# IS CATCHING UP POSSIBLE IN EUROPE?

**Daniel Dăianu***

***Abstract***. *In the current debate on the European Union enlargement there is an apparent mythical belief that, if the set of preconditions set by Brussels are fulfilled, rapid and sustained economic growth would ensue, which would allow the newly admitted countries to catch up economically with the better off European countries. An encapsulation of this thesis is the expression: „A well functioning competitive market economy", which would be able to withstand competitive pressures inside the EU. Those who accept this thesis are ready to point out to the experiences of Ireland and Spain in Europe, in particular. But the evidence in this regard is not so conclusive. In addition, there is glaring evidence worldwide as to the rarity of catching up. Thence, taking for granted the above hypothesis can be misleading unless the possible sources of growth are examined in a thorough and open-minded way. This paper aims at raising awareness on an issue, which is more complicated to deal with than is conventionally assumed.*

## 1. Introduction: The scarcity of catching-up in modern economic history

As generally known, the EU accession of Central and Eastern European countries is predicated upon the fulfillment of economic and political preconditions. Less known, however, is that whereas political criteria, for most of the candidates, are considered less of a problem, economic criteria still pose significant difficulties. In this sense, although there are large differences amongst accession (transition) countries, it is nonetheless true that not few of them suffer from spreading poverty and diminishing *social cohesion*, high inflation and fragility of financial systems, worsening social indicators, weak public administration etc., all of which should indeed cause serious worry as to their ability to achieve „real" convergence[1] and cope with competitive pressures inside the EU. Real convergence would, in simple terms, boil down to a rapid increase of income per capita, that is to say, to economic catching-up.

In the current debate on EU enlargement, there is an apparent mythical hypothesis/belief that if the set of preconditions set by Brussels are fulfilled, rapid and sustained economic growth would ensue, which would allow the newly admitted countries to catch up economically in the not too distant future. An encapsulation of this thesis is the expression: „A well functioning competitive market economy", which would be

This is a version of the paper **Is Economic Convergence Possible in Europe**, which was published in *Romania after 2000. Threats and Challenges*, Bucharest, Romanian Academic Society, 2002; this paper is also on the site of the *TIGER Institute of Warsaw*.

* Daniel Dăianu is a Professor of Economics, Academy of Economic Studies, Bucharest, and Visiting Professor, UCLA; ddaianu@rnc.ro. I thank Radu Vranceanu for his observations.

[1] By real convergence, I refer to the fundamental institutional set up of a society, which fosters sustainable technological and economic progress (income per capita growth), without social disruptive effects.

able to withstand competitive pressures inside the EU. Those who accept this thesis are ready to point out to the experiences of Ireland and Spain in Europe, in particular, and to, a lesser extent, Portugal. But the evidence in this regard is not so conclusive. Therefore, I will argue, in this paper, that taking for granted the above hypothesis can be misleading, unless the possible sources of growth are examined in a thorough and open-minded way.[2]

There is glaring evidence around the world, which should make us more cautious about the chances of economic catching-up. Angus Maddison's magisterial work[3] on long-term dynamics in the world economy, is telling in this respect. As a matter of fact, these dynamics exhibit essentially the divergence between rich and poor countries. The only exception is the rise of a cluster of Asian countries after the Second World War. Catching up with the rich countries, or '*beta*-convergence', as some economists call it, is very rare; more frequent is convergence inside clusters (groups) of countries, or what is called '*sigma*-convergence'. However, Central and Eastern European countries (CEECs) are interested primarily in *beta*-convergence, that is to say in catching-up with the richer countries of the EU. Such a convergence would supposedly mitigate possible tensions between the richer and the poorer countries of an enlarged EU (against the backdrop of regional aid accounting for much of the EU budget).

Worldwide experience shows that economic catching-up (*beta*-convergence) requires high saving and investment ratios, constant upgrading of educational standards and of the work force, steady improvement of competitiveness, and tolerable social strain (i.e. a high degree of *social cohesion*); and first and foremost, it requires a steady and rapid improvement in what economists call *total factor productivity*[4], which relies on a steady and fast increase of labor productivity. And it is not clear at all that the „magic" words of reform (liberalization, privatization, opening) are sufficient in order to provide the definitive solution. As regards proper institutions, which should be conducive to rapid and sustained growth, arguably, these cannot be constructed or improved at will[5].

This paper aims at raising awareness on an issue, which is more complicated to deal with than is conventionally assumed.

## 2. The current debate on the sources of economic growth (development)

The debate on the sources of economic growth (potential for catching-up) is reflected often inadequately in the operational frameworks used by governments and aid agencies. This is, to some extent, not surprising, since there has always been a delay between theoretical developments and applied science. But there are stark facts, which should be kept in mind, and several pieces of compelling evidence:

[2] For an interesting and broadly based explanation (including cultural) of economic growth, see Deepak Lal (1999).

[3] Angus Maddison, **Monitoring the World Economy: 1820-1992**, *Development Centre Studies* (1995).

[4] Total factor productivity is meant to denote the rate of technological progress, or the so-called „Solow residual" (i.e. what remains in the neoclassical growth equation after the quantitative increase of capital and labor).

[5] On a general upbeat tone Grzegorz W. Kolodko examines the chances for catching-up in the context of globalization. In this regard, he underlines the need for „correct policies", which is an indisputable statement (2002). Nonetheless, I assume that Kolodko, himself, accepts the existence of controversial policy issues and venues.

