



A Theoretical View of the Current Situation on Economic Integration in the EU Countries that are not Part of the Eurozone

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Abstract

The European Union (EU) has developed dramatically in the last two decades as new member nations have joined. Since the establishment of the EU Single Market, the number of EU member states has increased from 12 to 28 (27 after Brexit). The process of European Union integration of the countries of Southeast Europe has brought a lot of progress, but again the real convergence in terms of real GDP per capita remains a current challenge. In this paper, we will look at the main types of integrations that embrace different countries in different situations. One of the most important processes that affect the economic development of these countries is economic integration. During this process, member countries agree to coordinate their trade and fiscal/monetary policies.

Keywords: Maastricht criteria, Copenhagen criteria, political integration, economic integration, ERM II.

1. Introduction

The European Union (EU) has developed dramatically in the last two decades as new member nations have joined. Since the establishment of the EU Single Market, the number of EU member states has increased from 12 to 28 (27 after Brexit).

European Union serves member countries as a means for coping with globalization challenges and achieving greater prosperity and wealth. According to Mussa (2000), the main goal of the European Union is to create conditions for economic union by reducing various tariffs. In addition to an integration in the economic sphere, this union has at its core to clarify the economic relations between the countries. Most of the EU countries use as an official currency the euro. Most of the countries that are part of the EU have adopted the euro as an official currency¹. The financial and economic crisis of 2008-2009, as well as the euro-area sovereign debt crisis, showed certain flaws in the Economic and Monetary Union's (EMU) economic governance framework. To ensure the EMU's long-term viability, the Union's economic governance has been strengthened overall.

¹ ec.europa.eu

2. Copenhagen and Maastricht criteria for EU membership

The Copenhagen criteria are the first criteria that candidate countries should fulfill to become a member state: *The Copenhagen criteria* include a number of criteria that are focused on the political field, such as guaranteeing democracy and enforcing the law; the economic field which focuses on respecting competition; as well as administrative criteria aimed at adapting the capacities of the administration to those of the EU.

During the association process, the EU has the right to decide when a country is ready to be part of this Union and to monitor the fulfillment of the criteria. While the Maastricht criteria may be met throughout accession negotiations, the Copenhagen criteria of democratic governance, norms, and democratic values are absolute requirements that any applicant must meet at a satisfactory level before becoming an EU member. If a country becomes part of the European Union, then according to the regulation the central banks of these countries must be included in the European System of Central Banks (ESCB). Some other criteria that must be met are included in the group of economic ones and are classified as follow:

1. Inflation rates that are not more than 1.5 percent higher than the rates of the three best-performing Eurozone countries to ensure a high level of price stability;
2. Interest rates for the long-term are no more than 2% higher than those of the three best-performing Member States;
3. For two years before adopting the single currency - Euro, exchange rate variations must be within the exchange rate mechanism's allowable range;
4. Budget deficits must not exceed 3% of GDP, and overall public debt must not exceed 60% of GDP.

3. Economic integration stages

Economic integration can be divided into five stages, according to the literature (Balasa, 1960):

1. Zone of free trade
2. Union of customs
3. A unified market
4. The European Economic and Monetary Union
5. The final stage corresponds to political union².

A free trade agreement (FTA) allows two states to reduce or eliminate customs taxes on their internal borders. A free trade area is a form of trade bloc made up of nations that have agreed to abolish tariffs and restrictions on goods traded between them.

A common market brings the unification of economic policies (tax, social welfare benefits, etc.). A single market supports the free movement of all production factors between countries, resulting in more effective allocation of resources and increased output.

Consumers have a lot of benefits from the single market because the competitive environment brings them more types of products and services accompanied by lower prices. Furthermore, businesses competing in the market will innovate to offer new items, which will benefit customers.

The next stage, after complete economic integration, includes the harmonization of fiscal policy and monetary union (Table 1).

Table 1: Stages of Economic Integration

Stage of economic integration	Diminishing trade barriers	Setting up common external tariffs	Freedom of movement of factors of production	Common currency and economic policy	Integration in non-economic areas (like common foreign affairs)
A free trade area	X				
A customs union	X	X			
A common market	X	X	X		
An economic and monetary union	X	X	X	X	
Complete economic integration	X	X	X	X	X

Source: Balassa (1960)

² The degree of economic policy unification varies, with the political union being the most unified.

