

State Involvement and Economic Growth

(The Future of the European Economy: Over to the State, or to the Market?)



27th Economic Forum

Krynica, Poland

September 2017

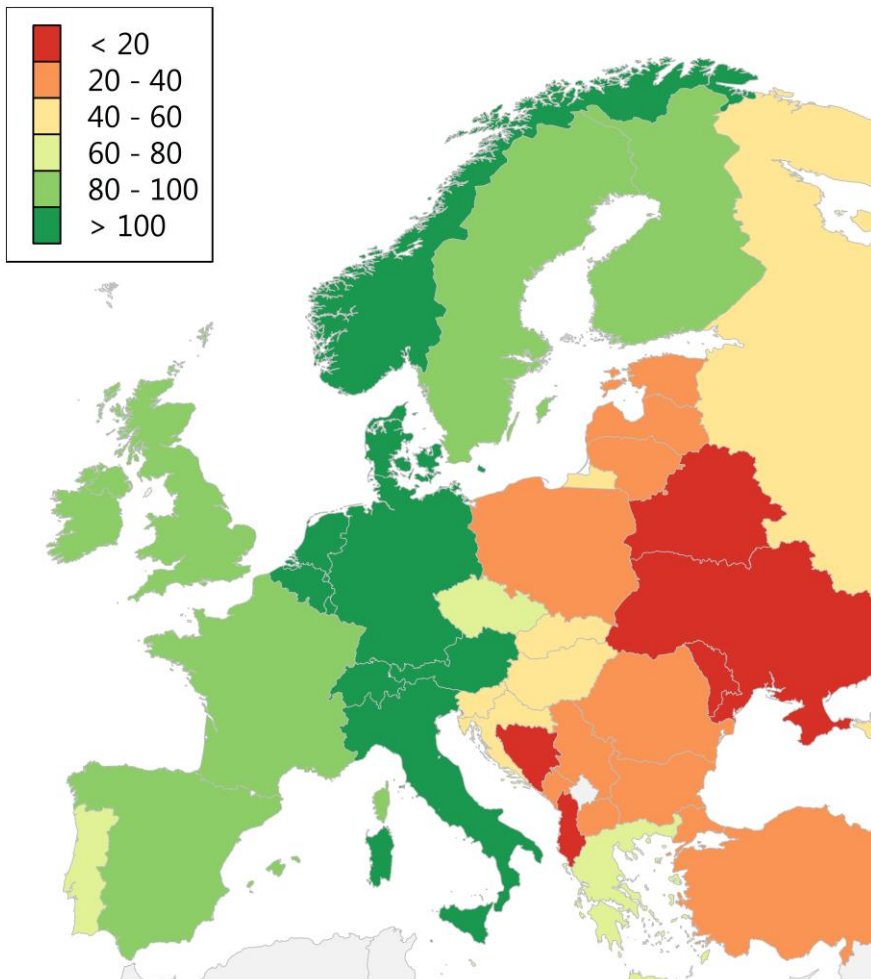
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Senior Regional Resident Representative
for Central and Eastern Europe

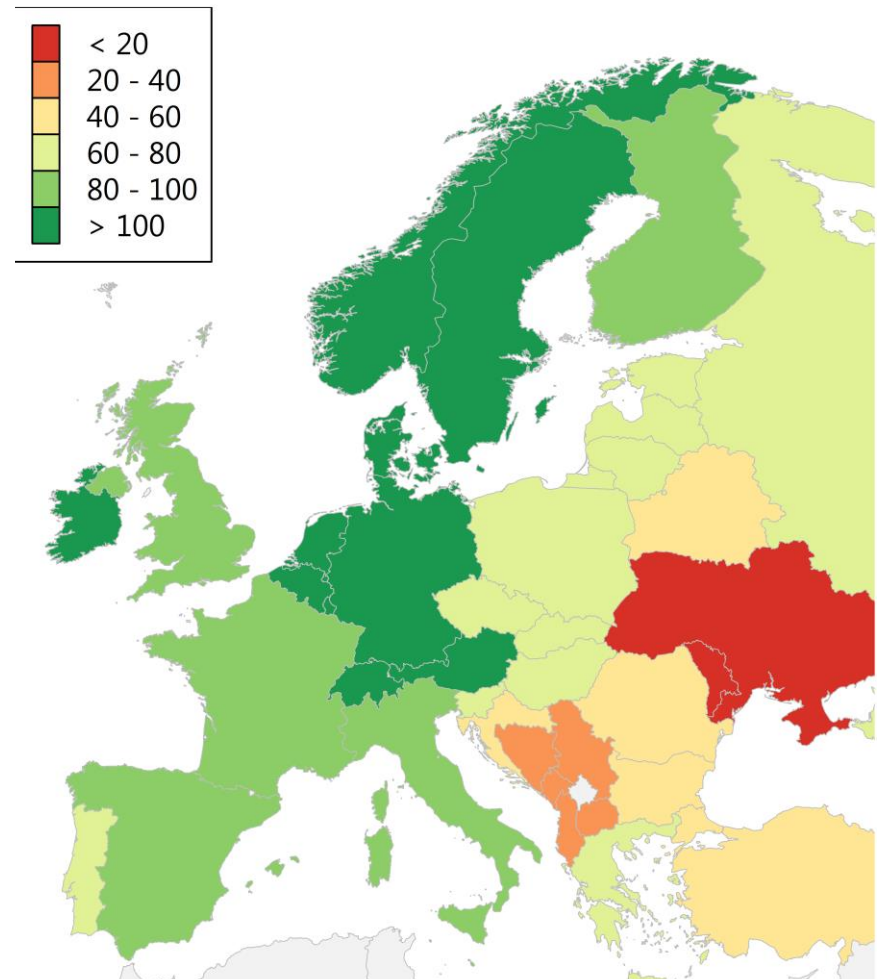
In last two decades income gap between CESEE and Western Europe has narrowed



Real GDP per capita in 1995
(Percent of EU15)