• Policies aimed at fostering growth in developing countries seem to have fared quite poorly, in many respects, in the last couple of decades - a time of firm application of the main tenets of the „Washington Consensus"[6]. According to a foremost development economist, William Easterly (until recently on the World Bank staff), during 1980-98, average per capita income growth in developing countries was practically 0.0% (!), as compared to 2.5% during 1960-79[7]. I would add that this discrepancy becomes even larger when singling out the economic performance of some Asian countries - which, as an increasing number of economists would concede, did pursue export orientation, but also implemented measures which, often, were at odds with the „orthodox" policies[8]; these countries shaped their own, particular, strategies. As Easterly also points out, „the increase in world interest rates, the increased debt burden of developing countries, the growth slowdown in the industrial world, and skill-biased technical change may have contributed" to this stagnation[9]. Easterly also stresses the inability of governments' policies worldwide to make good use of incentives for growth. This state of affairs begs a simple question: why is it so difficult to use incentives in order to foster sustained growth?[10] Easterly goes on, „We economists who work on poor countries should leave aside some of our past arrogance. The problem of making poor countries rich was much more difficult than we thought".

• Mainstream (neoclassical) theory has still to explain why divergence is so much prevalent in the world economy[11]. Moreover, endogenous growth models[12] and economic geography models have reinforced misgivings about the unqualified optimism on the distribution of benefits of free trade and free capital movements. Hence, a natural question arises: is opening (integration) to the outer economy advantageous, irrespective of circumstances?

• There has been an insufficient attention paid to the reality of asymmetries and informational problems in the functioning of both domestic and international markets, and to the key role of institutions. Partially, this is mirrored

---

6 The Washington Consensus, as a name, was concocted by the economist John Williamson, with reference to the essence of IMF and World Bank's policies pursued in the last couple of decades.

7 Easterly's results seem to contradict one of the main conclusions of the *World Bank's Global Economic Prospects for Developing Countries 2001*, which asserts that „Developing countries as a group enjoyed accelerated economic growth over the past decade…" (*World Bank Policy and Research Bulletin*, April-June 2001, p. 1). It is fair to say, however, that Easterly refers to per capita income growth.

8 These countries achieved macroeconomic stabilization via low budget deficits and tight monetary policies, but did nor refrain from targeting potential „winners", through industrial and trade polices. A normal question arises whether such policies can be effective under the pressure of globalization and when public administration is weak, or captured by vested interests, as is the case in many transition economies.

9 William Easterly, 2001, *manuscript*. See also his **The Elusive Quest for Growth** (2001).

10 *Op. cit.*, p. 291.

11 See The *World Bank's Annual Conference on Development Economics*, proceedings of 1999 and 2000 meetings. As the World Bank economist P. Richard Agenor put it, „the conventional neoclassical theory has proved incapable of explaining in a satisfactory manner the wide disparities in the rates of per capita output growth across countries" ( 2000, p. 392).

12 Pioneered by Paul Romer and Robert Lucas. Radu Vranceanu pointed to me that Lucas (1988, p. 3-42) explains why divergence does happen, instead of convergence.

by the talk regarding „second-generation reforms", „good governance" and „reinvigorating the state's capabilities". But as Dani Rodrik remarked, „The bad news is that the operational implications of this for the design of development strategy are not that clear", and „There are many different models of a mixed economy. The major challenge facing developing nations is to fashion their own particular brands of mixed economy"[13]. In this respect, he stresses the key role of institutions of property rights, conflict management and law and order. This search for country-specific solutions does not clash with the need to use the so called „best practices", but one should equally acknowledge that „best practices" are not always clear. In this context, one has to give a fair hearing to Mauro Guillen, who argues that globalization should not be understood as encouraging „convergence toward a single organizational pattern" and that „…organizational outcomes in the global economy are contingent on country-specific trajectories"[14]. The implication is that *variety*[15] does matter and adds value!

• The issue of asymmetries acquires particular salience in the international economy, where there is increasing disenchantment with the distribution of trade gains[16] and the functioning of financial markets. In this respect, one has to stress both the *distribution* aspect of trade (which relates to the rules of the game and to the way in which industrial countries defend their own markets[17]), and the institutional dimension.

• Prominent voices argue that the world community needs new arrangements, new institutions, which should be capable of addressing the problems of world governance[18]. For instance, it is disconcerting to see that the efforts initiated in the field of financial markets reform, by the Financial Stability Forum, in 1998, subsided. As Larry Summers astutely pointed out, world integration demands financial integration, but, as the 20s and the 30s of the last century prove, recurrent financial crises can lead to world disintegration[19].

To sum up: the current debate on

---

[13] Dani Rodrik (2000), *manuscript*. Rodrik emphasizes five functions that public institutions must serve for markets to work properly: protection of property rights, market regulation, macroeconomic stabilization, social insurance, and conflict management. He also underlines that „there is in principle a large variety of institutional setups that could fulfill these functions"(p.3).

[14] Mauro F Guillen **The Limits of Convergence. Globalization and Organizational Change in Argentina, South Korea and Spain**, *Princeton, Princeton University Press* (2001).

[15] Kevin Lancaster stressed variety as a value, decades ago; and it applies to institutional constructs as well as to product markets.

[16] As the *World Bank's Global Economic Prospects and the Developing Countries 2001* report says, „trade barriers in industrial countries represent a major roadblock for developing countries" (Ibid., p. 2).

[17] The preparations for the Doha WTO conference were quite telling in this respect, with the USA, the EU and Japan having basically set the Agenda.

[18] This is the message of a recent report on globalization prepared by a group led by George Soros (February 2002). Lord Dahrendorf is also very critical of the way in which the existing international institutions address these issues (his lecture delivered at the New Europe College, Bucharest, October, 2001).

