

The relationship between the European Union's economic power status and the economic convergence of the Member States

Tudor Mugurel AURSULESEI¹, Ștefan Cătălin TOPLICEANU², Liviu-George MAHA³

Abstract

In this paper, we set out to look at where the European Union is located globally from an economic point of view. Let us observe what are the indicators that characterize European Union as a global economic power, at the same time, what are the indicators where union have problems. We consider it appropriate to observe whether the European Union's top-level indigenous people are internally influenced by the lack of convergence between the member states of the Union. All the Member States of the European Union have committed themselves to convergence, but over time we have noticed that convergence is often abandoned to the detriment of national interests. In the first part, we intend to observe the areas in which the European Union reflects the status of world economic power, using The World Bank's indicators from 2013-2017. In the second part, we focused on an analysis of the following indicators, which determine a European Union deficit at the global level: GDP growth, unemployment rate and inflation rate. Finally, we propose to conclude if, for the three indicators, there is a correlation between the economic convergence between the European Union states and its world economic status.

Keywords: European Union; economic power; convergence; inflation rate

JEL code: E42; E52; E58; F02; F33; F45; F50; O50; O57

¹ Tudor Mugurel AURSULESEI is a PhD student at the „Alexandru Ioan Cuza” University of Iași. Email: aursulesei.tudor.mugurel@gmail.com

² Ștefan Cătălin TOPLICEANU, PhD, „Alexandru Ioan Cuza” University of Iași. Email: tstefan.catalin@yahoo.com

³ Liviu-George MAHA is a professor at the „Alexandru Ioan Cuza” University of Iași. Email: mlg@uaic.ro

1. Introduction

Generally, power is defined by various concepts such as influence, domination, force, constraint and capability. This concept is often seen as the capacity of imposing your own will (Pausenberger, 1983, p. 131) or to control another person using different instruments. These perspectives come from social relations` point of view, but in international relations power is seen as the capacity to influence other actors` behavior through economic or military instruments. (Bucur, 2015, p. 9) In a much wider vision, power is considered the ability of an international actor to exert a significant influence over the world economy (Kebabdjian, 1994, p. 297). The actor can be represented either by an economic or political entity, either by an international organization or company. In all situations, the influence exerted by this actor can be an economic one, or political, military, social and cultural, but we believe that the economic dimension is the most important and most used today.

Over time, economic power was expressed in different forms; especially its manifestation being under military aspects. The world supremacy was held by various ancient, medieval and colonial empires. Even if the world economy suffered historical mutations under regional or international powers, the economic component remains the one which causes most of these changes. Nowadays situation presents a multipolar world with unprecedented intensities so far. The economic competition is driven by multiple actors, such as the United States, the European Union, China, Russia, India, Japan, Turkey, Israel, Nigeria, Brazil, South Africa and other, some of them being considered international power centers and other regional powers. (Huntington, 1999, pp. 35-36; Khanna, 2008, pp. 17-21) Within this multipolar world, it is interesting to see the position of the European Union, especially in the conditions of recently shifted United States` foreign policy, of China`s rise and of the events regarding Brexit. This research seeks to respond why the European Union is considered a power center and which are its strengths and weaknesses in competition with other powers.

It is interesting to note whether the status of the European Union's economic power is influenced by the convergence of the Member States of the Union. "Unity in diversity" is the slogan of the European Union.

Unfortunately, this diversity also occurs in the economic development of the states.

2. Literature Review

In order to measure the power level of an economic actor, the literature provides various instruments, either quantifiable or non-quantifiable. Generally, the economic power is generated by territory, economic and military capabilities, natural resources, population size and political stability (Waltz, 2006, p. 183) or by advantageous geographical position, economic and technological resources, strong currency, military and nuclear capabilities, cultural values, diplomacy and international connections. (Yilmaz, 2010, pp. 197-198)

In fact, possession of resources is a power` source; whether they are referring to human, cultural or physical resources or to financial, technological and energetic ones. The important thing for the economic actor is to be able to convert his resources in influence, becoming a smart power (Nye, 2010, pp. 24-26). On the other hand, it is (Carlsneas *et all.* 2013, pp. 273-298) considered that the measurement of power should not be important and the focus should be on quantifying the distribution of power on specific components.

