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# THE INSTITUTIONS AND FRAMEWORK OF THE EUROPEAN MONETARY SYSTEM; WHAT ARE THE OPTIONS FOR ICELAND?

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Lokaverkefni í Félagsvísinda – og lagadeild.

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Ragnar Sigurðsson

Lokaverkefni til 90 eininga B.A-prófs í Félagsvísinda- og lagadeild.

Instructor: Timothy Murphy

Ég lýsi því hér með yfir að ég einn er höfundur þessa verkefnis og að það er ágóði eigin rannsókna.

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Ragnar Sigurðsson

Það staðfestist hér með að lokaverkefni þetta fullnægir að mínum dómi kröfum til B.A.-prófs í Félagsvísinda- og lagadeild.

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Timothy Murphy

## Útdráttur

Í þessari ritgerð er farið yfir stofnanir Evrópusambandsins sem snúa að Evrunni og þær lagalegu kröfur sem gerðar eru til ríkja sem hyggjast taka upp Evru sem sinn gjaldmiðil. Stofnanir Efnahags – og myntbandalags Evrópu verður gefin greinargóð lýsing sem og ákvarðanatökur innan stofnana þess. Umfjöllun um möguleika Íslands á upptöku Evru hefur eflaust ekki farið fram hjá neinum Íslendingi, þessir möguleikar verða skoðaðir frá lagalegum og pólitískum hliðum. Embættismenn Evrópusambandsins hafa verið afdráttarlausir í sínum yfirlýsingum er varðar einhliða upptöku Evru, þessar yfirlýsingar fela þó ekki í sér neinar hótanir af neinu tægi. Það er þó alveg ljóst að einhliða upptaka Evru er vel möguleg í lagalegum skilningi en áhættan er mikil og ávinningurinn illsjáanlegur. Afstaða Íslands gagnvart inngöngu í Evrópusambandið setur þjóðinni skörður hvað varðar upptöku Evru með formlegum hætti, þessi afstaða og afstaða Evrópusambandsins er gefin ítarleg lýsing. Farið verður stuttlega yfir stöðu einstakra þjóða gagnvart Evrunni sem gefur innsýn inn í viðbrögð Evrópusambandsins þegar samræmingarferli þjóðanna er ógnað. Loks er farið yfir ókosti þess að taka upp Evru einhliða.

## Summary

In this thesis the institution of the European Union concerning the Euro currency are described and so too are the legal requirements which States must fulfil if they intend to adopt the Euro. The institutions of the Economic and Monetary Union will be examined, as will the process of how decisions are taken within these institutions. Discussions about the possibilities of Iceland in adopting the Euro have been increasing recently, these possibilities will be looked upon from the legal and political perspective. Officials of the European Union have been absolutely clear in their statements concerning unilateral adoption of the Euro, these statements do not involve threats of any kind. It is clear that unilateral adoption is possible in a legal sense but the risk is high and the benefits are not within clear sight. The Icelandic stand concerning European Union membership puts restrictions on the state concerning the formal adoption of the Euro, and the Icelandic and the European Union position in this matter is discussed. A short introduction to the position of several states concerning the Euro will be given to provide an insight into the reaction of the European Union when the coordination process of the member states is threatened. Finally the disadvantages of unilateral adoption will be touched upon.

## **Pakkarorð**

Oft hefur borið á þeirri gagnrýni að stjórnvöld forðist umræðu um Evrópusambandsaðild og upptöku Evrunnar. Ef litið er til annarra ríkja sem annaðhvort hafa gengið í Evrópusambandið eða stefna að því þá má glögglega sjá að stuðningur og þrýstingur á inngöngu var og er mun meiri í flestum tilfellum. Eðlilega helst í hendur aukin umræða og aukin stuðningur líkt og sjá má hér á landi. Því má vísa á bug að stjórnvöld forðist þessa umræðu enda er til mjög mikið efni um kosti og ókosti Evrópusambandsaðildar. Í raun má segja að veraldarvefurinn sé uppfullur af umræðum um aðildarumsókn bæði frá almenningi og stjórnvöldum.

Gefnar hafa verið út fjölmargar bækur varðandi Evrópusambandið og skipuð var nefnd um Evrópumál árið 2004 á vegum Alþingis. Markmið nefndarinnar er m.a. að kanna hvort Ísland eigi möguleika á undanþágum í aðildarsamningi við Evrópusambandið og þá hvað fólgið sé í slíkum undanþágum. Nefndin á jafnframt að skoða kostnað ríkissjóðs við aðild að Evrópusambandinu og hverjir væru kostir og gallar evrunnar fyrir Ísland.

Það er því vel við hæfi að þakka fyrir þá greinargóðu umræðu sem hefur átt sér stað um Evrópusambandsaðild. Umræðan hefur að flestu leyti verið rökræn, skýr og jöfn og því auðvelt að marka sér skoðun á málefninu. Almenningur þarf þó að bera sig eftir upplýsingum um málefnið til forðast staðreyndavillur sem enn ber talsvert á. Það er rík ástæða til þess að velta því fyrir sér hvernig umræðan skuli fara fram áður en gengið er til þjóðaratkvæðagreiðslu um slíka afdrifaríka ákvörðun. Kosningaþáttaka í Íslandi er meiri en víðast hvar annarstaðar og áhygguefni ef þjóðaratkvæðagreiðsla færi fram án skýrar vitundar þjóðarinnar.

Ég vill fyrst og fremst þakka félagsvísinda – og lagadeild Háskólans á Akureyri fyrir að skipulagningu á umræðutorgum er varða Evrópusambandsaðild sem og leiðbeinanda mínum Timothy Murphy. Einnig þakka ég Þórunni Hyrnu Víkingsdóttur fyrir málefnalega umræðu um Evróðusambandið og Pétri Dam Leifssyni fyrir greinargóða og vel skipulagða áfanga í Evrópurétti.

## Table of Contents

<b>Introduction.....</b>	<b>2</b>
<b>Chapter 1. The Eurosystem.....</b>	<b>5</b>
<b>Chapter 1.1. Economic and Monetary Union (EMU) .....</b>	<b>6</b>
<b>Chapter 1.2. European Central Bank (ECB) .....</b>	<b>8</b>
<b>Chapter 2. The history of Icelandic currency .....</b>	<b>10</b>
<b>Chapter 3. Icelandic monetary policy .....</b>	<b>12</b>
<b>Chapter 4. Legal aspects of entrance into the Eurosystem .....</b>	<b>15</b>
<b>Chapter 5. Comparative analysis .....</b>	<b>24</b>
<b>Chapter 5.1. Sweden .....</b>	<b>24</b>
<b>Chapter 5.2. United Kingdom.....</b>	<b>26</b>
<b>Chapter 5.3. Montenegro .....</b>	<b>29</b>
<b>Chapter 6. The possibilities for Iceland .....</b>	<b>32</b>
<b>Chapter 6.1. Unilateral adoption .....</b>	<b>32</b>
<b>Chapter 6.2. The formal route.....</b>	<b>35</b>
<b>Conclusion .....</b>	<b>37</b>
<b>Bibliography .....</b>	<b>39</b>

## Introduction

Currency adoption in Iceland is a highly debated issue. The debate concerns two possibilities regarding the adoption of the Euro (€) as an official currency of Iceland. One possibility is joining the Economic and Monetary Union (EMU) which involves the fulfilments of several legal and economic conditions including the requirement of being an EU member; the other possibility is to change the currency to € unilaterally (without negotiating with the EU). In this thesis the main topic is to cover these two possibilities, that is whether Iceland can adopt the € formally through participation in the EU or unilaterally, and the effects of both options. In doing so, the legal environment of the European monetary system will have to be examined as well as its policies.

France, Luxemburg, Belgium, Finland, Italy, Austria, Netherlands, Ireland, Portugal, Spain and Germany established the EMU in May 1998 and adopted the € as their currency 1999. The main objective of the EMU is to support a single united monetary system. In 1998 the European Central Bank (ECB) was established and its objective is to create a frame for and to govern the process of a united single monetarism of the members of the EMU. In 2002 the € started to make its way into the member states as an official currency. This is one of the biggest and influential decisions in the short history of the EU. This does not only affect the member states but also Europe as a whole and the global economic system. Therefore it is of a huge importance to examine this field from every aspect to evaluate which status Iceland wishes to have in this new developing Europe; “[...] the advent of the Euro gives a reason to reconsider the present exchange-rate regime of the Icelandic *Króna* due to the economic effect which the establishment of the EMU has on Iceland, both direct and indirectly [...]” as Jón Sigurðsson said in his book in the prelude of the € development.<sup>1</sup>

In order to understand the pathway of the € and the reaction of the EU if Iceland would unilaterally adopt the € as its currency, it is necessary to clarify the Eurosystem. The Eurosystem is basically the institutions that uphold the single monetary system in the EU and

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<sup>1</sup> Jón Sigurðsson, *Evra – Aðdragandi og afleiðingar*, (Reykjavík, Hið íslenska bókmenntafélag, 1999.) P. 15.

President of the Nordic Investment Bank 1994- 2005, Chairman of the Central Bank of Iceland 1993- 1994. Congressman from 1987 – 1993, Minister of Trade 1987- 1993, Minister of Industry 1988 – 1993 and Minister of Justice 1987 – 1988.

is laid down in the Maastricht Treaty which was signed in 1992 and established the EMU among other legal provision of the EU. The Eurosystem is a compound of the European Central Bank (ECB) and the national central banks (NCB) of the member states. The role of these institutes will be described in the first chapter of this thesis as well as their policies and objectives.

