CESEE and EU: Closing the remaining gaps

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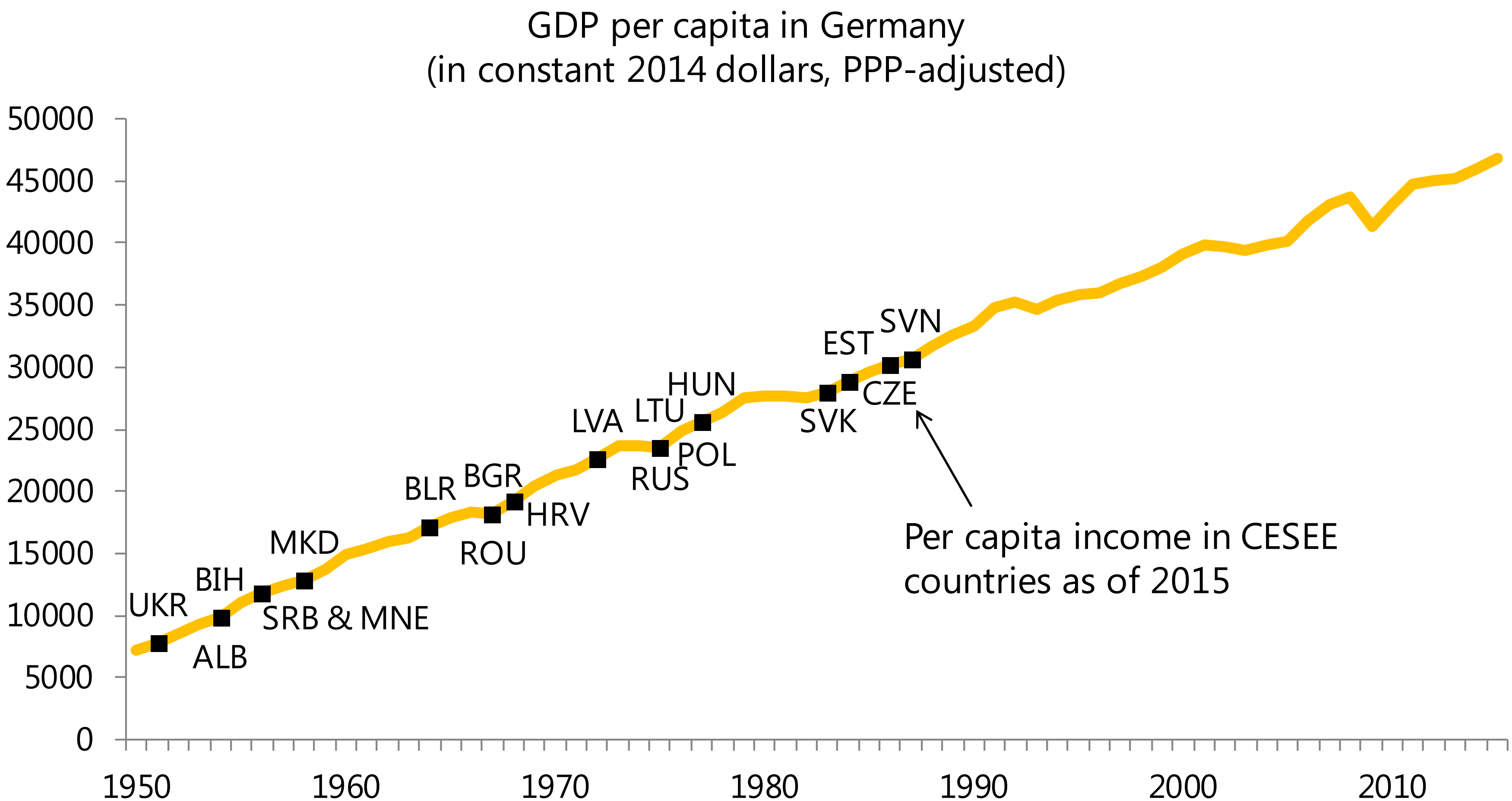
CESEE is still much poorer than Germany

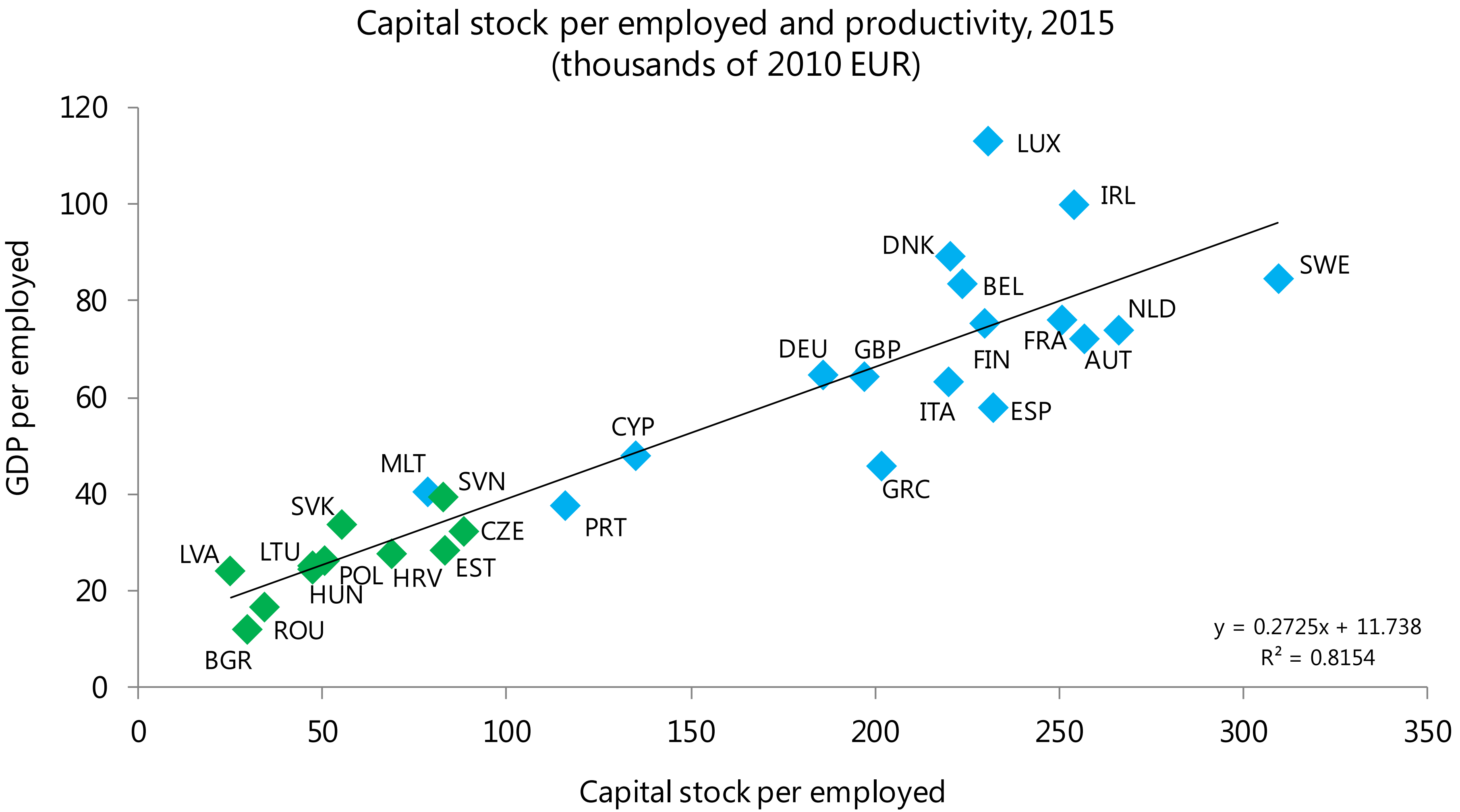


How to close gap?