Some authors give importance to both quantitative and qualitative elements, grouped according to their temporal action on power. They consider that (Goldstein and Pevehouse, 2014, pp. 47-49) the quantitative aspects related to power are the quality of government, the size of GDP, the military force, population, natural resources, territory and other geographical elements. On the other hand, the qualitative elements of power are the education, the political leadership, the cultural attractiveness, the values promoted and the degree of technological knowledge.

The empirical evidences demonstrate that economic power is negative influenced by level of taxes, inflation and interest rate uncertainties, (Lensink and Hermes, 2000, pp. 142-163) but it can be also stimulated by political stability and human resources (Barro, 1991, pp. 407-443). Also, there are some evidences (Pop-Silaghi and Mutu, 2013, pp. 135-154) that investments,

government efficiency and trade have a positive effect on the growth of economic power while the level of corruption influences it in a negative way.

Usually, the empirical studies use statistical techniques based on various indicators in order to measure the power level and the world economic structure. The most used indicators are Gross Domestic Product, investment attractiveness, population, finance, foreign trade structure, poverty, inflation, interest rate and labor force. Also, there are some specialized institutions including Heritage Foundation, World Intellectual Property Organization (WIPO), World Economic Forum, The Business School for the World (INSEAD) and The United Nations Development Programme (UNDP) which developed composite indicators such as Human Development Index (HDI), Global Competitiveness Index (GCI), Index of Economic Freedom and other.

Unlike the other world powers, the European Union consists of a monetary union (only 19 of the 28 member states) and a number of states that are in the process of joining this monetary union. This lack of unity leads to a number of disadvantages.

A first disadvantage is the influence of the single currency on the national fiscal policy. In their analysis, Bovenberg, Kremers and Masson conclude that, within a common monetary union, national fiscal policy diminishes its influence (Bovenberg, et al., 1991, p. 395). At the same time, Rotte and Zimmermann anticipate the risk of an expansion of the fiscal policy of the national economies under the conditions of a low depreciation risk (Rotte& Zimmermann, 1998, p. 404). The debt crisis and the size of taxes are also being analyzed by Kenen. He considers that these components of fiscal policy end up negatively influencing participants in a monetary union, risking disrupting the balance between states (Kenen, 1995, pp. 181-192).

Increasing regional disparities is another disadvantage of joining a monetary union. This is due to the developmental differences between states from the moment of accession (Von Hagen, 1992, p. 250). A final disadvantage is the loss of earnings following the speculation with the exchange rate (Casella, 1992, p. 115). In some cases, when states give up their autonomy to trade their own currency and use it in international trade, states also give up the advantage of earning from foreign exchange differences (Cohen & Wyplosz, 1989, p. 325).

Rose through his research has shown that two countries with a single currency make more trade than the same two countries, but with different currencies. Thus, a monetary union can lead to the strengthening of trade between Member States (Rose, 1999, pp. 11-15).

Fatas also takes into account the dynamic aspects of a common monetary area. It is precisely for this reason that he is skeptical of the European Monetary Union. Fatas does not believe in the power of the EMU to resolve regional and country-specific crises. However, his study has shown that for EU member countries, borders are no longer an impediment to economic development and expansion. For this reason, his fears about the inability of the European Monetary System to prevent and mitigate possible regional crises are also unfounded (Fatas, 1997, p. 749).

Eichengreen and Frieden study the political-economic aspects of a monetary union, not just those of the economic dimension. The monetary union is formed on the basis of a political decision, and the politicians want to maximize the profits. Under these conditions, the chance of the emergence of interest groups within the union increases, each group tending towards the development of a certain region or for the implementation of certain policies (Eichengreen & Frieden, 2000, pp. 236-237).

3. Methodology

This research aims to show why the European Union is considered a power center in the world economy and to compare the European economy with other power centers, such as the United States, BRICS countries, Japan, Canada, Turkey, South Korea and Israel. Also, this study seeks to analyze if the convergence indicators of the European Union members lead to an increase or a decrease in the influence of the European Union at the global level. For these purposes, we will use several indicators selected from the World Bank's statistical base for 2013-2017. The selection of this time span for the analysis is based on the fact that in 2013 Croatia has joined the European Community and the data for 2017 are the latest from The World Bank's database.

