Cross-Country Differences in Convergence in CESEE

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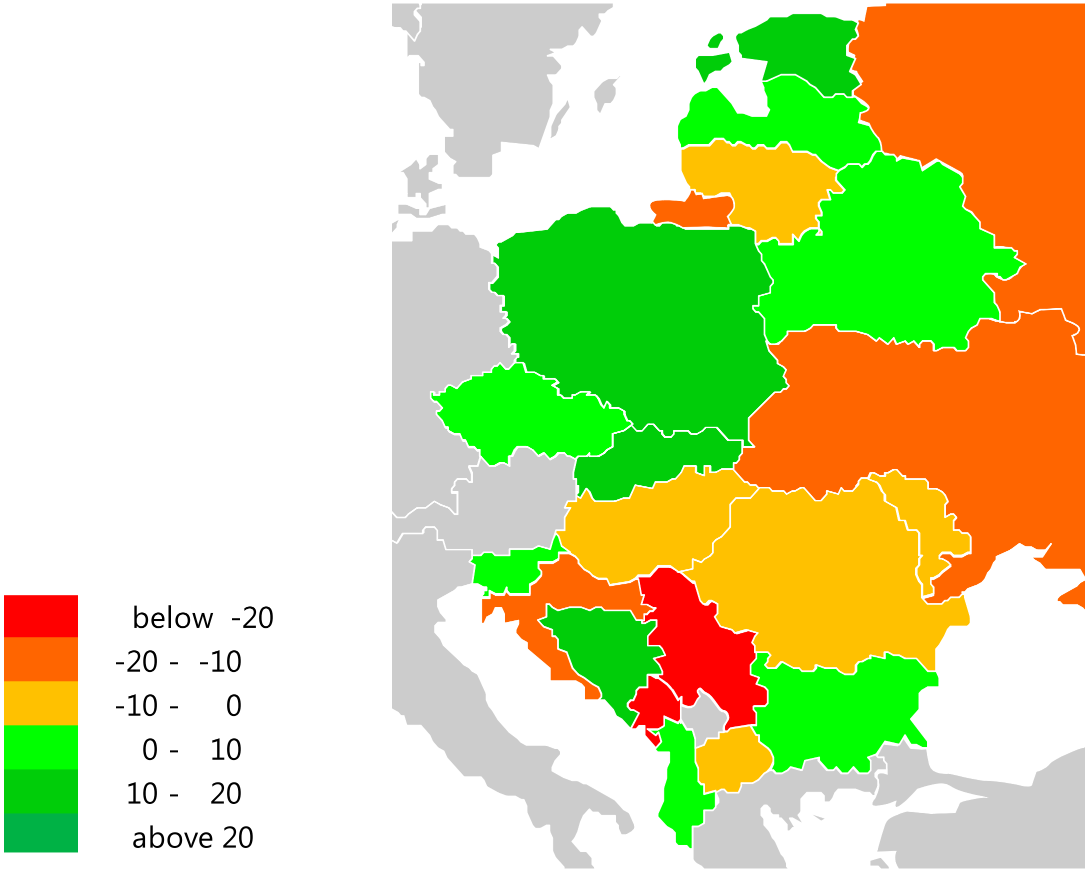
Bas B. Bakker
Senior Regional Resident Representative
for Central and Eastern Europe

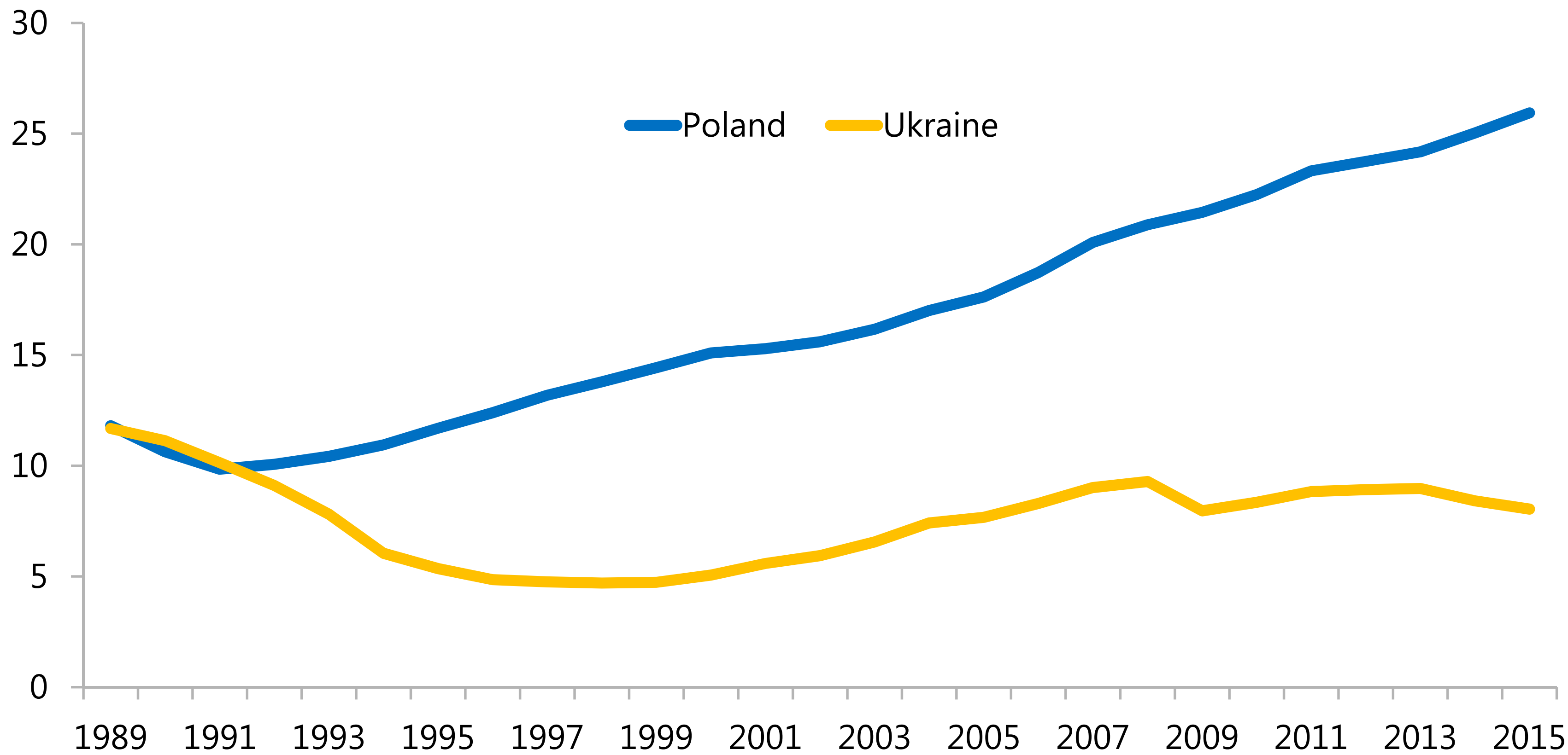
Available GDP data suggest there have been large differences in convergence between 1989 and 2015

Change in income per capita gap to USA, 1989-2015
(percentage points, PPP-adjusted)