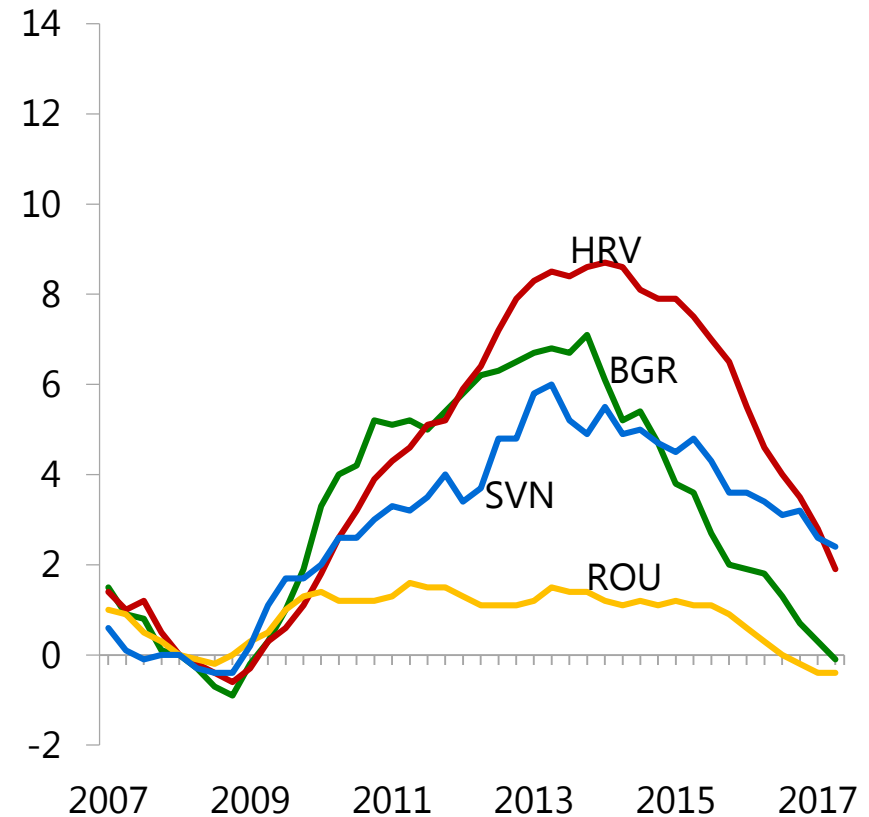
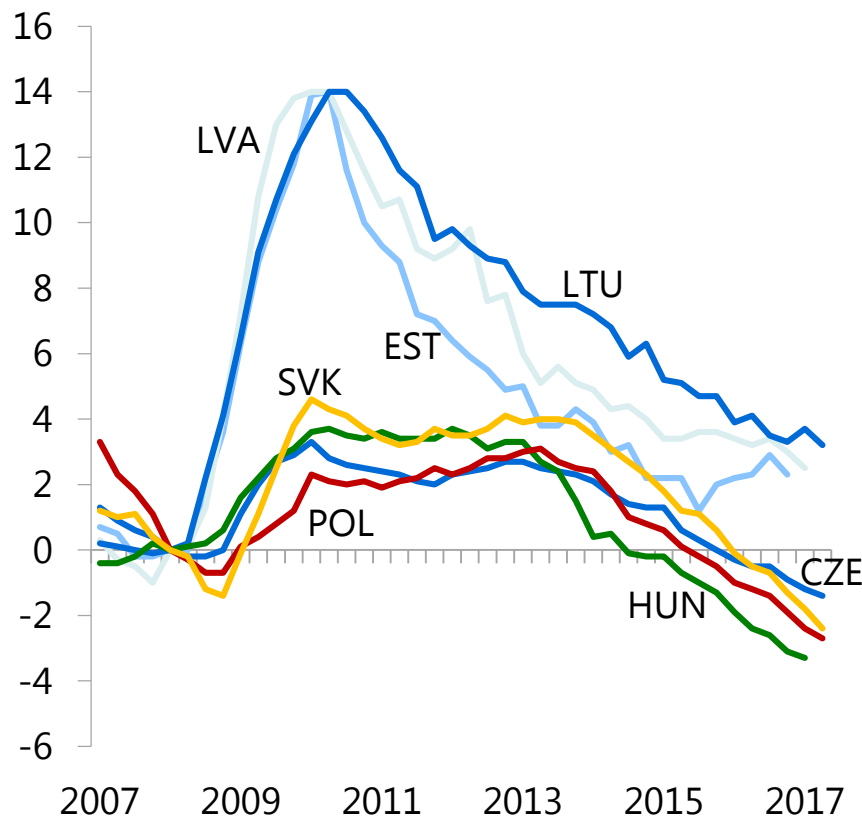
Real GDP per capita in 2016
(Percent of EU15)



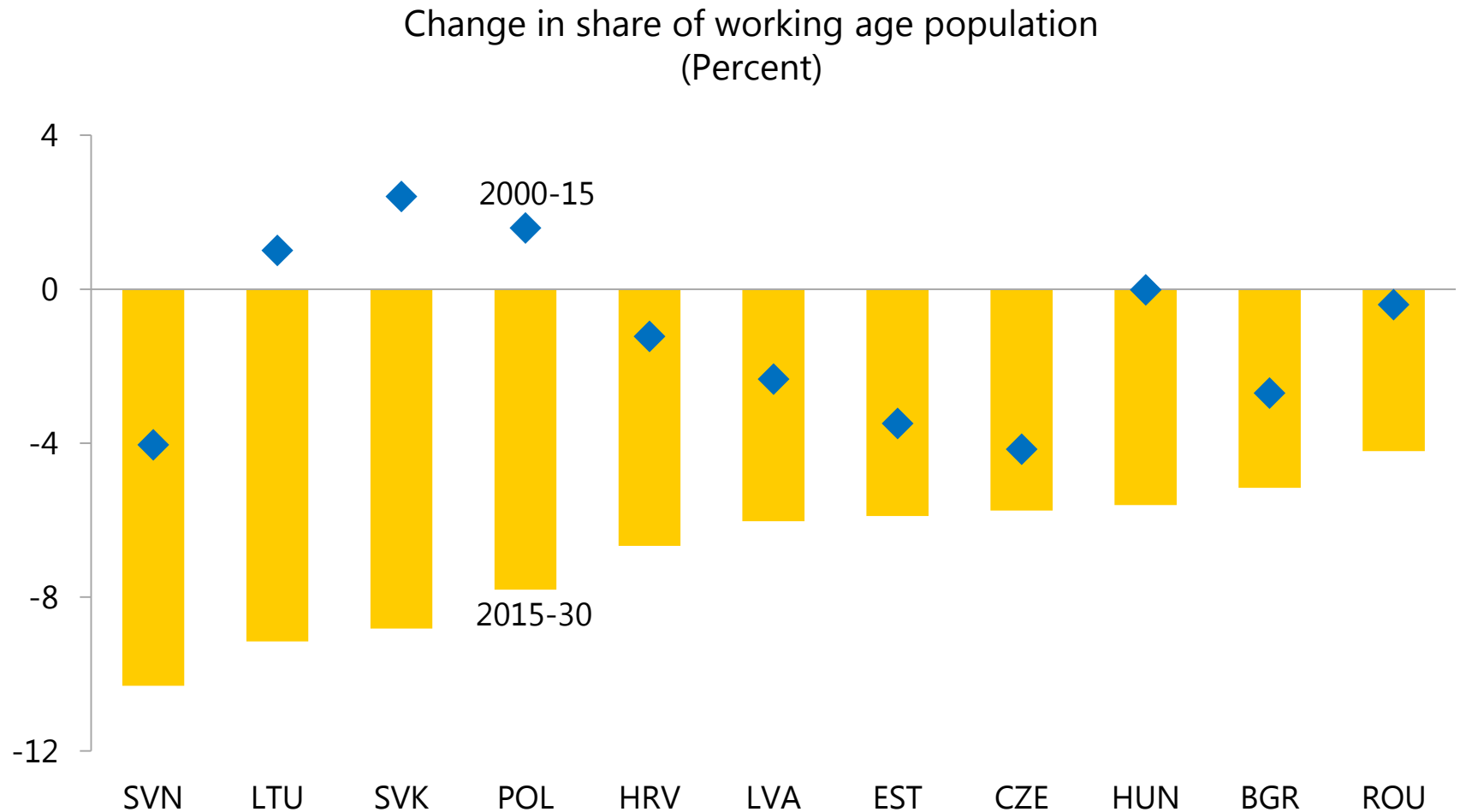
But further convergence will be harder. Labor markets tightening rapidly...



