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EFFECTS OF THE EUROPEAN MONETARY UNION ON MEMBER STATES

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Abstract: Although founded as an experiment of the twentieth century, without a political union and non-compliance with the agreed basic principles of integration, the European Monetary Union will definitely mark the new millennium. Divided politically and monetarily integrated Europe withstood many challenges and pressures, but the problems that existed from the very beginning not only did not solve, but there are created and new. Despite the efforts of the EU member states to join the EMU, it is necessary to analyze the level of development of the EMU countries' ex ante and ex post accession to the EMU. This paper is devoted to the analysis of problems and changes in key economic parameters of the Member States, 12 years after joining the EMU.

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1. Problems in the EMU

The need to create some form of universal payments dating back to ancient times, and usually various political and economic reasons make countries joining together to some form of monetary union. Given that the monetary union cannot avoid a heterogeneous impact of different Member States, State governed by the logic of the economic benefits of unification, which are numerous, but they are not easy to measure and difficult to understand their nature and importance.

European Economic and Monetary Union was an experiment of the twentieth century, as established without a political union. This is particularly important due to the fact that countries in the EMU differ in size, commissioned by power, the geopolitical situation, different economic and political structures, history, social heritage, political ideology, and so on. Because of the large differences between EU member states, Mundell`s optimal currency area criteria (Mundell 1961, 509-517) is not met, it is therefore necessary to create a viable currency area, which in addition to the monetary union requires political union (Kenen, Meade 2008, 14).

If we look at the level of political integration, it is necessary to analyze the institutional and functional structure of political unification. Despite the large number of common institutions, the problem arises from a functional point of view, because the EU in some areas is over the sovereignty of national governments (agricultural and trade) in the areas of taxation, social security, incomes policy, defense and foreign policy of the national government retained the right to making. Disparities also occur because of the structural reform process, which has remained in national jurisdictions. Political integration is essential to national budgets to centralize and redistributing income countries provided by asymmetric shocks. Also, the political union can reduce asymmetric shocks, because the separation of spending and taxation by the national government creates asymmetry. Non-harmonized wage policies lead divergent trends, leading to a domino effect where each country tries to ensure competitiveness folding rigid wages. In the case of a political union, France could not arbitrarily reduce the workweek to 35 hours, which created a negative supply shock in France and EMU GDP decline. In the event that there was a harmonized incomes policy, Germany would not be able to adapt their tight wage policy to reduce wages by 10% and thus increase the competitiveness of their products. This has had negative consequences for the entire EMU, because all the other members were forced to modify their wage policies, create recessionary tendencies with a reduction in employment and low growth in consumption and investment (Talani 2009, 50-89).

The lack of political integration is just one of many flaws of EMU, in which errors were made by the foundation. Although the Maastricht Treaty, which created the European Monetary Union, stipulates that the move towards monetary union, in addition to the principle of convergence is based on the principle of gradualism, EU leaders have significantly accelerated the start of the third stage (start functioning EMU) and some states have made a number of concessions and exemptions (Furtula 2011, 202). States have had the biggest problem with the fiscal convergence criteria, in conjunction with the budget deficit and public debt. Gradualism that is required, replaces the urgency, and the mistakes that were made can be seen in the case of Greece. Greece was admitted to the EMU 2001 without the actual convergence criteria, and then the

problem of public debt and deficit escalated in 2010 and threatened to jeopardize the entire EMU project. In December in 1997, only Finland, Luxembourg and Portugal have fully met the convergence criteria, and in 1999 it was decided that all EU member states become part of the EMU.

