PRICE STABILITY - A MAIN OBJECTIVE OF EUROPEAN MONETARY POLICY

Tudor Mugurel AURSULESEI*, Liviu-George MAHA**

Abstract

According to Article 127 of the Treaty on the Functioning of the European Union, the main objective of the European System of Central Banks is to maintain price stability. Through a monetary policy strategy, the Governing Council aims to stabilize inflation to the lowest level, below 2% in the medium term. The EU Member States have assumed the transposition of monetary policy into national policy and compliance with the inflation threshold. However, the implementation of European policies lies with the political decision-makers of each state, who most often place their interests above the interests of the Union. The research aims to analyse how the states have implemented European monetary policy. Monetary policy imposed an annual inflation rate of maximum 2%. In 2018, only 12 of the 19 European Monetary Union Member States managed to maintain the inflation rate below 2%.

Keywords: Eurozone, inflation rate, European monetary policy, Maastricht Treaty

Introduction

The inflation rate plays a key role in the development of the European Union and the euro area. This indicator is a criterion of real convergence, also found in the Maastricht Treaty. In order to move towards an optimal monetary area, the European Monetary Union must pay close attention to price stability across the Union. Any disturbance of inflation in a Member State has repercussions on the whole area.

The research aims to analyse the European monetary policy. We consider such an analysis to be appropriate, especially now in a period of impasse for the European Union and the Eurozone. We want to see how the states have succeeded in implementing the monetary policy and whether they manage to stabilize their inflation below 2%. In order to accomplish this goal, we identified three main objectives: describing European monetary policy, identifying methods for

* Tudor Mugurel AURSULESEI is PhD Student at Alexandru Ioan Cuza University of Iasi, Doctoral School of Economics and Business Administration Iasi, Romania; email: aursulesei.tudor.mugurel@gmail.com.
** Liviu-George MAHA is Professor at Alexandru Ioan Cuza University of Iasi, Doctoral School of Economics and Business Administration Iasi, Romania; e-mail: mlg@uaic.ro.

ISBN 978-606-714-568-7 | ISSN 2393-2384 | ISSN-L 2392-8867

implementing monetary policy decisions and analysing the degree of compliance with the monetary policy.

The current paper aims to answer the following question: Do Member States follow the decisions of the European System of European Banks imposed through the monetary policy?

The structure of the paper aims to facilitate the research as a whole. In the first part, we observe the main features that define the European monetary policy and how a common monetary policy has been reached. The second part is devoted to identifying the methods for implementing monetary policy decisions through monetary policy instruments. The last part is devoted to analysing the degree of monetary policy implementation of the already member states and those that are about to join the Eurozone.

The research methodology combines both qualitative and quantitative analysis. The theme is topical but also very complex. Therefore, it is necessary to have several study methods to provide both a current analysis of the subject and to define the future perspectives of price stability in the Eurozone. The methods to be used in this research correspond to the purpose and objectives set. In the first two parts we focus on the qualitative analysis. The documentary analysis will help us collect data on the concepts, phenomena and processes analysed in the research. The purpose of the documentation is to create a theoretical framework that allows us to correctly separate the concepts used in the research, as well as the evolution of the European monetary policy. In the last part we will use the quantitative analysis. Through statistics, we outline the main developments and trends of the inflation rate among European countries. The scientific approach will be based in particular on the reports and documents of the European Central Bank.

For a monetary area to work in an optimal way, the Member States' economies need to resemble or move towards a common target. Normally, this adjustment of the economy takes place through the exchange rate. To join a monetary area, states have to decide how the national economy wants to align with the economies of member countries.

Once admitted to the European Union, Member States undertake the implementation of the EU monetary policy. The Euro Area Policy is coordinated by the European System of Central Banks, comprising the European Central Bank and the national central banks of all the Member States of the European Union.

1. European Monetary Policy

The European Monetary System functioned until the euro came into being. The reduction of the inflation rate in the participating states was one of the most important achievements of the European Monetary System (Cernea, 2009, p. 106). Even if the system was abandoned theoretically when the euro was implemented, an improved version of the system is still in place - the European Monetary System II.

In order to better understand the European Monetary System, we need to see what its main features are. First of all, there is the ECU - European Currency Unit, a common currency unit based on a foreign exchange basket, all of which comprise the member countries' currencies. Each Member State's currency was part within a certain percentage of the ECU component. Starting with the following of some pivotal rates between the currencies of the Member States and the ECU, a fixed but adjustable exchange rate was established between the currencies of the participating States. The course changed only with the acceptance of all Member States and, in addition, it had to fluctuate off the pivot rate within a maximum of +/- 2.25%. Another feature was the existence of some divergence indicators for each currency participating in the European Monetary System. The role of these indicators was to show the evolution of that currency against the other currencies of the system. A lasting but extremely important feature was the creation of a pool of shared reserves of the participating States and the possibility of granting mutual credits in the event of imbalances in the balance of payments. This solidarity between states was made possible through the European Monetary Cooperation Fund.

The European Monetary System suggested creating a monetary union in three alternative forms: by carrying out a “shock therapy”, by a progressive and cooperative method or by a competitive method (Ignat, 2002, pp. 109-112). The progressive method aimed at developing the European Monetary System from close to near. This is the method that has been chosen in the development of this union. On the other hand, the competitive method pursued the development of the European Monetary System through a competitive relationship between the Member States. This method leads to the dissemination of good practices and the desire to develop the Member States and the entire system. The European Monetary System is a huge leap into the unknown (Eijffinger and de Haan, 2000).

On 1st January 1999, the euro was adopted by 11 European countries: Belgium, Austria, Finland, France, Germany, Ireland, Italy, Luxembourg, Portugal, the Netherlands and Spain. On January the 1st, 2001, Greece, which also met the convergence criteria, joined the monetary union. On 1st January 2002, the euro banknotes and coins were officially launched and the other national currencies of the Member States of the European Monetary Union were withdrawn from use. Following the official appearance of the euro, other states have also joined the single currency: Slovenia (2007), Cyprus and Malta (2008), Slovakia (2009), Estonia (2011), Latvia (2014), Lithuania (2015). In addition to the 19 European Union countries that joined the Euro Area, there are also other countries using the euro as a result of the agreements with other Euro Area countries, under the approval of the Council of the European Union: The Vatican and San Marino (both countries have an agreement with Italy and use customized coins), Monaco (agreement with France, while also using customized coins), Andorra (uses euro coins from France and Spain). Without the agreement of the Council of the European Union, the euro is also used in Montenegro, Kosovo and in the former

French, Portuguese and Spanish colonies that have retained their dependence on European countries.

Even if they met all the criteria for joining the Eurozone, the UK and Denmark received a derogation from not adhering to the single currency. Britain and Denmark have not renounced their monetary sovereignty, but have joined the community (Padoa-Schioppa, 2000, pp. 168-181). Also, although it has not formally received any derogation, Sweden has no intent to join the European single currency either.