The most debated situation recently is the discussion on the accession of candidate countries to the European Union, the degree of fulfillment of EU-set criteria as well as the economic relations between these countries. Economic integration has the potential to promote the development of financial institutions (Ehigiamusoe and Lean, 2018), capital accumulation, productivity, and economic growth. Economic integration has several important channels through which it affects the region's economic growth³: banking and financial sector of the economy, improving exports and imports, and macroeconomic development. The fifth kind is the Economic and Monetary Union, which has as its primary purpose the coordination of economic policy among member countries.

According to a study conducted by Konig (2015), since 1993 when the European Economic Market was first created, the EU has more than double the number of countries it had at the beginning. The biggest turmoil the European Union has faced is the decision of a superpower like the UK to leave the Union. Following Britain's decision not to be part of the European family, political pressure increased in some member states to leave the EU. This political situation raises doubts about the long-term economic benefits of economic unions for member states.

Productivity disparities and rising trade inequalities between member nations, a lack of fiscal and financial union, and the combined central bank's limited power are only a few of the challenges. As a result, in recent decades, several developing and rising economies have begun a rapid financial integration process. This is because financial integration can promote capital allocation, production specialization, international consumption risk-sharing, and economic growth⁴. It has been proven in many studies that economic growth is stimulated by one country's financial integration with other countries. Financial integration brings about increased productivity of production factors through efficiency in resource allocation and expansion of investment opportunities⁵.

Moreover, financial integration can speed up the development and operation of the domestic financial sector, as well as promote greater foreign investment and faster economic growth, by increasing competition and allowing for the import of financial services⁶. The notion and creation of economic integration were not firstborn in Europe. To see the link of economic integration to countries outside the European continent, various theoretical and empirical research has concentrated on the idea that economic federations built in Europe, Asia, Africa, and Latin America offer to member nation's economic benefits for a long-term period. As a result, the following are the study's objectives: firstly, a review of recent research on the relationship between economic integration and the expansion of the economy will be conducted, and secondly find the latest macroeconomic data about economic growth in the last ten EU member states.

4. Economic Integration

Economic integration is a process that happens across neighboring nations over the world. Economic integration helps markets to easily expand and as a consequence, people increase their purchasing power and this helps the economy to grow. The unification of certain economics into one single category to create a larger and unified economy is known as the process of economic integration⁷.

- Economic integration and cooperation.
- Economic and political integration.
- Economic integration and globalization.
- Economic integration and firm integration.

5. How to understand economic integration

Economic integration is a complex issue that stimulates economic growth through financial integration. For economic development assumed that trade integration and financial integration can work together to stimulate more growth.

The liberalization of emerging market countries offers a new opportunity for investors to diversify their portfolios and increase their profit. All developed countries have already completed this process of liberalization, whereas growing countries must go through a series of adjustments. According to the experts, if a country has some barriers and does not allow other countries to enter, this makes difficult economic integration. Tax laws, foreign investment limitations, legal

³ www.economics-ejournal.org

⁴ Acemoglu & Zilibotti, (1997); Gehringer, (2015); Obstfeld, (1994); Saafi et al., (2016).

⁵ Gehringer, (2013); Giannett et al. (2002).

⁶ Klein & Olivei, (2008); Levine, (2001).

⁷ e-jei.org

challenges, and accounting requirements are all examples of barriers⁸ that make it difficult or impossible to enter the country.

The following are the key benefits of the European Union:

- The free market, which refers to the unrestricted movement of commodities and services from one location to another.
- The Member States' Customs Union, which implies the elimination of customs barriers between EU countries and the adaptation of preferential tariff policies with other countries.
- The single market, which, aside from the aforementioned, comprises facilitating conditions for starting a business in each of the member countries.
- The economic and monetary union represents the final step of reaching a union of a country. The foregoing, as well as the usage of a common currency (Euro), is referred to as the Economic and Monetary Union (EMU).

Regarding the last point (EMU) it should be that not all member countries have found it reasonable to drop their currencies from their country and support the euro (this part will be further explained when we talk about the advantages and disadvantages of the use of the euro as official currency)⁹.