Cumulative changes in unemployment rate
(2008Q1=0, seasonally adjusted)



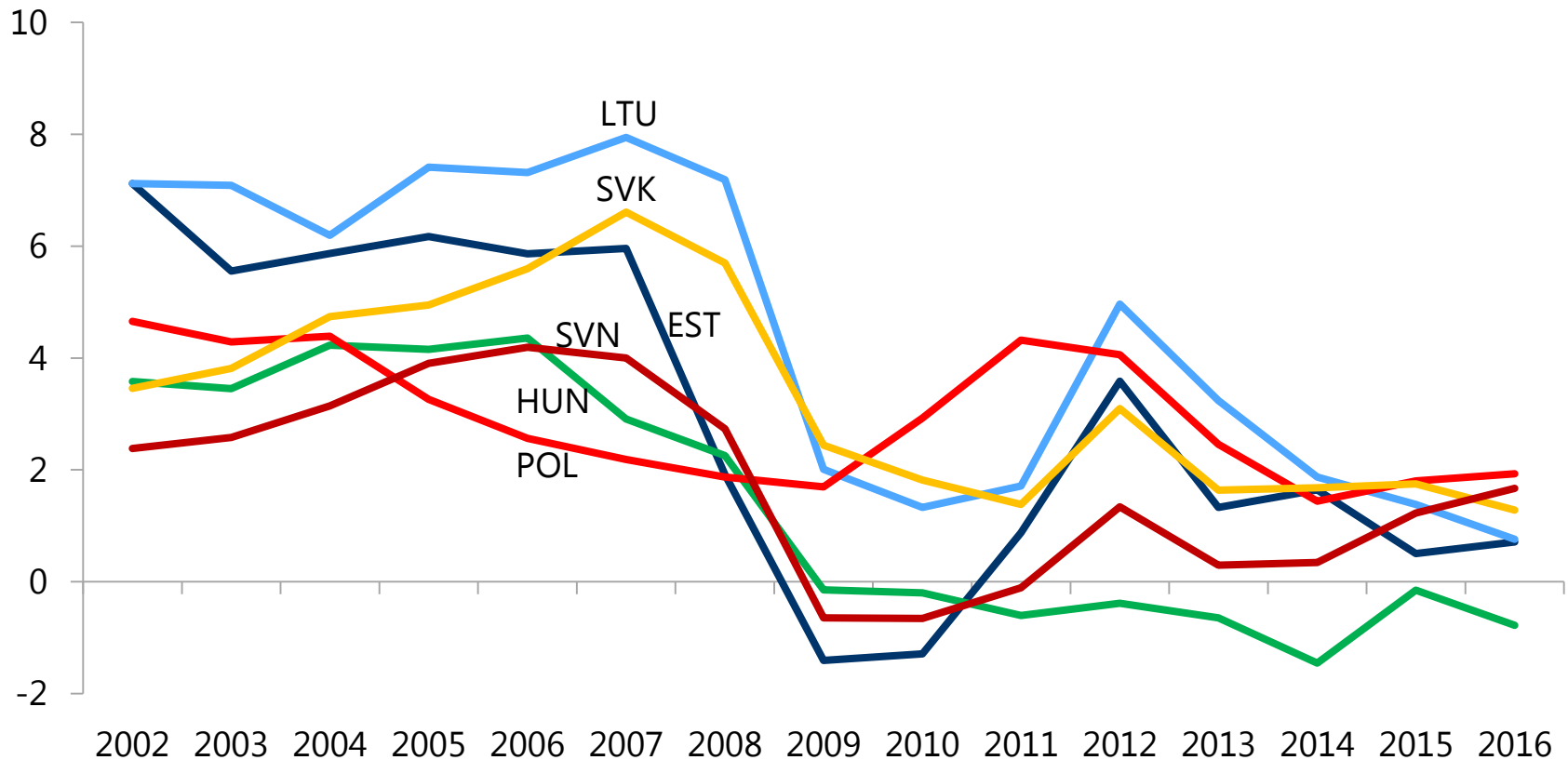
...working age population is set to decline sharply...



...and productivity growth has slowed



Growth of GDP per employed person
(Percent, 3-year moving average)