[19] Larry Summers, **International Financial Crises: Causes Prevention and Cures**, Richard T Ely Lecture in the *American Economic Review. Papers and Proceedings*, May 2000, p. 1. See also Ulrich Beck **Globalization's Chernobyl**, *Financial Times*, November 6, 2001, p. 17.

development economics has rediscovered several of its old issues and, in this context, it reemphasizes the existence of externalities, multiple equilibrium, bad path-dependencies, vicious circles and „underdevelopment traps", all of which pose numerous challenges to public policy. For, it is increasingly obvious that public policy (at the national and the international level) has a role to play in order to address *coordination failures*. This is because „There may be a social equilibrium in which forces are balanced in a way that is Pareto improving relative to one in which the government's hands are completely tied – and certainly better than one in which the private sector's hands are completely tied"[20]. In this context, one needs to underline the importance of good institutions, of proper structures for public and corporate governance, which condition the overall performance of the economy. It is, therefore, increasingly clear that the wide variety of economic performance in transition countries has to be related to the different functioning of institutional set-ups.

### 3. Some European Union evidence

The European Union provides some evidence on the possibility for convergence. I refer in particular to the EU admission of poorer European countries in the 70s and the 80s. Ireland joined the EU in 1973, when its per capita income was 59% of the EU average. By 1998, Ireland had caught up, with a per capita income that was slightly over the EU average[21]. By contrast, Greece's experience is less encouraging: its income per capita, as compared to the EU average, went down from 77% at the time of joining the EU (in 1981), to 66% in 1998. But the Irish growth was due to a very special set of circumstances, which can hardly be replicated elsewhere. „Without those special circumstances, all the macroeconomic stability in the world could not have achieved economic growth rapid enough to promote convergence"[22]. And even this growth needs to be seen in a proper perspective when distinguishing between GDP and GNP dynamics.[23]

A recent study finds convergence within the EU and between the EU and the USA[24]. Table 1 illustrates two things. One is that the European Union as a whole has been converging towards the level of per capita income in United States; this may be the result of fast economic reconstruction after the second world war, and of the ensuing benefits of EU integration. Second, the lower income members of the Union (the so-called cohesion countries, to indicate their

---

[20] Karla Hoff, **Beyond Rosenstein-Rodan: The Modern Theory of Coordination Problems in Development**, 2000 in *Annual World Bank Conference on Development Economics. Proceedings*, World Bank, Washington D.C., p. 170.

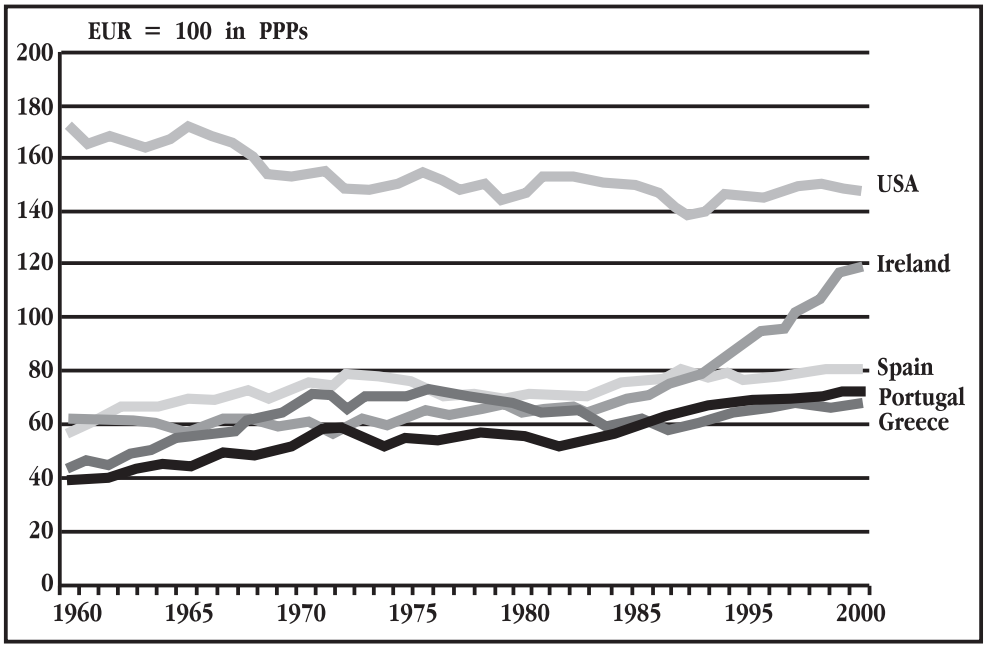
[21] **Progress Toward the Unification of Europe**, *The World Bank*, Washington DC (2000), p. 40.

[22] Denis O'Hearn in M. Dauderstadt and L. Witte, **Cohesive Growth in the Enlarged Euroland,** Bonn, *Friedrich Ebert Stiftung* (2001), p. 80.

[23] While foreign profit repatriations made up 3% of GDP in 1983, by 1995 they climbed to 19% and, by 1999, to a stunning 40% of GDP (Denis OHearn, op. cit., p. 83).

[24] Carmela Martin, Francisco J. Velazquez, and Bernard Funck, **European Integration and Income Convergence. Lessons from Central and Eastern European Countries**, May 2001.

**Table 1. Per Capita GDP at PPS[26]; 1960-2000**




**Source**: European Commission data, quoted in Carmela Martin, Fr. Velazquez and B. Funck, op. cit, p.10.

eligibility for the EU Cohesion Fund)[25] have been closing up the gap that separated them from the EU average.

However, the evidence provided by this study needs to be qualified. Similarly to Ben David (2000) the study indicates that the cohesion countries were converging towards the EU average income per capita before entering the Union; and that the same occurred with member countries belonging to the European Free Trade Area, during that period. Strikingly, Ireland's big advance in convergence - in the 80s - took place a decade after its accession into the EU, which points to certain national policies, which fostered growth - specially in the field of education and attracting foreign direct investment. As Carmela Martin, Fr. Velazques and B. Funck highlight, income convergence is closely associated with labor productivity convergence; and the rise in labor productivity is determined by how a country benefits from the international diffusion (transfer) of technology, by the „ability to harness technological spillovers" (op. cit, p.16). The heavy inflow of foreign direct investment in Ireland seems to explain this country's rapid growth in

[25] The Cohesion Fund was created in 1993 in the wake of the Maastricht Treaty to help poorer member countries cope with the demands of monetary union.