Currently the list of countries in the Euro Area¹⁰ includes: Finland, Estonia, Latvia, Lithuania, Ireland, Netherlands, Belgium, Luxemburg, Germany, Slovakia, Austria, Slovenia, France, Italy, Greece, Spain, Portugal, Malta, and Cyprus (ordered north-to-south)¹¹. The remaining European Union countries use their currencies: United Kingdom, Denmark, Sweden, Czech Republic, Poland, Croatia, Hungary, Romania, and Bulgaria (west-to-east). The exceptions being the United Kingdom and Denmark, which have a permanent opt-out. To make things complicated: some countries use the Euro as a sole legal tender but are neither in the European Union nor in the Euro Area. Some use the Euro with the consent of the EU - Vatican, Monaco, San Marino, and Andorra. Some other countries as Monte Negro and Kosovo started to use the Euro without asking anybody.

6. The European Union organization

The difficulties of organized the European Union is not that there are 27 countries, but it emphasizes the difficulties that may arise because of to make unanimous decisions on certain issues. For this reason, the European Union has a sound organizational structure composed of legislative, executive, judicial, and economic institutions. From 1 January 2001, the European Agreements' (EAs) trade provisions established a free trade area (FTA) encompassing the EU and the CEECs. The specific provisions and timelines of CEEC EAs' transition to free trade in industrial products vary, but several key points are consistent. The economic growth that was the main feature of the European Union, this union was engulfed by numerous waves of enlargement with new member states. The trade liberalization process began in the 1960s, and the first EU enlargement occurred in 1973 (with the accession of three countries). In the 1980s, more countries joined the EU (Greece, Spain, and Portugal), followed by a development of the Single Market program. This was followed by another extension (Austria, Finland, and Sweden) and the adoption of the single currency and the creation of the monetary union. Some other enlargements followed: Bulgaria in 2004, Romania in 2007, and finally Croatia in 2013).

Some of the CEE accession countries have made progress on the road of EU. This country strengthens and stabilizing its economies and institutions. In the process of leaving the central plan economy, the candidate countries carried out ambitious structural reforms. Although differences in income levels are not incompatible with EU and even EMU membership, accession countries need to increase real convergence. True economic integration is necessary to build economic cohesion in the European Union and the European Monetary Union because it promotes integration among member states. Help minimize the risk and impact of asymmetric shocks, which will benefit candidate countries. Albania, Bosnia, and Herzegovina are in the waiting room on the way to becoming EU candidates, while Kosovo is still in limbo.

Population growth has an inverse relationship with the GDP per capita. This means that if other things being equal, the lower the population the higher the GDP per capita in the EU region. The same author also points out that the form of government of a country, if it's a democratic government, has a positive impact on GDP growth per capita in that country.

According to the quantitative analysis by Kim, Hewings, and Nam (2014), taking into account the overpopulation of the Seoul Metropolitan Area, we can say that higher population concentration contributes to lower economic growth.

⁸<https://theintactone.com/2019/07/06/fms-u1-topic-6-financial-liberation-theory/>

⁹<https://www.quora.com/What-is-the-difference-between-the-European-Union-and-Eurozone>

¹⁰ European Union Committee, 1st Report of Session 2014-2015

¹¹ Central Banks of UK, Denmark, Sweden, Czech Republic, Poland, Croatia, Hungary, Romania, Bulgaria

According to Dao (2012), population growth has a negative impact on per capita income.

Inflation is one of the most important variables that affect GDP per capita. According to many studies, inflation and GDP per capita are correlated and there is a positive relationship. Early research inferred that the effects of integration on growth were mediated through integration's effects on commerce.

The early literature inferred that the effects of integration on growth worked through the effects of integration on trade Baldwin and Seghezza (1996). Economic integration as a concept was born long ago, debates about the effect that integration has on the economic growth of the various countries that are part of this integration are also old. The effects of economic integration in countries that have roughly the same per capita income values are followed by technological developments especially through innovative ideas and R&D (Rivera-Batiz and Romer, 1991). A very important issue that often draws the attention of experts in the different types of integration, because each has its characteristics. The various economic agreements that are signed between different countries can be introduced into the type of "institutional integration" to distinguish it from the political integration process, which left other features and is deeper as a process.

According to Cappelen et al. (2003), was examined the impact of EU regional support on economic growth and convergence in the EU region. According to these studies, the economic benefit is larger in more developed countries, implying that receiving countries' policies help to strengthen integration's influence on growth. Cuaresma et al. (2008) used panel data methodologies to investigate the effects of European integration on long-run growth in 15 EU states. According to the study, the term EU membership has a favorable effect on growth, with the benefit being stronger in poorer countries.

