European Department

Why Have Some CESEE Countries Done Better Than Others since Early Transition?

IMF Macroeconomic Policy Seminar

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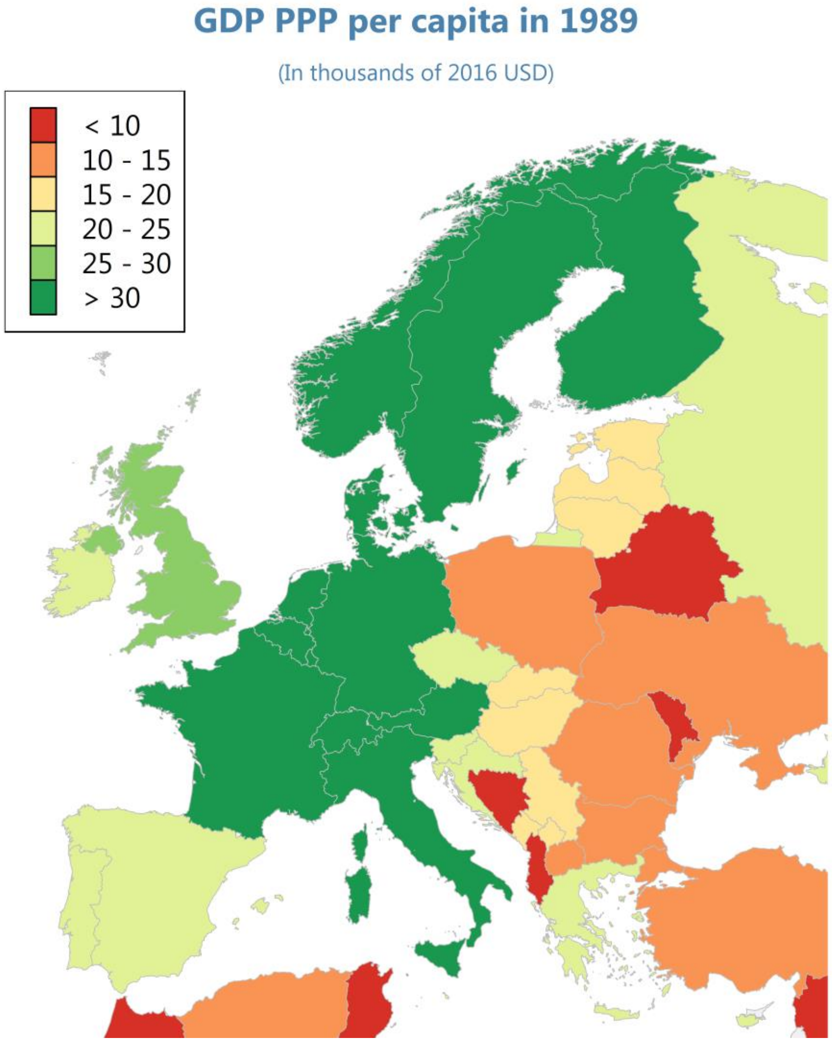
In 1989, CESEE countries were much poorer than Western Europe



Note: For BIH data for 1990.

Then communism was abolished

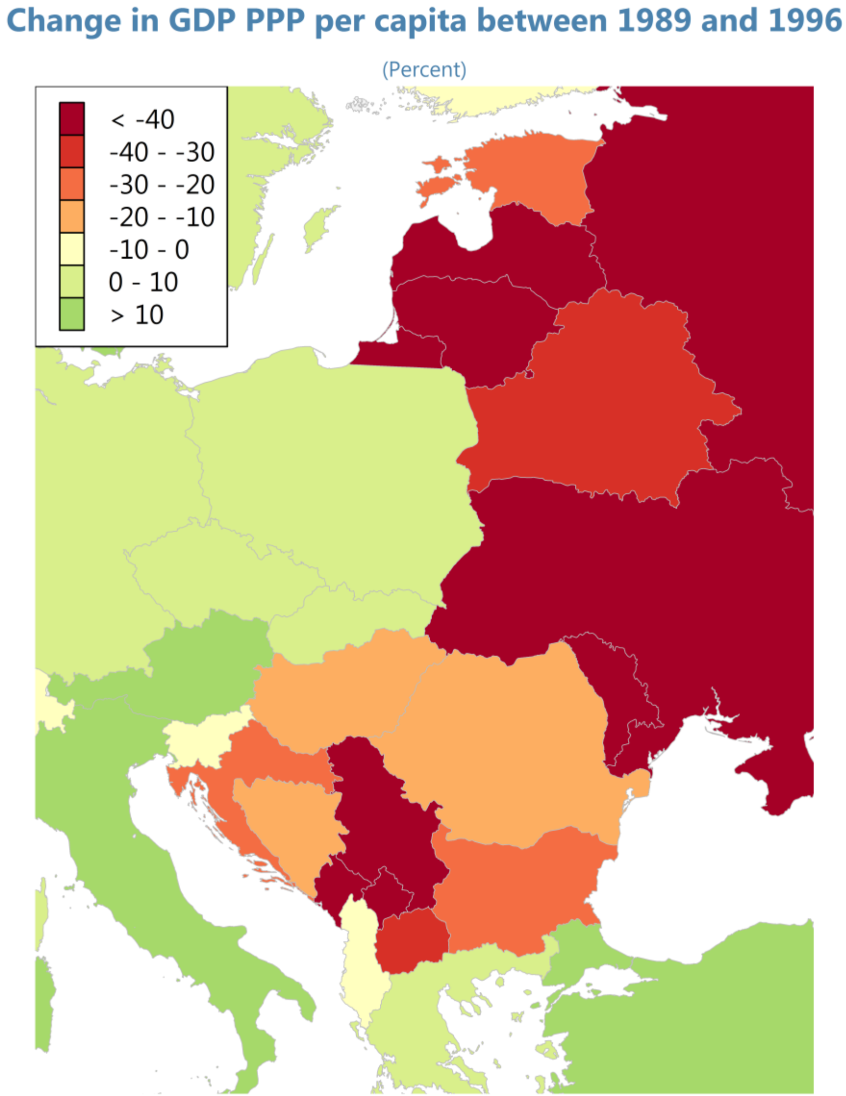
- What would we have expect to have happened?
  - Income differentials with Western Europe would become smaller
  - Poorer countries would grow faster than richer countries

Convergence between 1989 and 2017

What happened in practice?

- After initial decline in GDP in early transition, countries started growing again in early to late 1990s
- Since then there has been clear convergence with Western Europe
- But some countries have done much better than others
- Some countries are still poorer than they were in 1989

After a deep post-transition recession

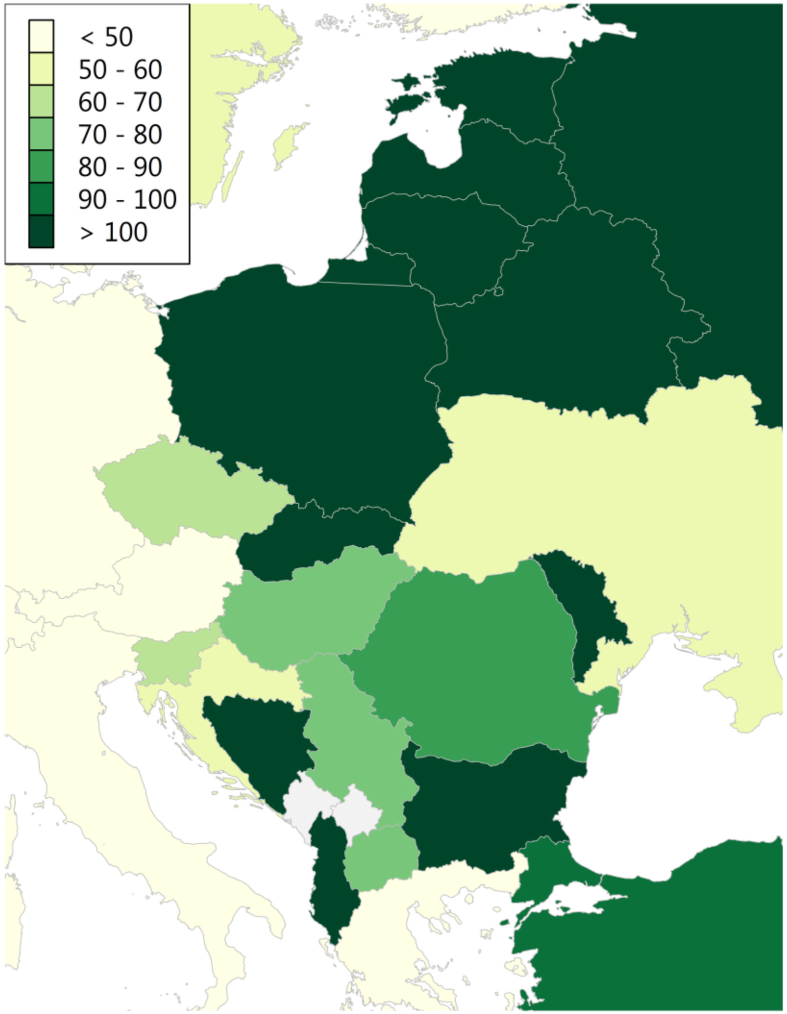


Note: For BIH data for 1990-1996

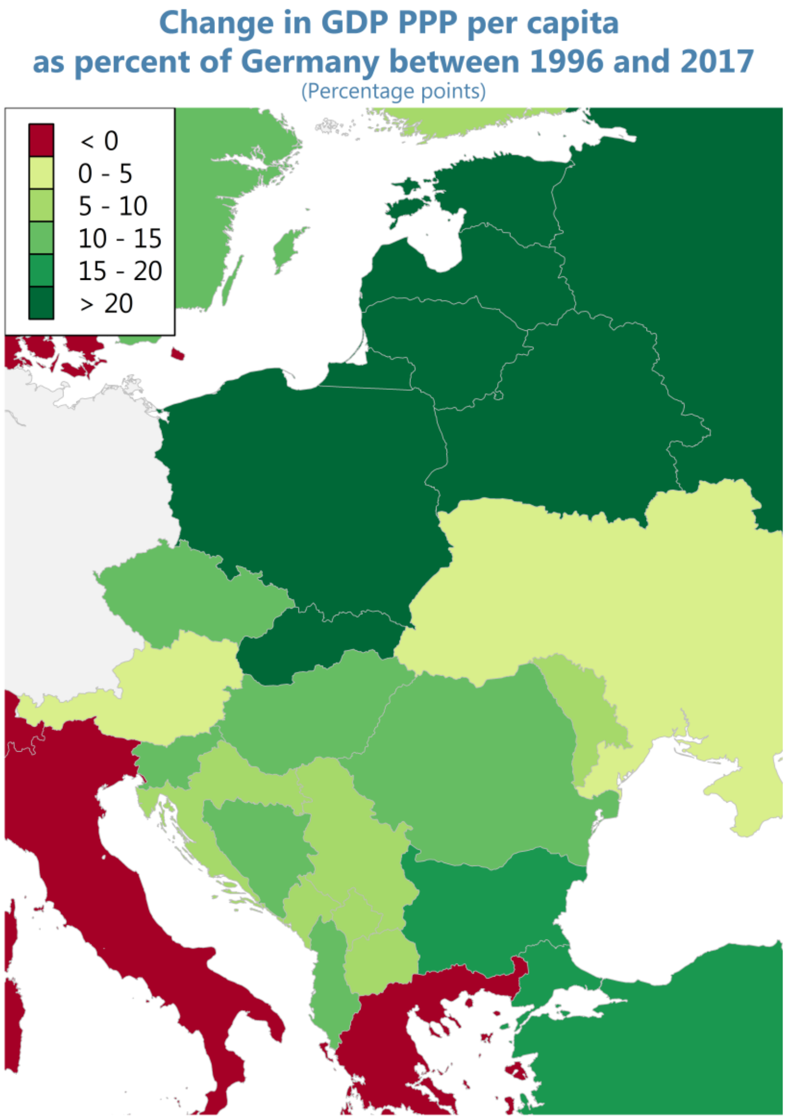
Most countries have grown strongly over the past two decades

Change in GDP PPP per capita between 1996 and 2017

(Percent)

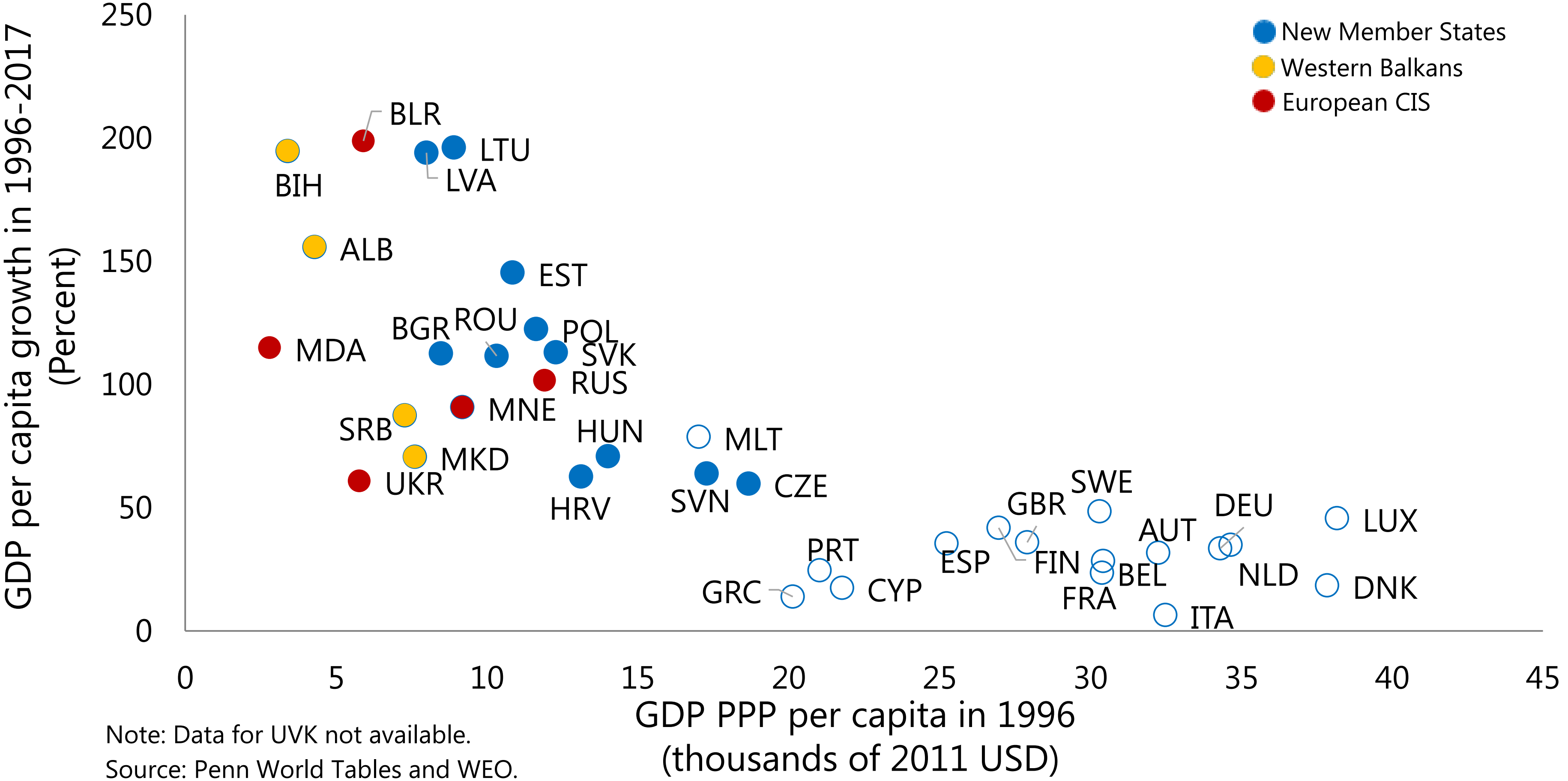


In the past two decades all countries have narrowed income differentials with Germany



