CESEE:
Remaining challenges for faster growth

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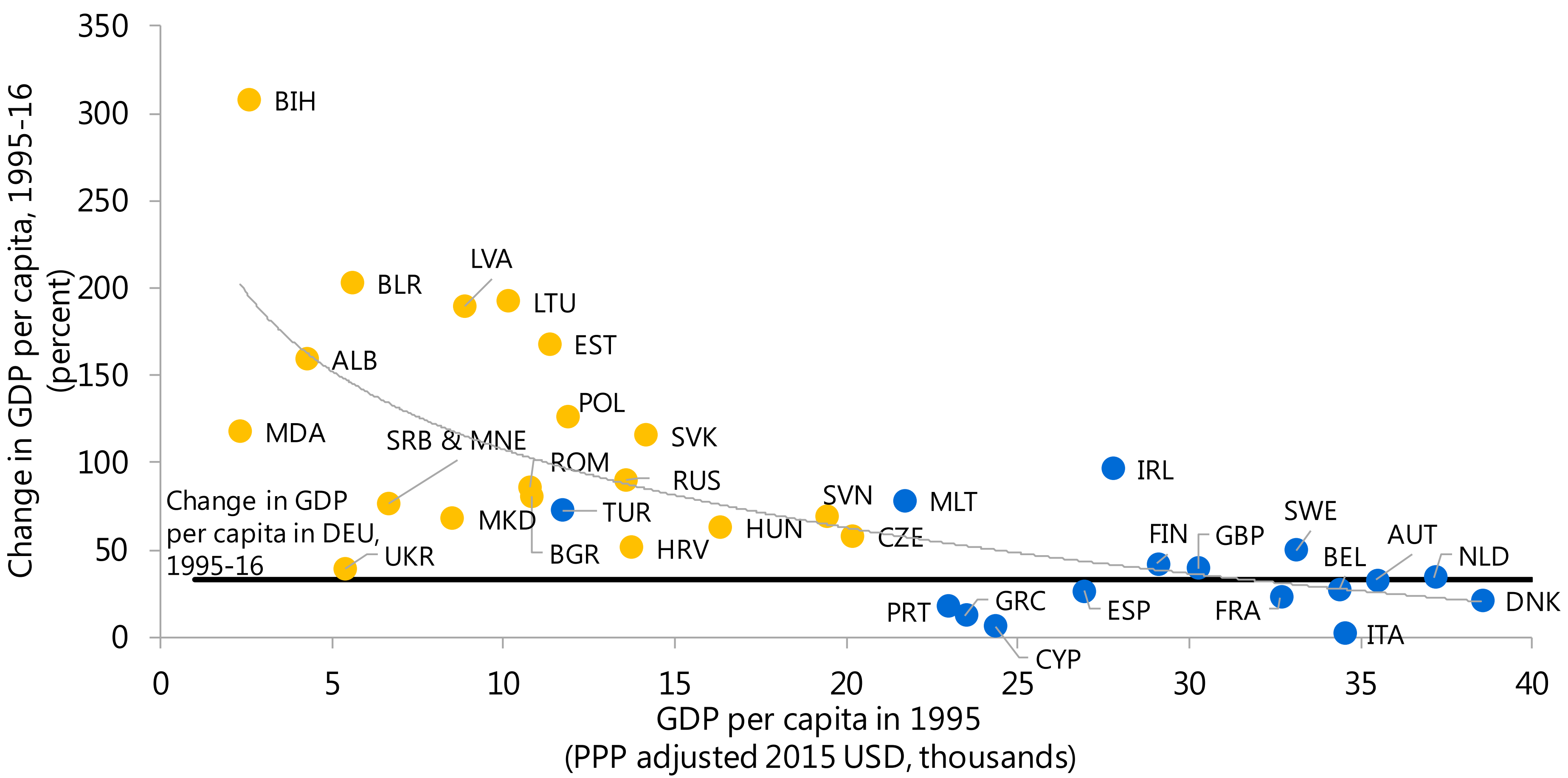
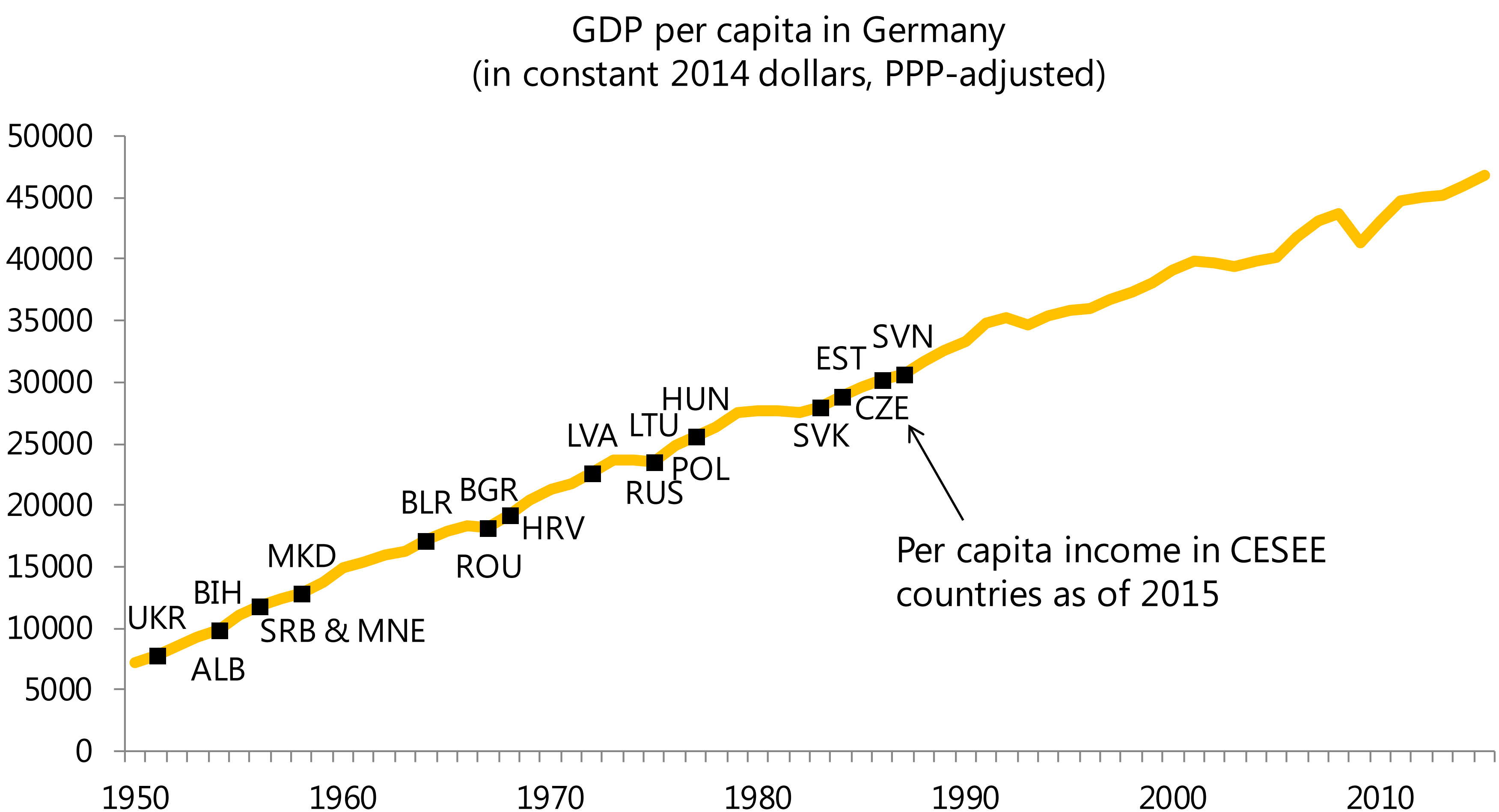
Since the mid-1990s, CESEE has converged with Germany