The Commission's decisions increase enterprise and its efficiency, produce different types of goods and services, and helps reduce prices and improve quality. The Commission uses instruments of competition policy and market experience to help the Union achieve its goals of jobs, growth, and investment including fields of energy, financial and industrial services, etc. The Commission pursues effective enforcement of competition rules in the areas of antitrust and mergers, and state aid adapt the tools of competition to market developments. To encourage competition and economic growth, the European Commission follows a strict economic as well as a legal approach. Competition policy is needed because it:

- Offers low prices to everyone: Offering the best pricing is the quickest approach for a company to achieve a substantial market share. This helps the consumers and businesses at the same time. The policy of low prices encourages consumers to buy what they want, and on the other side encourages businesses to produce and to help the economy to grow.
- Increase innovation: To produce better products, businesses need to be competitive— in what they produce, production techniques, services they offer, etc.
- High level of competition in global markets: this helps the businesses being stronger outside the EU — and to be more and stronger against global competitors.
- Several empirical investigations showed that economic integration has a negative impact on income disparity. Membership in a large family such as the European one also has disadvantages that countries should consider:
- The high cost of membership: Becoming a member of the EU does not come cheap. Membership in the EU has a lot of advantages as we listed above, but at the same time to be part of the EU each country should pay a fee for participating.
- Problems with Single currency: Although the EU doesn't require all its members to convert to the Euro, they emphasized it and insist on the use of the Single Currency.

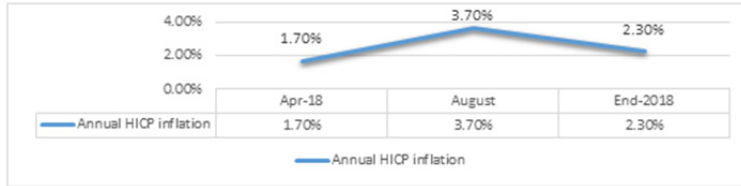
7. Fulfillment of Maastricht criteria.

In this part of the paper is presented an analysis of secondary data obtained from the European Commission Reports for countries that are part of the European Union, but they do not have the euro as their official currency. At the end of this section, we will present a summary of the Maastricht criteria these countries have met and of those they have not yet met.

7.1 Bulgaria

Bulgaria does not fulfill the criterion of price stability. The average inflation rate during 2019 was 2.6%, above the reference value of 1.8%.

Graph 1. Annual HICP inflation

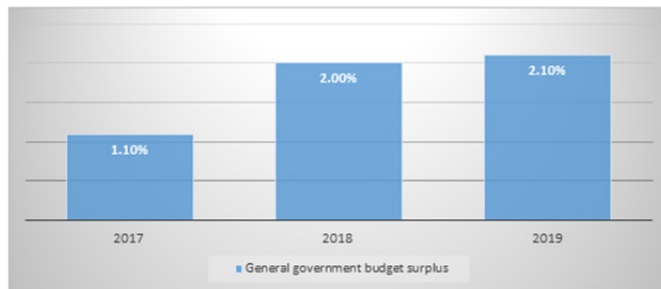


Source: World Bank Indicators 2019

In January 2020 inflation started to rise again, reaching 3.4%. Services inflation was strong, partly due to rapid unit labor cost growth. From January 2020 annual inflation decreased and stood at 2.4% in March 2020.

Bulgaria fulfills the criterion of public finances. The Government budget surplus has increased steadily from year 2017 to year 2019 from 1.1% to 2.1% respectively.

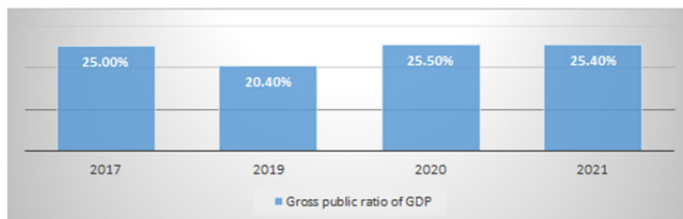
Graph 2. The Government budget surplus



Source: World Bank Indicators 2019

The pandemic caused a deepening of the Bulgarian government deficit by about -2.8% of GDP in 2019, according to the Commission services' Spring 2020 Forecast. As for the government debt ratio, it reached 25% of GDP in 2020 after a decline in 2019.

