

Selected Issues Concerning Real and Nominal Convergence within the European Union

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Introduction

Although it passed through a distinct phase of cohesion and convergence in 1990s, the economic environment of the European Union still represents a territory in which individual countries and especially their regions display very different key economic characteristics.

The said differences are demonstrated by a whole range of aspects. The pace of economic performance in individual EU member states still varies considerably, both in immediate comparison and in terms of their ability to maintain a higher growth efficiency. This is clearly visible from the economic development indicators comparing the amount of GDP per capita. And last but not least, in spite of the climate of the Economic and Monetary Union (EMU), in particular the introduction of single currency as a legal tender in 12 out of the 15 current EU member states and the enforcement of joint principles of monetary policy, the differences in price level dynamics of individual member states have not yet been completely eliminated and their price levels completely adjusted.

Convergence can, therefore, be divided into real and nominal. As a result, there are not only differences between real and nominal economic factors, but also different ways and concepts of their cohesion and negotiation.

Notes on Real Convergence

Economic cohesion – current situation

Regions – EU member states

Even though the differences in revenues among the individual members of EU-15 are being levelled gradually, **the difference in GDP per capita remains quite considerable**. While in 2002 the amount of GDP per capita measured through spending power parity in Spain, Greece and Portugal amounted only to some 71 – 86% of the EU average, the GDP of other EU member states was almost equal to or exceeded the EU average.

The differences among regions are even more distinctive and their levelling – compared with the levelling of national differences – is extremely slow. The average amount of GDP per capita concerning the 10% of the population living in the most prosperous EU regions is 2.6 times higher than the amount of GDP per capita concerning the 10% of the population living in the least prosperous EU regions.

The European Union consists of 213 regions (NUTS 2) whose GDP per capita ranges from 53% of the EU average in the Greek Dytiky Ellada to 263% of the EU average in Inner London, Britain.

Table 1: The richest and poorest regions within the EU-15¹

Regional GDP per capita in the EU in PPS (EU-15 = 100) in 2001

The ten highest			The ten lowest		
1	Inner London (UK)	263	1	Dytiki Ellada (EL)	53
2	Bruxelles-Capitale (BE)	217	2	Anatoliki Makedonia, Thraki (EL)	53
3	Luxembourg	194	3	Extremadura (ES)	53
4	Hamburg (DE)	171	4	Ipeiros (EL)	54
5	Île de France (FR)	165	5	Açores (PT)	56
6	Wien (AT)	152	6	Norte (PT)	57
7	Berkshire, Buckinghamshire & Oxfordshire (UK)	149	7	Centro (PT)	58
8	Oberbayern (DE)	148	8	Cornwall & Isles of Scilly (UK)	60
9	Stockholm (SE)	145	9	Ionia Nisia (EL)	60
10	Provincia Autonoma Bolzano (IT)	143	10	Dessau (DE)	60

Source: Eurostat

Among the 21 regions in which the amount of GDP per capita exceeds 125% of EU average are 5 German regions, 3 Italian regions, 3 British regions and 1 region of Belgium, France, Ireland, Luxembourg, Austria, Finland and Sweden, respectively.

On the other hand, in 2001 the amount of GDP per capita in one fifth of all the current regions of EU-15 amounted to less than 75% of the EU average (11 out of 13 Greek regions, 5 out of 7 Portuguese regions, all 10 regions of the former East Germany, 6 Spanish regions, 5 Italian regions, 4 British regions and 2 Belgian regions.)²

A lower amount of GDP per capita is usually accompanied by a lower output per employee, a lower level of education and training, a lower extent of research and development activities and innovations and a slower implementation of new information and communications technologies.

¹ It should be noted, however, that in some regions the GDP per capita figures can be significantly influenced by commuter flows. Net commuter arrivals in these regions push up production to a level that could not be achieved by the resident active population on its own. The result is that GDP per capita can be overestimated in these regions (e.g. Inner London) and underestimated in the regions where the commuters live (e.g. Outer London, Kent and Essex). In other cases, a high proportion of pensioners in a region can lead to lower regional GDP per capita.

² No 2001 data are as yet available from the Spanish regions of Ceuta and Melilla and French overseas territories whose GDP per capita in 2000 amounted to less than 75% of EU average.

Regions – new EU member states

The difference in regional economic development of the ten new EU member states is much smaller. They are divided into 41 regions of the NUTS 2 type whose GDP per capita ranges from 29% of the EU-15 average in Lubelskie, Poland to 135% in Prague. It is clear that Prague's position is quite good even in a European context.