The *Króna* does not have a long history, mainly because Iceland was a part of the Danish monarchy. Iceland did not have full sovereignty in financial matters until 1918. In the second chapter the evolvement of currency matters in Iceland will be looked upon from the Danish *Piaste* to the Icelandic *Króna*.

After the last Icelandic parliamentary elections it was clear that efforts to join the European Union would not be on the agenda, at least not in this parliamentary term. However discussions about the need to switch the *Króna* to another currency are increasing due to the fall of the *Króna* and they are mostly concerned with the adoption of the €. To give a clear idea of how beneficial this option is, it is important to analyze the past experience and the agenda of the EU institutions. The Icelandic monetary policy concerning the adoption of the € is described in the third chapter.

The formal adoption of the € requires the fulfilling of legal conditions set by the EMU. The biggest conditions are the qualification of being an EU member and three inflexible economical conditions, these conditions will be explained. The uncertainty about whether the requirement of EU membership for adopting the € is necessary or negotiable will be eliminated. Unilateral adoption of the € is much more complicated and the legal aspects are unclear although the statements from the administration of the Eurosystem has been very clear. The legal aspect of these two possibilities will be analyzed and the international legal interaction which a unilateral adoption would execute. The qualification of joining the EMU and the adoption of the € will be explained in the fourth chapter as well as the condition of the Icelandic state concerning the requirements to fulfil the convergence criteria.

The past experience of the EMU has precedents of opt – clauses, states with a derogation and unilateral adoptions of the €. These experiences will be examined to reach a better understanding on the Eurosystem's position concerning the consistency of the adoption of the €. Sweden, UK and Montenegro are different cases in the adoption route and it is important to



look at them to understand the political position of the EU. In the fifth chapter these precedents will be explained giving a comparative analysis on this topic.

After examining the EMU framework, legal requirements and the precedents of the € adoption, the possibilities of Iceland concerning the € adoption is revealed in chapter six.

Most of the discussions about the adoption of the € concerns the legal, political and economic aspects of this issue. However many scholars and others have been inclined to approach the subject on the wrong presumption using their strong romantic sensation for the independence of Iceland. It does not give a clear view on this topic because they block out the idea of the € due to the fear of losing some of the independence by joining the EU. The fear does not seem to be towards the adoption of a new currency, but towards the framework which follows the adoption of the € that is the EU and the rendition of the states powers. This thesis will assess these ideas and some of the misunderstanding concerning the € adoption that has been evident in discussions in Iceland.

## Chapter 1. The Eurosystem

The institutions that govern the € are complicated; they are many and often difficult to realise which institution governs a certain economic field. The institutions are diplomatic which often leaves room for presumptions concerning statements from the official of the Eurosystem. The Eurosystem is basically the institutions that uphold the single monetary system in EU. These institutions have their power vested in the Maastricht treaty<sup>2</sup> and the treaty also defines the institutes from each other. The Maastricht treaty gives us a clear idea on how the Eurosystem works as for their objectives and restrictions.<sup>3</sup> As has been said the Eurosystem is governed by the European System of Central Banks (ESCB) and compound of the European Central Banks (ECB) and National Central Banks of the Member States (NCB). The ESCB's primary tasks are directed through article 105(2) which lays down these four basic tasks:

“to define and implement the monetary policy of the Community,  
to conduct foreign-exchange operations,  
to hold and manage the official foreign reserves of the Member States,  
to promote the smooth operation of payment systems.”<sup>4</sup>

The ESCB has to consult the ECB in matters which are regulated by Article 105(4)<sup>5</sup>. The ECB has a very important role within the ESCB, cooperated with the national central banks,

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<sup>2</sup> Treaty on European Union. 29 July 1992. (Protocol on the Statute of the ESCB and ECB). No. C 191/68. Official Journal of the European Community.

<sup>3</sup> Treaty on European Union. 29 July 1992. Article 105(1) “*The primary objective of the ESCB shall be to maintain price stability. Without prejudice to the objective of price stability, the ESCB shall support the general economic policies in the Community with a view to contributing to the achievement of the objectives of the Community as laid down in Article 2. The ESCB shall act in accordance with the principle of an open market economy with free competition, favoring an efficient allocation of resources, and in compliance with the principles set out in Article 4.*”

<sup>4</sup> The Treaty Establishing the European Community. 29. 12. 2006. No. C 321 E/89. (Accessed: 21. April 2008.) <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2006:321E:0001:0331:EN:pdf>

<sup>5</sup> Treaty Establishing the European Community, Article 105(4)

“*The ECB shall be consulted:*

and they together perform the tasks they have been entrusted with. The ECB has legal personality under public international law. The ECB will be described in a more extensive way in chapter 1.2.

The ESCB is compound of the ECB and the NCB as well as all EU member states (whether they have adopted the € or not) operate in accordance with article 107.1 of the Treaty establishing the European Community. The aim of the ESCB is making a single monetary system for the EU and still there are countries that are EU members but still not a member of the €area such as United Kingdom and Denmark.<sup>6</sup> The decision making power of the ESCB is guided by Article 107 which states:

- “1. The ESCB shall be composed of the ECB and of the national central banks.
2. The ECB shall have legal personality.
3. The ESCB shall be governed by the decision-making bodies of the ECB which shall be the Governing Council and the Executive Board.”<sup>7</sup>

The objective of the ESCB is to maintain price stability by working jointly within national central banks and the ECB. ESCB maintains price stability by controlling the interest rate and by trying to influence the EU market.

### **Chapter 1.1. Economic and Monetary Union (EMU)**

Today the euro is the single currency of 15 Member States, which together survey the €area. These member states are a part of the Economic and Monetary Union (EMU) which is the

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— on any proposed Community act in its fields of competence,

— by national authorities regarding any draft legislative provision in its fields of competence, but within the limits and under the conditions set out by the Council in accordance with the procedure laid down in Article 107(6).

*The ECB may submit opinions to the appropriate Community institutions or bodies or to national authorities on matters in its fields of competence.”*

<sup>6</sup>Official homepage of the European Central Bank. *ECB, ESCB and the Eurosystem*. (Accessed 30. april, 2008.) <http://www.ecb.int/ecb/orga/escb/html/index.en.html>

<sup>7</sup> The Treaty Establishing the European Community. 29. 12. 2006 . C 321 E/89. (Accessed 21. April 2008.) <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2006:321E:0001:0331:EN:pdf>

political and economic framework that supports the € and complements the EU's single market. The EMU forms a common market through the member states and they coordinate in making economy policies that supports the single market. The EMU plays a major role in the process of economic integration. This process can be divided into six steps:

- “1. A preferential trading area (with reduced customs tariffs between certain countries).
2. A free trade area (with no internal tariffs on some or all goods between the participating countries).
3. A customs union (with the same external customs tariffs for third countries and a common trade policy).
4. A common market (with common product regulations and free movement of goods, capital, labour and services).
5. Economic and monetary union (a single market with a single currency and monetary policy).
6. Complete economic integration (all the above plus harmonized fiscal and other economic policies).”<sup>8</sup>

Steps 4 and 5 of this process are basically the role that the EMU has in economic integration. These steps give a clear idea on the view which the EMU has on states adopting the € unilaterally. The EMU policy on unilateral adoption is very clear and stated in various writings and statements. In the publication of the European Commission, *One Currency for One Europe; The Road to the Euro*, the aim and goal of economic integration and EMU is declared in a clear manner “[t]hose Member States which are not part of the euro area retain their own currencies and conduct their own monetary policies[...].”<sup>9</sup> and then it continues to

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<sup>8</sup> European Commission. *One Currency for One Europe; The Road to the Euro*. (Belgium, European Communities, 2007). P. 3.

<sup>9</sup> European Commission. *One Currency for One Europe; The Road to the Euro*. (Belgium, European Communities, 2007). P. 3.

give us a clear idea on the EMU agenda by stating that “[t]o reach complete economic integration would require all Member States to join the euro area and harmonize their fiscal policies, including taxation, and other economic policies.”<sup>10</sup> It would always cause much criticism and even perhaps a critical trade restriction on Iceland if Iceland would adopt the € unilaterally due to the risk of damaging the main goal and aim of the EMU. The EMU is a political institution that works as an instrument to further the objectives of the European Union in ensuring a balanced and sustainable economic growth and a high employment.

### **Chapter 1.2. European Central Bank (ECB)**

In 1998 the ECB was established to create a frame and govern the process of a united single monetary of the members of the EMU. In 2002 the euro as coinage began to enter into the member states. Within the ESCB, the ECB and the central banks of the € area form the Eurosystem, whether they have adopted the € or not. However, this does not give a clear view on how the ECB works within the ESCB and in this chapter the ECB's role will be distinguished so that the reader can differentiate it from the ESCB.

The decisions in ECB are taken by the Governing Council, Executive Board and the General Council of the ECB.<sup>11</sup> The Governing Council is an influential decision-making body and deals with decisions relating to the monetary policy and decisions concerning monetary policy can only be taken there.

The administration of The Governing Council is described in the Maastricht Treaty in this way: “The Governing Council of the ECB shall comprise the members of the Executive Board of the ECB and the Governors of the national central banks”<sup>12</sup>. The Governing Council of the ECB is a supreme decision-making body on the EU monetary policy and directs the ESCB in many ways.<sup>13</sup> The Governing Council is responsible for the formulation of a

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<sup>10</sup> Ibid.

<sup>11</sup> Treaty on European Union. 29 July 1992. (Protocol on the Statute of the ESCB and ECB). No. C 191/68. Art. 12. Official Journal of the European Community.

<sup>12</sup> Treaty on European Union. 29 July 1992. (Protocol on the Statute of the ESCB and ECB). No. C 191/68. Art. 10.1. Official Journal of the European Community.

