

# THE LEGAL CONVERGENCE CRITERION AND THE CZECH REPUBLIC

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## Abstract

The “Maastricht” criteria are to ensure the convergence of economic performance as a basis for the introduction of the single currency. There are five conditions, grouped in two classes: the economic convergence criteria and the “legal convergence” criterion. The last criterion is the one of the most forgotten in discussions of the “Maastricht criteria”. This Treaty obligation applying to Member States with a derogation is also referred to as “legal convergence”. This paper takes a closer look at the areas of legal convergence criterion and the Czech Republic.

## Key Words

Legal convergence criterion; the Act on Czech National Bank; the independence of national central banks; legal integration of NCB's into the Eurosystem.

## Introduction

According to the European Central Bank: „*Czech law, and in particular the Law on the Czech National Bank, does not comply with all the requirements for Czech National Bank's independence and legal integration into the Eurosystem. The Czech Republic is a Member State with a derogation and must therefore comply with all adaptation requirements under Article 109 of the Treaty.*”<sup>1</sup> The Czech Republic is a member state with a derogation. A derogation shall entail that the following articles do not apply to the Member State concerned:

- In the excessive deficit procedure the Council can't decide to give notice to the Member State to take measures for the deficit reduction and can't apply any sanctions.<sup>2</sup>
- The objective system and the basic tasks of the ESCB, and the community rules of the issue of banknotes and coins.<sup>3</sup>

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<sup>1</sup> ECB Convergence Report 2006, pp. 36

<sup>2</sup> EC-Treaty, Art. 104 (9), (11)

<sup>3</sup> EC-Treaty, Art. 105 (1)-(3), (5), 106

- The lawmaking of the ECB.<sup>4</sup>
- The competence of the Council concerning the exchange-rate policy.<sup>5</sup>
- The appointment of the members of the Executive Board of the ECB.<sup>6</sup>

According to the Treaty, those states can join the third part of the economic and monetary union (EMU), and can introduce the single currency, who meet the necessary economic and legal requirements. These requirements are known as the Maastricht convergence criteria. There are five conditions, grouped in two classes: the economic convergence criteria and the “legal convergence” criterion.<sup>7</sup>

However the most interesting research area is the legal convergence criterion for us. According to the Article 109 of the Treaty: *“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.”* Article 122(2) of the Treaty requires the ECB (and the Commission) to report, at least once every two years or at the request of a Member State with a derogation, to the EU Council in accordance with the procedure laid down in Article 121(1). Each such report must include an examination of the compatibility between, on the one hand, the national legislation of each Member State with a derogation, including the statutes of its NCB, and, on the other hand, Articles 108 and 109 of the Treaty and the Statute of the European System of Central Banks and of the European Central Bank. This Treaty obligation applying to Member States with a derogation is also referred to as “legal convergence”. When assessing legal convergence, the ECB is not limited to a formal assessment of the letter of national legislation but may also consider whether the implementation of the relevant provisions complies with the spirit of the Treaty and the Statute. The ECB is particularly concerned about recent growing signs of pressure being put on the decision-making bodies of some Member States’ NCBs, which would be inconsistent with the spirit of the Treaty as regards central bank independence. The aim of assessing legal convergence is to facilitate the EU Council’s decision as to which Member States fulfil the necessary conditions for the adoption of the single currency.

The following legislation forms the legal basis for Czech National Bank and its principal operations:

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<sup>4</sup> EC-Treaty, Art. 110

<sup>5</sup> EC-Treaty, Art. 111

<sup>6</sup> EC-Treaty, Art. 112 (2)

<sup>7</sup> About the economic convergence criterion see the protocol on the convergence criteria.

