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# Economics, Not Politics, is Central Europe's Big Problem

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**The Financial Times**
**8 November 2006**

Central Europe's political malaise has caught international attention. The region's governments are weak. Populism and nationalism are rising. These political problems are contrasted with good economic performance.

But central Europe's economic results are impressive only by European Union standards. From 2000 to 2005, Poland, the Czech Republic, Slovakia and Hungary grew on average by 4 per cent a year, compared with 8 per cent a year in the 15 former Soviet republics. Even in this boom year, central Europe will grow by 5 per cent, while the former Soviet Union comes close to 9 per cent. Star performers are Armenia, Azerbaijan and Kazakhstan.

Barely half as wealthy as the west European countries, the central European nations need to grow more than twice as fast to converge with them. The absence of convergence breeds a sense of permanent backwardness. Unemployment remains high at 15 per cent in Poland. Budget deficits have been abundant, ballooning to 10 per cent of gross domestic product in Hungary. Apart from Slovakia, none of these countries has reformed significantly in the past half decade.

This malaise has coincided with their EU accession. In a prescient paper of 1996, Jeffrey Sachs and Andrew Warner warned that the central European countries would not converge economically with western Europe if they did not cut their high taxes, reduce their excessive social transfers and deregulate their labour markets. A decade later, their public expenditures linger at 46 per cent of GDP, the EU average.

Formally, the EU has not forced these countries to maintain high public expenditures, but its social charter and political pressures point in that direction. Initially, EU accession contributed to deregulation, but its last part was dominated by illiberal chapters, such as the common agricultural policy.

After having joined the EU, the central European countries behave as Greece did under prime minister Andreas Papandreou from 1981 to 1996. Greece maintained a large budget deficit, relying on EU subsidies, and undertook few reforms. Growth was poor. Pious complaints from Brussels make little difference as long as they do not influence the flow of subsidies.

Two-thirds of the much higher growth in the former Soviet countries can be explained by their far lower public expenditures. The only other significant factor is the high world prices for oil. The ex-Soviet countries have become part of the high-growth belt from China via India to the Baltics and they look to the economic models of east Asia, with low taxes, limited social transfers and free labour markets, rather than the EU.

Until 1998, good things went together privatisation, liberalisation, macroeconomic stabilisation, democracy, good governance and economic growth. Cynics said that the closer to Brussels a country, the better off it was. Now, the further a country is from Brussels, the higher its growth is. The Russian financial crash of 1998 was the dividing line. It forced post-Soviet countries to make large cuts in public expenditures to balance their budgets. With the exception of Belarus, Turkmenistan and Uzbekistan, the post-communist world is dominated by private enterprise, free markets and low inflation.

Admittedly, the Baltic countries Estonia, Latvia and Lithuania are EU members and they perform well, with growth rates of around 8 per cent a year, balanced budgets, low flat taxes and moderate public expenditures. But the cause of their good fortune does not lie in their EU accession, but in their fresh memory of horrendous financial crises and a potent Russian threat. They have resisted accusations of both tax dumping and wage dumping by west European leaders.

Central Europe's problem is not political instability. Until recently, it had relatively stable, but irresponsible governments, which did little while their economic problems deepened. The recent political turmoil in central Europe may be welcomed as a wake-up call. The Baltic countries are maintaining their stellar economic performance by changing government once a year.

In 1992, the grand old Hungarian economist Janos Kornai noticed that the central European states had developed a premature west European social welfare system. Their prime dilemma is economic and a general EU problem. Like the EU, central Europe needs to overcome its poor economic dynamism through lower taxes, reduced social transfers and freer labour markets. Possible cures are increasing tax competition from the east and freer labour migration within the EU.

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