GDP per capita in 1995 and its change, 1995-16

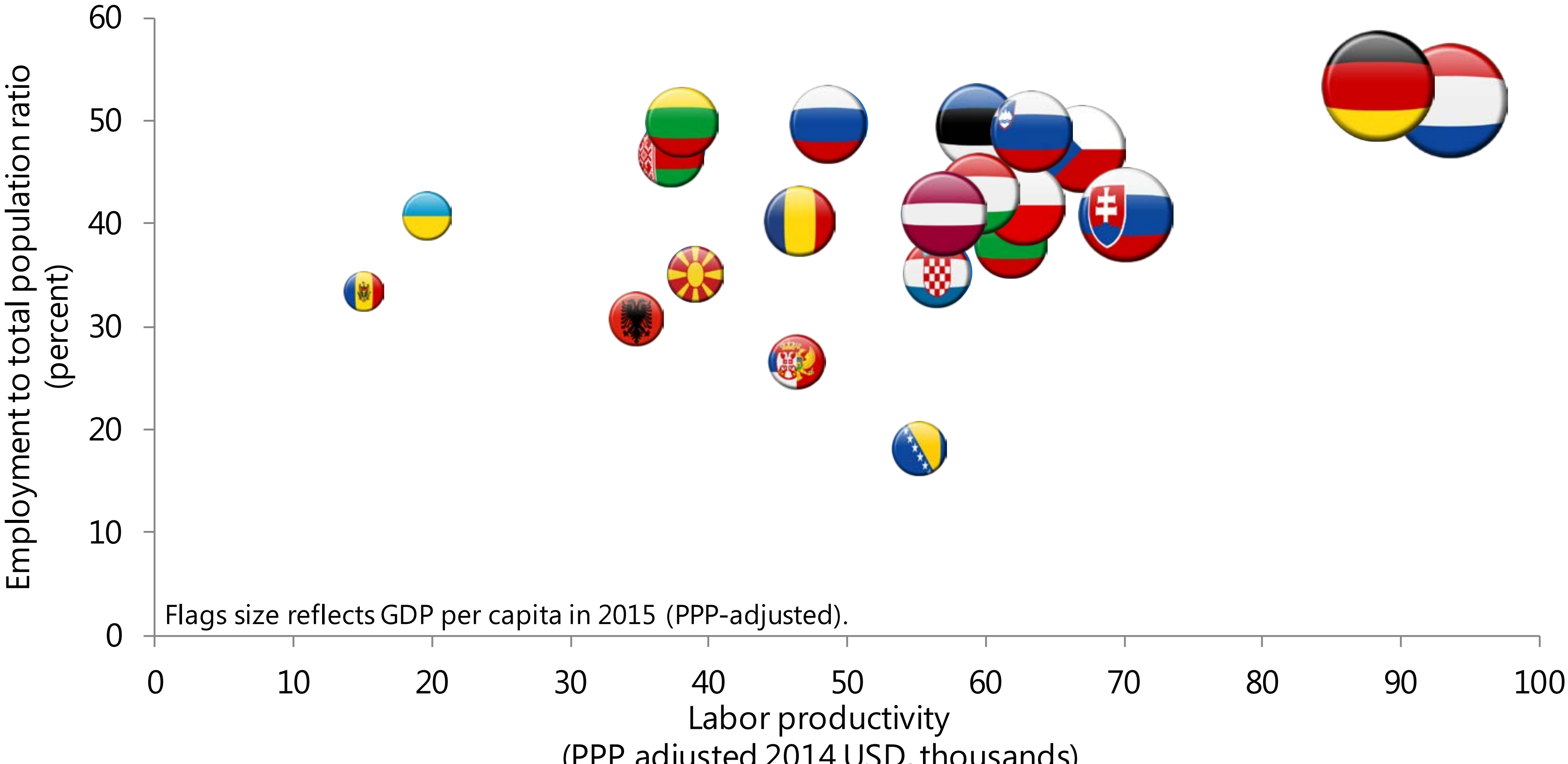


However, CESEE is still much poorer than Germany



Why is CESEE poorer? Result of less labor input and lower labor productivity.

Labor productivity and employment to total population ratio, 2015



What determines labor input and labor productivity?

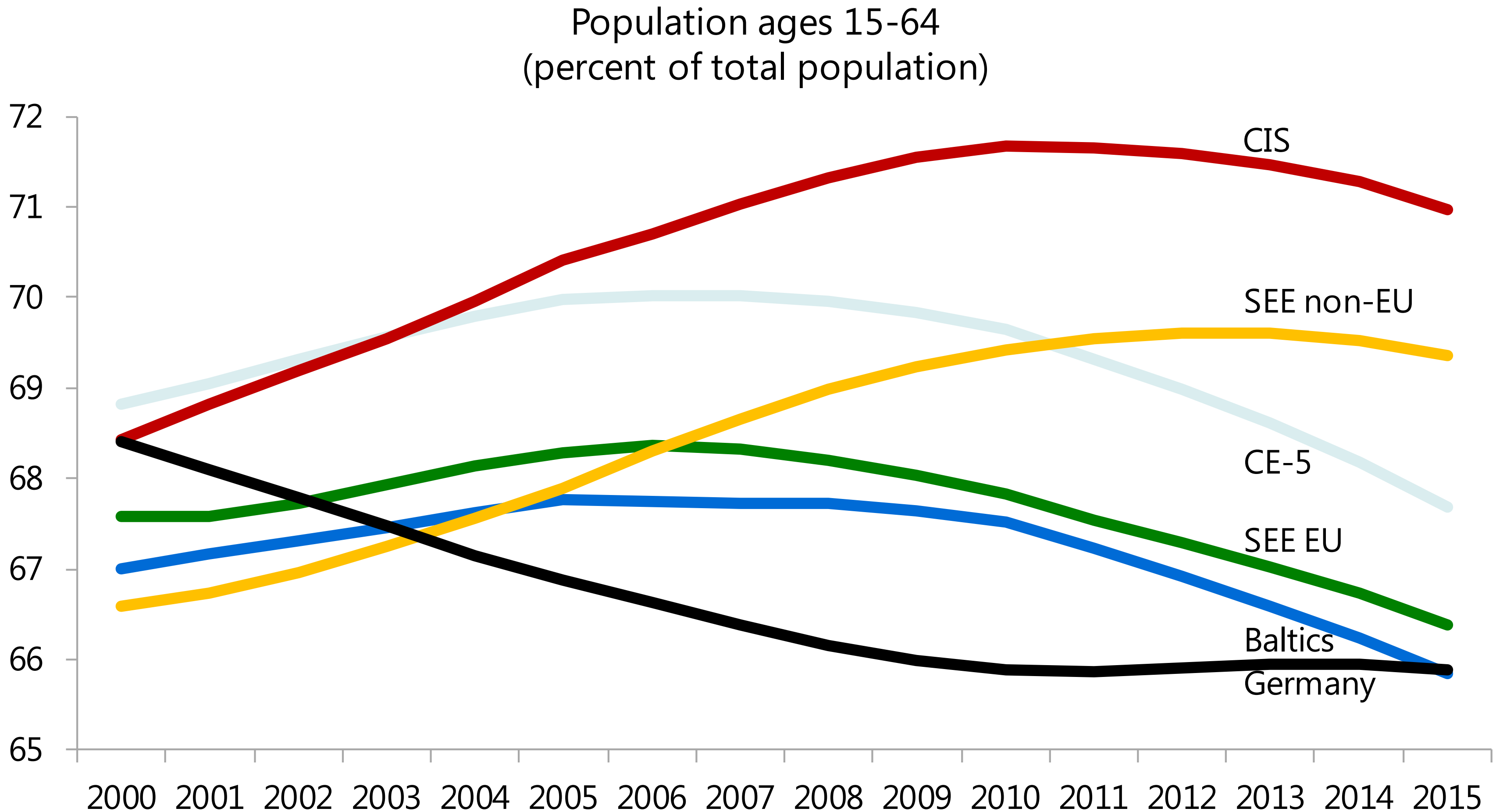
- Labor input per capita determined by
  - Employment rate of working age population
  - Share of working age population in population

- Labor productivity determined by
  - Capital stock per worker
  - Total factor productivity

