Abstract

The paper considers the implications for the EU accession candidates in Central and Eastern Europe of the fiscal-financial constraints imposed by the Stability and Growth Pact and the Maastricht Treaty. Our findings apply also to those current EU members whose initial conditions (e.g. infrastructure and progress in state pension reform) or other relevant structural characteristics (e.g. demographic structure, growth potential, Balassa-Samuelson equilibrium real exchange rate appreciation) differ significantly from the EU average. We find the existing criteria to be seriously flawed and propose an alternative rule, the *Permanent Balance Rule*, based on a strong form of tax smoothing.