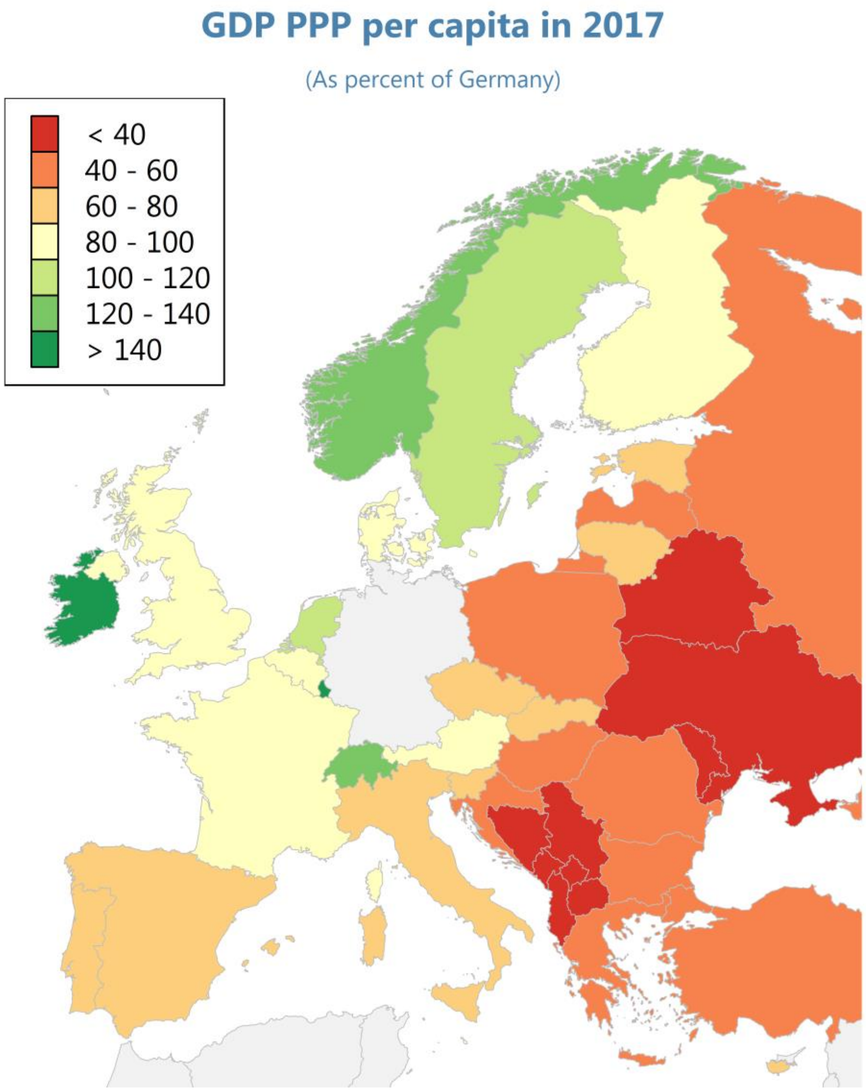
EU New Member States have done better than Western Balkans and CIS

GDP PPP per capita in 1996 vs. its change in 1996-2017

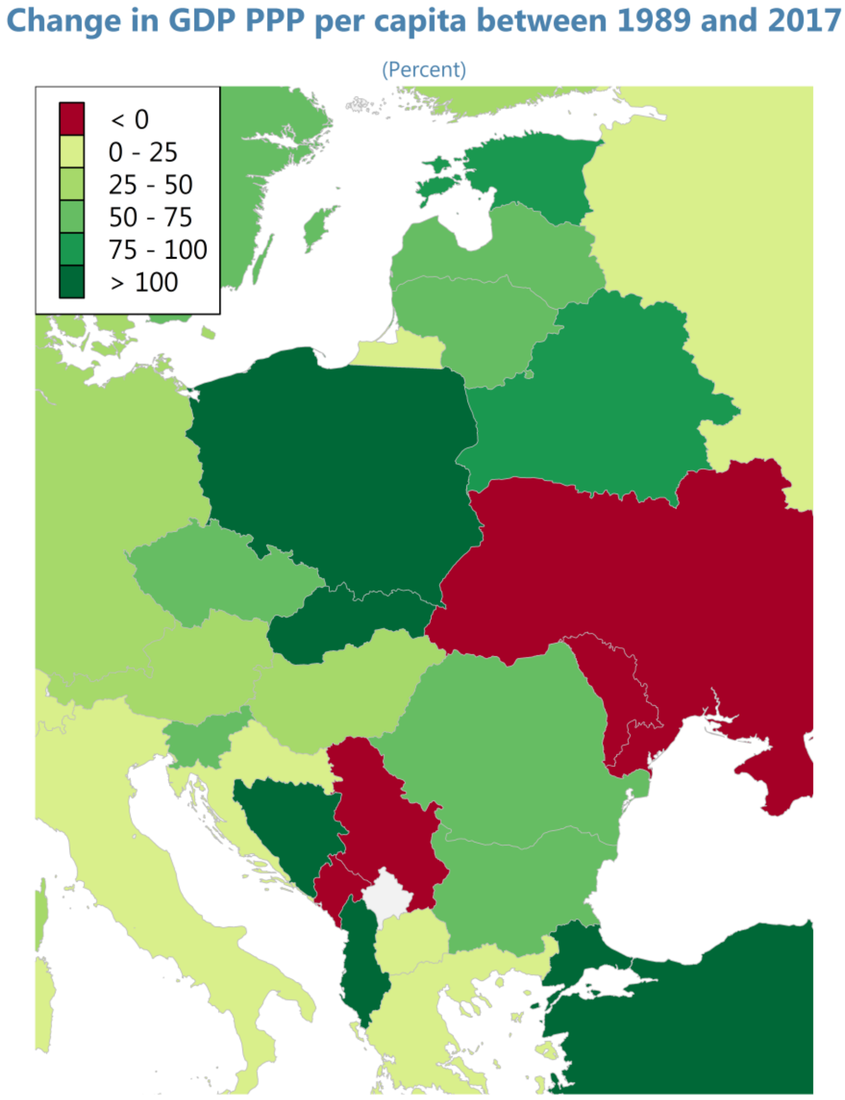


Note: Data for UVK not available.
Source: Penn World Tables and WEO.

Some parts of CESEE have similar income levels to Spain and Italy; others are still poorer



Most-but not all-countries are richer now than in 1989



What explains these differences?

1. Is it data issues?
2. Early transition
3. War and conflicts
4. Boom-busts / macro-stability
5. EU Membership
6. Whether transition has been completed
7. Institutions
8. Country case (a) Poland vs. Ukraine
9. Country case (b) Belarus

1. Do differences reflect data issues?

- GDP statistics in late 1989 not very good
  - Prices were not right
- Other problem: GDP not good indicator of consumer welfare
  - Much of what was produced was not wanted by consumers (cf. military expenditures)
  - Much was of low quality

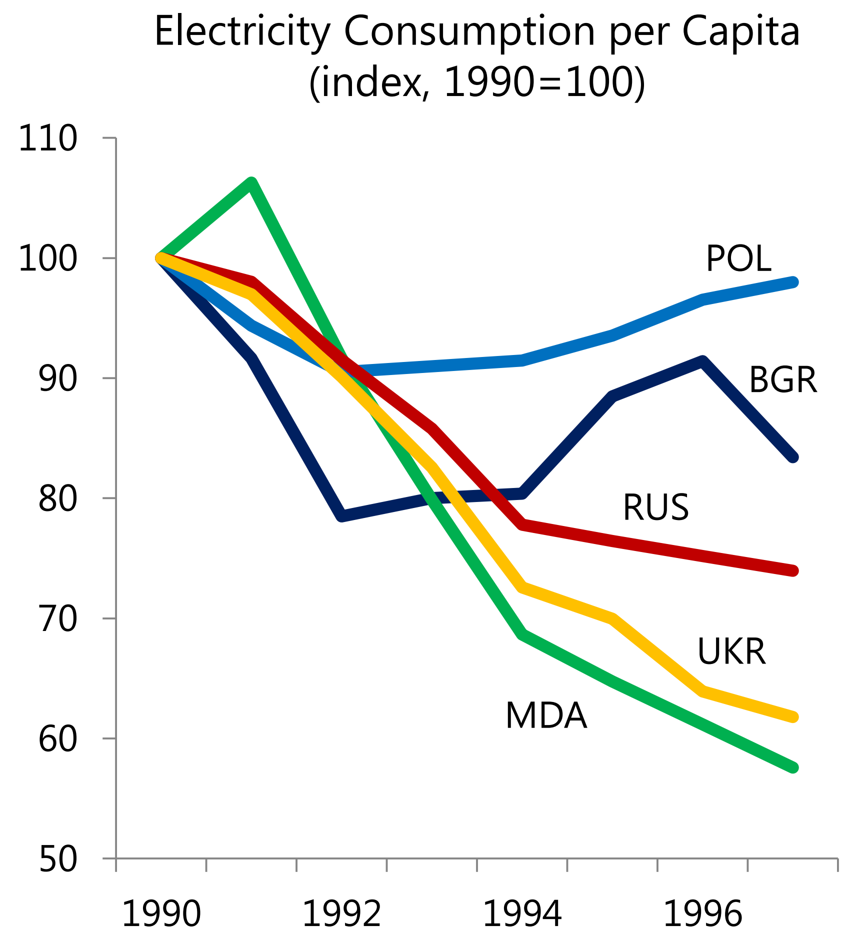
However, even if size of initial collapse was exaggerated, there clearly were large cross country differences

Other more easily measurable indicators also suggest:

- Large initial output falls
- Large cross country differences

Between 1990 and 1995, electricity consumption fell

- by almost 40 percent in Moldova and Ukraine
- very little in Poland.

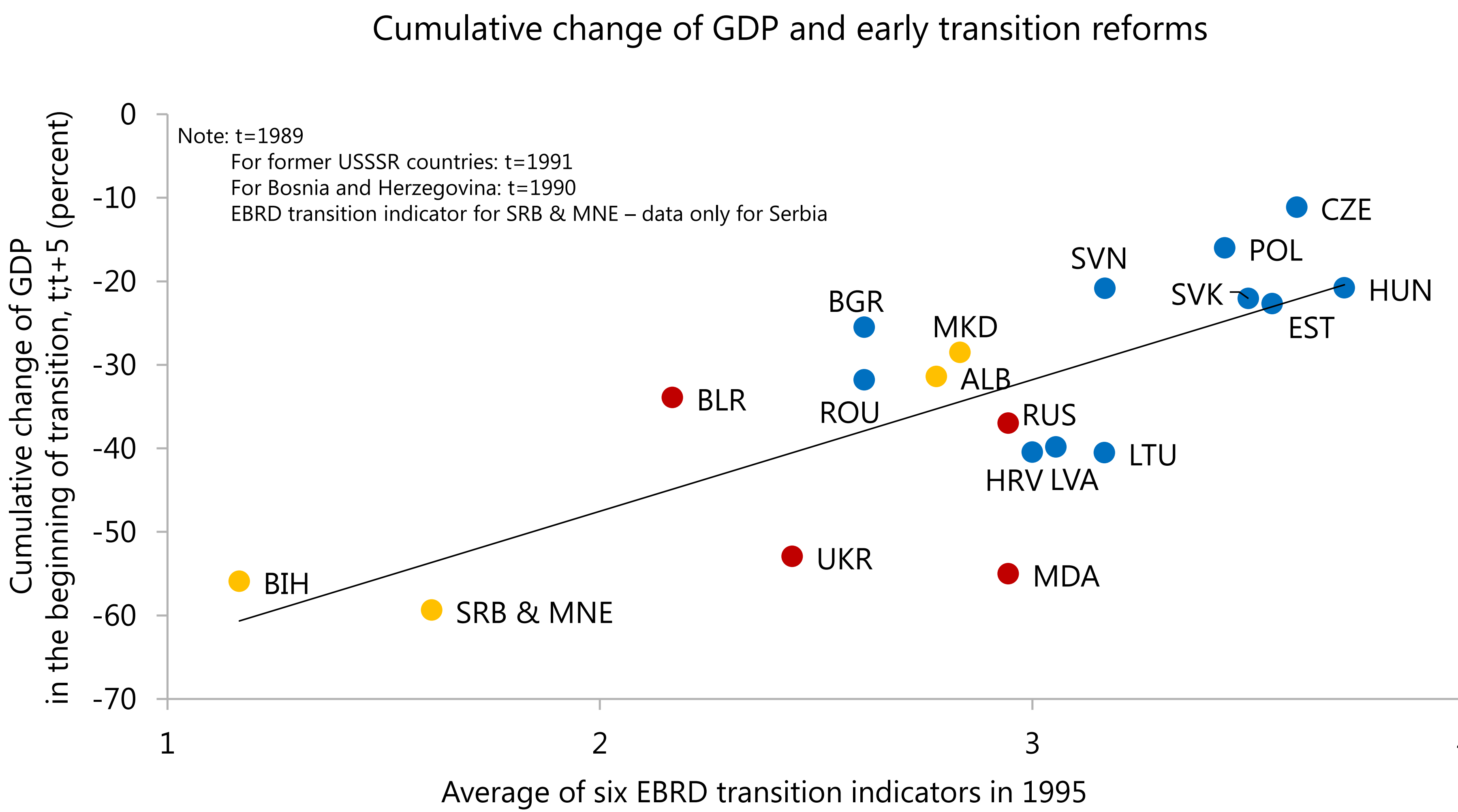


Both progress and cross-country differences can be seen in satellite pictures

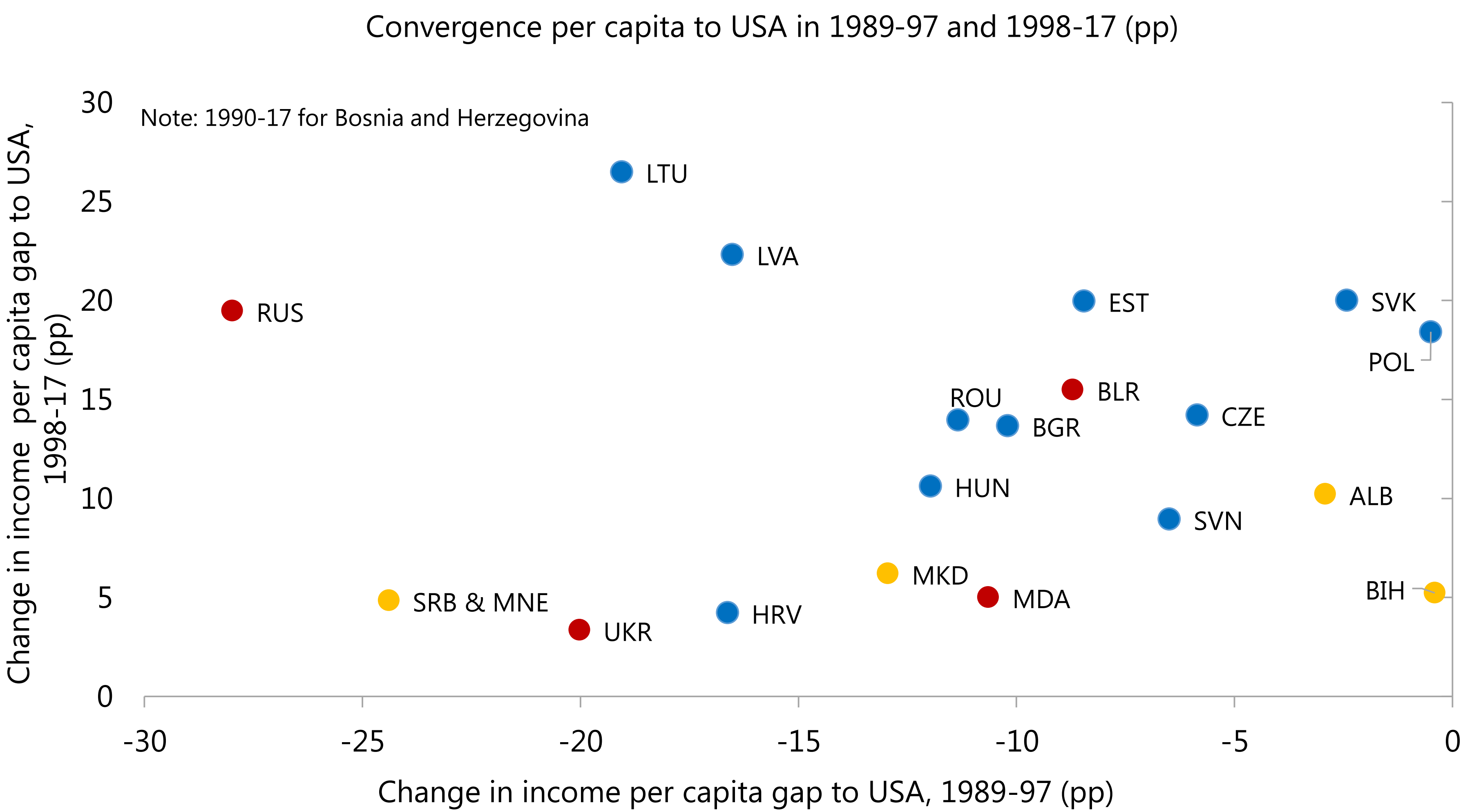
2. Early transition to market economy

- In early 1990s there was a debate whether reforms should be gradual
- Worry was that more rapid reforms would be too painful
- Rapid reforms were indeed painful—unemployment in early reformers rose sharply
- However, countries that postponed reforms had a much ***longer and deeper*** initial recession
- Why? Without hard budget constraint on firms, it was hard to get credit growth and inflation under control

