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CENTRAL EUROPE IS DOING BETTER THAN IT SAYS

Matthew Olex-Szczytowski and Jacek Rostowski

There is an unspoken compact underlying the expansion of the European Union. At least, that is what many in the eight central European accession countries believe. They have gone through wrenching reforms at a speed largely determined by the EU and are having to import the acquis communautaire - the EU's body of law, widely seen as an impediment to growth - en bloc. Now as they join the Union and their "riskiness" falls they expect a massive flow of foreign direct investment in compensation.

FDI is vital to the economic and political success of EU expansion, a source of capital to balance central Europe's savings shortages. Yet if the hoped-for surge is to happen, and capital is to be wisely allocated, the overly gloomy economic data that emanate from the region must be challenged.

Given the high stakes, the simplistic reliance by many in the west on official data is perplexing. While some of the eight's successes are dutifully recorded, such as growth (on a weighted basis it officially averages 3.5 per cent this quarter), crucial achievements are habitually disregarded and problems over-emphasised. This probably stems from a subconscious desire by left-leaning commentators to see capitalism fail where communism has collapsed.

Perhaps the most serious flaw in the data is the massive underreporting of GDP, largely because of failure to account for shadow economic activity. Since communist times this has been of a different order of magnitude in central Europe than in the old EU, and is widespread in the fast-growing new entrepreneurial sectors. The phenomenon has been accentuated in recent years by the growth in regulations and social charges. Friedrich Schneider, an economist at Linz University, has estimated that the shadow economy in the eight in 2000-01 averaged 28 per cent of official GDP, up from 23 per cent in the early 1990s. The percentages ranged from "only" 18 per cent in the Czech Republic and Slovakia to 40 per cent in Latvia. It follows that the region today generates well over 100bn euros in unrecorded output... a shadow Czech Republic plus Slovakia.

Labour markets are also healthier than the headlines imply. Prof Schneider found that the proportion of the working age population involved in shadow output ranged from 13 per cent in the Czech Republic to 33 per cent in Estonia. As with the GDP figures, these estimates are confirmed by local studies. In Poland, for example, a survey last year for the Private Employers' Confederation put the proportion of workers in the shadow economy at 19 per cent.

Such positive phenomena are rarely recognised in the region itself, for reasons rooted in the convoluted psychology of the post-communist elites. Being of a generation that has seen foreigners sweep all before them, they are scarred by an unspoken culture of failure and despair. Many, politicians and commentators alike, do not fully understand the modern economic world. An atavistic egalitarianism and envy of the new wealth creators are endemic. So they create ideologies of "crisis". It is politically incorrect to praise success or to admit that there are legions of working "unemployed".

These doctrines of doom reflect (and infect) mass opinion. In a recent Polish survey of 4,000 families, 68 per cent of respondents thought life had become much worse since communism fell. Yet official real consumer expenditure per capita has risen by 55 per cent in the past ten years (the EU managed 26 per cent). In the Czech Republic, where irrational pessimism is dubbed blba nalada or "bad mood", about 30 per cent feel they are now poor. However, in recent years fewer than 5 per cent of Czech households have been below the official poverty line. Indeed, the World Bank sees the Czech Republic and Slovakia as exemplars of equality alongside Austria and Japan. By standard measures such as the Gini coefficient the Czech Republic, Hungary, Poland and Slovakia, with coefficients in the twenties, are much more "equal" than say Italy or the UK with "Gini's" at around 35. As the IMF has noted, in the Region "the increase in income inequality has been modest".

The central European accession countries are more prosperous and productive, and thus better investment targets, than the databases usually indicate. Yet the western press is all too ready to echo the woeful themes that are repeated in the eight's own lugubrious media. We deserve a truer picture of these messy but dynamic economies. And when vying with that local Weltschmerz, the more rational elements in the eight need all the help they can get.

Matthew Olex-Szczytowski is head of division at the European Investment Bank.
Jacek Rostowski is professor of economics at Central European University and member of the Council of CASE – Center for Social and Economic Research