

## The Future of the European Economy

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**ABSTRACT:** *After the collapse of Communism in 1990, the European Union (EU) has immediately sustained in the process of democratization in the ex-communists countries, and has provided necessary technical and financial assistance in order to place a market economy. The enlargement was (and always is) the most significant and the most ambitious European project since the signature of the Treaty of Rome<sup>1</sup>: it reconciles one of the economic projects of the united Europe with geo-strategic vision of the European continent, which will allow the important position of the EU in the World. The 1<sup>st</sup> May 2004 the EU has passed to the twenty-five member countries<sup>2</sup>, with accession of ten New Member States (NMS). The process of enlargement has continued on January the 1<sup>st</sup>, 2007 by accessing to the EU of Bulgaria and Romania. The “Single Market”, Economic and Monetary Union (EMU) and the process of integration are the major points of the Europe of twenty-seven member countries. The process of preparation of accession to the EU, has announced the preparation in the Central and East European Countries (CEEC) from the 1989, and it marked some difficulties for the CEEC – on the level of political integration but also economic and social. The present article show us, also, the importance of the introduction of the euro – which present the very important phase in the evolution of the EU, and the biggest monetary changement in the history of Europe...We consider euro as the concretization of the EU. It represents the success of the “Single Market” and contributes to the economic stability of the EU. Also, it is important to know that the euros play his important role to the politic and economic fields. The New Member States (NMS) are engaged to enter to the EMU in his future<sup>3</sup>. For the success of their entrance to the EMU, the NMS have to align their economies with these of the old member states of the EU. This economic alignment, so called “convergence”, constitutes the supplementary phase on their aim toward European integration. The latest enlargements represent the most important moments in the history of the European continent. Today, the question is also the integration of the Balkan countries to the EU and their future toward European integration.*

### Introduction

The enlargement policy of the European Union (EU) is noted in the article 49 of the Treaty<sup>4</sup> of the EU<sup>5</sup>, which dispose that “any European State which respects the principles set out in Article 6(1) may apply to become a member of the Union...”. The EU is defined the political and economic

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<sup>1</sup> The Treaty of Rome, signed by Belgium, France, Germany, Italy, Luxembourg and the Netherlands on March 25, 1957, established the European Economic Community (EEC) and came into force on 1 January 1958.

<sup>2</sup> Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovak Republic and Slovenia

<sup>3</sup> Slovenia as the NMS has entered the EMU the 1<sup>st</sup> January 2007.

<sup>4</sup> The Maastricht Treaty (formally, the Treaty on European Union, TEU) was signed on February 7<sup>th</sup>, 1992 in Maastricht, the Netherlands after final negotiations on December 9<sup>th</sup>, 1991 between the members of the European Community and entered into force on November 1<sup>st</sup>, 1993 during the “Delors” Commission. It led to the creation of the European Union and was the result of separate negotiations on monetary union and on political union. The Maastricht Treaty has been amended to a degree by later treaties.

<sup>5</sup> “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. The conditions of admission and the adjustments to the Treaties on which the Union is founded, which such admission entails, shall be the subject of an agreement between the Member States and the applicant State. This agreement shall be submitted for ratification by all the contracting States in accordance with their respective constitutional requirements.”

criteria for accession. Before the accession to the EU, some phases are necessary to be established for all the Central and East European Countries (CEEC). The following phases are necessary (obliged) for each European country which would like to become the member of the EU:

- To candidate: each European country can deposit candidature for the membership to the EU.
- To become candidate: the Treaty of the EU precise two conditions, before the country obtain candidate status: to be European and democratic country. After this condition completed, the European commission recognise the statute of the candidate country. It isn't the only criteria the one European country obtain the full membership to the EU.
- The strategy of pre-accession: when the county has become the candidate, the strategy of pre-accession is necessary. This strategy has the objective to "familiarise" the candidate country with the procedure and policy of the EU – giving the possibility to the candidate country to participate to the programmes "communautaires" and accordant the financial aid. The opening processes of the negotiations for the accession: To join the EU, each New Member State (NMS) must fulfill three criteria:
  - political: stability of institutions guaranteeing democracy, the rule of law, human rights and respect for and protection of minorities;
  - economic: existence of a functioning market economy and the capacity to cope with competitive pressure and market forces within the Union;
  - acceptance of the Community "acquis": ability to take on the obligations of membership, including adherence to the aims of political, economic and monetary union.
- Signature of the Treaty of accession: The results of the negotiations included in the Treaty of the EU are transferred to the European Council for confirmation by it and to the European Parliament for his agreement.
- Accession to the EU: after the signature, the Treaty is transferred to the Member countries and to the Candidate(s) country(ies) for the ratification, in some cases, by referendum. The Treaty takes place, and the candidate country becomes the EU member state.