- the Constitution of the Czech Republic<sup>8</sup>,
- the Act on Czech National Bank.<sup>9</sup>

Article 109 of the Treaty requires that national legislation is “compatible” with the Treaty and the Statute; any incompatibility must therefore be removed. Neither the supremacy of the Treaty and the Statute over national legislation, nor the nature of the incompatibility, affects the need to comply with this obligation. The requirement for national legislation to be “compatible” does not mean that the Treaty requires “harmonization” of the NCB statutes, either with each other or with the Statute. National particularities may continue to exist to the extent that they do not infringe the Community’s exclusive competence in monetary matters. Rather, the term “compatible” indicates that national legislation and the NCB statutes need to be adjusted to eliminate inconsistencies with the Treaty and the Statute and ensure the necessary degree of integration of the NCBs into the ESCB. In particular, any provisions that infringe an NCB’s independence, as defined in the Treaty, and its role as an integral part of the ESCB should be adjusted. It is therefore insufficient to rely solely on the primacy of Community law over national legislation to achieve this. Furthermore, inter alia as a tool to achieve and maintain the compatibility of national legislation with the Treaty and Statute, the ECB must be consulted by the Community institutions and the Member States on draft legislative provisions in its fields of competence, pursuant to Article 105(4) of the Treaty and Article 4 of the Statute. Council Decision 98/415/EC of 29 June 1998 on the consultation of the European Central Bank by national authorities regarding draft legislative provisions<sup>10</sup> expressly requires that the Member States take the measures necessary to ensure compliance with this obligation. According to the practice of the ECB the legal convergence means: the independence of national central banks; prohibition on monetary financing and privileged access; the single spelling of the euro; and legal integration of NCB’s into the Eurosystem. This paper takes a closer look at the areas of legal convergence criterion and the Czech Republic, especially the independence of national central banks and legal integration of NCB’s into the Eurosystem.

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<sup>8</sup> Constitution Law No 1/1993 Coll.

<sup>9</sup> Act No. 6/1993 Coll. of 17 December 1992, on the Czech National Bank

<sup>10</sup> OJ L 189, 3.7.1998, p. 42.

## **1. The independence of national central banks**

In 1997 the EMI established a list of features of central bank independence for the first time which were the basis for assessing the national legislation of the Member States at that time, in particular the NCB statutes. The concept of central bank independence includes various types of independence that must be assessed separately, namely functional, institutional, personal and financial independence.

### **Functional independence**

Functional independence requires that each NCB's primary objective is stated in a clear and legally certain way and is fully in line with the primary objective of price stability established by the Treaty. It is served by providing the NCBs with the necessary means and instruments to achieve this objective independently of any other authority. The Treaty's requirement of central bank independence reflects the generally held view that the primary objective of price stability is best served by a fully independent institution with a precise definition of its mandate. Section II of the Act on the Czech National Bank (furthermore 'the CNB-Act') declares that the primary objective of the CNB is to maintain price stability and the CNB shall, without prejudice to its primary objective, support the general economic policies of the European Community with a view to contributing to the achievement of the objectives of the European Community.<sup>11</sup>

### **Institutional independence**

The Treaty refers clearly to the institutional independence.<sup>12</sup> The basic of the institutional independence is the prohibition of asking for order and accepting order given by other outside organ. The content of it is laid down by the convergence reports in the following:

- *Prohibition on giving instructions*

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<sup>11</sup> CNB-Act, Section II 1. (a)

<sup>12</sup> "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." EC Treaty, Art. 108

Rights of third parties to give instructions to NCBs, their decision-making bodies or their members are incompatible with the Treaty and the Statute as far as ESCB-related tasks are concerned. According to the CNB-Act: “*When exercising the powers and carrying out the tasks and duties conferred upon them by this Act, the Treaty establishing the European Community and the Statute, neither the Czech National Bank, nor any member of its Bank Board shall seek or take instructions from European Community institutions or bodies, from any government of a Member State of the European Union or from any other body.*”<sup>13</sup>

- *Prohibition on approving, suspending, annulling or deferring decisions*

Rights of third parties to approve, suspend, annul or defer NCBs’ decisions are incompatible with the Treaty and the Statute as far as ESCB-related tasks are concerned. There aren’t such provisions in the Act on the CNB.