In comparison with other regions, however, Prague is still an exception. The second richest region is the Southwest, whose GDP per capita amounts to a mere 55% of the EU average.

Table 2: Regions in the Czech republic

GDP per capita in PPS (EU-15 = 100) in 2001

1	PRAHA	135.5
2	JIHOZÁPAD	55.1
3	JIHOVÝCHOD	53.4
4	SEVEROVÝCHOD	50.8
5	MORAVSKOSLEZKO	50.6
6	STŘEDNÍ ČECHY	50.0
7	STŘEDNÍ MORAVA	48.1
8	SEVEROZÁPAD	47.9

Source: Eurostat

National level – old and new EU member states

As mentioned above, the differences in economic development – indicated by the amount of GDP per capita – on a national level are not as distinctive as on a regional level. In 2002 the said indicator in EU-15 ranged from 71% (Greece and Portugal) to 189% (Luxembourg).

The dynamic point of view is also very interesting. The amount of the gross domestic product per capita of EU-15 measured through spending power parity remained very different both in the second half of 1990s and at the beginning of the new millennium. The said disparity will be deepened even further as a result of EU expansion.

Table 3: Economical strength in the EU

GDP per capita in PPS in the EU (EU-15 = 100)

	1995	1996	1997	1998	1999	2000	2001	2002
EU-15	100	100	100	100	100	100	100	100
Belgium	109	107	107	105	105	106	107	107
Denmark	113	114	114	113	116	116	115	113
Finland	96	96	101	103	102	104	104	102
France	104	103	104	104	104	104	105	105
Ireland	90	94	102	106	111	115	118	125
Italy	104	104	102	103	102	101	100	98
Luxembourg	161	161	168	175	189	199	194	189
Germany	108	107	105	104	103	102	100	100
Netherlands	109	109	110	110	110	111	113	111
Portugal	66	66	67	68	70	70	71	71
Austria	114	115	113	113	114	114	112	111
Greece	65	65	66	65	65	66	67	71
Spain	79	79	80	81	84	83	84	86
Sweden	107	107	106	104	108	109	106	105
United Kingdom	100	101	104	103	103	104	105	107

Source: Eurostat

*Table 4: Economical Strength among Acceding and Candidate Countries***GDP per capita in PPS in the EU (EU-15 = 100)**

	1995	1996	1997	1998	1999	2000	2001	2002
Acceding and Candidate Countries	43	44	44	44	45	45	46	47
Czech republic	63	63	62	60	58	60	61	62
Estonia	31	32	35	36	35	37	39	40
Cyprus	75	74	73	73	74	76	78	76
Lithuania	31	32	34	35	34	35	37	39
Latvia	26	27	29	30	30	31	33	35
Hungary	45	45	46	47	48	49	51	53
Malta	69	69	70	70	71	71	70	69
Poland	36	37	39	40	41	41	41	41
Slovakia	40	42	43	43	43	44	45	47
Slovenia	61	62	64	64	67	66	68	69
Bulgaria	29	26	24	24	24	24	26	26
Romania	21	23	24	24	23	23	24	27
Turkey	28	29	30	29	27	28	24	25

Source: Eurostat

Situation in the first phase after expansion

The lowest current development decile in EU-15 is considerably below the economic level of the Czech Republic, which – measured through the sum of GDP per capita – amounts to 62% of the EU-15 average. In addition, the expected higher economic growth in the Czech Republic (in comparison with EU-15) should result in a relative strengthening of the country's economic weight in years to come. It is, however, also true that thanks to the economic recession occurring at the end of the 1990s, the position of the Czech Republic decreased temporarily.

The difference in revenues will increase twice as a result of EU expansion

The differences among individual countries and regions will change significantly after the **expansion of the European Union**. Immediate expansion of the current EU-15 to EU-27 would have the following consequences:

- On a **national level**: approximately **one third** of the EU population would live in countries whose GDP per capita amounts to less than 90% of the EU-15 average (the limit for assistance from the **Cohesion Fund**) in comparison with just **one sixth of population** of the existing EU-15. The differences among individual member states will thus increase twofold.
- On **regional level**: the average sum of GDP per capita concerning the 10% of the population living in the least prosperous regions of EU-27 would amount to a mere 31% of the EU average in comparison with the present situation, when the same indicator concerning EU-15 amounts to 61% of the EU average. The differences among individual regions will thus also increase twofold.

The expansion of the EU will, therefore, contribute in a short period of time to a significant strengthening of regional differences. Considering the existing level of GDP per capita in the EU candidate states, regional convergence in EU-27 would take at least two generations (on the condition that the current pace in EU-15 were maintained).

