

Adjusting Exit Strategies to the Needs of New Member States

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Workshop

'The Impact of the Crisis on the New Member
States - Non-Eurozone New Member States'

EPP Group, CRIS Committee





Growth before the crisis

- **In the last decade the region experimented with unique model of growth through integration into the EU**
- **Key features**
 - Strong institutional anchoring
 - Trade and FDI integration
 - Financial integration (downhill capital flows)
 - Labour mobility
- **Made considerable sense in view of initial conditions**
 - Foster institutional build-up after transition
 - Substitute lack of domestic saving by foreign saving
 - Make use of wealth of human capital

Has the growth model broken?

- Elsewhere (Asia, Latin America) such crises in the

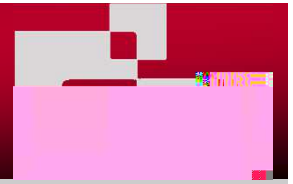
Two different clusters within NMS

1. Central Europe: Czech Republic, Hungary, Poland, Slovakia and Slovenia
 2. Baltics/Balkans: Bulgaria, Estonia Latvia, Lithuania, and Romania
- Differences across countries
 - Same overall developments, but different degree
 - External imbalances & indebtedness; domestic credit booms; housing booms
 - Composition of capital flows & composition of FDI
 - Unit labour costs/real exchange rates
 - Export performance





'Internal devaluation': will it work?



Which were the important factors?

Some made better use of the model than other

- Overall policy mix: importance of macro stability

Other factors

- Initial conditions (significant role of development level); geographic closeness; size
- Exchange rate regimes (floaters more successful)
- Financial regulation
- Structural policies e.g. infrastructure investment, competition (entry) play important role in shaping allocation of capital
- Fiscal policy

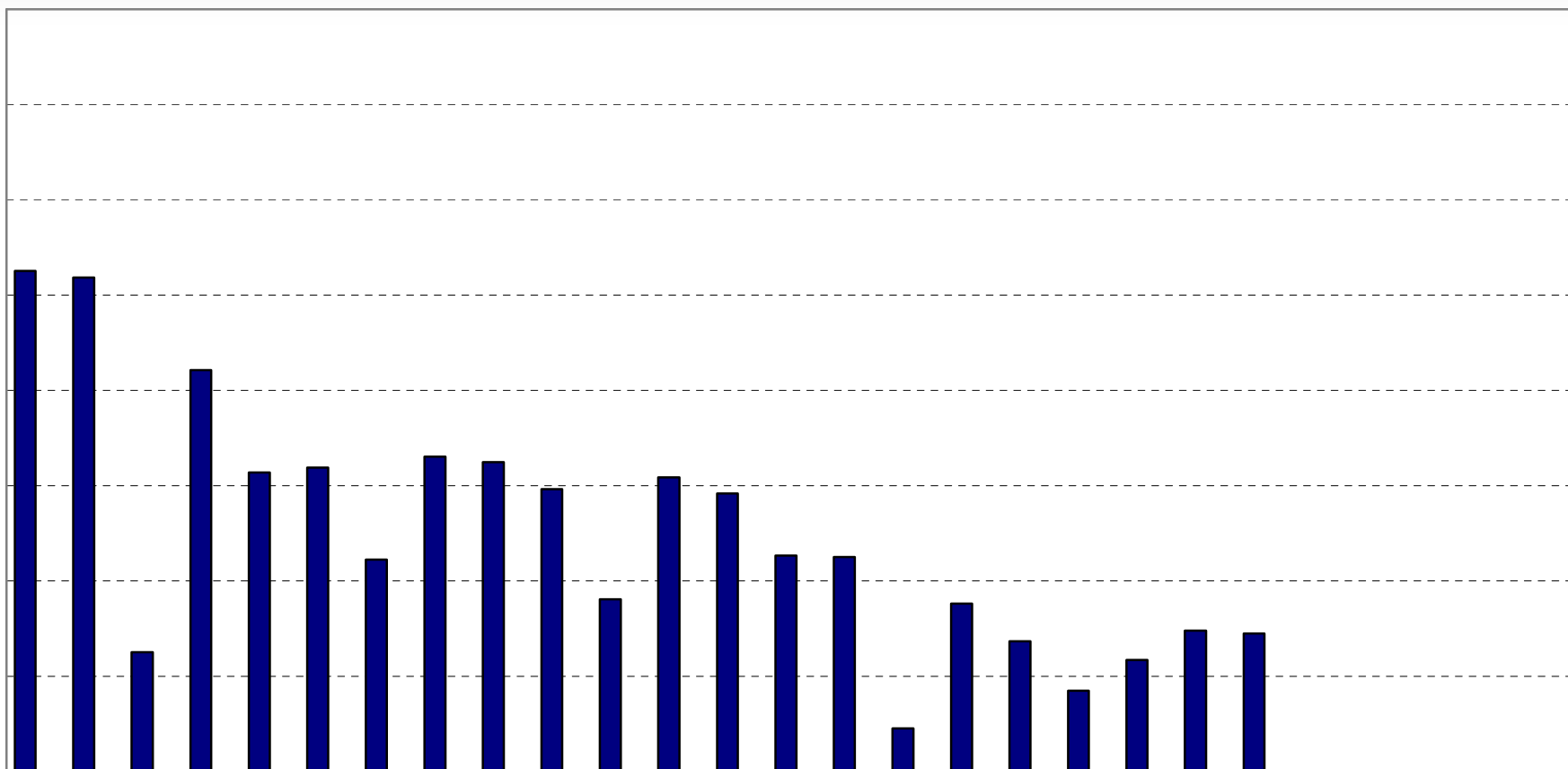
EU institutional framework: not well designed for catching-up economies and for crisis management