The eight CEEC<sup>6</sup>, and also Cyprus and Malta, has entered to the EU on the 1<sup>st</sup> May 2004. Bulgaria and Romania has joined the EU on the 1<sup>st</sup> January 2007. These two enlargements have had the biggest effect in the history of the enlargements of the EU. In this article we will pointed to the economic criteria for the NMS of the EU, but also to the effects (after the enlargements) that have been produced in (and for) the NMS and the EU old member states. It is necessary to know that the latest enlargements have had very positive effects, but also "some negative effects" (less than positive effects) for the new and old member states of the EU.

The introduction of the euro represents the essential phase in the evolution of the EU, and the biggest monetary change in the history of Europe<sup>7</sup>. Euro is the concretization of the Economic and Monetary Union (EMU). The EMU consists of three stages coordinating economic policy and culminating with the adoption of the euro, the EU's single currency. Under the Copenhagen criteria, it is a condition of entry for states acceding to the EU that they be able to fulfil the requirements for monetary union within a given period of time. The twelve NMS that acceded to the

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<sup>6</sup> Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia and Slovenia

<sup>7</sup> Cf. Redžepagić, S. (2006), *L'analyse de l'évolution de l'Union européenne – les effets économiques d'élargissement*, ISSN 1453-8202, Editor: University Valahia Targoviste, The 17th International Conference organized by CEDIMES, Faculty of Economics - University of Targoviste (XVIIème Colloque fédérateur CEDIMES), University of Valahia, Targoviste, Romania, November 2006, pp. 122 – 133

EU in 2004 and 2007 all intend to join third stage of the EMU in the next ten years, though the precise timing depends on various economic factors. Similarly, those countries who are currently negotiating for entry will also take the euro as their currency in the years following their accession (Slovenia has entered to the Euro zone the 1<sup>st</sup> January 2007).

## Enlargements

The enlargement of the EU represented (and I hope represent also today and for the future) one of the most important chances for the EU for the 21<sup>st</sup> century. The enlargements represented (and probably will represent) the advantages in the field of stability and the prosperity for the NMS but also for the old members of the EU. The EU summit<sup>8</sup> was scheduled to invite ten (twelve) more countries to join the EU. This enlargement brought the number of EU member states up from 15 to 27. In the past the EU was limited to Western Europe, but following the impending expansion it included the whole of Eastern Europe up to the former Soviet border and, in addition, the two Mediterranean island nations of Malta and Cyprus. In Western Europe, Norway and Switzerland are the only countries not to have joined the EU. In the East, only the Balkan nations of ex-Yugoslavia<sup>9</sup> (with the exception of Slovenia) and Albania remain outside the EU. With the latest enlargements, the population of the EU has grown by 75 million, brought it up to half a billion people. With 9,200 billion euros, the EU's Gross Domestic Product (GDP) is equal that of the United States of America.

It is important to know, the full timeline of past enlargements (and Treaties) were<sup>10</sup>:

- 23 July 1952 – The Treaty of Paris entered into force, establishing the European Coal and Steel Community (ECSC). Founding members were the Benelux countries (Belgium, the Netherlands, and Luxembourg), France, Italy and West Germany.
- 1 January 1958 – The Treaty of Rome entered into force, establishing the European Economic Community (EEC), which later becomes the European Community (EC).
- 1 January 1973 – (First enlargement); Denmark, Ireland, and the United Kingdom accede to the EC (Norway signed the treaty but failed to ratify due to a negative opinion in a national referendum on accession).
- 1 January 1981 – (Second enlargement); Greece accedes to the EC.
- 1985 – Granted home rule by Denmark six years earlier, Greenland decides to leave the EC following a referendum. (See member state territories).
- 1 January 1986 – (Third enlargement); Portugal and Spain accede to the EC.
- 1 November 1993 – The Maastricht Treaty takes effect, formally establishing the European Union.
- 1 January 1995 – (Fourth enlargement); Austria, Finland, and Sweden, accede to the EU.
- 1 May 2004 – (Fifth enlargement, part I); Comprising the largest number of countries ever admitted at one time, Cyprus, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia and Slovenia accede to the EU.
- 1 January 2007 – (Fifth enlargement, part II); Bulgaria and Romania joined EU.