It is not even certain whether any convergence at all will be realised. While we can reasonably assume that regional differences on a national level will be eliminated gradually (depending on the available resources), there is absolutely no reason why the amount of GDP per capita of the new member states should draw significantly closer to the current

average in EU-15. **The only way of achieving this is to change the relative capacities of individual regions, including human resources, i.e. to eliminate all differences in education and training between the most and the least developed regions of EU-27.**

Nevertheless, the position of the Czech Republic within EU-27 remains relatively good. It is undoubtedly one of the most developed countries among the membership candidates. Thanks to the expected economic growth, it should easily retain its fourth position in this group. On the other hand, it is rather alarming that the Czech Republic, as one of the few candidates, was unable to improve its position significantly in the past eight years, with some areas suffering from stagnation and some even experiencing factual decline.

It is clear from the assessment of the Union's structural policy following after the reform of 1988 that

its main effect was the planned support of economic convergence. The Czech Republic should realise that it will take some time before the enhancement of economic convergence becomes apparent. This means that we cannot expect the current forms of pre-admission support focused on the enhancement of **economic convergence** to bring an immediate effect.

On the contrary, **in the second half of 1990s the Czech Republic was practically the only Central and Eastern European economy undergoing transformation that experienced divergent tendencies.** These were caused by the relatively low proportion of pre-admission assistance in both the country's overall economic performance and the total amount of structural aid that the Czech Republic can expect as soon as it becomes a full-fledged member of the European Union.

It is clear that investment potential is much higher in the countries and regions subject to cohesion, i.e. in those receiving subsidies from the Structural Funds. Individual regions have begun complying with investment conditions, and thus also with sustainable development conditions. As a result, individual regions and sectors are becoming **much more competitive**. However, the most important condition is the effective management of structural support: it is necessary to concentrate only on those financial and geographical areas in which subsidies have real effects.

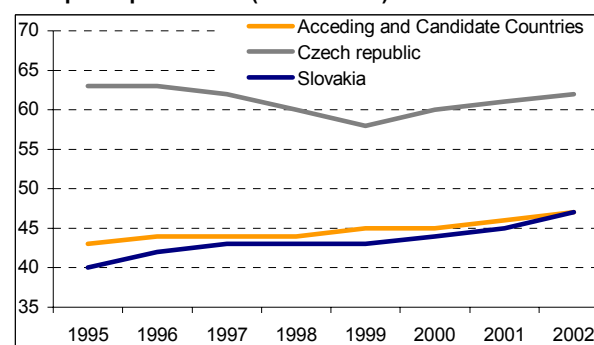
We also have to ask ourselves what is going to happen when the supported areas, regions and sectors lose their right to receive **structural assistance**. Will they be able to function properly even without it? Does the current structural assistance contribute to their long-term independence on similar forms of external aid? Another problem is the future relationship (long-term symbiosis) between the regions whose level of economic and social development has been improved thanks to structural assistance and the regions which have received none even though they have almost qualified and now show divergent characteristics anyway.

Economic growth rate

If we compare the rate of economic growth of individual countries with their achieved level of economic development, we will come to a simple conclusion: even the relatively very dynamic growth experienced by most EU membership candidates in comparison with the average growth in EU-15 cannot guarantee that the new member states will draw significantly closer to the current member states in terms of average economic performance in a short period of time.

It will probably take at least one decade (and in some cases even several decades) before any of the new member states really catches up with the average economic level of EU-15. The economic boom experienced by Ireland in the end of the 1980s and especially in the second half of the 1990s should be regarded as a miracle rather than a rule.

GDP per capita in PPS (EU-15 = 100)



Source: Eurostat

Table 6: GDP growth in the EU Member Countries (v % year-on-year)

	1995	1996	1997	1998	1999	2000	2001	2002	2003*
EU-15	2.4	1.6	2.5	2.9	2.9	3.6	1.7	1.0	0.7
Belgium	2.4	1.2	3.5	2.0	3.2	3.8	0.6	0.7	0.8
Denmark	2.8	2.5	3.0	2.5	2.6	2.8	1.6	1.0	0.8
Finland	3.4	3.9	6.3	5.0	3.4	5.1	1.2	2.2	1.5
France	1.7	1.1	1.9	3.4	3.2	3.8	2.1	1.2	0.1
Ireland	9.9	8.1	11.1	8.6	11.3	10.1	6.2	6.9	1.6
Italy	2.9	1.1	2.0	1.8	1.7	3.1	1.8	0.4	0.3
Luxembourg	1.4	3.3	8.3	6.9	7.8	9.1	1.2	1.3	1.2
Germany	1.7	0.8	1.4	2.0	2.0	2.9	0.8	0.2	0.0
Netherlands	3.0	3.0	3.8	4.3	4.0	3.5	1.2	0.2	-0.9
Portugal	4.3	3.5	4.0	4.6	3.8	3.4	1.7	0.4	-0.8
Austria	1.6	2.0	1.6	3.9	2.7	3.4	0.8	1.4	0.9
Greece	2.1	2.4	3.6	3.4	3.4	4.4	4.0	3.8	4.1
Spain	2.8	2.4	4.0	4.3	4.2	4.2	2.8	2.0	2.3
Sweden	4.1	1.3	2.4	3.6	4.6	4.3	0.9	1.9	1.4
United Kingdom	2.8	2.7	3.3	3.1	2.8	3.8	2.1	1.7	2.0