- Through combination of
  - More capital per worker
  - Higher employment to population ratio
  - More efficient use of inputs.

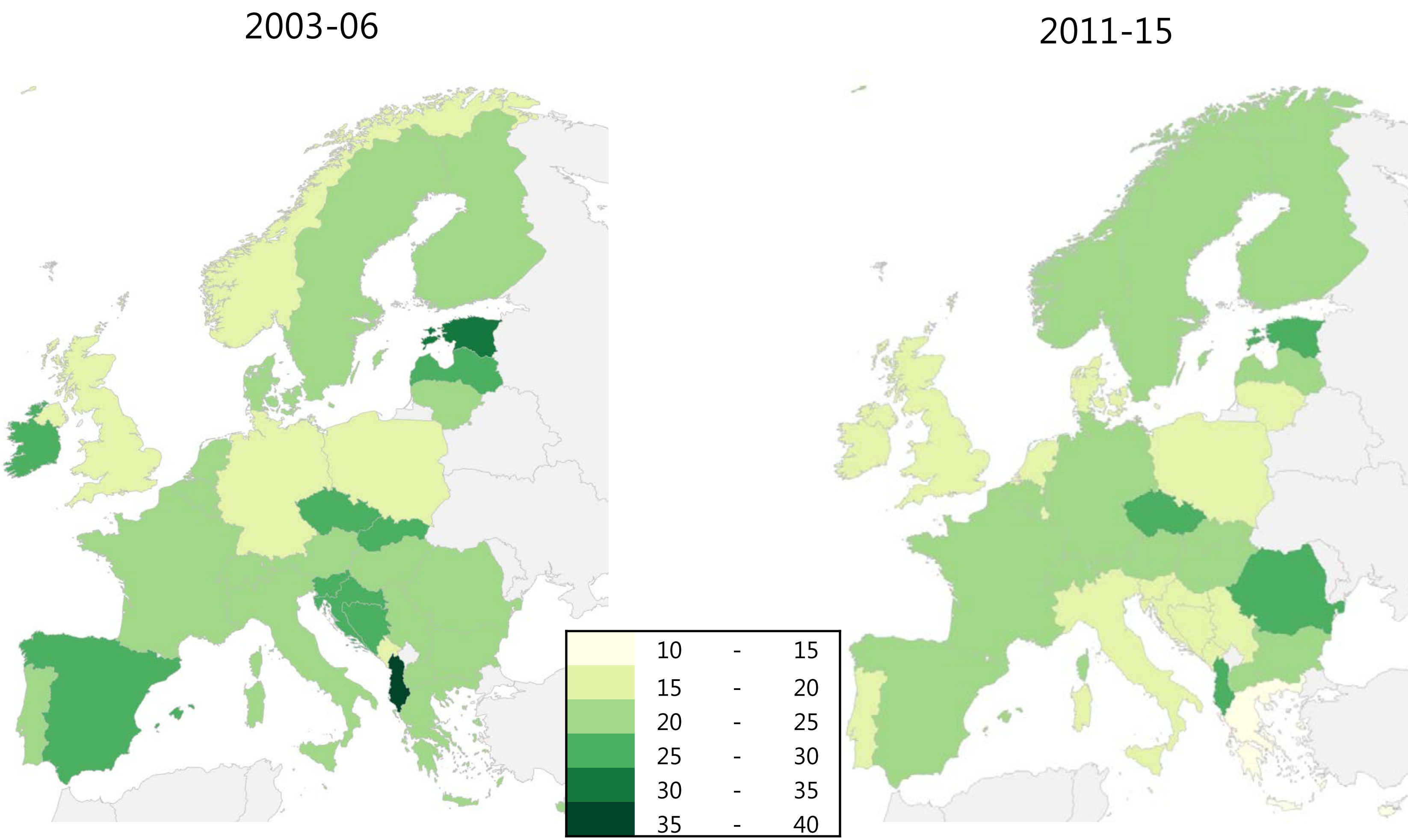
Capital

Capital stock per worker in CESEE is still much lower than in Western Europe



But investment rates are too low compared with Western Europe for a rapid catch-up

Average investment rate
(percent of GDP)



Investment needs are large: infrastructure less developed than in Western Europe

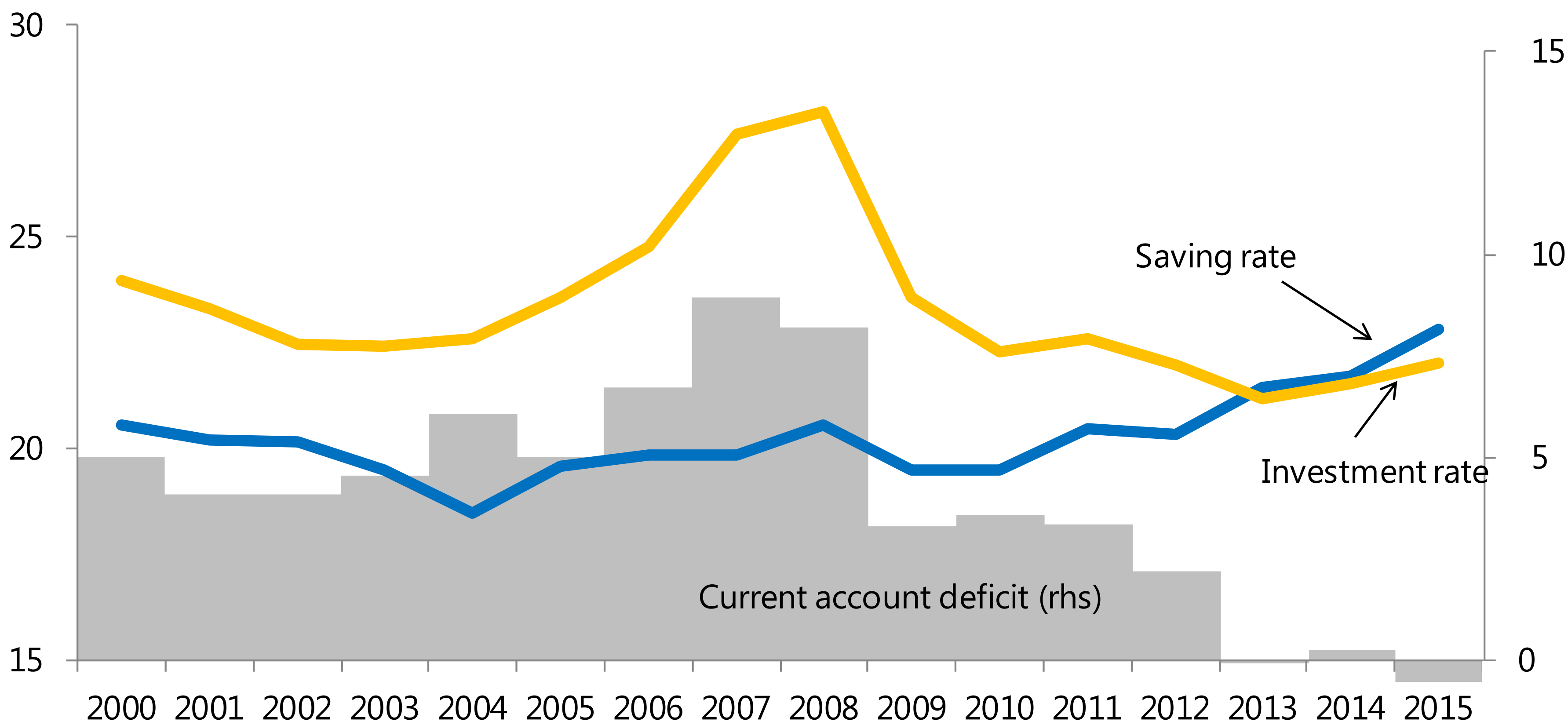
Railways

Highways

Colored lines denote railways with maximum speed above 200 km/h

Increased investment would necessitate higher saving (otherwise foreign capital needed)

