



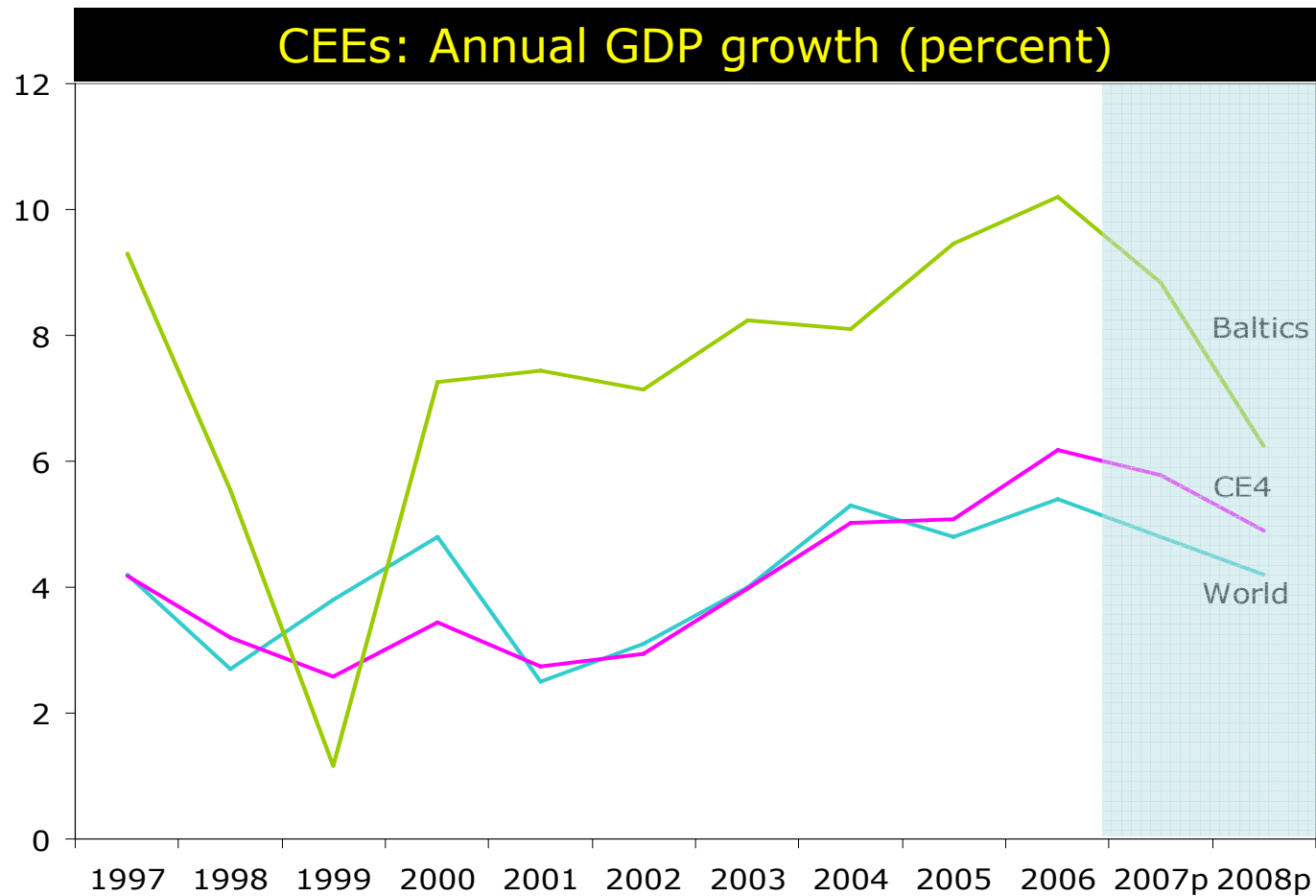
Economic and Fiscal Trends in Central and Eastern Europe

Central European AmCham Conference

Prague, March 11, 2008

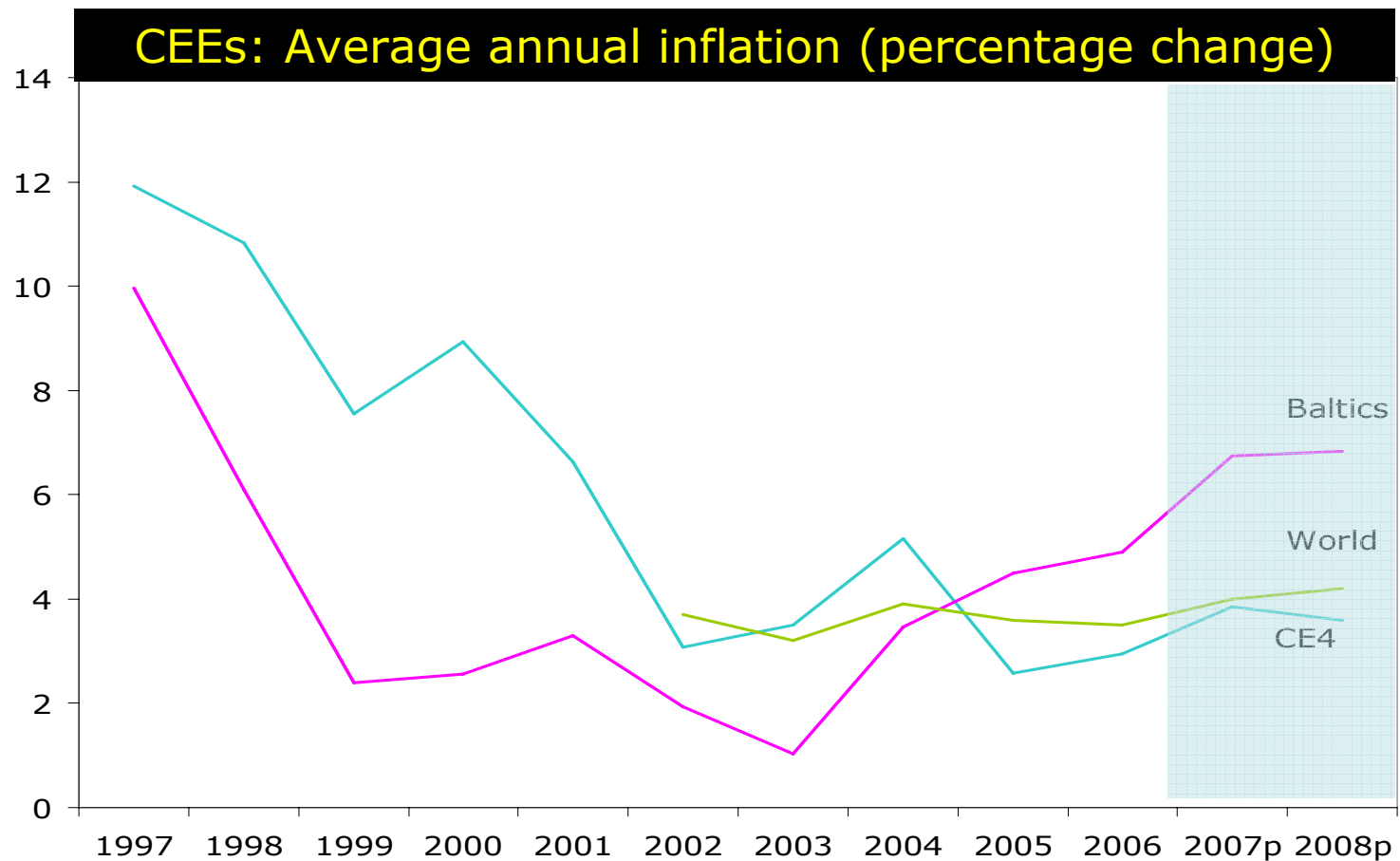
**Christoph Rosenberg
International Monetary Fund
Warsaw Regional Office**

