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

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In 1989, CESEE countries were much poorer than Western Europe

GDP PPP per capita in 1989
(In thousands of 2016 USD)

Note: For BIH data for 1990.
Then communism was abolished

- What would we have expected 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

Change in GDP PPP per capita between 1989 and 1996

Note: For BIH data for 1990-1996
Most countries have grown strongly over the past two decades
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.

Change in GDP PPP per capita between 1989 and 2017

- < 0
- 0 - 25
- 25 - 50
- 50 - 75
- 75 - 100
- > 100

(Percent)
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.

![Electricity Consumption per Capita](chart.png)
Both progress and cross-country differences can be seen in satellite pictures.
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

Cumulative change of GDP and early transition reforms

Note: t=1989
For former USSR countries: t=1991
For Bosnia and Herzegovina: t=1990
EBRD transition indicator for SRB & MNE – data only for Serbia

Countries that postponed reforms suffered deeper output losses

Cumulative change of GDP in the beginning of transition, t; t+5 (percent)
Average of six EBRD transition indicators in 1995
Weaker growth in early transition not compensated by faster growth later

Convergence per capita to USA in 1989-97 and 1998-17 (pp)

Note: 1990-17 for Bosnia and Herzegovina
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

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

Average annual GDP growth in 2002-07 vs. GDP growth in 2009

GDP growth in 2009 (Percent)

Average annual GDP growth, 2002-07 (Percent)
Crises led to high NPLs and weak banks, which holds back growth

NPL ratio in 2008 and peak value between 2008-16
(Percent)

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

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

**Average of six EBRD indicators in 2014**

- **EU countries**
- **non-EU countries**

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

CESEE-EU countries (as of 2007)

Candidate countries and Croatia

Note: Bosnia and Herzegovina has been recognized as a potential candidate country by the EU
By contrast, no convergence in European CIS

Average GDP per capita growth, 1989-17, and its level in 1989

Average annual GDP per capita growth, 1989-17 (percent)

GDP per capita in 1989, thousands of 2016 PPP US dollars
6. Countries that have more completed transition are richer...

GDP per capita as percent of US in 2017 and average of EBRD transition indicators in 2014

Note: EBRD data for CZE from 2007 and for SRB & MNE – only for Serbia
...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)

Government Effectiveness vs. Income Per Capita, 2016

Ranges from approximately -2.5 (weak) to 2.5 (strong) governance performance
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

1992

2013
Macro-stabilization occurred much earlier in Poland.
Poland has not had any crisis; Ukraine has had three.

- Russian crisis
- GFC
- Ukrainian crisis

**Exchange Rates vs EUR (Percent m/m)**

**GDP Level (Index, 1997=100)**
Poland reformed earlier and deeper

Average of EBRD Transition Indicators

Max

Poland

Ukraine
Poland has much better institutions

Worldwide Governance Indicators, 2016
(CESEE countries in global ranking)
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:

- Post-independence contraction
- Boom years
- Slow growth and recession
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.

Export market growth
(Percent, y/y)

5-year moving average

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

Real Capital per Worker vs. Real GDP per Worker in Belarus
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