Can Greece legally withdraw from the Euro?

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Section IADS

There has been talk for some time among commentators, economists and politicians of Greece leaving the eurozone as a possible solution to the Greek debt crisis and to any further damage to the eurozone as a whole. However, on 23 May 2012 an informal European Council meeting on growth discussed the political and economic situation in Greece, concluding that it wanted Greece "to remain in the euro area while respecting its commitments" and that it was "fully aware of the significant efforts already made by the Greek citizens".

It is not clear how the Greek debt crisis can be resolved, but a legal Greek withdrawal from the euro would not be as straightforward as some observers seem to think. There is no provision for this in the EU Treaties, which are the basis of Economic and Monetary Union, although there is a provision in Article 50 TEU for a Member State to leave the EU altogether. This would allow the exiting State to leave the eurozone, but it would not necessarily be a quick or easy procedure and it would involve a renegotiation of Greece's relationship with the EU, probably with a view to Greece later rejoining the EU.

This note looks at the Treaty base for EMU and some of the informal suggestions as to how Greece might leave the euro and/or the EU legally. For detailed information on the economic repercussions of the Greek crisis and its possible withdrawal from the Eurozone, see Standard Note 6232, "The eurozone crisis – rescuing Greece", 25 May 2012.

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1 Pre-Lisbon Treaty obligations

The EU Treaties do not provide for withdrawal from the Euro. In addition, the basic conditions for EU membership outlined in the 1993 "Copenhagen criteria" include the ability to take on the obligations of membership, including the adoption of the *acquis communautaire* and "the aims of political, economic and monetary union" - in the case of the latter, subject to prior adherence to the necessary convergence criteria.[1] There appears to be little doubt that the Member States' intention was for EMU to be irreversible and irrevocable.

The *Treaty Establishing the European Communities* in 2006, as it stood after the Nice Treaty changes but before the Lisbon Treaty ones, provided for the irreversibility and the irrevocability of the move to Economic and Monetary Union (EMU), much as originally provided in the 1992 *Treaty on European Union* (Maastricht Treaty). There are seven references to the irrevocable fixing of exchange rates in the TEU, for example:

> Article 4(2)
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> 2. Concurrently with the foregoing, and as provided in this Treaty and in accordance with the timetable and the procedures set out therein, these activities **shall include the irrevocable fixing of exchange rates leading to the introduction of a single currency**, the ecu, and the definition and conduct of a single monetary policy and exchange-rate policy the primary objective of both of which shall be to maintain price stability and, without prejudice to this objective, to support the general economic policies in the Community, in accordance with the principle of an open market economy with free competition.
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> Article 118
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> The currency composition of the ecu basket shall not be changed. **From the start of the third stage, the value of the ecu shall be irrevocably fixed in accordance with Article 123(4).**
>
> Article 123 (4)
>
> 4. At the starting date of the third stage, the Council shall, acting with the unanimity of the Member States without a derogation, on a proposal from the Commission and after consulting the ECB, **adopt the conversion rates at which their currencies shall be irrevocably fixed and at which irrevocably fixed rate the ecu shall be substituted for these currencies, and the ecu will become a currency in its own right.** This measure shall by itself not modify the external value of the ecu. The Council, acting by a qualified majority of the said Member States, on a proposal from the Commission and after consulting the ECB, shall take the other measures necessary for the rapid introduction of the ecu as the single currency of those Member States. The second sentence of Article 122(5) shall apply.

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[1] See EP briefing 34, "Economic and Monetary Union (EMU) and enlargement"

Attached to the Maastricht Treaty was the ***Protocol on the transition to the third stage of Economic and Monetary Union****,* which stated (my emphasis):

> THE HIGH CONTRACTING PARTIES,
>
> **Declare the irreversible character of the Community's movement to the third stage of Economic and Monetary Union** by signing the new Treaty provisions on Economic and Monetary Union.
>
> Therefore all Member States shall, whether they fulfil the necessary conditions for the adoption of a single currency or not, respect the will for the Community to enter swiftly into the third stage, and therefore no Member State shall prevent the entering into the third stage.
>
> If by the end of 1997 the date of the beginning of the third stage has not been set, the Member States concerned, the Community institutions and other bodies involved shall expedite all preparatory work during 1998, in order to **enable the Community to enter the third stage irrevocably** on 1 January 1999 and to enable the ECB and the ESCB to start their full functioning from this date.
>
> This Protocol shall be annexed to the Treaty establishing the European Community.