Countries that postponed reforms suffered deeper output losses

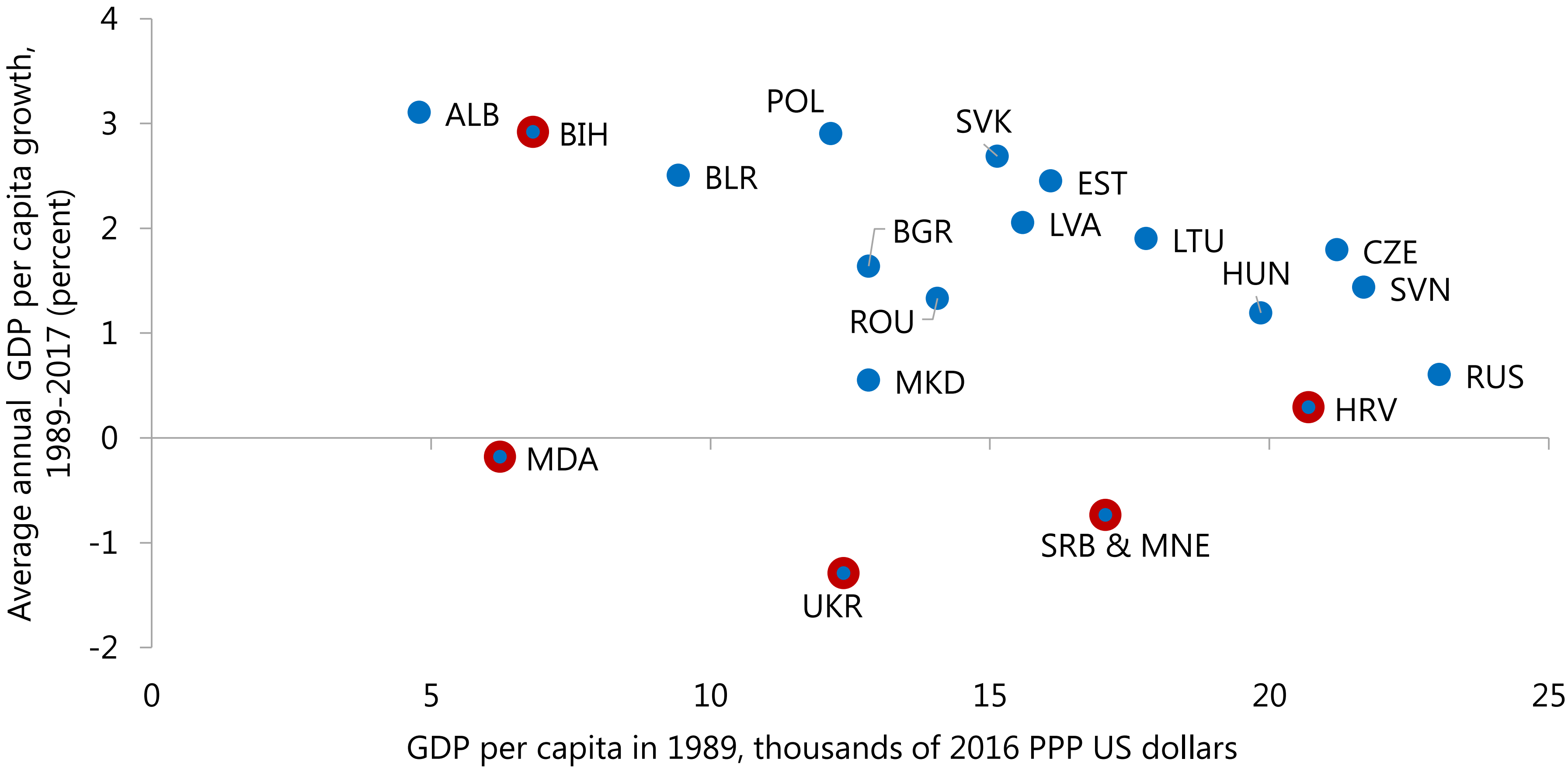


Weaker growth in early transition not compensated by faster growth later



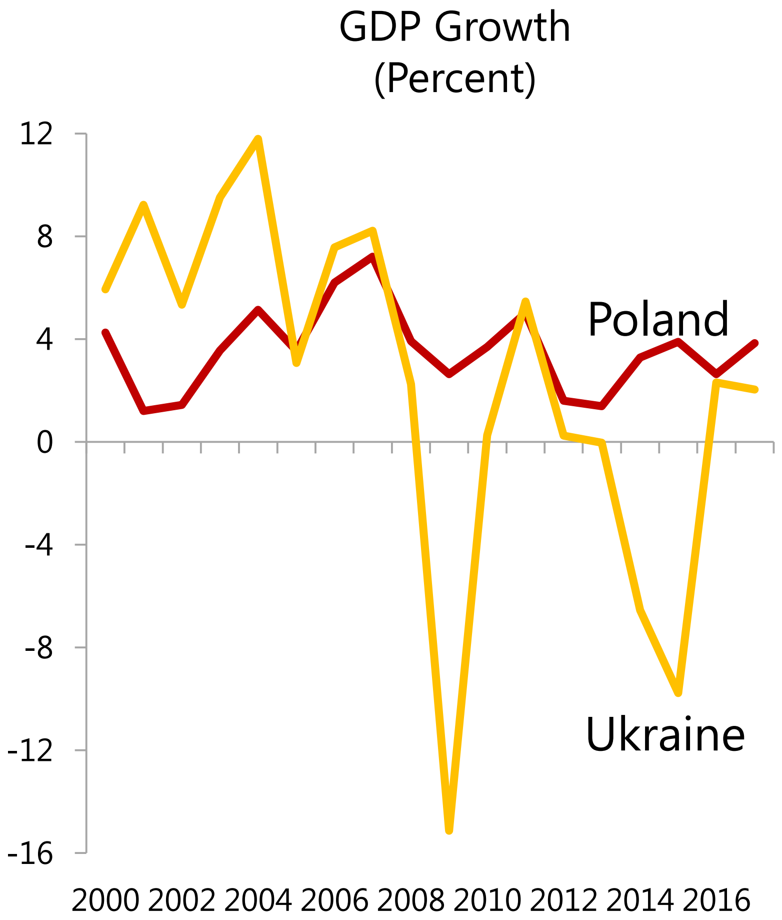
3. Wars and conflicts: the four countries with the lowest growth all had wars

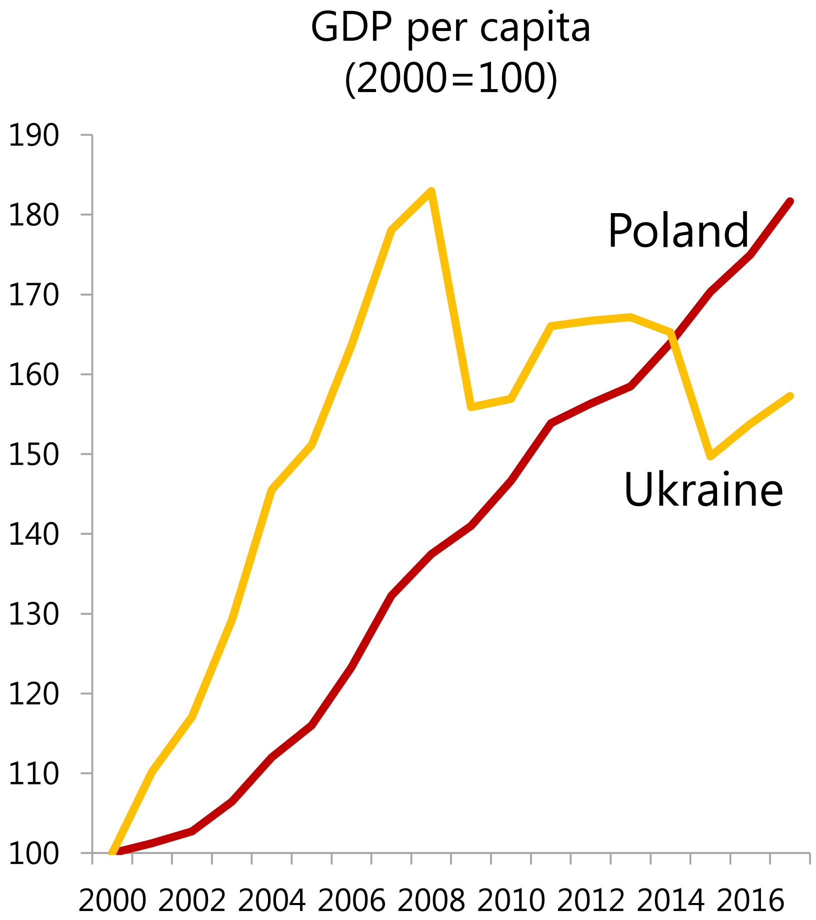
Average GDP per capita growth, 1989-17, and its level in 1989
Red circle indicate whether a country experienced a war in 1989-17



Note: 1999-2017 for BIH.

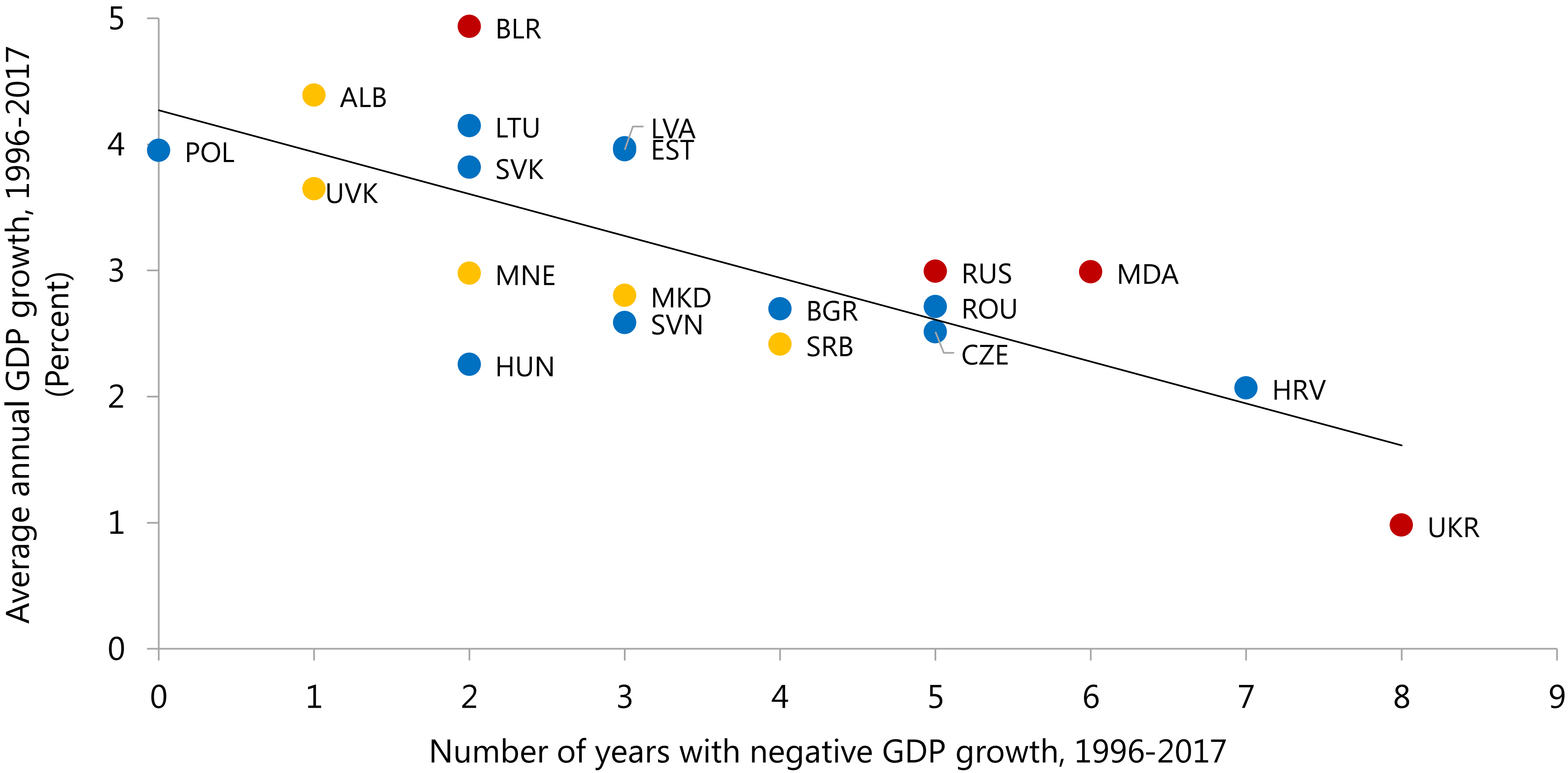
4. Some countries have gone through boom-busts that slowed average growth





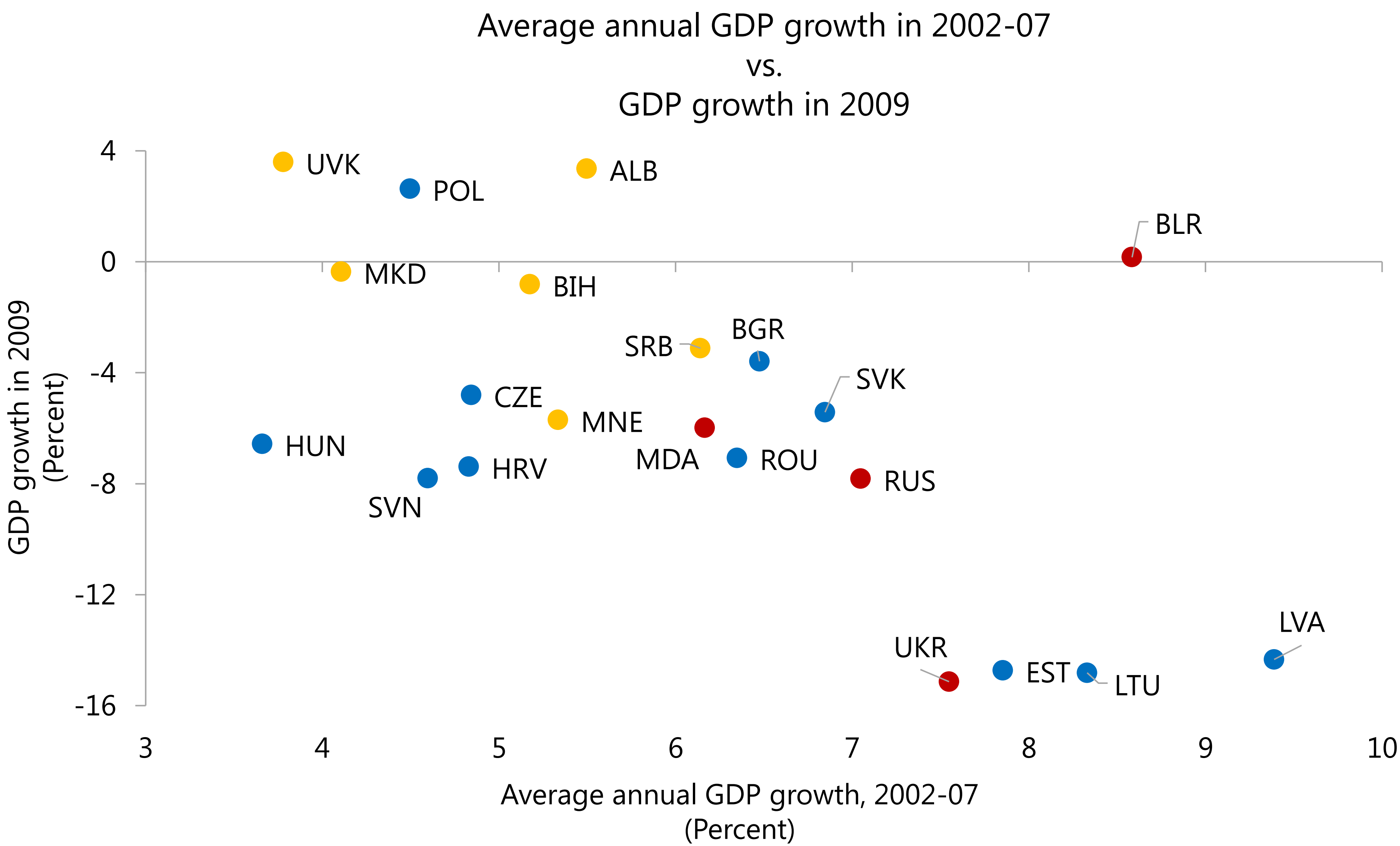
Countries with fewer recessions grew faster on average

Number of years with a decline of GDP vs. annual average GDP growth between 1996 and 2017

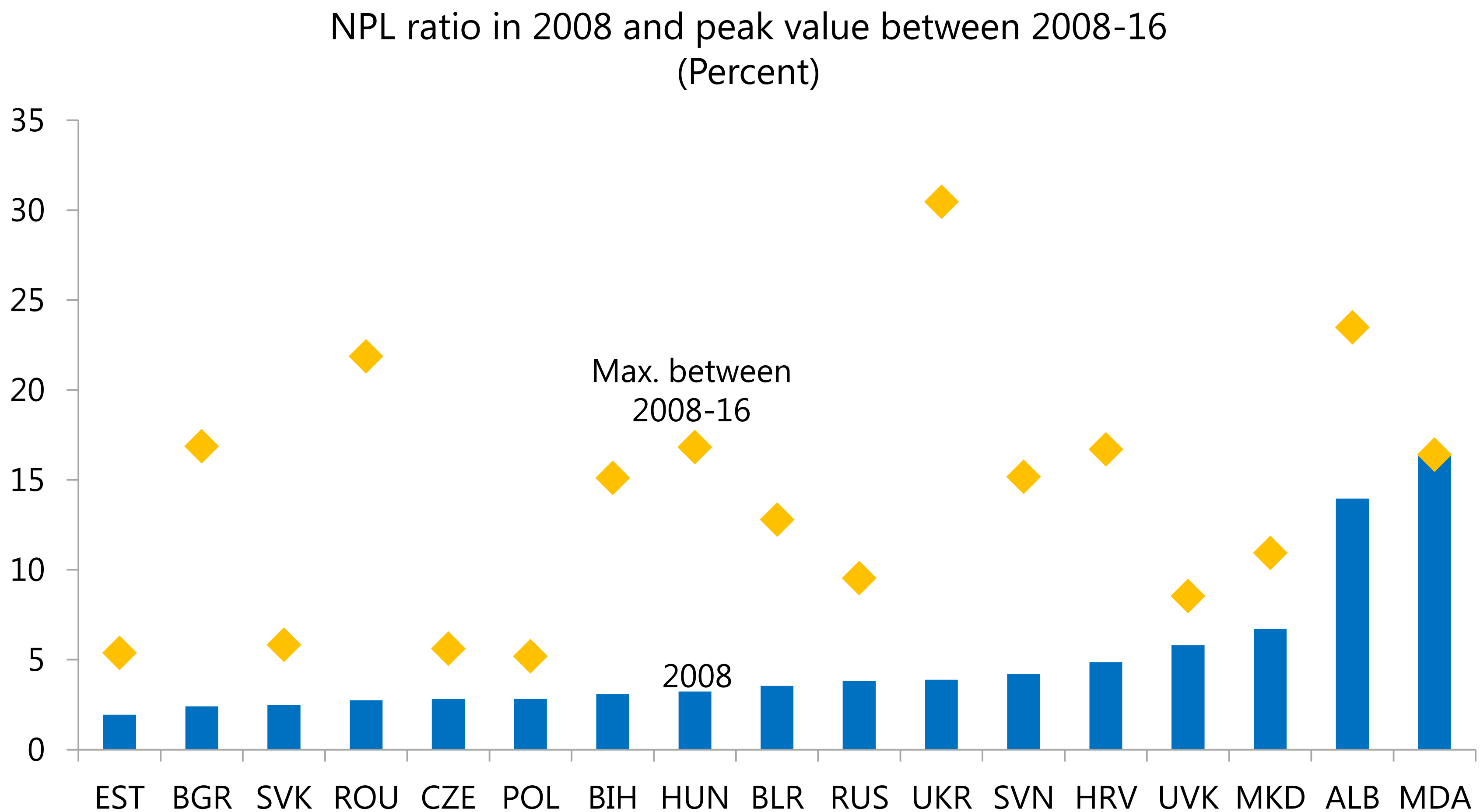


Note: for MNE and UVK: data for 2001-17; for SRB: 1998-2017.