In June 1993, EU leaders meeting in Copenhagen set three criteria that any candidate country

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<sup>8</sup> Being held December 12<sup>th</sup> and 13<sup>th</sup> in Copenhagen.

<sup>9</sup> Bosnia and Herzegovina, Croatia, Macedonia, Montenegro and Serbia

<sup>10</sup> For the full explanation see the site official of the European Commission.

must meet before it can join the EU. In order to become a candidate for entry to the EU, countries need to fulfil the economic and political conditions known as the “Copenhagen criteria”, according to which a prospective member must:

- have stable institutions guaranteeing democracy, the rule of law, human rights and respect for and protection of minorities
- have a functioning market economy as well as the capacity to cope with competitive pressure and market forces within the EU
- take on board all the “acquis” and support the various aims of the EU (especially, the ability to take on the obligations of membership including adherence to the aims of political, economic and monetary union).

These three criteria have been fulfilled by all NMS. In addition, each NMS must have a public administration capable of applying and managing EU laws in practice<sup>11</sup>. The EU reserves the right to decide when a candidate country has met these criteria and when the EU is ready to accept the new member, as this was the cases for each NMS before her enter to the EU.

## Economy in the Enlarged EU

According to the International Monetary Fund, the EU has a large economy, greater than that of the United States of America with a 2005 GDP of 12,865,602 USD million vs. 11,734,300 USD million (USD figures). The enlargements have always some significant economic consequences on the economy of the EU<sup>12</sup>. So the reason is because the bigger market which stimulate the economic growth in the NMS. The EU's member states account for 30.3% of the world's total GDP in 2005<sup>13</sup>.

After the signature of the Treaty of Rome<sup>14</sup>, one of the most important objectives for the EU consists to maintain the economic and social progress in order to assure the health, prosperity and better future for the Europeans. Economic performance varies from state to state, as presented in the table 1.

*Table 1: EU member states economic indicators*

Member States	GDP (PPP*) 2006 millions of euros	GDP (PPP*) per capita 2006 euros	% of EU27 average GDP (PPP*) per capita	GDP (PPP*) 2007 millions of euros	GDP (PPP*) per capita 2007 euros	Percentage of EU27 average GDP (PPP*) per capita
<i>European Union</i>	11,557,853	23,500	100%	12,172,536	24,600	100%
Austria	250,247	30,200	129%	264,472	31,900	130%
Belgium	302,570	28,700	122%	319,867	30,200	123%
Bulgaria	66,799	8,700	37%	71,714	9,500	39%
Cyprus	16,849	21,900	93%	17,773	22,900	93%
Czech Republic	191,080	18,600	79%	207,174	20,100	82%
Denmark	161,613	29,700	126%	171,298	31,200	127%
Estonia	21,170	15,900	68%	23,919	17,900	73%
Finland	143,818	27,300	116%	153,595	28,900	117%
France	1,673,128	26,500	113%	1,744,444	27,800	113%

<sup>11</sup> For more precisely explanations see the official web site of the European Commission.

<sup>12</sup> GAUTHIER A. (2005), “La construction européenne : Étapes et enjeux”, Forth Edition, Bréal, Paris.

<sup>13</sup> Source: World Bank

<sup>14</sup> The Treaty of Rome, signed by France, West Germany, Italy and Benelux (Belgium, the Netherlands and Luxembourg) on March 25, 1957, established the European Economic Community (EEC) and came into force on 1 January 1958.