This became Protocol No 24 in the 2006 consolidated versions of the TEU and TEC.[2]

1 Post-Lisbon Treaty obligations

The Lisbon Treaty repealed the EMU Protocol[3] and Articles on EMU were amended to remove the timetable for the move to stage three of EMU, but the irrevocability of the adoption of the euro was specified in the following Articles of the amended Consolidated versions of the Treaty on European Union and the Treaty on the Functioning of the European Union.[4]

> Article 46(3)
>
> The General Council shall contribute to the necessary preparations for **irrevocably fixing the exchange rates** of the currencies of Member States with a derogation against the euro as referred to in Article 140(3) of the Treaty on the Functioning of the European Union.
>
> Article 49
>
> Following the irrevocable fixing of exchange rates in accordance with Article 140 of the Treaty on the Functioning of the European Union, the Governing Council shall take the necessary measures to ensure that banknotes denominated in **currencies with irrevocably fixed exchange rates** are exchanged by the national central banks at their respective par values.
>
> Article 140(3)
>
> If it is decided, in accordance with the procedure set out in paragraph 2, to abrogate a derogation, the Council shall, acting with the unanimity of the Member States whose currency is the euro and the Member State concerned, on a proposal from the Commission and after

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2 OJC 321, 29 December 2006

3 See Protocol No 1 amending the protocols annexed to the TEU, TEC and Euratom Treaties.

4 OJC 115, 2008

> consulting the European Central Bank, **irrevocably fix the rate** at which the euro shall be substituted for the currency of the Member State concerned, and take the other measures necessary for the introduction of the euro as the single currency in the Member State concerned.

The Commission drew attention to Article 140(3) in reply to a Written Question on 24 March 2011. David Campbell Bannerman (EFD) asked: "In the event of the euro collapsing in one or more EU countries, which currency will be used in the interim?" Olli Rehn answered: "The Commission wishes to draw the Honorable Member's attention to Article 140.3 TFEU: Membership in the euro area is irrevocable".

2 Comment

There appears to be a majority opinion that if Greece wanted to leave the Euro it would have to leave the EU first. A report in BBC News on 10 May 2012 implied this was a simple procedure under Article 50 TEU: "Leaving is straightforward: it involves a member state notifying the European Council - that is, the leaders of EU countries - that it wants to go. The Council then agrees the terms of the exit via a qualified majority".

While Article 50 does provide for a Member State to leave the Union, the negotiations for withdrawal and the "framework for its future relationship with the Union" could be complicated and therefore take some time to agree. Even if there is the political will for a fast track approach to applying Article 50 – which is quite possible – negotiating withdrawal would not be easy or swift. A *EurActiv* report on 16 May 2012 stated as much:

> But while it may have become commonplace to discuss a Greek exit (or Grexit as some economists call it), the practicalities and implications of such a decision are far more complicated and daunting than many outside observers tend to acknowledge.
>
> It's not even clear Greece can leave the common currency. The EU's Lisbon Treaty does not make any such provision - it only considers a country leaving the European Union. And in theory a country cannot be forced out of the bloc - it has to decide of its own accord whether it wants to stay.

Article 50 provides for withdrawal to be effective two years from the date of notification or from the date of agreement with the Council concerning continuing relations between the exiting Member State and the rest of the EU. Thus, as Larry Eaker, associate professor at the American University of Paris, writes in "The Debt Crisis and the Legality of Leaving the Eurozone",[5] "a departing member state could legally withdraw in two years and one day without any specific agreement concerning ECB-governed currency issues". He adds, however, that in practical terms:

> ... a concerned member state would most likely pay very close attention to details pertaining to the return of capital contributions and reimbursement of foreign reserve holdings by the ECB. Therefore, complex and perhaps contentious withdrawal negotiations with EU institutions — and in particular, the ECB — seem to be a given for any exiting member state.