Saving and investment rate in CESEE-EU countries (percent of GDP)

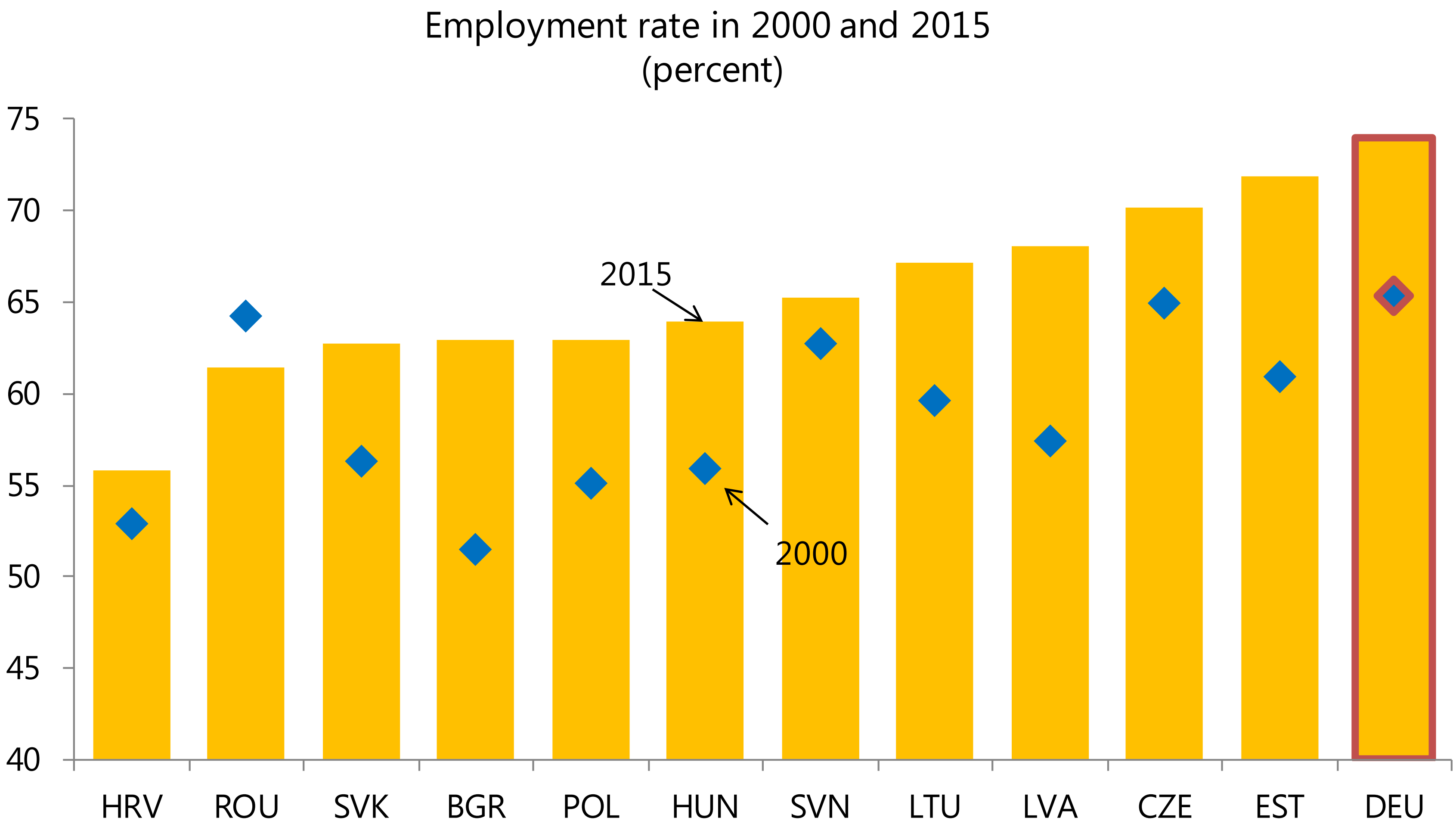


But how to increase domestic saving?

- Little appetite to increase government saving (i.e., reduce deficits)
- Corporate saving will come under pressure from tightening labor markets
- Can household saving be increased?

Labor

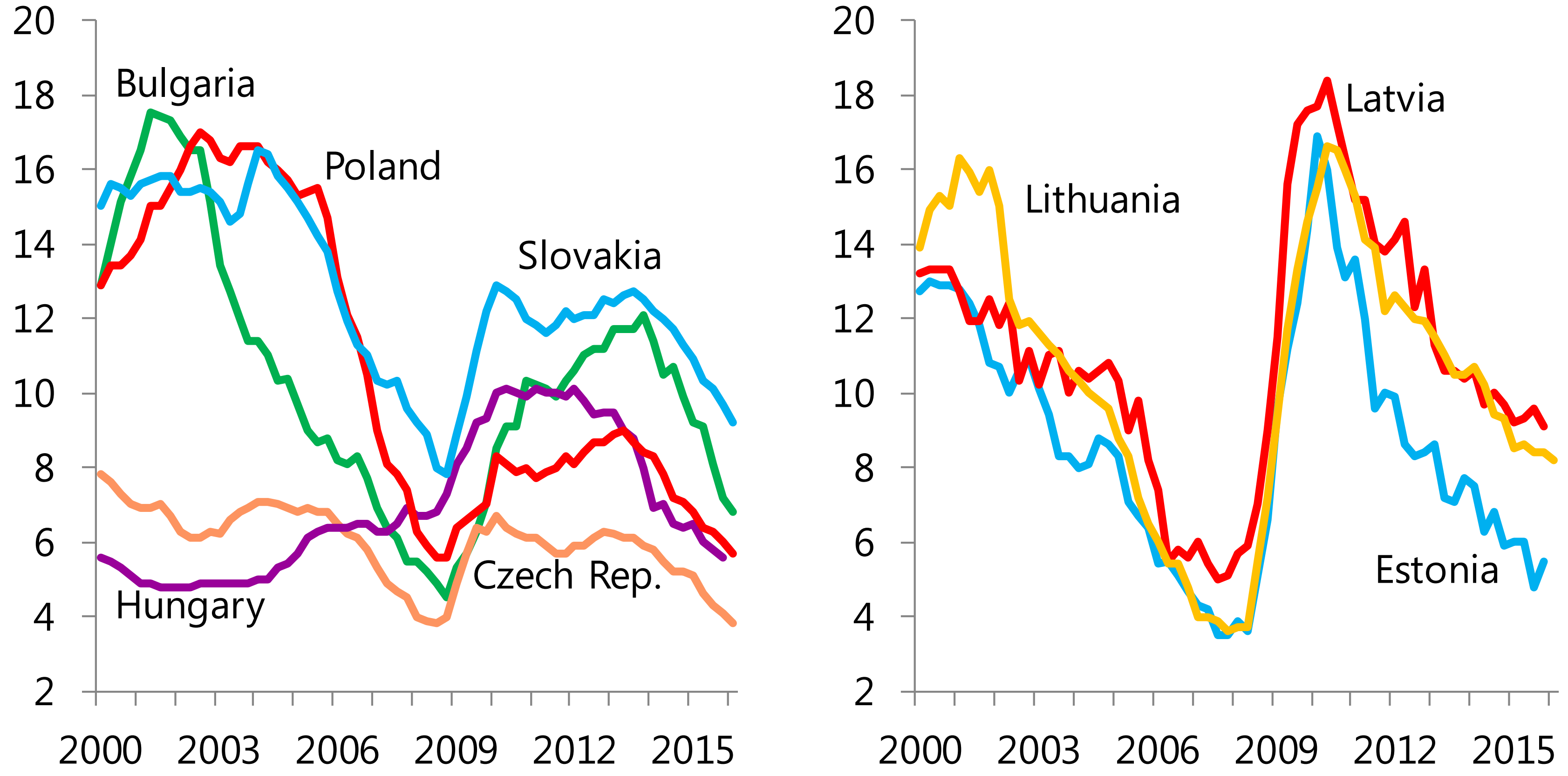
Employment rates have increased sharply since 2000