What is needed is “smarter” growth

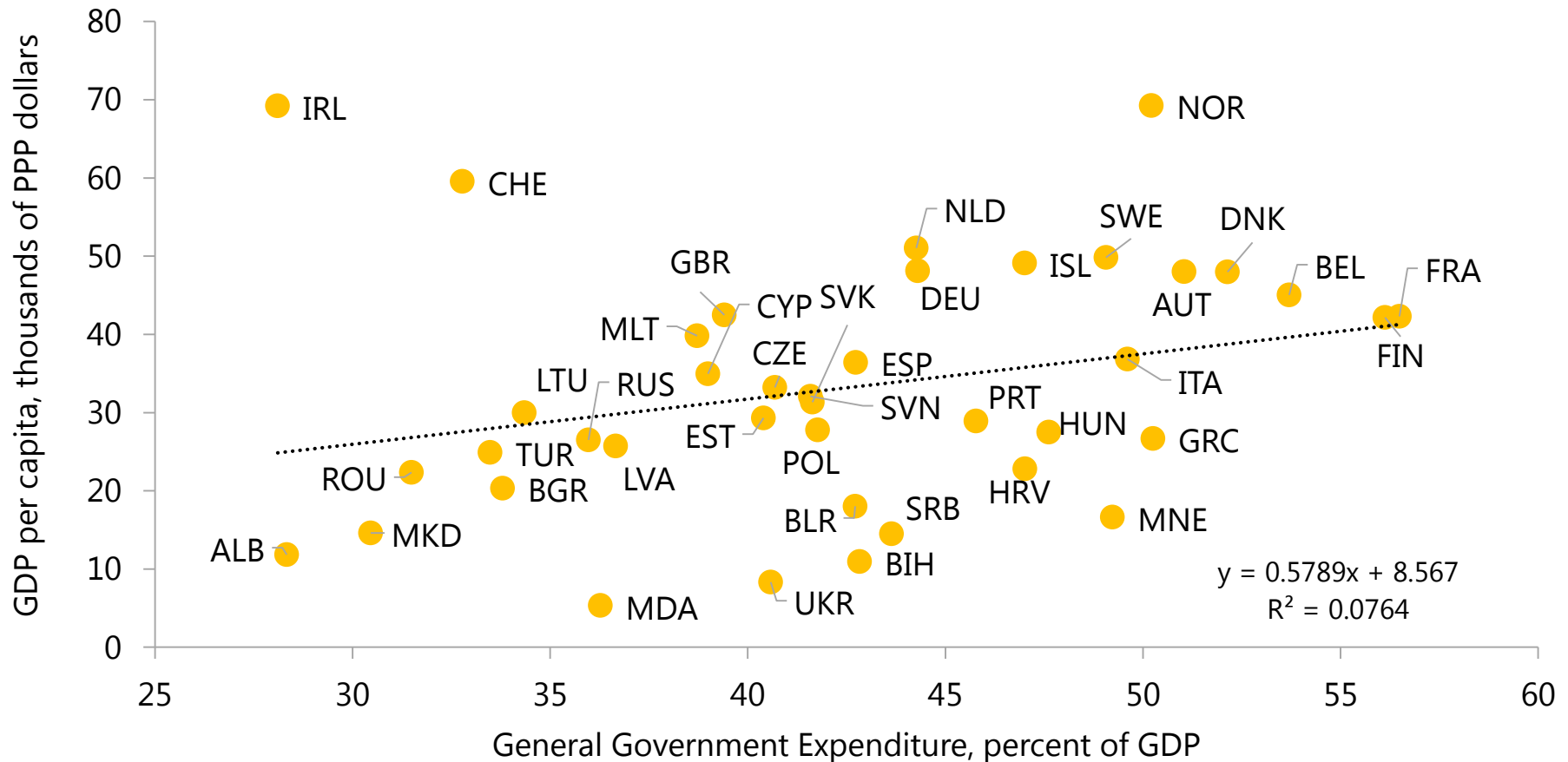


- More innovation
- Higher productivity growth
- But how do we get this?
- Do we need *more* government involvement?
- Or *less*?

There is no clear relationship between the *size* of the government and GDP per capita...



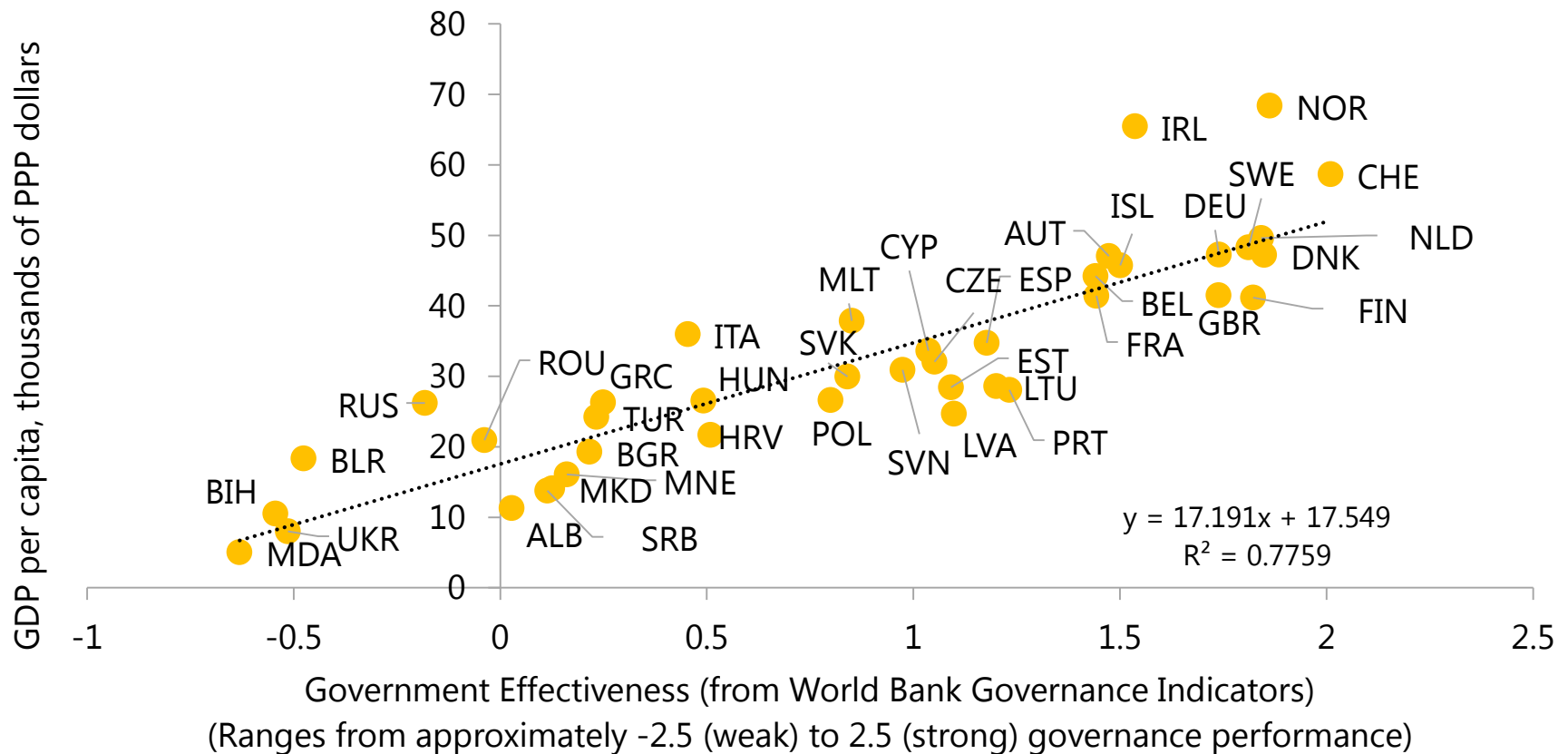
General Government Size vs. GDP per capita PPP, 2016



...but government *effectiveness* seems to matter—
richer countries have more effective governments



Government Effectiveness vs. GDP per capita in PPP dollars, 2015



Of course—causation may at least partly go two ways!

How can government be more effective?



- Improve efficiency public investment and tax collection → enhance government efficiency
- Improve institutions and rule of law → address factors that might constrain private sector productivity
- Ensure there is sufficient private sector competition
- Make sure SOEs are well run

Address factors that might constrain private sector 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)



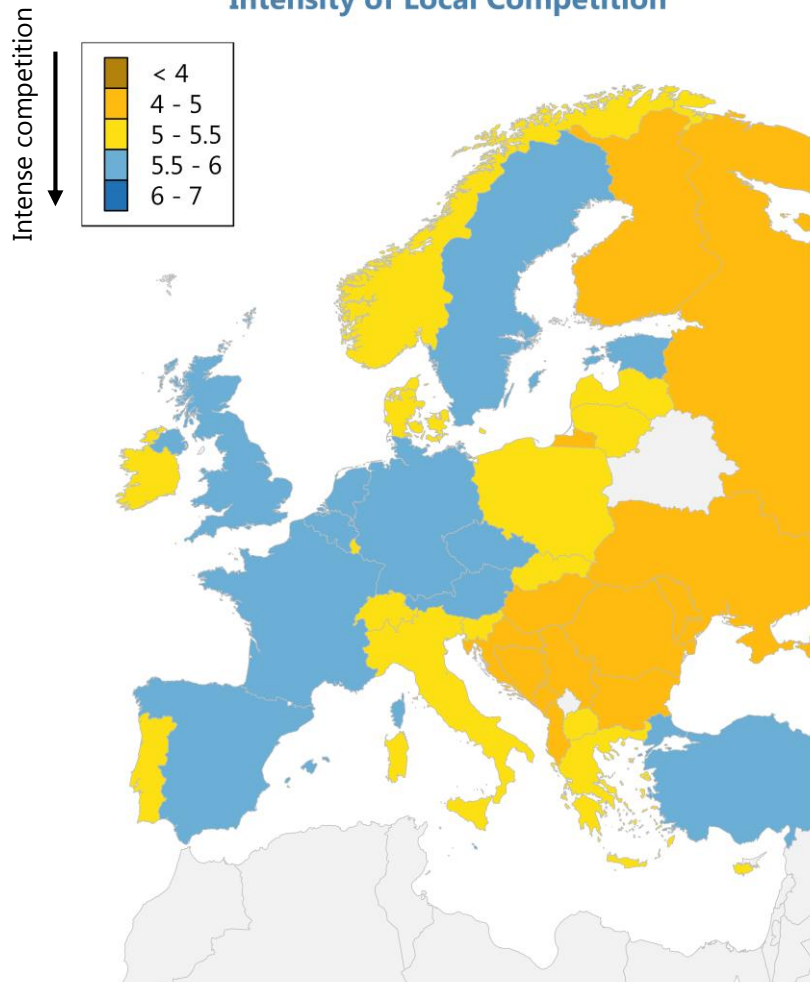
- Closing efficiency gaps in public investment and tax collection could bring sizable benefits.
- Further upgrades of public investment management should focus on improving allocation and implementation frameworks and procedures.