The main objective of the optimal monetary policy is reaching the price stability. This objective has its origins in Article 127 (1) of the Maastricht Treaty. At the same time, the Euro system supports the achievement of the general economic objectives in the European Union. Among these general objectives, we can recall employment and balanced economic growth among the Member States. However, considering the order of priorities, price stability is the most important objective. The Maastricht Treaty establishes that monetary stability will materialize in a high rate of employment and a favourable economic environment through price stability. Maintaining stable prices on the basis of coherent policy is the basis of a harmonious economic development. Given the fact that monetary policy can affect real short-term activity, the European Central Bank needs to control excessive fluctuations in output and employment (Tratatul de la Maastricht, 1992)[1]. Price stability contributes to a high level of economic development and a high level of employment within the Union.

When the European Central Bank had to choose what monetary strategy it should follow, it had two options: to set a monetary or an inflation target. In both scenarios, the ultimate goal is price stability. In the first case, namely the monetary target, the objective to increase the rate of one or more monetary aggregates is announced, with the ultimate goal being price stability. In the second case, inflation targeting, the government imposes an explicit inflation target on the Central Bank and delegates the bank governor to meet the target (Eijffinger and de Haan, 2000, pp. 55-60).

Nevertheless, the Maastricht Treaty does not describe how the objective of maintaining price stability should be achieved. However, in 1998 the Governing Council of the European Central Bank established that price stability is defined as the year-on-year increase of the Harmonized Index of Consumer Prices (a method of calculating the inflation rate) by a maximum of two percent (Eijffinger and de Haan, 2000, p. 64). The Governing Council has also stated that, in pursuit of price stability, it aims to keep inflation rates lower but close to 2% in the medium term.

A transparent price mechanism contributes to price stability. Changes in relative prices can easily be observed, which gives the population much more

[1] Tratatul de la Maastricht (1992), available at: http://eur-lex.europa.eu/legal-content/RO/TXT/?uri=LEGISSUM%3Axy0026 [Accessed 8 Decembrie 2017].

relevant information on consumption and investments, thus creating a more efficient distribution of resources.

2. Common monetary policy instruments

The European Central Bank (ECB) is the only issuer of the euro currency. Taking this into account, we can conclude that it is the monopoly supplier of the monetary base. The central bank may influence the conditions by which banks can trade on the money market. At the same time, the ECB can influence the cash-flow situation, as well as interest rates. In its operations, the ECB aims to ensure proper functioning of the money market and to help credit institutions meet their liquidity needs in a smooth manner.

In addition to the functions described in the Maastricht Treaty, the European Central Bank also pursues a number of guiding principles. Firstly, we need to remember operational efficiency. In other words, there is an increased adaptability of the operational framework to allow monetary policy decisions to synchronize as quickly as possible with short-term money market rates. Another principle requires all credit institutions to be treated equally, regardless of the criteria that distinguish them from each other.

The system operates on the principle of decentralization. The European Central Bank is the one that draws the directions of monetary policy, but the Central Banks of the Member States are the ones that carry out the transactions and implement those directions.

The monetary policy instruments are (Eijffinger and de Haan, 2000, p. 66):

- Deposit facility for collecting liquidity from banks at rates lower than market rates. The rate of this facility acts as a lower limit for short-term money market rates;
- The marginal lending facility or the lombard facility that provides banks with liquidity at rates that typically exceed market rates. The rate of this facility thus acts as an upper limit for short-term money market rates;
- Fixed and fixed-term open market operations for targeting and adjusting very short-term money market rates;
- Mandatory minimum reserves with an average monthly averaging facility.

There is no evidence that the first pillar in the formation of the European Central Bank, namely the prominent role of monetary aggregates, has any relevance in the formulation of monetary policy in the Euro Area. ECB policy can be modeled on the inflation targeting behaviour (Mihov, 2001, p. 401).

Decisions on monetary policy are influencing price levels through the transmission mechanism. Unfortunately, it is considered to be deficient, because it is characterized by long delays in implementation, instability and uncertainty (ECB, 2019).

For example, suppose the European Central Bank wants to change the official interest rate. With the monopoly power over the issuance of the euro, the

ECB provides money-system funds and pays interest. This intervention of the ECB will influence banks and interest rates on the money market. Infrequently interest rates on loans and deposits will also be influenced by the rate between customers and banks. These changes can affect the expectations of economic agents towards future developments, which can influence the evolution of prices. Changes in monetary policy decisions influence agents and states' decisions to save or invest, but also the population's decision to consume or invest (Orosz, 2018). At the same time, changes in consumption and investment will influence domestic demand for goods and services relative to domestic supply. When demand exceeds supply, there will be a rise in price pressure.

Even if we are talking about a monetary union, the health of the banking system varies considerably from country to country. As domestic demand is limited, banks should focus on expanding their business in other Member States. However, few banks have started lending outside their country (Kashyap and Stein, 1997).

3. Monetary policy in the Member States of the European Monetary Union

Today, twenty years after the emergence of the European Monetary Union, we consider it appropriate to analyze the degree of monetary policy implementation by member countries. We aim to see how the inflation rate has evolved in the euro area member countries compared to the 2% ceiling imposed by monetary policy. The main question that arises, once they join the European Monetary Union, is whether, the states have tried to keep the inflation rate under control. Accounting for the level of inflation in 2018, we divided the sample into groups: countries with inflation rates between 0% -1%, between 1% -2% and over 2%.