Accelerated creation of the European Monetary Union, with a number of concessions and under-defined rules, cannot be rationally explained, but presumably the result of an effort to create a zone of monetary stability in Europe, as a counterpart to the United States, and to annul the effects of turbulence on the dollar in Europe economy. In fact, some European countries (Germany, Austria, Belgium, Netherlands, Luxembourg ...) feared that a devaluation of the dollar affect the dollar will be replaced by their currencies, which will lead to an appreciation of their currencies and make it difficult to export. Joining the EMU and euro adoption does not automatically mean better economic performance. To make progress in the euro zone, the state should implement appropriate policies. By joining EMU, they lose their national instrument of adjustment of nominal exchange rate. This provides greater flexibility to the domestic economy and increased responsibility for the harmonization of national economic policies of the Member States, because they have to compensate for the loss of this channel of adjustment. Because of a common monetary policy and exchange rate policy, the states in the fight against asymmetric shocks are available fiscal policy, labor mobility and price flexibility. With regard to fiscal policy have redistributive and stabilizing role that economic analysis suggests little correlation between labor migration and asymmetric shocks, as the only response to asymmetric shocks, the state is the flexibility of prices. The problem of the inability to respond to asymmetric shocks is reduced because of the dynamics of functioning of EMU, as the ten-functioning state largely harmonized business cycles and growth rates.

Due to the dominant influence of the German Bundesbank and the constitution of the ECB as an explicit objective of the monetary policy of the European Central Bank was established price stability, which was the primary goal of the Bundesbank. But unlike the primary objective of the Bundesbank, which is supported by the German government, the ECB has met with opposition from many governments, especially France. Inflation has been a problem in 1980 of the last century, and many state officials are expected to target the single central bank is focused on production and employment. Also, in addition to the dominant objective of price stability, the problem is far too low a certain limit to the growth rate of 2% per year, especially if we consider the fact that 11 of the 17 EMU countries never achieved the required rate of inflation.

The insistence on the sole purpose of price stability, unemployment is put into the background, leaving its implementation to national governments. In the case of low employment, national officials will be dismissed, even though

monetary instruments as a key to solving this problem, is not in their jurisdiction. Also, the anti-inflation Maastricht convergence criteria and the Stability and Growth Pact, created a hysteresis in unemployment. It is a phenomenon in which the temporary shock of unemployment, such as during recession, transformed into a permanent shock. Since the ECB acting as a conservative bank with a focus solely on price stability, hysteresis problem has become more difficult, as in the case of not solving the problem of unemployment, temporary rise in unemployment would become too large and led to persistent unemployment, i.e. it would increase the natural rate of unemployment.

Monetary policy is an instrument of economic policy and the objectives of monetary and economic policies must be identical, but the EMU versus independent European Central Bank and a single monetary policy, there is a lack of policy integration and harmonization of economic policies. The Member States in addition to the loss of monetary sovereignty retained the right to manage fiscal policy, which is the problem of lack of coordination of economic policies even more pressing importance.

In order to eliminate these shortcomings the Stability and Growth Pact, was passed which with its controversial name (it is impossible to simultaneously achieve price stability and economic growth, as the main intention of the Pact, the agreement with the primary objective of the ECB, which automatically implies inability to increase economic growth) due to the numerous concessions, modifications and sanctions ceased to exist. Stability and Growth Pact is built on a weak institutional base, and putting government spending and taxation in the domain of national governments, is only an advisory role and not the regulator. Also, the lack of Stability and Growth Pact is the emphasis on the budget deficit rather than on a problem of public debt, which has a much greater impact in the long term. If we observe the attitude of the Member States relating to the Stability and Growth Pact, it can be concluded that small and open states correspond to the rules, and the rules and large opposed the primacy given discretion in decision-making. Fiscal stimulus in a small and open country in the absence of rules is being poured into greater exports and developed countries, while developed countries are less open and fiscal stimulus remains within national borders.

Coordination of monetary and fiscal policy is necessary because the fiscal policy could jeopardize and limit the effects of monetary policy. In the case of large deficits and public debt EMU countries, the European Central Bank will be under pressure from financial debts of member states. In the EMU, it is impossible for a single monetary policy of the ECB to eliminate the negative effects of fiscal policy in each country individually, because in some countries expansionary fiscal and other restrictive policies are pursued. In case that one

country enters the budget deficit by increasing government spending, monetary policy has to respond by raising interest rates. The increase in interest rates affects the reduction of economic growth in all Member States, which will cause the individual states still have budget deficits, and the ECB will be forced to raise interest rates again (Goodfriend, McCallum 1997, 1480-1057).