Growth in CEEs has been high, but is expected to slow in the near term



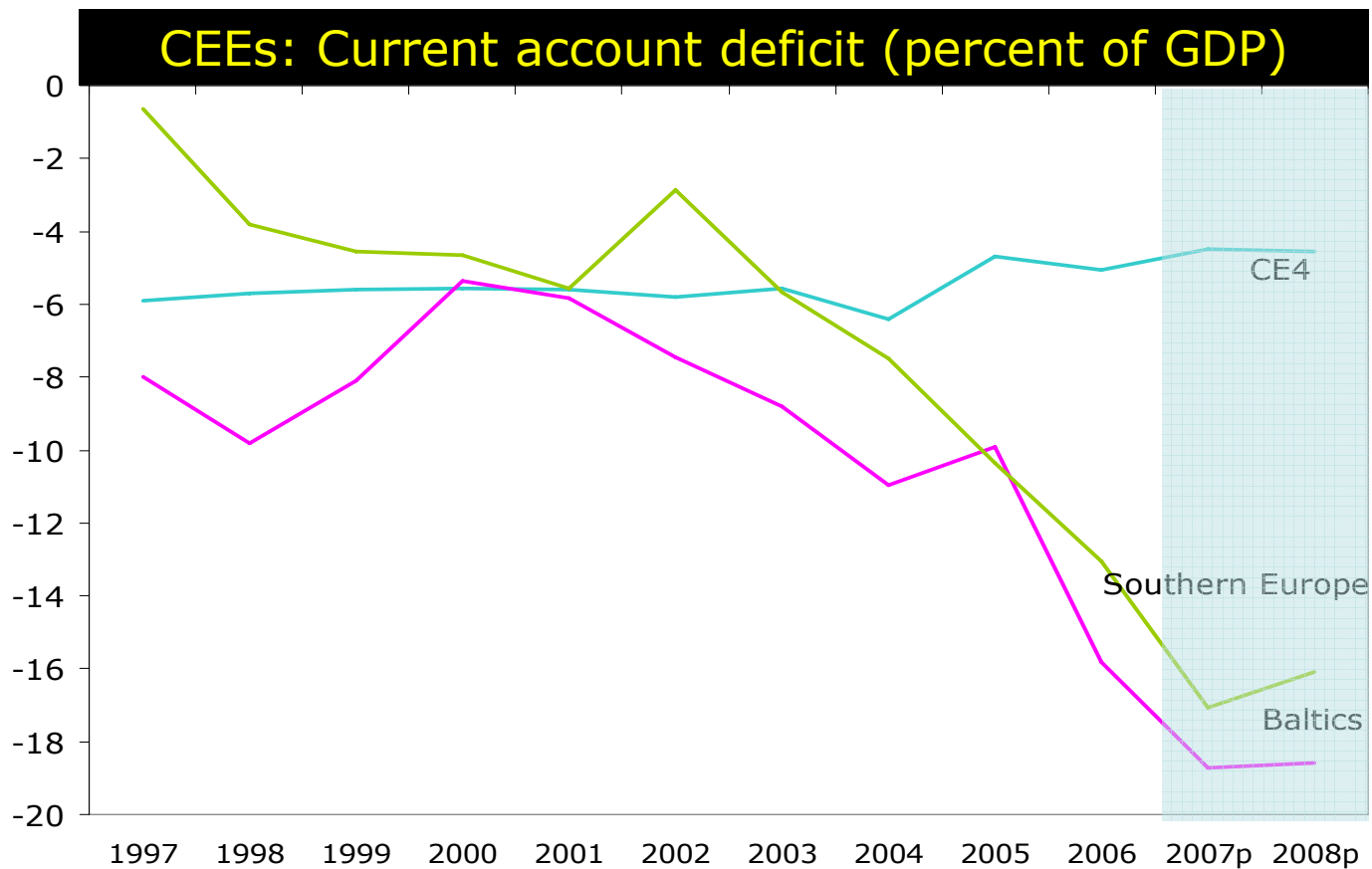
Source: WEO update Jan 2008.

