

## TEN YEARS OF EMU: Convergence, Divergence and New Priorities

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### ***Abstract:***

As the tenth anniversary of EMU is approaching, a debate is under way in both the economics profession and the European political bodies as to whether the Single Currency has promoted or hindered convergence among the countries of the Euro-zone.

On the one hand, there is wide agreement on that asymmetric shocks have substantially subsided after the creation of the Single Currency, and also that FDI flows have been substantially promoted both intra- and out-EMU as a result of reduced exchange rate volatility.

But when one comes to examine the developments in per capita income in the Eurozone countries, there is little support for convergence. By employing various measurements of convergence to analyze the co-movements among output indicators, most of them are found to show that a process of divergence is under way after the implementation of EMU in 1999.

Both the levels of National Income (using GNI data) and of domestic economic activity (using the GDP data) are found to be diverging, in contrast to the substantial progress that has taken place before 1999. Regional convergence is also examined and found to wane away, though the evidence is less conclusive. Risk-sharing strategies in the presence of asymmetric shocks and labour immobility leads to capital stock migration *within* the EMU and this results to higher variability of GDP, but less so with respect to GNI.

Discrepancies among GDP and GNI indicate imbalances in the Current Account. In fact, one of the most worrying developments in the Euro-zone is the recent emergence of CA deficits in the Southern European countries, while the Northern constellation of the Eurozone enjoys substantial surpluses. Although both categories are receiving more FDI after the EMU than before, it appears that the southern countries are more attractive for investment in housing rather than the production sector. This puts in motion the so called "Rybszcynski effect", that is shifting the composition of output in favour of the non-traded sector, thus causing a deterioration in the trade balance. This issue is now emerging as a matter of policy concern in the EU, and triggers the discussion for new priorities on competitiveness so that a better internal and external balance is achieved.

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