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2010/0135 (NLE)

Proposal for a

COUNCIL DECISION

on the adoption by Estonia of the euro on 1 January 2011

EXPLANATORY MEMORANDUM

1. CONTEXT OF THE PROPOSAL

On 3 May 1998 the Council decided that Belgium, Germany, Spain, France, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Austria and Finland fulfilled the necessary conditions for the adoption of the euro on 1 January 1999. Denmark and the United Kingdom made use of their opt-out clauses and were not, therefore, assessed by the Council. Greece and Sweden were considered by the Council as Member States with a derogation. On 19 June 2000, the Council decided that Greece fulfilled the necessary conditions to adopt the euro on 1 January 2001. The countries which joined the European Union on 1 May 2004 (the Czech Republic, Estonia, Cyprus, Latvia, Lithuania, Hungary, Malta, Poland, Slovenia and Slovakia) became Member States with a derogation in accordance with Article 4 of the respective Act of Accession. On 11 July 2006, the Council decided that Slovenia fulfilled the necessary conditions to adopt the euro on 1 January 2007. Bulgaria and Romania, who joined the European Union on 1 January 2007, became Member States with a derogation in accordance with Article 5 of the respective Act of Accession. On 10 July 2007, the Council decided that Cyprus and Malta fulfilled the necessary conditions to adopt the euro on 1 January 2008. On 8 July 2008, the Council decided that Slovakia fulfilled the necessary conditions for adopting the euro as of 1 January 2009.

Articles 140(1) of the Treaty on the Functioning of the European Union (hereinafter the Treaty) provides that at least once every two years or at the request of a Member State with a derogation, the Commission and the European Central Bank have to report to the Council on the progress made in the fulfilment by Member States with a derogation of their obligations regarding the achievement of economic and monetary union. Based on its own report and that of the ECB, the Commission can submit to the Council a proposal for a Council decision, in accordance to the procedure laid down in Article 140(2) of the Treaty, to abrogate the derogation of the Member States fulfilling the necessary conditions.

The previous Commission and ECB regular Convergence Reports were adopted in May 2008. Denmark and the United Kingdom have not expressed a wish to adopt the euro. Therefore, the Convergence Report 2010 covers the following nine Member States with a derogation: Bulgaria, the Czech Republic, Estonia, Latvia, Lithuania, Hungary, Poland, Romania and Sweden.

The Commission Convergence Report 2010 was adopted by the College on 12 May 2010. The ECB adopted its report on 12 May. The reports include an examination of the compatibility of the national legislation, in particular the statute of each national central bank, with Articles 130 and 131 of the Treaty and the Statute of the ESCB and of the ECB. The reports also examine the achievement of a high degree of sustainable convergence by reference to the fulfilment of the convergence criteria and take account of several other factors required under the final sub-paragraph of Article 140(1) of the Treaty.

In its Convergence Report, the Commission concludes that amongst the assessed Member States only Estonia fulfils the conditions for the adoption of the euro.

On the basis of its report and that of the ECB, the Commission has adopted the attached proposal for a Council decision to abrogate the derogation of Estonia with effect from 1 January 2011.

2. RESULTS OF CONSULTATIONS WITH THE INTERESTED PARTIES AND IMPACT ASSESSMENT

Discussions with Member States on economic policy challenges in Member States are held under various headings on a regular basis in the Economic and Financial Committee and ECOFIN/Eurogroup. These include informal discussions on issues specifically relevant to the preparation of eventual euro area entry (incl. exchange rate policies). Dialogue with academics and other interested groups takes place in the context of conferences/seminars and on an ad-hoc basis.

Economic developments in the euro area and the Member States are assessed in the framework of the various procedures of economic policy co-ordination and surveillance (notably under Art. 121 of the Treaty), as well as in the context of the Commission's regular monitoring and analysis of country-specific and area-wide developments (incl. forecasts, regular publication series, input to EFC and ECOFIN/Eurogroup). In accordance with the proportionality principle and in line with past practice, the Commission proposes not to develop a formal impact assessment.