Difference between Ukraine and Poland is stark

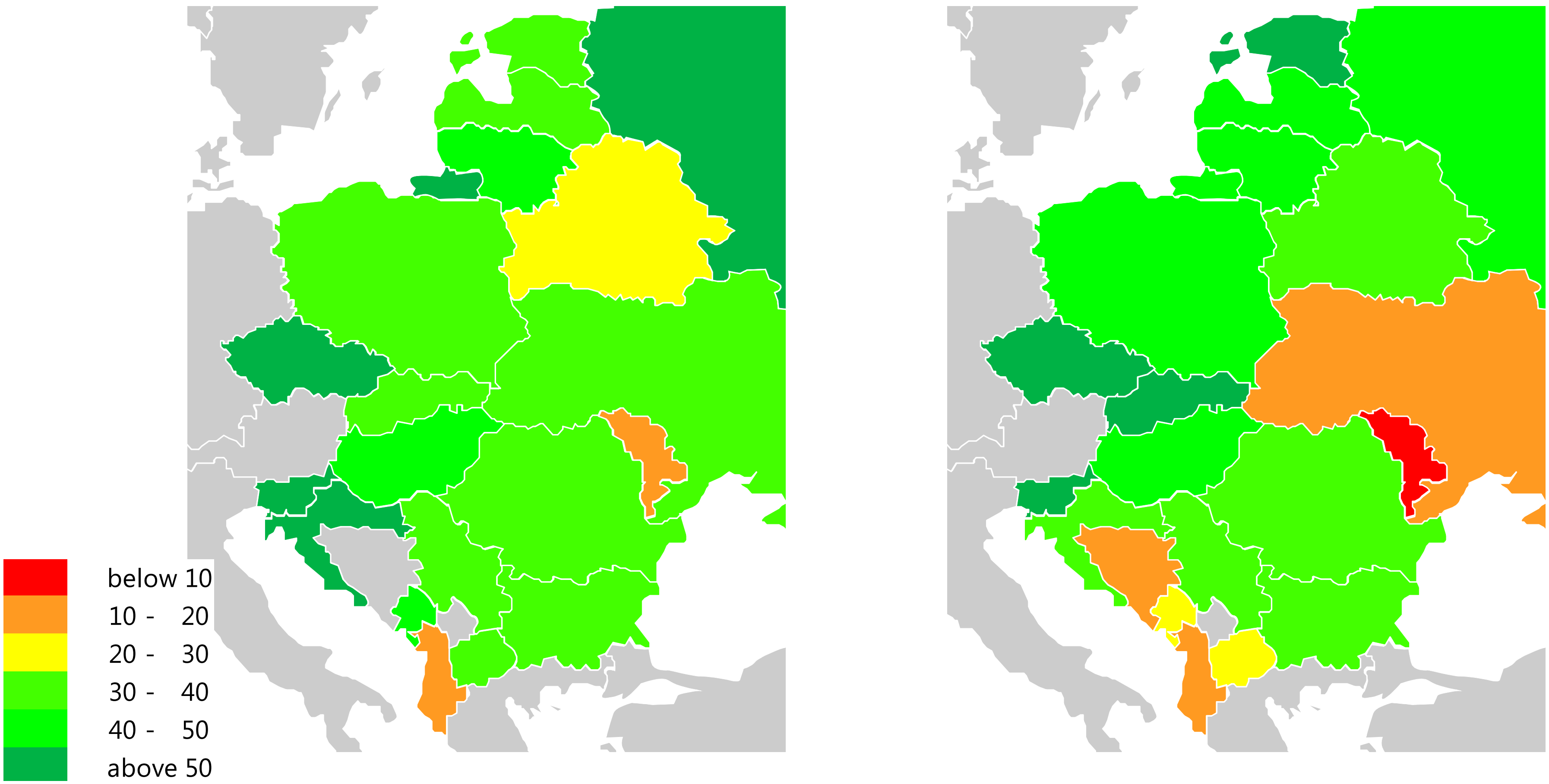
GDP per capita in thousands of US dollars
(2014 price level with updated 2011 PPPs)



Cross-country income differences remain large

GDP per capita
(percent of US GDP per capita, PPP-adjusted)

1989 | 2015



Convergence between 1989 and 2015

What explains these differences?

1. Is it data issues?
2. Early transition
3. War and conflicts
4. Boom-busts
5. EU Membership
6. Whether transition has been completed

1. Do differences reflect data issues?

- GDP statistics in late 1989 not very good
  - Prices were not right
- Other problem: GDP not good indicator of consumer welfare
  - Much of what was produced was not wanted by consumers (cf. military expenditures)
  - Much was of low quality

However, even if size of initial collapse was exaggerated, there clearly were large cross country differences

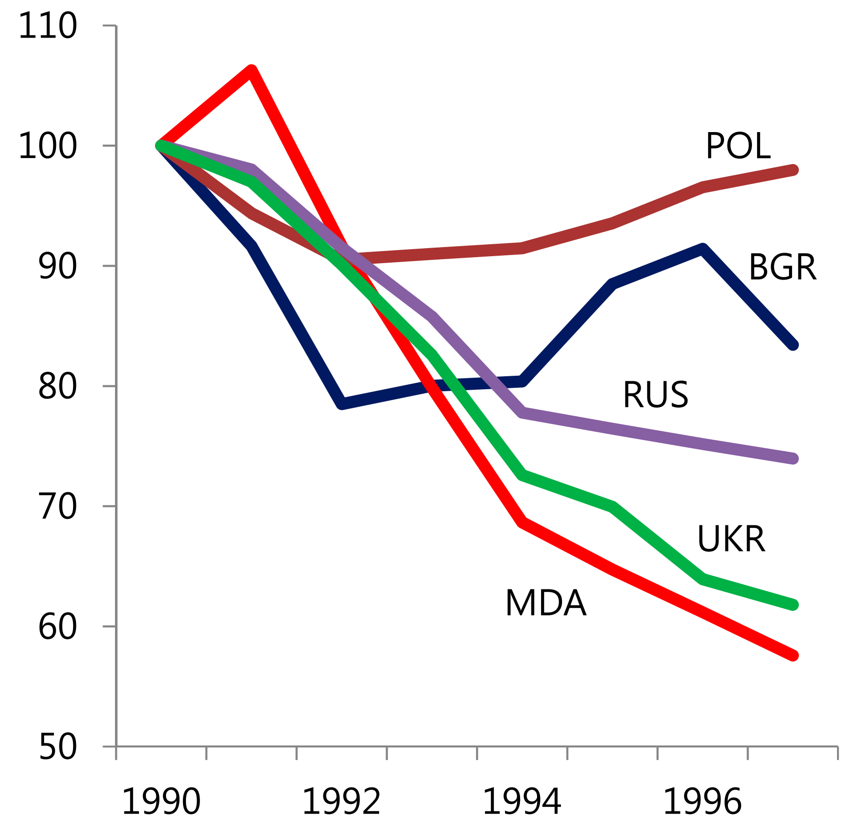
Other more easily measurable indicators also suggest:

- Large initial output falls
- Large cross country differences

Between 1990 and 1995, electricity consumption fell

- by almost 40 percent in Moldova and Ukraine
- very little in Poland.

Electricity Consumption per Capita
(index, 1990=100)

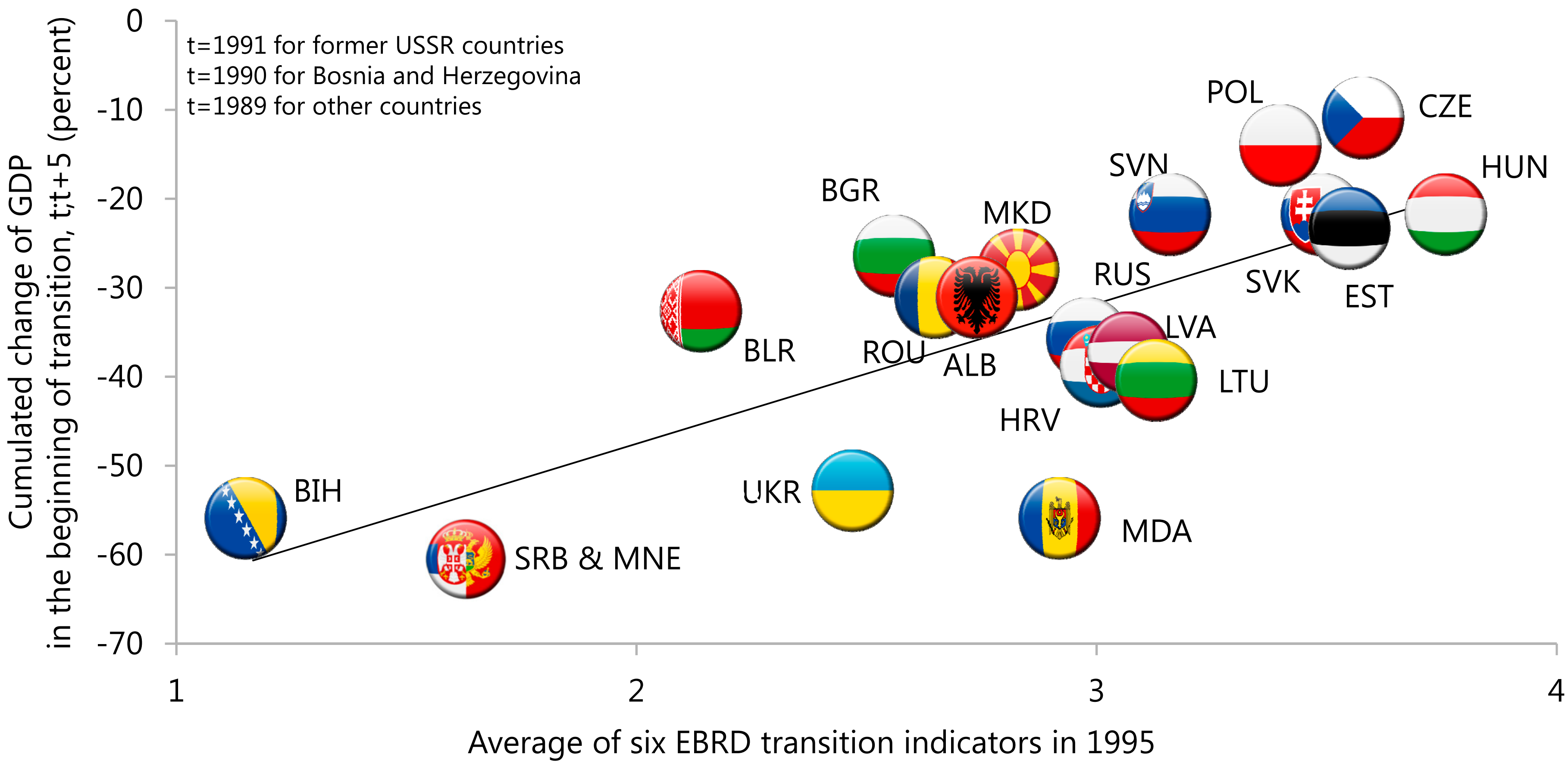


2. Early transition to market economy

- In early 1990s there was a debate whether reforms should be gradual
- Worry was that more rapid reforms would be too painful
- Rapid reforms were indeed painful—unemployment in early reformers rose sharply
- However, countries that postponed reforms had a much ***longer and deeper*** initial recession
- Why? Without hard budget constraint on firms, it was hard to get credit growth and inflation under control