Single monetary policy, prevents the response to asymmetric shocks in demand because it is impossible that all were at the same stage of economic growth. In some countries it is necessary to increase and the other to reduce the interest rate. The problem arises because in all analyzes that consider EMU monitors the performance only EMU, which is logical, but it does not pay attention to the particular country in which there are significant discrepancies. EMU members differ sharply on inflation rates, growth rates, the debt, deficit and surplus, relative to GDP, unemployment rates. The only thing is present at the level of harmonization of the EMU are interest rates, which recorded average reduction of 20% compared to the level of the 2000 (except Greece, Portugal and Ireland). However, we should distinguish between the nominal interest rate that does not affect the economy and the real interest rate, which is the difference between nominal interest rates and inflation. Due to differences in the rates of inflation and real interest rates are significantly different, which is a definite asymmetry was confirmed as the main feature of the EMU.

Despite all the problems, it is evident that the EMU withstood many pressures and relatively successfully functioned in the past decade, and its influence has changed and the economic environment in Europe. The EMU not only affects the 17 Member States, but also all the countries of Europe. Even countries that have not adopted the single currency (the United Kingdom, Sweden, Denmark), will not escape the impact of the EMU, because most of their trading partners and neighbors are in the process of or within the EMU. In an effort to become members as soon as the EMU, countries often do not perform a cost-benefit analysis of entry, so it is necessary to analyze whether the member states gain or lose by joining the EMU.

2. EMU Founding States - In the Period before and after the Joining EMU

Accelerated creation of the EMU had another opposite effect. The cost-benefit analysis is not performed in the long-run. In the all theoretical analysis, impact of the global financial crisis is not included (Blanchard, Faruquee, Das 2010, 33). Therefore, in order to determine the final effects of monetary integration, it is necessary to analyze the basic economic parameters (Taylor 2009, 16) in the EMU founding states (convergence criteria, GDP and unemployment), including the states in regime of exemptions, in the period

before and after the joining EMU. Review of basic economic parameters before and after the joining EMU is given in Table 1

Table 1 Percentage Changing in Basic Economic Parameters in 2011 (twelve years after joining the EMU), Compared to 1999 (before joining the EMU)

	GDP	Budget/GDP	Debt/GDP	Inflation	Interest rate	Unemployment
Euro zone	46	-2.83	72.65	125	-19	14
Belgium	54	-1.35	96.11	219	-24	-15
Germany	29	-2.26	68.16	317	-50	-31
Ireland	71	-4.5	45.73	-52	74	157
Greece	59	-7.36	114.25	48	158	47
Spain	85	-2.5	50.48	41	-2	64
France	46	-3.73	67.55	283	-38	-8
Italy	39	-3.34	108.68	70	-3	64
Luxembourg	115	1.62	9.71	270	-47	104
Netherlands	56	-1.63	54.28	25	-45	26
Austria	51	-2.04	66.11	620	-40	8
Portugal	44	-5.1	70.23	64	83	158
Finland	57	2.68	42.3	154	-45	-24
GreatBritain	47	-4.06	51.34	246	-46	36
Denmark	47	1.48	42	28	-52	46
Sweden	62	1.13	46.49	180	-51	12

Source: http://epp.eurostat.ec.europa.eu

Remark: GDP column represents the percentage of increase in nominal amount of the GDP, in 2011 compared to 1999. Budget/GDP column refers to the average budget surplus or deficit as the percentage of GDP from 2000-2011. Debt/ GDP column refers to the average value of debt as a percentage of the GDP from 2000-2011. Inflation column representing the percentage increasing/decreasing of inflation rate in 2011 compared to 1999. Interest rate column representing the percentage increasing/decreasing of long term interest rate in 2011 compared to 2000. Unemployment rate column representing the percentage increasing/decreasing of unemployment rate in 2011, compared to 1999.