[26] The purchasing power standard (PPS) is defined in such a way that, for each individual aggregate, the European Union total obtained from converting the values in national currency with the purchasing power parities is equal to the European Union total for that individual aggregate in euros. In a sense, the PPS can therefore be thought of as the euro in real terms (EUROSTAT definition).

the last couple of decades, and compensated for the lesser domestic research and development efforts. Clearly, the build-up of human capital (education) matters a lot, and infrastructure also plays an important role. The authors talk in this respect about certain absolute „thresholds" in public infrastructure and communication and transport networks, which are needed to take advantage of technological spillovers.

Here are some final comments on the evidence of catching up in Western Europe. One is that there are significant differences between the earlier decades and the current international environment. First, the earlier decades were a time of more rapid growth in Europe, in general. Second, the earlier candidate countries did not have to overhaul massive industrial sectors (as the transition countries have had to do) and benefited from already existing basic institutions of a market economy. And last, but not least, there are areas inside the EU member countries, which continue to lag behind substantially[27].

## 4. The Case of Central and Eastern European Countries

### 4a. Macroeconomic dynamics

For most of the past decade, policy makers in transition countries have been concerned with the construction of the main building blocks of the new economic system. Institutional disarray (*disorganization*[28]), and the effects of the collapse of the former COMECON trade area, brought about the first transformational recession and high inflation in the early 90s. Macroeconomic stabilization, privatization, opening, formed their main policy thrust in the early years of transition. Table 2. illustrates the collapse of output in these economies at the start of the transition period.

**Table 2. Annual GDP growth rates in CEECs (% on previous year)**

| Country | 1990 | 1991 | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Bulgaria | -9.1 | -8.4 | -7.25 | -1.48 | 1.82 | 2.86 | -10.14 | -6.94 | 3.5 | 2.51 | 5.8 | 5 |
| Czech R. | -1.22 | -11.49 | -3.29 | 0.57 | 3.21 | 6.36 | 3.91 | 0.98 | -2.5 | -0.21 | 3.1 | 3.5 |
| Estonia | -8.1 | -10.01 | -14.15 | -8.51 | -2 | 4.29 | 3.98 | 10.53 | 4.06 | -1.39 | 6.9 | 4.7 |
| Hungary | -3.5 | -11.9 | -3.06 | -0.58 | 2.95 | 1.5 | 1.34 | 4.57 | 5.07 | 4.27 | 5.2 | 3.8 |
| Latvia | 2.9 | -10.41 | -34.86 | -14.87 | 0.65 | -0.81 | 3.34 | 8.61 | 3.56 | 0.47 | 6.6 | 7.5 |
| Lithuania | -3.3 | -5.68 | -21.26 | -16.23 | -9.77 | 3.29 | 4.71 | 7.28 | 5.15 | -3.07 | 3.9 | 4.7 |
| Poland | -11.6 | -7 | 2.63 | 3.8 | 5.2 | 7.01 | 6.05 | 6.85 | 4.8 | 4.04 | 4 | 1.1 |
| **Romania** | **-5.58** | **-12.92** | **-8.77** | **1.53** | **3.93** | **7.14** | **3.95** | **-6.07** | **-5.43** | **-3.19** | **1.8** | **5.3** |
| Slovakia | -2.47 | -14.57 | -6.45 | -3.7 | 4.9 | 6.91 | 6.58 | 6.54 | 4.42 | 1.9 | 2.2 | 3.1 |
| Slovenia | n.a | -9 | -5 | 2.8 | 5.3 | 4.1 | 3.5 | 4.5 | 4 | 4.8 | 4.6 | 3 |

**Source**: Based on **Economic Survey of Europe** 2000, Vol. 2, UN-ECE, Geneva; *WIIW Research Report* 283/2002.

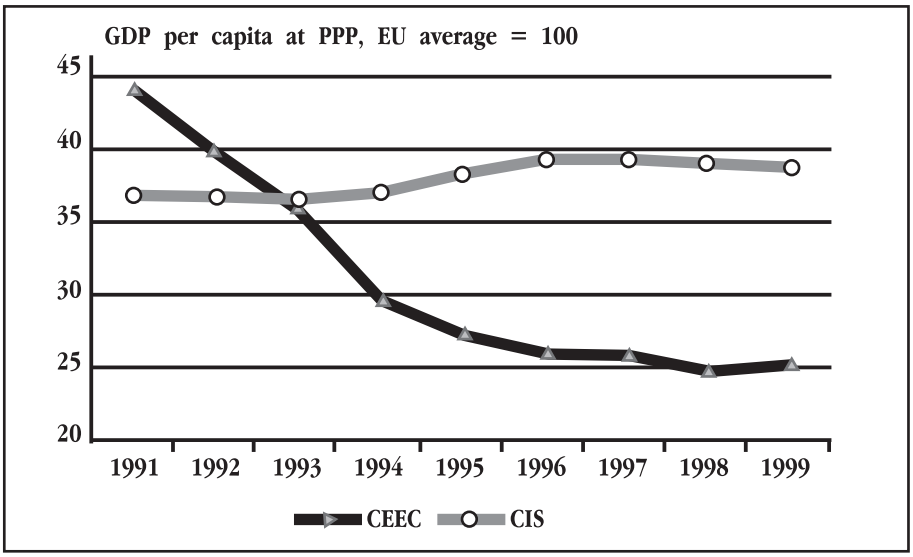
But even so, one can easily discern a major difference between macroeconomic dynamics in CEECs and in the CIS countries. In Central and

[27] Such as Mezzogiorno in Italy, parts of the United Kingdom, etc.