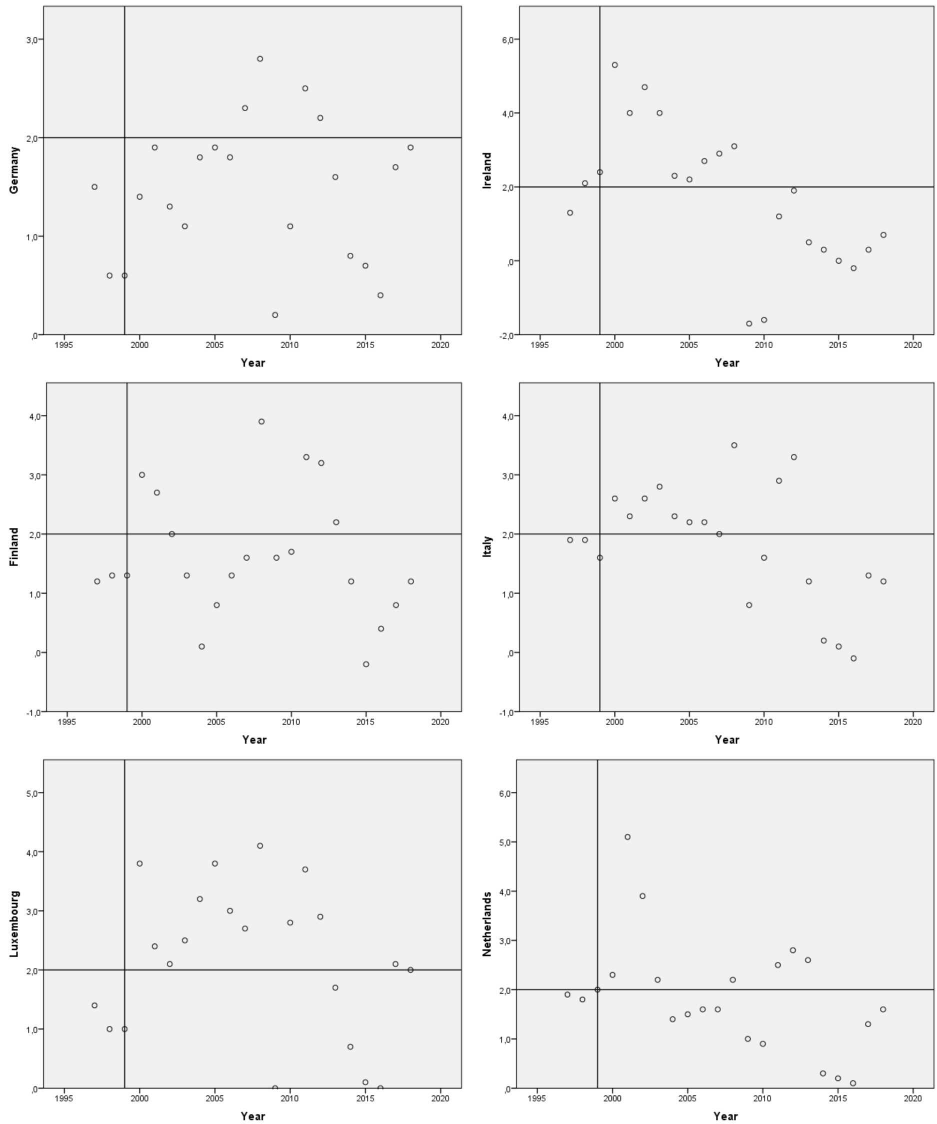
3.1. The founding states of European Monetary Union

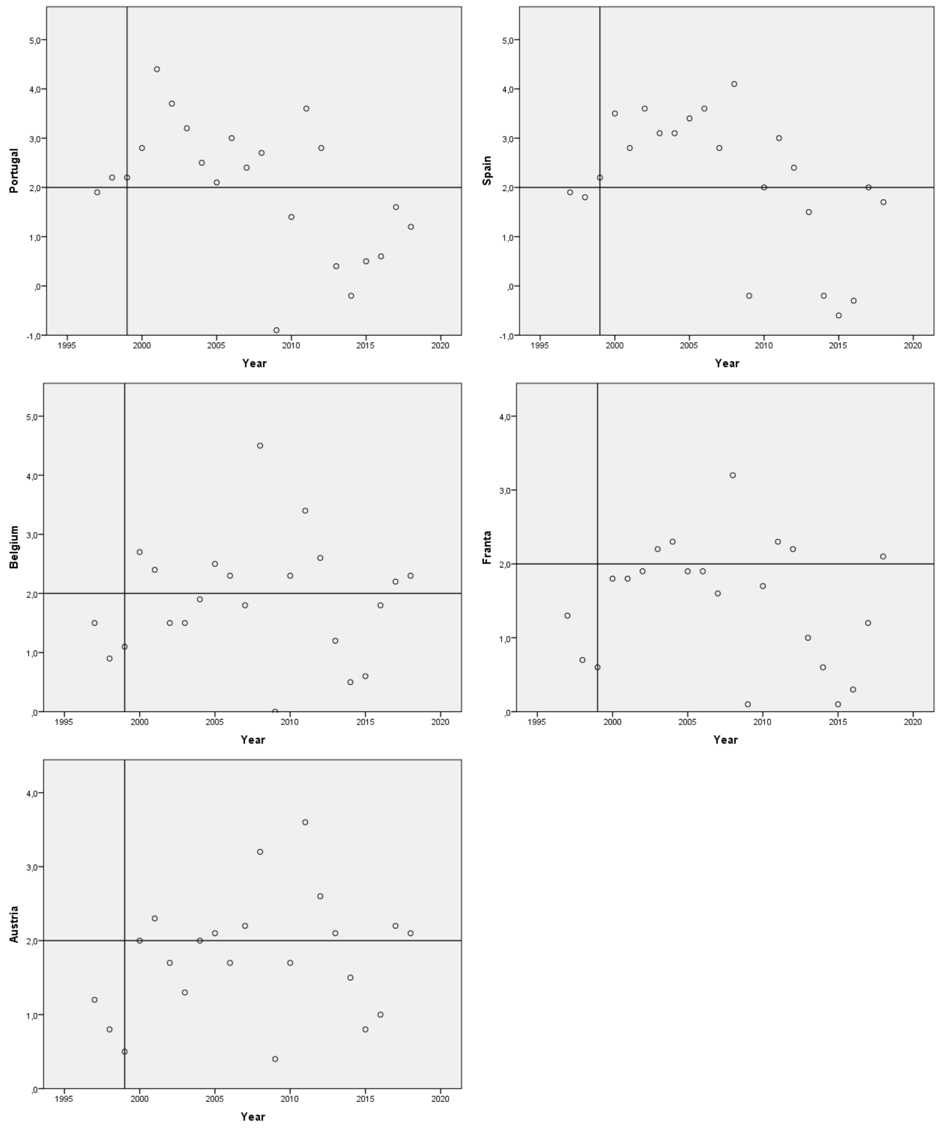
To begin with, we have proposed an analysis of the founding states of European Monetary Union: Ireland, Germany, Finland, Italy, Luxembourg, Netherlands, Portugal, Spain, Belgium, France and Austria.

First of all, we have **Germany**, which can be considered the engine of the whole union. It is the state with the most developed economy and a very well-established banking system. The European Central Bank was established on the basis of the German Central Bank. Since it joined the Eurozone, Germany has managed to keep its inflation rate below 2% almost at all times. As it can be seen in Figure 1, if at the time of the accession the inflation rate was 0.6%, in 2018 Germany the inflation rate is 1.9%. In these 19 years, the inflation rate exceeded the 2% threshold only four times. The highest inflation rate was recorded in 2008, when inflation stood at 2.8%. An inflation rate of over 2% can be explained by simply analyzing the events that took places during that period of time. Between

2007 and 2008, the high inflation was the result of the global financial crisis, which had also affected the German economy. Between 2011-2012 it happened due to Germany's role as a motor of the euro area.