Table 7: GDP growth in the Acceding and Candidate Countries (v % year-on-year)

	1995	1996	1997	1998	1999	2000	2001	2002	2003*
Acceding and Candidate Countries	5.4	4.6	4.7	3.8	3.2	9.5	2.3	2.5	3.1
Czech republic	5.9	4.3	-0.8	-1.0	0.5	3.3	3.1	2.0	2.2
Estonia	4.3	3.9	9.8	4.6	-0.6	7.3	6.5	6.0	4.4
Cyprus	6.5	1.9	2.3	4.8	4.7	5.0	4.0	2.0	2.0
Lithuania	-1.6	3.7	8.4	4.8	2.8	6.8	7.9	6.1	6.0
Latvia	6.2	4.7	7.0	7.3	-1.8	4.0	6.5	6.8	6.6
Hungary	1.5	1.3	4.6	4.9	4.2	5.2	3.8	3.5	2.9
Malta	6.2	4.0	4.9	3.4	4.1	6.4	-1.2	1.7	0.7
Poland	7.0	6.0	6.8	4.8	4.1	15.8	1.0	1.6	3.3
Slovakia	5.8	6.1	4.6	4.2	1.5	2.0	3.8	4.4	3.8
Slovenia	4.1	3.8	4.4	3.7	5.9	4.1	2.9	2.9	2.1
Bulgaria	2.9	-9.4	-5.4	3.9	2.3	5.4	4.1	4.8	4.5
Romania	7.1	3.9	-6.1	-4.8	-1.2	2.1	5.7	4.9	4.6
Turkey	7.2	7.0	7.5	3.1	-4.7	7.4	-7.5	7.8	5.1

Source: Eurostat, the year 2003 is a forecast

Inspiration of past development in “cohesion countries”

All EU membership candidates (the most efficient of which, Cyprus, produces only 80% of the average amount of the GDP per capita of EU-15) should analyse how the economies of Ireland, Greece and Portugal were affected by their admission to the European Community (European Union)³ and how it changed the dynamics of their economic growth and their relative position in Europe. It may seem that the admission of underdeveloped countries to the European

³ The so-called cohesion countries include Spain. However, because its economy is much larger than ours, we have not included Spain in our comparison.

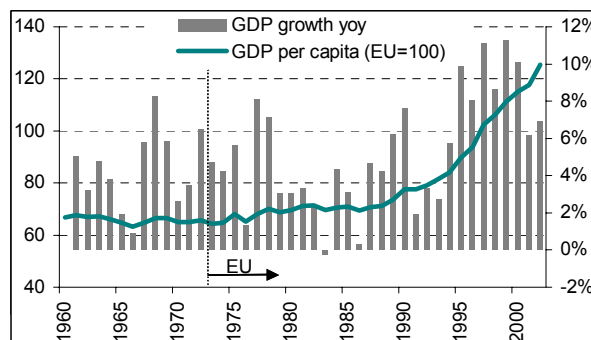
Communities must have affected their economic situation only positively. However, as the example of Greece clearly shows, this may not be true always and immediately.

Ireland

Ireland joined the European Communities in 1973. It is a prime example of an underdeveloped country turning into an economic leader. When Ireland joined the European Communities, its GDP per capita amounted to a mere 65% of the EC average. After ten years, the said indicator rose by 5%. In the end of the 1980s Ireland enjoyed a real economic boom. No wonder that in 2002 each Irish citizen generated 26% more GDP than the average EU citizen.

The increase of the relative importance of the Irish economy went hand in hand with growing GDP dynamics. The most striking increase became evident only in the 1990s.

