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THE RIGHT MOMENT FOR ENTERING THE REGIONAL INTEGRATION

Abstract*: The complex of problems associated with the right momentum of the country's entry into the regional integration is investigated in the article. From the theoretical point of the view, Mundel's optimum currency areas, various criteria must be met. Interestingly, the higher the level of fulfilment of the criteria, the greater the benefits of the integration, and the lower the costs of integration. It means that the country will be ready to join the regional integration only if it changes the structure of the economy (relying on the intra-industry trade and through technologically more intensive production process) and adapts to the competitive market, accepting a profound reform of public administration (i.e. the existence of efficient and effective institutions). Contrarily, economy will be faced with unfavourable and imposed deflationary adjustment process that will reduce GDP, rise unemployment rate and increase public debt as well as decrease wages. For the new members, the EU insists on the coordination and synchronisation of economic policies within the integration. The higher degree of integration (five degrees of integration by Balassa), the higher the coordination of economic policies within the integration. Therefore, each country should improve the economy and harmonise policies to make the adjustment process in the EU easier and cheaper. By achieving these goals, Serbia and Ukraine are to be realized greater benefits than costs in the future.*

Keys*: economic integration, EU, intra-industry trade*
JEL Classification*: F31, F33*

Introduction. This paper surveys the goals that country have to reach accepting criteria of the optimum currency area (OCA) and as much as possible higher degree of integration. The theory of OCA suggested serious concerns about the euro project. Entering the regional integration, like EU, the country gets benefits from a fixed exchange rate regime, but also from low transaction costs, lower inflation, larger market, the smaller impact of speculative capital, etc. On the other hand, the costs are reflected mostly in the loss of two important economic policies – monetary policy and exchange rate policy. This means that the process of adjustment is only possible with measures of fiscal policy [4], [2]. But there are constraints in using fiscal measures for EU members, which are more painful for smaller countries than for large ones. The government has no ability to use fiscal measures for increasing economic growth and reducing unemployment. The use of expansionary fiscal measures for stimulating the economy could affect the increase of prices and loss of competitiveness. Simultaneously, the mechanisms of foreign trade would not be fully manifested. This means that only coordinated fiscal action by all members can give expected positive results [11].

There are some structural differences among EU countries, but they can be managed overtime and optimal conditions can be achieved [10]. Such process requires a longer period. But the Maastricht convergence criteria (Price stability; Stability in public finance; Participation in the exchange rate mechanism of the European Monetary System; and Convergence of long-term interest rates) aren't the best solution because they are more concerned with examining transitory cyclical movements in financial indicators, rather than concentrating on fundamental convergence in real economy [17]. The evidence shows that the lack of enforcement of the 'convergence criteria' led to an unsustainable macroeconomic situation in the EU. This is because the achievement of convergence depends on particularly certain institutional and structural features and the degree of development of market mechanisms [9], [16], [6], [8].

The Optimal Currency Area VS Maastricht convergence criteria

In graph 1 we've showed the critical level of regional integration considering costs and benefits of regional integration. The benefit curve, BB curve, has a positive slope suggesting that the higher degree of economic integration, the higher the benefits of access to the integration, and vice versa. The cost curve, CC curve, has a negative slope showing that the costs of access to the currency area are reduced with a higher degree of economic integration, and vice versa. The intersection of two curves implies a critical level of integration in which the benefits and the costs of integration are equal.

Although the EU is (not) successful integration, there were numerous problems that have shown the real face during the global economic crisis in numerous countries [13] – such as Italy, Spain, Ireland and Greece. What is the reason that EU slid into problems? The problem lies in the divergence of the current EU concept of the fundamental concept of the optimum currency areas. Mundel [12] explained the process of integration of the countries in the economic area under the condition that the key criteria (1. Labour mobility, 2. Openness, 3. Diversification, and 4. Financial integration) must be fulfilled. The advantages of a common currency are obvious, but hardly measurable: reduced transaction costs, elimination of currency risk, greater transparency and possibly greater competition since prices are easier to compare. Contrarily, the disadvantages of a single currency come from loss of flexibility and the loss of a mechanism for adjustment.

Looking the member states according to the degree of development, there is a difference in obtaining benefits and covering the costs of regional integration. Small and underdeveloped countries have far more macro-economic problems whereas the effects of market mechanisms are less manifested within the economy. Hence, the entry of these countries in regional integration is doomed to failure – the costs overcome the benefits and deflationary adjustment process would be imposed.

The EU has achieved the last three criteria, but not the first one [11], perhaps the most important one for regional integration and the member states. The degree of openness is related to the intensity of international trade. The larger intension of trade allows small changes in prices that may affect the relative prices of export and import and lead to a new equilibrium. Also, growing diversification reduces pressure instability of export revenue. Simultaneously, diversified production gives greater price stability and increases employment in the economy. Finally, a greater financial integration allows small changes in interest rates contributing to higher capital movements and positive effects on the equilibrium of the balance of payments. But, the EU is faced with the problem of Labour mobility [14]. When the country is faced with external imbalance in the form of reduced exports (current account deficit) the balance can be reached only through a deflationary adjustment mechanism – reducing the cost and the output and increasing the unemployment. Costs will be reduced only if there is a high mobility of workers. In the EU, until recently, there was almost no possibility for a country with a higher labour demand to accept workers from other countries of the integration, who are faced with excess labour supply.

The convergence criteria are more concerned with examining transitory cyclical movements in financial indicators, rather than concentrating on fundamental convergence in real economy. The evidence shows that the lack of enforcement of the 'convergence criteria' led to an unsustainable macroeconomic situation in the EU. This is because the achievement of convergence depends on particularly certain institutional and structural features and the degree of development of market mechanisms [14].

The EU is located between 4th and 5th stage of integration in conformity with Balassa's theory [1], but with some great mistakes due to the political decision which neglected the theory of integration [7]. European countries started with Free Trade Agreement, in the second stage continued with the common market, followed by the mobility of production factors in the third stage. With the fourth phase, economic union included the harmonization of economic policies. Finally, in the fifth stage, the full economic union requested the full integration of economic policies, which is still not feasible for the EU.

Intra-industry trade (IIT)

The structure of production and trade is the key element in the integration. Only if the country has adapted the structure of commodity trade to the trade structure of the integration, the benefits could be expected. For example, the creation of the common currency euro produces an increase IIT in Euro Area (70% of total trade). The advantage is that the trade of these types of products (medium technical intensive and highly technical intensive) brings about the growth of the economy in the medium and long term.

In any given country, the economic structure has to be transformed by introducing diversified products in the export assortment [14]. The benefit would be even greater if country will be able to produce technologically higher level, which provide a greater volume of the IIT, rise a comparative advantage [5] and reduce the costs of adaptation to the current international trade structure [3].

Conclusion

Only full compliance with these criteria can guarantee progress and integration of all economies individually including the fulfilment of the catch-up process. This means that only coordinated policies by all members can give expected positive results for a whole integration.

The situation was partly improved with the changes that related to the criteria (new amendments of the Stability Pact and Growth; signed Euro Program Pact in 2011; formed European Financial Stability Facility in 2010; activated the European Stability Mechanism); what turned out were good decisions! It took several years to discover the deficiencies of the convergence criteria. We can expect that integration problems will be overcome the following solutions.

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