<sup>13</sup> European Commission. *One Currency for One Europe; The Road to the Euro*. (Belgium, European Communities, 2007). P. 11.

monetary policy for the euro area. The council makes decisions relating to monetary objectives, key interest rates, the supply of reserves in the Eurosystem, and the establishment of guidelines for the implementation of those decisions.<sup>14</sup> The president of the European Council and the members of the Commission can influence the decisions made by the ECB. They have the right to take part in the Governing Councils meetings without having the right to vote.<sup>15</sup>

The Executive Councils function is to manage the day to day activities of the ECB which involves the preparation of the Governing Councils meetings. The Executive Board implements the monetary policy for the € area in accordance with the guidelines and decisions taken by the Governing Council. The Council gives the necessary instruction to the euro area NCBs and is responsible for the communications between the NCBs and the ECB. The Executive Board exercises certain powers delegated to it by the Governing Council.<sup>16</sup>

The General Council is composed of the President and Vice-President of the ECB plus the governors of the NCBs which come from the 27 EU Member States. The General Council can be regarded as a transitional body and their main function along with the collection statistical information and annual reports is to carry out “[...] out the tasks taken over from the European Monetary Institute which the ECB is required to perform in Stage Three of Economic and Monetary Union (EMU) on account of the fact that not all EU Member States have adopted the euro yet.”<sup>17</sup>

In the next chapter we will look into the history of the Icelandic currency.

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<sup>14</sup> The official homepage of the European Central Bank. (Accessed 17. april 2008.)  
<http://www.ecb.int/ecb/orga/decisions/govc/html/index.en.html>

<sup>15</sup> Treaty Establishing the European community. Article 113.  
*(1) The President of the Council and a member of the Commission may participate, without having the right to vote, in meetings of the Governing Council of the ECB.  
The President of the Council may submit a motion for deliberation to the Governing Council of the ECB.*  
*(2) The President of the ECB shall be invited to participate in Council meetings when the Council is discussing matters relating to the objectives and tasks of the ESCB.*

<sup>16</sup> The official homepage of the European Central Bank. *Executive Board*. (Accessed 17. april 2008.)  
<http://www.ecb.int/ecb/orga/decisions/eb/html/index.en.html>

<sup>17</sup> Ibid

## Chapter 2. The history of Icelandic currency

The oldest currency bearing the name of Iceland is the Danish *piaste*, struck in the year 1771 at the Copenhagen Royal Mint. However this currency only bears the name of Iceland and was not the legalized currency in Iceland. The Danish *piaste* only symbolises the Iceland's status under the Danish crown. The history of the official currency started 7 years later by the formal validation of the Danish Courant Bank notes. The Danish Courant Bank notes are not thought to have been in much use since trade was restricted by the monopoly.<sup>18</sup> The Courant Bank notes practically became worthless when the Danish currency collapsed in 1813.<sup>19</sup> In 1813 the Rigsbank replaced the Courant Bank and given the sole right to issue notes. On the 20th of March 1815 the Rigsbank notes were introduced in Iceland by a royal decree.<sup>20</sup>

Under the law which clarified the governance position of Iceland within the Danish Crown (*Stöðulögin*), 2. Jan 1871, Icelandic and Denmark finances were separated and the National Treasury was founded. Three years later the Icelandic parliament was given the legislative power about the rules governing the National Treasury. Then in 1885 the National Treasury was permitted to issue notes in its own name for the value of half million *Króna* and became the initial capital of the National Bank of Iceland.<sup>21</sup> Following the Sovereignty Act of 1918 the National Treasury was renamed without any change in its role and the National Treasury became State Treasury.<sup>22</sup> Legislation in 1927 and 1928 regarding the National Bank of Iceland gave it the status of national central bank and sole issuer of banknotes.<sup>23</sup> By law nr.

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<sup>18</sup> The Central Bank of Iceland and the National Museum of Iceland, *The Currency of Iceland*, (2. nd. ed. 2002, Reykjavík). p. 7.

<sup>19</sup> The Central Bank of Iceland and the National Museum of Iceland, *The Currency of Iceland*, (2. nd. ed. 2002, Reykjavík). p. 14.

<sup>20</sup> The Central Bank of Iceland and the National Museum of Iceland, *The Currency of Iceland*, (2. nd. ed. 2002, Reykjavík). p. 14.

<sup>21</sup> The Central Bank of Iceland and the National Museum of Iceland, *The Currency of Iceland*, (2. nd. ed. 2002, Reykjavík). p. 14 - 15.

<sup>22</sup> The Central Bank of Iceland and the National Museum of Iceland, *The Currency of Iceland*, (2. nd. ed. 2002, Reykjavík). p. 29.

<sup>23</sup> The Central Bank of Iceland and the National Museum of Iceland, *The Currency of Iceland*, (2. nd. ed. 2002, Reykjavík). p. 34.

63/1957 of the National Bank of Iceland was divided into two sections, commercial bank and central bank, with an independent executive power.<sup>24</sup> Four years later the Central Bank of Iceland was founded as a separate institution with the rights and obligations of issuing banknotes in accordance with the law nr. 10/1961 of the Central Bank of Iceland.<sup>25</sup>

The law of the Icelandic currency, nr. 22/1968, the official currency of Iceland is established in article 1, “The Currency of Iceland is called *Króna* [...]”.<sup>26</sup> This law governs the current situation of the official currency of Iceland.

The next chapter clarifies the Icelandic policy concerning the current status of the *Króna*.

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<sup>24</sup> The Central Bank of Iceland and the National Museum of Iceland, *The Currency of Iceland*, (2. nd. ed. 2002, Reykjavík). p. 43.

<sup>25</sup> The Central Bank of Iceland and the National Museum of Iceland, *The Currency of Iceland*, (2. nd. ed. 2002, Reykjavík). p. 46.

<sup>26</sup> Law nr. 22/1968. *Lög um gjaldmiðil Íslands*. 23. April 1968. (Accessed 25. April 2008.)  
<http://www.althingi.is/dba-bin/unds.pl?txi=/wwwtext/html/lagasofn/135a/1968022.html&leito=gjaldmiðil\Ogjaldmiðlunum#word1>



### Chapter 3. Icelandic monetary policy

After the last Icelandic parliamentary elections, in 2007, it was clear that efforts to join the European Union would not be on the agenda for this term. Discussions about currency changes began to arise seriously soon after the elections due to the instability of the *Króna*. In relations to that discussion the adoption of the € started to get louder and more public. Iceland has the smallest currency area in the world but exists alongside the biggest currency area in the world.<sup>27</sup> This is a common argument of the supporters of the € and the statement that the Icelandic *Króna* cannot thrive any longer within the current globalisation. Adoption of the € is therefore the logical continuation on the nation's globalisation.<sup>28</sup> The negative aspect of joining the EU did influence the debate due to the requirement of being an EU member to adopt the €. The discussion about joining EU has met a large degree of criticism due to the bad influence on the fishing industry which many agree on and the fear of reducing the independence of Iceland. Taking the EU member requirement aside there seems to be a sceptical view on what influences would occur if Iceland would put the governance of the economy in the hands of the ECB due to inflation policy.

The policy of the Icelandic government is that negotiations talks with the EU will not occur while this government is in office. The current Prime Minister of Iceland, Mr. Geir H. Haarde, has been very clear on this matter giving no room for discussion that could lead Iceland closer to the € or the European Union. Mr. Haarde has admitted that the governmental parties have different policies in this matter but the diplomatic conclusion was that EU membership would not be on the government's agenda. Mr. Haarde also pointed out that if Iceland would consider adopting the € it would be through the "Euro route" due to the unilateral adoption being irresponsible and that Iceland;

” [...] would lose all its influences on currency affairs and a unilateral adoption would be looked upon as a sign of weakness and that the

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<sup>27</sup> Speech: Ásgeir Jónsson. *Tími krónunnar liðinn*. Meeting held by SA-Confederation of Icelandic Employers on Currency Matters. (Reykjavík, Hotel Loftleiðir, 17. January 2008).

<sup>28</sup> Ibid.

Icelandic economy would then be an easy prey for business speculators and investors”<sup>29</sup>

Many people share the opinion that the adoption of the € is only a question of time due to the development of the European economy. The Icelandic *Króna* is very weak at moment and due to the small size of the economy the *Króna* is very open to fluctuations creating an instable currency. These are very unhealthy conditions for many companies in Iceland and more and more companies have been asking for permission to stockade in other currencies such as the €. This weakens the *Króna* and causes problems that Icelandic politicians need to tackle if they intend to keep the *Króna* on the market as a substantial currency. The € is used more and more by companies and the Icelandic government faces huge difficulties due to this development. Some say that it is only a question of time before companies will start to pay salary partly or fully in € if the current economy situation continues.<sup>30</sup> The tourist industry is giving out prices in € which they transform into Icelandic *Króna* later on. This development does have a negative influence on the Icelandic economy.

Even so, the Icelandic government shows little concern regarding this development and seem to look at it as a natural result of globalization. If the Icelandic government would try to make it more difficult to stockade in other currencies than the Icelandic *Króna* the consequences would probably be catastrophic. Restriction in this matter could lead to uneconomic business environment which would perhaps force companies to move abroad.<sup>31</sup>

The Stockade Law in Iceland allows companies to stockade in the currency they choose if their main income comes from foreign trades or that their main activities are abroad. Companies can also sign their operating currency at the National Central Bank and stockade

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<sup>29</sup> Geir H. Haarde. *Að taka upp evru einhliða álitid veikleikamerki*. Morgunblaðið. (29. 9. 2007).

<sup>30</sup> Katrín Ólafsdóttir, lektor við Viðskiptadeild Háskólans í Reykjavík. *Evra eða ekki Evra?*. Viðskiptablaðið. (24. Janúar, 2007).