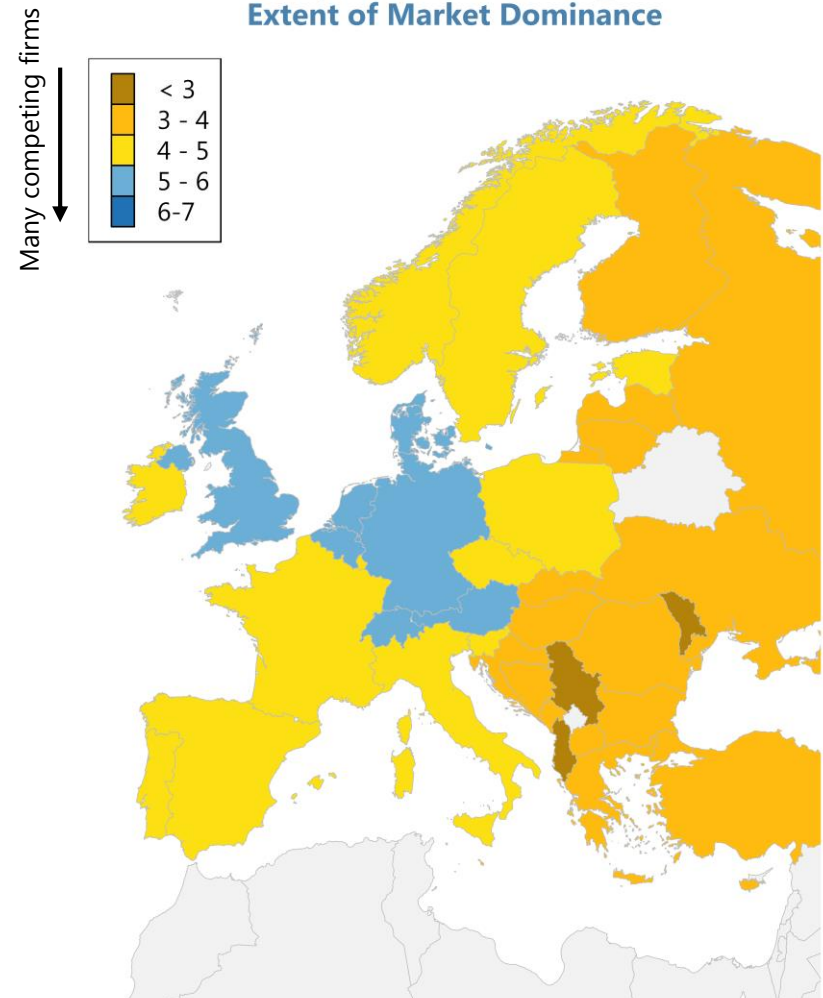
CESEE markets are less competitive than Western Europe



Global Competitiveness Ranking 2016-17:
Intensity of Local Competition



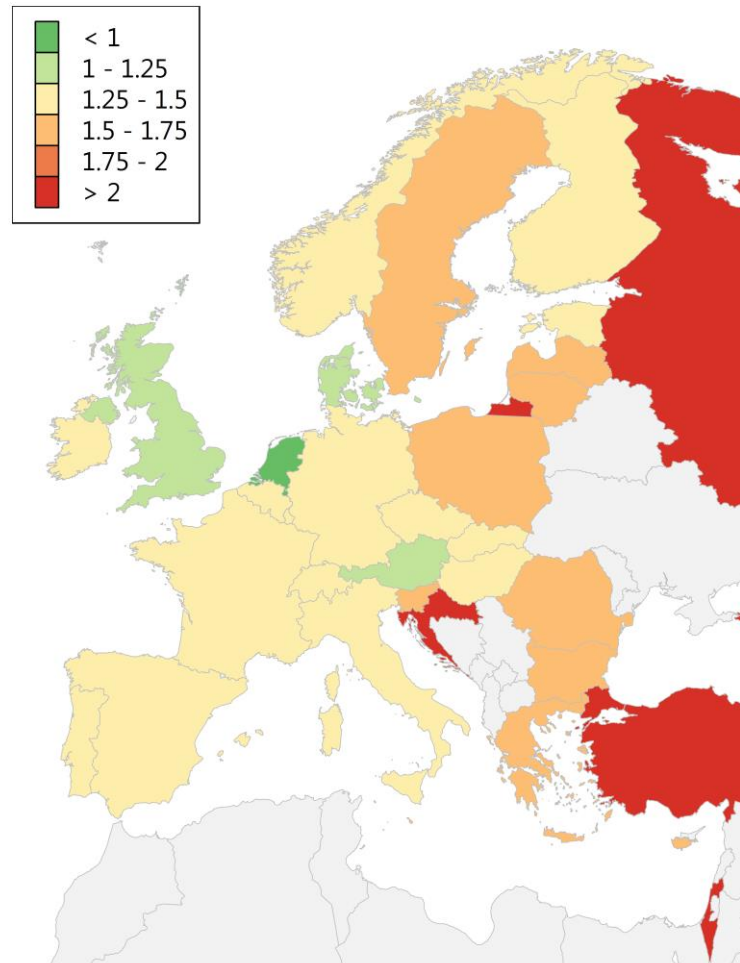
Global Competitiveness Ranking 2016-17:
Extent of Market Dominance



