In this chapter a framework is developed for macroeconomic policy analysis during the transition to membership of the EU and the euro zone. The framework is applied to four accession countries in Central Europe (CE): the Czech Republic, Hungary, Poland and Slovakia. A multi-annual fiscal adjustment strategy (MAFAS) and a pre-pegging exchange rate regime (PPERR) appropriate for maintaining internal and external balance are described and evidence on budgetary procedures is presented. A comparison suggests that the four CE countries are better prepared for fiscal stabilization than Greece, Spain and Portugal were in the 1970s. Nevertheless there is still considerable room for institutional improvement. A stronger commitment to fiscal targets at the preparatory stage would improve fiscal performance in all four countries, and their transition would be more credible if they adopted some group procedures for convergence.

Introduction

A common orientation for macroeconomic policy and institutions can be found in the countries of Central Europe (CE) that are set to become members of the European Union (EU) in 2004. Policy-making institutions in the Czech Republic, Hungary, Poland and Slovakia will eventually conform to those of the EU. The criteria for joining the euro zone also imply the eventual convergence of their macroeconomic performance. While the process of developing a market economy lasts several decades, and fulfilment of the criteria has not been part of the enlargement negotiations, the change in the economic regimes of the CE countries towards nominal stability is already being monitored by world financial markets. Indeed this occurs in both member and associated states. The reason for this scrutiny is that the regime change requires the countries’ medium-term strategy to be credible and their
macroeconomic framework to be understood not just internationally but also by citizens and social partners within those countries.

Whether or not a reform strategy is understood at home and abroad depends on how policy-making institutions interact with the specifics of the economy and society. The absence of an efficient, equitable and simple to run tax system is seen as a major microeconomic and macroeconomic obstacle to growth, as well as to social consensus. The same is true, more broadly, of the absence of a transparent legal environment, which deters domestic and foreign investment. These examples show how institutions may determine whether popular support for reforms will be sustained during the transition or whether a ‘stop and go’ reform pattern will emerge instead, delaying adjustment and ultimately threatening national cohesion. That being said, we shall confine our analysis of institutions to budgetary procedures in four of the 10 accession countries – the Czech Republic, Hungary, Poland and Slovakia, which were the founding members of the Central European Free Trade Agreement (CEFTA).

Evaluating the macroeconomic policies and performance of an economy in transition is a difficult task. In 1995 Branson and Braga de Macedo developed a framework for that purpose. Here we shall present more detailed evidence on the Czech, Polish, Hungarian and Slovak budgetary procedures and extend the framework.

The first problem faced by Branson and Braga de Macedo when developing an analytical framework was that before their transition these economies had very large government and state enterprise sectors, making it difficult to distinguish monetary from fiscal policy. In their centrally planned economies there was no private sector, so there was no separate public sector and no public sector deficit or debt. Without a private sector there was no one for the public sector to have a deficit with: monetary policy was simply the provision of finance for investment in the central plan. Essentially, fiscal and monetary policy were the same thing. The four CE countries were somewhat more advanced than their neighbours in having some market institutions at the beginning of transition.

As the economies moved through the transition, privatization created a private sector and the distinction between public and private sectors acquired macroeconomic significance. Fiscal policy gradually emerged as the concepts of public expenditure, tax revenues, government budget and public debt became operational. With the creation of a central bank, and the withdrawal of the central bank from automatic financing of the budget deficit, monetary policy emerged as the provision of credit to the private sector. During the transition the countries were expected to introduce market-oriented policy-making institutions in which the distinction between fiscal and monetary policy was clear, and the use of these policies in maintaining internal and external balance could be analysed in the usual fashion.

Fortunately, at least for the purpose of economic analysis, these national economies, as all others, faced an external constraint throughout their