

## Eurozone Exit: a Legal Forward Guidance?

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Does the EU's current legal framework permit a break-up of the Eurozone? The author discusses the inapplicability of Article 56 Vienna Convention and the reasons why the newly introduced Art. 50 TEU does not apply when only the European Monetary Union is concerned. He then criticizes this legal solution, by referring to the financial situation and the need for options.

*Abstract provided by the Editorial Board*

“The reluctance to talk about divorce on the wedding day”<sup>1</sup> is a factor often cited by the doctrine to explain the absence of withdrawal clauses in EEC and EU treaties before Lisbon. Nonetheless, roughly 15 years in existence, Europe's monetary union has been facing the openly discussed prospect of a break-up at least since the global financial crisis triggered by the Lehman Brothers failure in 2007. The crisis has since spread to European banks, and ultimately brought out the excessive levels of public debt in a number of European countries – as Warren Buffet famously observed: “You only find who has been swimming naked when the tide goes out”. Trimming public debt back to a sustainable level can be achieved either by direct debt reduction or by redenomination of debt into a new, devaluated currency. While the former can be attained by various means, in particular austerity measures, debt restructuring or inflation, the latter implies an exit from the Eurozone for the concerned EU Member States. In this respect, the “Exit Clause” inserted in the Lisbon Treaty in 2009 may well turn out to be a game changer. The purpose of this paper is to assess whether the legal framework currently in force in the EU permits a break-up of the Eurozone, with a particular emphasis on recent developments in the financial markets.

What is commonly referred to as the Eurozone is in fact an Economic and Monetary Union (EMU) of EU

Member States using the Euro as sole legal tender<sup>2</sup>, established by the Maastricht Treaty in 1992. As such, the Eurozone rests on an international treaty, suggesting from the outset that international public law is applicable to investigate rights and obligations deriving from it, in particular the right of unilateral withdrawal.

Before the Lisbon Treaty, both the EEC and the EU treaties contained no provisions that dealt directly with their termination. Whereas it is widely accepted that a consensual withdrawal from an international organisation is in principle always possible, it is usually assumed that the Vienna Convention<sup>3</sup>, specifically Article 56, does not permit expulsion or unilateral withdrawal<sup>4</sup>. However, in a landmark ruling, the European Court of Justice (ECJ) stated that “the Community constitutes a new legal order of international law”<sup>5</sup>. This position has led the majority of authors to support the view that the European treaties resemble a constitution that entails a permanent limitation of Member State sovereignty<sup>6</sup>, and that the Vienna Convention is not applicable for EU-internal affairs. This view has been supported to date<sup>7</sup>, and the existence of a right of withdrawal from the Eurozone will henceforth be investigated under EU law solely.

The Lisbon Treaty saw the introduction of Article 50 TEU, commonly dubbed “Exit Clause”. This provision allows EU Member States to file a notice of withdrawal that will be effective at most two years later, unless an exit agreement between the

<sup>2</sup> Art. 3 (4) of the consolidated version of the Treaty on European Union (TEU), OJ C-326, 26.10.2012.

<sup>3</sup> Vienna Convention on the Law of Treaties, 23.05.1969 (SR 0.111).

<sup>4</sup> AKEHURST MICHAEL, Withdrawal from International Organizations, Current Legal Problems, 32 (1), 1979, 143–154, p. 151.

<sup>5</sup> ECJ, Case 26/62 *van Gend & Loos v Administratie der Belastingen*, 1963, ECR I ; position confirmed in ECJ, Case 6/64 *Costa v Enel*, 1964, ECR 585.

<sup>6</sup> HILL JOHN A., The European Economic Community: the Right of Member State Withdrawal, Ga. J. Intl. & Comp. L. 12, 1982, 335–357, p. 339 ; WEILER, op. cit, p. 286.

<sup>7</sup> ATHANASSIOU PHOEBUS, Withdrawal and Expulsion from the EU and EMU: Some reflections, ECB, Legal Working Paper Series, 10, 2009, p. 18.

<sup>1</sup> WEILER JOSEPH H. H., Alternatives to withdrawal from an international organization: the case of the European Economic Community, Isr. L. Rev. 20, 1985, 282–298, p. 282.

exiting Member State and the EU is reached earlier. While Article 50 TEU addresses the exit of the EU as a whole, the Lisbon Treaty remains silent as to an exit from the Eurozone specifically. First, does the Exit Clause comprise a unilateral right of withdrawal from EMU? Second, can the Exit Clause be selectively applied on subsets of the EU, such as EMU?