Figure 1. Evolution of the inflation rate between 1997 and 2018 in the founding states of European Monetary Union





Source: own processing based on Eurostat data (Eurostat, 2019)

As we have seen earlier, during the Greek and Cypriot crisis, German authorities tried saving the two states from a possible bankruptcy. The price paid by Germany for aiding the two countries was an increased domestic inflation. Either way, on a whole, the monetary policy seems to be best implemented and respected by the German state.

Ireland, is one of the founding countries of the European Monetary Union. As it can be seen from the Figure 1, in 1999 Ireland's inflation was at 2.4%, the rate on the upward trend. Although Ireland has assumed European monetary policy, after the accession, the inflation rate has continued to increase, reaching a peak of 5.3% in 2000. Since joining the Eurozone, Ireland was given 10 years to stabilize its inflation rate in the range between (-2%) and 2%. It was only in 2009 that the inflation rate fell to -1.7%. The deflationary tendencies can be explained by the crisis faced by Irish banks. They registered huge losses, the state could no longer support them and turned to foreign aid. The European Central Bank has provided liquidity, thus sacrificing major bank creditors who have had to bear the financial losses. Ireland's recession created the need to implement a rescue plan and trigger early elections. Populist measures and the desire to protect themselves as a result of the increased budget deficit have led Ireland to a collapse (Peet and La Guardia, 2017, p. 77). The intervention of the European Central Bank was a decisive one. One effect of the Irish crisis was the establishment in 2011 of the European Stability Mechanism, which is a permanent fund of financial assistance. In 2018 Ireland had an inflation of 0.7%, the smallest of the member countries of the European Monetary Union.

Finland joined the euro area in 1999 when it recorded an inflation rate of 1.3%. In 2018, the inflation rate was 1.2%. As with Germany, there is an increase in inflation over the 2% ceiling during the economic crisis and during the Greek crisis. In addition, Finland recorded an increase in inflation immediately after joining the euro area. Currently, the inflation trend is an upward one, but within the limits of monetary policy.

Another founding country of the European Monetary Union, **Italy** entered with an 1.6% inflation rate and reached 1.2% in 2018. Even if, in 1999 it respected the monetary policy objective, it grew afterwards. It was only in 2009, when Italy managed to return to an inflation rate below 2%, but it felt the Eurozone crisis in 2011-2012 and the inflation rate started to rise again. Italy has been and is a problematic country, whose economy is extremely sensitive to changes. Another reason is the high level of corruption (Del Monte and Papagni, 2001, p. 14). This is precisely why it is found in the category of PIIGS countries. Although, foreign lending has also managed to save Italy in some instances, since 2016, the country is facing a deflation.

At the time of accession, the inflation rate in **Luxembourg** was 1%. After that, the inflation rate was on an upward trend, reaching a maximum of 4.1% in 2008. Only in 2013, the inflation rate has fallen below 2%, thus respecting the European monetary policy. In 2018, inflation stood at the 2% limit. Even if it is a small state with one of the highest GDP per capita and a high living standard. We can see that Luxembourg fails to maintain price levels at a constant level, the inflation rate often exceeding the level of 2% imposed by the European Central Bank.

In 1999, the inflation rate in the **Netherlands** was 2%, but rose to 5.1% in 2001. In 2018, the inflation rate was 1.6%. In the 19 years since joining the euro area, the Netherlands managed to maintain its inflation below 2%, and when it exceeded this ceiling, the increase was not a big one, except when in 2008 it felt the financial crisis and in 2011 when the union faced the Greek crisis.

Portugal and **Spain** resemble in many ways. Firstly, both are founding members of the European Monetary Union. In 1999, both Spain and Portugal had an inflation rate of 2.2%. None of the countries managed to keep their inflation rate below 2% by 2009, when both went directly to deflation. Both countries are part of the PIIGS group. Like the other countries in this group, they represent an increased risk of vulnerability to economic shocks. Both Spain and Portugal have gone through more difficult times, each of whom needed the intervention of the European Central Bank. In 2018, the inflation rate in Spain was 1.7%, while in Portugal it was 1.2%. From Figure 1, we can see that the two countries have hardly managed to lower their inflation rate below 2%. Nowadays, an upward trend in the inflation rate can be observed.

Belgium is one of the founders of the euro area. In 1999, the inflation rate was 1.1%. After the accession, the inflation rate fluctuated a lot. In 10 of the 20 years we analyzed, the inflation rate was over 2%. However, the overrun of the ceiling often fell below one percentage point. The only exceptions being 2008, with a maximum of 4.5% and 2011 with a 3.4% inflation. As with the other analyzed countries, these peak points were reached due to the global financial crisis and the Eurozone crisis. In 2018, the interest rate was 2.3%, but the trend of the last years is an upward one.

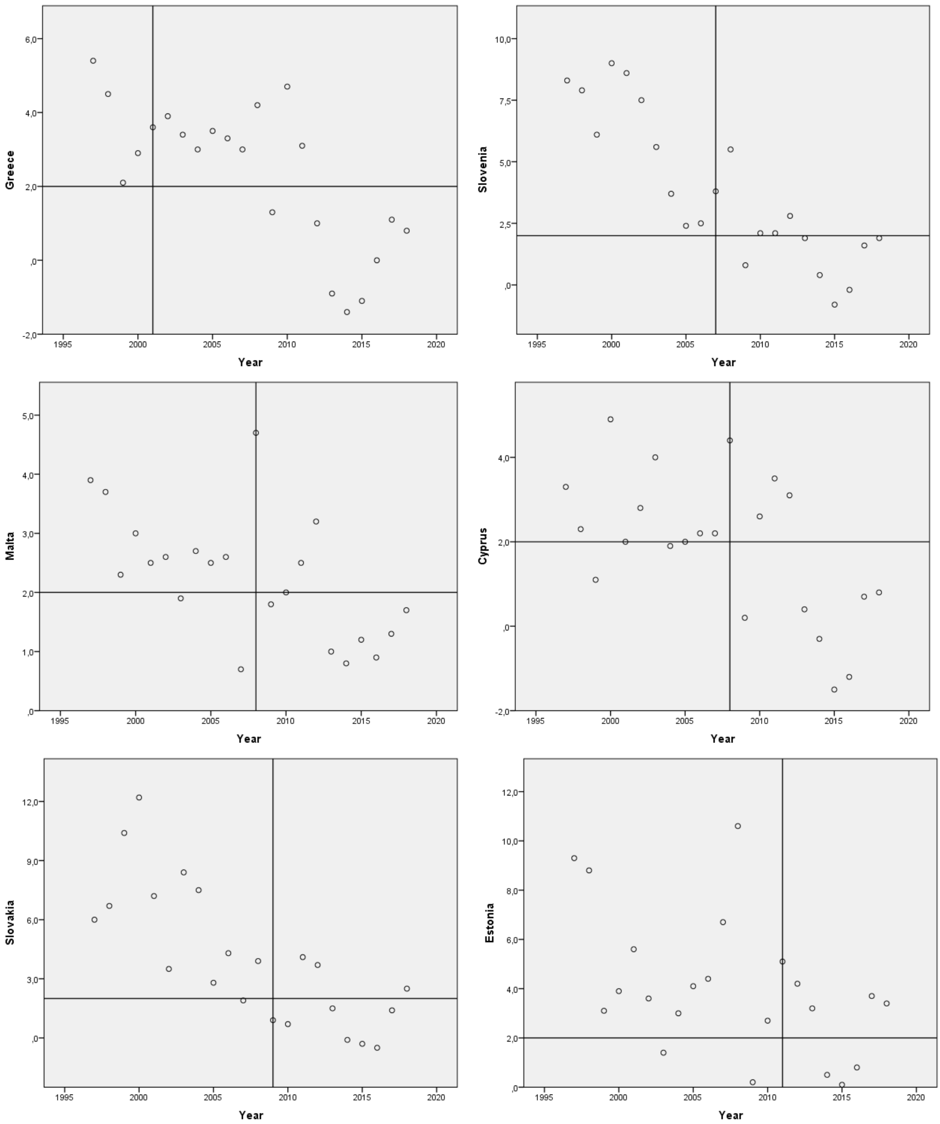
France, the second engine of the Euro Zone, after Germany, had an inflation rate of 0.6% in 1999. During the reviewed period, the inflation rate was below 2%. However, in 2008, in full financial crisis, France reached an inflation rate of 3.2%. In 2018, inflation stood at 2.1%. This growth over the 2% limit was mainly due to national instability. Numerous protests and strikes have influenced the French state to resort to some populist measures that have led to a rising inflation.