Ireland



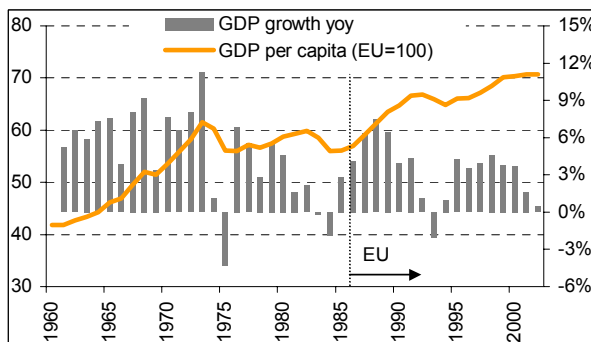
Note: GDP in PPS, source: DG for Economic and Financial Affairs

Portugal

There is no doubt that Portugal benefited hugely from its admission to the European Communities in 1986. As illustrated by the graph, the relative weight of the Portuguese economy increased significantly as a result. While in the mid-1980s Portugal's GDP per capita represented approximately 56% of the EC average, ten years later, the same indicator reached 66% (i.e. 10% more). Portugal has been drawing closer to the rest of Europe almost without interruption since its admission. In 2002, its overall amount of GDP per capita exceeded 70% of the EU average.

It is clear that Portugal's admission to the European Communities also had a positive effect on the dynamics of its economic growth. While 10 years before its admission Portugal's economy grew by 3% a year, 10 years after its admission it grew by 3.7% a year, i.e. 0.7% faster.

Portugal



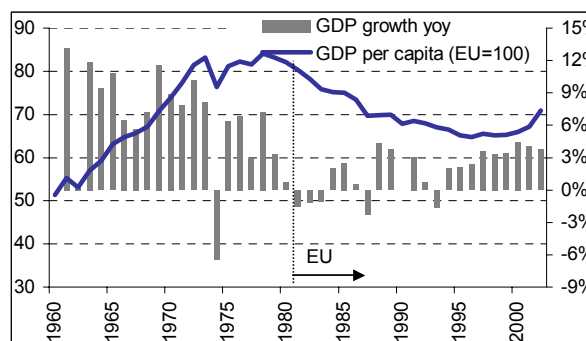
Note: GDP in PPS, source: DG for Economic and Financial Affairs

Greece

However, not every new member state followed the example of Ireland or Portugal. The Greek economy enjoyed its best years in the 1960s and 1970s. The beginning of the 1980s was a period of economic stagnation or insignificant growth. This negative trend was not changed even by the country's admission to the European Communities.

At that time the relative weight of the Greek economy was decreasing steadily. While in 1978, the amount of GDP per capita amounted to 84% of the EU average, in the second half of the 1990s it amounted to a mere 65%. Afterwards, Greece's contribution to the Union's economy started growing again.

Greece



Note: GDP in PPS, source: DG for Economic and Financial Affairs

Elimination of differences in the area of real economy and possible real convergence scenarios

Upon the conditions of progressive monetary integration, the financial instruments of regional policy represent one of the possibilities.

Structural policy results more than 10 years after the reform of the Structural Funds

Increased investment opportunities

Over the past ten years, the overall amount of financial means redistributed through the Structural Funds has increased almost twice, from 0.27% of the GDP in 1989 to 0.46% of the GDP in 1999. Most transfers were designated for "cohesion" countries, representing approximately 1.5% of Spain's GDP, 3.3% of Portugal's GDP and 3.5% of Greece's GDP in the 1989 – 1999 period. In Greece and Portugal the financial means from the Structural Funds represented more than 10% of all investments.

Increased financial and geographical concentration

As a result of the decision of the European Council of **March 1999** focused on the first phase of EU expansion, in 2006 the overall amount of financial means allocated for the purpose of cohesion policy to the **current EU-15** will be **reduced to its 1992 level** (i.e. to **0.31%** of the GDP of the current fifteen members of the European Union).

On the other hand, however, the interest in **underdeveloped regions** will be concentrated in a manner warranting that in the 2000 – 2006 period the average amount of assistance per capita for such regions is **kept at the 1999 level**. In total, 60% of the financial means of the Structural Funds and the Cohesion Fund will be received by member states representing less than 20% of the Union's overall GDP (i.e. 70% will be received by underdeveloped regions).

The geographical concentration of the Structural Funds has never been as distinctive as today. Only 41% of the overall population of EU-15 live in the regions covered by **objective 1** and **objective 2** (i.e. the regions undergoing restructuring) in the programme period ending in 2006. However, the concentration is limited by a high level of fragmentation in the regions covered by **objective 2**, on the one hand, and by insufficient connection with the schemes of national regional assistance, on the other.