1. If we observe the average percentage increase in GDP, it is evident that the EMU Member States got different benefits from joining the EMU, during the time period 1999-2011. Luxembourg (115%), Spain (85%), Greece (71%) and Ireland (59%) recorded the highest increase in this parameter. From the other hand, Germany (29%), Italy (39%) and France (46%)

recorded the lowest increase. Great Britain and Denmark, which are in the regime of exceptions, recorded similar level of increase as the average of Euro zone (approximately 50%). Sweden recorded increase by 62%.

2. The data also illustrate the average value of surplus and budget deficit as a percentage of GDP during the period from 2000-2011, it can be concluded that all EMU Member States except Luxembourg and Finland realized an average budget deficit, while Greece, Portugal, Ireland, France and Italy exceeded permitted level of this ratio determined by the Stability and Growth Pact of by 145%, 70%, 50%, 24% and 11%, respectively. Great Britain has exceeded level of this ratio required by the Stability and Growth Pact by 35%, while Sweden and Denmark recorded an average budget surplus during this period.
3. If we consider the ratio debt/GDP, we can see that the Eurozone has exceeded permitted level (60%) of this ratio by 20%, namely, the Eurozone recorded an average of this ratio at 72.65%. Ireland, Spain, the Netherlands and Luxembourg are the countries which did not exceeded permitted level of this ratio. From point of view of this parameter, Greece and Italy recorded the most alarming average, and they have exceeded permitted level of this ratio by approximately 100%. Great Britain, Denmark and Sweden are within the permissible limits.
4. If we consider an average change of inflation rate during the time period 1999-2011, we observe three very important facts. Firstly, 8 of 15 countries which are analyzed, they recorded three digit increase of the inflation rate. Secondly, only Ireland of the Eurozone Member States recorded decrease in the inflation rate. And thirdly, the Eurozone realized an average increase in inflation rate by 125%. Finland recorded increase by over 150%, Belgium, Germany, France and Luxembourg recorded increase of inflation rate in range of 220-320%, while Austria is “recorder” with amazing 620% of increase. Great Britain and Sweden, which did not join the EMU, realized increase of 246% and 180%.
5. The percentage change in the level of the long-term interest rates during the time period 2000-2011 had following features: Greece, Portugal and Ireland recorded increase of interest rate by 158%, 83%,74%, respectively. Other Eurozone Member States realized decrease of interest rates. They can be divided into 3 groups. The first group consists of countries which recorded decrease to 20% (Spain), the second group comprises the countries which recorded decrease in range of 20-40% (Belgium, France and Austria) and the third group consists countries which recorded decrease in the level of the interest rate in range of 40-50% (remaining countries in table). Great Britain, Sweden and Denmark, which did not participate in the third phase of the Maastricht Treaty, recorded decrease of interest rate by approximately 50%.

6. Percentage change of the unemployment rate in the EMU shows large disparities between countries during the time period 1999-2011. Negative unemployment rate, namely the increase in employment rate was recorded in Belgium, Germany and France, while the increase of unemployment rate by more than 50% was recorded in Spain, Italy (both of them 64%), Ireland, Luxembourg and Portugal (third of them over the 100%). Denmark recorded increasing by 50% compared to non-Euro zone Member States in the EU.

7. Conclusion

Unlike various positions, considering absence or presence asymmetric shocks in the EMU, most economists agree that the survival of the EMU just depends on the possibility of eliminating the crises. It can be concluded that the problems and solutions for asymmetric shocks are embedded into the idea of the EMU, while the financial crisis are exceptional circumstances, outside of European asymmetries, and EMU leaders did not design predefined solutions.