<sup>31</sup> Official homepage Icelandic Chamber of Commerce. 6. March, 2008. (Accessed 24. April, 2008.) <http://www.vi.is/files/2139112675uppgjor7.pdf>

in that currency.<sup>32</sup> If a company believes that it qualifies these conditions it can apply for admission to stockade in a foreign currency.<sup>33</sup> The Prime Minister, Mr. Geir H. Haarde, accepted these laws and was very much in favour of them and stated that it is only a fair and normal to accept these requests and respect the companies' increasing trade relations with foreign states. Most of the companies that stockade in foreign currencies stockade in U.S. dollars as a result of this law.<sup>34</sup>

At the annual meeting of the Icelandic Central Bank the Prime Minister, Geir H. Haarde, gave a speech where he dealt with the growing discussions of both unilateral adoption of the € as well as a formal adoption. In his speech he mentioned that a unilateral adoption would be “completely impractical” and that a question of a formal adoption of the € instead of the *Króna* is not a matter of adopting the € but rather a question of joining the EU. Mr. Haarde stated that the adoption of the € would not solve any problems just cause new ones. A small nation such as Iceland will always have more economic instability than bigger nations. By adopting the € the Icelandic government would lose their power of influencing the Icelandic economy. Instead of an exchange-rate fluctuation we would have more unemployment and the choice would rather be currency fluctuations rather the high unemployment rate.<sup>35</sup>

The Icelandic policy appears to be to hinder the progress of the € into the Icelandic economy and community in the hope to strengthen the Icelandic *Króna* so that it can be maintained.

The following chapter concerns the legal aspects of entrance into the Eurosystem and the status of Iceland concerning those requirements and conditions of the adoption of the €

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<sup>32</sup> The Stockade Law of Iceland. 2006, nr. 6, 17 january. Article 8. (Accessed 25. April, 2008.) <http://www.althingi.is/dba-bin/unds.pl?txi=/wwwtext/html/lagasofn/135a/2006003.html&leito=%E1rsreikning#word1>

<sup>33</sup> Stockade Law of Iceland. 2006, nr. 6, 17 january. Article 9. (Accessed 25. April, 2008.) <http://www.althingi.is/dba-bin/unds.pl?txi=/wwwtext/html/lagasofn/135a/2006003.html&leito=%E1rsreikning#word1>

<sup>34</sup> Geir H. Haarde, Prime Minister of Iceland. The annual meeting of the Icelandic Central Bank. Reykjavík, 30. Mars 2007. (Accessed 17. April, 2008) <http://www.forsætisraduneyti.is/radherra/raedurGHH/nr/2576>

<sup>35</sup> Ibid.

## Chapter 4. Legal aspects of entrance into the Eurosystem

The formal adoption of the € requires the fulfilment of legal conditions set by the EMU and the Maastricht Treaty. The biggest term is the qualification of being an EU member and three inflexible economic conditions which are called the “convergence criteria” or the “Maastricht criteria”. These conditions will be explained and the requirement of being an EU member described and how it effects the adoption of the €

Unilateral adoption of € is very complicated and the legal aspects are unclear although the statements from the administration of the ECB have been very clear. The legal aspect of these two possibilities will be analyzed and the international legal interaction which a unilateral adoption would execute.

Richard Portes, professor at the London School of Economics believes there are three possibilities in the adoption of the € in a legal sense; join the ESB and adopt the € from so called “Euro route”, adopt the € unilaterally, or try to reverse the increasing usage of the € in Iceland.<sup>36</sup>

Legally Iceland could adopt the € unilaterally; however sanctions could be imposed if Iceland would do so due to the EU being against any unilateral adoptions. The fact that the ECB is against all unilateral adoption makes the adoption very irresponsible, both because of we would lose all influence on currency affairs and Iceland would be without any support if an economic disaster would occur. Jurgen Stark, Board Member of the ECB, stated that ECB would not support or intervene if Iceland would decide to adopt the € unilaterally, however he did not mention that there is a possibility that the member states could impose some kind of implicit sanctions. States that adopt the € unilaterally do it at their own responsibility and at their own risk and neither the EU nor the ECB will have any obligations to support those states.<sup>37</sup>

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<sup>36</sup> Richard Portes. Business convention of the Viðskiptaráð Íslands. 13. Feb. 2008. Morgunblaðið. 14. Febrúar 2008. p. 20

<sup>37</sup> Jurgen Stark. Business convention of the Viðskiptaráð Íslands. 13. Feb. 2008. Morgunblaðið. 14. Febrúar 2008. p. 20

The articles in the Treaty of the European Union which concern the Economic and Monetary Union all apply to EU member states.<sup>38</sup> That fact supports the view that the EU and the ECB would not support Iceland if they would adopt the € unilaterally and Iceland would have no impact on any economic decisions of the EMU and would therefore give up their sovereignty in economic matters.

Due to the present government's opposition to joining the EU the question arises of whether Iceland could get an exception and join the EMU without being a member of the EU. All the members of the EMU have taken the same route in adopting the € and no states have received any exception as to the requirement of EU membership.<sup>39</sup> The conditions of being an EU member is not without reason, it is the main function of a single currency for Europe and by allowing that kind of an exception would ruin the main objective of the EMU which is a joint currency for all Europe. It is absolutely impossible to get that kind of an exception both because of the main objective of the EMU and because it would violate the equality that is supposed to prevail amongst the states that have already entered.<sup>40</sup>

José Manuel Barroso, president of the European Commission, has shown that he is very much against states adopting the € without going the formal route. The EU will not support Iceland if they will adopt the € unilaterally and that the € adoption will only occur through EU membership if Iceland decides to go the formal way.<sup>41</sup> This statement along with others given

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<sup>38</sup> The Treaty of the European Union. 29. 12. 2006. OJ C321/E1. (Accessed 20. April, 2008.) <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2006:321E:0001:0331:EN:pdf>

<sup>39</sup> The official homepage of the European Commission. "There are states using the Euro without the EU membership, those states used before currencies which were used by states before adopting the Euro. Monaco, the Vatican, San Marino and Andorra use the Euro with special agreement with the EU. Montenegro and Kosovo however do not have any agreement with the EU but used the Deutsche Mark before." (Accessed 29. April, 2008.) [http://ec.europa.eu/economy\\_finance/the\\_euro/the\\_euro6484\\_en.htm](http://ec.europa.eu/economy_finance/the_euro/the_euro6484_en.htm)

<sup>40</sup> The Treaty of the European Union. 29. 12. 2006. OJ C321/E11. Article 3: "The Union shall be served by a single institutional framework which shall ensure the consistency and the continuity of the activities carried out in order to attain its objectives while respecting and building upon the *acquis communautaire*. The Union shall in particular ensure the consistency of its external activities as a whole in the context of its external relations, security, economic and development policies. The Council and the Commission shall be responsible for ensuring such consistency and shall cooperate to this end. They shall ensure the implementation of these policies, each in accordance with its respective powers." (Accessed 20. April, 2008.) <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2006:321E:0001:0331:EN:pdf>

<sup>41</sup> Morgunblaðið. *Uptaka Evru aðein með aðild að ESB*. Morgunblaðið, 28. February, 2008.

out by the EU and/or the ECB executives gives a clear answer to the speculations of Iceland receiving an exception in adopting the € due to the EEA membership or other reasons. The EU community has also adopted regulations stating that “[...] the single currency will be introduced only in the Member States without derogation.”<sup>42</sup> Those countries who participate in the European Monetary Union have all followed the same route in adopting the € based on the principle of equal treatment. Although it would not take a very long time to enter the EU for Iceland due to the EES membership Iceland does not really have that option of adopting the € even through membership of the EU, at least not at the moment and it will take some time for Iceland to meet those requirements of joining EMU (the convergence criteria).<sup>43</sup>

The convergence criteria are:

“[...]to ensure the sustainable convergence required for the achievement of economic and monetary union (EMU), the Treaty sets four convergence criteria which must be met by each Member State before it can take part in the third stage of EMU and hence before it can adopt the euro. Compliance is checked on the basis of reports produced by the Commission and the European Central Bank (ECB). The criteria are:

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;

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<sup>42</sup> European Commission. COUNCIL REGULATION (EC) No 974/98. 3. May, 1998. On the introduction of the euro. Article 23. (Accessed 21. April, 2008.)  
<http://www.consilium.europa.eu/uedocs/cmsUpload/compilationmonetary.pdf>

<sup>43</sup> The Treaty of the European Union. 29. 12. 2006. OJ C321/E1. Article 121. (Accessed 20. April, 2008.)

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. “<sup>44</sup>

The convergence criteria are meant to ensure that economic development within EMU is balanced and does not give rise to any tensions between the Member States. The criteria relating to government deficit and government debt must continue to be met after the start of the third stage of EMU (1 January 1999). To this end, a stability pact was adopted at the Amsterdam European Council in June 1997 and enables the members of the Euro-zone to coordinate national government budget policies and avoid excessive government budget deficits.<sup>45</sup> These are the first two stages of adopting the € in accordance to the formal route of the EU that is; becoming an EU member and the fulfilment of the convergence criteria. There are very few signs that Iceland is moving towards neither of these basic requirements. However there is a lot more to it than just the two stages of the adoption of the €, after entering into the EU the member state eventually has the obligation of joining the € area if the adoption of the € is their intention.

The states that have entered the phase of becoming a member state without the adoption of the € are states with derogation. That means that those states have obligations whether they intend to adopt the € or not.<sup>46</sup> These obligations concern the Exchange Rate Mechanism (ERM II) which is a mechanism of the EU created to ensure exchange rate discipline and fosters a convergence that helps the states in the € area to adopt the €. ERM II links all the currencies of the non- € states that have entered into the € area. States that have joined the €

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<sup>44</sup> Europa – Glossary. (Accessed 16. April, 2008.)  
[http://europa.eu/scadplus/glossary/convergence\\_criteria\\_en.htm](http://europa.eu/scadplus/glossary/convergence_criteria_en.htm)

<sup>45</sup> Ibid.