Countries which grew very fast pre-crisis experienced the deepest decline in 2009



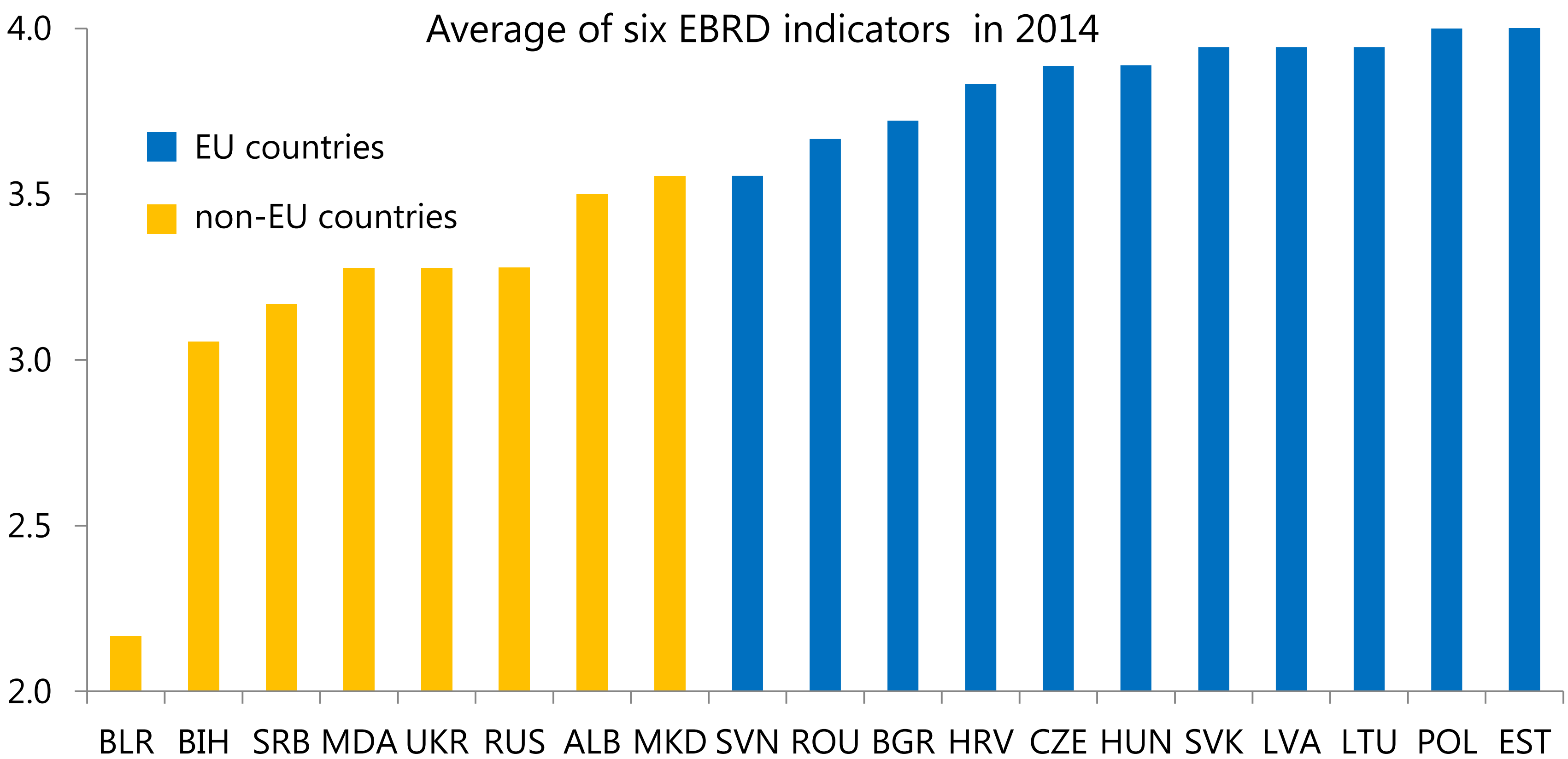
Crises led to high NPLs and weak banks, which holds back growth



Note: for BLR, UVK and ALB: bar showing data for 2010; for MDA: 2009.

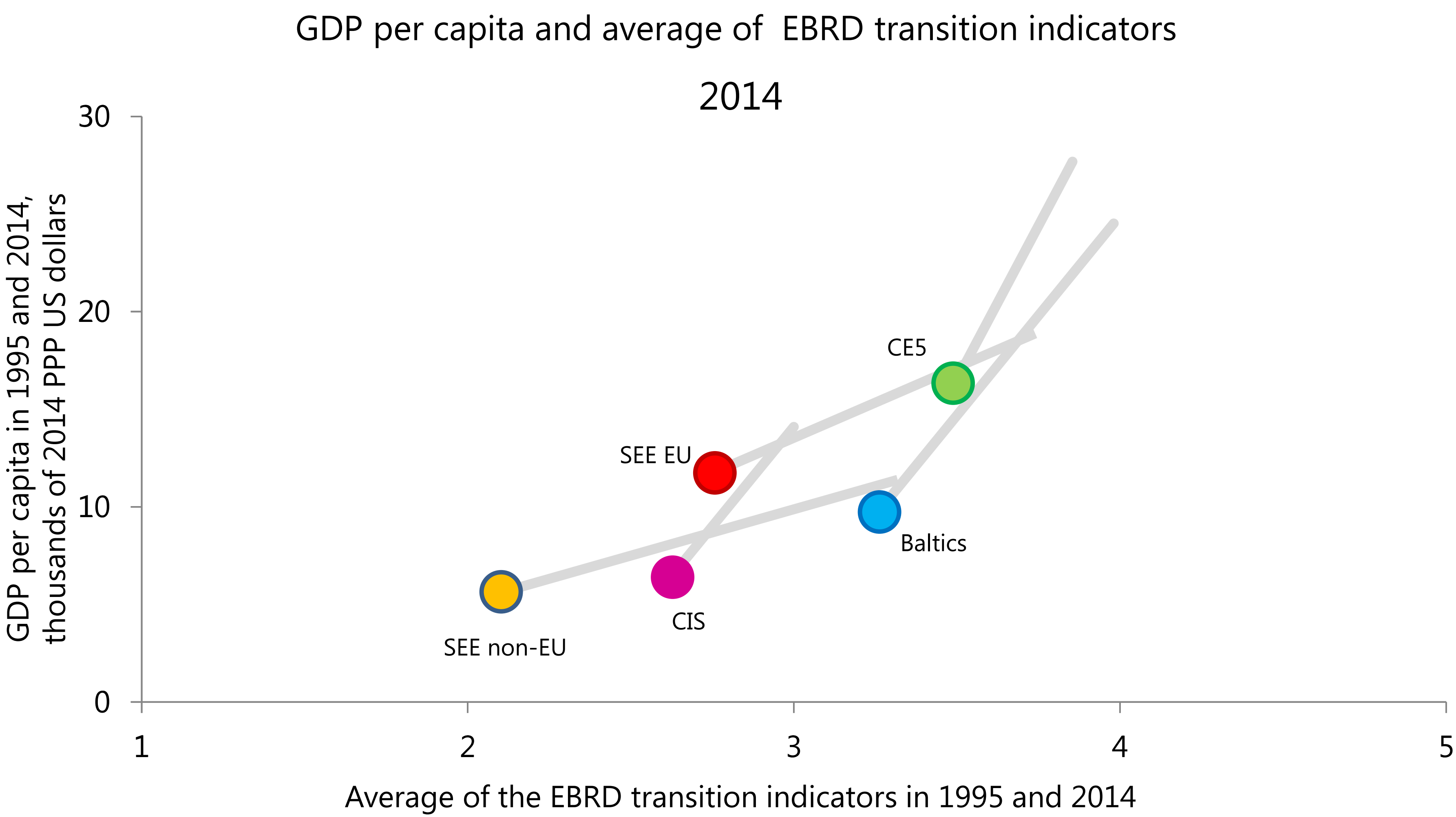
5. EU Membership

- EU accession was powerful catalyst for reforms and upgrading of institutional framework