3. LEGAL ELEMENTS OF THE PROPOSAL

3.1. Legal basis

The legal basis for the present proposal is Article 140(2) of the Treaty, which lays down the procedure for a Council decision on euro adoption and for abrogation of the derogation in the concerned Member States.

The Council shall act on a proposal from the Commission, after consulting the European Parliament, after discussion in the European Council and after having received a recommendation of a qualified majority of those among its members representing Member States whose currency is the euro.

3.2. Subsidiarity and proportionality

The proposal falls under the exclusive competence of the Union. The subsidiarity principle therefore does not apply.

The present initiative does not go beyond what is necessary to achieve its objective and, therefore, complies with the proportionality principle.

3.3. Choice of the legal instrument

The Decision instrument is the only appropriate legal instrument according to Article 140(2) of the Treaty.

4. BUDGETARY IMPLICATION

The proposal has no implications for the budget of the Union.

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THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Article 140(2) thereof,

Having regard to the proposal from the European Commission,

Having regard to the report from the European Commission[1]

Having regard to the report from the European Central Bank[2]

Having regard to the opinion of the European Parliament,

Having regard to the discussion of the European Council,

Having regard to the recommendation of the members of the Council representing Member States whose currency is the euro,

Whereas:

(1) The third stage of economic and monetary union (hereinafter 'EMU') started on 1 January 1999. The Council, meeting in Brussels on 3 May 1998 in the composition of Heads of State or Government, decided that Belgium, Germany, Spain, France, Ireland, Italy, Luxembourg, the Netherlands, Austria, Portugal and Finland fulfilled the necessary conditions for adopting the euro on 1 January 1999[3].

(2) By Decision 2000/427/EC[4] Council decided that Greece fulfilled the necessary conditions for adopting the euro on 1 January 2001. By Decision 2006/495/EC[5] Council decided that Slovenia fulfilled the necessary conditions for adopting the euro on 1 January 2007. By Decisions 2007/503/EC[6] and 2007/504/EC[7] Council decided that Cyprus and Malta fulfilled the necessary conditions for adopting the euro on 1

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3 Decision 1998/317/EC (OJ L 139, 11.5.1998, p.30).

4 OJ L 167 of 7.7.2000, p.19.

5 OJ L 195 of 15.7.2006, p.25.

6 OJ L 186 of 18.7.2007, p.29.

7 OJ L 186 of 18.7.2007, p. 32

January 2008. By decision 2008/608/EC[8] Council decided that Slovakia fulfilled the necessary conditions for adopting the euro.

(3) In accordance with paragraph 1 of the Protocol on certain provisions relating to the United Kingdom of Great Britain and Northern Ireland annexed to the Treaty establishing the European Community (hereinafter EC Treaty), the United Kingdom notified the Council that it did not intend to move to the third stage of EMU on 1 January 1999. This notification has not been changed. In accordance with paragraph 1 of the Protocol on certain provisions relating to Denmark annexed to the EC Treaty and the Decision taken by the Heads of State or Government in Edinburgh in December 1992, Denmark has notified the Council that it will not participate in the third stage of EMU. Denmark has not requested that the procedure referred to in Article 140(2) of the Treaty on the Functioning of the European Union (hereinafter the Treaty) be initiated.

(4) By virtue of Decision 98/317/EC Sweden has a derogation as defined in Article 139(1) of the Treaty. In accordance with Article 4 of the 2003 Act of Accession[9], the Czech Republic, Estonia, Latvia, Lithuania, Hungary, Poland and Slovakia have a derogation as defined in Article 139(1) of the Treaty. In accordance with Article 5 of the 2005 Act of Accession[10], Bulgaria and Romania have a derogation as defined in Article 139(1) of the Treaty.

(5) The European Central Bank (hereinafter the 'ECB') was established on 1 July 1998. The European Monetary System has been replaced by an exchange rate mechanism, the setting-up of which was agreed by a resolution of the European Council on the establishment of an exchange-rate mechanism in the third stage of economic and monetary union of 16 June 1997[11]. The procedures for an exchange-rate mechanism in stage three of economic and monetary union (ERM II) were laid down in the Agreement of 16 March 2006 between the European Central Bank and the national central banks of the Member States outside the euro area laying down the operating procedures for an exchange rate mechanism in stage three of economic and monetary union.[12]

(6) Article 140(2) of the Treaty lay down the procedures for abrogation of the derogation of the Member States concerned. At least once every two years, or at the request of a Member State with a derogation, the Commission and the ECB shall report to the Council in accordance with the procedure laid down in Article 140(1) of the Treaty. The latest Commission and ECB regular Convergence Reports were adopted in May 2010.