[28] Concept used by Olivier Blanchard **The Economics of Post-Communism**, London, *Clarendon Press*, 1997.

Eastern Europe inflation was brought down much more rapidly and output recovery started earlier. What lies behind this difference? A World Bank study remarks that „while initial conditions are the dominant factor in explaining the output decline at the start of transition, the intensity of reform policies explains the variability in output recovery thereafter"[29].

**Table 3. CEECs and CIS Per Capita GDP at PPP: 1991-99 percent of EU average**




**Source**: World Bank calculations (in C .Martin, Velazquez and Funck, op. cit., p. 24).

**Table 4. CEECs: Labor Productivity in Industry (base year = 100)**

| | 1989 | 1990 | 1991 | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 |
|---|---|---|---|---|---|---|---|---|---|---|
| Bulgaria | 100 | 91.4 | 86.6 | 83.9 | 81.5 | 91.8 | 98.5 | 101.8 | 98 | n.a. |
| Czech Republic | 100 | 99.6 | 78.7 | 76.6 | 75.2 | 78.9 | 87.6 | 96 | 106.7 | 112.7 |
| Hungary | 100 | 100.4 | 82.4 | 91.2 | 107.9 | 115.8 | 128.4 | 140 | 160 | 181.3 |
| Poland | 100 | 78.9 | 69.5 | 81.3 | 92.1 | 105 | 112.3 | 123.5 | 138.5 | 147.2 |
| **Romania** | **100** | **75.9** | **59.4** | **53.1** | **58.7** | **64.7** | **77.6** | **87** | **87.9** | **101.9** |
| Slovak Republic | 100 | 99 | 81 | 78.9 | 81.8 | 89.4 | 94.1 | 96.5 | 100.4 | 112 |
| Estonia | n.a. | n.a. | n.a. | 100 | 101.1 | 107.9 | 108.3 | 112.3 | 141.9 | 145.1 |
| Latvia | n.a. | n.a. | n.a. | 100 | 77.4 | 84.8 | 83.9 | 91.1 | 116.6 | 118.9 |
| Lithuania | n.a. | n.a. | n.a. | 100 | 77.6 | 68.2 | 76.4 | 82.9 | 89.2 | 99 |
| Slovenia | n.a. | n.a. | n.a. | n.a. | 100 | 111.8 | 121.2 | 129.3 | 135.1 | 142.4 |

n .a. – not applicable

Note: The indices have different base years because of differences in data availability for the different countries.

**Source**: World Bank calculations based on data from EBRD **Transition Report**, various issues (in Carmela.Martin, Fr.Velazquez, and B.Funck, op. cit., p. 24).

[29] Pradeep Mitra and Marcelo Selowsky, **Transition: The First Ten Years**, *World Bank 2001, manuscript.*

I would argue that initial conditions and geography played a major role during all this period, and that bad path dependencies have evolved in the meantime. Table 3. shows the different evolution of per capita income in the two mentioned groups of countries, and Table 4. shows the improvements in labor productivity in industry, which occurred in CEECs during the last decade. This period was accompanied by substantial labor shedding, against the background of industrial restructuring.

The World Bank study mentioned above highlights four major lessons of transition, namely:

- the key role of the entry and growth of new firms (the strategy of encouragement and discipline);
- the need to develop and strengthen legal and regulatory institutions;
- the need for more aggressive use of the budget during a reform program, in order to protect the most vulnerable social groups;
- the recognition that initial winners may oppose later stage reforms.

However, what seems to be underplayed in this enumeration, is the time consuming nature of institutional development, which is at the root of various path dependencies. In this regard, one needs to highlight the relationship between precarious institutions (illustrated by endemic corruption amongst others), and the persistence of bad equilibria, which hamper long-term economic growth.

But not the whole of the CEECs area has had similar macroeconomic dynamics. The most salient feature is the boom and bust dynamic of Romania and Bulgaria (see Table 2.) and the persistence of high inflation in Romania. This evolution indicates more severe initial conditions and less consistent policy-making.

Over time, and in conjunction with reform consolidation, new concerns have emerged for the CEECs. Thus, economic growth has become of paramount importance in the quest to join the European Union, and also, as a means to solve increasingly sensitive social difficulties, at a time of rising unemployment. The main features of economic dynamics in the CEECs, which have relevance for the debate on catching-up, are summarized below:

steady high growth rates have proved to be quite an elusive goal for CEECs;

1. in all CEECs there have been substantial fluctuations of GDP growth rates, besides the impact of the first transformational recession. Poland, which was a champion of high growth rates in the late 90s, returned to a much lower growth in the last couple of years. And Hungary's recent years of relatively higher growth still need to be validated in view of the ever closer link between its economy's business cycle and that in the EU.

2. moderate (not high) growth rates seem to be characteristic for the better performing CEECs (see Table 2.). Slovenia's record is telling in this respect, with a growth rate averaging 4-4.5% in recent years. Actually, Slovenia is the only accession country, whose income per capita is above 2/3 of the EU average.

3. boom and bust cycles did appear in a few cases – notably in Bulgaria and Romania, and this type of dynamics may appear again – and not only in those two countries – unless severe balance of payments crises are avoided.

4. saving and investment ratios are not impressive, whereas the inflows of FDI were concentrated in a few countries.

5. all CEECs trade extensively with the EU. For all of them, the EU is by far the largest trading partner. Arguably, therefore, output dynamics in the CEECs has benefited from increased openness and integration with the EU[30].