The indicators used are and include Gross Domestic Product, nominal and per capita, both based on purchasing power parity (PPP), the annual

economic growth, trade aspects (exports, imports and external balance on goods and services), unemployment and inflation. Using these convergence indicators, we analyze if the European Union was united and strong enough between 2013 and 2017 to compete with other powers of the world economy.

In the study of real convergence, we will use the sigma convergence test (Barro& Sala-i-Martin, 1995). He defined this concept as follows: “a group of countries converges in the sense of Sigma convergence if the dispersion in terms of GDP / capita decreases over time” (Sala-i-Martin, 1995). In other words, the convergence σ is revealed by the temporal dependence of the standard deviation or the coefficient of variation of GDP / place within a group of countries (Dvorokova, 2014, p. 315).

$$\sigma = \sqrt{\frac{1}{n} \sum_{i=1}^n \left[\log \left(\frac{y_i}{y^*} \right) \right]^2} \quad (1.1.)$$

y_i represents the indicator analyzed at time i

y^* represents the indicator analyzed at time 0

However, the most common indicator used in calculating the coefficient of variation is:

$$Cv_T = \frac{\sigma_T}{\bar{X}_T} \quad (1.2.)$$

Cv_T represents the coefficient of variation between the period T

σ_T is the square value of the degree of regional development in the period T and is calculated as follows:

$$\sigma_T = \sqrt{\frac{1}{n} \sum_{i=1}^n (X_{i,T} - \bar{X}_T)^2} \quad (1.3.)$$

\bar{X}_T represents the average level of development during the T .

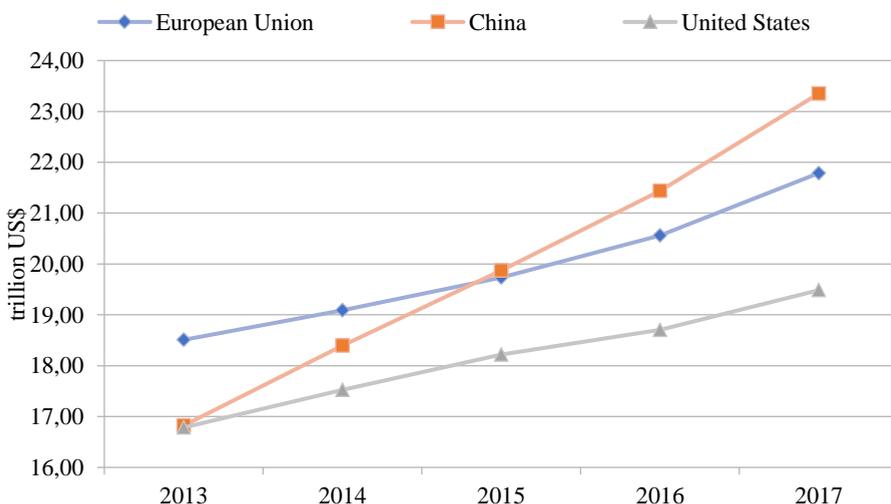
Closely related to the sigma test, we will make a descriptive analysis of the evolution of the main indicators. The picture provided by the sigma test for one year, gives us an overview of the situation in the European Union.

4. Analysis and findings

4.1. The European Union - one of the world's economic power centers

The European Union is great positioned worldwide at Gross Domestic Product based on purchasing power parity, exports, imports and external balance on goods and services.

Figure 1. The world`s top 3 largest economies by GDP-PPP between 2013-2017 (trillion US\$)



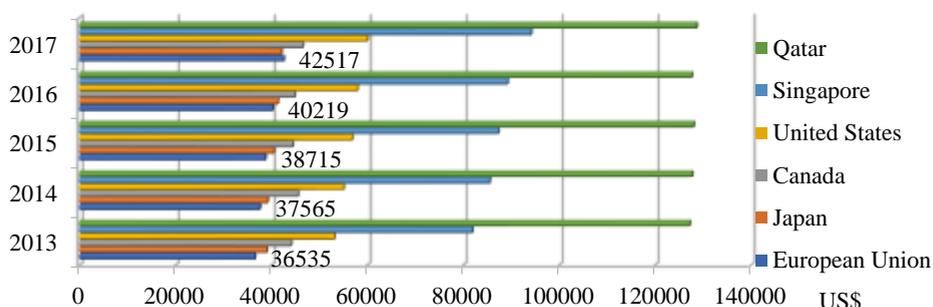
Source: own representation based on The World Bank, World

