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COMPARATIVE ANALYSIS OF READINESS FOR MONETARY INTEGRATION: CASE OF POLAND AND UKRAINE

В роботі проведений порівняльний аналіз відповідності економік України та Польщі передумовам валютної інтеграції. Розглядаються альтернативні сценарії валютної інтеграції.

Ключові слова: *валютна інтеграція, міжнародні економічні зв'язки, економіка країн Європи*

В работе проведен сравнительный анализ соответствия экономик Украины и Польши предпосылкам для валютной интеграции. Рассматриваются альтернативные сценарии валютной интеграции.

Ключевые слова: *валютная интеграция, международные экономические связи, экономика стран Европы*

Author makes comparative analyses of satisfying preconditions for monetary integration in case of Ukraine and Poland. Several alternative scenarios of monetary integration are considered.

Key words: *monetary integration, international economic relations, economy of the European countries*

As for today Ukraine uses managed floating exchange rate and practices independent monetary policy. There is similar situation in Poland, but it is obliged to join the euro area as soon as convergence criteria are satisfied. Let's consider readiness of these countries for monetary integration with the existing euro area and hypothetical monetary union in EurAsEC. Close monetary integration would mean joining a monetary union, while weaker form of it would mean pegging exchange rate.

Monetary integration may be successful when certain preconditions are satisfied:

1. Trade openness of an economy. In open economy fixed exchange rate is better because of more stable prices and devaluation is less efficient. In 2009 in the foreign trade of Ukraine was equivalent to 85% of its GDP (the share of the EU was 30% (euro area – 17%), EurAsEC – 36% (Russia – 26%). Thus, both directions of monetary integration can be beneficial for Ukraine. Poland is much more oriented to the euro area. In Poland foreign trade was equivalent to 67% of GDP (share of the EU was 70% (euro area 38%), Russia – 6%).

2. Capital mobility. Gross private capital flows (rough estimations according to financial account of balance of payments) are 25% of GDP in Ukraine and 35% in Poland. At the beginning of 2010 78% of foreign direct investment (stock) to Ukraine came from the EU (including 64% from the euro area, without Cyprus 42%). In Poland in 2007 86% FDI flow came from the EU. By this criteria both countries are more European oriented.

3. Export and production diversification. In 2009 32% of Ukrainian exports were the exports of non-precious metal products.

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In Poland 43% of exports were the export of machinery and equipment, which itself is more diversified group of products.

4. Structural similarity of economy. It affects the way economies react to external shocks – in similar or different way. In 2009 economic structures were the following:

Table 1 Structure of economies (by value added)

Branches	Euro area	Poland	Ukraine	Russia
Agriculture, fishing	1-чер	3-чер	7	5
Industries	17-сер	24-кві	22	27
- Manufacturing	15.0	18.6	16	15
Construction	6.3	7.3	2	6
Trade, hotels restaurants, transport	20.7	26.9	24	30
Financial intermediation, real estate	29.3	18.3	18	18
Public administration, community services, activity of households	24.3	19.4	13	14

Ukrainian economic structure is more similar to Russia. Structure of Polish economy is something in between the euro area and Russia. But if we consider the role of energy sector, Russian economy would be much different from the other three economies.

5. Business cycles synchronism or correlation between GDP growth rates. In 1997-2009 Ukraine had high correlation with Russia (0,83) and the euro area (0,68), while relatively low with the U.S (0,38). Poland had quite high correlation with the euro area (0,55) and the U.S. (0,54), and lower with and Russia (0,25). If we consider a shorter period 2001-2008 in case of Ukraine correlations were much smaller, in case of Poland – stable or smaller with the exception of Russia – it was much higher.

6. Similar transmission mechanism of monetary policy. This is quite a disputable issue. In Poland and Ukraine it may differ from the mechanism in the euro area considering lower level of financial sector development. For example, in 2008 quasi-liquid liabilities (M3-M1) were 52% GDP in the euro area, 25% in Poland, 30% in Ukraine, and 22% in Russia.

7. Trust in national currency. In September 2010 in Ukraine 43% of deposits were denominated in foreign currencies. In Poland 9% of deposits and other liabilities to non-government entities were denominated in foreign currency. Both currencies were devalued during the recent financial crisis – by 30% against the euro in July 2008 – February 2009, though in a year half of the devaluation of zloty was liquidated.

8. No primary overvaluation or undervaluation of national currency. Considering current account balance close to zero in Ukraine, in 2010 Ukrainian national currency hryvnia was close to its equilibrium level. In Poland zloty is rather overvalued according to the current account criteria (deficit 1.6% of GDP).