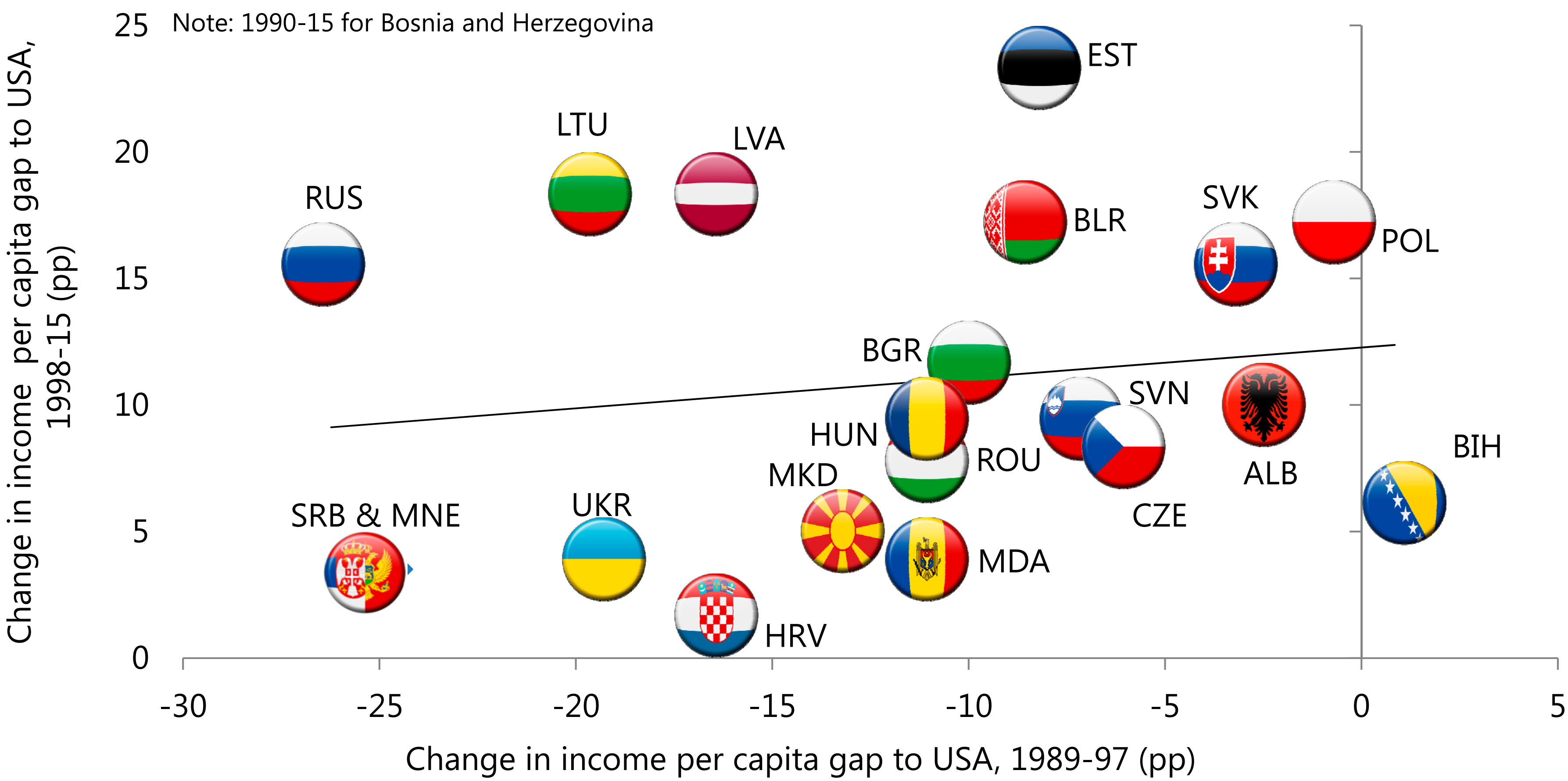
Countries that postponed reforms suffered deeper output losses

Cumulated change of GDP and advancement of reforms in the beginning of transition

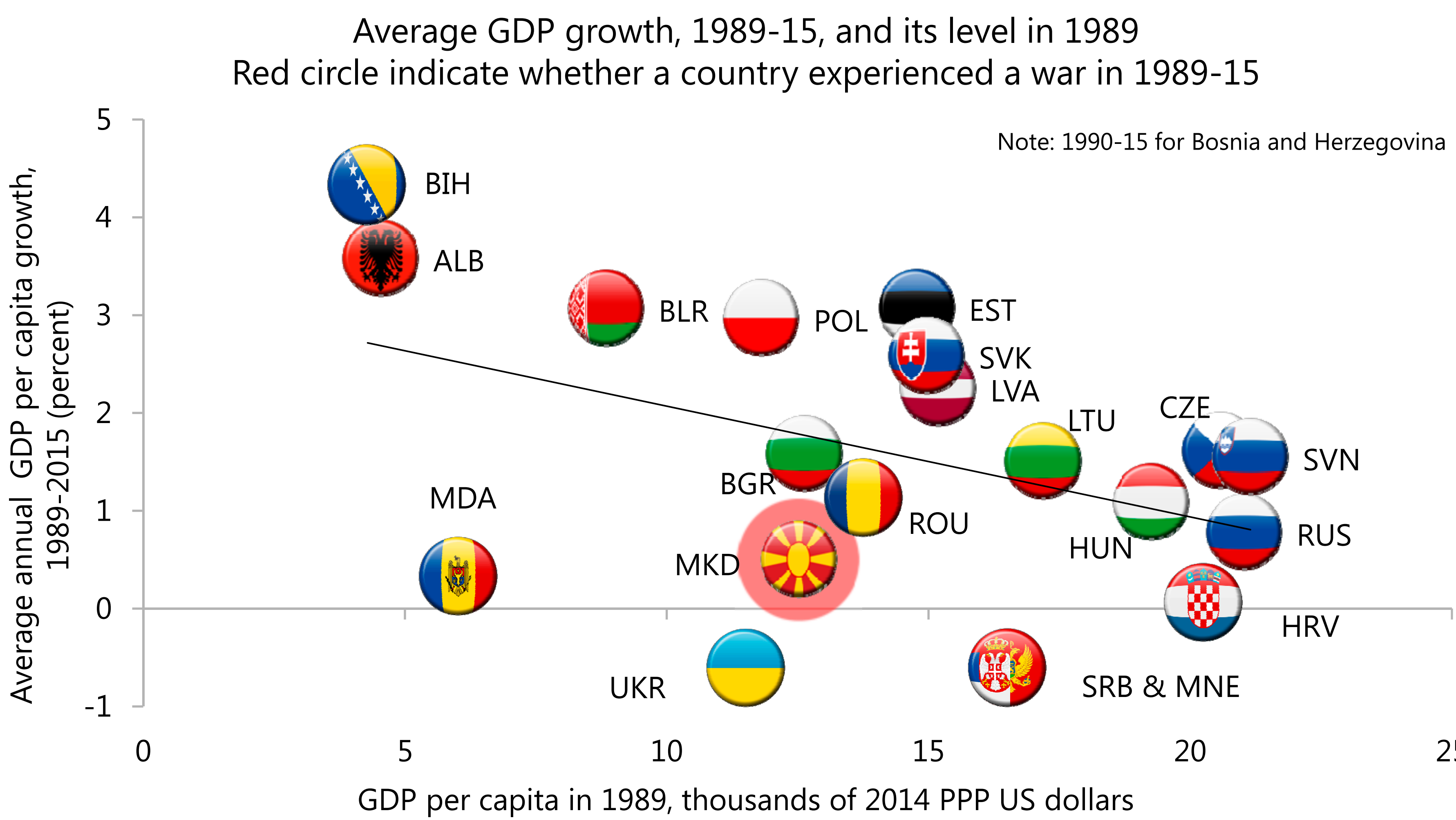


Weaker growth in early transition not compensated by faster growth later

Convergence per capita to USA in 1989-97 and 1998-15 (pp)

