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

below 10
10 - 20
20 - 30
30 - 40
40 - 50
above 50
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

- t=1991 for former USSR countries
- t=1990 for Bosnia and Herzegovina
- t=1989 for other countries

Average of six EBRD transition indicators in 1995

Cumulated change of GDP in the beginning of transition, t:t+5 (percent)
Weaker growth in early transition not compensated by faster growth later.
2. Wars and conflicts: the five countries with the lowest growth all had wars

Red circle indicate whether a country experienced a war in 1989-15

Note: 1990-15 for Bosnia and Herzegovina
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

Average of six EBRD indicators in 2014

- EU countries
- non-EU countries

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

CESEE-EU countries (as of 2007)

Candidate countries and Croatia

Note: Bosnia and Herzegovina has been recognized as a potential candidate country by the EU
By contrast, no convergence in European CIS

Average GDP per capita growth, 1989-15, and its level in 1989

Average annual GDP per capita growth, 1989-15 (percent)

GDP per capita in 1989, thousands of 2014 PPP US dollars
4. Countries that have more completed transition are richer…

![Graph showing GDP per capita as percent of US and average of EBRD transition indicators, 2014](image)

- **GDP per capita as percent of US and average of EBRD transition indicators, 2014**
- **Note:** EBRD data for CZE from 2007 and for SRB & MNE – only for Serbia
...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.
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