- *Prohibition on censoring decisions on legal grounds*

A right for bodies other than independent courts to censor, on legal grounds, decisions relating to the performance of ESCB-related tasks is incompatible with the Treaty and the Statute since the performance of these tasks may not be reassessed at the political level. There aren’t such provisions in the Act on the CNB.

- *Prohibition on participating in decision-making bodies of an NCB with a right to vote*

Participation by representatives of third parties in an NCB’s decision-making body with a right to vote on matters concerning the exercise by the NCB of ESCB-related tasks, even if this vote is not decisive, is incompatible with the Community law. According to the Act on the CNB the Minister of Finance or other nominated member of the Government may attend the meetings of the Bank Board in an advisory capacity and may submit motions for discussion.<sup>14</sup>

- *Prohibition on ex ante consultation relating to an NCB’s decisions*

An express statutory obligation for an NCB to consult third parties ex ante provides the latter with a formal mechanism to influence the final decision and is therefore

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<sup>13</sup> CNB-Act, Section II 1. (c)

<sup>14</sup> CNB-Act, Art. 11 (2)

incompatible with the Treaty and the Statute. There aren't such provisions in the Czech law.<sup>15</sup>

### **Personal independence**

- *Minimum terms of office for Governors*

EC law require a minimum term of office of five years for a Governors. The Act on the CNB does not make any distinction between the Governor of the CNB, the two Deputy Governors of the CNB and the four other members of the Bank Board of the CNB. Their term of office is six years and no person shall be allowed to hold this position more than twice.<sup>16</sup>

- *Grounds for dismissal of Governor*

According to EC law a Governor may be relieved from office only if he no longer fulfils the conditions required for the performance of his duties or if he has been guilty of serious misconduct. The purpose of this requirement is to prevent the authorities involved in the appointment of Governors, particularly the government or parliament, from exercising their discretion to dismiss them as Governor. There are three grounds of dismissal in the Czech law: *“The Governor shall be relieved from office by the President of the Republic if he no longer fulfils the conditions required for the performance of his duties or he has been guilty of serious misconduct. The President of the Republic may also relieve the Governor from office if he fails to perform his duties for a period exceeding six months.”*<sup>17</sup> According to the ECB this Article needs to clarify in what circumstances the President may justifiably consider the Governor to “fail to perform his duties...”. In particular, it is unclear how such additional ground for dismissal interacts with the first ground for dismissal, namely “if the Governor no longer fulfils the conditions required for performance of his duties.” In the ECB’s opinion this Article should therefore be brought into line with the Community law.<sup>18</sup> It must be stressed that the Czech Governemnt and Parliament haven’t terminated this incompatibility yet.

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<sup>15</sup> See CNB-Act, Art. 49b

<sup>16</sup> CNB-Act, Art. 6

<sup>17</sup> CNB-Act, Art. 6 (13)

<sup>18</sup> ECB Convergence Report 2004, pp. 218

- *Security of tenure and grounds for dismissal of members of NCBs' decision-making bodies, other than Governors, who are involved in the performance of ESCB-related tasks*

In my opinion there is serious problem that the legal assurances of personal independence on community level apply only to the members of the Executive Board of the ECB and the governors of national central banks. The other members of the decision-making panel of member state central banks is not stable from this perspective, however, especially that the governor of national central banks have the right to designate a deputy for a shorter or longer period, who can participate in the work of the Governing Council with full legal jurisdiction. Therefore, it would be justified that the guarantees mentioned previously be extended also to them in some way. According the ECB personal independence would be jeopardised if the same rules for the security of tenure of office and grounds for dismissal of Governors did not also apply to other members of the decision-making bodies of national central banks involved in the performance of ESCB-related tasks.