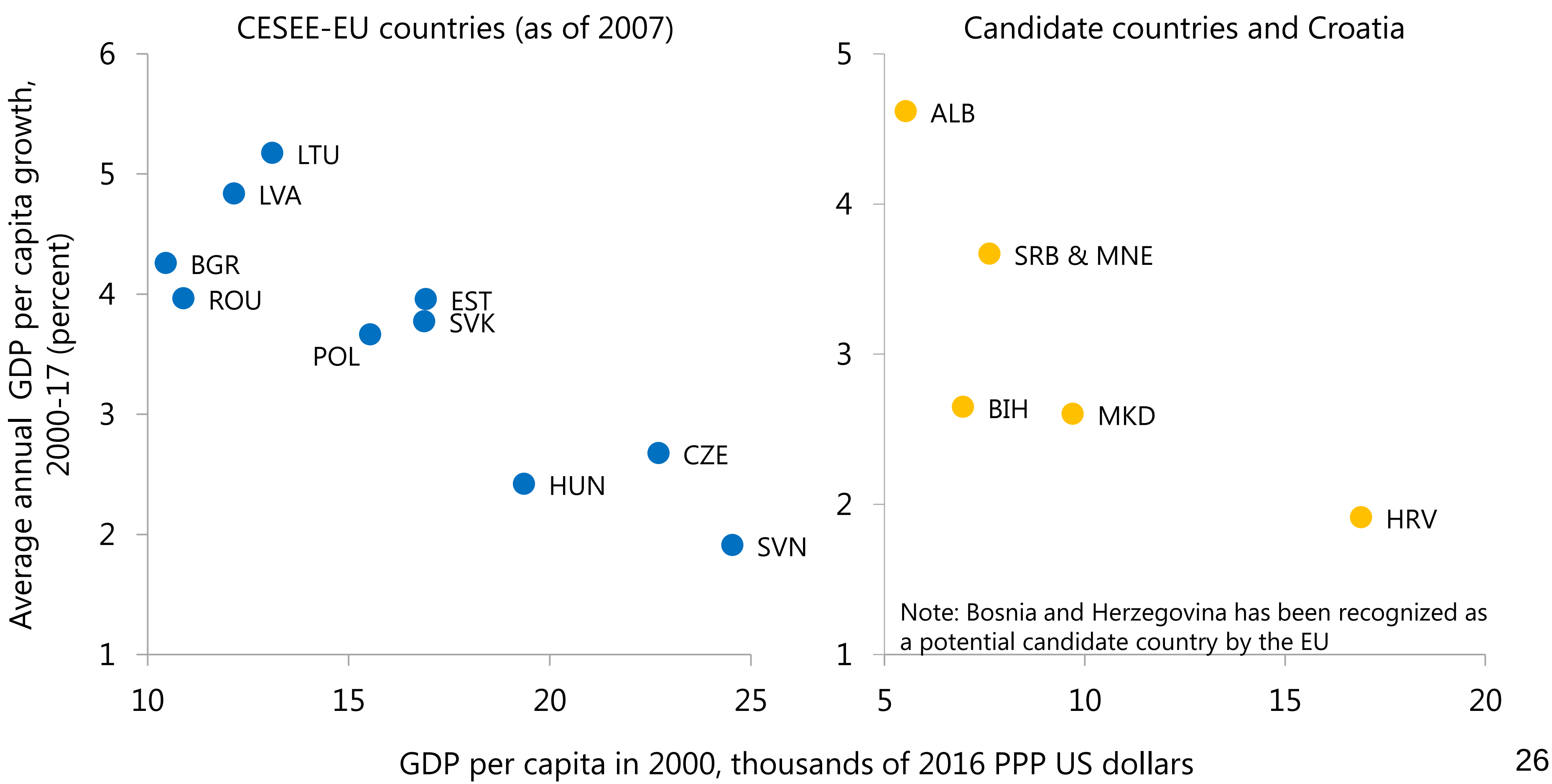
Note: 2007 for Czech Republic

(Prospects of) EU Membership led to more reforms and higher growth

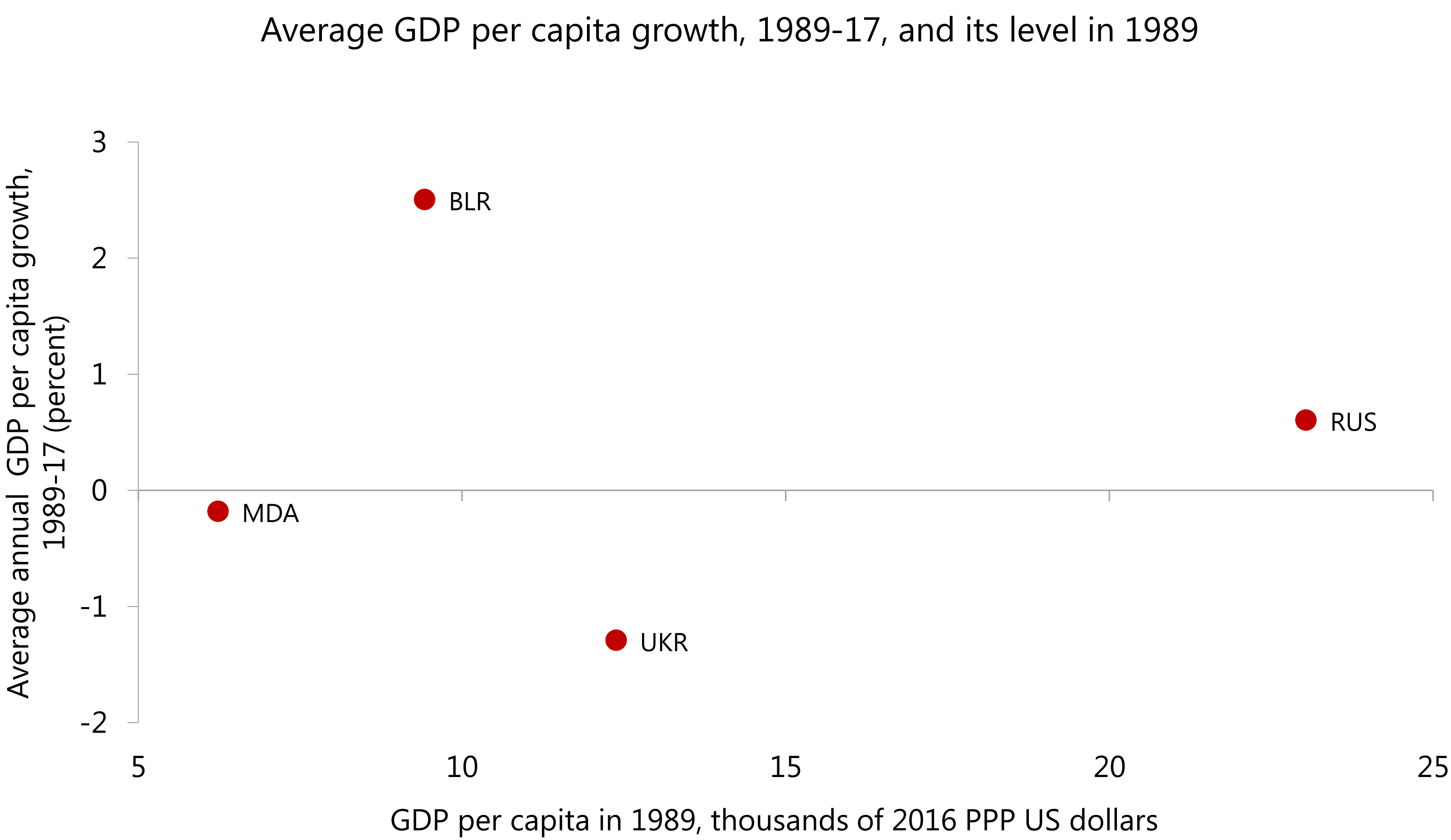


Rapid convergence in EU and EU candidate countries

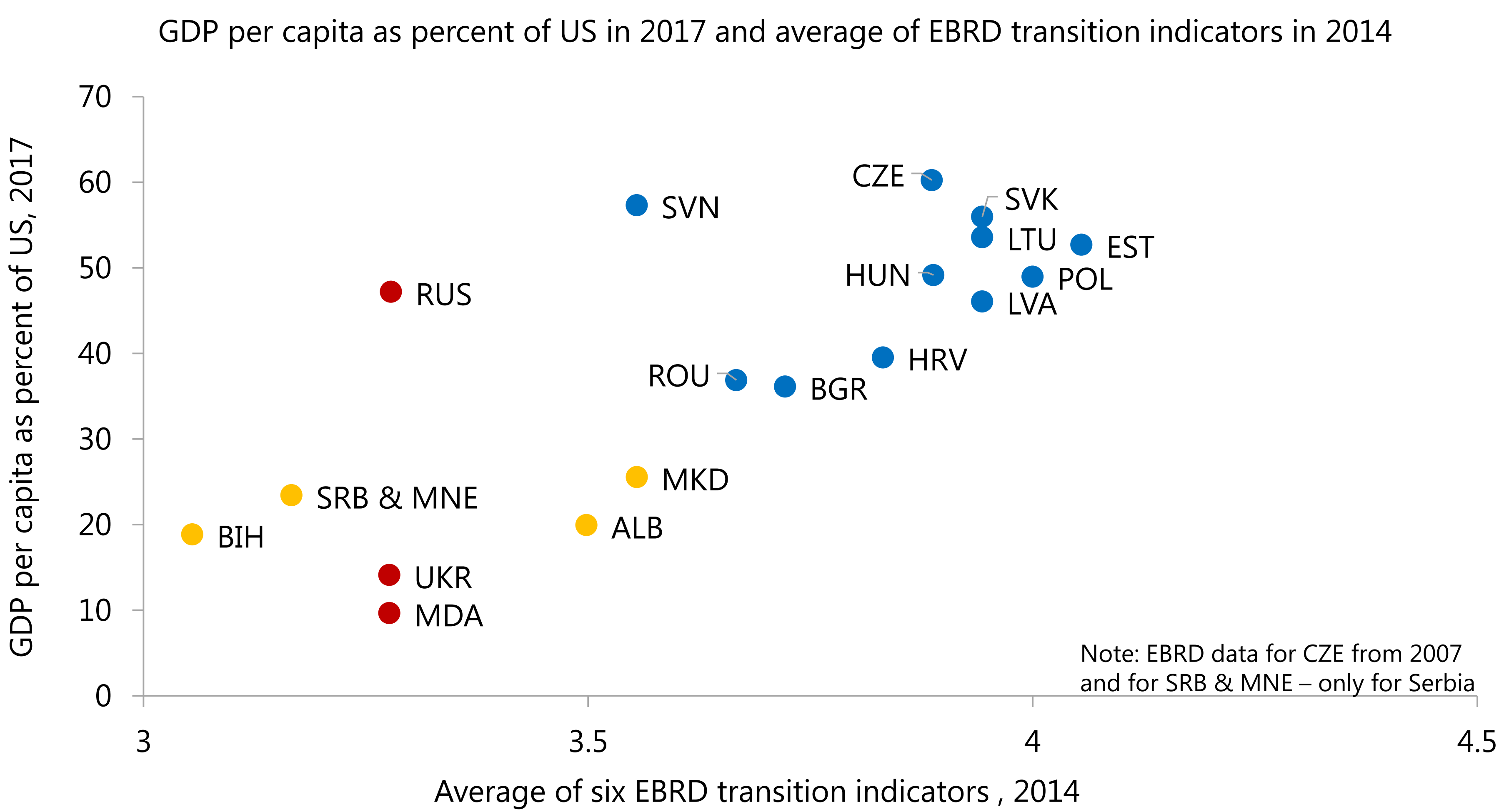
Average GDP per capita growth, 2000-17, and its level in 2000



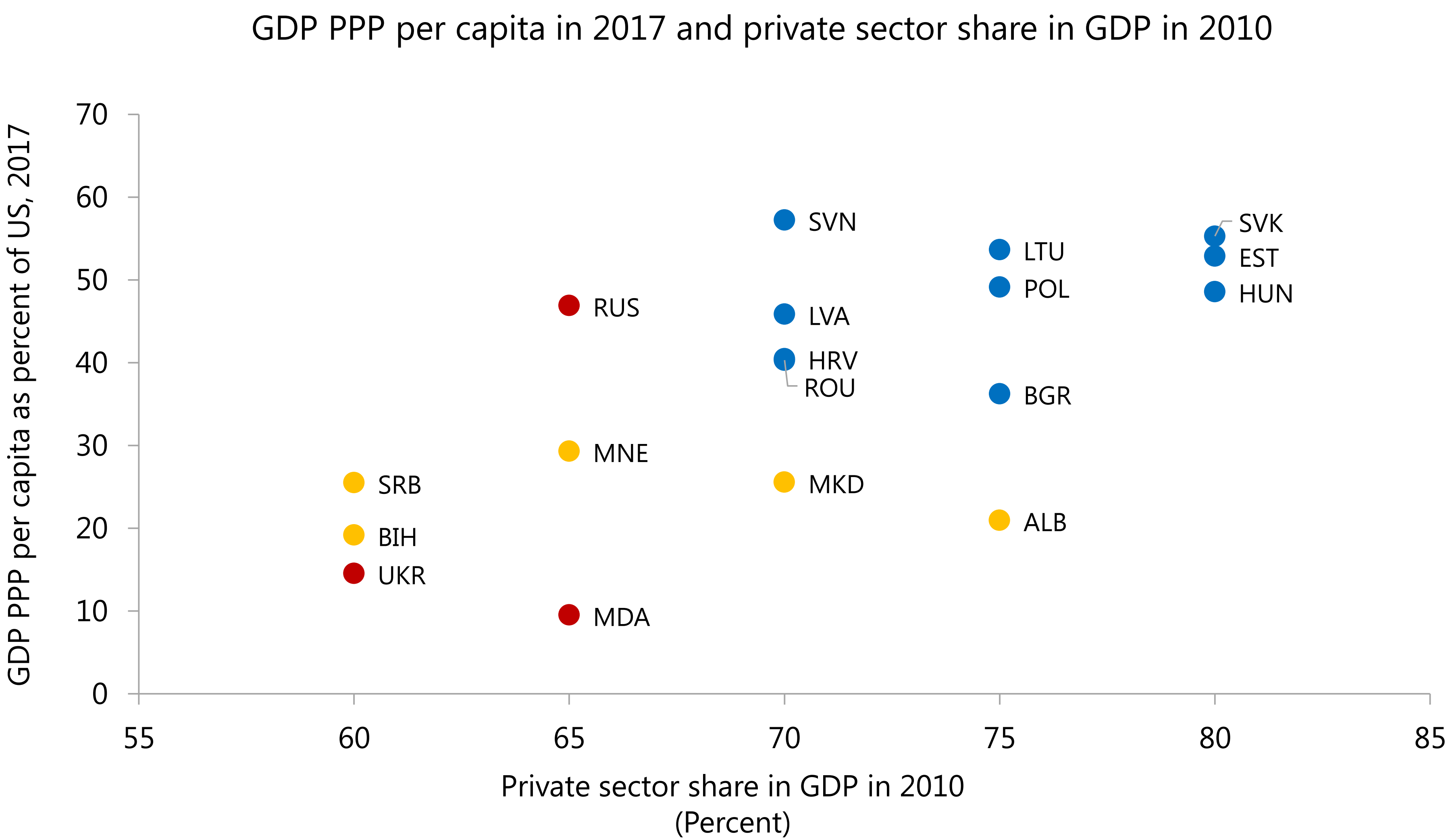
By contrast, no convergence in European CIS



6. Countries that have more completed transition are richer…

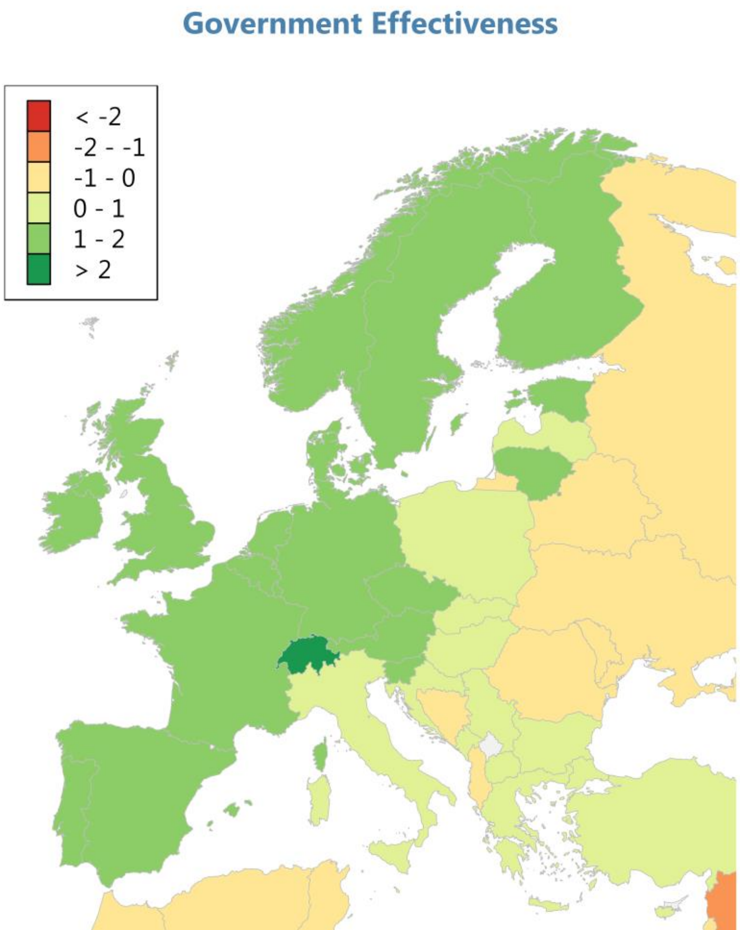


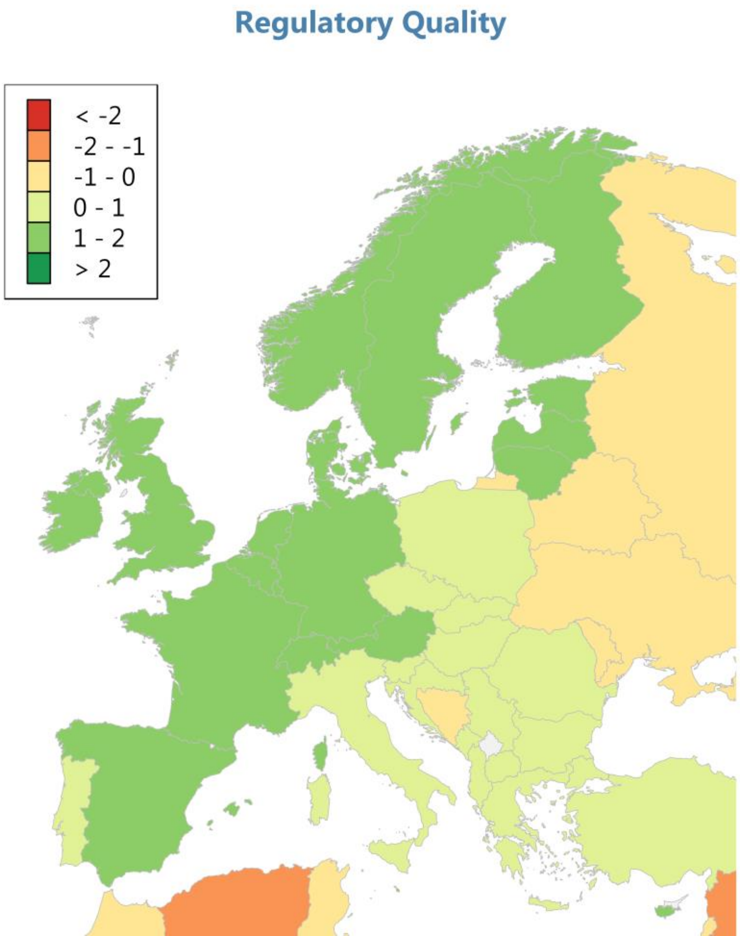
…as do countries where private sector is more vibrant



7. CESEE countries differ in the quality of institutions, e.g. in governance….

Worldwide Governance Indicators, 2016
(Ranges from -2.5 (weak) to 2.5 (strong) governance performance)



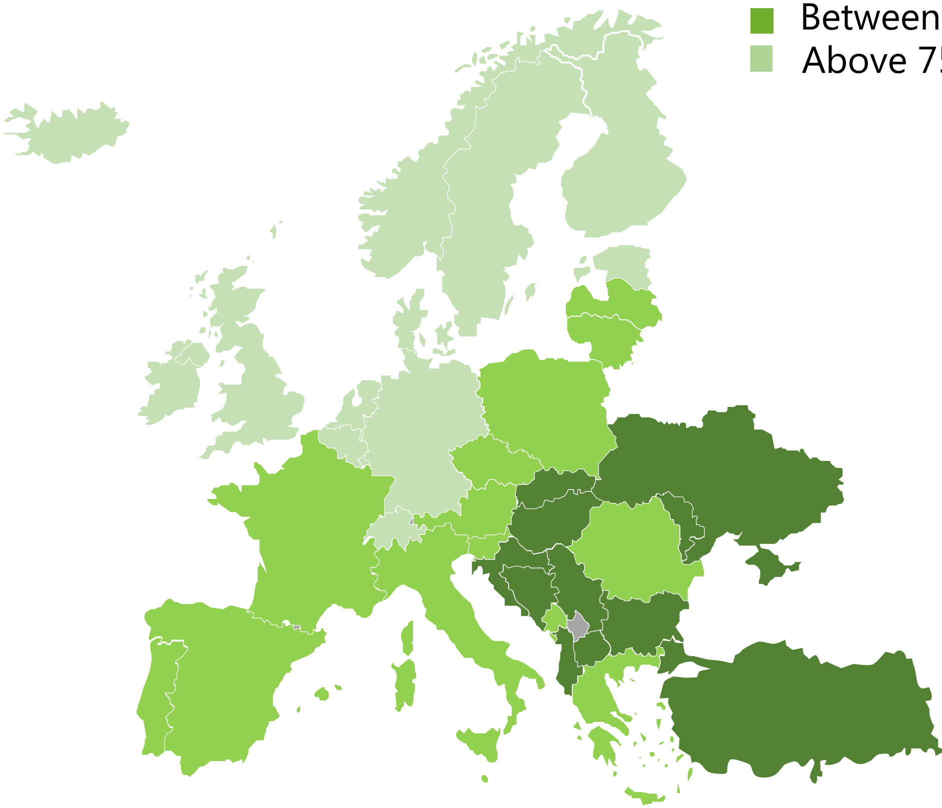


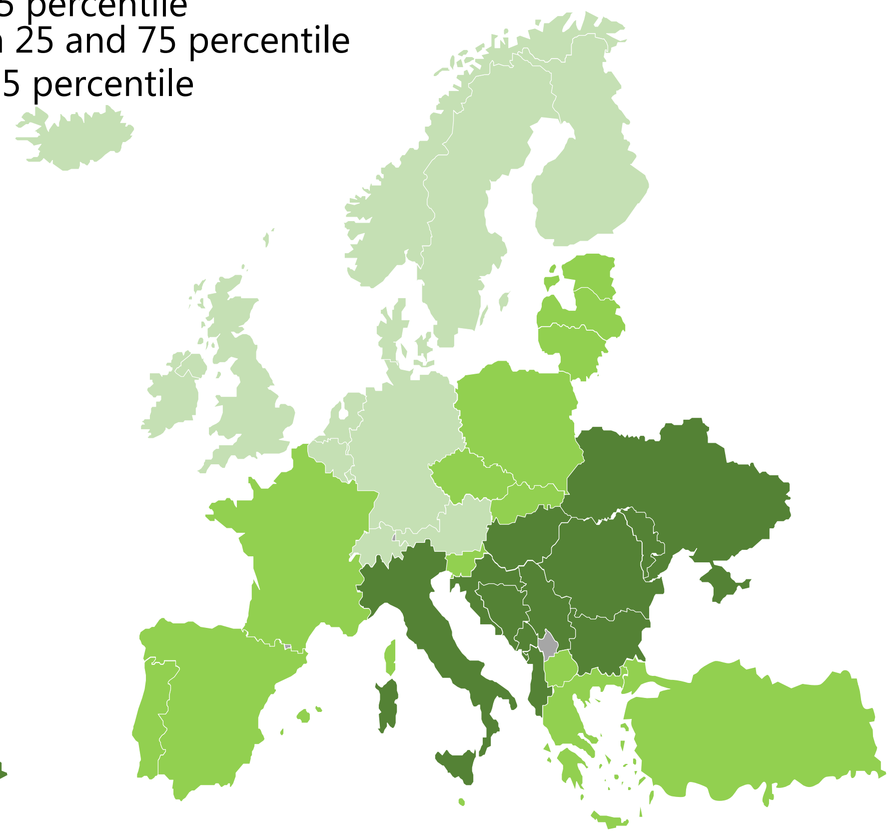
…and the judiciary.