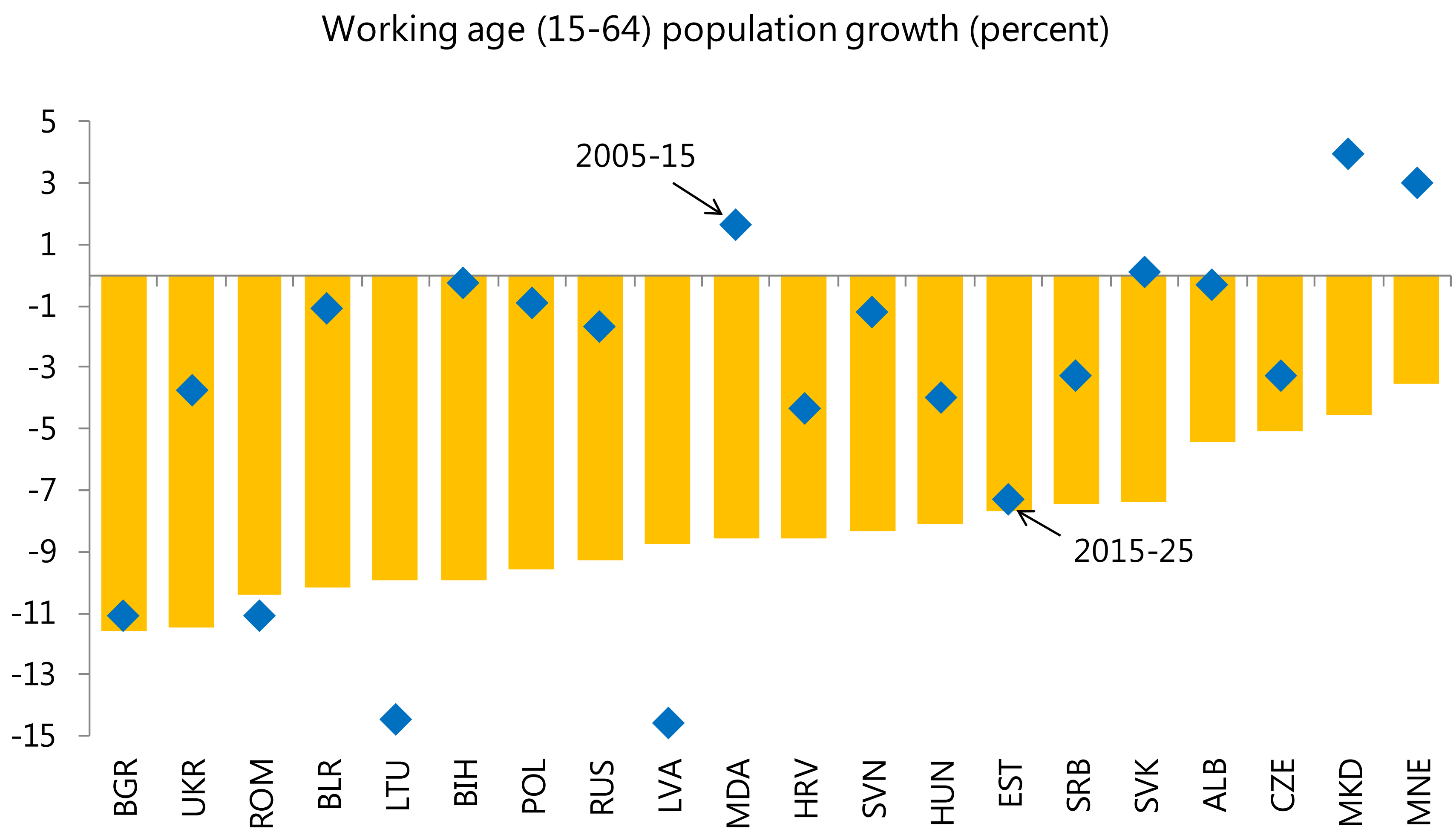
Note: For HRV data for 2002 and 2015.

Labor markets are tightening—labor may soon become scarce

Unemployment rates
(percent)