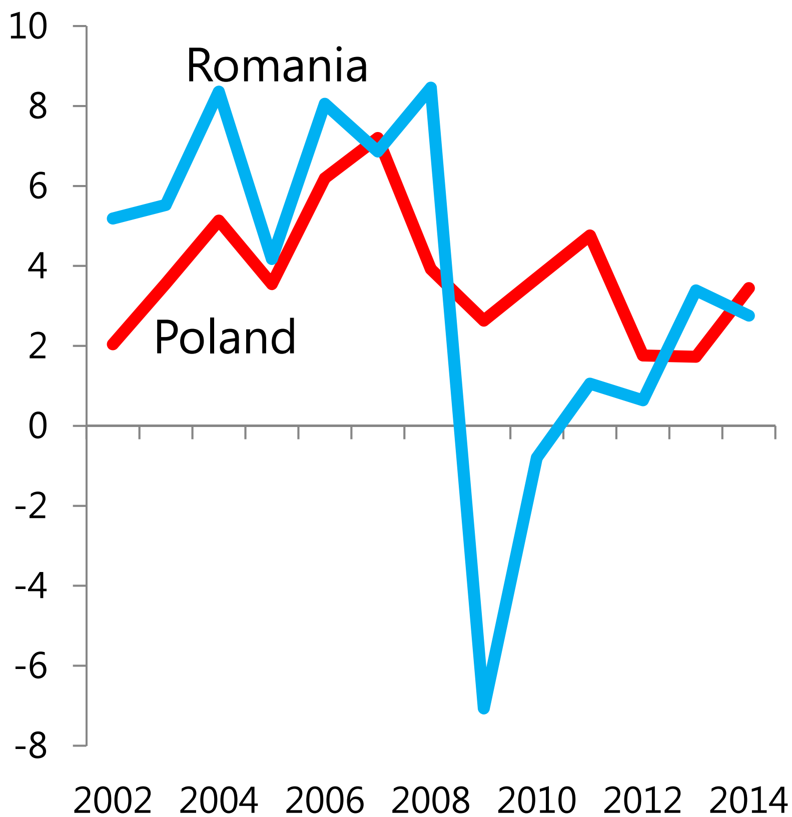


2. Wars and conflicts: the five countries with the lowest growth all had wars

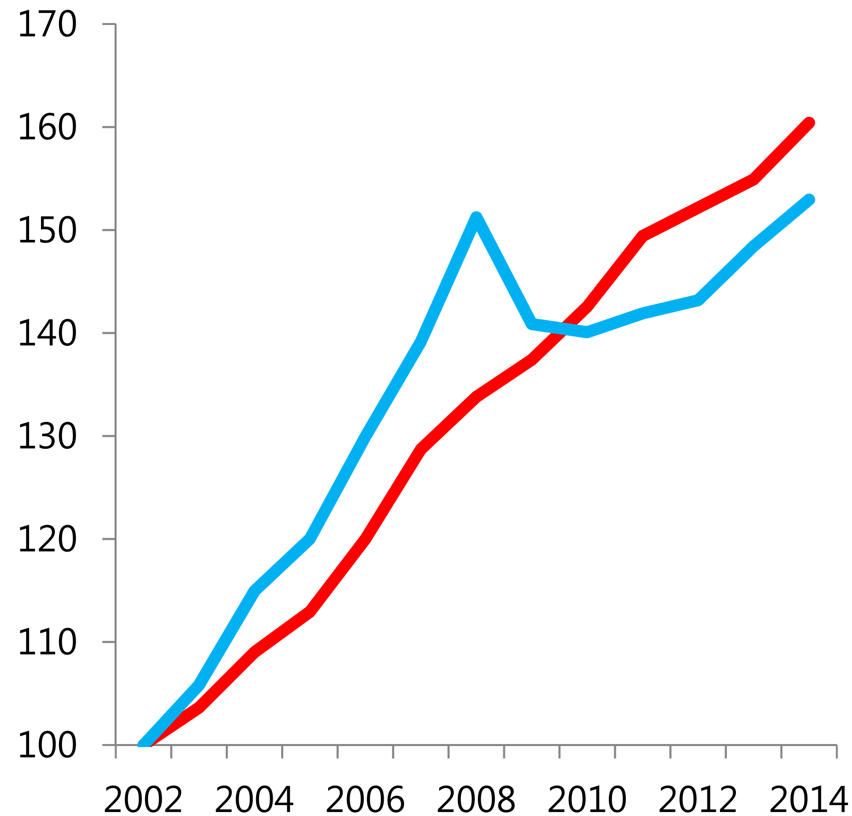


3. Boom-busts in the 2000s

GDP growth, 2002-14

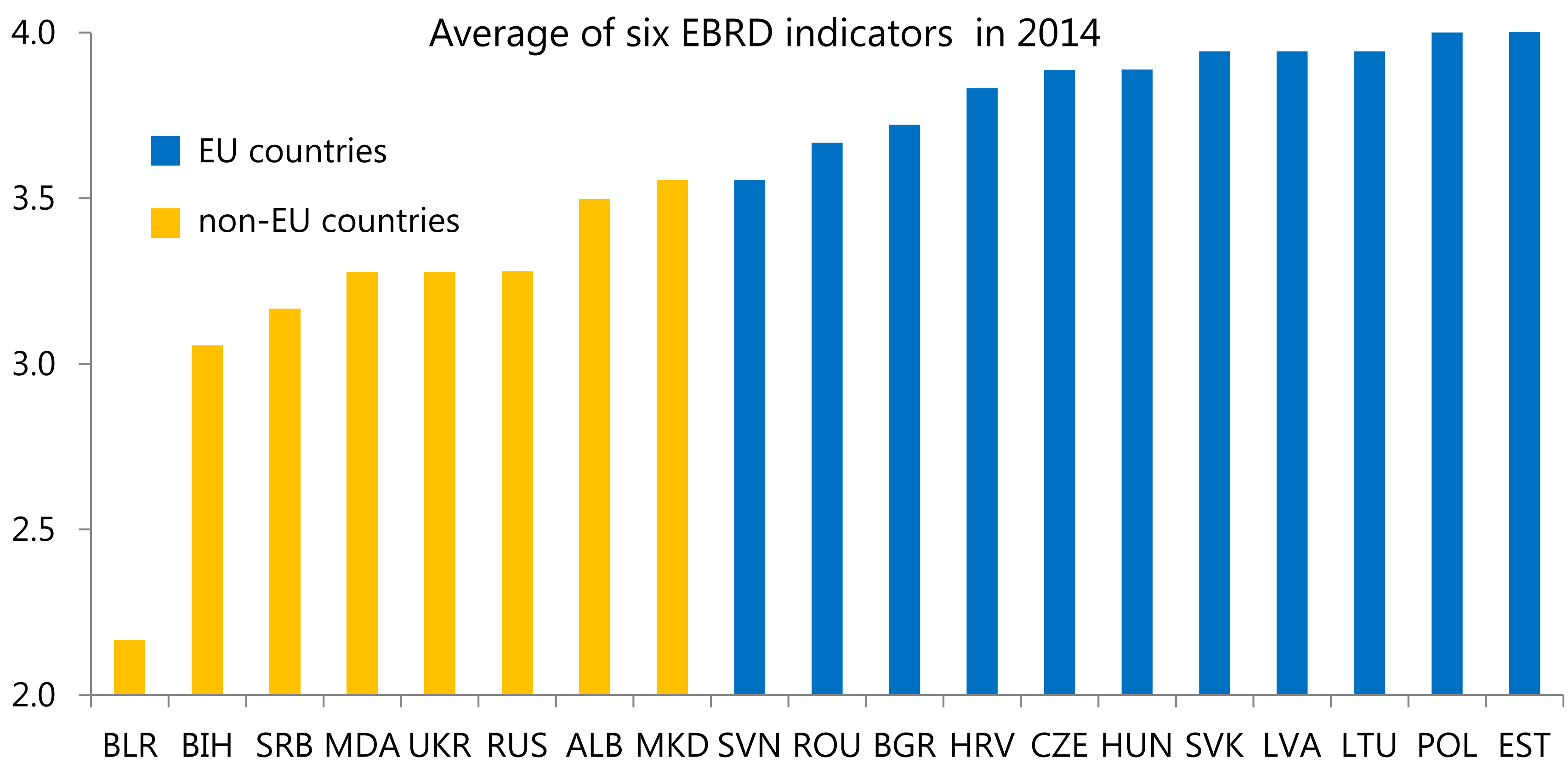


GDP per capita, index 2002=100



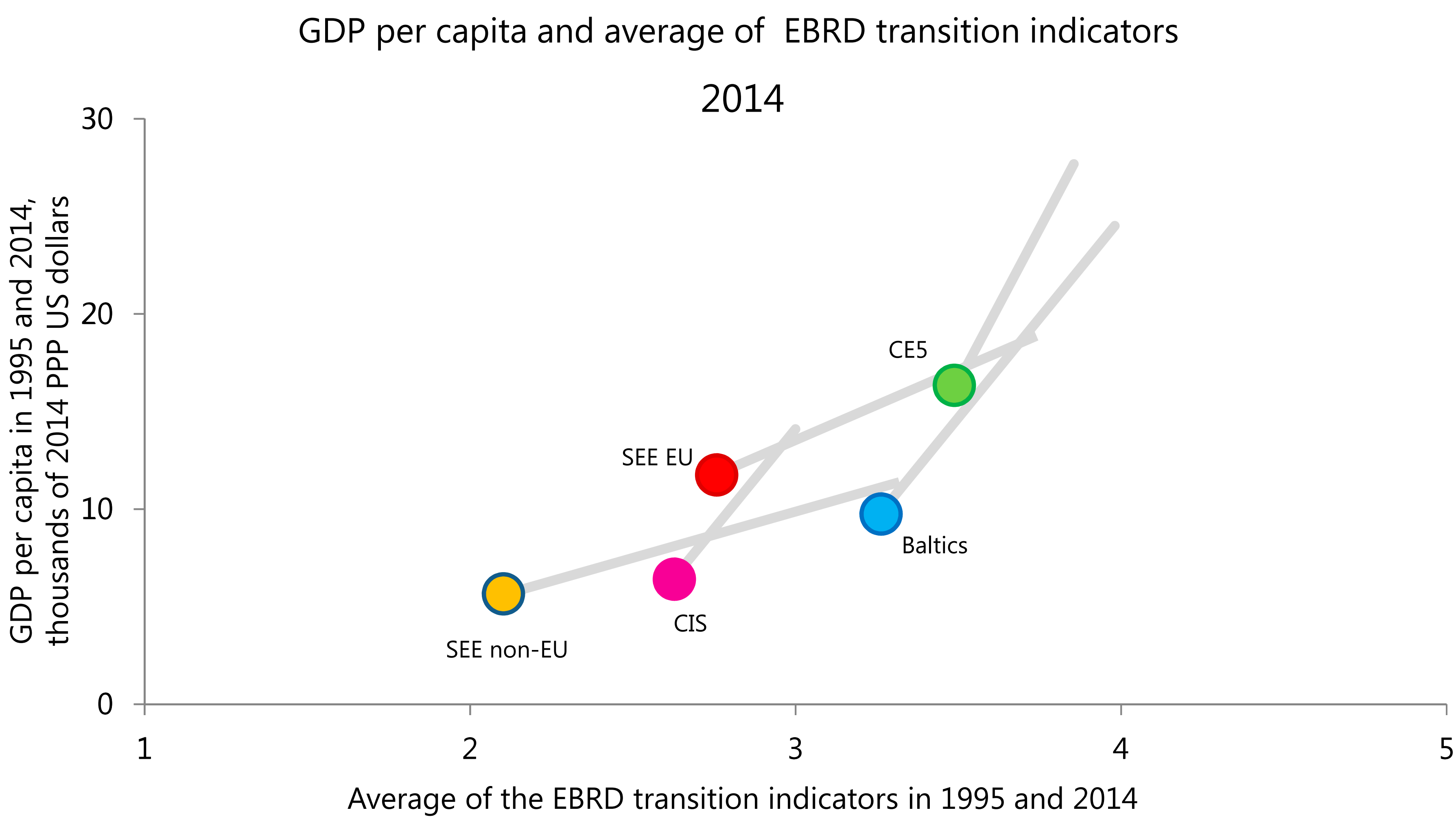
4. EU Membership

- EU accession was powerful catalyst for reforms and upgrading of institutional framework