Judicial Independence, 2015

Impartial Courts, 2015

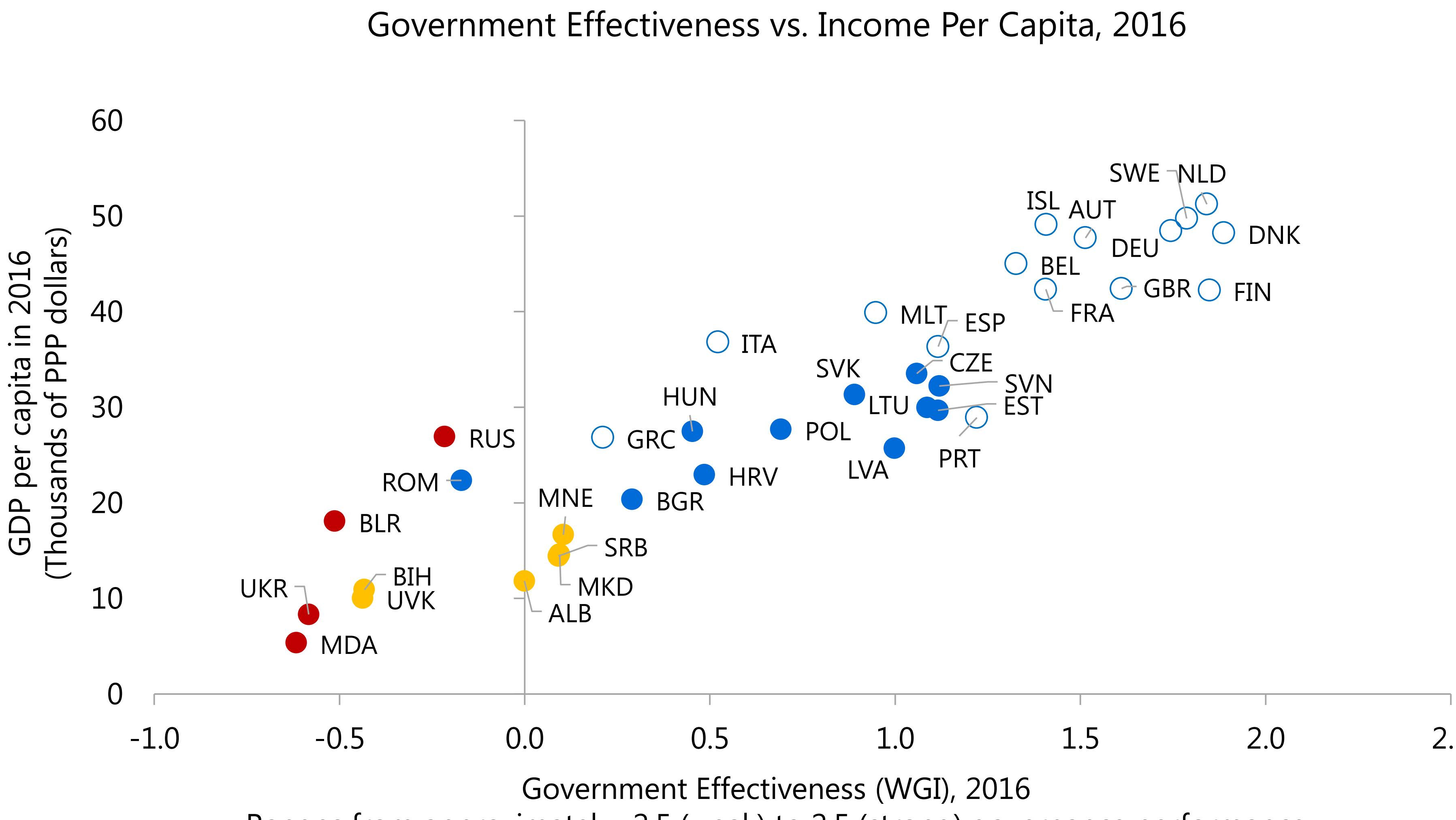
Below 25 percentile
Between 25 and 75 percentile
Above 75 percentile





Source: World Economic Forum. Note: Worldwide distribution excluding LICs

Richer countries have better institutions (though causality may go both ways)



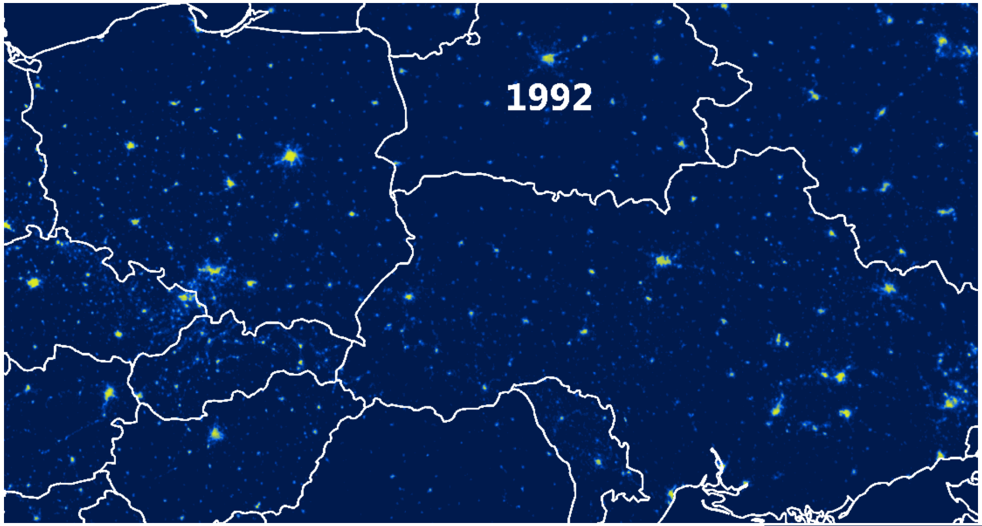
COUNTRY CASES

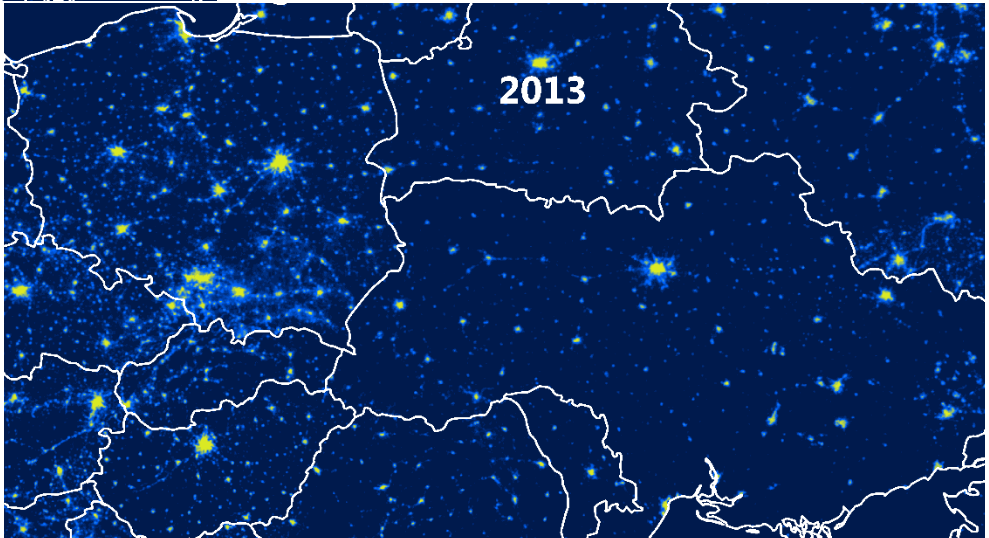
8. Country case (a) Poland vs Ukraine

- Poland has done much better than Ukraine
- In 1989 they were equally rich
- Now Poland is three times as rich
- Why?
  - Poland more macro-stability
  - Poland reformed more and earlier
  - Poland has better institutions

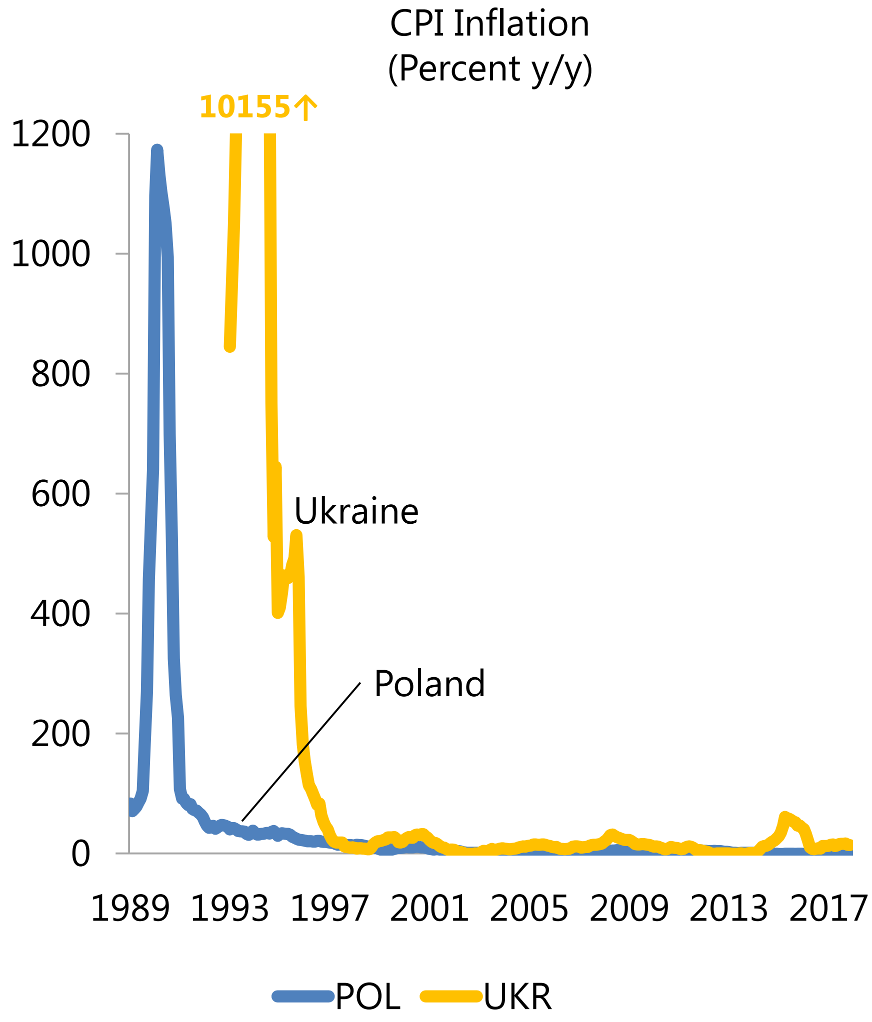
Difference is clearly visible on satellite pictures.

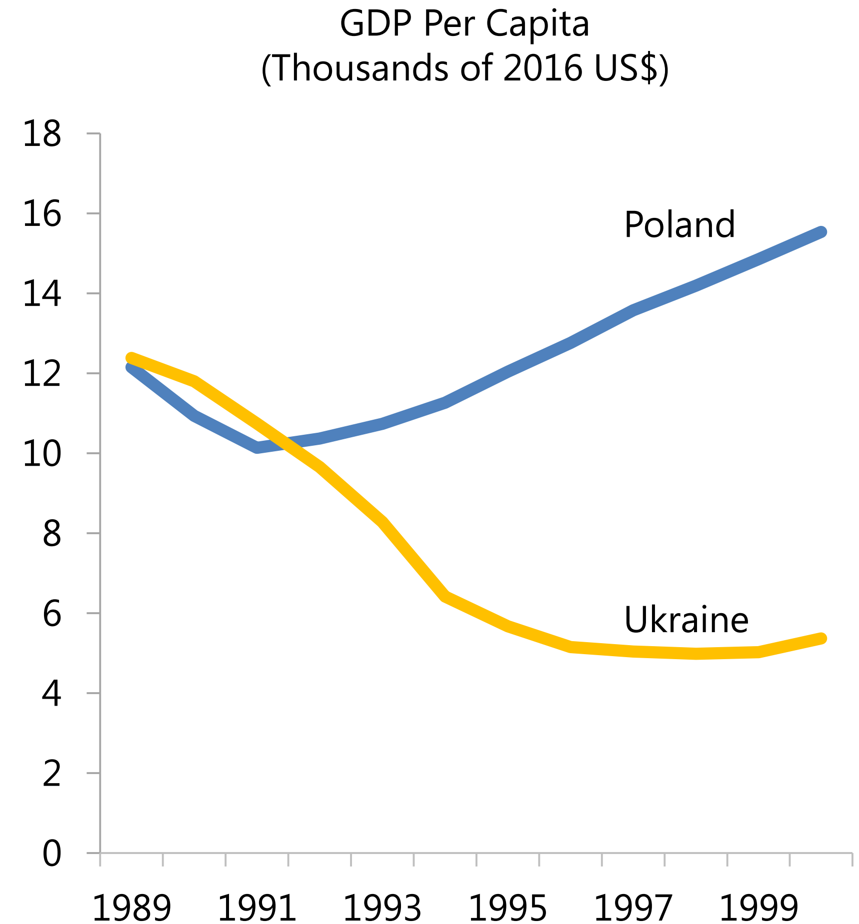
Nightlights intensity





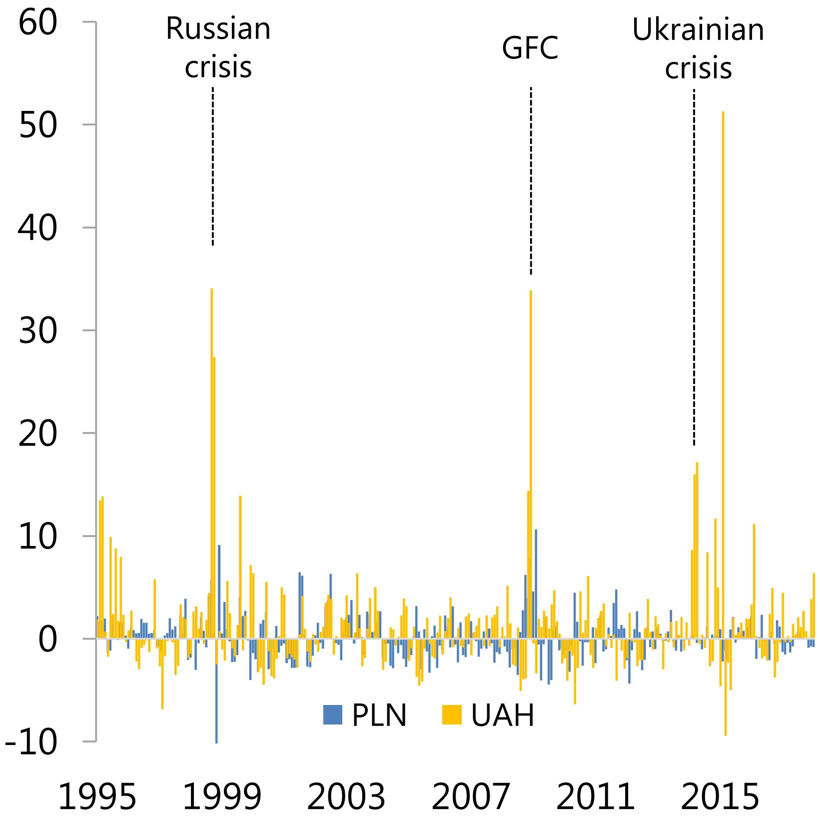
Macro-stabilization occurred much earlier in Poland.