Inflation is rising especially in the Baltics



Source: WEO update Jan 2008

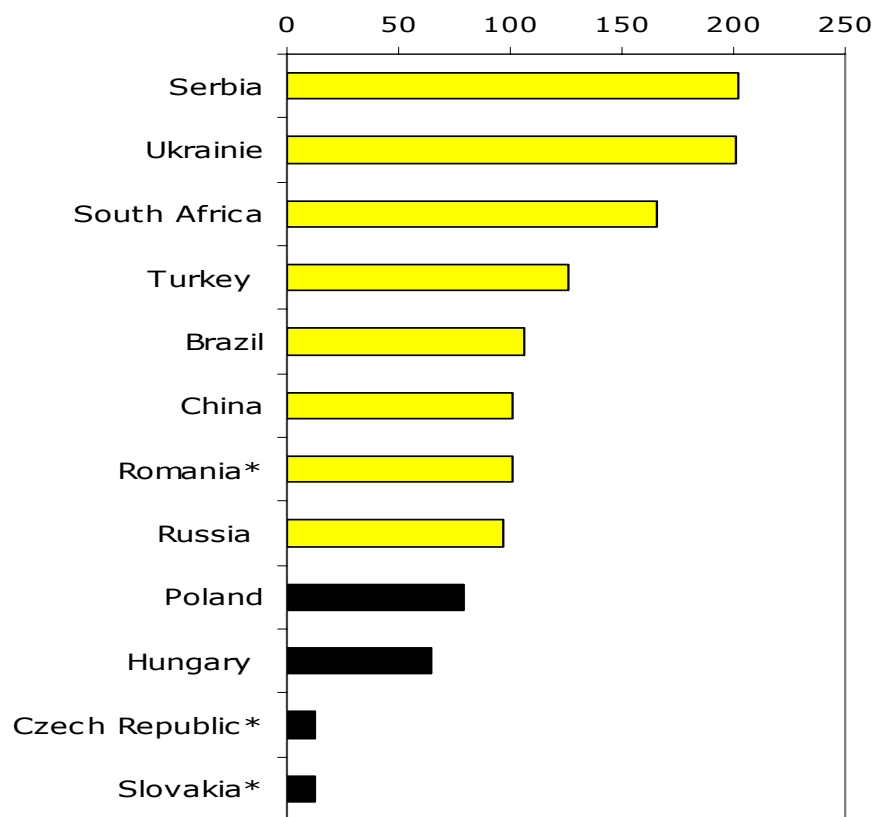
...and external imbalances are growing



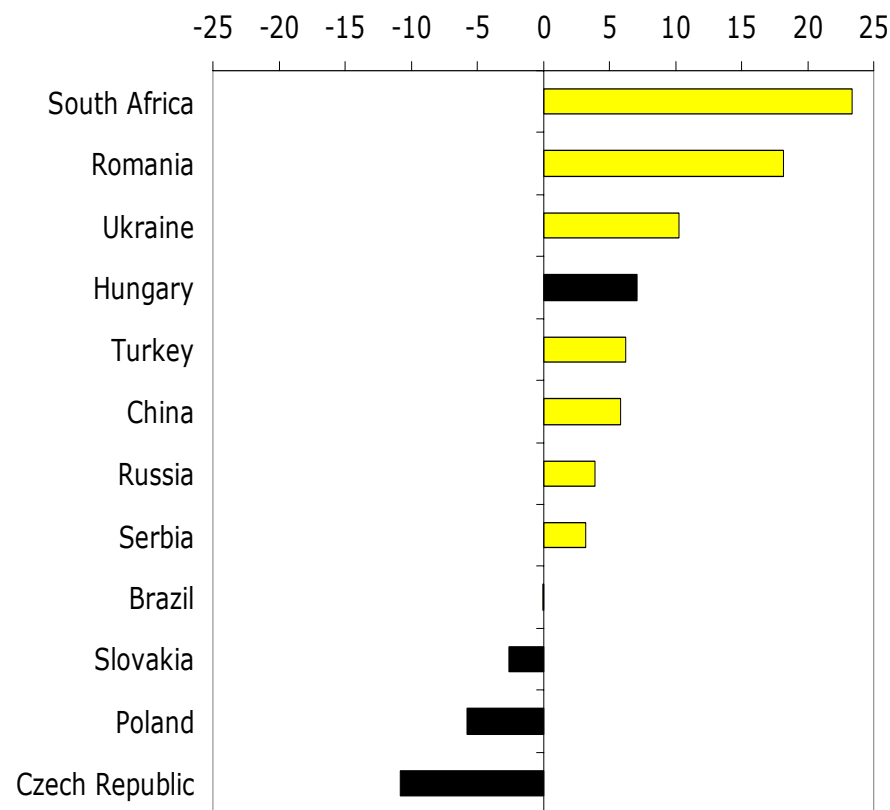
Source: WEO update Jan 2008

Most NMSs have weathered the subprime market fallout better than other EMs

Change in EMBI
July 16 – March 6 (bps)



Change in the EURO exchange rate
July 16 – March 6
(+= depreciation, percent)



Source: Bloomberg, national statistics.
*.Jul 16 - Februar 22

Strong growth hides underlying macro vulnerabilities

Key Macro Indicators 2006 (in percent of GDP)

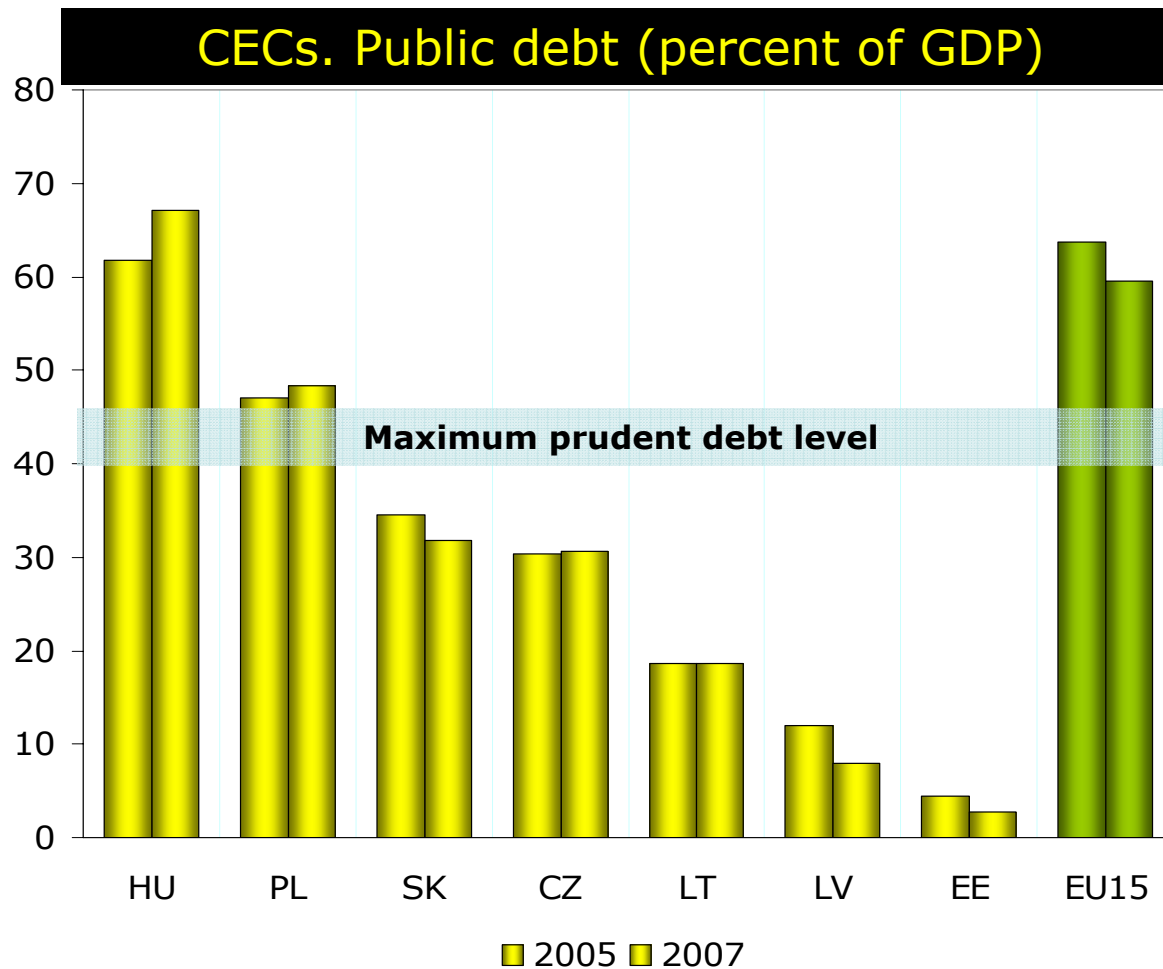
	CE4	Baltics	other EM countries*	Asia 1997**
General government deficit	-4.9	0.9	2.0	-1.8
C/A balance	-5.2	-15.6	2.7	-3.3
External debt	57.7	89.8	22.0	66.5
Public debt	43.4	10.9	31.2	18.5
Reserves/ST debt	115.1	54.8	353.0	20.1
Credit growth (in percent)	8.4	37.6	11.4	13.9

