Chapter 4

Financial Integration: Crisis and Economic Development

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ABSTRACT

Financial integration is an inseparable part of economic integration. It affects capital movement and economic development. Certain studies have shown that financial integration is beneficial to the economy. However, integration may be slowed down by occurrence of a crisis. Over the past 10 years, several crises have been underway. They have affected both economic development and financial integration. The aim of the chapter is to present theoretically the relation between financial integration, crisis, and economic development. An overview of EU and SEE financial integration and economic development is given. Development and integration of both regions have been slowed down due to the global and EU crisis, but there has been an improvement over the past few years. The fact is that SEE countries do not have a very developed financial integration but they meet certain prerequisites to reach a higher level of integration.

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INTRODUCTION

Financial integration has become necessary due to globalisation. Various economic or political integrations lead to financial integration. Today, integration is the most common issue because of the advantages it brings to an economy. Integration of financial institutions and capital on regional basis provides liberalisation of capital movements. Such liberalisation provides funding and inflow of capital in the developing countries. International capital, particularly foreign direct investments (FDI), is the primary source of economic growth and development financing of countries in transition (Prasad et al., 2007; Globerman et al., 2006, Damijan et al., 2013; Parezanin et al., 2017). High interest rate and profit that attracts foreign capital, on one hand, and loans from abroad, on the other, provide capital for funding economic development. Moreover, financial integration influences the exchange rate, consumption, competitiveness and other economic performances that also push up economic development. Even if financial integration exists and provides benefits for an economy, crises and imbalances can cause decrease in inflows of capital. Prior to the global crisis, liquidity was high. However, during and after the crisis liquidity decreased and risk aversion rose. The availability of foreign borrowing dropped. Consequently, economic growth and development were slowed down in developing countries.

The aim of this chapter is mostly a theoretical analysis of relationships between financial integration, crisis and economic development. Financial integration in the EU and South-Eastern European (SEE) countries will be reviewed, with a particular emphasis on Serbia.

The structure of the chapter is as follows: after Introduction, there is Background section that presents a theoretical framework of financial integration and various types of crises. The global economic crisis and the EU crisis, along with the policies and solutions for overcoming the crises are overviewed. The Main Focus section of the chapter provides the analysis of EU and SEES financial integration, development and crisis. The following sections provide solutions and recommendations, as well as future research. The last section provides concluding marks.

BACKGROUND

Financial Integration

Economic integration has an integral part of the global world. Due to changes, the integration has brought different benefits to economies, regions and markets. The benefits are: efficiency, competition, production and trade increase, better
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