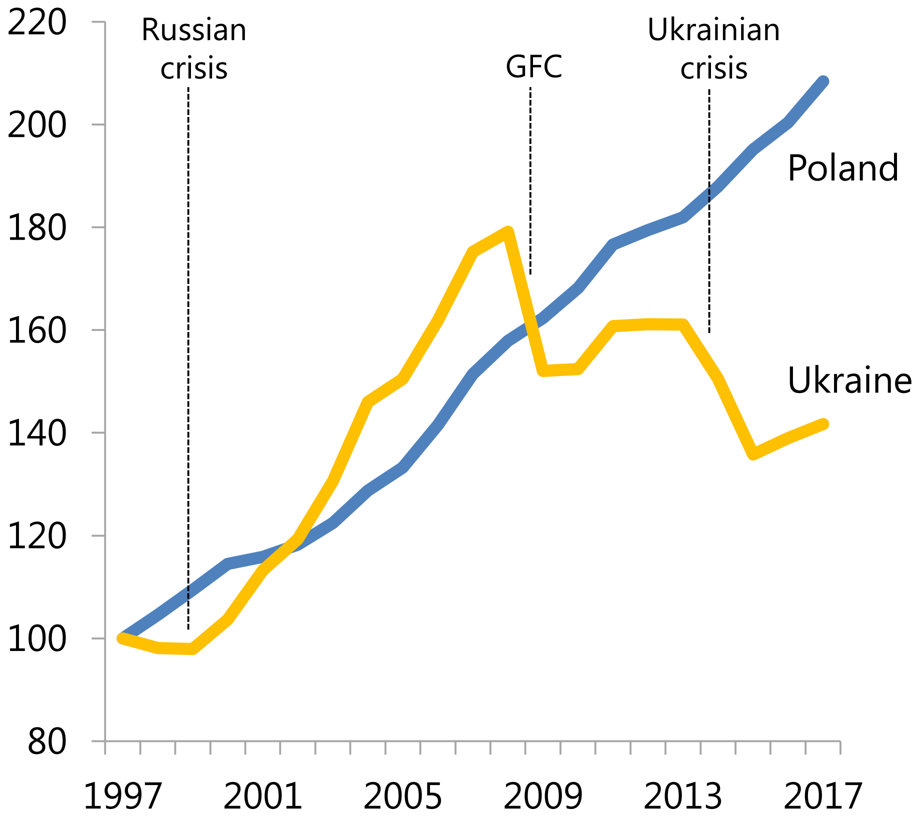


Poland has not had any crisis; Ukraine has had three

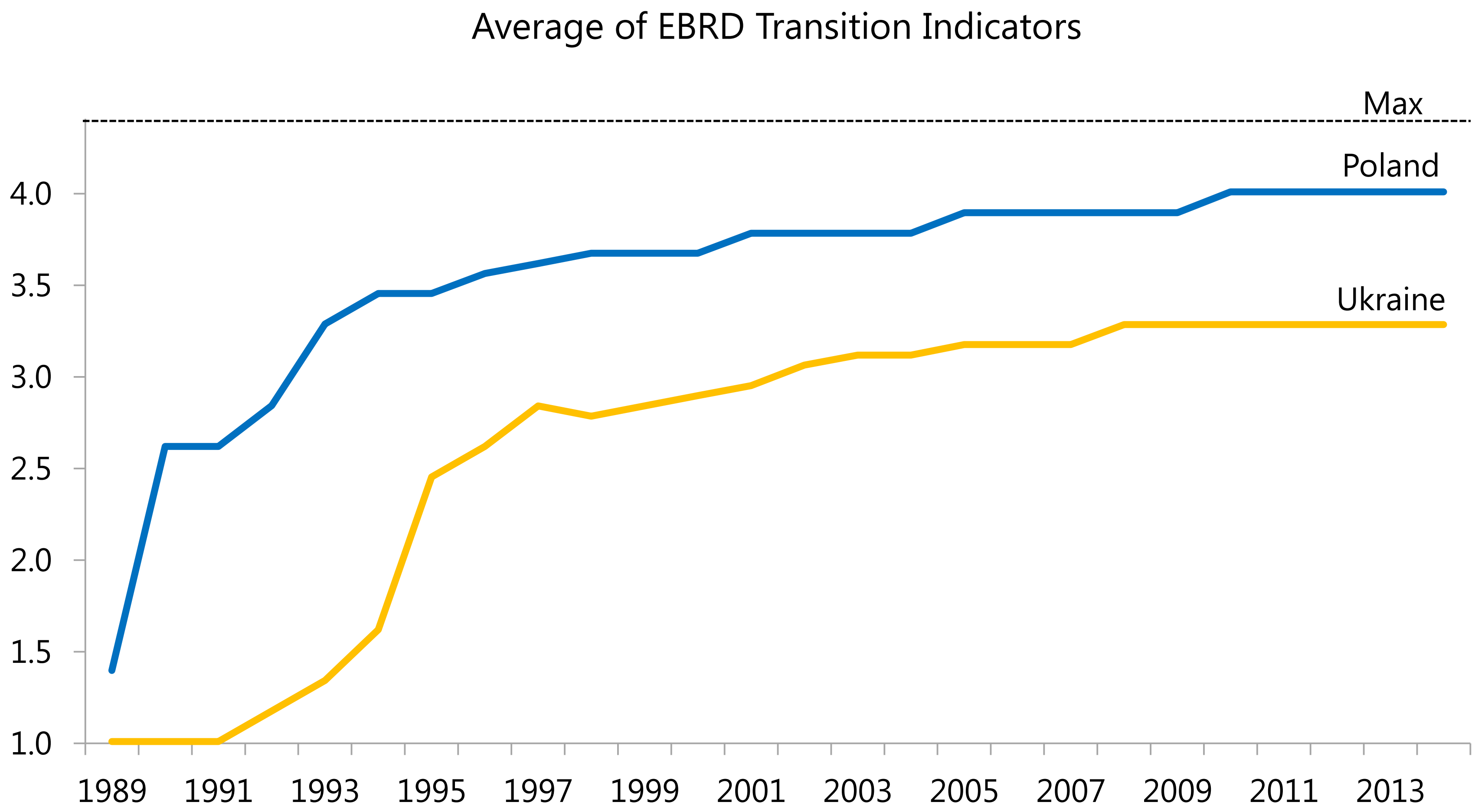
Exchange Rates vs EUR
(Percent m/m)



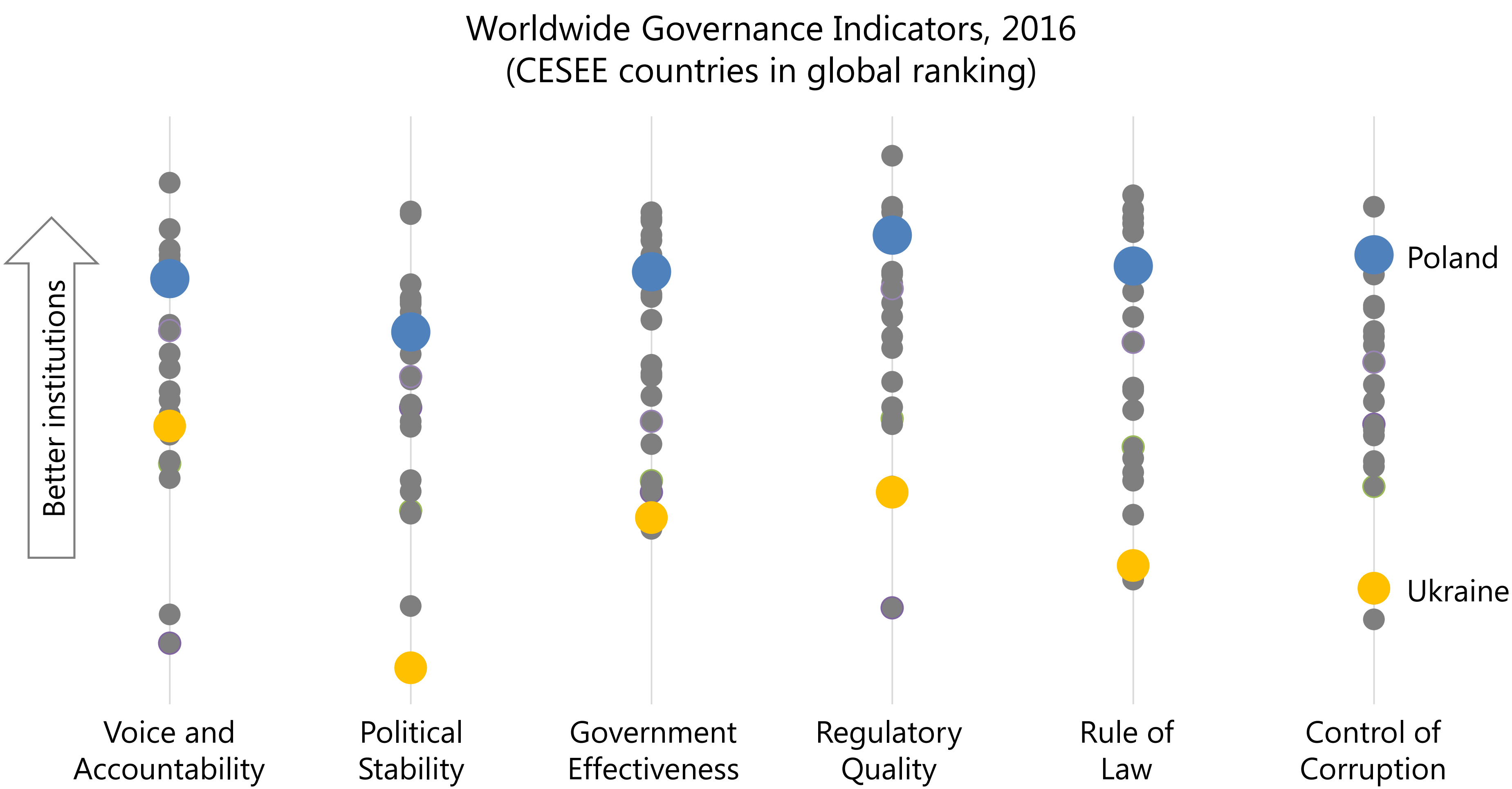
GDP Level
(Index, 1997=100)



Poland reformed earlier and deeper



Poland has much better institutions

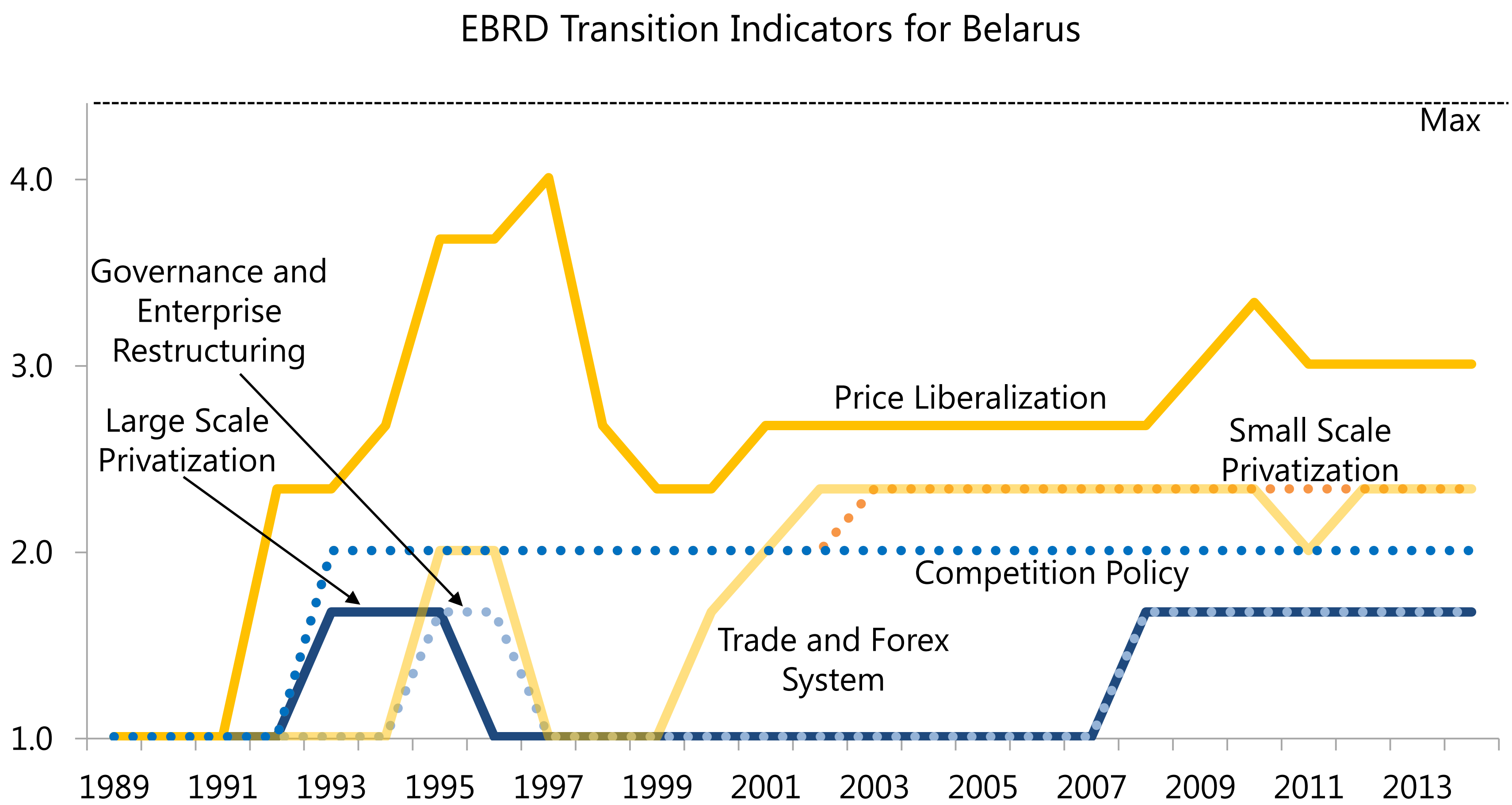


BELARUS

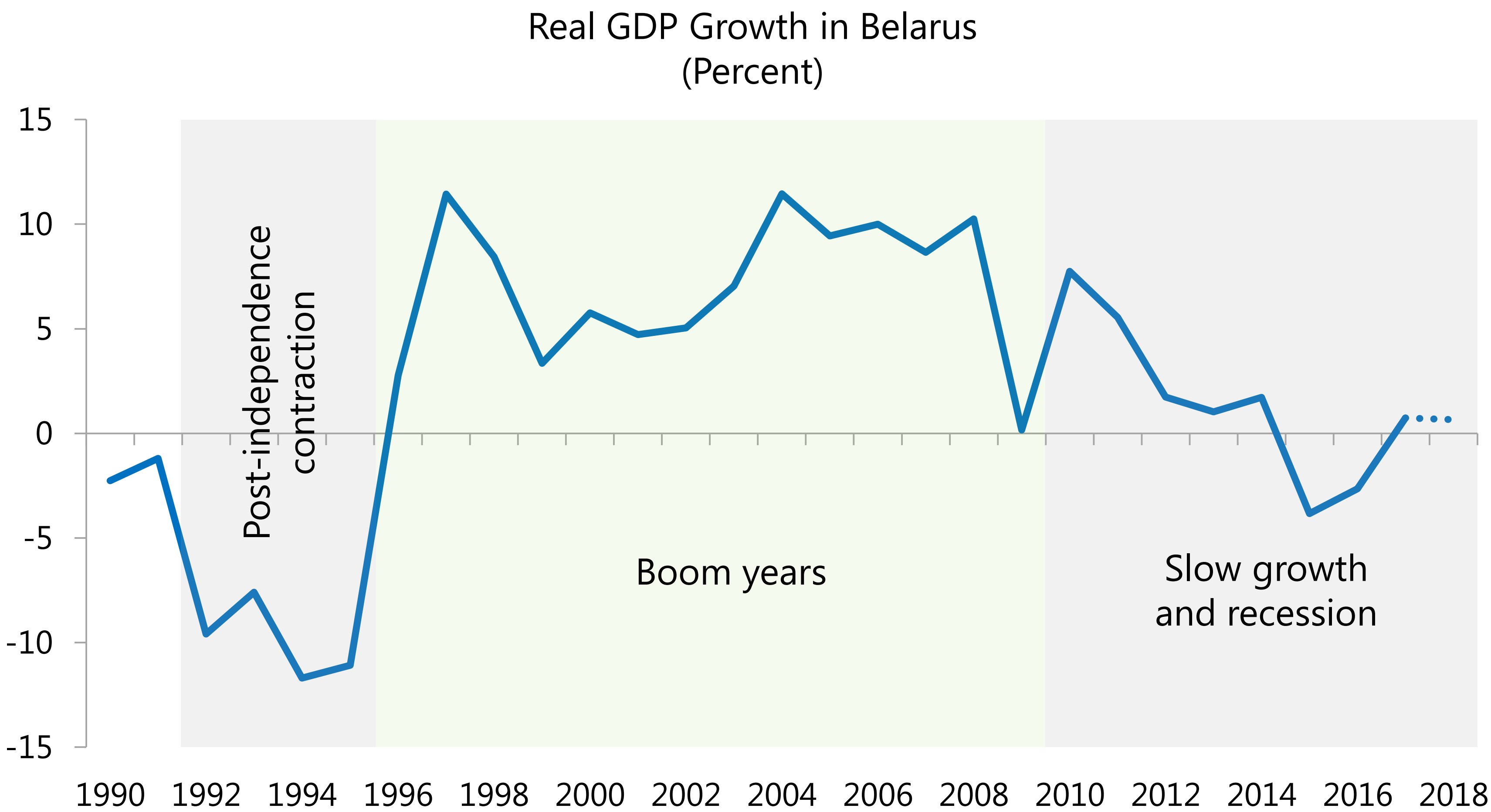
9. Country case (b) Belarus

- Belarus is another interesting example
- Reformed much less than EU New Member States
- It grew quite rapidly between 1995 and 2010
- But in recent years economic growth has been well below other CESEE countries
- What explains this?