Graph 3. Gross public debt ratio



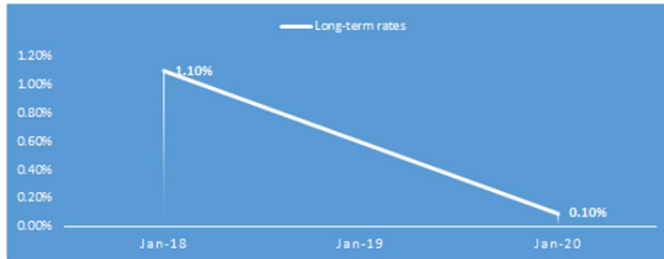
Source: World Bank Indicators 2019

Bulgaria does not fulfill the exchange rate criterion. The national currency of Bulgaria (Lev) is not participating in ERM II. In the context of a Currency Board Arrangement (CBA), the Bulgarian National Bank (BNB) has the responsibility of pursuing its primary goal of price stability through an exchange rate anchor.

Bulgaria fulfills the criterion of the convergence of long-term interest rates. In the year leading up to March

2020, Bulgaria's average long-term interest rate was 0.3 percent, far below the reference figure of 2.9 percent.

Graph 4. Long-term rates

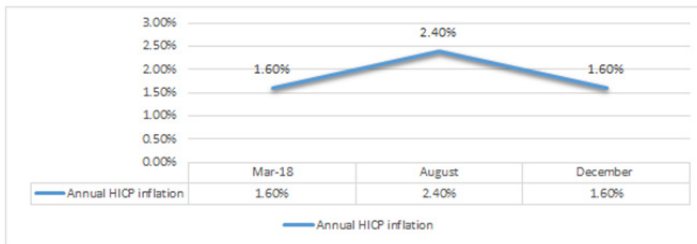


Source: World Bank Indicators 2019

7.2 Czech Republic

Czech Republic does not fulfill price stability criterion. In the 12 months leading up to March 2020, the Czech Republic's average inflation rate was 2.9 percent, far higher above the 1.8 percent reference value. The inflation rate during 2018 and 2019 is 2% and 2.6% respectively in the case of the Czech Republic.

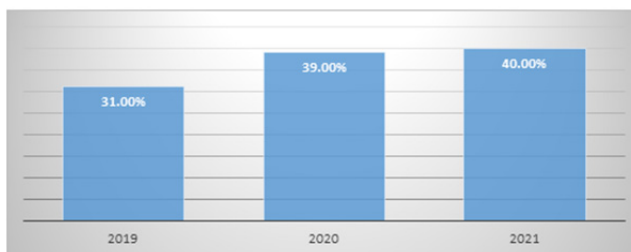
Graph 5. Annual HCIP inflation



Source: World Bank Indicators 2019

The Czech Republic fulfills the criterion of public finances. In 2019, the general government balance was 0.3 % of GDP in surplus.

Graph 6. The Government budget surplus



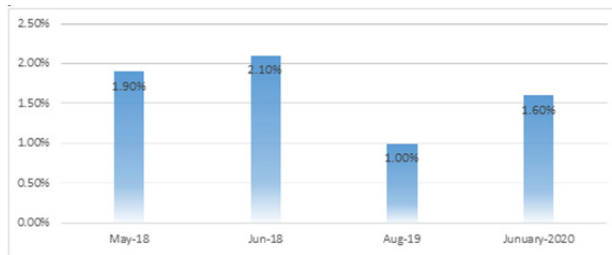
Source: World Bank Indicators 2019

The exchange rate criterion is not fulfilled by the Czech Republic. The Czech Republic follows a floating exchange

rate regime, and this means that the country allows foreign exchange market interventions by the central bank. From 25.7 CZK/EUR in January 2019, it varied in a reasonably narrow area of roughly 1% before declining to 25.9 CZK/EUR in September 2019.

The Czech Republic fulfills the criterion of the long-term interest rates convergence. In the year to March 2020, the Czech Republic's average long-term interest rate was 1.5%, lower than the reference norm of 2.9%.

Graph 7. Long-term interest rates

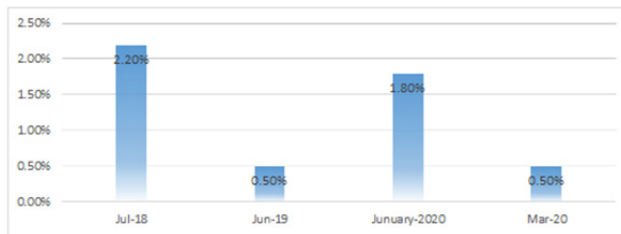


Source: World Bank Indicators 2019

7.3 Croatia

Croatia fulfills the criterion of price stability. During the 12 months to March 2020, the average inflation rate in Croatia was 0.9%, lower than the reference norm of 1.8%.