(7) National legislation in the Member States including the statutes of national central banks shall as necessary be adapted with a view to ensuring compatibility with Articles 130 and 131 of the Treaty and the Statute of the European System of Central Banks and of the European Central Bank (hereinafter the 'Statute of the ESCB and of

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8 OJL 195, 24.7.2008, p. 24.
9 OJ L 236, 23.9.2003, p. 33.
10 OJ L 157, 21.6.2005, p. 203.
11 OJ C 236, 2.8.1997, p. 5.
12 OJ C 73, 25.3.2006, p. 21. Agreement as amended by the Agreement of 14 December 2007 (OJ C 319, 29.12.2007, p. 7).

the ECB'). The reports of the Commission and the ECB provide a detailed assessment of the compatibility of the legislation of Estonia with Articles 130 and 131 of the Treaty and the Statute of the ESCB and of the ECB.

(8) According to Article 1 of the Protocol No 13 on the convergence criteria referred to in Article 140 of the Treaty, the criterion on price stability referred to in the first indent of Article 140(1) of the Treaty means that a Member State has a price performance that is sustainable and an average rate of inflation, observed over a period of one year before the examination, that does not exceed by more than one and a half percentage points that of, at most, the three best performing Member States in terms of price stability. For the purpose of the criterion on price stability, inflation will be measured by the harmonised indices of consumer prices (HICPs) defined in Council Regulation (EC) No 2494/95 of 23 October 1995 concerning harmonised indices of consumer prices[13]. In order to assess the price stability criterion a Member State's inflation has been measured by the percentage change in the arithmetic average of 12 monthly indices relative to the arithmetic average of 12 monthly indices of the previous period. A reference value calculated as the simple arithmetic average of the inflation rates of the three best-performing Member States in terms of price stability plus 1.5 percentage points was considered in the reports of the Commission and the ECB. In the one-year period ending in March 2010, the inflation reference value was calculated to be 1.0 percent, with Portugal, Estonia and Belgium as the three best-performing Member States in terms of price stability, with inflation rates of, respectively -0.8 percent, -0.7 percent and -0.1 percent. In the current economic circumstances characterised by a large common adverse shock, where a significant number of countries face episodes of negative inflation rates, it seems warranted to exclude from the best performers those countries whose average inflation rate is distant from the euro area average inflation (0.3% in March 2010) by a wide margin – in line with the precedent of the 2004 Convergence Report – , as these outliers cannot reasonably be judged as being best performers in terms of price stability and including them would severely affect the reference value and thus the fairness of the criterion. In March 2010, this leads to the exclusion of Ireland, the only country whose 12-month average inflation rate (at -2.3% in March 2010) deviated by a wide margin from that of the euro area and other Member States, mainly reflecting the severe economic downturn.[14]

(9) According to Article 2 of the Protocol No 13 on the convergence criteria annexed to the Treaty, the criterion on the government budgetary position referred to in the second indent of Article 140(1) of the Treaty shall mean that at the time of the examination the Member State is not the subject of a Council decision under Article 126(6) of the Treaty that an excessive deficit exists.

(10) According to Article 3 of the Protocol No 13 on the convergence criteria annexed to the Treaty, the criterion on participation in the exchange-rate mechanism of the European Monetary System referred to in the third indent of Article 140(1) of the Treaty means that a Member State has respected the normal fluctuation margins

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[13] OJ L 257, 27.10.1995, p. 1. Regulation as amended by Regulation (EC) No 1882/2003 of the European Parliament and the Council (OJ L 284, 31.10.2003, p. 1) and by Regulation (EC) No 596/2009 of the European Parliament and the Council.