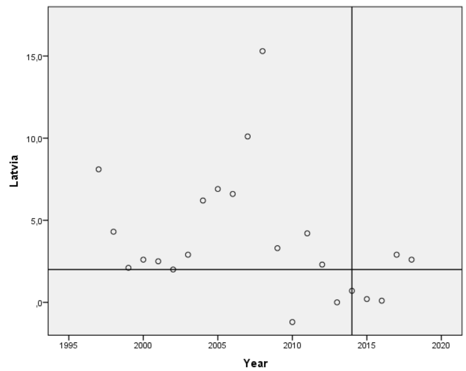
Austria, the last founding member of the euro area to be reviewed, had an inflation rate of 0.5% in 1999. Austria tried to meet the 2% margin but was deeply affected by both the financial crisis of 2008 (3.2%) and the Greek crisis in 2011 (3.6%). In 2018, the inflation rate was 2.1%. The Austrian government has tried to keep inflation below 2%, but has been affected by the inflation fluctuations in other member countries of the European Monetary Union.

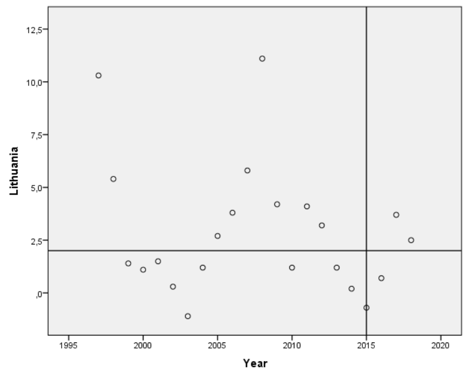
3.2. States that joined the European Monetary Union after its formation

The second category, which the member states that joined the European Monetary Union after its formation. Here we find most of the member countries: Greece, Slovenia, Malta, Cyprus, Slovakia, Estonia, Latvia and Lithuania.

Figure 2. Evolution of the inflation rate between 1997 and 2018 in States that joined the European Monetary Union after its formation







Source: own processing based on Eurostat data (Eurostat, 2019)

In Figure 2, we can observe the evolution of the inflation rate in 7 of the 11 founding countries of the European Monetary Union. As we can see, even if all fall within the 2% ceiling, each state has its own specificity.

As we can see in Figure 2, a problematic country within the European Monetary Union was **Greece**. It joined the euro area in 2001. That year, the inflation rate was 3.6%. Greece managed to reduce it below the 2% ceiling only in 2012, when it recorded an inflation rate of 1%. Just like in the case of Ireland, there are three years in which inflation has dropped sharply below 0%. The year 2018 places the inflation rate at 0.8%. The maximum level after the accession (4.7%) was recorded in 2010. This is due to the extremely populist measures of the Greek government during the economic crisis. These two correlated events led Greece to a bankruptcy step. There has been little talk of Greece leaving the Eurozone. Grexit was wanted both by the euro member states and by the Greek government, which was not willing to adopt austerity measures. The only state that came to grips with was Germany, which was scared of a possible spread of instability throughout the union (Peet and La Guardia, 2017, pp. 83-92). At the pressures of Germany, which has taken on the role of a mediator, the European Central Bank has agreed to pump money into the Greek economy. At the same time, Germany also provided loans and assisted the Greek government in implementing austerity policies. These events explain the fall in inflation from 2012 and then the appearance of deflation. The Greek crisis was the biggest crisis the Eurozone so far. However, even if the inflation rate was below 2% in 2018, there is a rapid growth trend in this economic indicator. It feels that like the Greek state has returned to the populist practices of rising public spending.

Slovenia joined the euro area in 2007. At the time of accession, the inflation rate was 3.8%. Slovenia came after a bad period in which the inflation rate was very high. In 2000, the inflation rate was 9%. Following its accession to the European Monetary Union, Slovenia managed to keep its inflation rate under control, dropping below 2% in 2009. In 2018, the inflation rate was 1.9%. But, like in the other countries in this category, the inflation rate is on an upward trend.

Malta joined the euro area in 2008, with an inflation rate of 4.7%, the maximum of the analyzed period. Starting from 2013, the inflation rate remains below 2%. In 2018, the inflation rate was 1.7%.

Cyprus joined the European Monetary Union in 2008 and the inflation rate was 4.4%. Even if the inflation rate stood above 2% before accession, the country assumed monetary policy and managed to lower its inflation rate. From 2013 onward, it was below 2% per year. In 2018, the inflation rate was only 0.8%. Even if it is not part of the PIIGS group, Cyprus was a troubled country after the financial crisis. Since the Cypriot economy is closely linked to Greece's economy, the Greek crisis has also been felt in the Cypriot banking system. This, plus an incident that led to the closure of the largest power plant, has brought Cyprus to a collapse in 2012. Again, the European Central Bank was actively involved in the "rescue" of Cyprus. The control system imposed on banks, the austerity measures and the capital infusion of the European Central Bank led to the appearance of deflation. In Cyprus, capital control was introduced for the first time, which means that the value of one euro in Cyprus was no longer the same as one euro in another country (Peet and La Guardia, 2017, p. 126).