6. substantial inflows of FDI foster growth, but they need favorable accompanying circumstances.

7. persistent large current account deficits cause balance of payments crises and harm sustainable growth.

growth rates that CEECs need in order to catch up with the EU area. It may well be that what is realistic to achieve are more moderate rates of income per capita growth. However, even such moderate growth rates require heavy advances in structural and institutional reforms. Higher growth rates may occur if FDI flows are substantial (and profits are reinvested), and there is constant upgrading of production. But, at the same time, the CEECs would have to avoid, as much as possible, adverse external shocks.

Table 5. resorts to some simple calculations. Assuming that the CEECs grow at an average per

**Table 5. Years required to close per capita income gap (in PPP terms) with the EU**

| | Assuming 5% long term growth rate average | | |
|---|---|---|---|
| | **EU average** | **75% of EU average** | **50% of EU** |
| Slovenia | 13 | 3 | |
| Czech Republic | 18 | 8 | |
| Hungary | 24 | 14 | 0 |
| Slovakia | 31 | 16 | 2 |
| Estonia | 34 | 24 | 10 |
| Poland | 34 | 24 | 10 |
| Latvia | 40 | 30 | 16 |
| Lithuania | 40 | 30 | 16 |
| **Romania** | **45** | **35** | **21** |
| Bulgaria | 50 | 40 | 26 |

**Source**: **Progress towards the unification of Europe**, *World Bank Report* (2000), p. 42.

The features highlighted above cast doubt on the thesis that catching up is looming at the horizon, or that it is very likely to happen as an outcome of current policies. This inference should sober us, particularly in view of the kind of

capita long-term rate of 5%, and that the similar rate for the EU area is 2%, it will take between 13 years (for Slovenia) and 50 years (for Bulgaria) to achieve convergence to the EU average[31]. Romania would need 45 years in order to do so.

---

[30] Lucian Cernat and Radu Vranceanu: **Globalisation and Growth: New Evidence from Central and Eastern Europe**, May 2001.

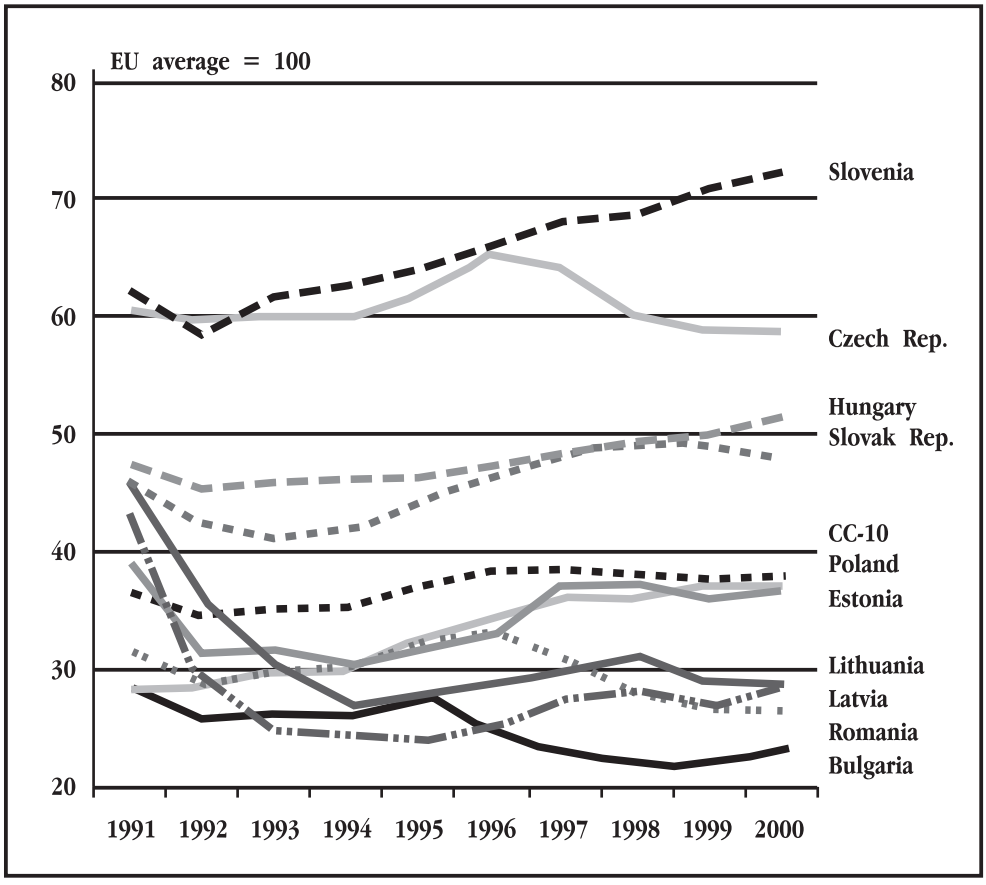
[31] **Progress Toward the Unification of Europe**, Washington DC, *World Bank*, 2000, p. 42.

**Table 6. Per capita income levels in Europe (1998, in PPP terms as % of EU average)**

| Country | Per Capita income level | Country | Per Capita income level |
|---|---|---|---|
| Greece | 66 | Latvia | 27 |
| Ireland | 101 | Lithuania | 31 |
| Bulgaria | 23 | Poland | 36 |
| Czech Republic | 59 | Romania | 27 |
| Estonia | 37 | Slovakia | 46 |
| Hungary | 49 | Slovenia | 68 |

**Source**: **Progress Towards the Unification of Europe**, *op. cit.*, p. 40.

**Table 7. CEECs: Per Capita GDP at PPS: 1990-2000, compared to EU average**




**Source**: EUROSTAT, Figures for 1990-94, and for 2000 are extrapolated based on constant price data in local currency (cited by C. Martin, Velazquez and B, Funck, p. 25).