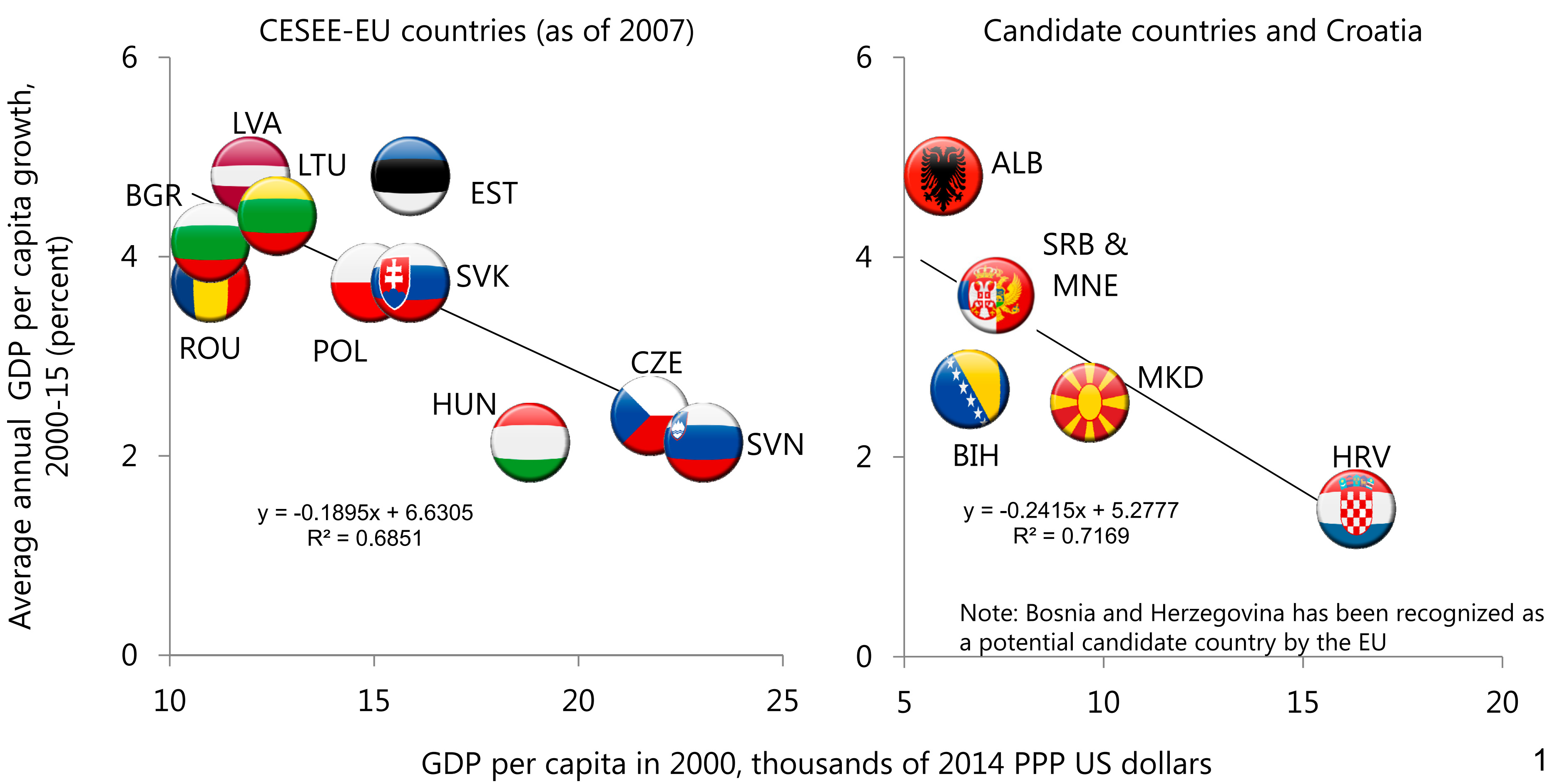
Note: 2007 for Czech Republic

(Prospects of) EU Membership led to more reforms and higher growth

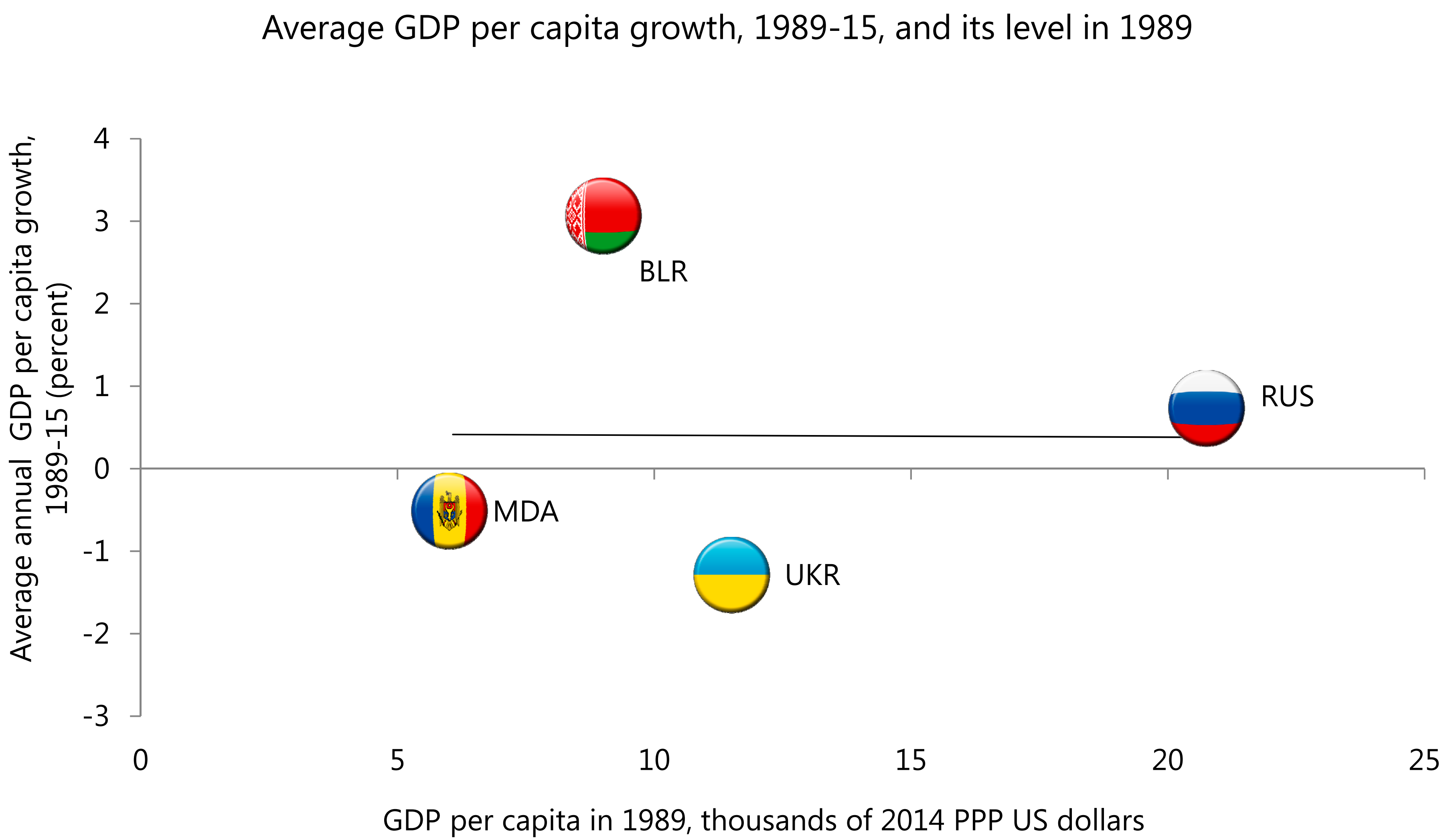


Rapid convergence in EU and EU candidate countries