Let's look at these factors in more detail

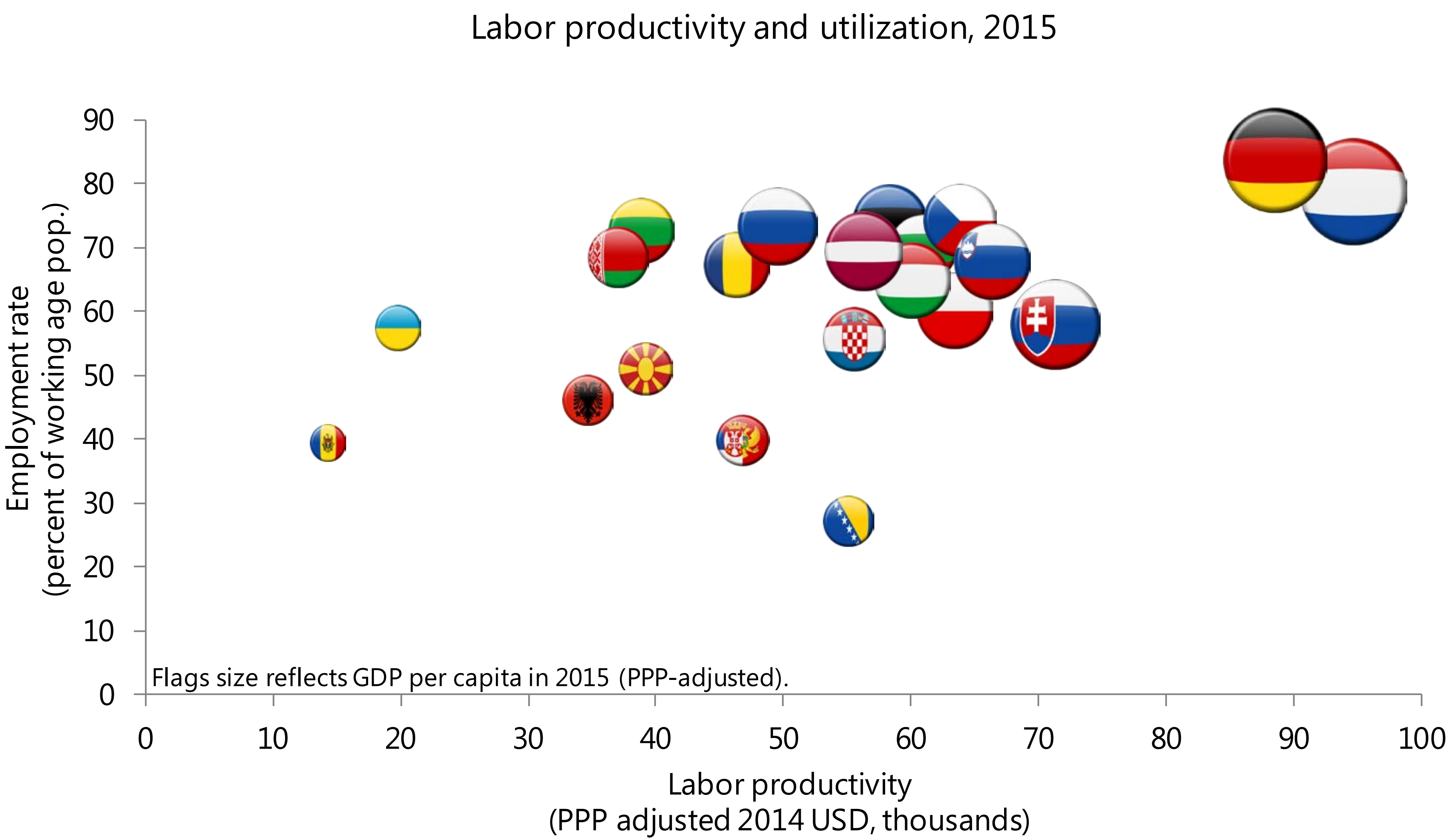
- What are prospects for further increase of employment to population rate?
- What is happening with growth of capital stock?
- What is happening with TFP— and what can be done to boost it?

The share of the working age population is relatively high—although it is now declining

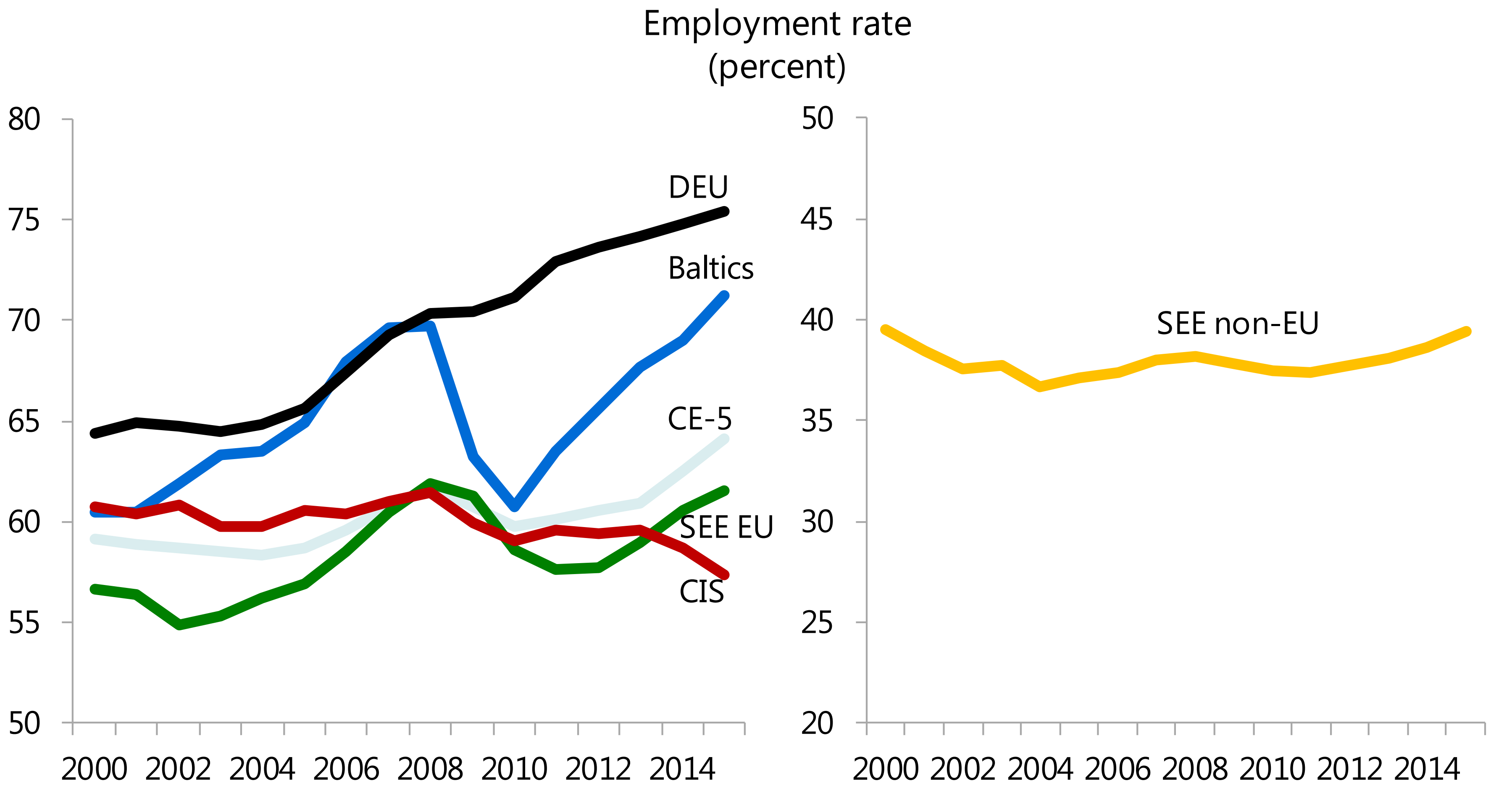


Note: Simple average of given countries.

If we compare employment to working age population rate differences in labor input with Germany are more pronounced