### 4b. EU integration and catching-up

Central and Eastern European societies do not look poor in important respects (e. g. the literacy rate of the population and general educational standards, behavioral patterns), but most of them face a set of challenges, which are specific to poor countries: still fragile institutions, perturbing growing inequality[32] (precarious *social cohesion*), incompetent governments (political elites), endemic corruption, which distorts and taxes business, etc. Therefore, these countries need to formulate policies, which should tackle poor countries-type problems as well; they need development (catching-up) strategies.

Can integration into the EU be viewed as a Grand Strategy for economic catching-up (*beta*-convergence) and modernization – for the „Big Push", which most of CEECs have been seeking during the last century?[33] It is worthwhile reminding what Paul Rosenstein-Rodan had in mind when he wrote his famous article in 1943. In that article, he referred to key inter-dependencies in an economy, which may preclude its development, unless there is effective coordination among its constituent parts (industries). Development asks for complementary changes of action and resources. And such simultaneous endeavors may not be possible in the absence of a strong stimulus, of a „Big Push". This is a fundamental question to be addressed by policy makers.

In this respect it should be underlined that the EU, as a phenomenon, is exceptional, in a historical perspective. It is unique both economically and politically in modern history. This is why, for example, one can hardly establish an analogy between NAFTA and the Europe agreements, which the accession countries have with the EU. As a matter of fact, the accession countries see in the EU enlargement an historical chance to speed up their economic development and modernization.

In the above context, a related question appears immediately: are the current negotiations and the efforts to adopt the *Acquis Communautaire* the equivalent of an effective strategy for economic catching-up? In many domains, they may well be so, to the extent that good institutions are smoothly „imported" and function effectively, and to the extent that technology transfer and upgrading of production (via FDI) occur intensely, for the benefit of a majority of the citizens (and *social cohesion* is not impaired).

Empirical analyses show that the opening of the economy and integration with the outside world, have better chances to foster economic growth when there is an intense inflow of foreign direct investment, which upgrades the capital stock and human capital of the recipient countries. It is no surprise, therefore, that the frontrunner accession countries have received a disproportionate share of FDI.

---

[32] It should be acknowledged, nonetheless, that much of this growing inequality is unavoidable, as a result of the change from a command (highly equalitarian) to a market-based economic system.

[33] P. N. Rosenstein-Rodan: **Notes on the Theory of the Big Push** in H. S. Ellis: **Economic Developemnt for Latin America**, 1961, New York, *St. Martin Press*; see also Paul Rosenstein-Rodam: **Problems of Industrialization of Eastern and South-Eastern Europe**, *Economic Journal*, 1943, Vol. 53, June-September, p. 202-211.

Equally, a strategy for economic development (catching-up) requires policy ownership, which refers to both domestic intellectual capabilities (expertise), as well as to the capacity to formulate policies. This is the lesson of the most impressive cases of catching-up of the last century (whether one thinks of Japan, South Korea, Singapore, and more recently, Ireland).

It may be that the EU arrangements could supplant partially the need for domestic policy capabilities. But, as the reports of the European Commission consistently document, particularly in the case of the less performing accession countries, public administration reform is critical for development, which is a clear indication of the essential tasks of domestic policy. It is true, however, that, within the constraints of the institutional functioning of the EU, domestic policy formulation acquires a new connotation. But the problem remains as such, since Brussels cannot be a substitute for key decisions at the national level.

Here is a caveat about the linkage between EU integration and convergence. Some of CEECs premises for catching-up may clash with the strict conditionality of the Maastricht Treaty criteria, in case the accession countries intend to join the Exchange Rate Mechanism (ERM2) and, later on, the Monetary Union. A related situation is entailed by the implications of the *Balassa-Samuelson Effect*, which may make it impossible for accession countries to comply with the requirement of a low inflation rate in order to fit the EU (ERM) area[34]. And, should they try to attain a very low inflation rate, this may undermine growth and, therefore, catching-up. If this is the case, should some of the accession criteria be made more flexible? How would the EU member countries view such a weakening of criteria? To what extent can the logic of a „variable geometry" play a role in this context? Would such a variable geometry process of enlargement be manageable?

For the EU candidate countries, the low inflation criteria (and, further, the Maastricht Treaty provisions) and the negotiations with Brussels raise two main sets of questions. One regards trade links and, more specifically, the capacity of accession countries to withstand competitive pressures when trade asymmetries disappear. The other issue regards the possibility for the candidate countries to accommodate the stern exigencies of a very low inflation environment, even if they do not adopt the single currency.

It should be also highlighted that, against the backdrop of vagaries in an increasingly uncertain world environment, the EU can provide a shelter, which should be seen in the context of a world tendency for the formation of economic and monetary blocks.

---

[34] Dariusz Rosati: **The Balasssa-Samuelson Effect among CEECs** paper presented at the *Balassa Commemoration Conference*, Budapest, October 18-19, 2001. See also Laszlo Halpern and Charles Wyplosz: **Economic Transformation and Real Exchange Rates in the 200s: The Balassa Samuelson Connection**, chapter 6. p. 227-240 in **Economic Survey of Europe 2001**, *UN/ECE*, Geneva, 2001.

## 5. Final remarks

If the line of reasoning suggested by this paper is accepted, it does make sense to ask the question: what are the basic premises for the EU accession countries to embark on rapid and sustained growth trajectories? The drastic decline of growth in Poland, lately, shows that such trajectories are hard to achieve and sustain.

One should not forget that substantial flows of FDI were attracted, in many cases, by big privatization deals. Once such deals come to an end (because the number of interesting state assets put on sale is limited), a drastic reduction of capital inflows can strain severely the balance of payments and may require painful adjustments, which would bring growth rates down.