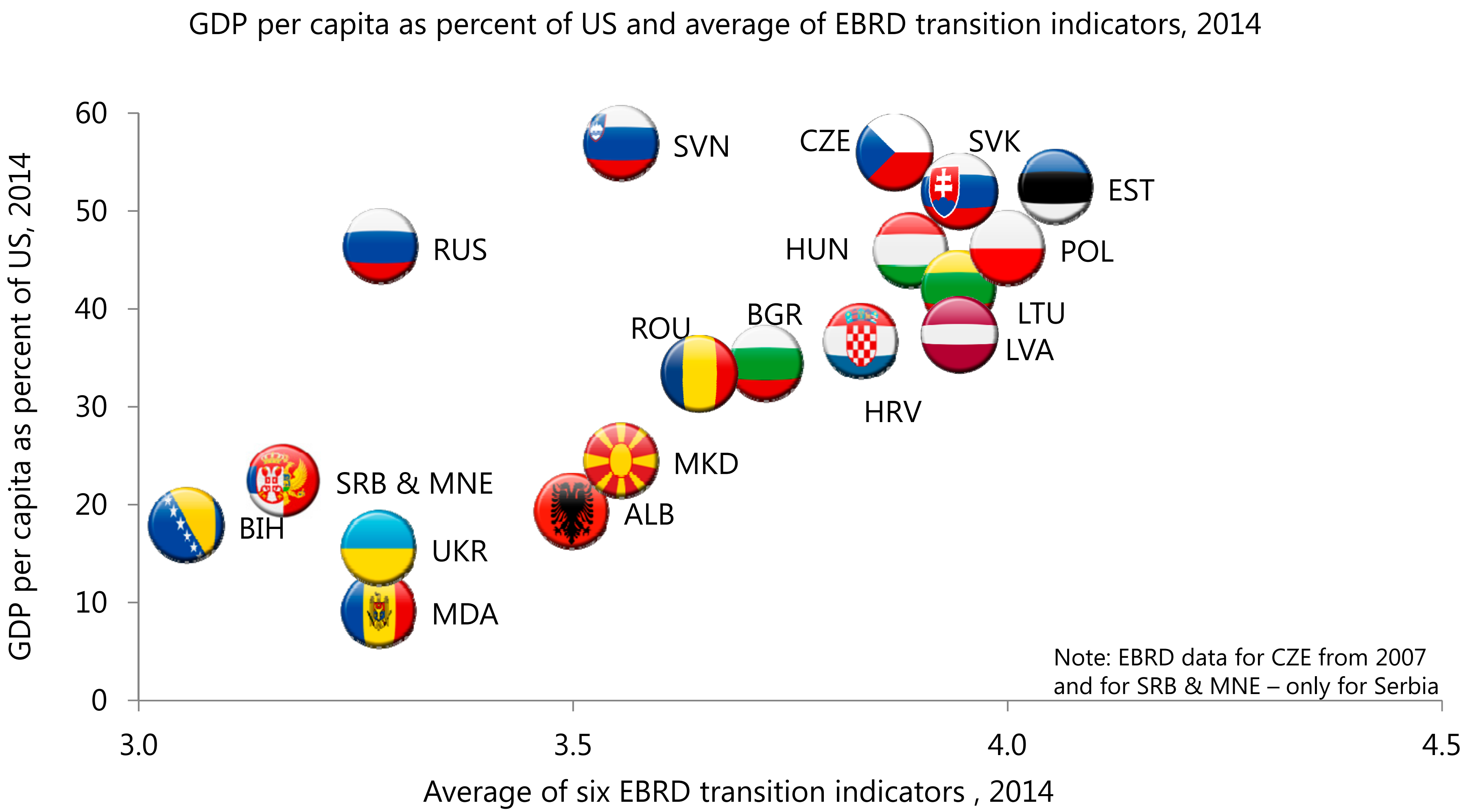
Average GDP per capita growth, 2000-15, and its level in 2000



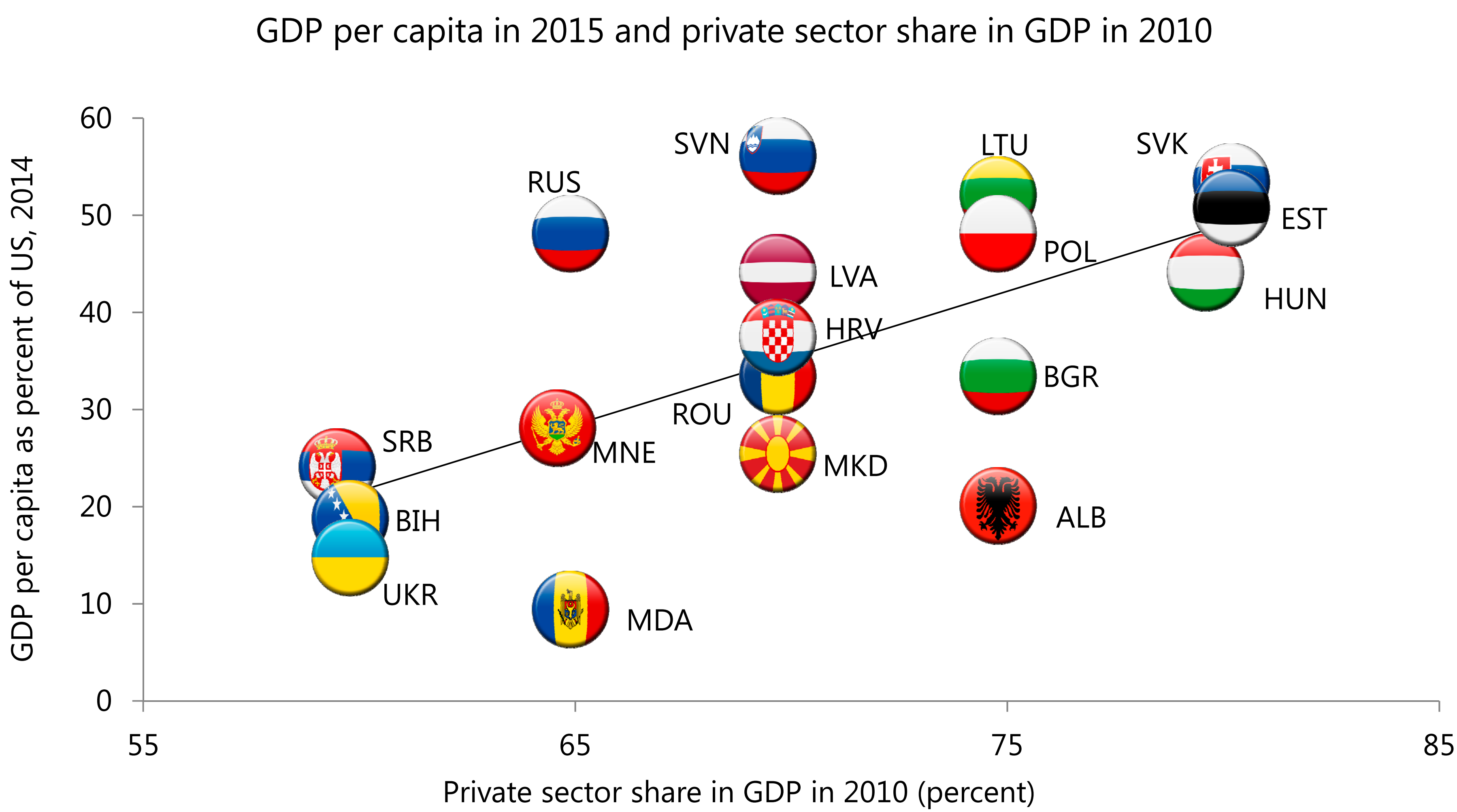
By contrast, no convergence in European CIS