* EM countries - Brazil, Chile, China, Colombia, Indonesia, Peru, Russia, Thailand.

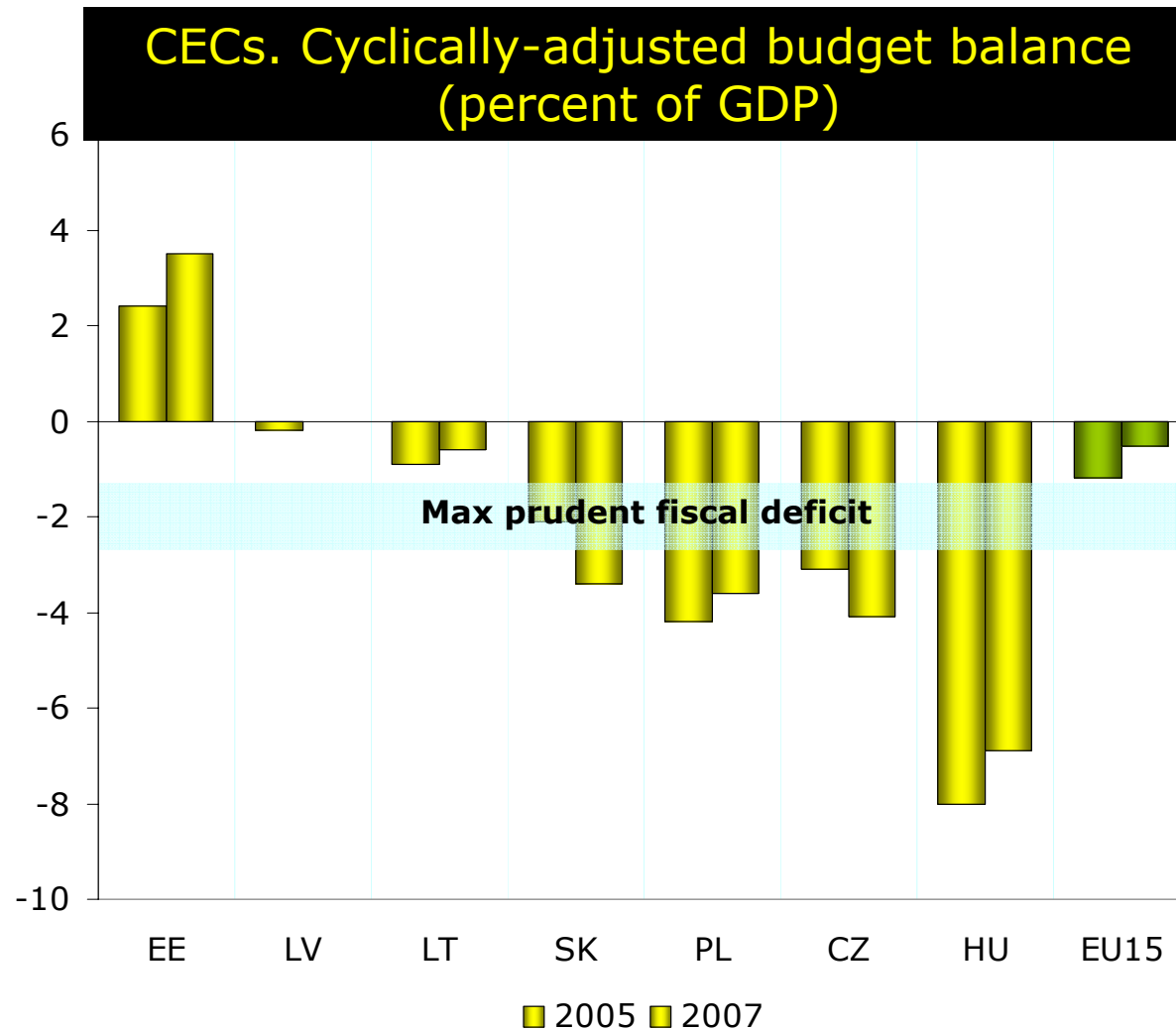
** Korea, Indonesia, Thailand.