The first serious challenge for the EMU was precisely the global financial crisis, which imposed the issue of the possibility of the EMU's survival. Although started in the U.S. unexpectedly, the crisis spread to the European continent soon, and seriously damaged the EMU. The emergence of the global financial crisis in the U.S. in August 2007, nobody could predict, and definitely no economist could determine the speed of diffusion of the global financial crisis on the whole world economy. Another important problem related to the global financial crisis is the fact that everybody analyzed the reasons of crisis, and no negative effects caused by the financial crisis and how to prevent these negative effects, and thus the crisis was rapidly spreading through the global financial system.

The growing differences between the member states contributed to the unexpected negative impact of the global financial crisis (Feldstein 1997, 61-62). The gap between developed and lower developed countries of the EMU, escalated ahead of the global financial crisis, multiplying the differences in borrowing capacity. For example, the interest rate on the long-term government securities in Greece was five times higher than the interest rates on the German government securities. Borrowing costs increased in countries outside the EMU, as well, but that countries had monetary sovereignty and operational capacity of national monetary policy, which could, ultimately print national money and eliminate differences.

The global financial crisis has raised another problem in the EMU. Solving the crisis situation is usually at the level of the monetary union, while at the national level, there was no over activity of the problem. The absence of a

unified European response is the result of heterogeneous national plans and fiscal policies, which in turn implies the conclusion that EMU is a unique creation. It is notable that in the EMU, there is a lack of crisis management and a higher level of coordination and cooperation between national governments, national central banks and the European Central Bank.

As a final conclusion regarding euro winners and euro losers, we must point out that there is no harmonized action of certain factors and criteria in the EMU. Although the EMU is defined as a harmonized entity, only the interest rate shows a correlation between the Member States, but if we look at the real interest rates correlations is negative. This can be explained by large asymmetries and differences between countries. Ireland, Greece and Spain, on the one hand, and Germany, Portugal, Luxemburg and the Netherlands, on the other, have diametrically opposed economic cycle. The tables above could rather represent the states from different continents than the EMU states with a single monetary policy.

Analyzing the time period before and after 2008, and 12 years of functioning of the EMU, it can be pointed out that euro winner is Finland, and followed by the Netherlands, Belgium and Germany. It have to be concluded, if we observe inflation rate which is the primary aim of ECB, that all countries have lost after the joining the EMU. The biggest looser is definitely Greece, and behind Greece is Portugal. In addition to the unstable financial markets and fiscal challenges, the recovery of the EU economy is faced with another challenge: the uneven nature of economic recovery. Different countries are facing different challenges to establish and maintain sustainable economic growth.

Surely the most important question of all European countries is whether the European monetary union can create a supranational European monetary union or to collapse and thereby bring down the entire European project. Is the EMU "steel" or "glass" design? The future is difficult to predict, even when things are certain, than it can be concluded that the existence and successful functioning of the EMU in the long term it will lead to the formation of European Republic or the United States of Europe (after the United States). Imaginary such terms and conditions cause imaginary EMU, which will definitely be at the crossroads in the next downward phase of the cycle and in the next world crisis. Meanwhile, the EMU will survive in a given form, with the new member states, only if there is no abandonment of certain states.

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EFEKTI EVROPSKE MONETARNE UNIJE NA DRŽAVE ČLANICE

Apstrakt: Fomirana kao svojevrsni eksperiment XX veka, bez prethodnog političkog ujedinjenja i nepoštovanja osnovnih dogovorenih principa integracije, Evropska monetarna unija definitivno će obeležiti i novi milenijum. Politički podeljena a monetarno integrisana Evropa, odolela je brojnim izazovima i pritiscima, ali problemi koji su postojali od samog osnivanja ne samo da nisu rešeni, već su kreirani i novi. Pored nastojanja država članica EU da pristupe EMU, interesantnim se nameće analiza nivoa razvijenosti država članica EMU ex ante i ex post pristupanja EMU. Ovaj rad posvećen je analizi problema i promena ključnih ekonomskih parametara država članica, 12 godina nakon pristupanja EMU.

Ključne reči: EMU, monetarna integracija, kriterijumi konvergencije, problemi u EMU