4. Countries that have more completed transition are richer…



...as do countries where private sector is more vibrant

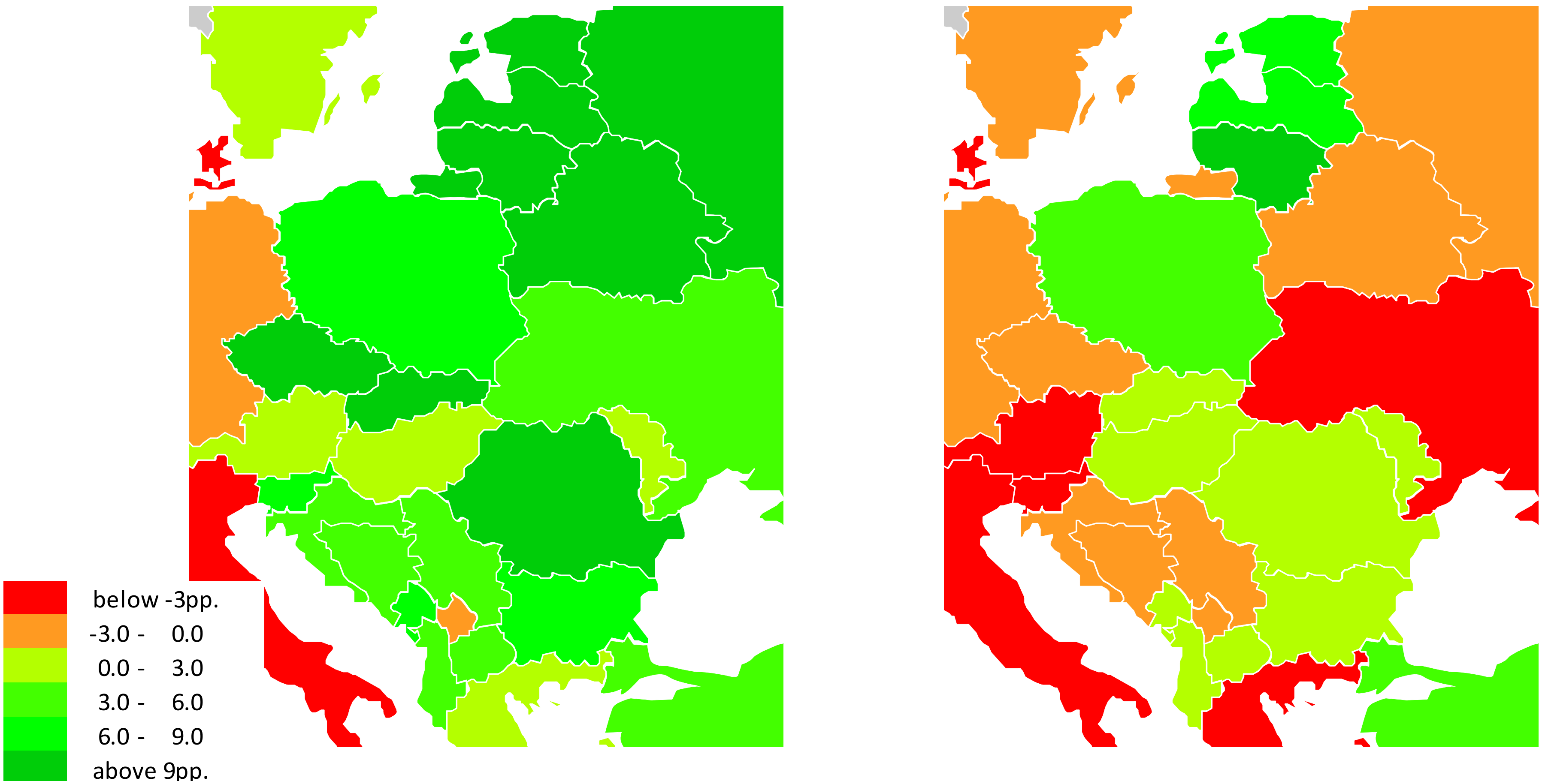


Convergence post 2009 crisis

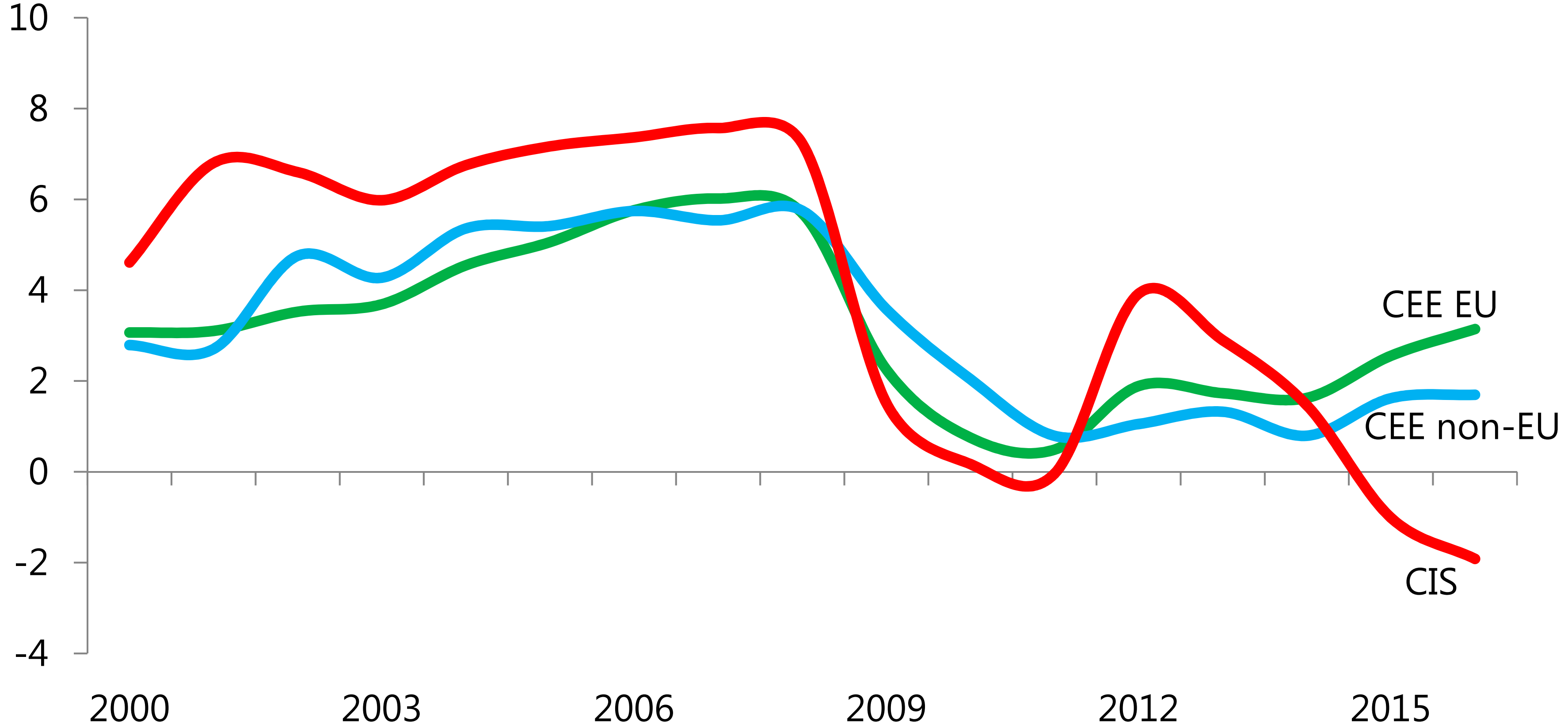
Catch-up has slowed down post-crisis

Change in income per capita gap to Germany
(percentage points, PPP-adjusted)