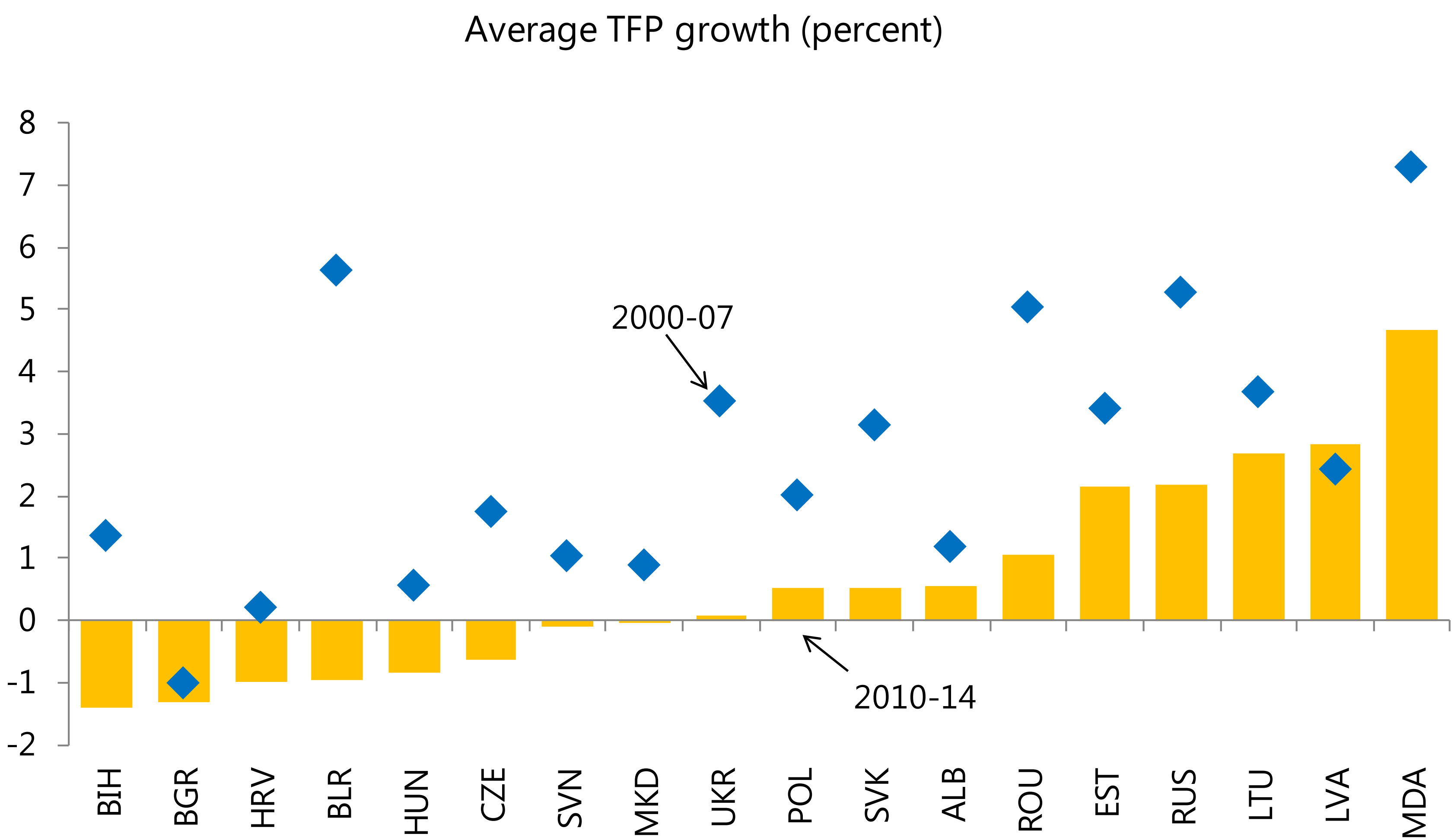


Working-age population is falling rapidly



Productivity

TFP was growing rapidly before crisis, but has slowed sharply



Why has TFP growth in CESEE slowed and how can we accelerate it?

Why did TFP slow?

- Partly global phenomenon (happened in other countries and regions as well)
- Why has it happened globally? (we really do not know much)

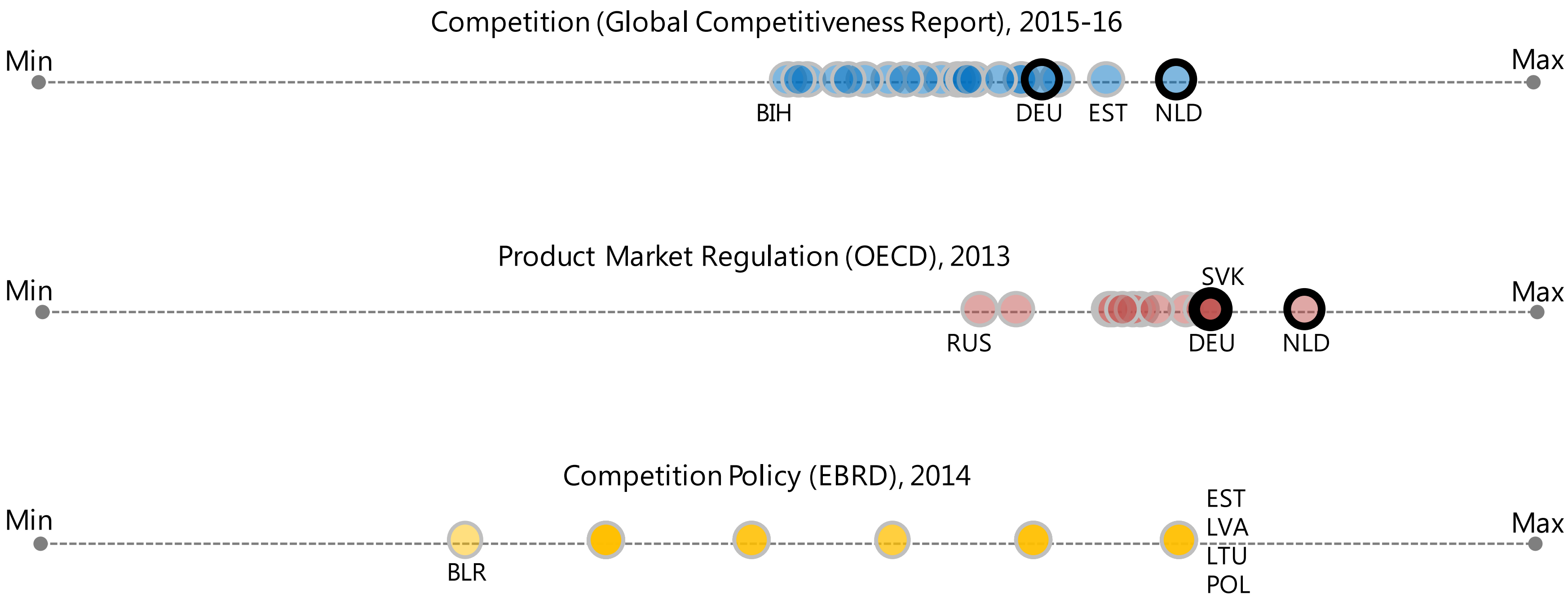
- How can we accelerate it?
  - We have a bunch of variables that are associated with higher TFP
  - But we do not have good models that explain the link