<sup>46</sup> Sweden is a state that participates in the EMU without adoption of the Euro due to that Sweden hasn't meet the legal condition for the adoption. Sweden rejected the adoption in a referendum and therefore has an exception for the participation in the EMU (member with a derogation).

area have to respect the policies of the EMU and the economic policies of those member states become a subject of coordination and surveillance at the EU. This is the first stage of the monetary policy handover to the EU due to the policy not being the responsibility of the state. Applying states that have joined the € area have to adopt the legal framework of the EMU which includes changes of the legal foundation of their national central banks and create a convergence between the legal framework of the EMU and the applying state.<sup>47</sup> If these convergence stages have been approved by the EU and the EMU, the applying state can adopt the € given that a referendum has approved both the EU membership and the adoption of the €, however that is depending on the constitutions of the states that apply for membership.<sup>48</sup>

As noted above, Mr. Jürgen Stark, a Member of the Executive Board of the ECB, stated in his speech which he delivered at the Icelandic Chamber of Commerce in Reykjavík on the 13 February 2008, the ECB would “neither encourage nor facilitate such a move” referring to the unilateral adoption.<sup>49</sup> This statement is interesting because of the fact that the EU has no jurisdiction over Iceland and no legal resources to impact a unilateral monetary decision.<sup>50</sup>

Each State has the right to regulate its own currency; this was established by the Permanent Court of International Justice in a case concerning Brazilian and Serbian loans. In the case of Brazilian loans the question arose as to whether Brazil should pay a contracted loan debt according to their agreement in paper francs or gold francs. The Ministry of Affairs of the

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<sup>47</sup> The Treaty Establishing the European Community. 29. 12. 2006. C 321 E/89. Article 109: „Each Member State shall ensure, at the latest at the date of the establishment of the ESCB, that its national legislation including the statutes of its national central bank is compatible with this Treaty and the Statute of the ESCB.” (Accessed 21. April 2008.) <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2006:321E:0001:0331:EN:pdf>

<sup>48</sup> Jürgen Stark, Member of the Executive Board of the ECB. *The adoption of the euro: principles, procedures and criteria*. Speech delivered at the Icelandic Chamber of Commerce in Reykjavík, 13 February 2008. Homepage: Law of the EMU and euro, news, legislation and legal (scholarly) publications on the European Economic and Monetary Union. (Accessed 27. April, 2008.) <http://www.lawofemu.info/blog/2008/02/ecb-unilateral.html>

<sup>49</sup> Ibid.

<sup>50</sup> The official homepage of the European Commission. “There are states using the Euro without the EU membership, those states used before currencies which were used by states before adopting the Euro. Monaco, the Vatican, San Marino and Andorra use the Euro with special agreement with the EU. Montenegro and Kosovo however do not have any agreement with the EU but used the Deutsche Mark before.” (Accessed 29. April, 2008.) [http://ec.europa.eu/economy\\_finance/the\\_euro/the\\_euro6484\\_en.htm](http://ec.europa.eu/economy_finance/the_euro/the_euro6484_en.htm)



France government prosecuted the States of Brazil on behalf of France holders of various Brazilian loans. The Permanent Court of International Justice concluded by stating:

“[...] as the court has explained in its judgment concerning the case of Serbian loans, it is a generally excepted principle that a State is entitled to regulate its own currency.”<sup>51</sup>

Theoretically Iceland could adopt the € unilaterally but the consequences are unforeseeable and depend on the political position of the member states of the EU and legal standing of the EEA agreement. The EEA agreement imposes cooperation and consulting clauses in economic and monetary affairs among other things. Unilateral adoption of the € could put the EEA arrangement into danger because the decision of adopting the € unilaterally is a violation of the agreement.<sup>52</sup> Inigo Arruga Oleaga, employee of the Principal Legal Counsel of the European Central Bank, pointed out that a unilateral monetary decision could well stir up the EEA arrangement due to the clauses of cooperation and consulting.<sup>53</sup>

Although that the EU could not intervene in the unilateral adoption it does not change the fact that Iceland has no authorization to issue € banknotes or coins. The ECB alone has the right to authorize the issue of € banknotes and coins.<sup>54</sup> This could make the unilateral adoption more difficult; however it would be very hard for the ECB to intervene if companies in Iceland would start to make their salary and other payments in € and therefore slowly adopt the €

It is absolutely clear that Iceland does not meet the qualifications of adopting the € by the formal route at the moment because Iceland does not fulfil the *convergence criteria*. The state

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<sup>51</sup> *Case Concerning the Payment of Various Serbian Loans Issued in France*. 12. 07. 1929. The Permanent Court of International Justice. Judgement no. 14.

<sup>52</sup> Agreement on the European Economic Area. Signed 03. 01. 1994. OJ No L 1, 3.1.1994. (Accessed 12. April, 2008) [http://secretariat.efta.int/Web/EuropeanEconomicArea/EEAAgreement/EEAAgreement/EEA\\_Agreement.pdf](http://secretariat.efta.int/Web/EuropeanEconomicArea/EEAAgreement/EEAAgreement/EEA_Agreement.pdf)

<sup>53</sup> Inigo Arruga Oleaga in the University of Reykjavík, 02. 03. 2007, about the Euro. Meeting held by the European Law Institute of the University of Reykjavik.

<sup>54</sup> The Treaty Establishing the European Community. 29. 12. 2006. OJ C 325. Art 106. (Accessed 21. April, 2008.) <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2006:321E:0001:0331:EN:pdf>

finances are in good conditions; the state deficit qualifies the criteria and the foreign debt of the state is very low. However the interest rate and the inflation rate are far too high and do not qualify the requirements set by the convergence criteria. However given that Iceland could meet the qualification of the convergence criteria it would take two years at least for Iceland to finish the negotiation talks with the EU before becoming an EU member. Two years is not an underestimate due to the EEA membership of Iceland which makes the entry to the EU much easier.<sup>55</sup> From the entry into the EU it would take at least two years to adopt the € due to ERM II.<sup>56</sup> But the convergence criteria are not the only legal conditions which Iceland would have to fulfil.

If Iceland intends to join the EMU it has to fulfil a functioning market economy respecting the free movement of goods, services, capital and workers, Iceland already fulfils a functioning economy market in accordance with the EEA agreement. The EEA agreement is an agreement between the European Free Trade Association (EFTA) except Switzerland and the EU.<sup>57</sup> The EEA agreement unites the trade market of the member states “[...] into an Internal Market governed by the same basic rules.”<sup>58</sup> These basic rules apply to the free movement of the goods, people, services and capital with exceptions in the matters of the fishing industry, agriculture, business relations with the third states, judicial powers, custom affairs, foreign and internal affairs and the EMU.<sup>59</sup> Through the EEA agreement Iceland fulfils some of the terms which are laid down in the “rule book of the EU” (*acquis*

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<sup>55</sup> Aðalsteinn Leifsson, Lektor við Háskólinn í Reykjavík. Interview on Rás 2, Ríkisútvarp. News 18:00, 20. April, 2008.

<sup>56</sup> Jürgen Stark, Member of the Executive Board of the ECB. *The adoption of the euro: principles, procedures and criteria*. Speech delivered at the Icelandic Chamber of Commerce in Reykjavík, 13 February 2008. Homepage: Law of the EMU and euro, news, legislation and legal (scholarly) publications on the European Economic and Monetary Union. (Accessed 27. April, 2008.) <http://www.lawofemu.info/blog/2008/02/ecb-unilateral.html>

<sup>57</sup> EFTA was founded and signed in Stockholm 4. January 1960. The EFTA member states are Iceland, Liechtenstein, Norway and Switzerland. (Accessed 25. April, 2008.) <http://secretariat.efta.int/Web/EFTAConvention/DetailedOverviewEFTAConvention/view>

<sup>58</sup> Official homepage of the European Free Trade Association. (Accessed 25. april 2008) <http://secretariat.efta.int/Web/EuropeanEconomicArea/introduction>

<sup>59</sup> EEA Agreement. Article 1(2). 01.08. 2007. Official Journal No. L 1, 3.1.1994. (Accessed 25. April, 2008.) [http://secretariat.efta.int/Web/EuropeanEconomicArea/EEAAgreement/EEAAgreement/EEA\\_Agreement.pdf](http://secretariat.efta.int/Web/EuropeanEconomicArea/EEAAgreement/EEAAgreement/EEA_Agreement.pdf)

*communautaire*).<sup>60</sup> The countries have to fulfil article 6(1) of the Treaty of the European Union<sup>61</sup> in accordance with article 49 of the Treaty of the European Union before entering into the EU.<sup>62</sup> By the EEA agreement Iceland already fulfils some of the legal requirement of the EU membership and leads to much easier membership negotiations. This results that Iceland could become a member state and adopt the € by the formal route after four years that is if Iceland would decide to apply for membership now.<sup>63</sup>

The biggest condition which hinders the Icelandic adoption now is the EU membership. Although the membership is the biggest obstacle it does not mean that Iceland could adopt the € even if it would decide to join the EU. Iceland does not fulfil the convergence criteria and it would take some time to meet those conditions and the current economic situation leaves Iceland far away from the requirements because the inflation is increasing. Iceland fulfils the condition of the internal market of the EU due to the EEA agreement. Still the obligation of being an EU member for at least two years before adopting the Euro leaves Iceland at least four years away from a formal adoption.

