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

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

Change in share of working age population (Percent)

-12  -8  -4  0  4

2000-15
2015-30

SVN  LTU  SVK  POL  HRV  LVA  EST  CZE  HUN  BGR  ROU
...and productivity growth has slowed
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...
...but government **effectiveness** seems to matter—richer countries have more effective governments.

Of course—causation may at least partly go two ways!
How can government be more effective?

- Improve efficiency in 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
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.
In part because product markets are more regulated
This may be a contributing factor why there is less innovation....
CESEE has many SOEs, in particular among energy companies, but also in manufacturing.

Top 100 CESEE non-financial companies by Deloitte + top 25 companies from Russia
Size of bubble reflects the volume of sales revenues in 2015
Bordered bubble indicates state-owned companies

- Lithuania
- Poland
- Czech Republic
- Slovakia
- Hungary
- Slovenia
- Croatia
- Romania
- Bulgaria
- Serbia
- Ukraine
- Russia

Energy and Resources
Consumer Business and Transportation
Manufacturing
Technology, Media and Telecommunications
Life Science and Health Care

The biggest bubble: 75.6 bln EUR (Gazprom, RUS)
The smallest bubble: 1.6 bln EUR (Polkomtel, POL)
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

Estonia
Lithuania
Poland
Czech Republic
Slovakia
Hungary
Slovenia
Croatia
Bulgaria
Romania
Ukraine
Russia

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

- More effective anti-monopoly policies (up)
- Less effective anti-monopoly policies (down)
- More state control
- Less state control
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