Source: IMF GFS, IMF IFS, IMF Article IV Consultations

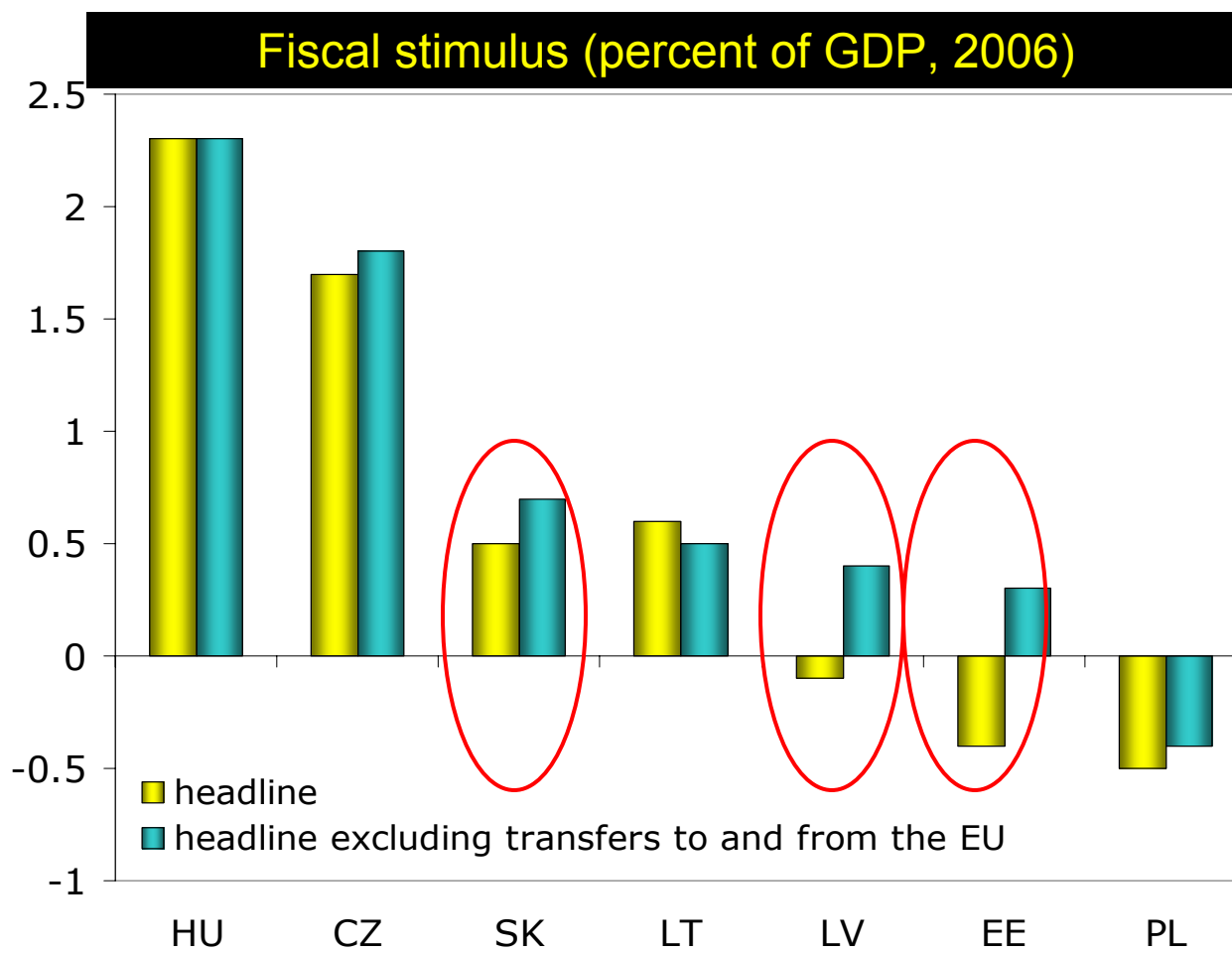
Despite buoyant growth, public debt has not been declining much...