Variables that are associated with higher TFP

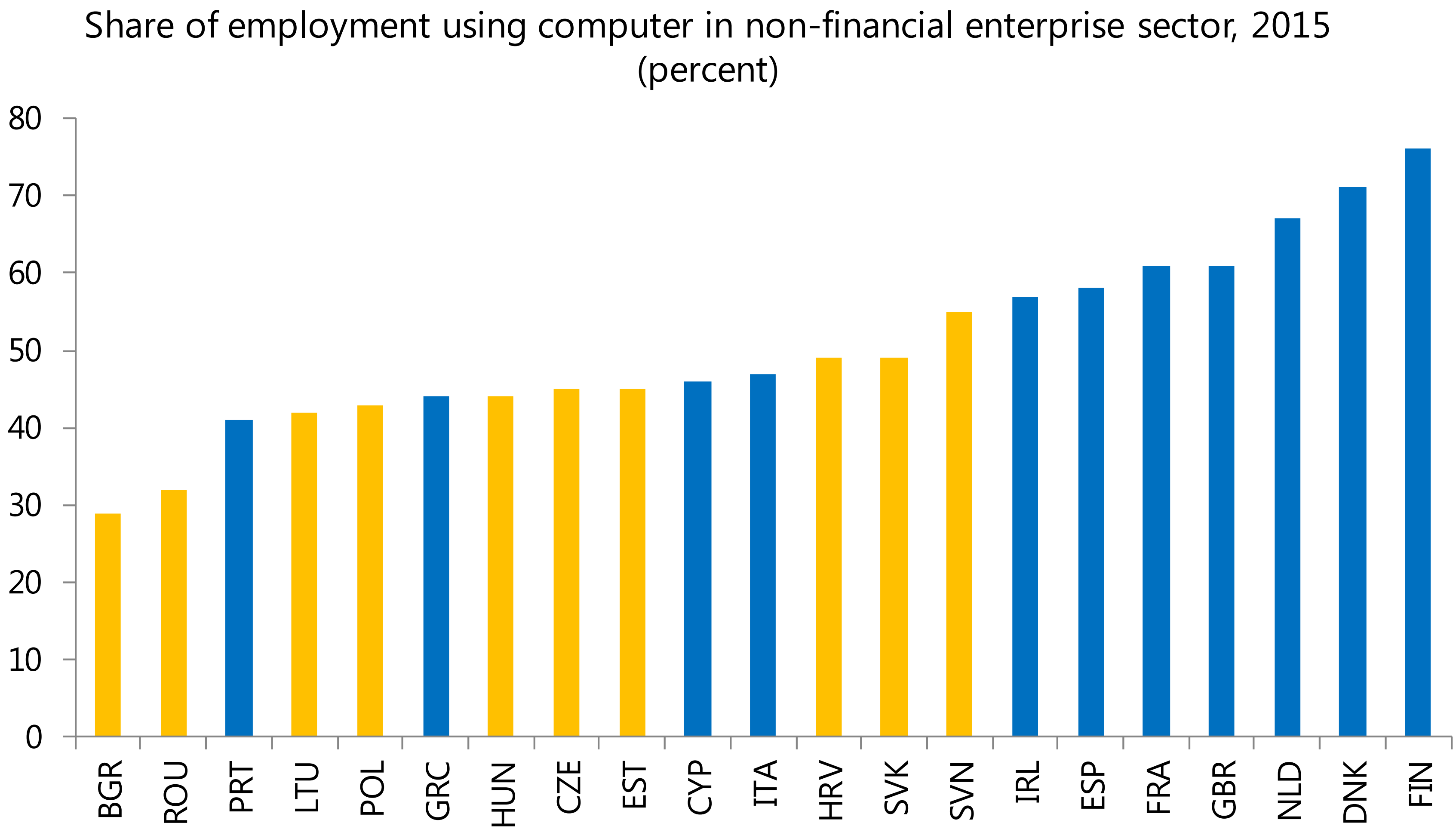
- Increased competition
- More use of technology
- More R&D
- Foreign firms can help
- More venture capital
- Further transformation of economy

Increased competition would support productivity

Standardized indicators of market development

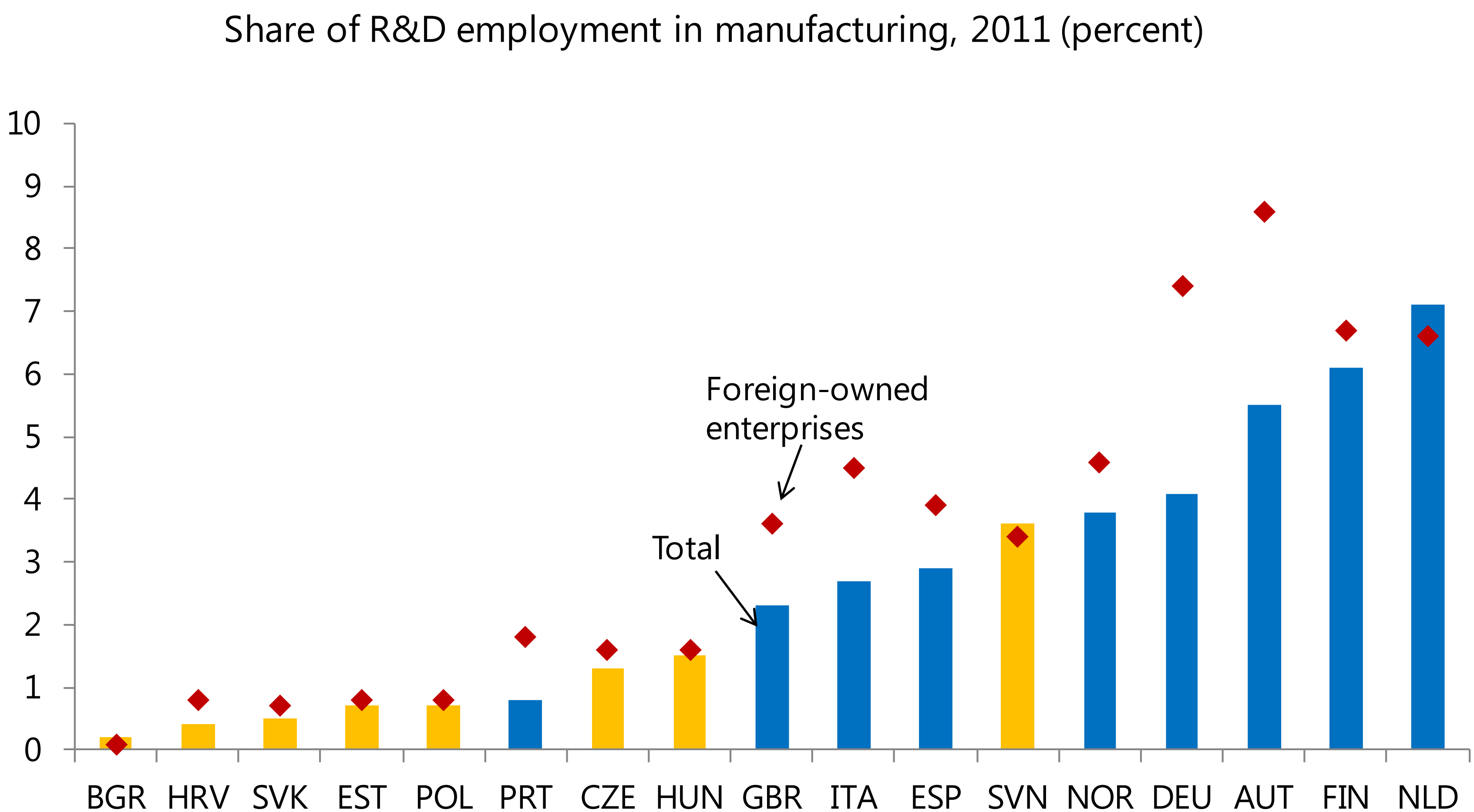


As would more use of technology



Note: CESEE countries in orange.

