowering transaction costs or creating exchange-rate stability.”23 The tolerance of inaccuracies in the case of first-wave Member States can be explained by the strong political will to move ahead with the single currency, allowing some Treaty provisions to be ignored. In contrast the lack of political will to admit new Member States into the euro area have led to the Treaty provisions being applied with great precision as an obstacle for entry.24

Judging this situation on a purely legal basis, there should be no other option than the principle of strict adherence to the convergence criteria in compliance with the provisions of the Treaty, but it should have been applied from the very beginning – the acceptance of deficiencies in the past and the strict application of the rules at the present could be regarded as a legal flaw and raises the question of the “principle of equal treatment”. This principle ensures that the new European Union Member State adopting the euro should neither be confronted with additional obstacles nor be allowed to adopt the euro on looser terms than earlier entrants.25 Strictly speaking there are no “additional obstacles”, just a “correct application of the provisions”, but the breach of the principle of equal treatment may be based on a contrario argument: the first-wave Member States were allowed to adopt the euro on looser terms than current entrants.

While Lithuania has not set its new national target date26 so far, Latvia expects to adopt the euro on 1 January 2014.27 The only other Member State with a national target date is Romania, which is aiming for 1 January 2015.28 Romania, together with Bulgaria, the latest European Union Member States, joined the European family in 2007 with ambitious plans regarding euro area entry. However both countries face delays. In 2010, Bulgaria’s government abandoned plans to join ERM II.29 According to the Romanian Central Bank governor, a delay of one or two years could be expected in the case of Romania.30

After accession to the EU, the Czech Republic, Poland and Hungary were among the most reserved with regards to the date of adoption of the euro. At present, it is solely the

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26 National target date should be distinguished from the setting of the date for the euro adoption which is within the competence of the Economic and Financial Affairs Council (ECOFIN Council).
28 Ibid.
30 Ibid.
Czech Republic that retains the same cautious position, as clearly expressed by the Czech President Václav Klaus. On the contrary, the recently resigned Hungarian president Pal Schmitt confirmed that Hungary remains committed to adopting the euro despite the crisis surrounding the European currency. According to Prime Minister Viktor Orban, however, Hungary is unlikely to adopt the euro before 2020. For Poland, a major policy change occurred in 2008 when joining the euro area became an important priority in the policy agenda of the government as opposed to when the government formed in 2007 and rapid membership into the euro area did not appear to be a key policy priority.

3. CONTROVERSIAL SWEDEN

Sweden, an EU Member State since 1995, and Greece were the only Member States not selected in 1998 for the first-wave entry into the euro area. Greece later joined the euro area in 2001 but Sweden has remained outside until the present date. Sweden adopted a Bill in 1997 that stipulated the euro would not be adopted in 1999 and any later decision to participate would have to be submitted to a referendum.

On the other hand Sweden has not fulfilled all the criteria necessary for acceptance into the euro area, specifically the currency stability rule (by not linking its currency to the ERM for two years) and achieving the independence of its national bank, which resulted in its non-admission in 1998.

An important event occurred in 2003 when the Swedish referendum on adoption of the euro took place. It should be noted again that a Bill with the decision to undergo a referendum on the euro was already adopted in 1997. The question of the 2003 referendum was as follows: “Do you think that Sweden should introduce the euro as its official currency?” It was a clear decision between two different regimes – a free float or a monetary union. The answer “No” was upheld by a majority of 55.9% of the population.

As a result, an interesting question arises regarding the obligation to adopt the euro for EU Member States without opt-outs. Opinions such as those of Usher, stating that participation in the third stage of EMU is voluntary, even if new Member States are not offered the special treatment given to the United Kingdom and Denmark, should be rejected: participation in the third stage of EMU is clearly an obligation for those countries which do not have an opt-out clause. In line with this comes the duty to do all that is needed to be done.
able to join the final stage.\textsuperscript{43} Sweden did not have any reservations like the United Kingdom or Denmark.\textsuperscript{44} A strict legal interpretation means that Sweden must join the euro area as soon as all the criteria of the Maastricht Treaty have been met.\textsuperscript{45} While Sweden fulfilled the economic criteria in 2008, it chose not to fulfil the legal convergence criteria or join ERM II.\textsuperscript{46} This may lead to the conclusion that Sweden committed an infringement by failing to fulfil its obligations through its deliberate decision to refrain from complying with the convergence criteria.\textsuperscript{47} Also Art. 4(3) of the Treaty on European Union (formerly Art. 10 of the Treaty establishing the European Community) may lend support to this conclusion.