Impact of structural policies: positive yet uncertain effects

In the period 1988 – 1998 the difference between the average amount of GDP per capita produced by the regions covered by **objective 1** and the average amount of GDP per capita in EU-15 decreased by approximately one sixth (increasing from 63% of the EU average to 70% of the EU average). In some regions, however, the said changes were much more distinctive and dynamic (Ireland, the former East Germany, Lisbon). Nevertheless, both **employment** and **unemployment** rates in a regional context show only a **very limited level of convergence**.

The available data concerning the regions covered by **objective 2** and the **former objective 5b** (rural development) clearly show that the development of employment and unemployment in these regions was more favourable than in the rest of the European Union. For example, the average rate of unemployment in the regions covered by **objective 2** decreased by 2.2% over the given period (compared to 1.3% in the rest of the European Union).

In the 1989 – 1999 period the Union's structural policy had a significant effect above all on Greece and Portugal, whose GDP increased by 9.9% and 8.5%, respectively. Ireland and Spain also experienced positive effects over the said period, albeit smaller than both aforementioned countries, with their GDP growing by 3.7% and 3.1%, respectively.

The system of financial instruments of regional policy, just like the membership in the European Union, must be perceived as an opportunity, not as salvation. Luckily for the new member states, there is a relatively strong inspiration from recent years (utilisation of regional policy instruments by current members of EU-15 with similar economic and social parameters).

It is, therefore, clear that the elimination of real convergence gaps will depend both on the EU membership candidates themselves and their ability to find an optimal balance between the needs of potential recipients of structural assistance and the availability of individual regional policy instruments of the European Union. One must not, however, forget that structural assistance will always play only a secondary role to private national entrepreneurial activities.

Box: former and current objectives of EU regional policyFormer objectives of EU structural policy (1994-1999)

- a) Support of the development and structural adjustment of underdeveloped regions, i.e. all regions whose economy is still to a large extent dependent on agriculture and suffers from low production and income, high unemployment and a weak (poor) infrastructure (concerning, above all, roads, railways, water supply, etc.) – **objective 1**.
- b) Redevelopment of all regions, border regions and areas (local labour markets or urban municipalities) seriously affected by the decline of industrial production (mainly regions in which economic activities have historically concentrated on sectors currently facing a decline, loss of perspective, restructuring, revitalisation or liquidation, such as the mining industry, steelworks and ironworks, ship construction or textile industry). The said regions have been fatally affected by the liquidation of many factories, outdated and unsuitable infrastructure and a high level of unemployment – **objective 2**.
- c) Fight against long-term unemployment, with special attention paid to persons older than 25 years of age unemployed for more than 12 months (representing the most critical group of the unemployed) – **objective 3**.
- d) Promotion of the employment of young people, especially those younger than 25 years of age and actively looking for jobs – **objective 4**.
- e) Adjustment of production, processing and marketing structures in agriculture and forestry (**objective 5a**) and the support of agricultural and farming regions (**objective 5b**).
- f) Support of regions with an Arctic climate and low population density (**objective 6**).

Current objectives of EU structural policy (2000-2006)

- a) **Objective 1** – support of the development and structural adaptation of all underdeveloped regions, i.e. all regions whose GDP per capita amounts to less than 75% of the EU average. This new objective concerns most remote regions (French overseas territories, the Azores, Madeira and the Canary Islands) and the regions covered by the former objective 6 resulting from the Accession Treaty concluded with Austria, Finland and Sweden. As in the past, two thirds of the operations concerning the Structural Funds concern objective 1. Almost 20% of the EU population could benefit from the measures adopted in connection with this objective.
- b) **Objective 2** – contribution to the economic and social conversion of all regions suffering from structural problems not covered by objective 1. This objective partially replaces the former objectives 2 and 5b, now also covering all regions facing economic diversification: in general, it concentrates on all areas undergoing economic change and on the decrease of productivity in rural areas, areas dependent on the fishing industry and urban areas in crisis. This objective does not concern more than 18% of the EU population.
- c) **Objective 3** – includes all measures concerning human resources, except for those covered by objective 1. It partially replaces objectives 3 and 4 and represents a reference framework for all measures resulting from the fight against unemployment defined in the Amsterdam Treaty and by the European Strategy of Employment.

Notes on Nominal Convergence

Introduction

It is possible to say that except for Slovenia, Cyprus and Malta, all the new EU member states have price levels completely different from those of EU-15. The average price level of the Czech Republic, for instance, currently amounts to approximately 52% of the EU average. This fact is closely related to discussions concerning a nominal convergence. Its most frequent subject is when and how our price level will reach the average price level of the European Union.