Belarus has reversed liberalizing reforms and restructuring has barely moved forward



Three phases in Belarus macro performance since independence:

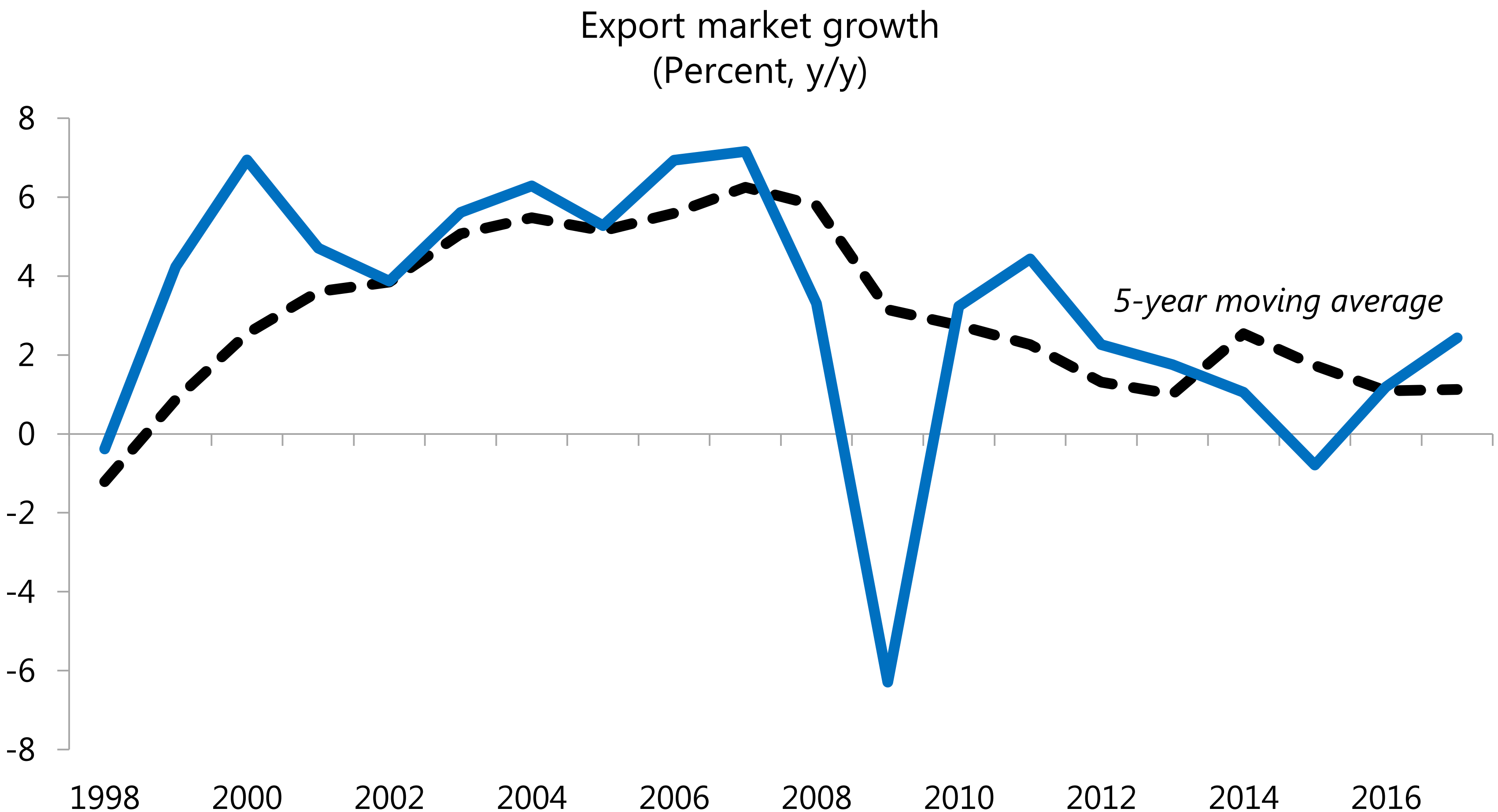


Why has economic performance deteriorated?

- Is it due to *external* reasons (including recession in Russia and Ukraine)?

- Or were there also *internal* reasons? Was the growth model unsustainable?

External factors have certainly played a role in the slowdown: Belarus export markets have done poorly

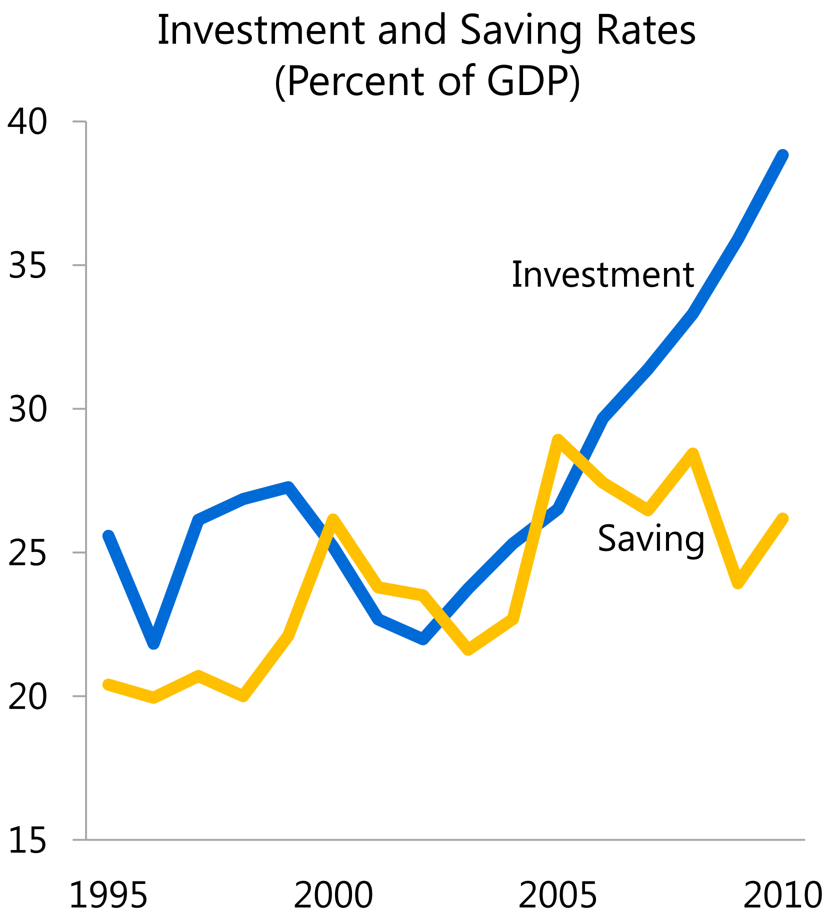


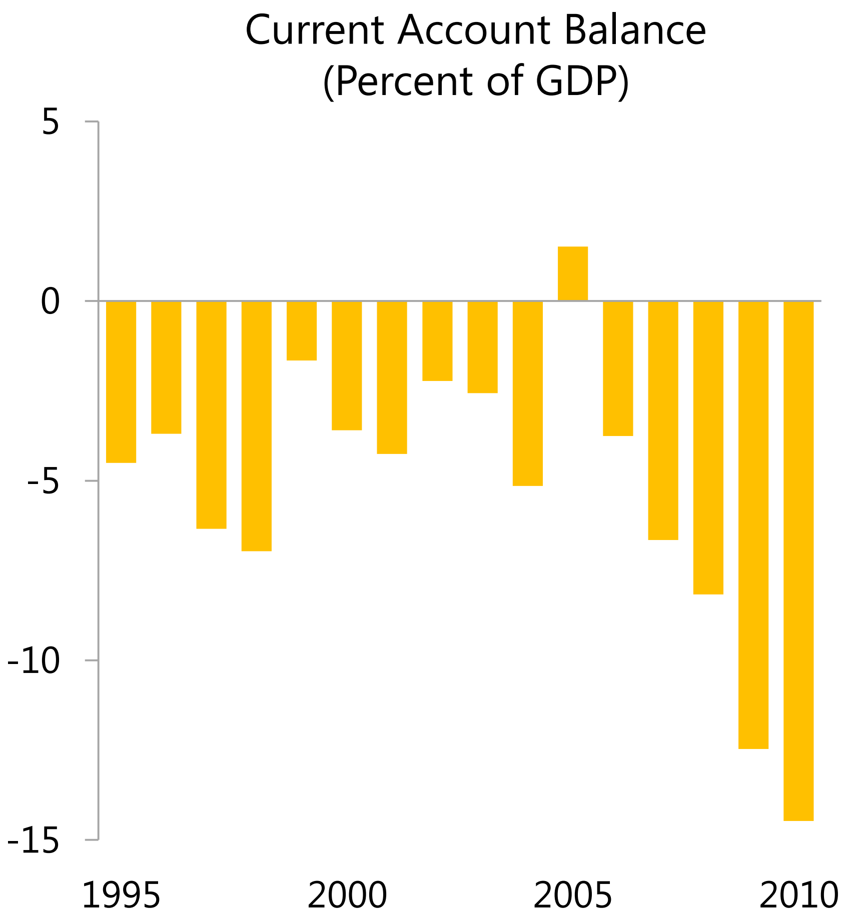
Note: export market growth is weighted average of Belarus' trading partners real GDP growth, covering over 95 percent of exports.

Internal factor: Belarus growth model was unsustainable

- Growth was increasingly driven by unsustainable investment / domestic demand boom
  - This led to BOP crises
  - Productivity (TFP) declined, offsetting the impact of the larger capital stock

Macro-situation during boom was not sustainable. Investment boom led to large CA deficit

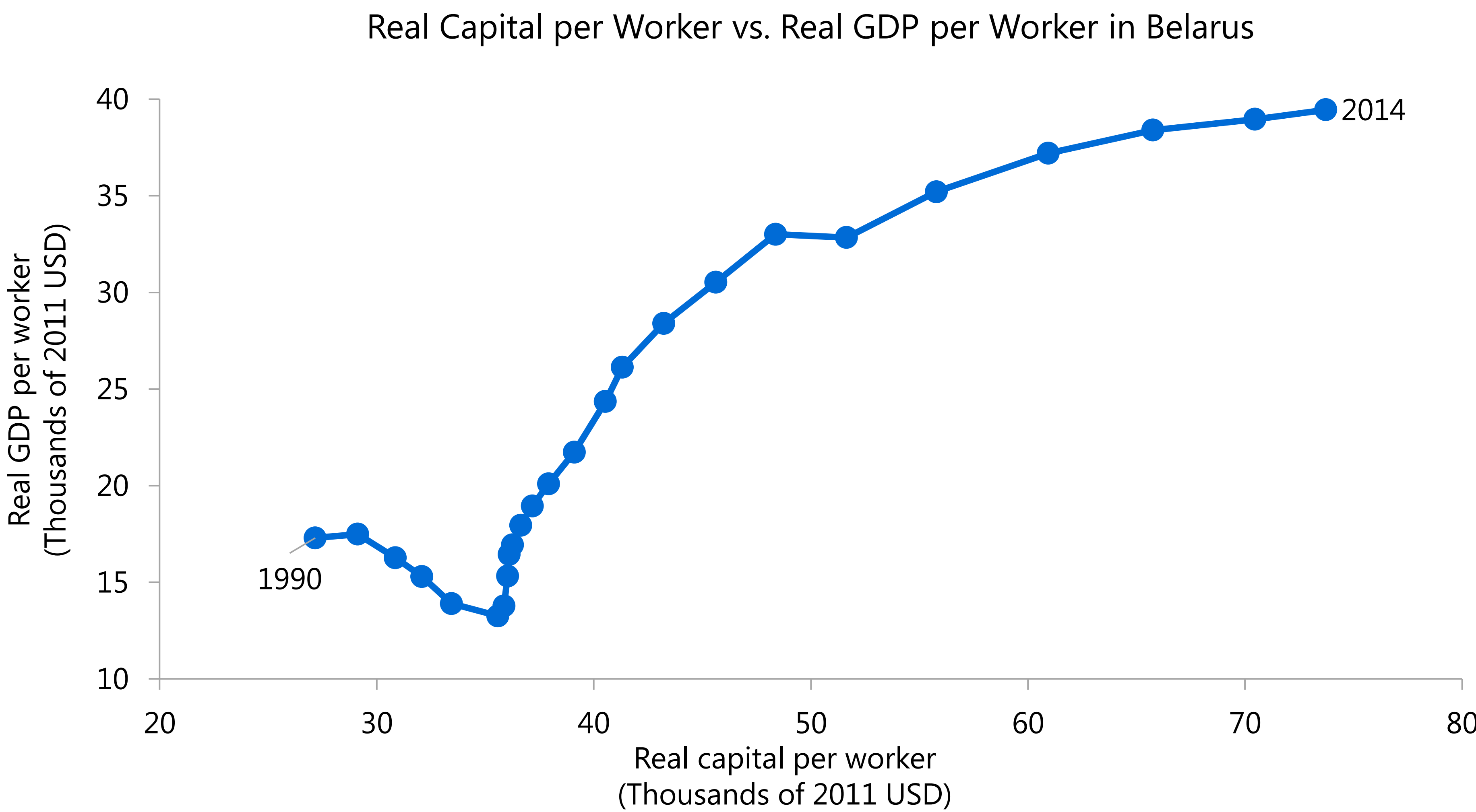




And micro-incentives were distorted

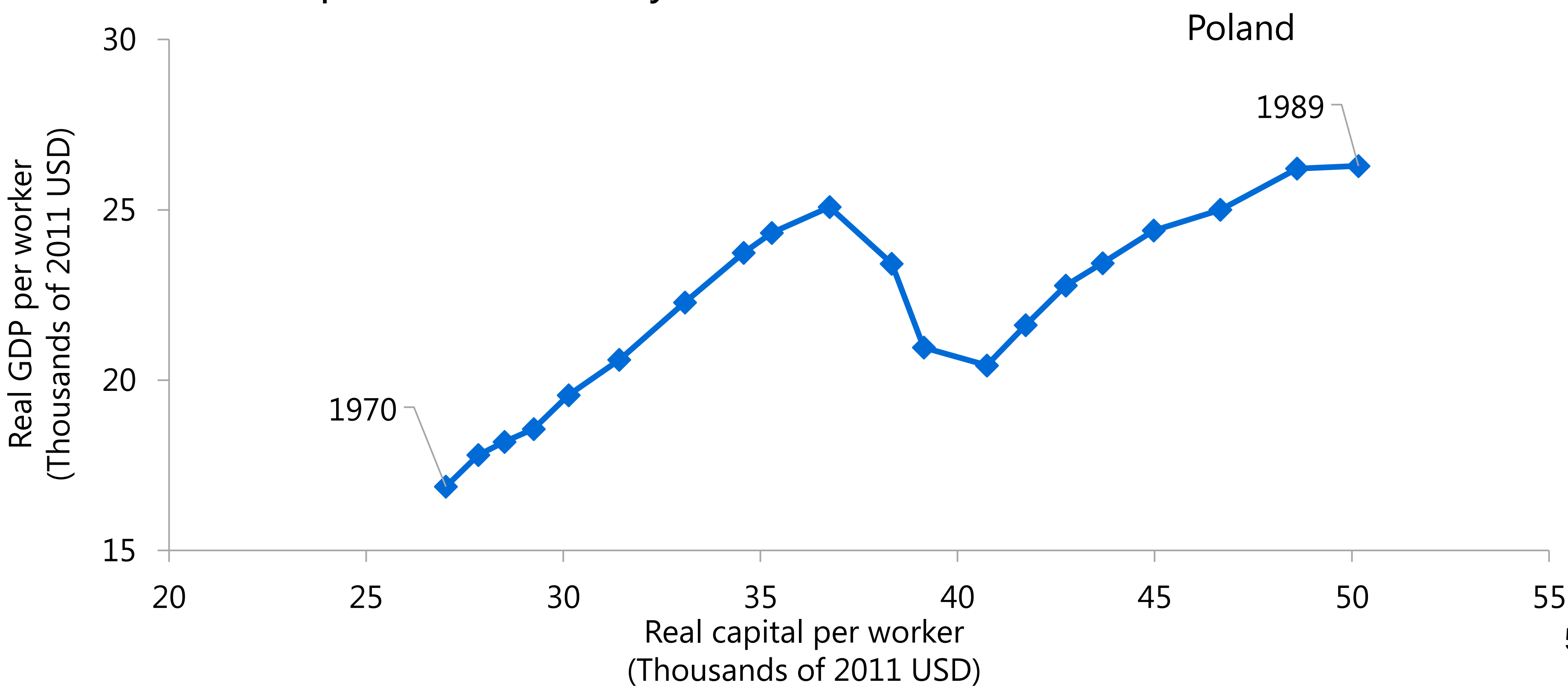
- Growth rates masked stagnating productivity
- Investment led to declining returns
- Capital use was also inefficient
- In many instances it kept unviable SOEs alive, rather than productively supporting new companies

Adding capital has run into diminishing returns



Lack of proper incentives, including in SOEs, hampers efficient use of resources

- Belarus is running into same constraints as Poland in 1980s
- Between late 1970s and late 1980s, capital per worker increased by almost half
- But GDP per worker barely increased



To get a more efficient use of resources, the restructuring of loss making SOEs is necessary, as well as a level playing field for the creation of dynamic new private sector companies

CONCLUSION

Why have some countries done better than others?

- Part of it is good luck
  - No wars
  - EU membership (due to geographical location)

- But policies also played a role

Good policies help

- Good macro-policies
  - Macro-instability hurts growth
- Good micro-policies
  - Good working markets help boost productivity/efficient allocation of resources
- Good institutions
  - Strengthens incentives to invest, innovate, and not emigrate

Thank you