...and structural fiscal balances do not show strong improvements

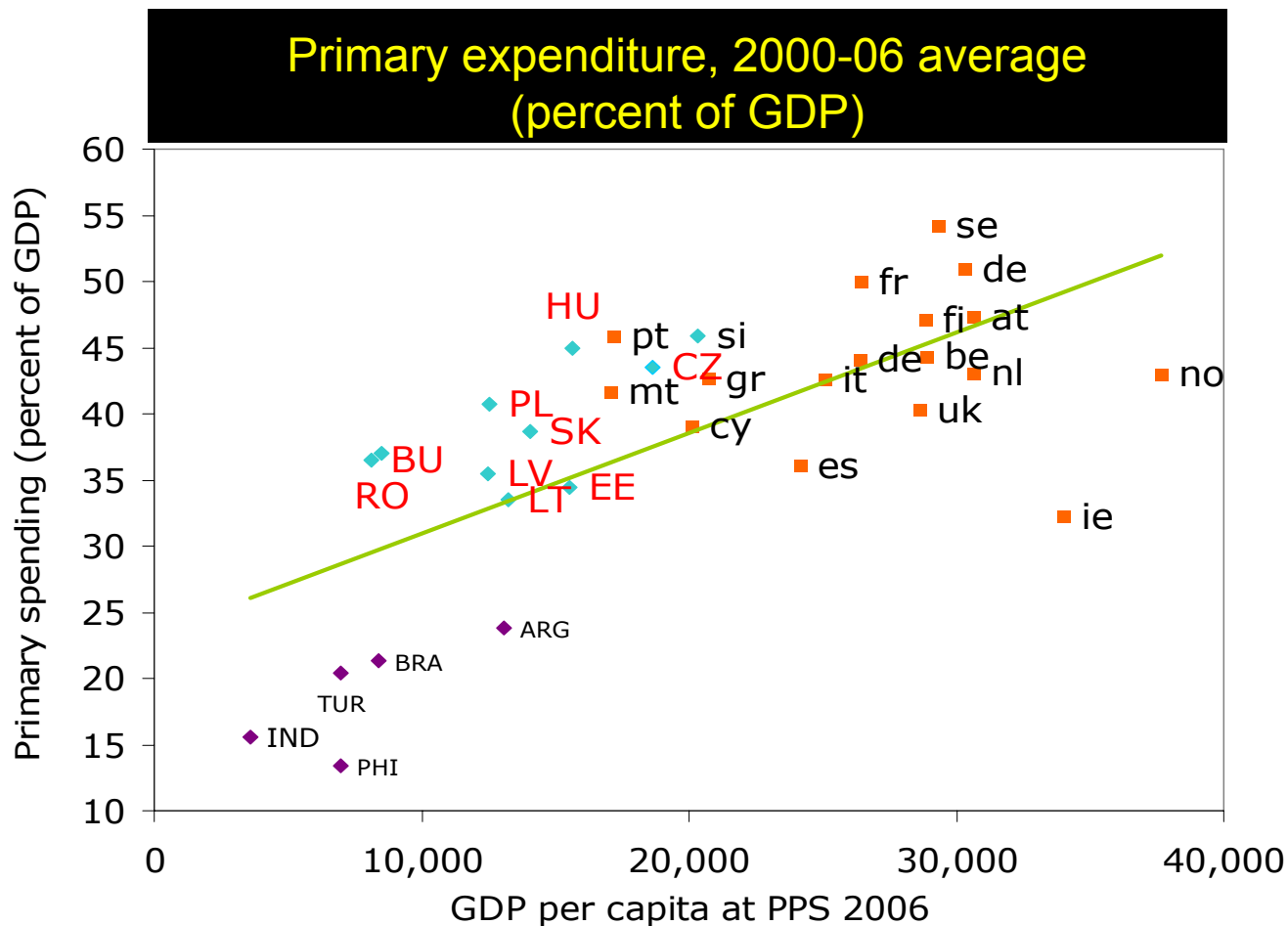


Fiscal policy is even more pro-cyclical if one accounts for the effect of EU funds

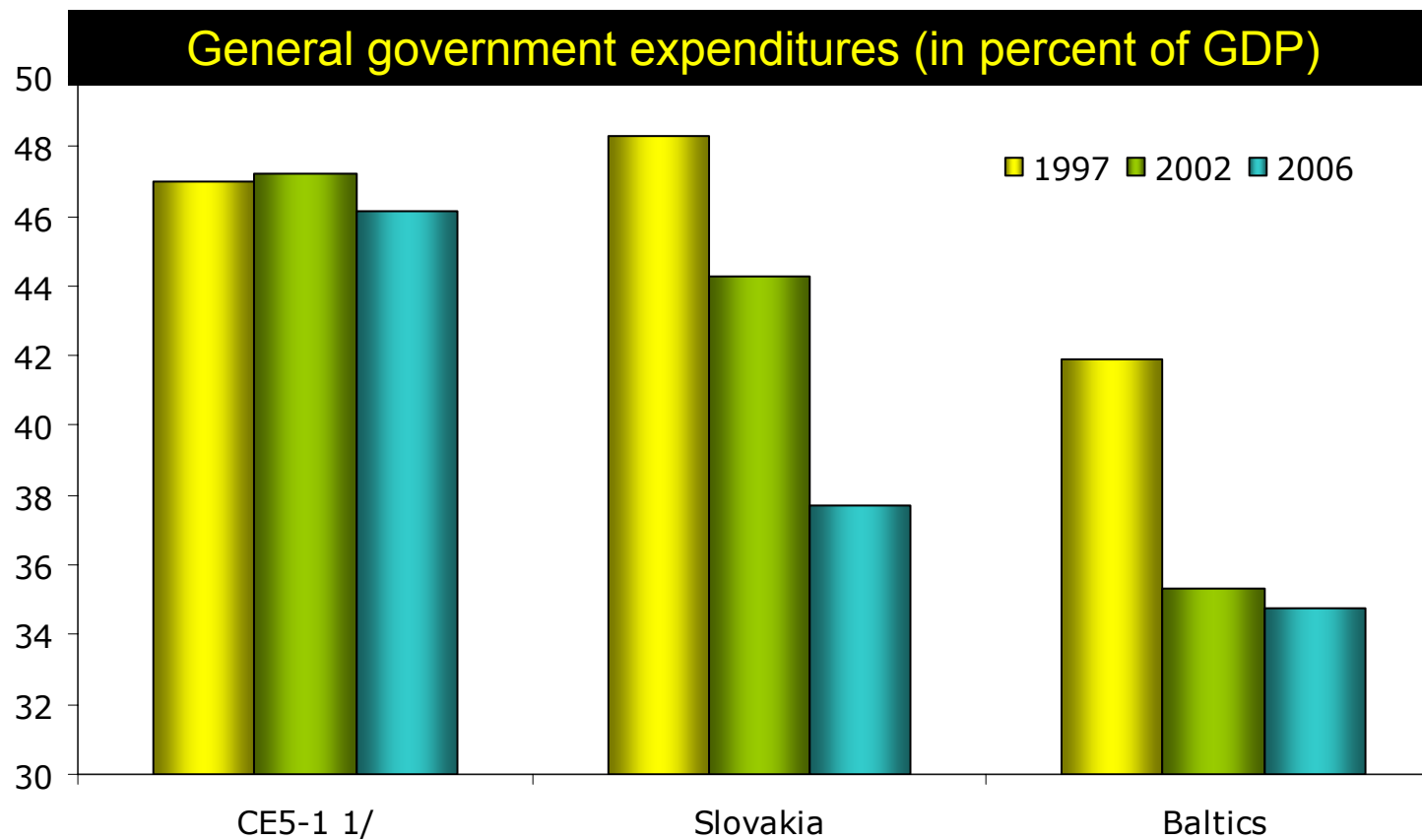


Source: Christoph B. Rosenberg and Robert Sierhej, Interpreting EU Funds Data for Macro Analysis in the New Member States, IMF Working Paper 07/77.

Primary spending in CEE is relatively high suggesting that fiscal adjustments should start on the expenditure side