Starting with GDP at purchasing power parity, the Figure 1 shows that the European Union is the world` second biggest economy. The European economy was the world`s leader in 2013 and 2014, but it was overcome by China. Even if the European GDP increased from 18.5 trillion US\$ to almost 21.8 trillion US\$ between 2013 and 2017, the Chinese economy has grown in a faster rate. Moreover, in 2017 the European GDP almost reached 22 trillion

US\$, while the Chinese one exceeded 23 trillion US\$. The American economy was positioned on the third place and did not succeed to reach 20 trillion US\$.

Also, the European Union has one of the highest levels of GDP per capita based on purchasing power parity in the world economy. We have chosen in representation, the states with the highest level of GDP per capita. China is not on the list, because GDP per capita is much lower than that of the top countries. According to Figure 2, the European GDP per capita grew from 36,535 US\$ in 2013 to 42,517 US\$ in 2017, becoming higher than the Japanese one in 2017. Despite of this grow, the European Union had a GDP per capita lower than other powers such the United States, Japan and Canada or than other countries. The biggest levels of GDP per capita based on purchasing power parity are recorded in Qatar and Singapore, according to The World Bank, but there are also countries which surpass the European Union such as the Arab states (Kuwait, Saudi Arabia, United Arab Emirates, and Bahrain), Brunei, Australia and European countries (Switzerland, Norway, Iceland and San Marino).

Figure 2. The European GDP per capita-PPP compared to other countries (US\$)



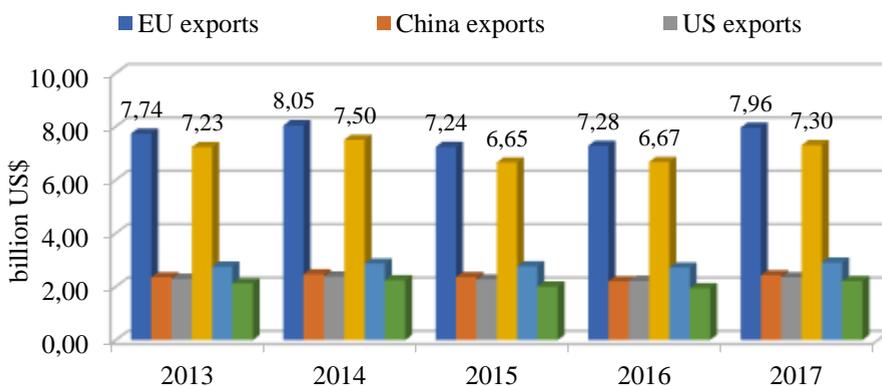
Source: own representation based on The World Bank, World Development Indicators, latest update 24th April 2019

Nevertheless, the European Union is the world's biggest exporter and importer of goods and services between 2013 and 2017 (intra-EU trade is included). In same time, the high level of imports does not stop the European Union for having the largest trade surplus in the world economy.

The European exports of goods and services exceed 8 trillion US\$ in 2014 and, after a short break, it almost reaches the same level in 2017, as it can be observed in Figure 3. Compared to them, the Chinese and the American exports remained below 2.5 trillion US\$ for the whole period 2013-2017. Actually, the European Union exports more than China and United States together, the same situation being met at imports. The European imports of goods and services reached 7.5 trillion US\$ in 2014 and have reduced below 7 trillion in next two years. But, in 2017, the European Union imported goods and services on amount of 7.3 trillion US\$. On the other side, the American imports has situated between 2.7 trillion US\$ and 3 trillion US\$ and the Chinese ones never exceeded 2.3 trillion US\$ in the analyzed period.

Even though the European imports were at high levels, the European Union had the largest trade surplus in the world economy. Its trade surplus reached 500 billion US\$ in 2013 and continued to grow next years, exceeded 600 billion US\$ in 2016. Moreover, in 2017, the European trade surplus amounted almost 655 billion US\$, being three times bigger than the Chinese one, China being the second country in the world according to trade surplus. Compared to both of them, the United States recorded only trade deficit, growing from 461 billion US\$ in 2013 to almost 550 billion US\$ in 2017.