His assessment of the legal effects of withdrawal from the euro confirms the view that this could be a difficult and possibly lengthy process:

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[5] JURIST - Forum, 22 September 2011

Clearly, the process of withdrawal from the EMU and the euro currency by a eurozone member is fraught with legal difficulties. These difficulties, however, pale in comparison to the legal quagmire which will ensue concerning the currency of payment for obligations involving both the government and private parties located within the withdrawn state. Will these payments be made in the new currency of the withdrawn nation at some statutorily fixed conversion rate, or will they be required to be made in the former currency? This problem becomes all the more important due to the fact that the euro would still exist after the withdrawal of a current eurozone member state. While the withdrawal from a supranational entity such as the EU and its currency union presents unprecedented legal issues, especially in a world of public international law focused upon the actions of "nation-states," several basic principles contained in the body of the "law of money" can provide some navigational aids for these rather uncharted waters.

Our first legal principle, referred to as *lex monetae*, or "state theory of money," provides that the law of the nation of the currency in which the debt is expressed shall decide what constitutes the currency. Although the euro is, legally speaking, the currency of the EU, it is also the legal tender of each individual eurozone member. Accordingly, pursuant to the *lex monetae* principle, an EU nation is free to exercise its sovereign powers to substitute a new national currency for the euro currency and to then, by national law, establish a conversion rate for the exchange of former euro obligations into the new national currency.

While the exercise of this sovereign right may be considered as perfectly legal under the withdrawing state's constitutional structure, such action may very well breach EU treaty provisions, and thus be considered by other member states as a violation of EU law and international obligations if carried out unilaterally.

Second, the "continuity of contracts principle" — which is widely followed throughout the world's major legal systems — would ensure that both domestic and international contracts expressed in the euro would remain valid and enforceable even though the euro may no longer be the legal tender of the obligor under the contract. Assuming that the new currency unit is considered as a "reasonable substitute performance" for the original euro payment provision, this legal principle would, in effect, thwart the classic defenses to contract enforcement such as "impossibility of performance," "frustration of contract" and "commercial impracticability," which might be posited by disgruntled parties. This continuity of contracts principle was in fact imposed upon all EU member states as a matter of law during the introduction of the euro currency. Most nations (and US states) applied this provision within their own legal systems in order to provide stability during the euro transition.

Third, the law applicable to the contract transaction involving withdrawn country obligations (whether private or public) will be key in determining the currency of payment thereunder. The currency of payment and conversion rules for so-called "domestic contracts" within the exiting euro member state — involving local parties and clearly subject to the withdrawing nation's law — would, in application of the *lex monetae* principle, be submitted to that nation's new currency laws. Most government debt issues are made subject to the debtor nation's laws; thus, it may be assumed that the currency payment situation is clear for such contracts. This is especially true where the parties are located in the withdrawn state and payment is to be effectuated in that nation. However, the situation becomes much less clear for contracts with an international dimension, whether concerning sovereign or private obligations. For contracts

> involving foreign parties and foreign law clauses entered into outside of the withdrawn nation and calling for payment outside of that nation, it is most likely that foreign courts would strictly apply the euro payment called for in such contracts. This is the case since the euro will still legally exist and, as expressed by several legal scholars, EU law concerning the euro may itself constitute the *lex monetae* of such "international contracts" denominated in euros. In all events, choice of law clauses and/or conflict of law determinations as to the applicable law will be central to outcomes concerning currency of payment in such situations.

Within this negotiated framework Eaker envisages a leading role for the ECB:

> Though not mentioned in the Lisbon Treaty's withdrawal clause, the ECB would, by necessity, play the leading role in these negotiations. Accordingly, the EU, ECB and departing member state may well be able to fix a negotiated euro conversion rate for the new national currency and impose it within all remaining member states. The more contentious issue (assuming that such could even be considered by the EU authorities) would be the decision concerning the currency of payment for what might be defined as "international contracts" compared to purely "domestic contracts" — at least within the remaining EU. The question remains as to which contracts will be payable in the still existing euro currency, and which will be payable in the new national currency of the departing member state.