We have to admit at the same time that, as Pipkorn noted, it would be contrary to Community practices to force a Member State to accept the single currency if it has serious constitutional difficulties in doing so.\textsuperscript{48} “Legal weapons are not very effective against such attitudes”.\textsuperscript{49}

For illustration, the Swedish krone does not participate in ERM II as of today and according to the latest Convergence Report 2010, “no amendments to the Riksbank Act were introduced with regard to the incompatibilities mentioned in the Convergence Report 2008. Consequently comments from 2008 are largely repeated in this year’s assessment.”\textsuperscript{50}

4. OPT-OUT FOR THE UNITED KINGDOM AND DENMARK

The United Kingdom and Denmark have a special position called an “opt-out”. Both countries have been exempted from participation in the third stage of the European Monetary Union under Protocols annexed to the Treaty establishing the European Community.\textsuperscript{51}

Even though some experts see this as an example of the principle of flexibility of closer cooperation, as introduced by the Amsterdam Treaty\textsuperscript{52}, it is necessary to distinguish between closer cooperation and exceptions which are granted to individual Member States (“opting-out”).\textsuperscript{53} Otherwise the opinions vary mainly due to the different conception of the terms, including the term “differentiated integration” as used by the European Central Bank, the term “graded integration”\textsuperscript{54} or the term “multispeed Europe” which is frequently used.\textsuperscript{55} The latter term may be defined as a situation “whereby common objectives are pursued by a group of Member States both able and willing to advance, it being implied that the others will follow later”.\textsuperscript{56}

\textsuperscript{45} JONUNG, L. To be or not to be in the euro? \textit{EC Economic Papers}. 2004, No. 205, EC, p. 6.
\textsuperscript{46} CLERC, O. \textit{Gouvernance economique de la zone euro}. Bruylant, 2012, p. 299.
\textsuperscript{48} Ibid.
\textsuperscript{49} Ibid.
\textsuperscript{51} Evropská komise. \textit{EMU after five years}. EC, 2004, p. 191.
\textsuperscript{53} BIEBER, R. \textit{Die Europäische Union}. Nomos, 2006, p. 97.
Concerning the United Kingdom, the right to remain outside the euro area, even if all convergence criteria are met, is governed by “Protocol No. 25 on certain provisions relating to the United Kingdom of Great Britain and Northern Ireland (1992)” . Under its Art. 1 it was necessary that the United Kingdom notified the Council that it did not intend to move to the third stage. This happened in 1997.57 Under Art. 4 of the Protocol, the United Kingdom retains its powers in the field of monetary policy according to its national law. It may however change the notification at any time in the future, according to Art. 10. In that case the right to move to the third stage exists provided that it satisfies the necessary conditions.

Denmark’s situation is governed by “Protocol No.26 on certain provisions relating to Denmark (1992)” . It was made clear in its Foreword that one of the purposes for this Protocol was to settle “certain particular problems” that existed at that time. This referred to the rejection of the Maastricht Treaty in the country’s referendum of 2 June 1992, leading to the necessity of adopting this Protocol.58 In accordance with Art. 2 of the Danish Protocol, Denmark received an exemption status after it notified the Council in 1992 that it would not participate in the third stage.59 The Protocol states in the same Article that the exemption shall have the same effect as a derogation. In contrast the Protocol on the United Kingdom goes much further because it exempts the United Kingdom from further Treaty provisions, including even the Article on the objectives of the introduction of a single currency or the Article on central bank independence.60

The Danish Constitution contains provisions which imply a Danish referendum must be held prior to Denmark’s participation in the third stage. The Danish euro referendum held in 2000 contained the choice between adopting the euro or maintaining the fixed exchange rate between the euro and the Danish krone within ERM II.61 Although the result was “No” to the euro with a majority of 53%, the close link to the euro in the framework of ERM II and its monetary and exchange rate policy makes Denmark a de facto member of the euro area.62 However Denmark’s adoption of the euro requires approval by the Danish people in a referendum.63 Denmark participates in ERM II and even though the Danish exchange rate to the euro is not irrevocably fixed and Denmark may change it, Danish domestic policy makers regard this option as highly undesirable, maintaining a fluctuation band of 2.25% around the central rate on a voluntary basis although it could be up to 15%.64 Unlike the Danish krone, the pound sterling of the United Kingdom is not included in ERM II.65

As already mentioned, the exemptions granted to both countries are permanent, however they have retained the right to “opt-in” at a later stage, provided they fulfil all the con-

58 MACH, P. Euro a jeho budoucnost, In: Euro dříve, nebo později. 2007, CEP, No. 56, p. 70.
60 Ibid.
61 JONUNG, L. To be or not to be in the euro? EC Economic Papers. 2004, No. 205, EC, p. 2.
62 Evropská komise. EMU after five years. EC, 2004, p. 201.
63 Ibid.
ditions necessary.\textsuperscript{66} Such an option seems more probable for Denmark than for the United Kingdom. According to certain analysts, Denmark, unlike the United Kingdom, would be eager to adopt the euro, but its voters are not persuaded.\textsuperscript{67} The speculation about a new referendum in Denmark has not been confirmed so far.