Figure 3. The world`s top 3 largest exporters and importers between 2013-2017 (billion US)



Source: own representation based on The World Bank, World Development Indicators, latest update 24th April 2019.

4.2. Convergence of Member States - Possible repercussions for the global economic position

Despite of these, the European Union has some weaknesses related to annual GDP growth, inflation at consumer prices and unemployment.

The annual GDP growth is relatively low compared with other economic powers of the world, as it can be seen in Table 1. In this table we have selected the countries with the highest level of annual GDP growth. The European economy grew with 0.26% in 2013 and with 1.78% in 2014 compared with previous years, while in 2013 all countries represented in Table 1 had an annual growth of GDP higher than the European one. In 2014, the European Union succeeded to surpass Japan.

The European annual growth rates of GDP were higher between 2015 and 2017, surpassing 2% every year. But these numbers remain relatively low compared with other economic powers. For example, the Chinese economy, which had an annual GDP growth higher than 7% before 2014, maintained an economic growth between 6.7% and 6.9% in 2015-2017.

In fact, besides Japan, the European Union surpassed Canada in 2015 related to GDP annual growth, while in 2016 the United States added to them. From all of these, only Canada succeeded to return in a better position after an almost 3% growth rate in 2017 compared with the European one.

Table 1. Gross Domestic Product annual growth (%)

Year	2013	2014	2015	2016	2017
China	7.76	7.30	6.90	6.70	6.90
Israel	4.14	3.90	2.57	4.01	3.44
South Korea	2.90	3.34	2.79	2.93	3.06
Canada	2.48	2.86	1.00	1.41	3.05
EU 28	0.26	1.78	2.35	2.04	2.46
United States	1.84	2.45	2.88	1.57	2.22
Japan	2.00	0.37	1.35	0.94	1.73

Source: own representation based on The World Bank, World Development Indicators, latest update 24th April 2019.

Regarding inflation at consumer prices, the European Union has recorded a downward trend until 2015, becoming negative in this year, as it can be observed in Table 2. In 2013, the inflation rate was 1.3%, almost the same with the one recorded in South Korea, but worst positioned at international level than the Japanese and the Canadian ones. The gap was recovered over the next three years. In 2014 and 2016, the European inflation rate was almost the same, respectively 0.22%, positioning the European Union very well among other economic powers.

But, this performance did not last for a long time. First of all, the European inflation rate continued the upward trend started in 2016 and reached almost 1.5% by the end of 2017. Secondly, Japan, which in 2016 has an inflation rate of -0.12%, was better positioned than the European Union in 2017 with an inflation rate of almost 0.5%. Thirdly, Israel has improved its negative inflation rates from 0.64% and -0.54% in 2015-2016 to 0.24% in 2017, being the best placed at international level. Nevertheless, the European inflation rates remain at optimal parameters compared with the Chinese or the American ones.

Table 2. Inflation at consumer prices (annual %)

Year	2013	2014	2015	2016	2017
Israel	1.57	0.49	-0.63	-0.54	0.24
Japan	0.35	2.76	0.79	-0.12	0.47
EU 28	1.31	0.22	-0.05	0.22	1.47
China	2.62	1.92	1.44	2.00	1.59
Canada	0.94	1.91	1.13	1.43	1.60
South Korea	1.30	1.27	0.71	0.97	1.94
United States	1.46	1.62	0.12	1.26	2.13

Source: own representation based on The World Bank, World Development Indicators, latest update 24th April 2019.

On the other hand, the unemployment situation in the European Union is not as good as the inflation rate one. Even though the unemployment has improved, decreasing from rates above 10% in 2013 and 2014 to 7.6% in 2017, it has remained at higher levels compared to other economic powers.

Table 3 shows that the European unemployment rates were the biggest among the economic powers in 2013 and 2014 and the only ones above 10%.

Despite the performance of reducing the level of unemployment over the next years, the unemployment in the European Union remained high. The European Union recorded the highest unemployment rate during the entire period under review. The best performances related to unemployment were recorded in Japan and South Korea with rates below 4%.