[14] In its result, this approach is also consistent with what was done in 2004 when Lithuania's average 12-month inflation was 2.3 percentage points below the euro area average 12-month inflation and was excluded from the best performers.

provided for by the exchange-rate mechanism (ERM) of the European Monetary System without severe tensions for at least the last two years before the examination. In particular, the Member State must not have devalued its currency's bilateral central rate against the euro on its own initiative for the same period. Since 1 January 1999 the ERM II provides the framework for assessing the fulfillment of the exchange rate criterion. In assessing the fulfillment of this criterion in their reports, the Commission and the ECB have examined the two-year period ending on 23 April 2010.

(11) According to Article 4 of the Protocol No 13 on the convergence criteria annexed to the Treaty, the criterion on the convergence of interest rates referred to in the fourth indent of Article 140(1) of the Treaty means that, observed over a period of one year before the examination, a Member State has had an average nominal long-term interest rate that does not exceed by more than two percentage points that of, at most, the three best performing Member States in terms of price stability. For the purpose of the criteria on the convergence of interest rates, comparable interest rates on 10-year benchmark government bonds were used. Estonia, which was one of the best performing Member States in terms of price stability in March 2010, does not have a harmonized benchmark long-term government bond or a comparable security that could be used for the calculation of the reference value. Therefore, in line with the wording of the Protocol (referring to 'at most the three best performing Member States'), in order to assess the fulfillment of the interest-rate criterion a reference value calculated as the simple arithmetic average of the nominal long-term interest rates of the two other best performing Member States in terms of price stability plus two percentage points was considered in the reports of the Commission and the ECB. On this basis, the reference value in the one year period ending in March 2010 was 6.0 percent, the average of interest rate in Portugal (4.2%) and Belgium (3.8%).

(12) In accordance with Article 5 of the Protocol No 13 on the convergence criteria annexed to the Treaty, the data used in the current assessment of the fulfillment of the convergence criteria have to provided by the Commission. For the preparation of this proposal the Commission provided data. Budgetary data were provided by the Commission after reporting by the Member States by 1 April 2010 in accordance with Council Regulation (EC) No 479/2009 of 25 May 2009 on the application of the Protocol on the excessive deficit procedure annexed to the Treaty establishing the European Community.

(13) On the basis of reports presented by the Commission and the ECB on the progress made in the fulfillment by Estonia of its obligations regarding the achievement of economic and monetary union, the Commission concluded that:

(a) In Estonia, national legislation, including the Statute of the national central bank, is compatible with Articles 130 and 131 of the Treaty and the Statute of the ESCB and of the ECB.

(b) Regarding the fulfillment by Estonia of the convergence criteria mentioned in the four indents of Article 140(1) of the Treaty:

– The average inflation rate in Estonia in the year ending March 2010 stood at -0.7 percent, which is well below the reference value, and it is likely to remain below the reference value in the months ahead;

– Estonia is not the subject of a Council decision on the existence of an excessive deficit, with a budget deficit of 1.7% of GDP in 2009;

– Estonia has been a member of ERM II since 28 June 2004; in the two-year period ending 23 April 2010, the Estonian kroon has not been subject to severe tensions and there has been no deviation from the ERM II central rate since kroon's participation;

– As a result of Estonia's very low level of gross public debt, no benchmark long-term government bonds or other appropriate securities are available to assess the durability of convergence as reflected in long-term interest rates. While financial market risk perceptions vis-à-vis Estonia increased at the height of the crisis, their development during the reference period, as well as a broader assessment on the durability of convergence, including Estonia's continued prudent policies, would support a positive assessment on Estonia's fulfilment of the long-term interest rate criterion.

(c) In the light of the assessment on legal compatibility and on the fulfilment of the convergence criteria as well as the additional factors, Estonia fulfils the necessary conditions for the adoption of the euro.

HAS ADOPTED THIS DECISION:

Article 1

Estonia fulfils the necessary conditions for the adoption of the euro. The derogation in favour of Estonia referred to in Article 4 of the 2003 Act of Accession is abrogated with effect from 1 January 2011.

Article 2

This Decision is addressed to the Member States.

Article 3

This Decision shall be published in the *Official Journal of the European Union*.

Done at Brussels,

For the Council
The President