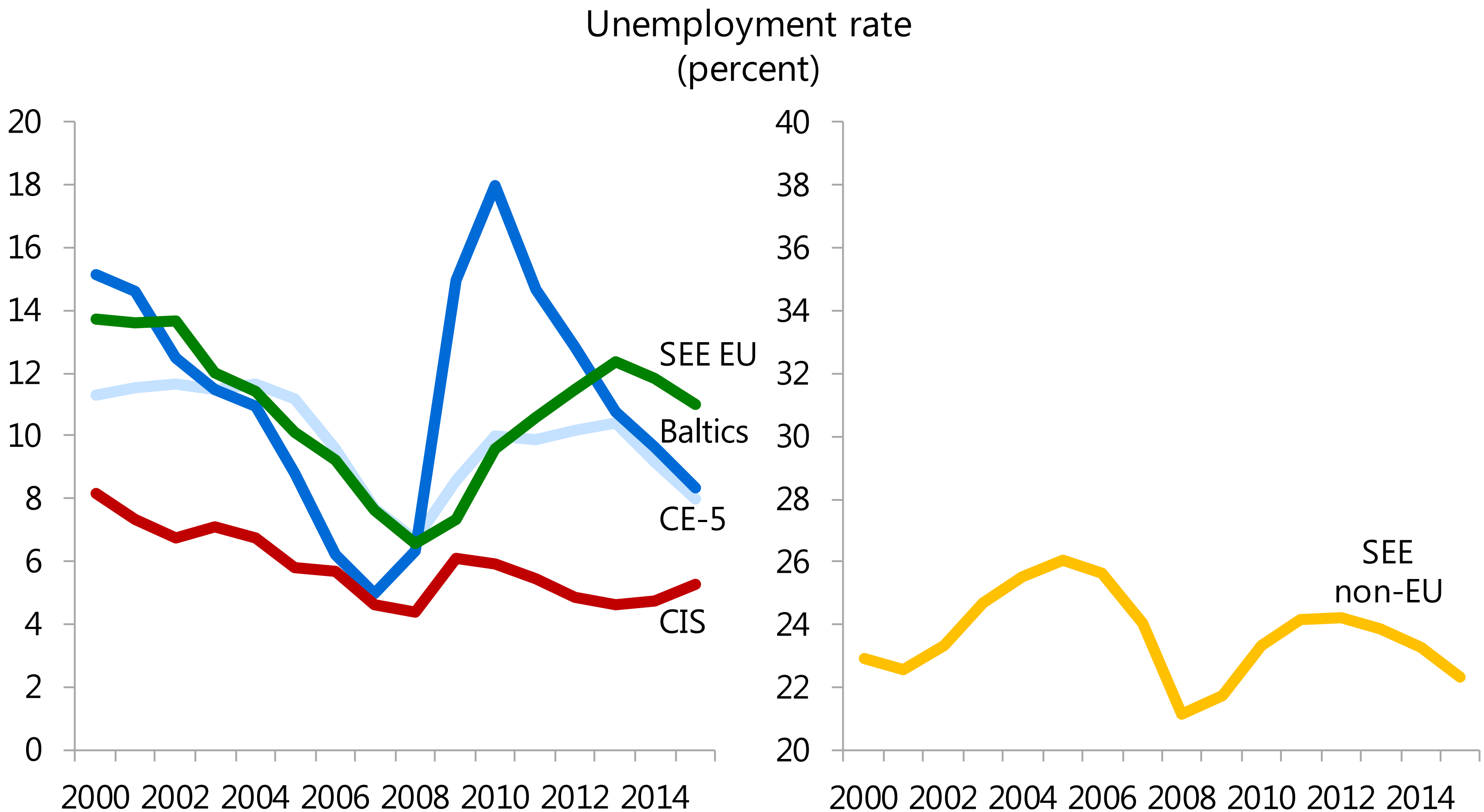


Employment rates are still well below Germany—with the exception of Baltics



Note: Simple average of given countries.

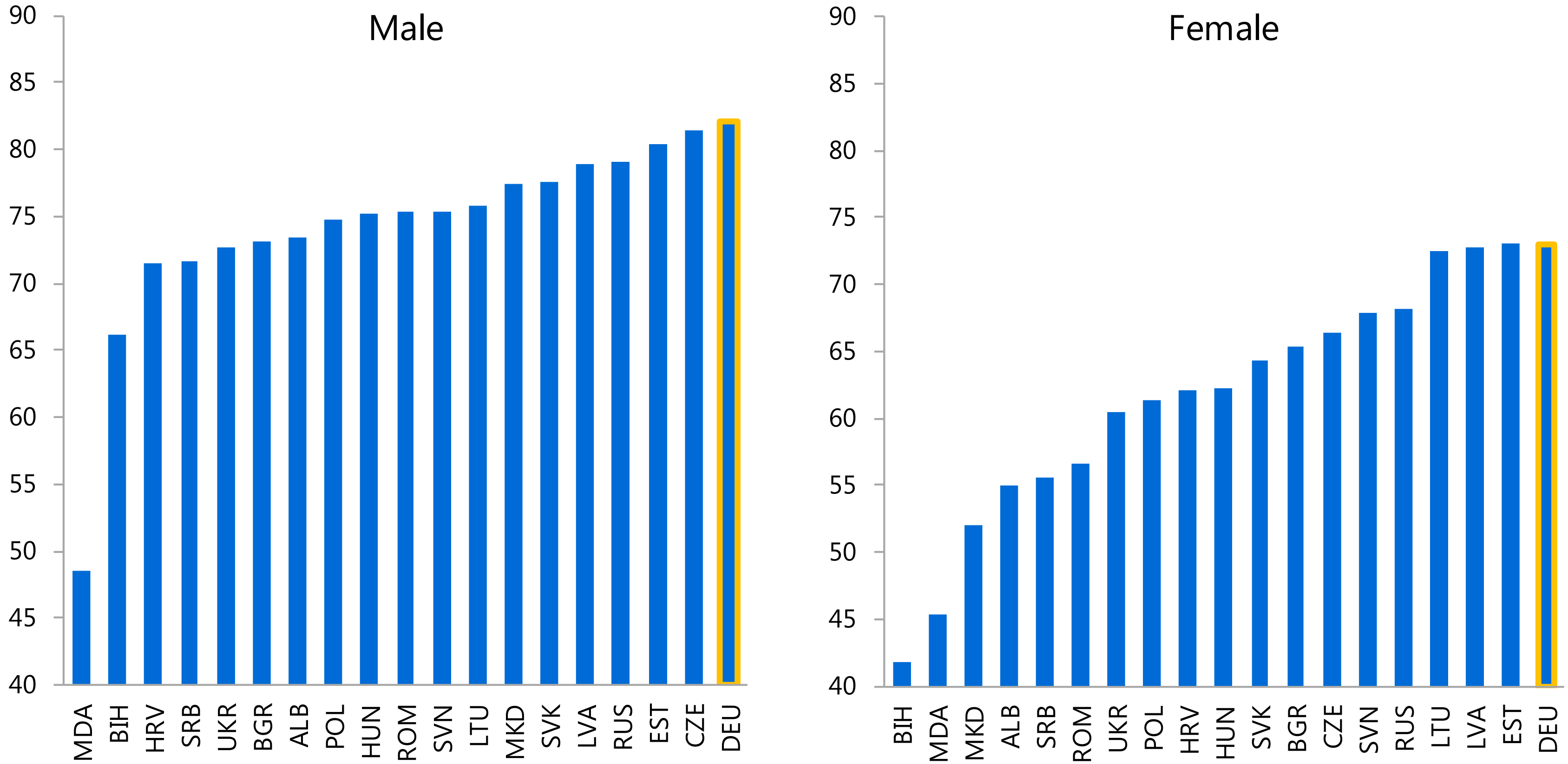
With unemployment rates falling rapidly, it will be important to increase labor force participation



Note: Simple average of given countries.

Including of women

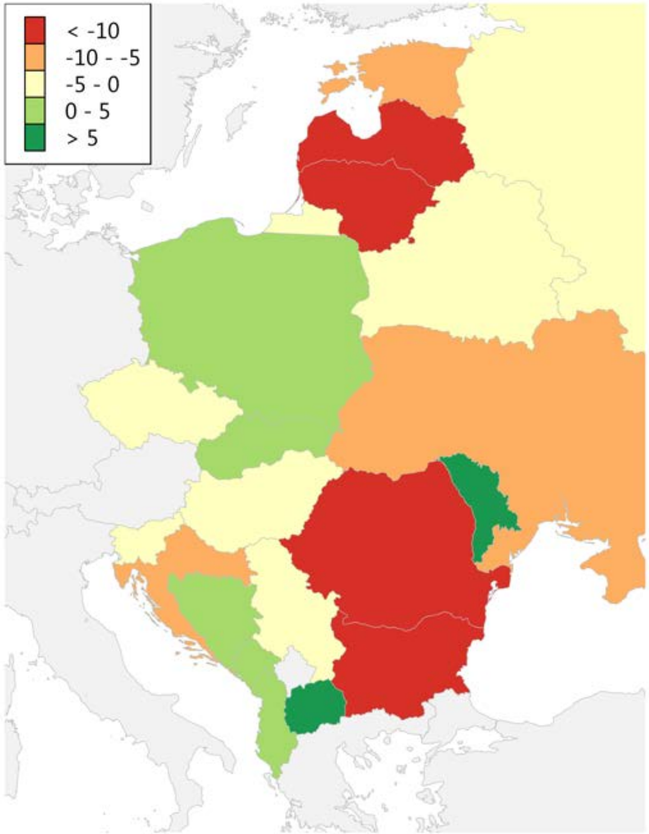
Labor force participation rate, 2015
(percent of either male or female population ages 15-64)