In part because product markets are more regulated



OECD Product Market Regulation in 2013



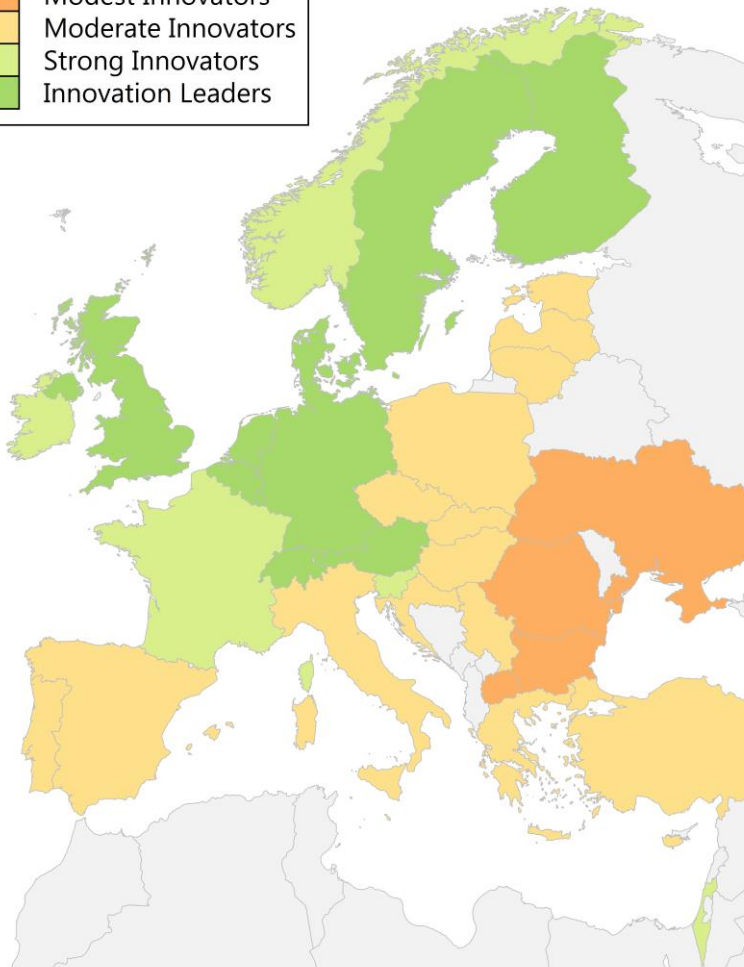
This may be a contributing factor why there is less innovation....



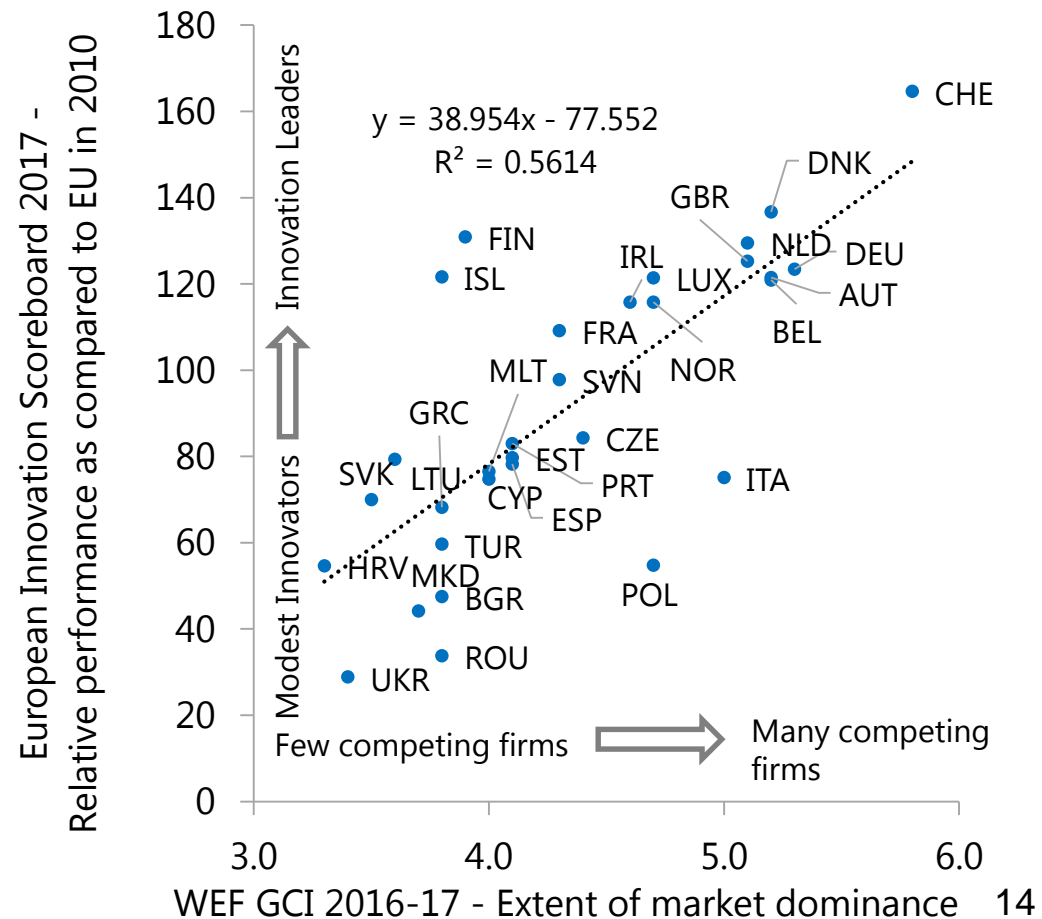
European Innovation Scoreboard in 2017

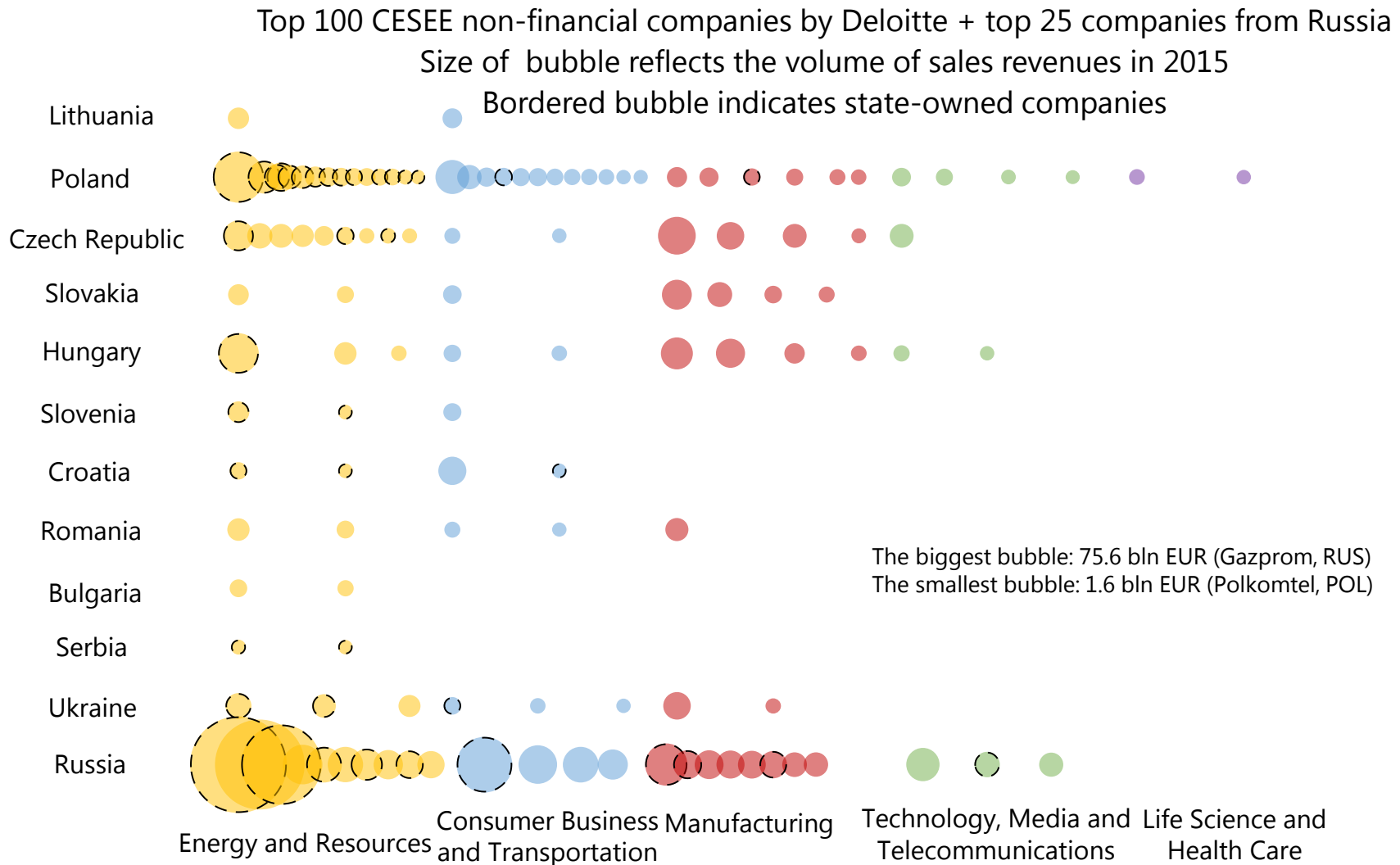
Relative performance as compared to EU in 2010