Table 3. Unemployment (% of total labor force)

Year	2013	2014	2015	2016	2017
Japan	4.00	3.60	3.40	3.10	2.80
South Korea	3.10	3.50	3.60	3.70	3.70
Israel	6.21	5.89	5.25	4.80	4.22
United States	7.38	6.17	5.28	4.87	4.36
China	4.60	4.60	4.60	4.50	4.40
Canada	7.07	6.91	6.91	7.00	6.34
EU 28	10.82	10.21	9.38	8.53	7.61

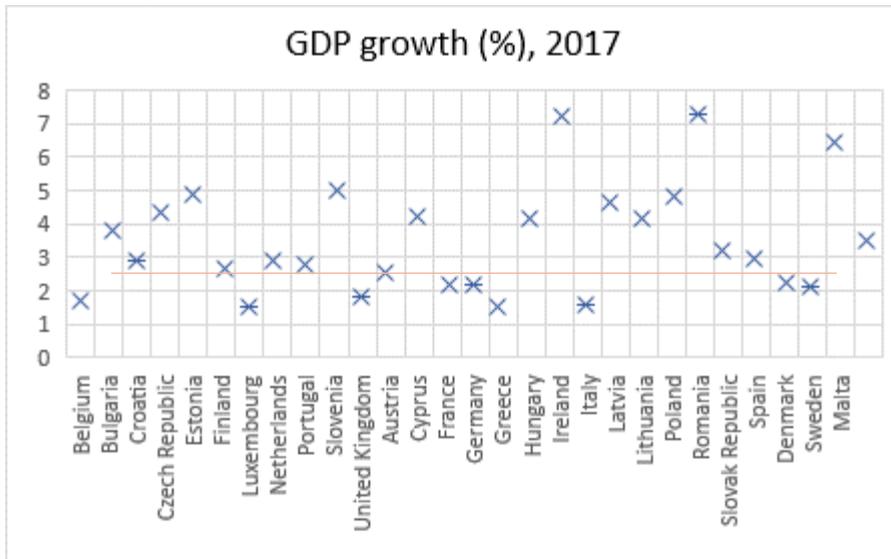
Source: own representation based on The World Bank, World Development Indicators, latest update 24th April 2019.

In the following, we consider it appropriate to conduct an analysis of the European Union to see what causes this modest ranking in the international charts of the three indicators. When a state accedes to the European Union, it assumes that it will do its utmost to keep its economy moving towards convergence with that of other Member States. If we want to deepen the integration process, move towards a monetary union that will include all the EU Member States, then a fiscal union, and ultimately a political union on the model of the United States of America, we must assume that the economies of all Member States need to synchronize. In a united Europe, we need to talk about a single economy that characterizes the entire European area.

Unfortunately, the policy of small steps adopted by the European Union does not stimulate states to cross the national barrier and to advance for the good and prosperity of the whole of the Union. Even now, states are reluctant to adopt common economic measures, and if they are adopted, they are often

not respected. The national interest of the Member States outweighs the common interest of the Union.

Figure 4. GDP growth in European Union in 2017



Source: own representation based on The World Bank, World Development Indicators, latest update 24th April 2019.

Over time, states have been urged to aim for a convergence of the economy through various measures. First of all, we are talking about the economic criteria imposed on pre-accession countries, different European economic or financial policies, and the Maastricht Treaty, which sets out the criteria for joining the European Monetary Union.

For this analysis, we chose 2017 as a reference in order to see an X-ray of the present situation within the European Union.