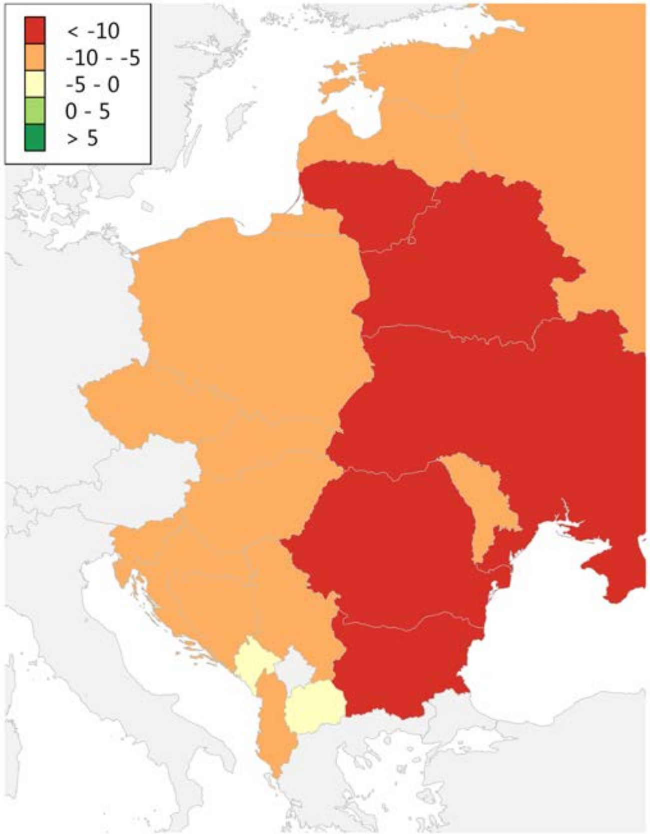
It's important given that the impact of aging will accelerate in the next decade…

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

2000-2015

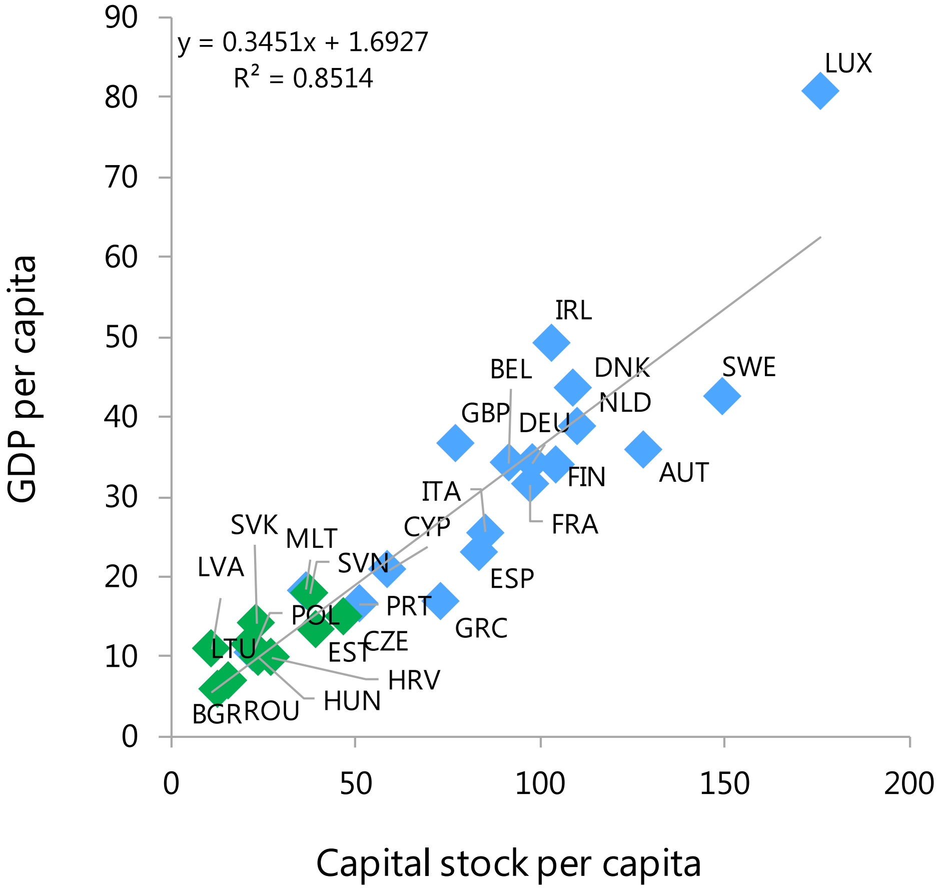


2015-2025

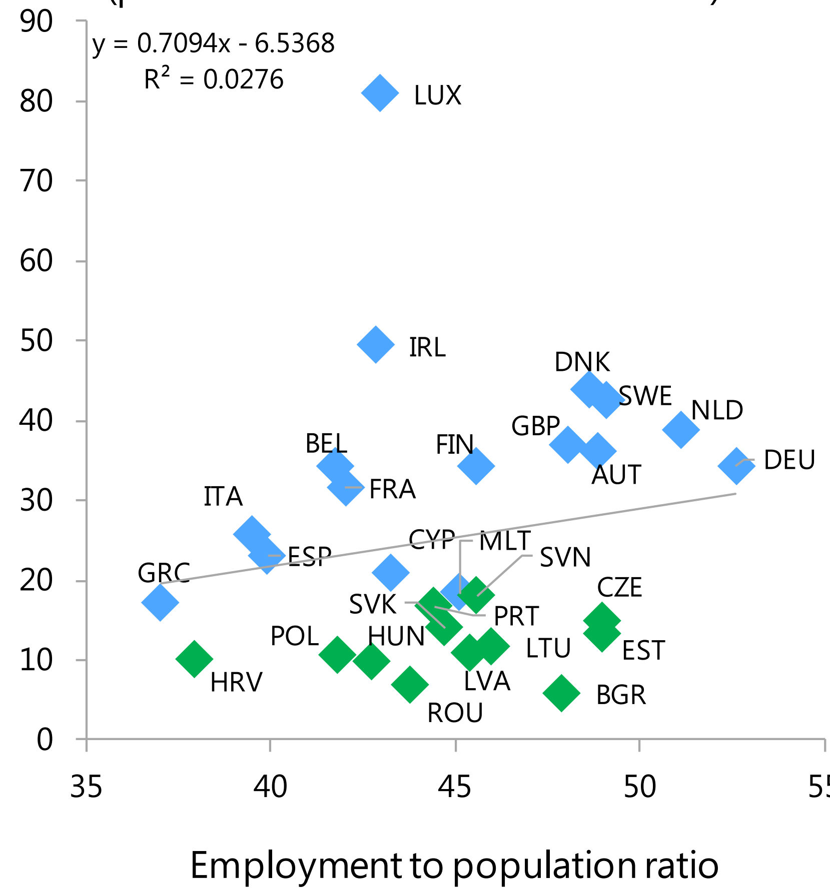


While higher labor input will help, higher capital stock and thereby labor productivity may be even more important