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<sup>60</sup> Europa – Glossary. “The Community *acquis* is the body of common rights and obligations which bind all the Member States together within the European Union. It is constantly evolving and comprises:  
the content, principles and political objectives of the Treaties;  
the legislation adopted in application of the treaties and the case law of the Court of Justice;  
the declarations and resolutions adopted by the Union;  
measures relating to the common foreign and security policy;  
measures relating to justice and home affairs;  
international agreements concluded by the Community and those concluded by the Member States between themselves in the field of the Union's activities.”  
(Accessed 21. April, 2008. [http://europa.eu/scadplus/glossary/convergence\\_criteria\\_en.htm](http://europa.eu/scadplus/glossary/convergence_criteria_en.htm))

<sup>61</sup> The Treaty of the European Union. Consolidated Version. Art. 6(1). C 321 E/12. 29. 12. 2006. „The Union is founded on the principles of liberty, democracy, respect for human rights and fundamental freedoms, and the rule of law, principles which are common to the Member States.”

<sup>62</sup> The Treaty of the European Union. Consolidated Version. Art. 49. 321 E /12. 29. 12. 2006. „Any European State which respects the principles set out in Article 6(1) may apply to become a member of the Union. It shall address its application to the Council, which shall act unanimously after consulting the Commission and after receiving the assent of the European Parliament, which shall act by an absolute majority of its component members.”

<sup>63</sup> Olli Rehn, member of the European Commission, responsible for the EU enlargement. Morgunblaðið. 17. 07. 2007. (Accessed 25. april, 2008.)  
[http://www.mbl.is/mm/frettir/innlent/2007/07/17/olli\\_rehn\\_umsokn\\_islendinga\\_um\\_adild\\_ad\\_esb\\_yrði\\_fa](http://www.mbl.is/mm/frettir/innlent/2007/07/17/olli_rehn_umsokn_islendinga_um_adild_ad_esb_yrði_fa)

The unilateral adoption is not a rational decision and it is a very desperate solution due to the uncertainty of implied sanctions imposed by the EU member states and the harm which such a decision would cause on the economy.

Let us now turn to look at the next chapter which will grant us an insight of some other states experiences which have similar currency issues or problems.

## Chapter 5. Comparative analysis

The past experience of the € is not a long history but there are nations that have both adopted the € unilaterally such as Montenegro, states with a derogation such as Sweden and states with a opt-out clause such as UK and Denmark. In this chapter the economic situation concerning the adoption of the € in the UK, Sweden and Montenegro will be discussed. The EMU has also rejected applications due to lack of requirements mostly because the economic situation has been inadequate. The issue of the EMU rejection is described in the case concerning Sweden and the difficult position which the EMU is facing concerning the Montenegro's adoption of the €

On 2 May 1998 the Council of the European Union decided that 11 Member States had fulfilled the conditions necessary for the participation in the third stage of the EMU and the adoption of the single currency on 1 January 1999. The initial participants were Belgium, Germany, Spain, France, Ireland, Italy, Luxembourg, the Netherlands, Austria, Portugal and Finland. The number of participating Member States increased to 12 on 1 January 2001, when Greece entered the third stage of EMU. Slovenia became the 13th member of the euro area on 1 January 2007, to be followed one year later by Cyprus and Malta.<sup>64</sup>

### Chapter 5.1. Sweden

On the 22 of May 2002 the Commission of the EU concluded that Sweden did not fully meet the convergence criteria.<sup>65</sup> The commission issues a Convergence reports every two years on States with derogations. The convergence report of 2002 on Sweden has not been modified due to a Swedish referendum in 2003. In the referendum 56.1% of the voters rejected the adoption of the €, 41.8% accepted the adoption. However if the referendum had involved the acceptance of the € adoption Sweden would have had to modify their national legislation on

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<sup>64</sup> The official homepage of the European Central Bank. *Economic and Monetary Union*. (Accessed 25. April, 2008.) <http://www.ecb.int/ecb/history/emu/html/index.en.html#stage1>

<sup>65</sup> Europa – Scadplus. Official homepage. "Under Article 122(2) of the Treaty establishing the European Communities (EC Treaty), the Commission and the European Central Bank (ECB) are required to draw up, at least once every two years or at the request of a Member State with a derogation, reports on the progress made by Member States in performing their obligations to achieve Economic and Monetary Union (EMU)." (Accessed 25. April, 2008.) <http://europa.eu/scadplus/leg/en/lvb/l25062.htm>

accordance with the requirement of the Treaty establishing the European Community.<sup>66</sup> In these reports the legal consistency of the commission is evident and gives a clear response on the ideas concerning states receiving any exceptions on the formal route of the adoption of the € The Commission concluded on the status of Sweden concerning the convergence criteria:

“Sweden fulfils the government finance, inflation rates and long-term interest rate criteria. Only the exchange-rate criterion is not fulfilled. Sweden has derogation but there is no provision to exempt it from participation in the third stage of EMU (as in the case of Denmark and the United Kingdom). Sweden is, therefore, required to adopt the euro, and this means that it must fulfil the exchange-rate criterion.”<sup>67</sup>

The Commission also concluded that Swedish national legislation was not compatible with the requirement of the articles 108 and 109 of the EC Treaty.<sup>68</sup> The compatibility with the requirements of the Treaty entails:

“independence of the national bank;

primacy of the objective of price stability;

legal integration of the Riksbank in the ESCB (statutes, tasks, instruments, organisation and financial provisions);

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<sup>66</sup> Europa – Scadplus. Official homepage. Sweden convergence reports (2002, 2004 and 2006). (Accessed 25. April, 2008.) <http://europa.eu/scadplus/leg/en/lvb/l25062.htm>

<sup>67</sup> Ibid.

<sup>68</sup> The Treaty Establishing the European Community. 29. 12. 2006. OJ C 325/77. Article 108:

“When exercising the powers and carrying out the tasks and duties conferred upon them by this Treaty and the Statute of the ESCB, neither the ECB, nor a national central bank, nor any member of their decision-making bodies shall seek or take instructions from Community institutions or bodies, from any government of a Member State or from any other body. The Community institutions and bodies and the governments of the Member States undertake to respect this principle and not to seek to influence the members of the decision-making bodies of the ECB or of the national central banks in the performance of their tasks.”

Article 109:

“Each Member State shall ensure, at the latest at the date of the establishment of the ESCB, that its national legislation including the statutes of its national central bank is compatible with this Treaty and the Statute of the ESCB.”

prohibition of public-sector financing by the Riksbank;

prohibition of privileged access by the public sector to financial institutions;

free movement of capital within the Union and with countries outside the Union;

compatibility of other legislative texts (issue of notes and coins, exchange-reserve management, exchange-rate policy, etc.).”<sup>69</sup>

In the report the Commission concluded on the legal compatibility that Sweden needed to make adaptations on three fields. The constitutional law, the law governing the Riksbank and the law governing the exchange-rate policy required adaptation to meet the requirements of article 109 of the Treaty establishing the European Community.<sup>70</sup> Sweden is still a member with derogation. Due to the rejection of the € in the referendum in Sweden a target date for adoption is probably a few years ahead.<sup>71</sup>

## **Chapter 5.2. United Kingdom**

When the Maastricht Treaty was concluded in 1992, the United Kingdom was granted an opt-out clause. By the terms of opt-out clause the United Kingdom was not required to participate in the third stage of economic and monetary union (EMU) and consequently introduce the €. The Protocol (No 25) concerns certain provisions relating to the United Kingdom of Great Britain and Northern Ireland, annexed to the Treaty establishing the European Community.<sup>72</sup> The Protocol states that certain articles of the Treaty do not apply to the United Kingdom:

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<sup>69</sup> Europa – Scadplus. Official homepage. Sweden convergence reports (2002, 2004 and 2006). (Accessed 25. April, 2008) <http://europa.eu/scadplus/leg/en/lvb/l25062.htm>

<sup>70</sup> The Treaty Establishing the European Community. 29. 12. 2006. OJ C 325/77.

<sup>71</sup> Referendum held 14, september. 2003.

<sup>72</sup> Treaty of the European Union. OJ C 191, 29 July 1992. Protocol nr. 25 on the position of the United Kingdom and Ireland. Article 1.

“its powers in the field of monetary policy are not affected by the Treaty (the United Kingdom retains its powers in the field of monetary policy under national law);

it is not subject to the provisions of the Treaty relating to excessive deficits;

it is not concerned by the provisions of the Treaty relating to the European System of Central Banks (ESCB), the European Central Bank (ECB) or the regulations and decisions adopted by those institutions. “<sup>73</sup>

The provision of the protocol means that the UK is still at the second stage of the EMU. In accordance with this Protocol the UK retains its powers in the field of monetary policy under its national law. The UK is not obliged to join the €area. It is for the UK to notify the EU Council whether it intends to do so.<sup>74</sup> The UK Government has announced that any move to the third stage of EMU will depend on five economic tests being met:

*“Convergence of business cycles:* Business cycles in the euro zone and the United Kingdom must be compatible. The assessment will focus on economic indicators such as inflation, interest rates, the output gap and the real effective exchange rate with a view to long-term convergence.

*Flexibility:* The UK economy must be flexible enough to ensure that any asymmetrical shocks can be absorbed by, for example, labour-market flexibility and mobility and by fiscal policy.

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“The United Kingdom shall notify the Council whether it intends to move to the third stage before the Council makes its assessment under Article 109j (2) of this Treaty. Unless the United Kingdom notifies the Council that it intends to move to the third stage, it shall be under no obligation to do so.”

