# Comment on "The Global and Regional Outlook in Central Europe," by Miroslav Hrnčíř

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I agree that the ultimate goal is not membership of the European Union *per se*, but catching up with the European Union's per capita income and standard of living. I also agree that the effort to comply with the formal accession requirements could, in general, help achieve this ultimate objective. I will further concentrate my comments on two points.

In general, the paper fails to identify or elaborate the main components of a pre-accession strategy for trade – or for other areas such as macroeconomic or structural policy. In trade, for example, we can envisage two scenarios for Central Europe. In the first scenario, liberalisation simply follows the Europe Agreements, and the Central European Free Trade Agreement (CEFTA) is rather insignificant. In the second scenario, rapid CEFTA liberalisation would play a significant role. This question of optimal trade policy during the pre-accession period has not been answered. Indeed, given the small volumes of trade within CEFTA countries, one may question the practical or empirical relevance of this trade issue. Nevertheless, it remains important. For instance, should the Central and Eastern European countries immediately adopt a common external tariff? The World Bank has been advising Poland to do so since its tariffs are slightly above the common external tariff of the European Union. And they have advised Slovakia not to do so because Slovakia's tariffs are slightly below the EU's common external tariff. Thus, the answer to the question obviously depends on initial conditions.

An interesting question in the macroeconomic area is: What set of macroeconomic policies should these countries follow during the pre-accession period? Before answering this question, we must note two things. First, we cannot say how long this period will be, some say 2002 and some say 2005, so let us simply say the first half of the next decade. And second, while output has been recovering and the inflation rate has been declining, this has occurred at a very uneven pace in the various countries, and some have even developed problematic current account deficits – in the order of 10 per cent of GDP in some cases. So, what is the optimal macroeconomic policy during the pre-accession period? First, we must determine what pol-



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icies can bring inflation rates closer to West European levels and whether these policies would result in unreasonable recession. Second, we need to ascertain the set of macroeconomic policies which is consistent with a high-growth strategy. Ms. Pearce has suggested that these countries would be viewed much more favourably and their accession to the EU would be facilitated if they became high-growth performers by the year 2002 or 2005. So any set of macroeconomic policies which would achieve both objectives of lowering inflation and placing these countries on a high-growth path would be desirable.

With regard to an optimal macroeconomic policy during the pre-accession period, the paper would benefit from identifying and elaborating the success stories. What set of policies was used for the three success stories in this region, the Czech Republic, Slovakia and Slovenia? I think there are common elements in these three cases. In all three cases, the exchange rate was used intensively as an anchor. Also in these three cases, fiscalpolicy was much more restrictive than the policy of neighbouring countries in the region. In addition, wage policy was used in some cases as an additional anchor – not an active wage policy, but wages were not allowed to spiral out of control. So an identification of the common ingredients in the three success stories would be highly beneficial.

What set of macroeconomic policies is consistent with a high-growth strategy? We know from recent growth literature that we should be optimistic about the long-run prospects of this region. The region already exhibits many of the conditions identified as necessary for high growth. They have a highly-educated labour force and proximity to markets, they are open to trade and they have relatively low inflation. While this provides reason for optimism, two basic indicators are still lacking. First, investment ratios are low. The Czech Republic and Slovakia have been able to maintain rather high investment of GDP ratios, about 30 per cent. In 1996, Slovakia's ratio even increased to an astonishing 34 per cent, which is similar to Southeast Asian figures. The Czech Republic and Slovakia are the only two countries in the region that did not experience a complete collapse of investment in the late 1980s and early 1990s. Most countries' investment ratios collapsed to below 20 per cent during the dismantling of central planning, and so far they have not been able to raise them again. The second problem facing these countries is the inherited tax system with extremely high marginal tax rates.

To summarise, we believe that growth prospects of these countries are good, and that achieving the formal pre-accession requirements would coincide with a high-growth strategy which increases economic efficiency. An effort to comply with the formal pre-accession requirements would, in general, help these countries achieve the objective of catching up with

Western Europe. According to our regressions and based on current policy, we anticipate convergence with Western European averages by 2030-2050. Finally, in addition to macroeconomic policy, we need to examine other areas, such as social policy and labour policy, in more detail. The pre-accession requirements are vague in these areas. While this offers substantial freedom for these countries to adopt the systems they want, it can also be hazardous. Countries in this region should avoid committing the same mistakes that have led to the excessive taxation and labour market rigidity that are plaguing Western European countries today.