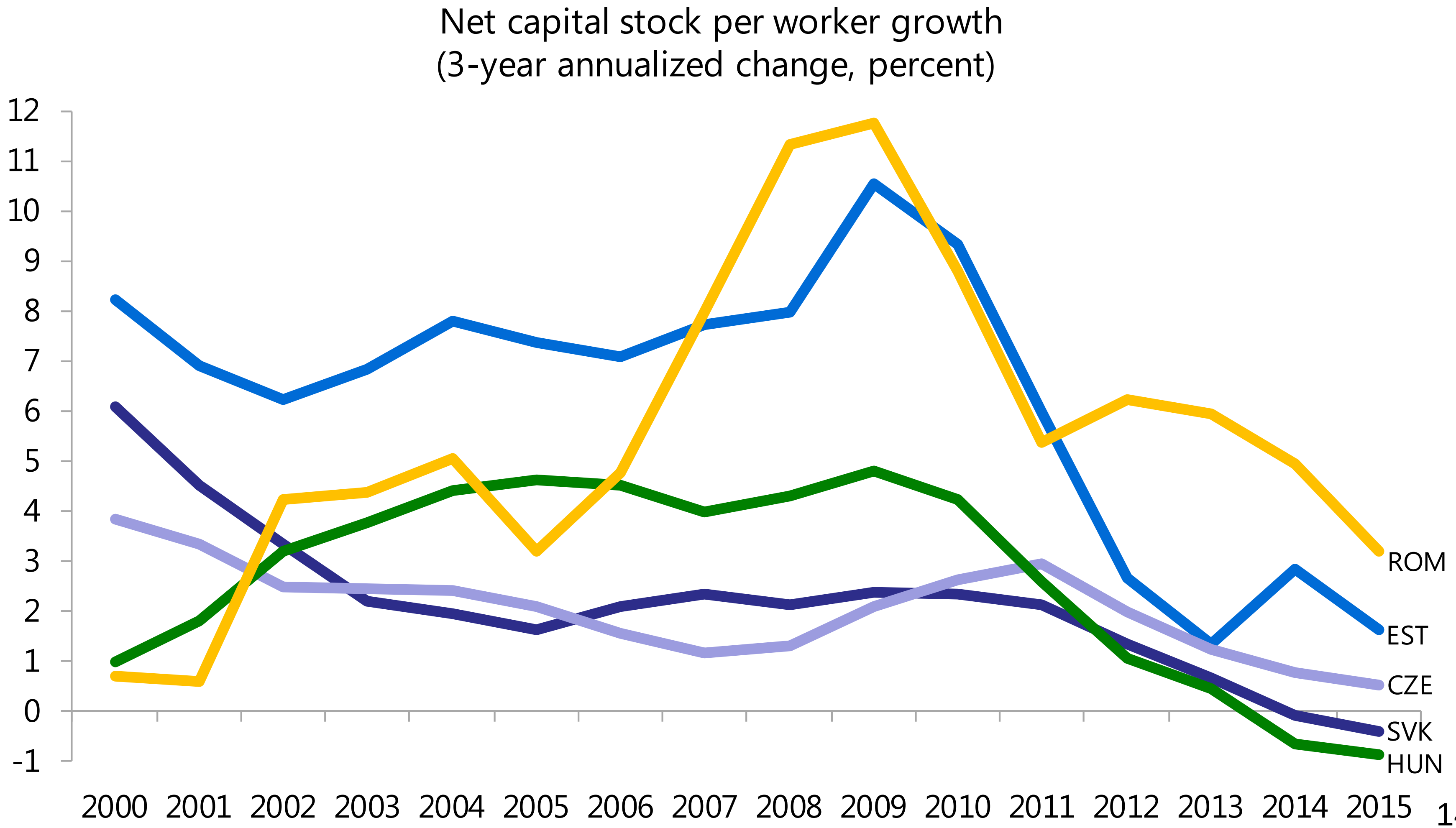
Capital stock and GDP per capita, 2015
(thousands of 2010 EUR)



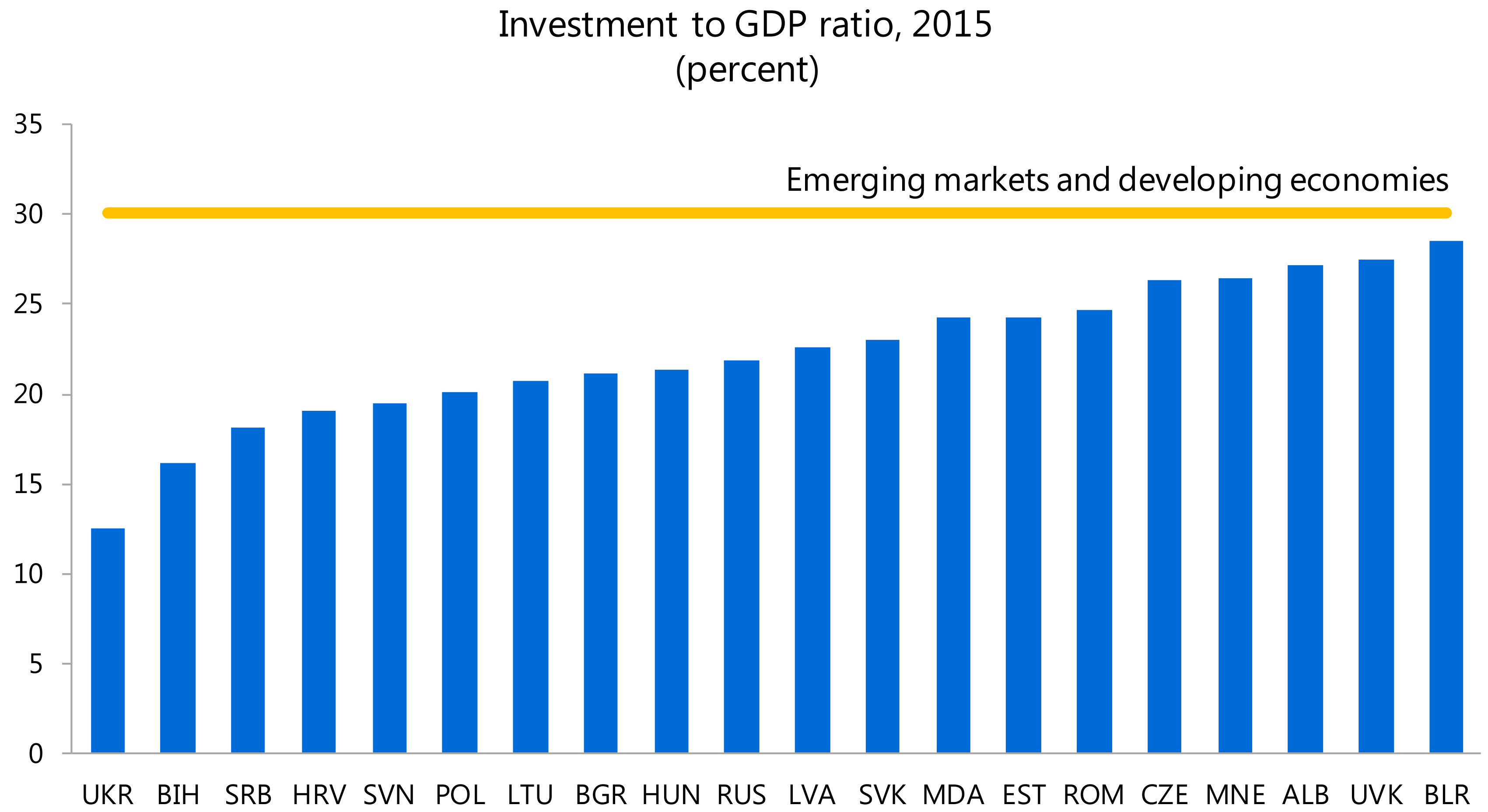
Employment to population ratio and GDP per capita, 2015
(percent and thousands of 2010 EUR)



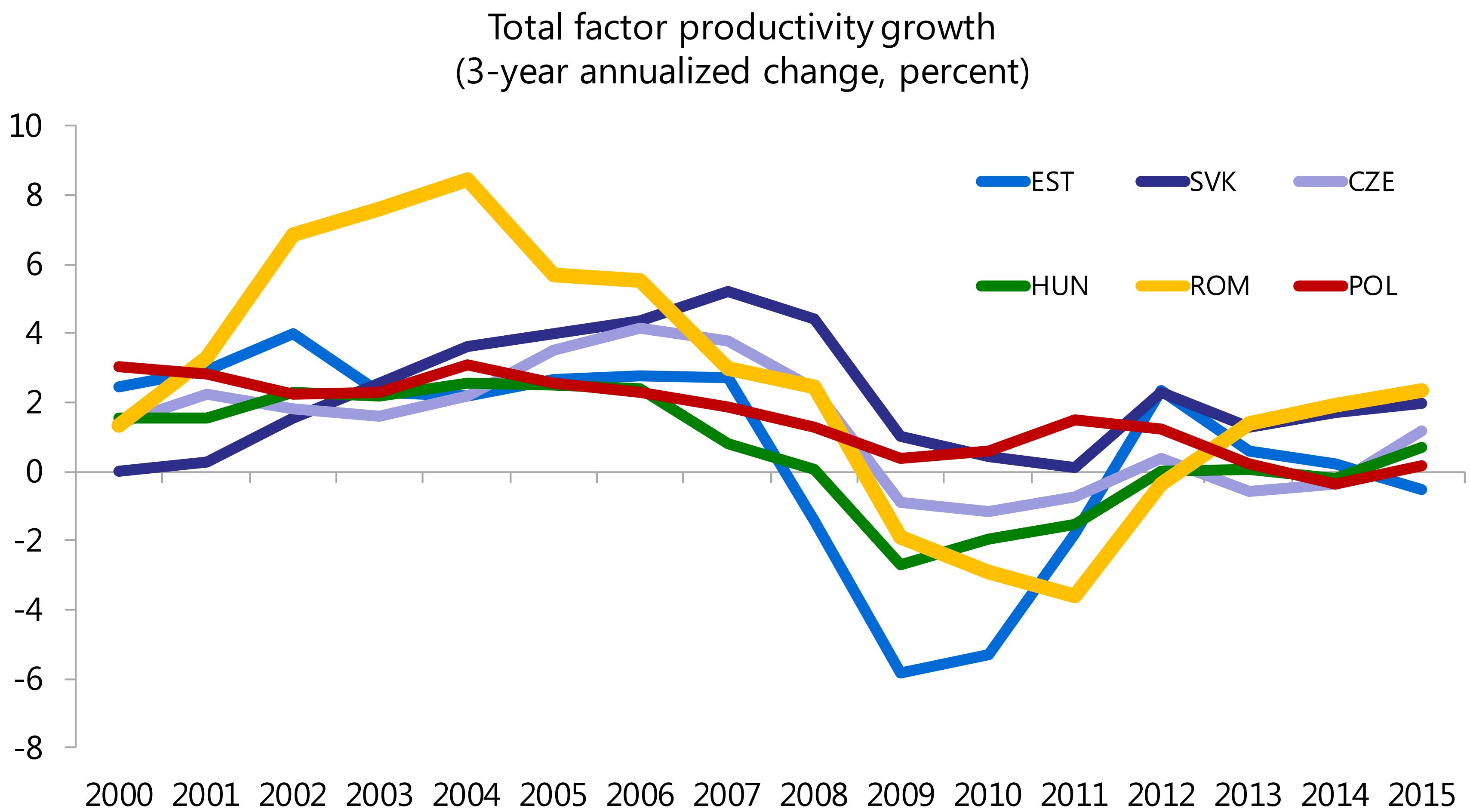
However, growth of capital stock has slowed…