- *Right of judicial review*

Members of the NCBs' decision-making bodies must have the right to submit any decision to dismiss them to an independent court of law, in order to limit the potential for political discretion in evaluating the grounds for their dismissal. Article 14.2 of the Statute stipulates the rules in connection with it.<sup>19</sup> National legislation should either refer to the Statute or remain silent on the right to refer the decision to the Court of Justice of the European Communities (as Article 14.2 of the Statute is directly applicable). National legislation should also provide for a right of review by the national courts of a decision to dismiss any other member of the decision-making bodies of the NCB involved in the performance of ESCB-related tasks. The Czech legislation is harmonized with these Community rules.<sup>20</sup>

- *Safeguards against conflict of interest*

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<sup>19</sup> "A decision to this effect may be referred to the Court of Justice by the Governor concerned or the Governing Council on grounds of infringement of this Treaty or of any rule of law relating to its application. Such proceedings shall be instituted within two months of the publication of the decision or of its notification to the plaintiff or, in the absence thereof, of the day on which it came to the knowledge of the latter, as the case may be."

<sup>20</sup> CNB-Act, Art. 6 (13)

Personal independence also entails ensuring that no conflict of interest arises between the duties of members of NCB decision-making bodies in relation to their respective NCBs and any other functions which such members of decision-making bodies involved in the performance of ESCB-related tasks may have and which may jeopardise their personal independence. As a matter of principle, membership of a decision-making body involved in the performance of ESCB-related tasks is incompatible with the exercise of other functions that might create a conflict of interest. In particular, members of such decision-making bodies may not hold an office or have an interest that may influence their activities, whether through office in the executive or legislative branches of the state or in regional or local administrations, or through involvement in a business organisation. Particular care should be taken to prevent potential conflicts of interest on the part of non-executive members of decision-making bodies. According to the CNB-Act membership of the Bank Board is incompatible with the position of member of a legislative body, member of the Government and membership of the governing, supervisory or inspection bodies of other banks or commercial undertakings, and the performance of any independent gainful occupation, except - for example - for scientific and literary activities, and incompatible with any activity which may cause any conflict of interest between the performance of this activity and membership of the Bank Board.<sup>21</sup>

#### **1.4. Financial independence**

Even if an NCB is fully independent from a functional, institutional and personal point of view its overall independence would be jeopardised if it could not autonomously avail itself of sufficient financial resources to fulfil its mandate. Member States may not put their NCBs in a position where they have insufficient financial resources to carry out their ESCB- or Eurosystem-related tasks, as applicable. Additionally, the principle of financial independence implies that an NCB must have sufficient means not only to perform ESCB-related tasks but also its own national tasks. The concept of financial independence should therefore be assessed from the perspective of whether any third party is able to exercise either direct or indirect influence not only over an NCB's tasks but also over its ability. There are two aspects of financial independence.

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<sup>21</sup> CNB-Act, Art. 6 (6)



- *Determination of budget*

If a third party has the power to determine or influence the NCB's budget, this is incompatible with financial independence unless the law provides a safeguard clause to the effect that such a power is without prejudice to the financial means necessary for carrying out the NCB's ESCB-related tasks. The rules of the Act on the CNB are compatible with this legislation.<sup>22</sup>

- *The accounting rules*

The accounts should be drawn up either in accordance with general accounting rules or in accordance with rules specified by an NCB's decision-making bodies. If such rules are instead specified by third parties, then the rules must at least take into account what was proposed by the NCB's decision-making bodies. The annual accounts should be adopted by the NCB's decision-making bodies, assisted by independent accountants, and may be subject to ex post approval by third parties. Where NCB operations are made subject to the control of a state audit office or similar body charged with controlling the use of public finances, the scope of the control should be clearly defined by the legal framework and should be without prejudice to the activities of the NCB's independent external auditors, as laid down in Article 27.1 of the Statute.<sup>23</sup> The state audit should be done on a non-political, independent and purely professional basis. According to the CNB-Act: "*The annual accounts of the CNB shall be audited by one or more auditors appointed by agreement between the Bank Board and the Minister of Finance.*"<sup>24</sup> According to the ECB these provisions do not acknowledge the Community's and the ECB's competence in this field under Article 111 of the EC Treaty. These provisions must be harmonised only at the time of the accession to the third phase of the EMU by a member state with a derogation.