Germany	2,184,612	26,700	114%	2,340,372	28,200	115%
Greece	230,659	20,800	89%	246,671	22,100	90%
Hungary	154,358	15,300	65%	166,031	16,200	66%
Ireland	143,475	33,700	143%	157,070	35,700	147%
Italy	1,432,261	24,300	103%	1,500,475	25,500	104%
Latvia	29,971	13,100	56%	33,630	14,900	61%
Lithuania	46,015	13,600	58%	50,241	15,000	61%
Luxembourg	30,183	65,300	278%	31,376	69,900	284%
Malta	7,289	17,700	75%	7,824	18,600	76%
Netherlands	500,762	31,000	132%	530,564	32,800	133%
Poland	473,774	12,400	53%	525,277	13,600	55%
Portugal	185,083	17,500	74%	190,882	18,200	74%
Romania	190,657	8,800	37%	208,220	9,700	39%
Slovakia	79,339	14,700	63%	88,602	16,400	67%
Slovenia	40,867	20,400	87%	44,040	21,800	89%
Spain	1,053,600	24,000	102%	1,121,961	25,400	103%
Sweden	256,327	28,200	120%	274,499	30,000	122%
United Kingdom	1,688,660	27,900	119%	1,847,105	29,400	120%

\*Purchasing Power Parity

Source: EUROSTAT – 21 April 2007, Percentages recalculated manually to EU-27

According to the literature<sup>15</sup>, and analyzing economic situation of the EU, the enlargement has provoked the supplementary economic growth of 1% per year in the NMS<sup>16</sup>. The supplementary economic growth registered by other Member States is less, but always significant.

Table 2: GDP per capita: Distribution of the richness

Country	%
Luxembourg	189
Ireland	125
Denmark	115
Netherlands	113
Austria	110
Belgium	108
Finland	104
France	103
United Kingdom	103
Germany	103
Italy	103
Sweden	102
Average of the EU-15	100
Spain	84
Slovenia	74
Cyprus	72
Portugal	69

<sup>15</sup> FARVAQUE E. et G. LAGADEC (2002), "L'élargissement à l'Est : risques, coûts et bénéfices, Intégration Economique Européenne : Problèmes et analyses", Edition : De Boeck University, 2002.

GIULIANI J-D. (2003), "Quinze plus dix : le grand élargissement", Foundation Robert Schuman, Paris : Albin Michel, 2003.

<sup>16</sup> And by previsions, will continue to present during the first ten years after the accession of the NMS!

Greece	66
Czech of Republic	60
Hungary	57
Malta	55
Slovakia	47
Estonia	42
Poland	39
Lithuania	39
Latvia	35

Source: Eurostat; European Commission

## Euro and Economic and Monetary Union

On the March 13<sup>th</sup> 1979, the European Monetary System (EMS) was created. The EMS has created a zone of monetary stability in Europe, encouraging growth and investment. It was based on the "Ecu"<sup>17</sup>, on the exchange rate and intervention mechanism<sup>18</sup> and the credit mechanism<sup>19</sup>. In order to remove the non-tariff barriers to the free movements of good, capital, services and persons, the EMS wasn't anymore enough and so the single currency became a necessity. The European monetary union was established during the Treaty of Maastricht which entered into force in 1993. Its formation spanned three stages:

1. Stage One: 1 July 1990 to 31 December 1993 – At this initial the Member States drew up convergence program designed to promote improvements in the convergence of economic performance, thereby making it possible to establish fixed exchange rates.
2. Stage Two: 1 January 1994 to 31 December 1998 – This was a transitional period during which a determined effort was made to achieve economic convergence. The European Monetary Institution (EMI) was set up in Frankfurt to strengthen the coordination of Member States' monetary policies, promote the creation of a European Central Bank (ECB) in Stage Three.
3. Stage Three: 1 January 1999 and continuing – At the beginning of this third stage a ECB was set up and the exchange rates among the participating currencies were fixed once and for all. The bank was made independent of the national governments and would manage the monetary policies of all the participating countries.

During the Madrid European Council the Member States decided to call the single currency "Euro". To be able to join, every member state had to accomplish the following criteria:

- o Deficits – national budget deficits must be close to or below 3% of Gross National Product (GNP).
- o Debt – public debt may exceed the 60% of GNP only if the trend is declining towards this level.
- o Price Stability – the rate of inflation may not exceed the average rates of inflation of the three member states with the lowest inflation by more than 1.5%.
- o Interest Rates – long-term interest rates shall not vary by more than 2% in relation to the average interest rates of the 3 Member States with the lowest interest rates.