<sup>73</sup> Europa – Scadplus. Official homepage. *United Kingdom: EMU opt-out clause*. (Accessed 25. April, 2008.) <http://europa.eu/scadplus/leg/en/lvb/l25060.htm>

<sup>74</sup> Law of the EMU and euro, news, legislation and legal (scholarly) publications on the European Economic and Monetary Union. *UK Euro coins for sale*. (Accessed 25. April, 2008.) [http://www.lawofemu.info/blog/2007/02/uk\\_euro\\_coins\\_f.html](http://www.lawofemu.info/blog/2007/02/uk_euro_coins_f.html)



*Investment:* UK participation in the single currency must promote investment (foreign or domestic) in the long term.

*Financial services:* EMU must improve the competitive position of the UK's financial services industry, particularly in London.

*Growth, stability and jobs:* EMU must have positive effects on employment and growth, measured by the impact on UK foreign trade, price differentials and macroeconomic stability. “<sup>75</sup>

A decision to adopt the single currency seems not currently in the UK national interest according to the UK government and the five economic steps have not fully been met.<sup>76</sup> Basically the UK's government is in favour of adopting the € given that the economic conditions are favourable. The former Chancellor of the Exchequer, Mr. Gordon Brown who is now the current Prime Minister of the UK, gave a statement in the House of Commons on 9 June 2003, committing the government to an annual review of progress.<sup>77</sup> In the latest report of 2008 the government does:

“[...] not propose a euro assessment to be initiated at the time of this Budget. The Treasury will again review the situation at Budget time next year, as required by the Chancellor's June 2003 statement.”<sup>78</sup>

It is unforeseen whether and when the UK will enter the third stage of the EMU. For now the policy of the UK remains that it should not propose the €assessment.

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<sup>75</sup> Europa – Scadplus. Official homepage. *United Kingdom: EMU opt-out clause*. (Accessed 25. April, 2008.) <http://europa.eu/scadplus/leg/en/lvb/l25060.htm>

<sup>76</sup> Ibid.

<sup>77</sup> Her Majesties Treasury. *Budget 2008. Stability and opportunity: building a strong, sustainable future*. Economic and Fiscal Strategy Report and Financial Statement and Budget Report. 12. March 2008. HM Treasury.

<sup>78</sup> Her Majesties Treasury. *Budget 2008. Stability and opportunity: building a strong, sustainable future*. Economic and Fiscal Strategy Report and Financial Statement and Budget Report. 12. March 2008. HM Treasury. P. 147.

### Chapter 5.3. Montenegro

Montenegro started using the € as its currency before they even got independence from Serbia. This was not a favourable move from the EU perspective but it was difficult to take any action against them because Montenegro was a state within the state of Serbia. Now Montenegro is applying for membership of the European Union and it is difficult to see what will occur in their currency matters because they still do not qualify for membership of the economic conditions set out by the EMU.

The EMU faces difficulties when it comes to the compatibility of the formal route to the € adoption because both Montenegro and Kosovo use the € as the legal tender. Montenegro introduced the € as a legal tender in January 2001; although Montenegro had no official reserves, the introduction was made by international donations which made the adoption capable.<sup>79</sup> The authorities in Montenegro took these measures in the hope of establishing economic confidence among the people and in order to do that the authorities “[...] to insulate the economy from the negative effects of expansionary monetary policies in Belgrade.”<sup>80</sup> The result of this economic measure did not present the desired outcome. The introduction of the € in Montenegro as a strong and convertible currency did not meet with confidence among the citizens as intended. Estimates in 2002 indicated that “[...] two thirds of money in circulation remained under mattresses, while half of all economic transactions were in cash, avoiding the mediation of official financial institutions.”<sup>81</sup>

In the case of Montenegro as well as Kosovo the adoption of the € is unilateral and is in the form of a “market driven” currency substitution. The substitution has no direct influences from the government administration measures and depends on citizen’s decision whether to hold savings in domestic or foreign currency. In the case of an economic crisis in Montenegro

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<sup>79</sup> Renzo Daviddi and Milica Uvalic. *Currencies in the Western Balkans on their way towards EMU*. Editors: Francisco Torres Amy Verdun, Chiara Zilioli and Hubert Zimmermann. Governing the EMU; Economic, Political, Legal and Historical Perspectives, (European University Institute, European Central Bank, European Investment Bank, July, 2004.) p. 297- 298. (Accessed 26. April, 2008.)  
<http://www.iue.it/Alumni/PDFs/LibroCompletoAA.pdf>

<sup>80</sup> Renzo Daviddi and Milica Uvalic. p. 297

<sup>81</sup> Renzo Daviddi and Milica Uvalic. P. 298.

and Kosovo the EU monetary policy will not accommodate these states as the unilateral adoption of the € means the acceptance of the loss of domestic monetary independence.<sup>82</sup>

The currency substitution puts the economic stability policy in danger but since 1999-2000 the EU Stabilisation and Association Process has offered the Western Balkan countries the prospect of EU membership in exchange for commitments to political, economic, trade, or human rights reform in a country. This agreement reduces the danger which the currency substitution has imposed on economic stability policy. In exchange for these commitments the countries that have signed the agreement of the Stabilisation and Association Process may be offered tariff-free access to some or all EU markets (industrial goods, agricultural products, etc), and financial or technical assistance.<sup>83</sup> The countries that have made this agreement are called Accession Countries. These are the ten new Member States (the Czech Republic, Cyprus, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia, and Slovenia) that joined the European Union (EU) on May 1, 2004, as well as to the other seven Candidate Countries along with Montenegro (Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Serbia, Macedonia and Romania) which are expected to join later.<sup>84</sup>

Although this agreement reduces the harm on EU economic policy it does not allow the countries to unilaterally adopt the €. The agreement makes the policy consistency more alike but the compatibility of the formal route becomes threatened if more and more countries start to unilaterally adopt the €. When states such as Montenegro and Kosovo become EU members the question of how the formal steps of the EMU should be taken arises. It is possible that the demands could be imposed on Montenegro that they stop using the € and adopt another currency while they fulfil the qualification of the EMU.<sup>85</sup> After Montenegro

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<sup>82</sup> Renzo Daviddi and Milica Uvalic. P. 300 -304.

<sup>83</sup> Renzo Daviddi and Milica Uvalic. P. 308 -310.

<sup>84</sup> Dominick Salvatore. *Restructuring and Euroization in Accession Countries*, (Department of Economics, Fordham University, New York, USA). Society for Policy Modeling Published by Elsevier Inc. 11. September 2004. (Accessed 27. April, 2008.) [http://www.sciencedirect.com/science?\\_ob=ArticleURL&\\_udi=B6V82-4D97SXW2&\\_user=713789&\\_rdoc=1&\\_fmt=&\\_orig=search&\\_sort=d&view=c&\\_acct=C000039858&\\_version=1&\\_urlVersion=0&\\_userid=713789&md5=b64252a5ff14924884a63ec851dc5b21](http://www.sciencedirect.com/science?_ob=ArticleURL&_udi=B6V82-4D97SXW2&_user=713789&_rdoc=1&_fmt=&_orig=search&_sort=d&view=c&_acct=C000039858&_version=1&_urlVersion=0&_userid=713789&md5=b64252a5ff14924884a63ec851dc5b21)

<sup>85</sup> Mr. Geir H. Haarde. Press meeting after the meeting of Mr. Haarde and the representatives of the European Commission. Brussel, 27. February. 2008. (Accessed 27. April 2008.) [http://www.vb.is/?gluggi=greinar\\_prenta&id=40125](http://www.vb.is/?gluggi=greinar_prenta&id=40125)

signed the Association Pact in mid October 2007 the EU and Montenegro's authorities have been working on a solution. However the EU ministers have stated that "unilateral introduction of the € was not compatible with the Treaty" the implication have not yet been decided.<sup>86</sup>

The following chapter concerns the possibilities which Iceland has in adopting the € in accordance with the conclusions of the previous chapters. These possibilities will be looked upon in consistency with the current status of the *Króna* and the deliberation on what is rational and responsible in accordance with the benefit of the Icelandic state will be explained.

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<sup>86</sup> Wien International. *Montenegro heading for EU membership*. Compress VerlagsgesmbH & Co KG. (Accessed 28. April 2008.) <http://www.wieninternational.at/en/node/5446>

## **Chapter 6. The possibilities for Iceland**

One possibility is joining the EC along with the EMU which is dependent on several legal and economic condition; the other possibility is to change the currency to € unilateral (without negotiating with EU). Other possibilities have not gained much discussion or speculation as the idea of hindering the development of usage of the € in Iceland.<sup>87</sup>

### **Chapter 6.1. Unilateral adoption**

The official legal tender of a state is the state's ultimate decision as a part of sovereignty. This is one of the fundamental rights of a sovereign state and this fundamental right along with the fact that EU have limited possibilities in hindering unilateral adoption does make the possibilities in € adoption open both through the unilateral way as for the formal route. Adopting the € unilaterally does not have to limit the independence of the authorities according to Richard Portes and he points out that since Iceland is already participating in several European collaborations without a representative in Brussels, the same stand could be taken in the monetary policy as well.<sup>88</sup> Portes refers to the cooperation of Iceland and the European Community through the EEA agreement, Schengen and other cooperation which Iceland is involved in due to their geographical position. Iceland is a participant in several European collaborations mostly because of the EEA agreement. Portes' view has met substantial resistance from the EU bureaucrats. The EU statements made by Barroso and Stark have clearly shown that unilateral adoption will not lead to more involvement in the European Community. Although the EU statements have not involved any direct threat of sanctions they have been very clear that the EU is against such an act. A unilateral adoption is possible however very dangerous and irresponsible not only due to economic terms but also administrative influences, legal uncertainty, European cooperation and the relations between the European nations.