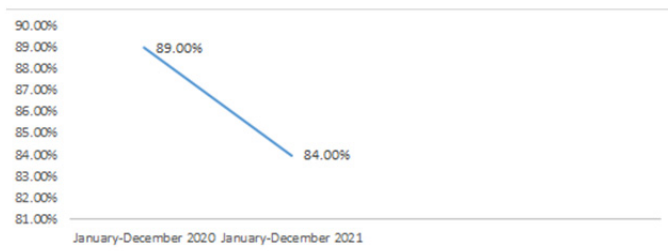
Graph 8. Average inflation rate



Source: World Bank Indicators 2019

Croatia fulfills the criterion of public finances. The government balance was slightly positive at +0.2% of GDP in 2018.

Graph 9. The general government debt



Source: World Bank Indicators 2019

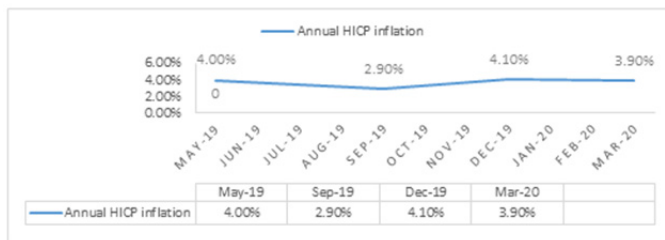
According to the CE report (2020), Croatia does not fulfill the criterion of the exchange rate. As in any other country and in Croatia, the negative effect of the Covid-19 pandemic was felt. The year 2020 brought a devaluation of the Croatian national currency, which fell in March this year to 7.60 HRK / EUR, in a decline which was about 2% compared to 2018. According to the report of the European Commission, the reference value of long-term interest rates for the euro area countries was 2.9%, while Croatia, according to the policy of its Central Bank, reports for 2020 a long-term interest rate of 0.9%.

7.4 Hungary

Hungary does not fulfill the price stability criterion.

The average inflation rate in the case of Hungary, during the last three years has increased 2.8%, 3.4% and 3.7%, respectively for 2018, 2019 and 2020. Due to a significant rise in unprocessed food and energy prices, it grew even more until January 2020, reaching 3.9 percent in March 2020.

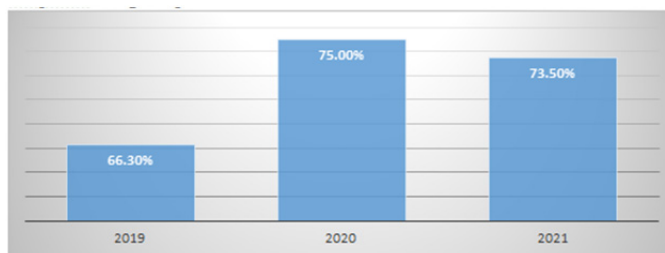
Graph 10. Annual HICP inflation.



Source: World Bank Indicators 2019

Hungary fulfills the criterion of public finances. The general government deficit in 2019 was 2.5 % and decreased to 2.1% of GDP in 2018, and then further to 2.0% in 2019.

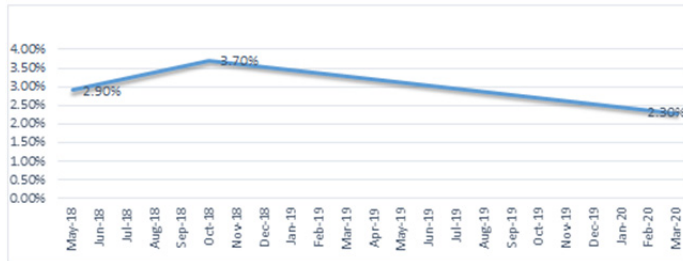
Graph 11. The gross public debt ratio



Source: World Bank Indicators 2019

The Hungarian fiscal system is well-developed, with strict debt control regulations and processes used across all levels of government; yet, the Fiscal Council's role in evaluating and influencing fiscal policy is limited. The Hungarian national currency (forint) is not participating in Exchange Rate Mechanism II. **Hungary fulfills the criterion of the long-term interest rates convergence.** In the year leading up to March 2020, the average long-term interest rate was 2.3 percent, which was lower than the reference norm of 2.9 percent.