He described another possible exit scenario that would be managed by the ECB:

> Another possibility discussed within would be for the EU to amend existing law to legally permit debt-impaired eurozone nations, so-called "peripheral zone nations," to remain within the union following a very radical adjustment of the EMU system. This plan would create a two currency system, allowing the peripheral eurozone members facing insolvency and unable to regain economic competitiveness to adopt a weaker currency for their respective economies — with the exchange rate for the euro and the weaker currency fixed by EU authorities.

In "Withdrawal and expulsion from the EU and EMU: some reflections",[6] Phoebus Athanassiou concluded that:

> ... negotiated withdrawal from the EU would not be legally impossible even prior to the ratification of the Lisbon Treaty, and that unilateral withdrawal would undoubtedly be legally controversial; that, while permissible, a recently enacted exit clause is, prima facie, not in harmony with the rationale of the European unification project and is otherwise problematic, mainly from a legal perspective; that a Member State's exit from EMU, without a parallel withdrawal from the EU, would be legally inconceivable; and that, while perhaps feasible through indirect means, a Member State's expulsion from the EU or EMU, would be legally next to impossible.

Athanassiou did not think the EU had a "collective 'right of expulsion' from the EU or EMU":

> ... not only is a collective right of expulsion not provided for in the text of the treaties, but, what is more, the legitimacy of its assertion or introduction would be highly questionable, both legally and conceptually. This main conclusion inevitably raises two further questions. Does the exclusion of a collective right

[6] European Central Bank Legal Working Paper Series No 10, December 2009

of expulsion deprive the EU of the ultimate deterrent against a Member State's non-compliance, the existence of which would otherwise presumably ensure compliance? And, if so, would there not be a need to introduce such an explicit right in the treaties, so that the risk of a Member State failing to comply with its obligations is countered by the threat of its expulsion[101]. These questions hark back to the fundamental jurisprudential question of whether sanctions are an integral part of any rule of law (even if only implicitly) or whether valid rules of law can exist even in the absence of sanctions for their infringement.

Footnotes:

101 To pose these questions seriously would be to ignore the historical antecedents and the sui generis nature of the European unification project which, as a commentator has argued, 'in contrast to past attempts … to unite Europe by force … is based on the consent of the Member States' (Hartley, p. 193). It would also gloss over the fact that Community law does provide for heavy sanctions against errant Member States (even if these do not go as far as to expel them).

The paper also notes that "while, institutionally, a Member State's membership of the euro area would not survive the discontinuation of its membership of the EU, the same need not be true of the former Member State's use of the euro".

In "The Euro crisis: Orderly Default or Euro Exit?", [7] Peadar o Broin comments that "while the collapse of the single currency continues to be anathema to core euro area states, it has become feasible to envisage an embattled euro area state on the periphery feeling compelled to leave or being expelled from the club". He also points out that although leaving EMU was not envisaged and there is no mechanism for it, Germany's Federal Constitutional Court, in its 12 October 1993 Maastricht Treaty decision, stated that Germany could leave EMU if the goal of stability was not achieved.[8]

O Broin set out a possible exit scenario for Greece:

Euro exit could happen by a forced exit (e.g. by a refusal to provide loans to the exiting state and the ECB withdrawing its SMP for that state) or by a voluntary withdrawal. The decision to exit the euro area, however, is not one that will be taken lightly. Regardless of whether the decision is an expulsion or a voluntary withdrawal, it is likely to be kept *sub rosa* while governments in the euro area can prepare as best they can to manage the market instability that would result from exit. As the EU Treaties are silent as to the legality of a euro exit, the legal obligations of both the exiting state towards the remaining euro area and its institutions (and vice versa) will be required to be clarified. To provide legal security, a euro phase-out would require a treaty ratified between the exiting euro area state and the rest of the euro area, which would most likely contain an agreement on repayment of debt and contractual undertakings by the exiting state. This could be done through a combination of opt-out from existing EU Treaty provisions and supplementary treaties negotiated among the exiting state and other euro area and EU Member States. The EU Treaties themselves would presumably need to be amended to reflect the reality that a Member States may, in exceptional circumstances, have to temporarily withdraw from the third stage of EMU.