Regarding the first question, although an author argues that “nothing short of the express [...] requirement for a negotiated withdrawal from EMU”<sup>8</sup> would be acceptable, even for a Member State that has previously left the EU on the basis of the Exit Clause, it cannot seriously be doubted that, reasoning *e maiore minus*, a right of unilateral withdrawal from the EU encompasses the same right for subsets of the EU, such as EMU. The converse, namely whether an exit from the Eurozone necessarily entails forfeiting EU membership altogether, is a dodgier issue. Two important features of the three-stage process lasting from 1992 to 1999 to establish the Eurozone were: (i) the legal obligation for EU Member States to adopt the Euro as soon as they satisfied the convergence criteria<sup>9</sup> and (ii) the irrevocable and irreversible character of EMU’s integration process<sup>10</sup>. However, the legal obligation for Member States to adhere to EMU has not yet fully materialised as opt-outs were negotiated by the United Kingdom and Denmark<sup>11</sup>. Besides, hardly consistent with the spirit of the law is Sweden’s decline to meet the convergence criteria in order to remain out of EMU<sup>12</sup>. Nevertheless, leaving the Eurozone is a wholly different affair than delaying accession, and there arguably exists no right to remain in the EU in the former case to this day.

This state of (legal) affairs may, though, not be in line anymore with the EU’s best interest in view of the recent developments in the financial markets. Already back in 2005, an author pointed to speculative attacks against the Euro by referring to investment strategies proposed by investment banks

based on the expectation of a Eurozone break-up<sup>13</sup>. Indeed, financial markets in general have been quite unimpressed by assurances that the possibility of a Eurozone break-up was “a very remote prospect”<sup>14</sup>, and have, in fact, bet on such a scenario. First, trading strategies have exploited so-called redenomination risk. They anticipate that bonds issued under the legislation of a Member State thought to leave EMU will be redenominated in the new local devaluated currency, while bonds of the same issuer under other legislations will be reimbursed in Euros<sup>15</sup>. As a result, investors holding locally issued bonds of a presumptively leaving Member State will earn an additional risk premium on their investment. And indeed, redenomination risk was shown to explain the unusually high yield spreads seen on the bond markets among different EMU Member States since 2011<sup>16</sup>. Second, and as a consequence of high yield spreads, Member States may be tempted to bring some relief to their budgetary woes by paying off their bills directly with new bond issues. Effectively introducing a new currency would then be just one step away, that is, accepting these bonds as a means of payment. Some commentators considered that Greece’s so-called “pharma bonds” came, in fact, dangerously close to introducing “quasi-drachmas”<sup>17</sup>. Third, the turmoil on the European bond market brought Cyprus’ financial system to the brink of collapse in March 2013. Emergency capital controls were put in place in order to avoid massive capital flight. These capital controls had not yet been fully lifted at the end of January 2014, raising questions about the compatibility of the measure with EU guarantees for the free flow of capital<sup>18</sup>.

In view of these developments, we adhere to the view that “insisting on the impossibility of withdrawal might be counterproductive, especially in an

<sup>8</sup> ATHANASSIOU, *op. cit.*, p. 29.

<sup>9</sup> Art. 109j of the Treaty on European Union, OJ C-224, 31.08.1992.

<sup>10</sup> Treaty on European Union, Protocol on the transition to the third stage of Economic and Monetary Union, OJ C-224/123, 31.08.1992.

<sup>11</sup> Treaty on European Union, Protocols on certain provisions relating to : the United Kingdom of Great Britain and Northern Ireland ; and Denmark, OJ C-224/123 ssq., 31.08.1992.

<sup>12</sup> SCOTT HAL S., When the Euro falls apart – A Sequel, Harvard Law School Public Law & Legal Theory Working Paper Series, 12 (16), 2012, p. 7.

<sup>13</sup> SMITS RENÉ, The European Constitution and EMU: An Appraisal, *Common Market Law Review*, 42, 2005, 425–468, p. 465.

<sup>14</sup> PROCTOR CHARLES, The Future of the Euro – What happens if a Member State Leaves ?, *European Business Law Review*, 17 (4), 2006, 909–937, p. 924.

<sup>15</sup> The Wall Street Journal, *For Euro Investors, Time to Check the Fine Print*, 21.11.2011.

<sup>16</sup> DI CESARE ANTONIO ET AL., Recent estimates of Sovereign Risk Premia for Euro-Area Countries, The Sovereign Debt Crisis and the Euro Area, Banca d’Italia, 2013, 13–52.

<sup>17</sup> The Financial Times, *Greek Funny Money*, 08.02.2012.

<sup>18</sup> While Art. 66 TEU may offer the basis for exceptions to the free flow of capital regulated in Art. 63 TEU, the ECJ has tended to interpret such exceptions restrictively.

organisation like the EU”<sup>19</sup>. Pushing that argument further, an author suggested that resisting withdrawal from EMU may “ultimately wreck the EU itself” and that a way out of the crisis was to “relieve the pressure by allowing withdrawals [from EMU] and put those withdrawing in the purgatory of [an exchange-rate mechanism] from which they can return some day to euro membership”<sup>20</sup>. This solution, though, requires

setting up a legal framework for an EMU exit while preserving EU membership. Such a “legal forward guidance” may not only contribute to an orderly Eurozone exit, but may also lessen the volatility in the financial markets by offering a clear roadmap to market participants and thereby reducing the opportunities for speculation.

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<sup>19</sup> HERBST JOCHEN, Observations on the Right to Withdraw from the European Union: Who are the « Masters of the Treaties » ?, German Law Journal, 6 (11), 2005, 1756–1760, p. 1760.

<sup>20</sup> SCOTT, op. cit., p. 3.