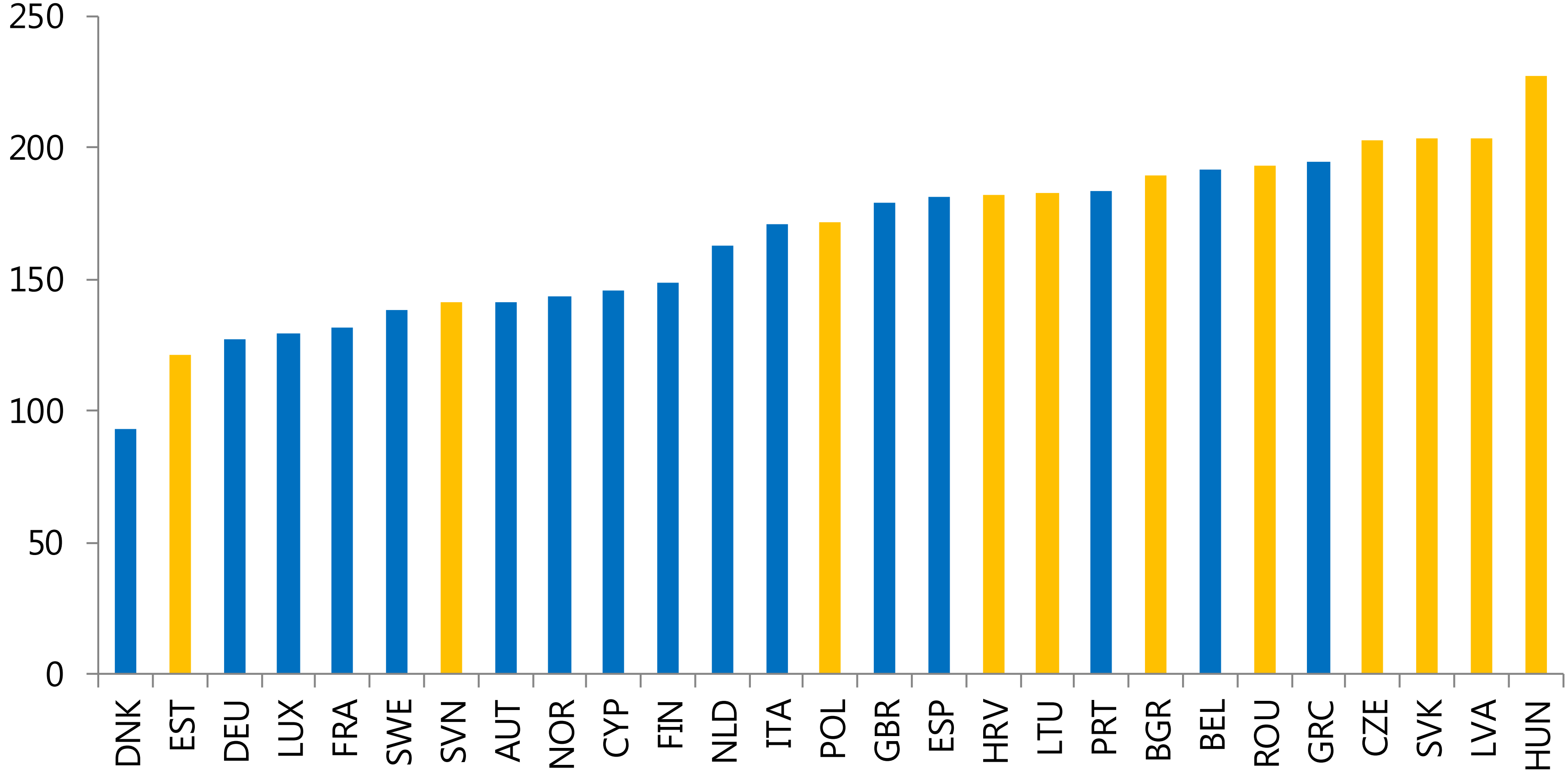
R&D is very low



Note: CESEE countries in orange.

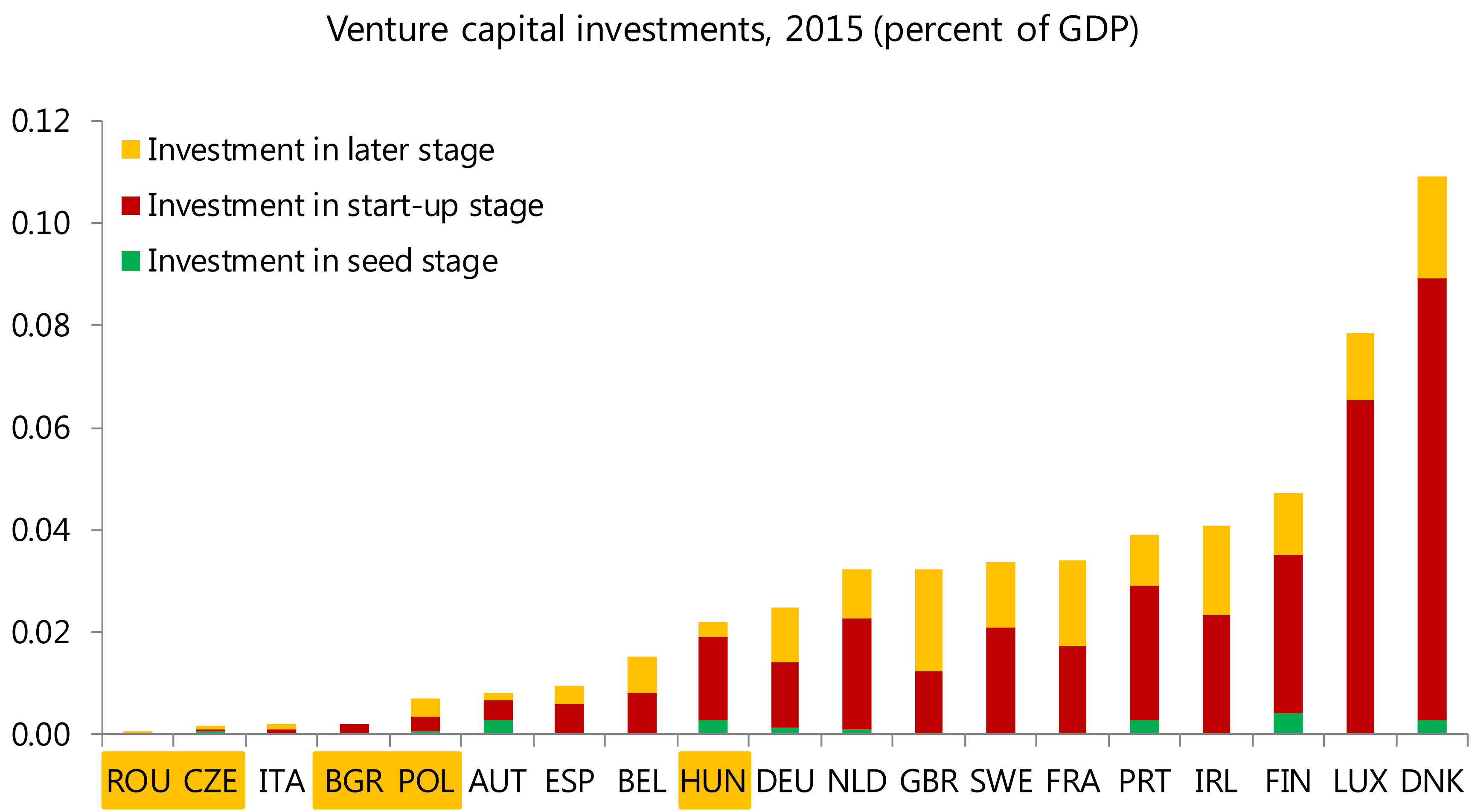
Foreign companies may bring higher productivity

Ratio of labor productivity in foreign- and domestically-controlled manufacturing enterprises, 2013 (percent)