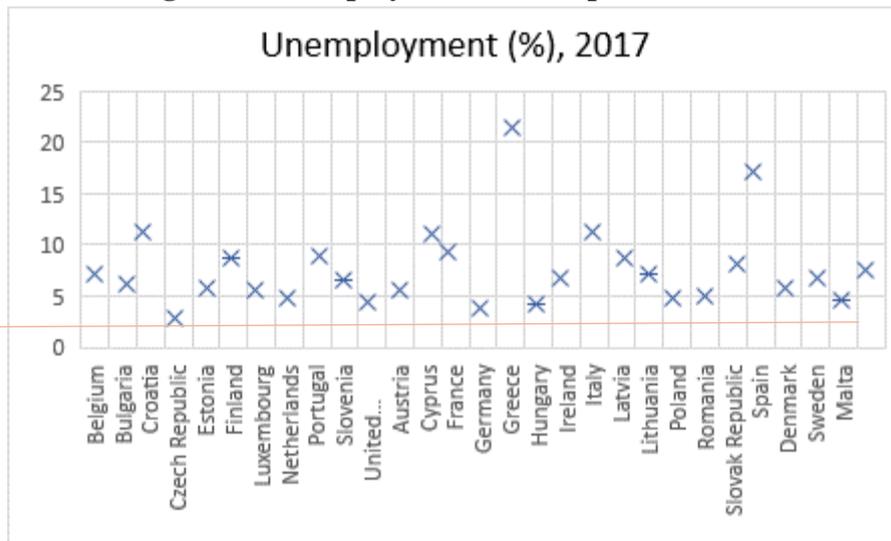
As we can see from Figure 4, the first indicator studied is GDP growth. As we have seen before, it is an indicator that pulls the European Union out of the international charts. According to the World Bank data, the EU average is 3.49%. From Figure 4, we can see that the distribution of the GDP growth rate in the Member States of the European Union in 2017 is relatively homogeneous. We have 16 states that have a GDP growth rate below the Union average and 12 states that exceed the average. The range in which GDP

growth rates fluctuate among Member States is 1.51% - 7.26%. Note that most of the mumble states have a rate that fluctuates by up to 2 percentage points from the average. Only Ireland, Romania and Malta, with a much higher than average GDP growth rate, are noted.

Applying the Sigma test on the GDP growth rate we reached a percentage change of 47.36%. In order to be able to say that an indicator has reached convergence in the case of a union, the percentage of variation must be 0 or close to 0. In the case of the GDP growth rate, we can say that it is not close to convergence. As we could see, there are significant differences between states. On the one hand we have Ireland and Romania with a marked increase in GDP and countries such as Greece and Luxembourg, where the growth is lower.

For a healthy economy, GDP growth rates need to be real, based on economic growth, not just on widening social spending.

Figure 5. Unemployment in European Union in 2017



Source: own representation based on The World Bank, World Development Indicators, latest update 24th April 2019.

Unemployment rate is another problem indicator for the European Union. In Figure 5, we can see the unemployment rate in the European Union

Member States in 2017. This year, the average unemployment rate in the European Union was 7.61%. As we can see, the rate at which the unemployment rate fluctuates within the union is: 2.89% - 21.49%.

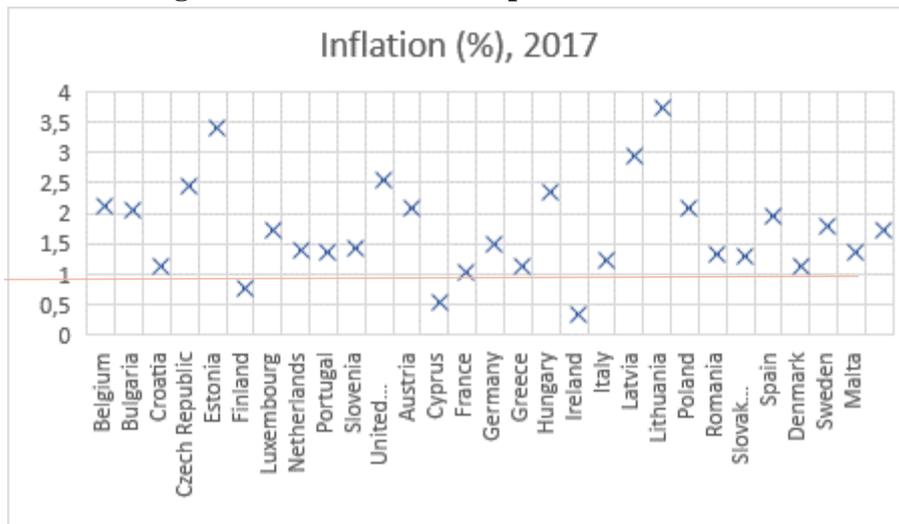
Greece and Spain are the countries that stand out with an unemployment rate of over 15%. The high unemployment rate in the two countries comes amid the 2008 financial crisis and the Eurozone crisis. Both countries have a high economic risk.

