

ENLARGEMENT IS AN OPPORTUNITY FOR EUROPE

Jacques de Larosière*

Having followed the economic development in Central and Eastern Europe for the last ten years or so, I am particularly pleased to contribute to this tenth anniversary edition of the National Bank of Slovakia's journal. My warm relationship with the Central Bank go back indeed to the very beginning of the formation of your State. I would like to make a few general comments on the occasion of this historical event.



If we look at the way in which macro-economic balances have been largely restored and consider inflation rates, budgetary discipline and monetary stability, it can be seen that the trend is very positive. With respect to structural elements such as the privatisation of economies, opening up to the world trade, the establishment of the rule of law, the strengthening of democracy and the development of a legal system that is predictable and reassuring for investors, it can also be said that it has been a success. These results have been accompanied by a thoroughgoing redirection of trade flows from East to West. This is one of the most substantial changes in modern economic history.

The balance of payments deficits recorded in the region (about 20 billion dollars a year since 1997, or 3-7 per cent of GDP depending on the country) have been fully financed and even „overfinanced“— by flows of private capital (estimated at 25 billion dollars for the year 2000). Most of these flows comes from foreign direct investment, the most stable form of external financing available to countries (an estimated 17 billion dollars for 2000).

In fact, despite the crisis which has affected emerging markets since 1996, direct investment flows to the most advanced countries of Central and Eastern Europe have continued to increase. This favourable

trend is directly linked to the progress in privatisation, liberalisation and structural reform achieved by these countries and the prospects opened up by the process of accession to the European Union.

The liquidity tightness from which some emerging markets have been suffering for some time has not spread to Central and eastern European Countries. The absence of such a link, which is helped by relatively modest debt levels, is an illustration of the phenomenon of convergence which already characterises the candidate countries.

It should, however, be pointed out that success is uneven. Some countries are further along the road of transformation. Hungary, Poland, the Czech Republic, Slovenia, Slovakia and certain Baltic countries can be said to be among the most advanced.

Enlargement is an opportunity for Europe, and we need to look at what counts in accession. It is often said that the average GDP or per capita income of the 10-12 candidate countries is more than 50 per cent lower than the average of members of the European Union, and that those countries are therefore far from accession. I believe this is a profound error. What is important is not to compare per capita income, but to examine the state of structures and of the institutional and legal environment that provides for sustainable growth. And financial stability and macro-economic discipline should be included in that environment. Seen from this angle, the problem of accession becomes easier to deal with. It can even be argued that weak per capita income represents an opportunity for western part of the Union and an opportunity for foreign investors to find manpower pool in favourable conditions.

We should be aware of the scale of the changes taking place. Central Europe has been growing on average by 4-6 per cent annually for some years.

* Presidential advisor at BNP Paribas. Former governor of the Banque de France and former president of the European Bank for Reconstruction and Development.



This is already remarkable, even though these rates imply a rather long period for catching up with the rest of Europe, but it may also be said that the situation is more favourable, since changes are occurring in these economies which we can glimpse but cannot yet measure very well. There are zones of modernity with high productivity growth, particularly in sectors such as communications or advanced technology industries. In some large multinational companies, for example, we are witnessing large-scale transfers of technology or research to countries of Central and Eastern Europe. This involves rather special growth models. It may be said in this regard that one growth rate may hide another, in other words, while it is true that these economies are growing at a rate of 4-6 per cent per annum, some sectors are growing much more rapidly, while others are in the process of adjustment or even extinction. An average figure is, therefore, perhaps not the best indicator in judging the dynamics of accession.

The accession of a number of countries (those which are at the forefront of the process) now seems relatively close. The date 2004 has been mentioned by the Gothenburg summit for the first accessions. In this context, it seems important that the European Union should maintain the principle of selectivity: the first country ready should be first to enter. It would appear to be abnormal and regrettable if a policy of "country grouping" prevailed over a very clear principle: the principle of assessing each candidate with respect to structural reforms, the institutional environment and absorption of the *acquis communautaire*.

There will, of course, be inevitable transition periods. They have occurred in the past, and will also have to be accepted for the new candidates in the future. Furthermore, economic union and monetary union should not be confused. Economic union is the first stage, and it depends to a great extent on reforms of the institutional framework and on community accession. Then there is monetary union, which is governed by the principles of Maastricht. Countries which have made progress in fighting inflation, reducing long-term interest rates, achieving currency stability and reducing budget deficit and public debt will indeed have come closer to the Maastricht criteria. They will then enjoy the convergence benefits which the markets confer on this type of movement and from which the countries of southern Europe have already profited.

In sum, we are very lucky to have our Eastern and Central European neighbours as candidates. It is true that there are costs to the Community which will have to be better distributed. At the level of original

funds, for example, room will have to be made for the newcomers. This is not very popular – as the recent Irish vote shows – but it is normal, when a club expands. However, if the political will exists – and the will to expand is there – ways of finding room for the new members will be found.

I also think that this is a challenge for Europe, in the sense that we, too, must be ready. Reference is always made to the 31 chapters which candidate countries must respect. But we must also be ready to enable them to accede. This means that we should be capable of simplifying our own political decision-making process and reducing the cost of European institutions to enable us to welcome countries which have lower standards of living. In this sense, enlargement is also a challenge and an opportunity for Europe.

It will become evident that I am an optimist. I am of course, aware of the importance of the challenges and the amount of investment required, particularly in the sphere of environment. But I am confident, because we have gone through very similar phases with countries like Spain, Portugal, Ireland and Greece. In this connection, the International Monetary Fund has carried out studies comparing the year $n-5$ before the accession of southern European countries with the current situation of candidate countries of central and eastern Europe, which may be regarded as being in year $n-5$ before accession. In terms of their macroeconomic discipline, the level of openness and a whole series of structural factors, the Central European countries regarded as being most advanced are already at the level, and sometimes even beyond it, of the degree of the discipline and structural quality attained by the countries of Southern Europe at the same time in the accession timetable.

Lastly, we must have the humility to look back. We are often impatient, because we want things to proceed faster, we want countries to be perfect. But we rather forget that we ourselves progressed slowly. Take, for example, the situation in Western Europe ten years after the war, in 1955, particularly with regard to the degree of openness, price and trade liberalisation, macro-economic discipline and inflation, comparing that with what is happening in Central Europe ten years after the fall of the Berlin Wall. This is something which could give us, the countries of western Europe a little humility, and also a lot of hope.

1) With an average catch-up rate of 2 per cent per annum (experience of the most recent enlargements), 33 years are necessary to halve the initial gap.