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<sup>87</sup> Richard Portes. Business convention of the Viðskiptaráð Íslands. 13. Feb. 2008. Morgunblaðið. 14. Febrúar 2008. p. 20

<sup>88</sup> Ibid.

The rendition of economic affairs without having any administrative influences on economic decision or policy-making is a large factor in unilateral adoption being a very huge mistake. The economy would be very vulnerable for business interest parties which have more and more influences on the economic condition of states especially small ones. If economic crisis occurs the EU have no responsibility in assisting the state and in fact it would be very hard to reach out the EU after having received a statement including such warnings and the EU opposition of unilateral decisions. The main reason for throwing the *Króna* away and adopting the € is the strong economic and financial support of the ECB and unilateral adoption would prevent Iceland from receiving such support.

There have been some accusations from officials in Iceland that the reason for the instability of the *Króna* and the recent downswing of the Icelandic financial market are foreign investors, hedge funds and newspapers which are accused of attacking the Icelandic economy causing impairs on stock and share holders. These accusations are being looked into by the Icelandic ministry of commerce and it is notable how much the Icelandic economy has been a favourable subject of newspapers especially in UK and Denmark. Some articles in foreign newspapers have occasionally been pretty harsh. The *Daily Telegraph* has been efficient in this matter and on the 23 of March this year the newspaper released an article on the crash of the *Króna*. This article has signs of having a slight exaggeration in a few statements concerning the economy such as “[w]hile financial stocks were being battered on both sides of the Atlantic Ocean, in between one government was scrambling to prevent a meltdown of an entire economy.” and:

“Iceland is being treated like one big toxic hedge fund. It's a tiny country who's corporate and banking sectors have leveraged up to get better returns and punch way above their weight. That leverage is now magnifying their losses. The story doesn't make sense any more. Nobody wants anything to do with it.”<sup>89</sup>

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<sup>89</sup> Louise Armitstead. *Iceland shows cracks as the Krona crashes*. The Daily Telegraph. 23. 03. 2008, (Telegraph Media Group Limited, 2008.) (Accessed 30. April, 2008.)  
<http://www.telegraph.co.uk/money/main.jhtml?xml=/money/2008/03/23/cckrona123.xml>

It seems so recently that newspapers were writing about the wonderful Icelandic economy and the fast progress that has been made on the financial market. Therefore it is quite understandable that the newspaper statements on the economy have been met with some frustration from the government officials of Iceland. Although the *Króna* is a very instable currency and weak towards any criticism the unilateral decision would not create a good image of the Icelandic financial market. The outcome would result in a lose of credibility and the economy would become much more vulnerable for these alleged acts which are supposed to be generated by interested parties such as hedge funds and other investors. Sigurður Einarsson, Chairman of the Kaupthing Bank, has supported these accusations stating that four British hedge funds (Lansdowne Partners, Trafalgar Fund, Ako Capital and Cheney Capital) had been spreading allegations about the ill prospect of the Icelandic financial market. Richard Portes stated that he received a phone call from one hedge fund where he was urged to be cautious in his discussion about the Icelandic economy. Portes warned both the British and Icelandic authorities of these communications.<sup>90</sup> If these accusations turn out to be right it makes reasons to be sceptic on the benefits of unilateral adoption.

Unilateral adoption would also possibly harm the European cooperation that Iceland already has. The fact that the European Community is not in favour of such acts gives reasons to believe that Iceland would risk their participation in several European collaborations. Although statements have suggested that the EU will not intervene in such act does not mean that member states of the EU will not impose implied commerce hindrance.

The EEA agreement obligates cooperation and consulting in clauses that involve economic and monetary affairs among other things. By losing credibility through unilateral decisions and violating the clauses of consulting and cooperation in the EEA agreement the agreement would be put into danger. The cooperation would not improve by such act and the member states would probably not be keen on such move due to the risk of damaging the image of the EEA as a whole. Any unilateral decision in economic and monetary affairs is a violation of the EEA agreement.

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<sup>90</sup> The Icelandic National Broadcasting Service. *Hedge funds make threats*. 14. 04. 2008, (The Icelandic National Broadcasting Service official homepage, 2008, Reykjavík, Iceland.) (Accessed 30. April, 2008.) <http://www.ruv.is/heim/frettir/frett/store64/item201547/>

## Chapter 6.2. The formal route

The formal route of adopting the € is the only possibility of adoption which is responsible. By the formal route the real profit of the € is guaranteed and that is the strong economic support which the single currency for Europe grants. In order to adopt the €, Iceland has to be a member of the EU for at least two years before adopting the €, that is if Iceland qualifies for the Maastricht criteria.<sup>91</sup>

The reason for the qualification of the Maastricht criteria is to limit the differences of each member states economy. Without the qualification of the Maastricht criteria the policy making of EMU would be in vain and the aim of the internal market of EU would become more distant.<sup>92</sup>

The Icelandic Minister of Commerce, Mr. Björgvin G. Sigurðsson, only sees two possibilities in currency affairs. The first possibility is to keep the current currency system and strengthen the economic tools of the Icelandic Central Bank. The second possibility is to apply for membership of the EU and the EMU later on. Sigurðsson admitted that in the current situation the best thing to do is to strengthen the Icelandic economy and make decisions after we have solved the current economic unrest.<sup>93</sup> It does not make any differences what Iceland will do in the future concerning other currencies; Iceland always has to start by creating economic stability. We should aim to reach the qualification of the Maastricht criteria whether we shall apply for membership or not.

Due the fact that EU membership is the main requirement of the formal adoption of the € one might ask that is premature to talk about the formal adoption of the €. The main discussion should therefore refer on the application of EU membership. The main concerns in that matter are the fishing industry, agriculture and the unique position of Iceland based on the

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<sup>91</sup> Eiríkur Bergmann Einarsson. *Evrópusamruninn og Ísland*. (Háskólaútgáfan, 2003, Reykjavík, Iceland.) p. 175 - 176

<sup>92</sup> Stefán Már Stefánsson. *Evrópusambandið of Evrópska Efnahagssvæðið*. (Bókaútgáfa Orators, 2000, Reykjavík, Iceland.) P. 885.

<sup>93</sup> Mannlíf. *Krónan dauðadæmd*. 5. tbl. 25. árg. (Birtingur útgáfufélag, 23. Apríl, 2008, Reykjavík, Iceland.) P. 26



geographical position, rural areas and the low population of the country which will reflect on the weight of influences within the EU.

## Conclusion

It is important when discussing the formal adoption of the € along with the advantages of the EMU that the formal adoption comes with a certain framework. This framework is an integral part of the formal adoption and has no room for negotiation; it is all or nothing in this matter.

The status of the Icelandic *Króna* is very weak at the moment and the inflation has been growing considerably recently. This has caused an increased discussion on currency replacement from interested parties which are encouraging the government to change their policy towards the €. The Icelandic government shows however no sign on conceding on their current policy which is that the EU membership is not on the government's agenda. The current government has stated that unilateral adoption is impractical. Therefore the real question should be whether to join the EU or to back up the current economic and monetary policy of Iceland. The latter seems to be the current policy.

The formal adoption of the € is only for the EU members. After becoming an EU member states have to wait for two years before they can adopt the €. In these two years the states have to adopt the Exchange Rate Mechanism, ERM II, and fulfil the convergence criteria. Due to the EEA agreement Iceland fulfils some of the basic requirements of becoming an EU member. The participation in the EEA agreement makes it much easier to adjust the EU membership requirements. Even so, Iceland is very far from qualifying the conditions of the convergence criteria.

Statements from the EU officials have suggested that Iceland will not receive any special treatment due to the EEA agreement. These statements conclude that the EU are using the € as a bait for countries as Iceland to become EU members. The EEA agreement grants the member states admission to the internal market of the EU and in exchange for harmonisation of the rules which govern the free movement of the goods, people, services and capital with exception which mostly refer on the fishing industry and agriculture. Iceland is therefore a member of the internal market of the EU and takes also participation in a several European cooperation. If the EU were not using the € as a bait it would probably grant the EEA countries the possibility of adopting the € following the qualification of the convergence criteria and the other basic requirements.

It will be interesting to follow up the process of the Montenegro application of becoming a member of the EU. Montenegro adopted the € unilaterally and the question arises on how the formal steps of the EMU should be taken when Montenegro becomes a member of the EU. Some suggestions have been made that Montenegro could be demanded to stop using the € while fulfilling the conditions of the EMU. The implications have not yet been decided but the unilateral decision of Montenegro could become a great regret if they have to adopt another currency while fulfilling the conditions. The EU decision on this matter might change the consistency of the formal route.

Legally Iceland could establish a legal tender of a state without consulting the currency executive power. This is supported by the Permanent Court of International Justice, 1929, in the case of Serbian and Brazilian loans. Unilateral adoption could however result in business hindrance set by the member states of the EU due to the disapproval of such move. Such a unilateral decision could also harm the European cooperation which Iceland is already a participant in. The EEA agreement would be in danger because unilateral adoption violates the cooperation and consulting clause of the agreement. Iceland would not receive any support from the EU in the case of economic crisis and the government would be in a very difficult position due to lack of economic tools to tackle the crisis.

The growing discussion in Iceland about the *Króna* and its replacement seems to involve that the € could solve that problem without much delay. This is a huge misunderstanding. First, a unilateral adoption does not solve anything in the economy of Iceland and in fact it would be quite the opposite. Secondly, the formal adoption does not involve any quick solutions for Iceland. This is very important to realise because the formal adoption will take at least five years and it comes along with the framework of the EU.

The EU membership is the major obstacle which hinders Iceland in the formal adoption of the € Iceland is not even considering the application although the public support grows. It is highly likely that the next election, scheduled 2011, will centre upon the EU membership due to the growing public support.

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