Graph 12. The long term interest rate

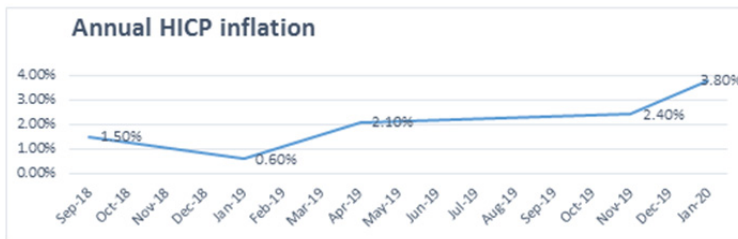


Source: World Bank Indicators 2019

7.5 Poland

Compared to the other countries we analysed above, Poland failed to meet the criterion of keeping inflation below the reference values of 1.8%. During 2020, the average inflation rate is around 2.8%, or 1% more than the average of the three countries with the lowest inflation of EU countries.

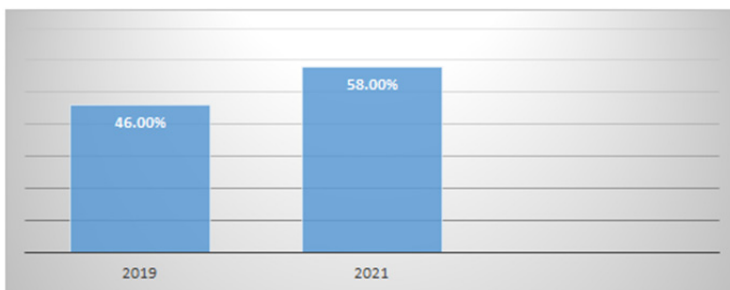
Graph 13. Annual HICP inflation



Source: World Bank Indicators 2019

Poland meets the public-finances criteria. The Polish national currency (zloty) is not participating in Exchange Rate Mechanism II. The only authority allowing all foreign exchange market interventions is the Central Bank of Poland. As a result of a slight economic downturn that Poland went through at the beginning of 2018, the national currency of this country suffered a depreciation and was exchanged approximately PLN / EUR 4.35 (August-September 2019). While in January 2020 the Polish zloty strengthened against the European currency with a rate of 4.25 19 PLN / EUR.

Graph 14. General Government debt ratio



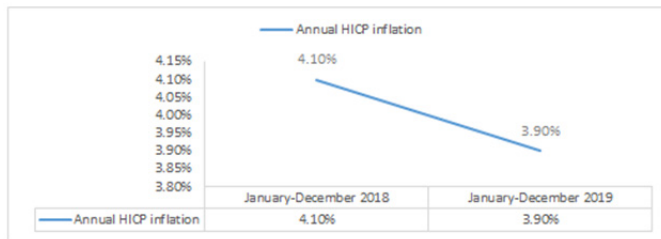
Source: World Bank Indicators 2019

Poland fulfills the criterion of the convergence of long-term interest rates. In the year leading up to March 2020, the average long-term interest rate was 2.2%, which was lower than the reference norm of 2.9%. Between May and November 2018, the monthly average long-term interest rate was about 3.2%, before dropping to 2.7% in early 2019. In the summer of 2019, it fell to approximately 2%, and by March 2020, it had dropped to roughly 1.8%.

7.6 Romania

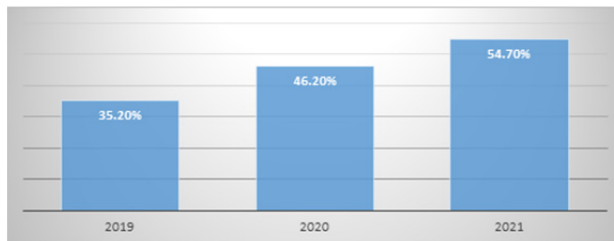
Romania on the other hand as well as Poland had a price instability which was accompanied by an inflation rate above the reference value declared by the European Commission around 1.8%. The average value of inflation in 2020 was about 3.7% or almost twice as much as the reference.