Slovakia joined the euro area in 2009, when it recorded an inflation rate of 0.9%. Figure 2 shows how adherence to the single currency and common monetary policy has positively influenced the Slovak economy. Before the accession, the inflation rate has always exceeded the 2% ceiling (except for 2007). The record inflation was registered in 2000, when Slovakia faced an inflation rate of 12.2%. After accession, it can be noticed how Slovakia tried to fall within the 2% margin, the Eurozone crisis (2011-2012) being the only period in which it deviates from this ceiling. In 2018, the inflation rate was 2.5%. The explanation for this is the upward trend in the inflation rate in all member countries, but also the populist measures implemented before the presidential elections in 2019.

Estonia joined the European Monetary Union in 2011. At the time of accession, the inflation rate was 5.1%. Prior to joining the euro area, Estonia faced high inflation rates. The peak in the period under review was recorded in 2008, when inflation reached 10.6%. This is mainly due to the financial crisis that affected the country in that year. As we can see in Figure 2, Estonia is far from respecting common monetary policy. In 2018, the inflation rate was 3.4%. Only between 2014-2016, Estonia had an inflation lower than 2%.

The second Baltic country joining the euro area was **Latvia** in 2014. Prior to accession, Latvia has consistently held inflation rates above 2%. The maximum value was recorded in 2008 when, due to the economic crisis, inflation reached 15.3%. At the time of accession, Lithuania's inflation went down to 0.7%. Even if we can see Latvia's tendency to keep the inflation rate below 2% in 2018, it reached 2.6%.

The most recent member of the European Monetary Union is **Lithuania**, a country that joined in 2015. In that year, the inflation rate was -0.7%. Unlike the other two Baltic countries, before accession, Lithuania faced fluctuations in the inflation rate. During the analyzed period, we can see how the inflation rate fluctuated between -1% and 5% on average, but also peaked in 2008 when the inflation rate reached 11.1%. It is difficult to estimate whether Lithuania will or may not comply with the common monetary policy. In the three years after accession, Lithuania managed to keep the inflation rate below 2% only once. In 2018, the inflation rate was 2.5%.

For all analyzed countries, there are two periods when the 2% ceiling imposed under the common monetary policy is abandoned. Firstly, 2008 is the year of the peak of the economic crisis, the only country that kept its inflation rate below 2% was Malta, but in return it saw a much higher value of this indicator this year, compared to the previous year. The second period is that of 2011-2012, where there were a series of crises in the euro area, the most important being the crisis in Greece. We can see how the effects of the Greek crisis spread in all countries, with very high increases in the inflation rate compared to 2010. A last common feature is encountered towards the end of the analyzed period. The inflation rate in all states is on an ascending trend in 2018, being very close to the 2% ceiling.

As we have seen, 7 of the 19 Member States of the European Monetary Union in 2018 did not comply with the ceiling of 2% inflation rate imposed by the common monetary policy. Reasons for non-compliance are varied. First of all, we can see a trend of rising inflation within the union in recent years. Older countries within the union go far beyond monetary policy. Some states are increasing the inflation due to populist measures taken by national governments before various election campaigns. At the same time, the newly adhered to the Eurozone countries did not go through the accession shock. The analysis range being low, we cannot predict the trend of the inflation rate.

4. Common monetary policy of the Member States of the European Union but not part of the European Monetary Union

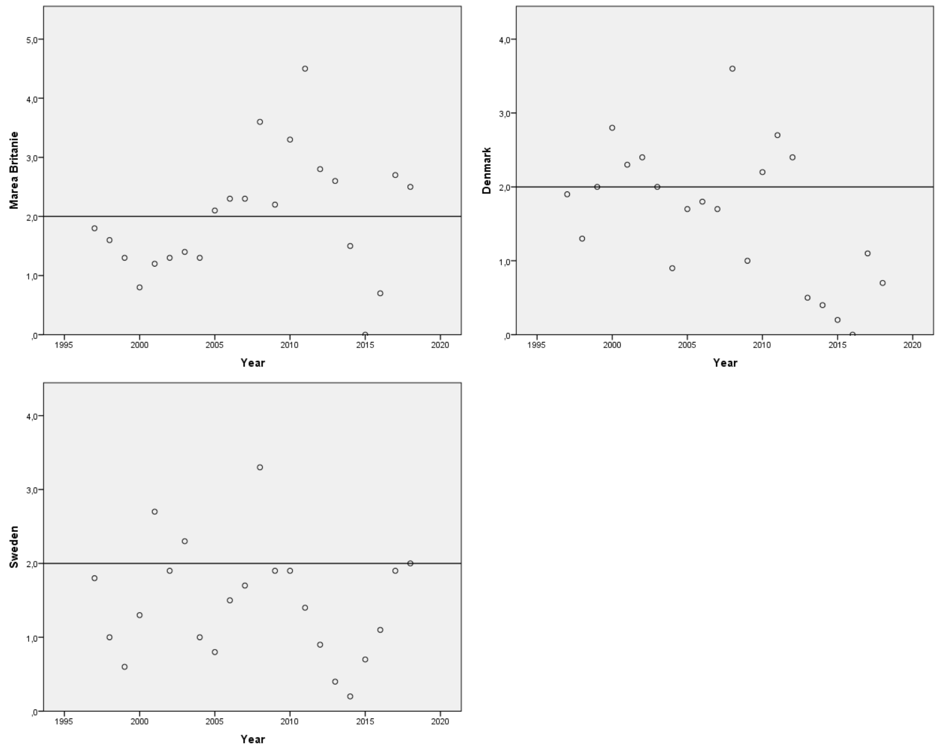
At the same time, looking forward, are the Member States of the European Union, but not members of the Eurozone, prepared to join in? Have they implemented the European monetary policy?

We considered it appropriate to extend the analysis to the EU member countries that have not yet adopted the euro. We see the situation of the countries that have decided not to join the euro area, then of the countries that have announced their desire to join the Eurozone.

4.1 The monetary policy in states that have refused to accede to the European Monetary Union

Even though the European Monetary Union is the next step towards joining the European Union, three states have refused to adopt the common currency. On the one hand, we have the UK and Denmark, which have also received a derogation from the European Commission in this respect. On the other hand, we have Sweden, which has not received any derogation, but has decided not to join the monetary union. However, we aim to observe whether these three countries meet the main objective of the common monetary policy.