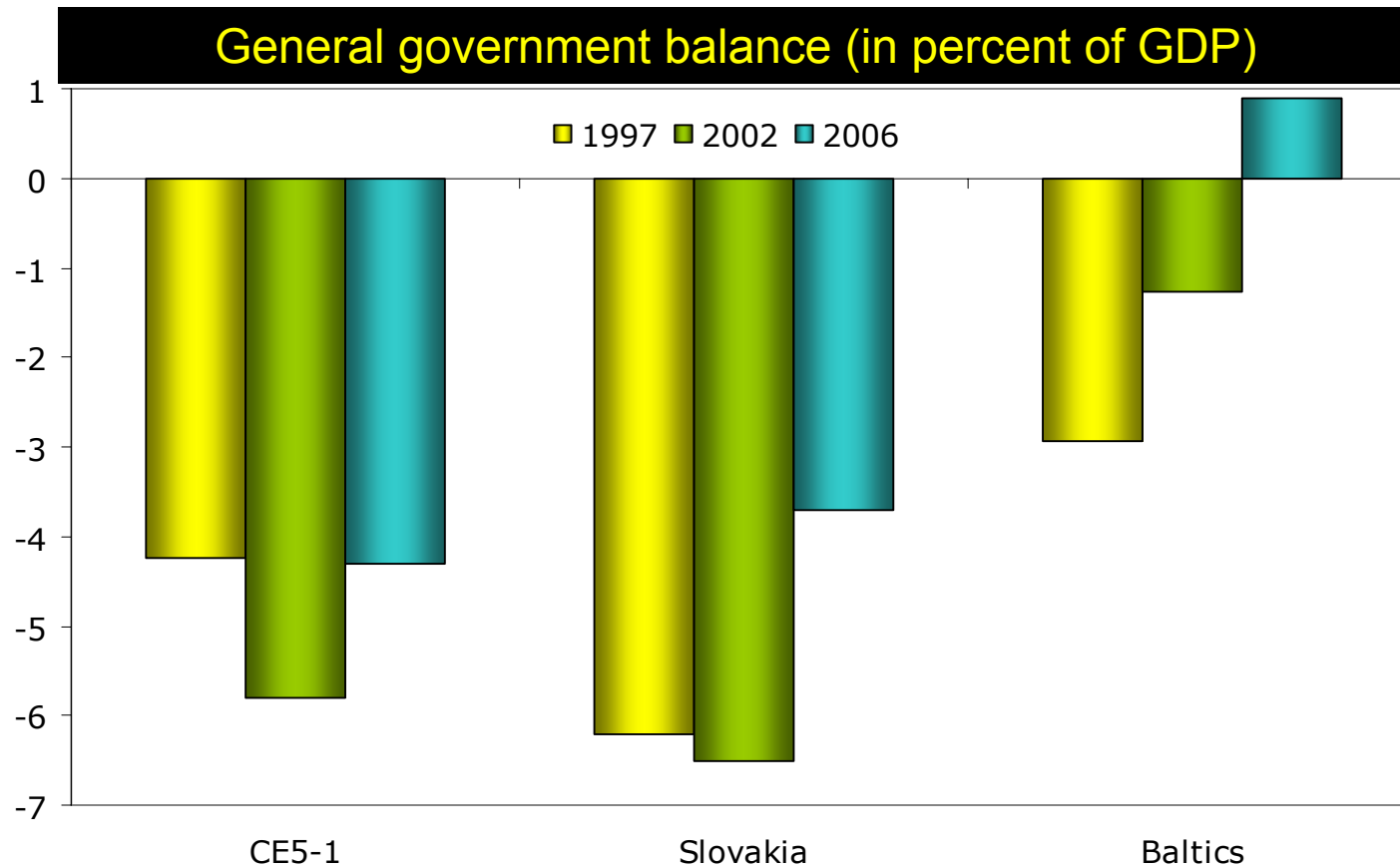
Some CEEs implemented deep spending cuts in the last decade...



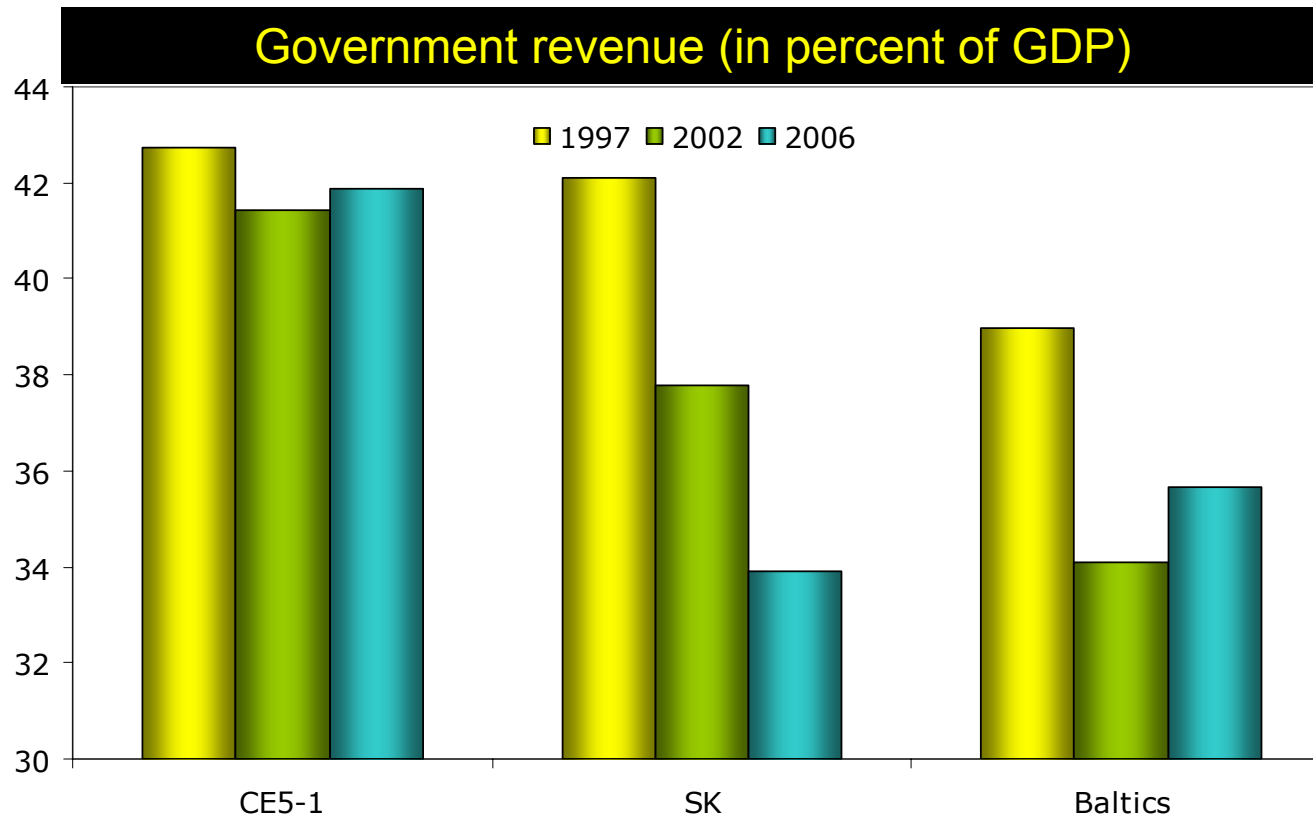
1/ Czech Republic, Hungary, Poland, and Slovenia.