5. A CLOSER LOOK AT THE UNITED KINGDOM

The question of whether the United Kingdom should join the European Monetary Union has always been a hot debate with both economic as well as political arguments forming the basis for the current hesitation.

In 2003 a complex study has been published, analyzing the issue of the costs and benefits of monetary union for the United Kingdom, formulated in the form of five economic tests: economic convergence, flexibility, investment conditions offered in EMU, competitive position of the United Kingdom’s financial services industry, and finally the prospects for growth, stability and employment in the European Monetary Union.\textsuperscript{68} According to the analysis, the United Kingdom was not ready to join the euro area, however it was agreed that structural reforms shall be carried out so that it would be possible for the United Kingdom to join the euro area in the future.\textsuperscript{69}

Generally two main economic arguments are presented against the United Kingdom joining the euro area: the exchange rate issue and the fact that “the United Kingdom belongs to the major EU countries about which one can have doubts that it is part of the optimal currency union with the rest of the EU”.\textsuperscript{70}

“While the United Kingdom showed much hesitation about its entry into EMU, the remarkable thing is that this hesitation existed despite the fact that the United Kingdom satisfied the Maastricht convergence criteria until 2008. All this illustrates that the Maastricht criteria are insufficient for judging whether countries are ready to enter monetary union.”\textsuperscript{71}

Is it therefore possible that the decision regarding the European Monetary Union and the adoption of the euro, a highly economical question in itself (of course with serious legal implications) could be based more on political than economical arguments? A research project on ‘Ideas, Institutions and Political Culture: The Europeanization of National Identities’, concluded, among other things that “the Euro is about identity politics and political visions of European order.”\textsuperscript{72} Some of the more extreme arguments of British Conservative Euro-sceptics have been quoted in this study with comments such as “the European Monetary Union will remove all characteristics of sovereignty”, or the “control of the central bank would be handed over to a group of foreigners under German domination” or arguments such as “abolish the pound and you abolish Britain”.\textsuperscript{73} According to

\textsuperscript{68} GRAUWE, P. \textit{Economics of monetary union}. OUP Oxford, 2009, p. 93.
\textsuperscript{69} Ibid.
\textsuperscript{70} Ibid.
\textsuperscript{71} Ibid.
\textsuperscript{73} Ibid.
the study, “European integration appears to threaten parts of the English nation-state identity”.74

The findings of the study are not surprising given that the pound sterling is still regarded as “one of the most powerful symbols of Britain’s great past as a world power, as the former world reserve currency”75 and “the world’s oldest currency still in use”.76 “The pound sterling has an unbroken history of over 900 years. In contrast most European countries have replaced their currencies at least once, Germany having done so several times in living memory, and many continental countries have been members of previous currency unions. Thus it is inevitable that the British should be more cautious about abandoning their national currency.”77

Most recently the former Deputy Prime Minister Lord Heseltine, currently a government adviser, has expressed his opinion that the United Kingdom will eventually join the euro because as he pointed out: “we have resisted the whole process of Europeanisation and we have failed at every turn”.78

6. CONCLUSIONS

The approach of the Member States outside the euro area towards the adoption of the euro varies significantly even though they fall to the same group with the same legal status.

Unlike the United Kingdom and Denmark, the newly acceding countries have not been allowed to apply the system of “opt-outs”.79 Within the Member States with derogation, it is understandable that the weak financial systems of new European Union Member States would need more time to cope with the situation and thus the timing might vary.80 However it would be contrary to the Treaty to deliberately set aside the commitment to enter in the monetary union or present an attitude of obstruction or a substantial lack of collaboration, which would constitute an infringement.81 Strictly speaking, the situation in Sweden could be interpreted in this way.

Even though from a legal point of view Sweden does not fall into the same category as Denmark and the United Kingdom, all three countries share an important commonality: all have indicated that any decision to join the euro must be put to a referendum.82 It is interesting that the United Kingdom, Sweden and Denmark should be so reserved towards

75 Ibid.
82 Ibid.
the euro. To a certain extent, this may be explained by their lower level of trust in the European Commission, the high acceptance and popularity of their national currency as well as their central banks and by the fact that they all are monarchies and traditionally stable democracies.83

The different approaches across the EU Member States shows that the adoption of the single currency is not only a legal and economical question but to a considerable extent a political decision of the individual governments. This is the case also for the Member States with derogation that are still waiting “ante portas” of the euro area: now that they have to cope with the consequences of the financial crisis and demands of tight fiscal consolidation, they are also faced with the shaken credibility of the euro project. This could temporarily diminish the attractiveness of the euro in the short term, but it should be remembered that the obligation of these countries to adopt the single currency remains unchanged.

83 JONUNG, L. To be or not to be in the euro?. *EC Economic Papers*. 2004, No.205, EC, p. 19.