Figure 3. Evolution of the inflation rate between 1997 and 2018 in states that refused to accede to the European Monetary Union



Source: own processing based on Eurostat data (Eurostat, 2019)

According to Figure 3, during the period under review, **Britain** has not made considerable efforts to maintain its inflation rate below 2%. Between 1997 and 2004, the London government maintained the inflation rate below 2%, but after that period the inflation rate rose to even 4.5% in 2011. It is interesting to note that this maximum value overlaps with the moment of the Eurozone crisis. Even if it is not part of the European Monetary Union, Britain's economy has suffered from the crisis by which the single currency has passed. The only years in which inflation fell below 2% was 2014-2016. In 2018, the inflation rate was 2.5%.

Unlike the UK, **Denmark** has largely managed to maintain inflation below 2% over the period under review. Denmark did not feel the crisis inside the

Eurozone, but was hit by the global financial crisis of 2008, when inflation reached 3.6%. In 2018, Denmark respected the common monetary policy, with an inflation rate of 0.7%.

Surprisingly, but among all the countries of the European Union, **Sweden** is the country with the most constant level of inflation. It is the only country that has managed to respect the common monetary policy over this entire time. Exceptions being 2001, 2003 and, of course, 2008, the year when inflation reached the maximum of 3.3% due to the global financial crisis. In 2018, the inflation rate was 2%. Even if they refused to join the European Monetary Union, the three countries managed to maintain a low inflation rate. In 2018, only Britain exceeded the 2% ceiling. Of note is Sweden, which managed to have the most constant inflation rate across the European Union.

4.2 The monetary policy in EMU candidate countries with an inflation rate below 2%

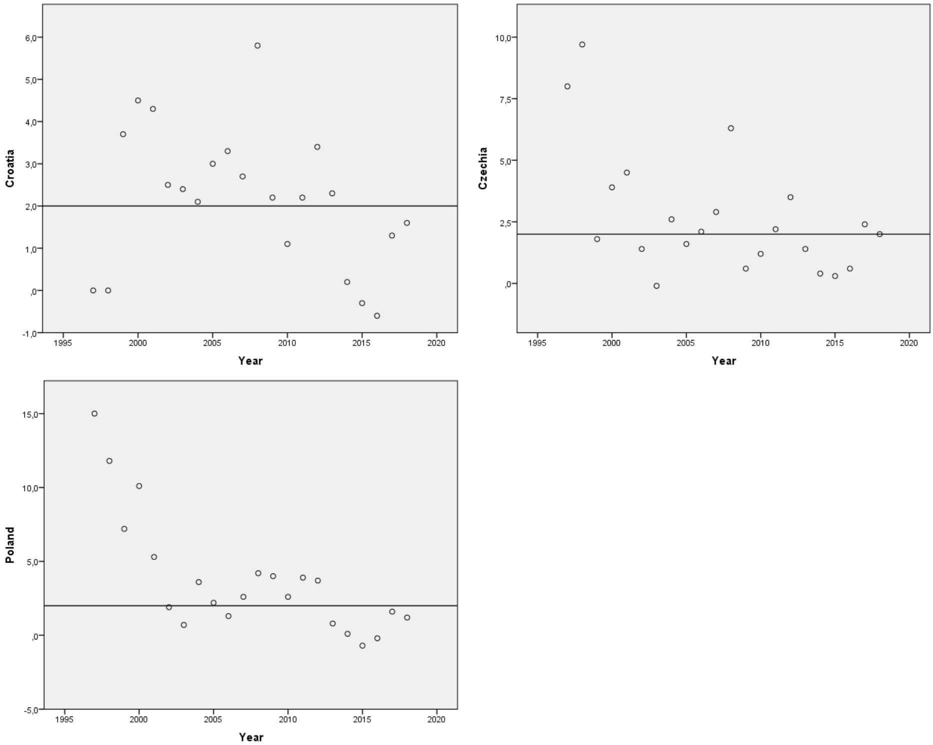
Among the member countries of the European Union but not yet members of the European Monetary Union, we note the three countries which in 2018 had an inflation rate below 2%: Croatia, the Czech Republic and Poland. Croatia and the Czech Republic are the countries that have announced their intention to join the single currency as soon as possible.

Croatia had an inflation rate of 1.6% in 2018. Until 2014, Croatia faced increased inflation, which exceeded the 2% ceiling. During the analyzed period of time, the maximum value was recorded in 2008, when the inflation rate was 5.8%. Between 2014 and 2018, Croatia has managed to meet the common monetary policy objective.

According to Figure 4, the inflation rate in the **Czech Republic** experienced major fluctuations. The country has moved from periods in which it kept inflation below 2% at periods when it has been steadily rising. The peak was recorded in 1998 when the inflation rate was 9.7%. In 2018, the inflation rate was 2%.

Unlike Croatia and the Czech Republic, during the analyzed period, **Poland** managed to record a downward trend in inflation. If in 1997 the inflation rate was 15%, in 2018 it reached 1.2%. From 2013, Poland respects the main objective of the common monetary policy.

Figure 4. Evolution of inflation rate between 1997 and 2018 in candidate countries to join the European Monetary Union, which had inflation below 2% in 2018



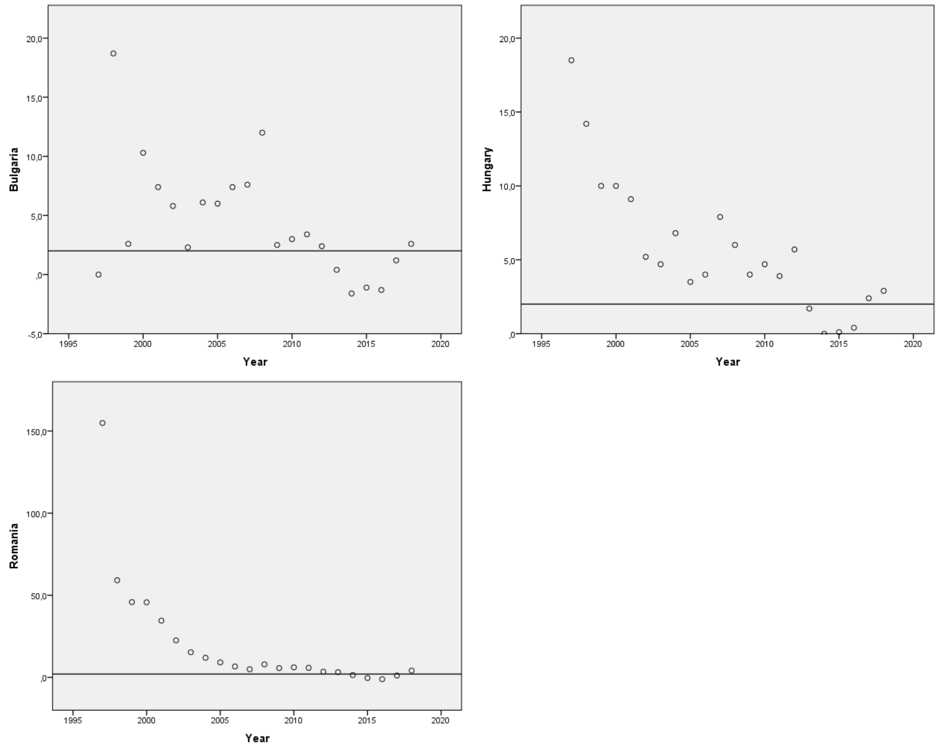
Source: own processing based on Eurostat data (Eurostat, 2019)

Following this inflationary trend, all three countries have the best chance of moving towards the Eurozone.