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[7] IIEA Working Paper 8, 2012

[8] The Court stated at para. 89: "Der Vertrag setzt langfristige Vorgaben, die das Stabilitätsziel zum Maßstab der Währungsunion machen, die durch institutionelle Vorkehrungen die Verwirklichung dieses Ziels sicherzustellen suchen und letzlich – als ultima ratio – beim Scheitern der Stabilitätsgemeinschaft auch einer Lösung aus der Gemeinschaft nicht entgegenstehen".

If the exiting euro area state wishes to remain a Member State of the European Union, this treaty would have to be negotiated among all EU Member States – not just euro area members – as it would require derogations and temporary suspensions of EU Treaty rules (e.g. on free movement of capital).

O Broin identified the following issues such a move would raise for the EU and the Eurozone:

- Legality of withdrawal: as the EU Treaties are silent as to the legality of a euro exit, the legal obligations of both the exiting state towards the remaining euro area and its institutions (and vice versa) will be required. If amending the EU Treaties proves too complicated to enable the withdrawing state to remain a member of the European Union, its exit treaty could envisage that the state remains a member of the European Economic Area, or it could create a special 'semi-detached' status that extends internal market rules to the exiting state, but that state would be removed from the EU institutions that shape internal market rules.

- Calendar of gradual withdrawal: a sudden split of a state away from the euro area is highly unlikely. The introduction of the single currency required an incremental move to monetary union; exit will require a similar timetable to gradually move the exiting state out of the euro area.

- Capital controls: derogation from EU Treaty rules on free movement of capital would be required, as an immediate impact of euro exit would be a bank run against the financial institutions of the exiting state.

- Convertibility controls: in order to regain competitiveness, the exiting state would presumably wish to rapidly devalue its new currency against the euro. The export sector, however, has to be significantly strong for devaluation to make any real impact on the economy. Argentina, for instance, was able to benefit from cheaper exports and a global commodities boom to foster a rapid return to high growth in its post-default years. In any case, a rapid depreciation against the euro is likely if the new currency was to float freely.

  The government of the exiting state may, however, determine artificial currency controls, such as an optimum exchange rate against the euro, and establish a peg with the euro to prevent volatility and the erosion of savings and the ballooning of public debt (a large proportion of which would be euro denominated). To ensure convertibility, the national central bank would have to keep its euro foreign exchange reserves at the same level as the cash in circulation.

- New physical currency of the exiting state: euro banknotes could be stamped to set the new value while the exiting state organizes minting of the new currency. Following the disintegration of Austria-Hungary in 1918 the new political states issued stamped Austria- Hungarian banknotes while they were developing their own independent monetary standards. The ECB could later collect these notes, but probably with a tax-deducted amount. Large scope for counterfeit during this period.

- Continued financial assistance: the exiting state would be cut to junk and considered high-risk by all credit ratings agencies, meaning the country would be unable to fund itself on the international markets. In

> this case the exiting state would be required to request emergency financial assistance from the International Monetary Fund and third states. If the exiting state is able to remain a Member State of the European Union, it is eligible to access the EU medium-term balance of payments facility (currently activated for Latvia, Hungary and Romania). This would in theory enable the exiting state to secure funding at lower interest rates that under the EFSF/ESM, which entail a 'penalty' interest rate.

European leaders agreed over dinner on 23 May that they wanted Greece to stay in the Eurozone and to solve its economic problems. The European Council President, Herman Van Rompuy, said with reference to the Greek elections on 17 June 2012 - which some fear will bring in an anti bail-out government:[9]

> Continuing the vital reforms to restore debt sustainability, foster private investment and reinforce its institutions is the best guarantee for a more prosperous future in the euro area. We expect that after the elections, the new Greek government will make that choice.[10]

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9 Elections on 6 May were inconclusive. Polls show increasing support for the Coalition of the Radical Left (SYRIZA). Its leader, Alexis Tsipras, has said that if the Eurozone does not accept a renegotiation of the austerity measures, he would call a referendum on Greek membership of EMU.

10 *EUObserver* 24 May 2012