9. Similar inflation. Considering consumer prices in 2009 it was 0.9% in the euro area, 3.5% in Poland (it is still above the reference value under the convergence criteria), 12% in Ukraine, and in 8.8% Russia.

10. Fiscal stability. All the considered countries and the euro area do not satisfy the legally set maximum budget deficit criterion (7.1% of GDP in Poland and 3.9% in Ukraine). Yet public debt in Poland was only 51% in 2009, in Ukraine (including publicly guarantied debt) – 34%.

11. Similar interest rates. The average long-term interest rate in Poland in the year to March 2010 was 6.1%, above the reference value of 6.0%. Lending rates in 2008 were 6.8% in Italy, 17.5 % in Ukraine, and 12.2 % in Russia.

12. Flexibility of prices and wages. In Ukraine, shadow wages in some enterprises allow them to decrease wages to withstand shocks. In some sectors prices are not flexible.

13. Labor mobility. There are much less legal barriers for labor mobility in case of Poland vis-à-vis the euro area. This direction constituted 51% of migration in 2008 in Poland. In case of Ukraine both directions of migration are more comparable by size.

14. The general level of economic and political integration. In the EU it is much higher than in the EuroAsEC. Poland is already member of the EU, while Ukraine is not integrated enough in both directions.

15. Leading country or/and developed system of institutions, that make exiting monetary union too costly. In the euro area there is a group of leading countries, while in the EurAsEC there is one leading country and institutional system is not developed.

16. Solidarity. Ability to act on behalf of the interests of the whole union is more specific to the EU, but the recent financial crisis was a challenge that threatened it.

17. Ability to delegate monetary policy to an institution which is accountable, representative, and effective. In general the euro area has such an institution – the Eurosystem based on the ECB. But legal convergence is still under way even in case of Poland. In the EurAsEc such institution has not been created.

But there is a point of view, that preconditions may be created later. A country may satisfy these preconditions after joining a monetary union or during the preparatory period.

If we roughly summarize the above considerations, 42 % of arguments would be in favor of Ukraine's monetary integration with the euro area, 34 % – with the EurAsEC, 24 % – with none of them. 60 % of arguments would be in favor of Poland's monetary integration with the euro area, 18 % – with the EurAsEC, 22 % – with none of them.

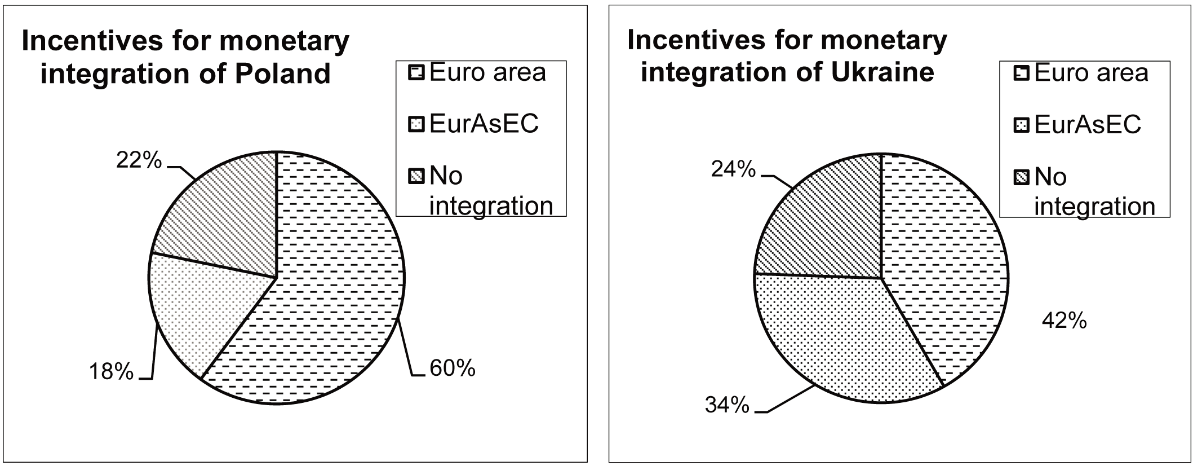

Diagram 1. Incentives for monetary integration

A hypothetical solution to smooth imbalances in the EU and to simplify monetary integration for non-euro area countries could be establishment of two monetary unions within the EU – one for traditionally stronger economies and another one for those countries that face considerable deficit of the current account.

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