4.3 The monetary policy in EMU candidate countries with an inflation rate above 2%

On the other hand, we have three member states of the European Union, but non-members of the European Monetary Union, which in 2018 had the inflation rate above 2%.

Figure 5. The evolution of the inflation rate between 1997 and 2018 in the candidate countries to join the European Monetary Union, which had an inflation above 2% in 2018



Source: own processing based on Eurostat (Eurostat, 2019)

Bulgaria had an inflation rate of 18.7% in 1998. Only in 2013 it managed to lower the inflation rate below 2%. However, in 2018, inflation rose again to 2.6%.

Hungary also started in 1997 with an inflation rate of 18.5%. From figure 5, we can see how Hungary managed to lower its inflation rate, yet by 2012, failed to bring it below 3.5%. In 2018, the inflation rate was 2.9%.

As shown in the figure above, the inflation rate in **Romania** has a very strange path. In 1997, Romania had an inflation of 154.9%. Throughout the analyzed period, this is the highest inflation rate registered by a member country of the European Union. The extremely high inflation rate from 1997-2004 is due mainly to the faulty political system in Romania. The country could not recover from the shock of the transition to the market economy (Ibrahim and Vaughan, 2002). However, Romania managed to maintain the inflation rate below 2% in 2014-2017. The low inflation rate was a signal that Romania was ready to move towards a common monetary policy, namely the European Monetary Union (Akin and Yavuzaslan, 2019, p. 111). Unfortunately, in 2018, the inflation rate reached

4.1%. This rise is explained by the populist politics of the governing party (Aursulesei, 2018). In 2018 wages increased artificially, increasing consumption.

As we can see, the three Eastern European countries have not adapted very well since moving from a closed centralized economy to a market economy. This inability to adapt can be seen in the extremely high inflation rate since 1997. However, all countries have managed to reduce their inflation rate to close to 2%. Unfortunately, the Eastern European mentality and the rise of populist parties led to a slight increase in the inflation rate in the three states over the last years (Siljak and Nagy, 2018, p. 183).

Conclusions

Following the analysis of the common monetary policy and the degree to which it is respected by the Euro Area Member States and the ones which aim at joining the euro area, we have come to a number of conclusions:

Price stability is the main objective of the common monetary policy. It can be achieved by controlling inflation. For this reason, monetary policy imposed an annual inflation rate of maximum 2%.

Following the analysis of the inflation rate, we could see that only 12 of the 19 European Monetary Union Member States managed to maintain the inflation rate below 2% in 2018. Surprisingly, there are also PIIGS countries among these 12 countries. Portugal, Ireland, Italy, Greece and Spain have faced various financial crises that needed external intervention in order to be resolved. However, all five countries managed to stick to the common monetary policy.

In 2018, 7 out of the 19 euro area member states did not follow the inflation rate ceiling imposed by monetary policy. Countries not respecting the 2% ceiling are: Belgium, France, Austria, Slovakia, Estonia, Latvia and Lithuania. As we have seen throughout the analyzed period, these countries have had problems with controlling the inflation rate in the past as well.

We can see that the inflation rate of all EU Member States has been affected by two events: firstly, the global financial crisis, in 2008 and the Eurozone crisis, in 2011. Eurozone crisis has been centered on the economy of Greece. The European Central Bank sacrificed the entire stability of the Eurozone to save the Greek economy.

States that have refused to join the Eurozone have also tried to fall below 2%. Sweden is the state of the European Union that managed to maintain an inflation rate below 2% throughout the whole analyzed period.

In the case of the member states of the European Union that have not joined the Euro Area yet, three of them respected the ceiling of 2% in 2018, while the other three exceeded this ceiling. We can see that all six countries started in 1997 with a very high inflation rate compared to the Western European inflation rate but still managed to bring this indicator down to around 2%.

This article may be the start of much more in-depth research on how price stability has been implemented in the Member States of the European Union.

Acknowledgement: The results of this research were presented at the EURINT International Conference (8th edition), 17-18 May 2019, Iasi, Romania.

References

Akin, T. and Yavuzaslan, K. (2019), The effects of demographic structures on savings in Eastern European countries, *Eastern Journal of European Studies*, 10(1), pp. 93-114.

Aursulesei, T. M. (2018), The sustainability of Romania's accession to the Euro Area - A political project anchored in economic reality, *CES Working Papers*, 10(4), pp. 480-490.

Cerna, S. (2009), *Economie monetară*, Timișoara: Editura Universității de Vest.

Del Monte, A. and Papagni, E. (2001), Public expenditure, corruption, and economic growth: the case of Italy, *European Journal of Political Economy*, 17(1), pp. 1-16.

Eijffinger, S. and de Haan, J. (2000), *European Monetary and Fiscal Policy,* Tilburg University, School of Economics and Management.

Eurostat (2019), *Harmonised Indices of Consumer Prices (HICP) between 1997-2018*.

Ibrahim, G. and Vaughan, G. (2002), Bye-bye central planning, hello market hiccups: institutional transition in Romania, *Cambridge Journal of Economics*, 26(1), pp. 105-118.

Ignat, I. (2002), *Uniunea Europeană de la Piața Comună la moneda unică*, București: Editura Economică.

Kashyap, A. and Stein, J. (1997), The role of banks in monetary policy: A survey with implications for theEuropean monetary union, *Federal Reserve Bank of Chicago*.

Mihov, I. (2001), Monetary policy implementation and transmission in the European Monetary Union, *Economic Policy*, 16(33), pp. 370-406.

Orosz, A. (2018), The impact of the 2018 economic and financial crisis on the public spending devoted to social protection in the EU, *Eastern Journal of European Studies*, 9(2), pp. 187-203.

Padoa-Schioppa, T. (2000), *The road to monetary union in Europe - The Imperor, the Kings, and the Genies*, New York: Oxford University Press Inc.

Peet, J. and La Guardia, A. (2017), *O uniune nefericită - Cum poate fi soluționată criza monedei euro - și a Europei*, București: Editura Comunicare.ro.

Siljak, D. and Nagy, S. G. (2018), Economic convergence of the Eastern Partnership countries towards the EU-13, *Eastern Journal of European Studies*, 9(2), pp. 169-185.