Some solutions are based on comparison with the development and dynamics of price level in Ireland, Portugal and Greece. Thanks to certain similar aspects, the said three countries can be used as a model and indicate the future development of the Czech Republic.

Relevant comparison

It is possible to say that at least the following **general observations** apply to all three countries compared below:

(a) Inflation development in all three of them has undergone several quite extreme changes closely related to key milestones of European integration. The smallest (yet most important) change resulted from their admission to the European Communities. It was followed by the establishment of the European Union (1991 – 1993) and other related issues (such the Economic and Monetary Union and its stabilisation mechanisms). Another important stabilisation effort – occurring before the launch of the European Union – was the factual introduction of monetary co-ordination within the European Communities in March 1979 (the European Monetary System [EMS] and its individual parts).

(b) When they joined the European Communities (Ireland in 1973, Greece in 1981 and Portugal in 1985), they were all facing high inflation. It needs to be said that their inflation rate was not high only in accordance with today's standards but also, for instance, in comparison with the then benchmark of monetary stability – Germany.

(c) All three states were positively affected by monetary stabilisation instruments, first to a smaller extent by their admission to the European Monetary System, especially the ERM, and later on, formally from 1993, by the necessity to meet the criteria of macroeconomic convergence agreed in Maastricht. We should realise in this context that in 1993, unlike today, the inflation criterion was regarded as the most important and factually superior to all other Maastricht criteria. That is why at first, individual national policies were concentrated above all on the considerable reduction of inflation rates to single figures and later on, at the end of the 1990s and the beginning of the current decade, on compliance with the relatively narrow inflation interval binding for all EU member states.

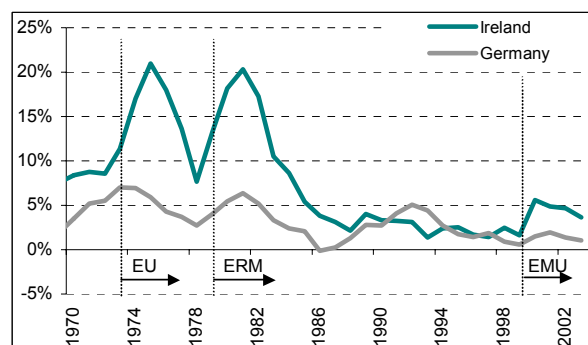
(d) As far as the structure of the consumption basket is concerned, none of the said countries shows a disparity between marketable and non-marketable items (and in particular, items subject to price regulation, including above all rental charges, public transport, power industry inputs, etc.) such as the Czech Republic in the course of the 1990s.

1. Ireland

Because of Ireland's admission to the European Communities as early as 1973 and to the EMS in 1979, the aforementioned milestones are not completely comparable with those of Portugal and Greece. In other words, Ireland was able to gain its first integration experience at a time when Greece was just an associated member (regarded as only slightly better than Turkey today, i.e. as an unwanted candidate) and Portugal was still governed by a relatively strict military autarkic clique.

The timing of Ireland's admission to the European Communities corresponded with the climate of the first oil crisis typified by a high-inflation environment. When Ireland joined the European Communities, its rate of inflation amounted to 10%, 4% more than the German stabilisation benchmark.

Ireland - inflation



Note: average inflation in the year, source: national statistical offices

Nevertheless, Ireland's first membership years – until the next summit in 1979 at which it became one of the founding members of the EMS – were characterised by a further acceleration of inflation. In mid-1975, Ireland's rate of inflation reached 25% (at that time, Germany's inflation rate amounted to approx. 6 – 6.5%).

The said phase was followed by a gradual reduction and deceleration of price growth. At the end of 1978, Ireland managed to cut its rate of inflation to 8% (in June of the same year, Ireland's inflation dropped to some 6% - the country's best result in the 1970s). However, the launch of the European Monetary System was accompanied by further price acceleration caused above all by the second oil crisis.

When Ireland joined the EMS and its stabilisation exchange rate mechanism, its inflation rate totalled 11% (in comparison with Germany's 3%; at that time, Greece and Portugal – both still outside the European Communities – recorded an inflation rate of approximately 20%).

During almost the entire first half of 1980s (in this period, price stabilisation and inflation minimisation were not regarded as integration priorities), Ireland's inflation rate never left the double figures, mainly oscillating around 20%, and only very slowly converged to 10% (even though Germany's average inflation rate at that time rarely exceeded 6%).