...as investment rates post-crisis are (too) low.

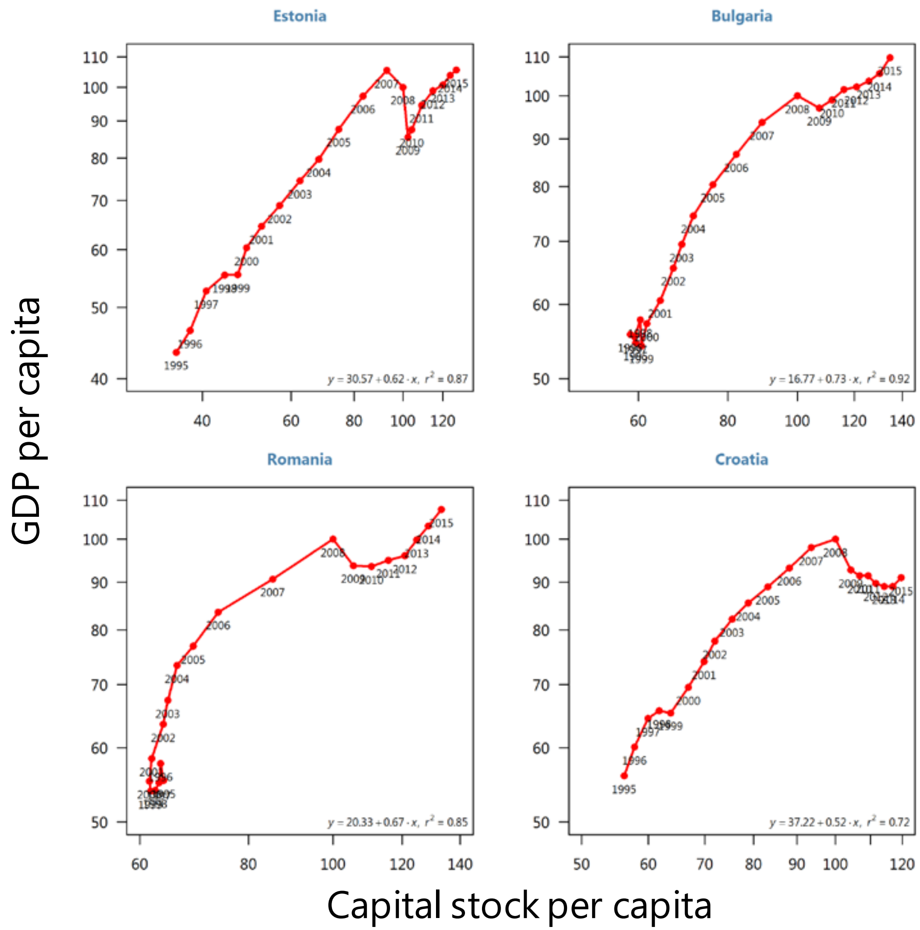


Low investment not only problem: TFP growth has slowed as well…



…which means that a given increase in production factors now leads to smaller increase in output.

Capital stock and GDP per capita
(2008=100, in logarithmic scales)



So what should be done?

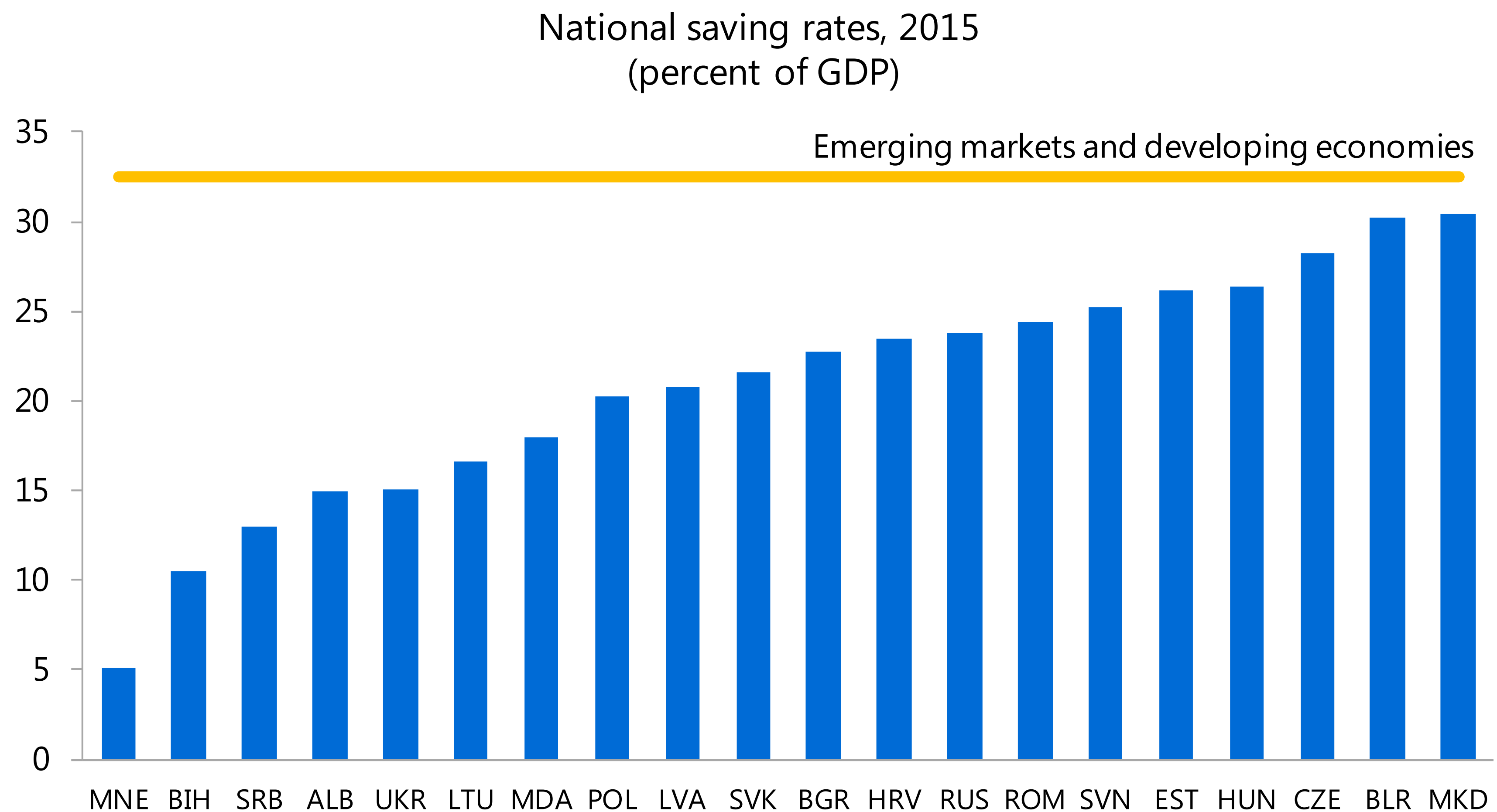
Address factors that might constrain productivity (REI May-16)

- Insufficient protection of property rights and
- Inefficient legal systems and other government services
- Limited access to financial services (e.g. for SMEs)
- Infrastructural gaps

Improve public investment management and tax administration (REI Nov-16)

- Closing efficiency gaps in public investment and tax collection could bring sizable benefits.
- Further upgrades of public investment management should focus on improving allocation and implementation frameworks and procedures.
- Improvements in tax administration should aim at reducing compliance gaps.
- Design of reforms should include elements that help reduce resistance to reforms and build the support base for their successful completion.