- Modest Innovators
- Moderate Innovators
- Strong Innovators
- Innovation Leaders



Extent of Market Dominance vs. Innovation Performance



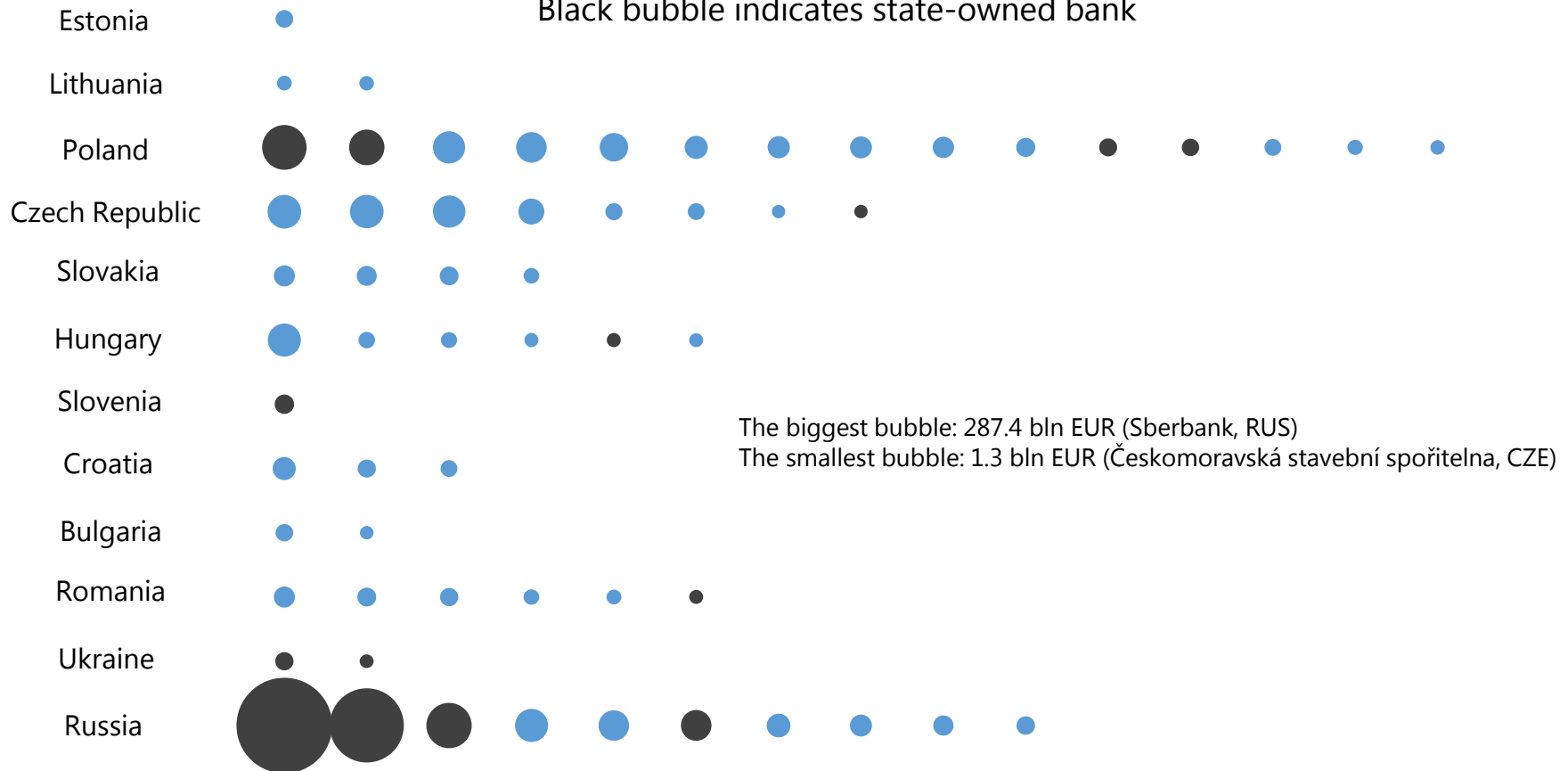


Russia and Poland have large state-owned banks



Top 50 CESEE banks by Deloitte + top 10 banks from Russia
The size of the bubble reflects the volume of assets in 2015

Black bubble indicates state-owned bank



The biggest bubble: 287.4 bln EUR (Sberbank, RUS)
The smallest bubble: 1.3 bln EUR (Českomoravská stavební spořitelna, CZE)