Source: Eurostat

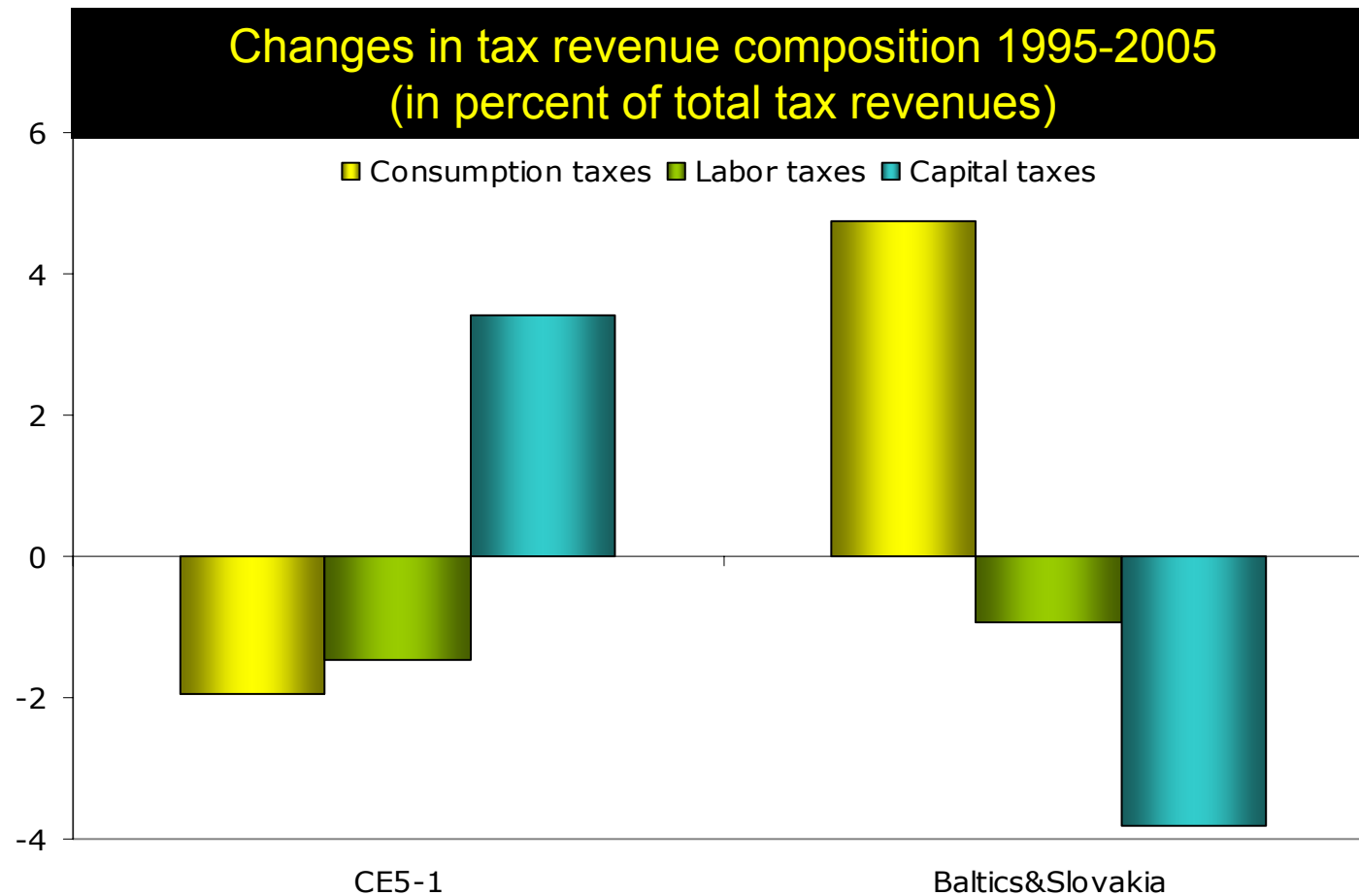
...achieving fiscal consolidation...



...while at the same time lowering
the tax burden



In the “reform countries” the tax structure has moved towards consumption



Source: EC, 'Taxation trends in the EU', 2007

Flat taxes are becoming increasingly popular in the region

Country	Year of reform	PIT rate	
		Before reform	After reform
Estonia	1994	16-33	26
Lithuania	1994	18-33	25
Latvia	1997	10;25	25
Russia	2001	12-30	13
Ukraine	2004	10-40	13
Slovakia	2004	10-38	19
Georgia	2005	12-20	12
Romania	2005	18-40	16
Czech Republic	2008	12-32	15

Revenue effects of reforms have been mixed (change in revenues in year t+1)

Country	PIT	CIT	Indirect	Total
Estonia	↓	↓	↑	↑
Lithuania	↑	↓	↑	↑
Latvia	↑	↑	↓	↑
Russia	↑	↑	↑	↑
Ukraine	↓	↓	↓	↓
Slovakia	↓	↓	↑	↓
Georgia	↓	↑	↑	↑
Romania	↓	↓	↑	↓

Some experiences with flat taxes:

- Micro-level evidence in support of flat taxes is weak:
 - Laffer curve effects are difficult to prove
 - Improved compliance is not automatic
 - The impact on work incentives is unclear
 - Flatness is certainly a simplification, but does not necessarily guarantee simplicity
- Generally, flat taxes appear to work best as a part of broader fiscal reforms

Does the global slowdown call for a fiscal stimulus?

The IMF has supported anticyclical easing in US and some other countries

Considerations in Central and Eastern Europe:

- Relatively little fiscal space (deficits are close to EDP / Maastricht limits, public debt is relatively high)
- Growth is not expected to slow down by much (no recession)
- Monetary policy is tightening

=> Letting automatic stabilizers work is for the time being the best course of action

Key messages

- The macroeconomic environment is still good, but vulnerabilities are growing.
- There has been 'reform fatigue' and an opportunity to reduce structural deficits and make budgets more flexible has been missed.
- Fiscal adjustment should start on the expenditure side, although recent fiscal reforms in CECs do not follow this pattern.
- Flat taxes are not an universal cure to fiscal problems. They should be a part of broader reform efforts.
- The global slowdown: let automatic stabilizers work

Thank you!

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