On the other hand, in the second half of the 1980s, the distinct disinflation trend characteristic for many European countries also affected Ireland. Its inflation rate dropped significantly in comparison with the previous period, eventually reaching the single figures. At that time, Germany even experienced temporary deflation. In 1988, Ireland succeeded in reducing its rate of inflation below 2%. In the beginning of the 1990s this figure increased slightly, oscillating around 4%.

The first half of the 1990s is very interesting because Ireland's inflation – in spite of the country's dynamic economic growth – remained significantly lower than in Germany. While at that time the rate of inflation in Ireland amounted to some 2%, it was twice as high in Germany.

The third milestone – real price stabilisation and monetary convergence resulting from the country's obligation to meet the agreed EMU criteria – came in the second half of the 1990s. In this period Ireland's rate of inflation was among the lowest in the entire European Union, its amount almost identical to Germany's.

At the end, Ireland was one of just two EU member states able to meet all five Maastricht criteria of macroeconomic convergence without excuses or discussions, while maintaining very dynamic real economic growth. As a result, it joined the Eurozone as a stabilisation power rather than possible risk element.

However, in the course of 2000 the country's high growth dynamics started affecting its inflation rate negatively until it became the highest in the entire European Union (eventually reaching 7%). The distinctive deceleration of economic growth in 2003 resulted in an inflation rate reduction to a level just exceeding 2%.

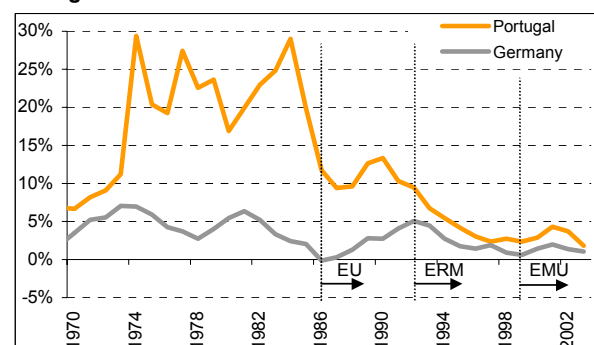
2. Portugal

In Portugal, milestones appeared slightly later than in Ireland. Even though Portugal joined the European Communities after Greece, it began a factual monetary integration and inflation reduction policy much earlier. That is why it is No. 2 in our review.

Portugal joined the European Communities in 1985. At that time, its rate of inflation was significantly higher than that of Ireland or Greece, amounting to some 25%. Soon afterwards, however, inflation began decreasing, eventually reaching single figures (in 1988). Although at the end of 1980s the rate of inflation started growing again, it never reached the country's pre-admission level.

In spite of the aforementioned development, at the beginning of the 1990s Portugal suffered from relatively high inflation (together with Greece, the highest in the European Communities). On the other hand, at that time, Portugal also managed to adjust its price level to the average price level of the European Communities.

Portugal - inflation



Note: average inflation in the year, source: national statistical offices

3. Greece

When Greece joined the European Communities in 1981, its inflation rate amounted to some 25%. Although a certain analogy with Portugal is clearly visible, Greece's enthusiasm for both the spheres of European integration and monetary integration and enhancement of price stability was much more reserved.

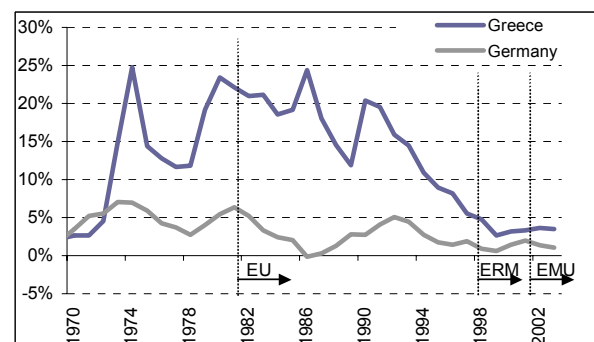
Unlike Portugal, however, its inflation rate stayed firmly in double figures almost throughout the 1980s (mostly oscillating around 20%) before it began decreasing (very slowly indeed).

For a long time, Greece had the highest inflation rate in the European Communities (and later in the European Union) as the aforementioned characteristic remained valid until the mid-1990s.

The serious approach of other EU member states to monetary stability and discipline forced Greece to keep up. As a result, when it joined the ERM in 1998, later than other EU members, and the Eurozone as its 12th member in 2001 (again, later than the others), its rate of inflation was already down to single figures.

Although at first oscillating around 10%, Greece's inflation rate improved considerably later on, especially after 2000. Since then it has been comparable to the inflation rate of other EU member states, in some periods being even lower than in Portugal.

Greece - inflation



Note: average inflation in the year, source: national statistical offices