Government ownership may not be inefficient in itself



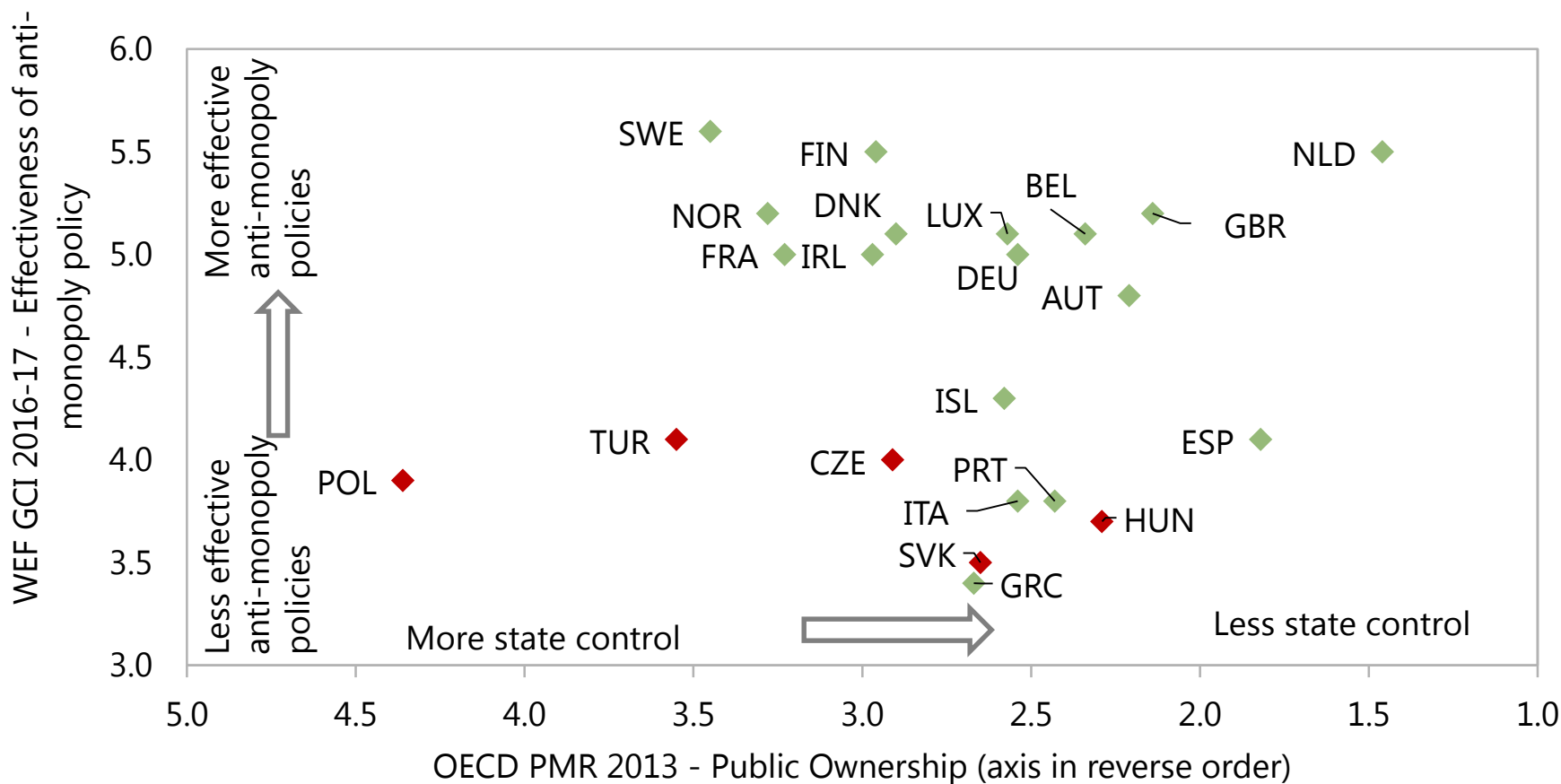
But subject to specific risks:

- Weak governance
- Soft budget constraint
- Political interference
- Distorted competition

Sweden has large SOE sector but also effective competition policy.



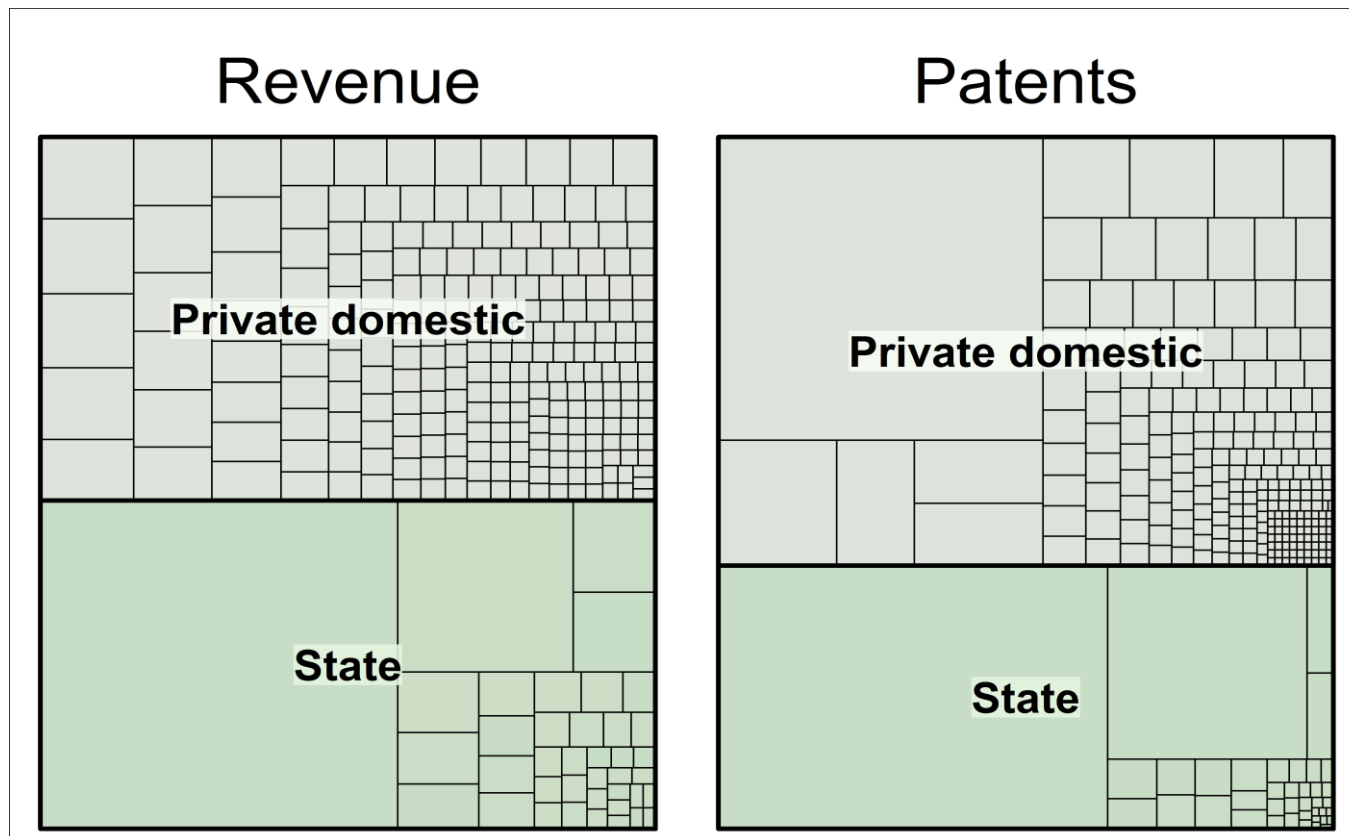
Public ownership vs enforcement of competition



Another concern is whether SOEs are as innovative as private sector



If we look at 265 manufacturing companies in CESEE with at least \$50 million revenue and at least 1 patent, private owned firms are on average more innovative than state-owned—but some SOEs are very innovative



Squares indicate revenue or number of patents of individual companies.

Conclusion



- Government *size* does not distinguish rich countries from poor
- But government *effectiveness* does
- There is scope in CESEE to improve government effectiveness
 - Improve efficiency of public investment and tax collection
 - Enhance institutions and rule of law
 - Enhance private sector competition
 - Make sure SOEs are well run



Thank you