What are the main differences among the clusters of accession countries, besides income per capita and economic performance (for instance, between the so-called Visegrad Group plus Slovenia, and Romania and Bulgaria)? Are there any particular traits pertaining to the Baltic countries – apart from the support that they receive from Nordic countries? Could Croatia (which is not yet a candidate country) move much faster than other Balkan countries? Arguably, in this regard, the quality of institutions plays a major role.

If growth trajectories are so hard to sustain, what would be the implications for the politics and the economics of EU *enlargement*? What are possible venues (prerequisites) for enhancing *convergence*, and for making it happen in the foreseeable future? The issue of convergence is relevant both for the countries which are likely to join the EU in 2004, as well as for the other candidate countries.

One should also keep in mind that it is the first time in its history when the EU is supposed to accept such a large number of countries, which are considerably less well off (in terms of income per capita and not only) and have lower economic performance. Under the current rules of the game, a „big-bang" enlargement could considerably strain the Union, both financially and functionally. Therefore, it is not clear that enlargement will be a success, unless the institutional reform of the EU and other common market issues are solved in a timely fashion. But is it possible? And, if not, would that involve a less impressive enlargement (fewer countries), or a delay of the process?[35] The worsening conditions of world economy, which are increasingly felt in Europe as well, will certainly have an impact on the public debate about enlargement, and the conditions attached to it.

In this context, the political and economic mechanics of *enlargement* would have to be considered in conjunction with what the candidate countries need, in order to achieve rapid and sustained economic growth.

Under the present circumstances, a more realistic goal for governments may be to foster sustainable growth, which will eventually allow convergence, rather than enforcing EU accession criteria at any costs. Whilst the former may be as difficult to achieve as the latter, it also is the only key to development.

[35] It is noteworthy that some leading politicians talk about a possible „big-bang" approach to EU enlargement. 10 countries would be eligible for admission in 2004.

**References**


- Agenor, P. Richard (2000), **The Economic of Adjustment and Growth**, New York, *Academic Press*.
- Beck, Ulrich, **Globalization's Chernobyl**, *Financial Times*, 6 November, 2001.
- Blanchard, Olivier (1997). **The Economics of Post-communism**, London, *Clarendon Press*, 1997.
- Cernat Lucian and Radu Vranceanu, **Globalisation and growth: New evidence from Central and Eastern Europe**, May 2001 *(manuscript)*.
- David, Ben (2000). **Trade, Growth and Disparity Among Nations**, in **Trade and Poverty**, WTA, Geneva.
- Dauderstadt, Michael and and Lothar Witte (2001) **Cohesive Growth in the Enlarged Euroland**, Bonn, *Friedrich Ebert Stiftung*.
- Ellis, H. S. (ed.), **Economic Development for Latin America** (1961). New York, *St. Martin Press*.
- Easterly, William (2001), **The Lost Decades: Developing Countries' Stagnation in Spite of Policy Reform 1980-1998**, February, *(manuscript)*.
- Easterly, William (2001), **The Elusive Quest for Growth**, Cambridge, *MIT Press*.
- Halpern, Laszlo and Charles Wiplosz (2001), **Economic Transformation and Real Exchange Rates in the 2000s: The Balassa-Samuelson Connection**, chapter 6 (p. 227-240) in **Economic Survey of Europe 2001**, UN/ECE, Geneva.
- Hoff, Karla, Beyond Rosenstein-Rodan: **The Modern Theory of Coordination Problems in Development** (2000), in: **Annual World Bank Conference on Development Economics. Proceedings**, World Bank, Washington DC, 2000.
- Guillen, Mauro. F. (2001). **The Limits of Convergence. Globalization and Organizational Change in Argentina, South Korea and Spain**, Princeton, *Princeton University Press*.
- Kolodko, Grzegorz W. (2002). **Globalization and Catching-up in Transition Economies**, Rochester, NY, and Woodbridge, Suffolk, UK, *University of Rochester Press*.
- Deepak, Lal (1999), **Unintended Consequences. The Impact of Factor Endowments, Culture, and Politics on Long-Run Performance**, Cambridge, *MIT Press*.
- Lucas, Robert (1988), **On The Mechanics of Economic Development**, *Journal of Monetary Economics*, Vol. 22 (July), 3-42.
- Maddison, Angus (1995), **Monitoring the World Economy: 1820-1992**, *Development Centre Studies*, OECD, Paris.
- Martin, Carmela and Francisco J. Velazquez, and Bernard Funck (2001), **European Integration and Income Convergence. Lessons for Central and Eastern European Countries**, May, *(manuscript)*.
- Mitra Pradeep and Marcelo Selowsky (2001), **Transition: The First Ten Years** *World Bank (manuscript)*.
- O'Hearn, Denis, in M. Dauderstadt and L. Witte, *op. cit*., p. 80-90.
- Rodrik, Dani (2000), **Development Strategies for the Next Century**, February, *Harvard University (manuscript)*.
- Rosati, Dariusz (2001), **The Balassa-Samuelson Effect among the CEECs**, paper presented at the *Balassa Commemoration Conference*, Budapest, 18-19 October.
- Rosenstein-Rodam, Paul (1943), **Problems of Industrialization of Eastern and South-Eastern Europe**, *Economic Journal*, 1943, Vol. 53 (June-September), p. 202-211.
- Rosenstain-Rodan, Paul (1961), **Notes on the Theory of the Big Push**, in H. S. Ellis, *op. cit*., p. 57-81.
- Summers, Larry (2000), **International Financial Crises: Causes, Prevention and Cures**, Richard T. Ely Lecture in the *American Economic Review: Papers and Proceedings*, May.
- The World Bank (2000), **Progress Toward the Unification of Europe**, Washington DC, *World Bank*.