Challenge: saving is very low, and may constrain investment

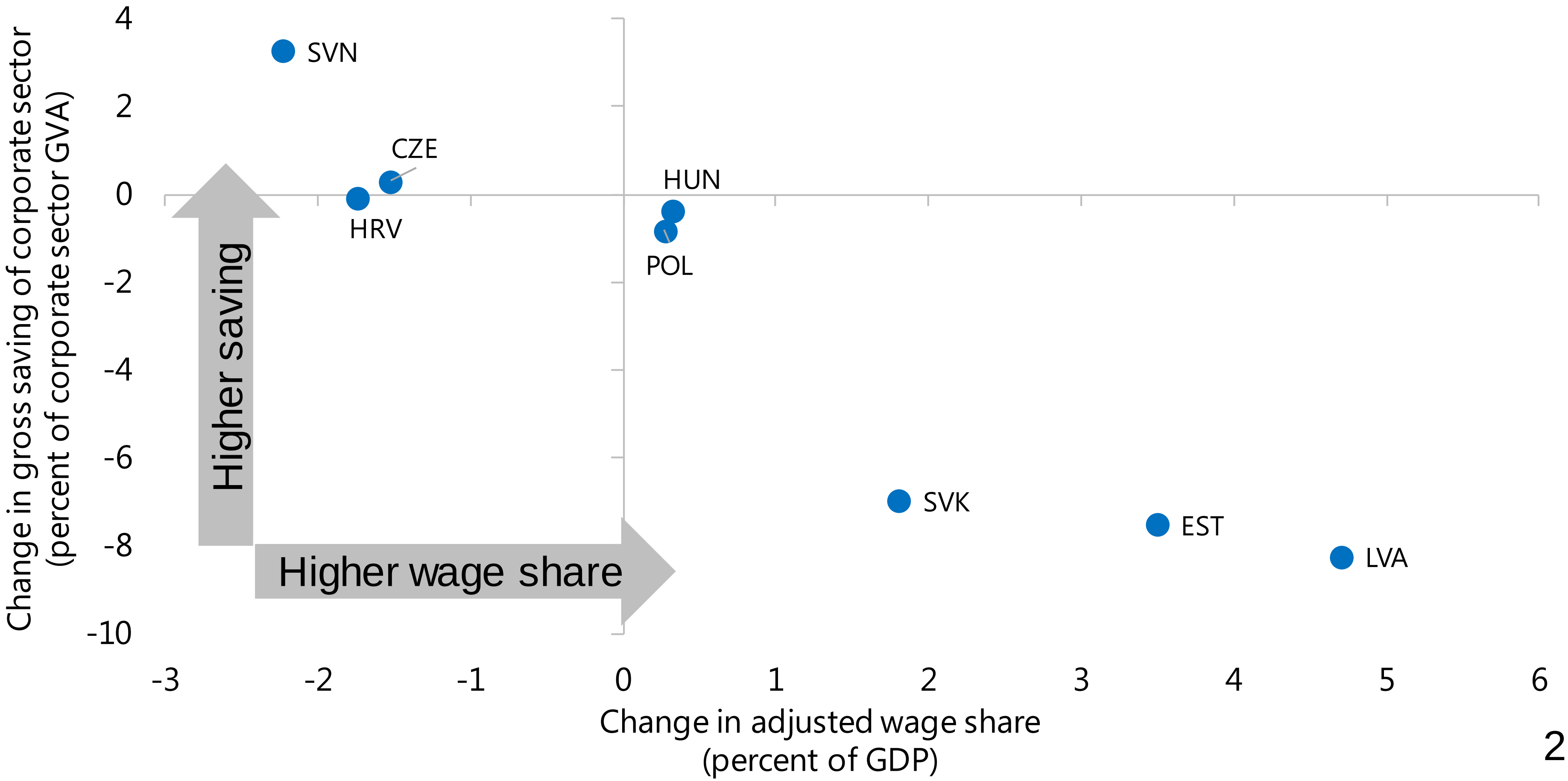


But can saving be raised?

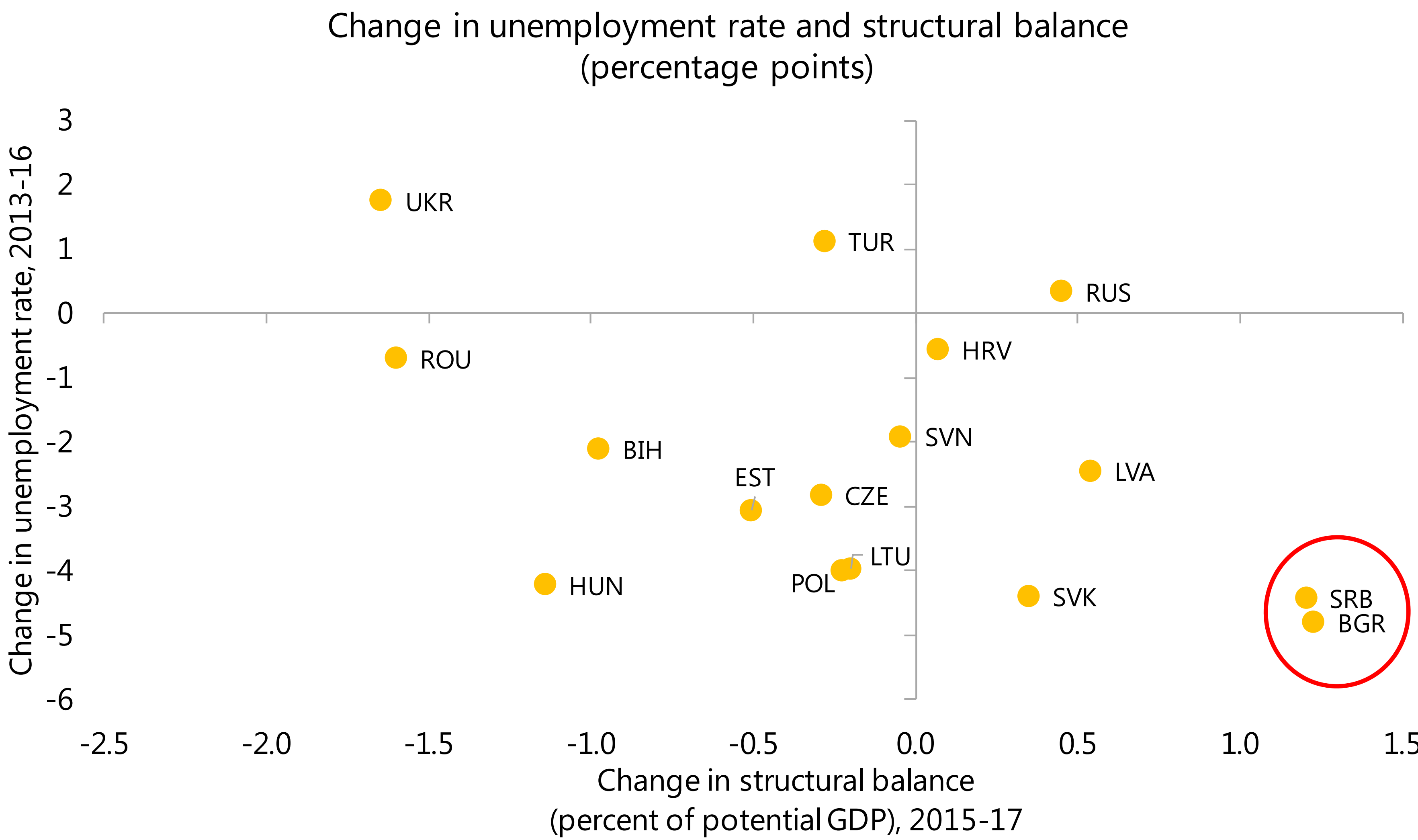
- Household saving difficult to influence
- Corporate saving more likely to *fall* as labor markets tighten further
- Little appetite for boosting government saving (i.e., reduce deficits)

Scarcity of labor will likely reduce corporate profits and saving

Change in wage share of income and corporate saving, 2013-16
(percentage points)



Only few countries are planning a meaningful increase of the structural balance (>1/2 percentage point a year) – even though unemployment is falling rapidly



Conclusion

- Further catch-up will necessitate
  - Increase labor force participation rate, which would also help to offset declining share of working age population
  - Higher investment, as capital stock is low
  - More efficient use of resources —boosting TFP
  - Improving institutions and frameworks key.

Thank you