If the two countries are to be eliminated, the rate at which the unemployment rate fluctuates is: 2.89% - 11.21%. And under these conditions the range is quite large, about 5 percentage points below average and 4 over it. This range confirms that as far as the unemployment rate is concerned, states still do not tend towards convergence. However, the European Union, through the Europe 2020 Strategy, has proposed to eliminate these differences between states. At the same time, the increase in employability is also mentioned in the monetary policy of the euro area.

In the context of massive migration in the European Union, both immigrants from outside the community and internal migration, states are leading a fierce fight to reduce the unemployment rate. Let us not forget that around the migration and the possibility of increasing national unemployment, Britain has chosen to leave the European Union.

According to the Sigma convergence test, the percentage of convergence variation is 53.31%, which indicates that in 2017, the unemployment rate did not tend towards convergence. In order for an indicator to tend towards convergence, the variation rate must be close to 0. As we have seen before, there are discrepancies in the value of the unemployment rate between the Member States of the European Union.

As mentioned earlier, the next step in the deepening of the Union is the accession of all the Member States of the European Union to the Eurozone. The main objective of optimal monetary policy is price stability. This objective has its origins in Article 127 (1) of the Maastricht Treaty (EUR-Lex, 1992). 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.

Figure 6. Inflation in European Union in 2017

Source: own representation based on The World Bank, World Development Indicators, latest update 24th April 2019.

However, in order of priorities, price stability is the most important objective. The Maastricht Treaty establishes that monetary stability will achieve a high rate of employment and a favorable economic environment through price stability. Maintaining stable prices on the basis of coherent policy is the basis of harmonious economic development. Given that monetary policy can affect real short-term activity, the European Central Bank needs to control excessive fluctuations in output and employment (European Central Bank, 2019). Price stability contributes to a high level of economic development and a high level of employment within the Union. 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 & de Haan, 2000, p. 64)

According to Figure 6, in 2017, the average inflation rate in the European Union was 1.72%. We can see that at the level of the European Union, the inflation rate ranges from 0.34% to 3.72%. If we limit ourselves to the margins of monetary policy, the inflation rate does not exceed 2%, 10 non-respecting Member States fall into this situation. Among countries with

an inflation of over 2%, we find: Belgium, Bulgaria, Czech Republic, Estonia, Great Britain, Austria, Hungary, Latvia, Lithuania and Poland. In this category, we find states both in the West and in the rest of Europe. Disparities between states arise as a result of the promotion of national interests, to the detriment of the European ones. Governors prefer to borrow, increase public spending in the social sphere, and pump money into the economy to attract their electorate on their side.

According to the Sigma test, even in the case of the inflation rate we cannot speak of convergence. The percentage of inflation rate change in 2017 is 47.19%.

5. Conclusions

Based on the analysis we made, we reached a series of conclusions:

There are different ways to quantify power and to analyze the economic powers in the world economy. In this study, we want to look if there is a correlation between the economic power status of the European Union and the economic convergence among the European Union states. The first part of this study demonstrates that the European Union is a great economic power at international level, being in the World's Top 3 largest economies related to Gross Domestic Product based on purchasing power parity, with a high GDP per capita and the world's biggest exporter and importer of goods and services between 2013 and 2017. Also, even though the European imports were at high levels, the European Union had the largest trade surplus in the world economy. Despite these performances, the European economy has some weaknesses due to discrepancies between Member States.

The three indicators analyzed: GDP growth, unemployment and inflation position the European Union outside the world rankings and, in some situations, in a worst position compared to other economic powers. At the same time, we have seen that within the European Union, Member States are far from tending towards the convergence of these indicators. This lack of convergence can be considered a possible cause of the European Union's inability to position itself in a leading position worldwide with these indicators.

European Union Member States put the national interest first, then the interest of the whole union. The political parties in the government are primarily aimed at attracting the electorate to win new mandates. They believe that if the state faces various economic difficulties, it will be "saved" by the rest of the Member States.

The lack of economic convergence of the Member States of the European Union led to a decrease in the influence of the European Union at the global level. The existence of economic development discrepancies slows down the overall economic growth rate of the union. Even though we have not determined the intensity with which the global economic position of the European Union is influenced by this article, as we follow the convergence trend of the Member States, we consider that this is only the starting point of a much broader future paper on this subject.

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