<sup>17</sup> A basket of the currencies of the Member States

<sup>18</sup> Based on that each national currency had a central exchange rate linked to "Ecu" and bilateral rate exchanges were allowed to fluctuate within a band of 2.25%, or up to 6%, increased finally at 15%

<sup>19</sup> When the bilateral exchange rates are approaching the 15% limit, the banks have unlimited liability to intervene to not pass the limit of 15%

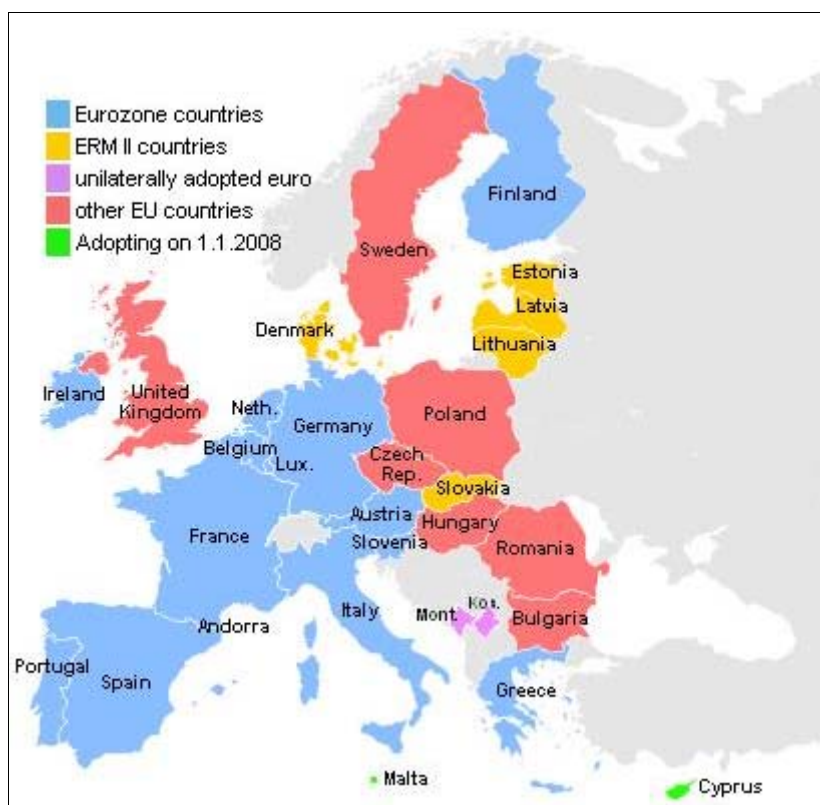
- Exchange Rate Stability – a national currency shall not have been devalued during the two previous years and must have remained within the EMS 2.25% margin of fluctuation.

On May 3<sup>rd</sup>, 1998, the Member States decided which of the 15 nations achieved the five criteria to join the single currency:

- Austria, Belgium, Finland, France, Germany, Ireland, Italy, Luxembourg, Netherlands, Portugal and Spain all qualified.
- Greece and Sweden did not achieve all the five criteria.
- Denmark and the United Kingdom took the “opt-out” choice but could join it anytime when the inner political conditions would allow it.

On January 1, 1999, the third stage of EMU began. The euro became a currency on its own right and the exchange rates were definitely fixed. Until January 1<sup>st</sup>, 2002, the national currencies were used with the banks with businesses completely transferring to Euro and the Euro coins and notes were introduced and are circulating beside the national currencies.

The European Exchange Rate Mechanism (ERM)<sup>20</sup> is based on the concept of fixed currency exchange rate margins, but with exchange rates variable within those margins. Before the introduction of the euro, exchange rates were based on the ECU, the European unit of account, whose value was determined as a weighted average of the participating currencies.



Source: European Commission (2007)

<sup>20</sup> The ERM was a system introduced by the European Community in March 1979, as part of the EMS, to reduce exchange rate variability and achieve monetary stability in Europe, in preparation for EMU and the introduction of a single currency, the euro, which took place on January 1, 1999.

Table 3: Respect the criteria of convergence in the CEEC – “Maastricht criteria”