Graph 15. Annual HICP inflation



Source: World Bank Indicators 2019

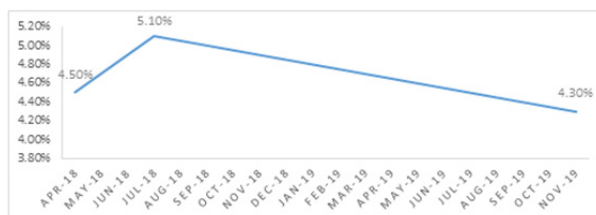
Graph 15. The public debt to GDP ratio



Source: World Bank Indicators 2019

Romania during all this period, operates with a floating exchange rate regime and for this reason, **Romania does not fulfill the exchange rate criterion.** Romania fails to meet the requirement of long-term interest rate convergence. In the year to March 2020, Romania's average long-term interest rate was 4.4%, higher above the reference rate of 2.9%.

Graph 16. Long-term interest rates

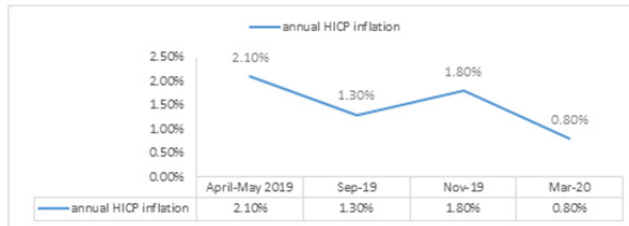


Source: World Bank Indicators 2019

Sweden

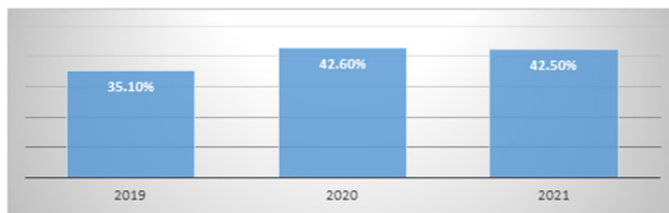
Sweden, if we compare it with the two countries we analyzed above (Romania and Poland) during 2020 has had an inflation rate of about 0.2% with less than the reference value, thus showing the maintenance of price stability.

Graph 17. Annual HICP inflation



Source: World Bank Indicators 2019

Graph 18. The gross general government debt-to-GDP ratio



Source: World Bank Indicators 2019

Public debt in the case of Sweden has increased in light values over the last three years reaching in 2021 at about 42.5% of GDP, thus respecting the limit set by the Maastricht criteria (which states that the value of public debt should not exceed 60% of GDP)¹². Sweden follows a flexible exchange rate regime and it is its Central Bank that decides on the timing and amount of changes in the foreign exchange market. In terms of long-term interest rates, they have remained below the average values of the three countries with the lowest interest rates in the Eurozone (average value around 2.9%). For 2020, the Central Bank of Sweden reports an interest rate of -0.1% many times lower than the reference value. The table below presents in a more concise way all the analysis presented above for all countries and all criteria that we take in consideration.

Table 4: Fulfillment of Maastricht from countries out of the Eurozone.

Country	Inflation, Price stability criteria	Public Debt	Budget Deficit	Long term interest rate	Exchange rate criterion
Czech Republic	2.90%	31%	Surplus +0.3%	1.50%	X
Sweden	1.60%	42%	Surplus +0.5%	-0.10%	X
Poland	2.80%	46%	Deficit 1.5%	2.20%	X
Hungary	3.70%	66%	Deficit 2%	2.30%	X
Rumania	3.70%	46%	Deficit 4.3%	4.40%	X
Bulgaria	2.60%	25%	Surplus 2.1%	0.30%	X
Croatia	0.90%	89%	Surplus 0.4%	0.90%	X

Source: Convergence criteria report 2020.

¹² <https://sputniknews.com/europe/201606071040953952-eurozone-candidates-fail/>

The main conclusions of this study will be listed below:

- All 27 countries of the European Union have met the Copenhagen criteria and only 21 of them have met the Maastricht criteria. Bulgaria, Romania, Poland, Sweden, Czech Republic, Hungary, and Croatia have not yet met the Maastricht criteria.
- The increase of the population in a certain country leads to a decrease in the per capita income, as a consequence of the proportion of the income with a larger number of inhabitants. The larger the population, the lower the per capita income.
- European Union serves member countries as a means for coping with globalization challenges and achieving greater prosperity and wealth
- Most of the EU countries use as an official currency the euro. The financial and economic crisis of 2008-2009, as well as the euro-area sovereign debt crisis, showed certain flaws in the Economic and Monetary Union's (EMU) economic governance framework. To ensure the EMU's long-term viability, the Union's economic governance has been strengthened overall.
- Economic integration is an agreement between countries and these countries agree to coordinate their trade and fiscal/monetary policies.

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