Exit? From what?

Fiscal and monetary policies during the crisis

	Fiscal policy	Monetary policy
Bulgaria	consolidation	currency board
Estonia	consolidation	currency board
Czech Republic	stimulus	loosening
Hungary	consolidation	tightening
Latvia	consolidation	quasi currency board
Lithuania	consolidation	currency board
Poland	stimulus	loosening
Slovakia	automatic stabilisers	euro
Slovenia	stimulus	euro
Romania	consolidation	tightening

General government gross debt (% GDP)



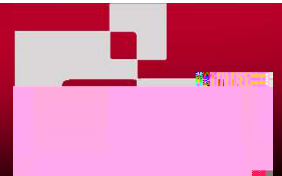
Policies: How good the EU framework?

- Benefits of integration model conditional on national

The negatives

- **No coherent growth strategy**

Some structural characteristics of NMS



scale: from 1 to 7 in most cases	Quality of institutions	Corruption perception	Ease of doing business (rank)	Infrastructure	Markets	Employment rate (%)	Quality of the educational system	Technology access	Absorptive capacity	Creative capacity
Bulgaria	3.3	3.8	44	2.8	4.4	62.6	3.3	3.8	3.6	3.1
Czech R.	3.9	4.9	74	4.1	5.2	65.4	4.7	5.0	4.5	4.2
Estonia	4.9	6.6	24	4.4	5.1	63.5	4.5	5.5	4.7	4.4



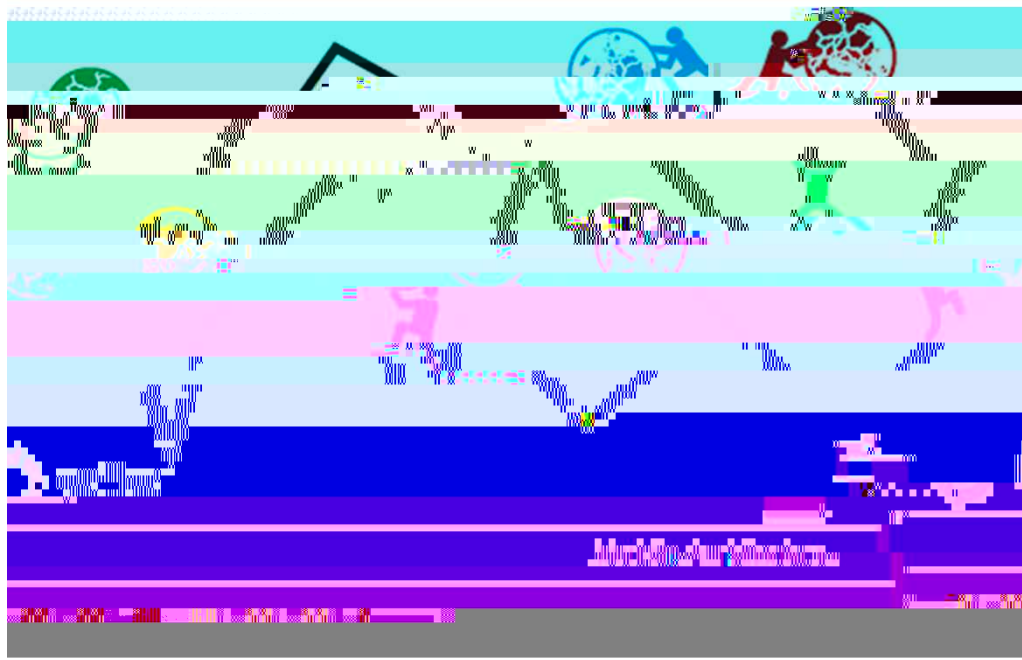
Lessons to learn

- **Preserve integration model of growth**
 - Cost of ditching it would be significant
- **But reform it**
 - More emphasis on supply-side conditions
 - More economic (less legalistic) approach of integration
 - Get the EU framework right: proper incentives & surveillance
- **Conditions for successful financial integration**
- **EU should support counter-cyclical fiscal policy**
- **Review conditions for euro membership**
- **Design better crisis resolution mechanism**

Whither growth in central and eastern Europe?

Reflections for all

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