Measured criterion	Price stability	Public finances	Results for public finances	Durability of convergence	Stability of convergence
How this criterion is measured	Inflation rate (consumption prices)	Budget deficit (% of GDP)	Public debt (% of GDP)	Interest rate (long term)	Stability of exchange rate
Criteria of convergence	< 1.5 % three Member States which have the lowest rate	Not more than 3 %	Not more than 60 %	< 2 % three Member States which have the lowest rate	Participation to the ERM II during two years
<b>Czech Republic</b>	1.8 %	12.6 %	37.8 %	4.7 %	During accession to the ERM II
<b>Estonia</b>	2.0 %	- 3.1 %	5.3 %	4.6 %	Accession 28.6.2004
<b>Latvia</b>	4.9 %	1.5 %	14.4 %	5.0 %	Accession 2.5.2005
<b>Lithuania</b>	- 0.2 %	1.9 %	21.4 %	4.7 %	Accession 28.6.2004
<b>Hungary</b>	6.5 %	6.2 %	59.1 %	8.1 %	During accession to the ERM II
<b>Poland</b>	2.5 %	3.9 %	45.4 %	6.9 %	During accession to the ERM II
<b>Slovenia<sup>21</sup></b>	4.1 %	2.0 %	29.4 %	5.2 %	Accession 28.6.2004
<b>Slovakia</b>	8.4 %	3.7 %	42.6 %	5.1 %	Accession 28.11. 2005
<i>Reference values for the Euro zone</i>	< 2.4 %	< 3.0 %	< 60 %	< 6.4 %	

Source: European Commission (2006), Calculated by author

As of 1 May 2004, the ten National Central Banks of the NMS became party to the ERM II Central Bank Agreement. The national currencies themselves will become part of the ERM II at different dates, as mutually agreed.

Table 4: Declarations of the Member States concerning their entrance to the EMU

Country	Declaration 2004	Declaration 2006	Entry to ERM II
Czech Republic	2009	2010	2007
Estonia	2007	2008	June 28, 2004
Lithuania	2007	2010	June 28, 2004
Latvia	2008	2010	May 2, 2005
Hungary	2009	2014	Without Declaration
Poland	2009	2013	Without Declaration
Slovenia	2007	2007	June 28, 2004
Slovakia	2009	2009	November 28, 2005
Cyprus	2008	2008	May 2, 2005
Malta	2008	2008	May 2, 2005

Source: The World Bank

<sup>21</sup> Slovenia has become the member of the Euro zone the 1<sup>st</sup> January 2007.



The Estonian kroon, Lithuanian litas, and Slovenian tolar were included in the ERM II on 28 June 2004; the Cypriot pound, the Latvian lats and the Maltese lira on 2 May 2005; the Slovak koruna on 28 November 2005. The currencies of the three largest countries which joined the EU on 1 May 2004 (the Polish zloty, the Czech koruna, and the Hungarian forint) are expected to follow eventually. Plans for Bulgaria are to apply for ERM II membership in 2007 and to commit to its rules regardless of the European Commission decision, while Romania plans to join ERM in 2010-2012. EU countries that have not adopted the euro are expected to participate for at least two years in the ERM II before joining the Euro zone. As Slovenia adopted the euro in 2007, the Slovenian tolar was removed from the ERM II and from circulation. The same will happen to the Maltese lira and the Cypriot pound on 1 January 2008. Sweden is expected to participate in ERM II in order to meet the convergence criteria required for switching currency, but has deliberately chosen to stay out of the mechanism, thus maintaining their currency Swedish krona. This choice is currently tolerated by the ECB, but it has been warned it won't be tolerated for newer union members.

## Conclusion

This study<sup>22</sup> makes use of the recent analyse for the EU New Member States. "Enlargement is both a political necessity and a historic opportunity for Europe. It will ensure the stability and security of the continent and will thus offer both the applicant States and the current members of the Union new prospects for economic growth and general well-being. Enlargement must serve to strengthen the building of Europe in observance of the *acquis communautaire* which includes the common policies." This is declared to the European summit of Madrid from December 1995<sup>23</sup>. Economic integration in general and enlargement of the EU to the East of Europe in particular created a wider European single market, thereby stimulating structural adjustment and economic specialization. This study analyzed economic situation in the enlarged EU with a special focus on the new EU member states and the monetary union. Finally, it is important to know that the policy (economic, social, political, etc.) options for the new EU member states played (and still play) the important role for the NMS but also for the EU-15 states (old member states).

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<sup>22</sup> For more precisely study, cf. Redžepagić, S. (2007), *Les politiques économiques comparées et les coûts d'intégration pour les pays de l'Est candidats à l'adhésion à l'Union européenne*, Doctoral dissertation under direction of professor J.-P. Guichard, University of Nice Sophia-Antipolis, CEMAFI (Centre d'Etudes en Macroéconomie et Finance Internationale), March 2007

<sup>23</sup> This summit held on 15 and 16 December 1995 in Madrid.

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