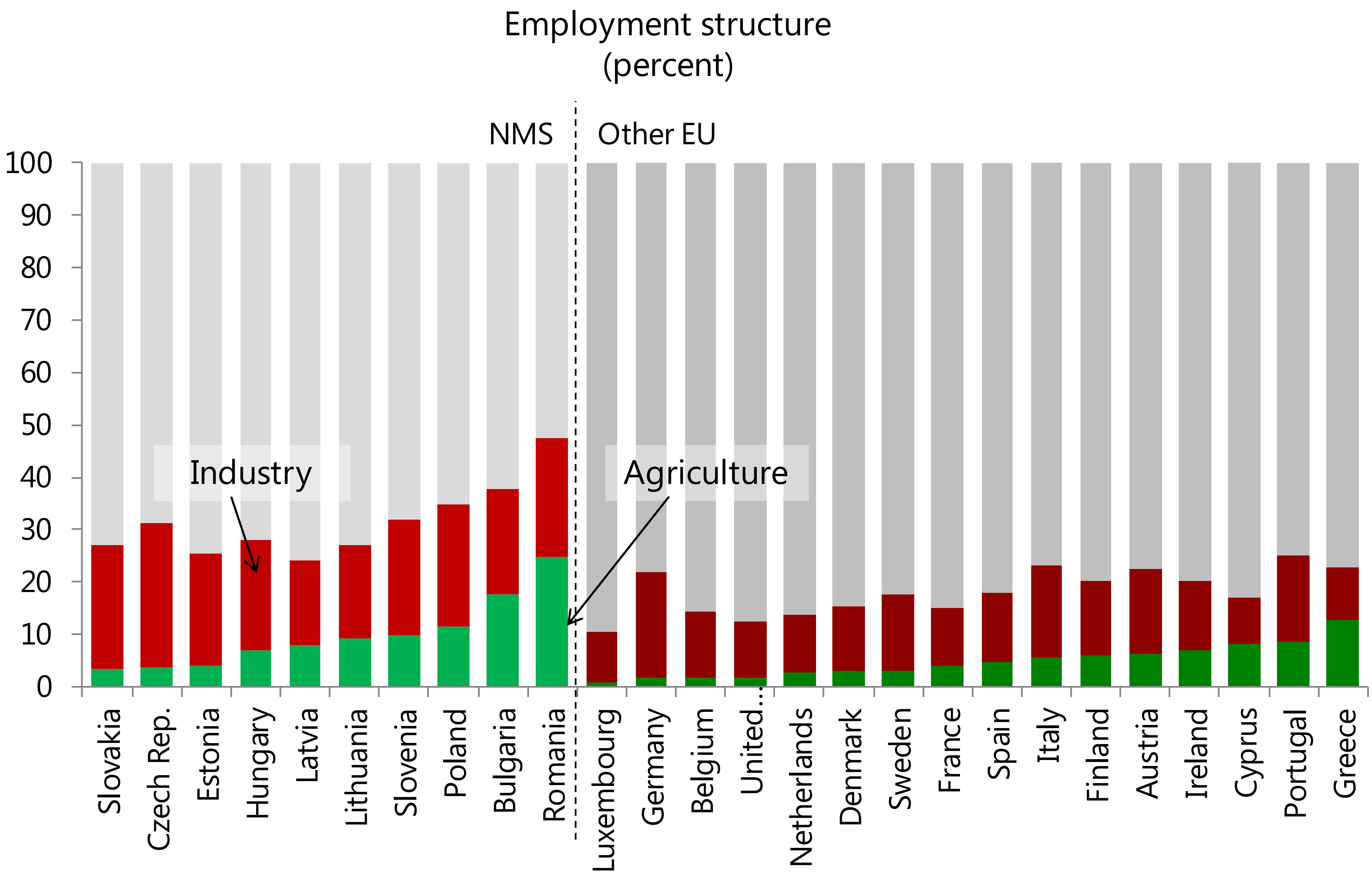
Note: CESEE countries in orange.

Venture capital financing is underdeveloped

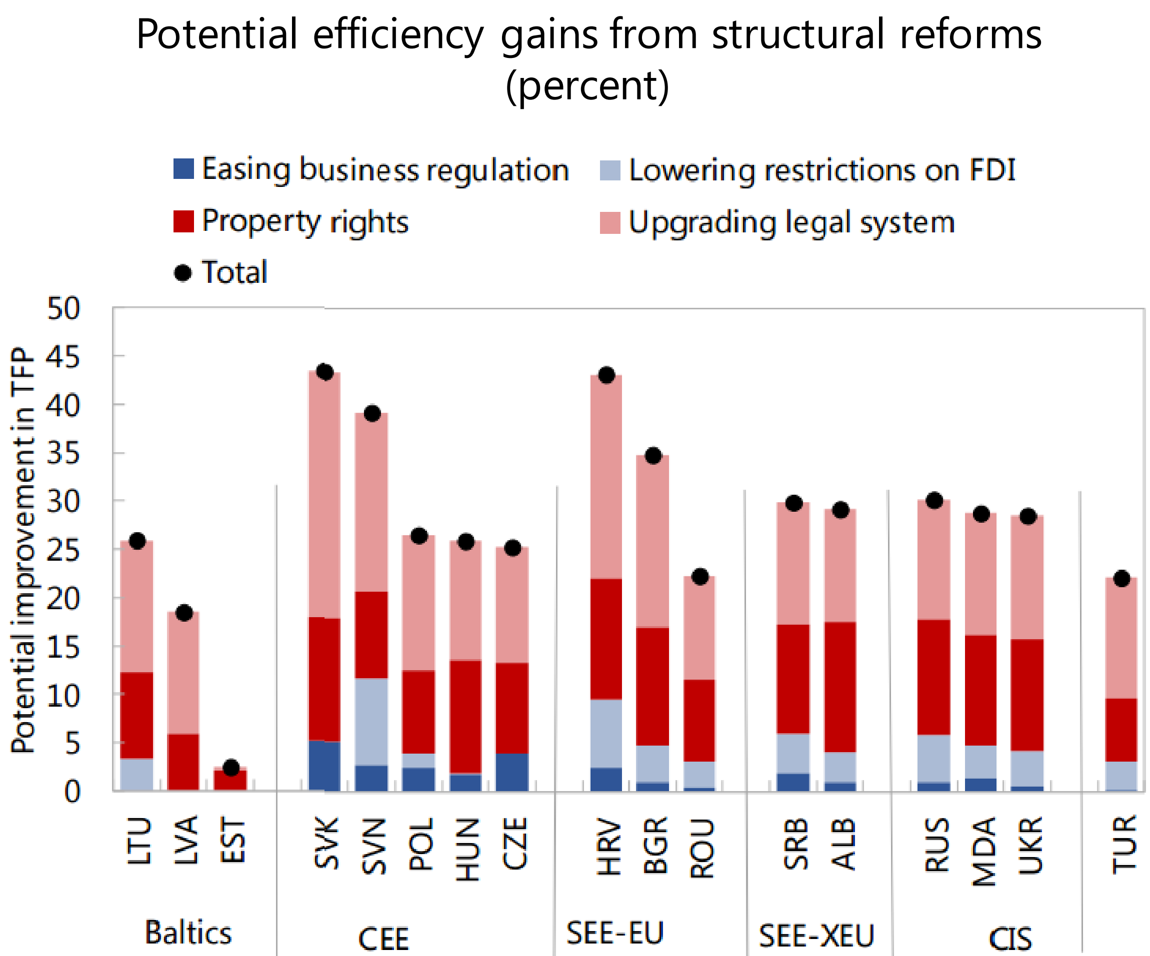


Note: CESEE countries highlighted in orange.

Further transformation: employment share of agriculture is still high



Regression suggest gains from structural reforms may be substantial



Source: IMF, CESEE Regional Economic Issues (Spring 2016)

Thank you