CESEE and EU: Closing the remaining gaps

26th Economic Forum in Krynica
Krynica, September 2016

Bas B. Bakker
Senior Regional Resident Representative
for Central and Eastern Europe
CESEE is still much poorer than Germany

GDP per capita in Germany (in constant 2014 dollars, PPP-adjusted)

Per capita income in CESEE countries as of 2015
How to close gap?

Through combination of

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

- **2003-06**
- **2011-15**

The maps show the distribution of average investment rates across different regions in Europe for the periods 2003-06 and 2011-15. The color codes indicate the percentage of GDP invested, with darker colors representing higher investment rates.
Investment needs are large: infrastructure less developed than in Western Europe

Colored lines denote railways with maximum speed above 200 km/h
Increased investment would necessitate higher saving (otherwise foreign capital needed)
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

Employment rate in 2000 and 2015 (percent)

Note: For HRV data for 2002 and 2015.
Labor markets are tightening—labor may soon become scarce
Working-age population is falling rapidly

Working age (15-64) population growth (percent)

2005-15

2015-25
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

Competition (Global Competitiveness Report), 2015-16

Product Market Regulation (OECD), 2013

Competition Policy (EBRD), 2014
As would more use of technology

Share of employment using computer in non-financial enterprise sector, 2015 (percent)

Note: CESEE countries in orange.
R&D is very low

Share of R&D employment in manufacturing, 2011 (percent)

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

Venture capital investments, 2015 (percent of GDP)

- Investment in later stage
- Investment in start-up stage
- Investment in seed stage

Note: CESEE countries highlighted in orange.
Further transformation: employment share of agriculture is still high
Regression suggest gains from structural reforms may be substantial

Potential efficiency gains from structural reforms (percent)

- Easing business regulation
- Lowering restrictions on FDI
- Property rights
- Upgrading legal system
- Total

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