2003-08 | 2010-2015

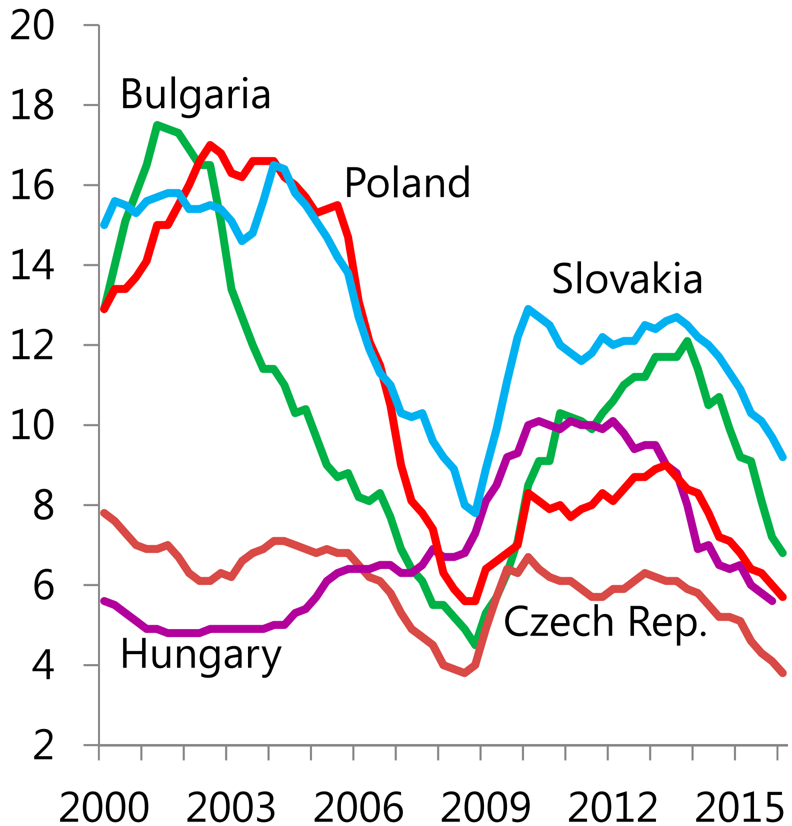


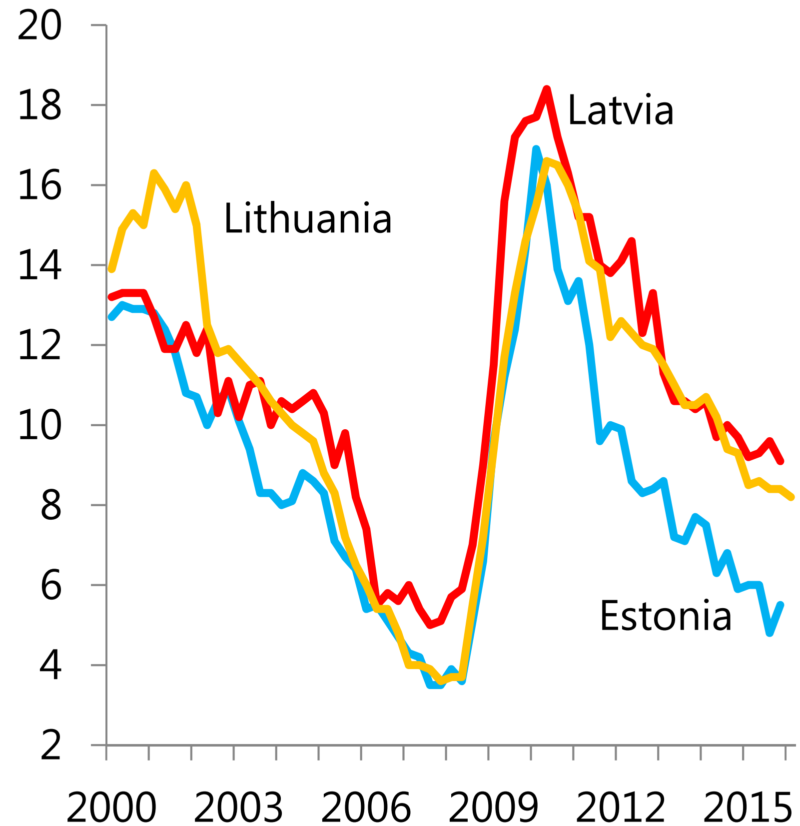
Big differences among regions: CIS in recession; non CIS doing much better



Labor markets in many EU New Member States are tightening rapidly

Unemployment rates (percent)

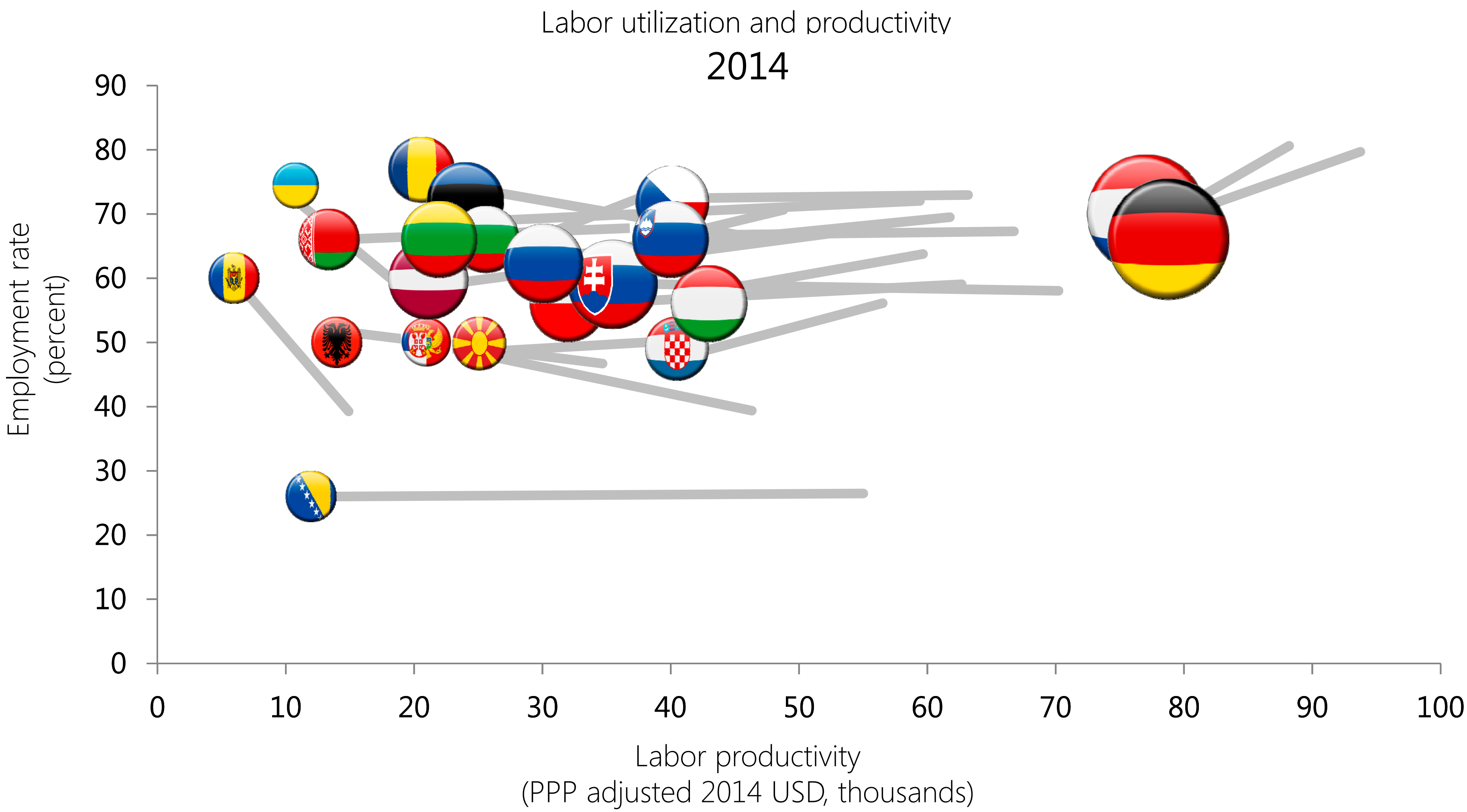




How can we boost convergence going forward?

- Question we addressed in depth in our just-published Spring 2016 issue of "CESEE Regional Economic Issues."

Further raising employment rates is needed, as is higher labor productivity



To raise labor productivity more investment needed

- The capital stock per capita in a typical CESEE economy only about a third of that in advanced Europe.
- Investment gaps are particularly wide in infrastructure
- In most of the region, domestic savings rates are too low
- Policies should therefore focus on institutional reforms that reduce inefficiencies and increase returns on private investment and savings.

Boosting Total Factor Productivity (TFP) is important as well

- CESEE countries may have to address structural and institutional obstacles that prevent efficient use of available technologies, or lead to inefficient allocation of resources.
- Our recent CESEE report suggests the largest efficiency gains are likely to come from
  - Improving the quality of institutions (protection of property rights, legal systems, and healthcare)
  - Increasing the affordability of financial services (especially for small but productive firms)
  - Improving government efficiency.

Thank you