## **2. Legal integration of NCB's into the Eurosystem**

Provisions in national legislation which would prevent the performance of Eurosystem-related tasks or compliance with ECB decisions are incompatible with the effective operation of the Eurosystem once the Member State concerned has adopted the euro. Statutory requirements

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<sup>22</sup> CNB-Act, Art. 47 (1-2)

<sup>23</sup> "*The accounts of the ECB and national central banks shall be audited by independent external auditors recommended by the Governing Council and approved by the Council. The auditors shall have full power to examine all books and accounts of the ECB and national central banks and obtain full information about their transactions.*" (Art. 27.1 of the Statute)

<sup>24</sup> CNB-Act, Art. 48 (2)

relating to the full legal integration of an NCB into the Eurosystem need only enter into force at the moment that full integration becomes effective, i.e. the date on which the Member State with a derogation adopts the euro.

## **2.1. Tasks of the NCB's**

The tasks of an NCB of a Member State that has adopted the euro are predominantly determined by the Treaty and the Statute, given that NCB's status as an integral part of the Eurosystem. In order to comply with Article 109 of the Treaty, provisions on tasks in NCB statutes therefore need to be compared with the relevant provisions of the Treaty and the Statute, and any incompatibility must be removed.

- Any national legislative provisions relating to monetary policy must recognise that the Community's monetary policy is a task to be carried out through the Eurosystem.
- National legislative provisions assigning the exclusive right to issue banknotes to the NCB must recognise that once the euro is adopted, the ECB's Governing Council has the exclusive right to authorise the issue of euro banknotes.
- With regard to foreign reserve management, any Member States that have adopted the euro which do not transfer their official foreign reserves to their NCB are in breach of the Treaty.

It must be kept in mind that the Czech Republic is a Member State with a derogation, therefore the ESCB's tasks and the right to issue banknotes do not refer to it. These provisions must be harmonised only at the time of the accession to the third phase of the EMU.

## **2.2. Exchange rate policy**

A Member State with a derogation may retain national legislation which provides that the government is responsible for the exchange rate policy of that Member State, with a consultative and/or executive role being granted to the NCB. However, by the time that Member State adopts the euro, such legislation has to reflect the fact that responsibility for the euro area's exchange rate policy has been transferred to the Community level. Article 111 of the EC Treaty assigns the responsibility for such policy to the EU Council, in close cooperation with the ECB. However in the Czech Republic the CNB shall after discussion

with the Government stipulate the exchange rate regime of the Czech currency vis-à-vis foreign currencies.<sup>25</sup>

## **Conclusion**

It can be ascertained that the Czech Republic meets the legal convergence criterion. The Act on the CNB is almost fully harmonised with the community law. Therefore gaps occur on the one hand with regard to the accession to the third phase of the EMU and on the other hand in connection with the personal independence, especially the grounds for dismissal of Governor, as I mentioned above. Last but not least the ECB finds important the principle of legal certainty as well. In my opinion in view of the fact that Act on the CNB has been amended several times in the last few years, it must be stressed the importance of legal certainty. It is in this regard essential for fundamental legislation regulating the central bank to serve as clear and constant guidance, and overly frequent changes to the central bank legislation may compromise this function.

## **Table of European legislative instruments and national legislation**

- The Treaty establishing the European Community (OJ C 321 E, 29.12.2006)
- Protocol on the convergence criteria
- ECB Convergence Report 2004, [www.ecb.int](http://www.ecb.int)
- ECB Convergence Report 2006, [www.ecb.int](http://www.ecb.int)
- Act No. 6/1993 Coll. of 17 December 1992, on the Czech National Bank as amended by Act No. 60/1993 Coll., Act No. 15/1998 Coll., Act No. 442/2000 Coll., the Constitutional Court ruling promulgated under No. 278/2001 Coll., Act No. 482/2001 Coll., Act No. 127/2002 Coll., Act No. 257/2004 Coll., Act No. 377/2005 Coll., Act No. 57/2006 Coll., Act No. 62/2006 Coll., Act No. 230/2006 Coll., Act No. 160/2007 Coll. and Act No. 36/2008 Coll.

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<sup>25</sup> CNB-Act, Art. 35