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.
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

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.
There are also visible differences in emigration
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
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

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

Cumulative change of GDP in the beginning of transition, $tt+5$ (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.

GDP Growth (Percent)

GDP per capita (2000=100)
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

Average annual GDP growth, 1996-2017

Number of years with negative GDP growth, 1996-2017

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

GDP per capita and average of EBRD transition indicators

Average of the EBRD transition indicators in 1995 and 2014

GDP per capita in 1995 and 2014, thousands of 2014 PPP US dollars

2014

SEE non-EU
CIS
SEE EU
CE5
Baltics
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) vs GDP per capita in 1989, thousands of 2016 PPP US dollars

- BLR
- MDA
- UKR
- RUS
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

GDP PPP per capita in 2017 and private sector share in GDP in 2010

GDP PPP per capita as percent of US, 2017

Private sector share in GDP in 2010 (Percent)
Limited privatization progress in Bosnia and Herzegovina and in Serbia stalled after the crisis.
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)

![Graph showing the relationship between Government Effectiveness and Income Per Capita, 2016. The x-axis represents Government Effectiveness (WGI), ranging from approximately -2.5 (weak) to 2.5 (strong) governance performance. The y-axis represents GDP per capita in 2016 (in thousands of PPP dollars). The graph includes data points for various countries, illustrating the correlation between better institutions and higher GDP per capita.](image-url)
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 reformd more and earlier
  - Poland has better institutions
Difference is clearly visible on satellite pictures.
Macro-stabilization occurred much earlier in Poland.
Poland has not had any crisis; Ukraine has had three.
Poland reformed earlier and deeper

Average of EBRD Transition Indicators

Max

Poland

Ukraine

1.0 1.5 2.0 2.5 3.0 3.5 4.0

1989 1991 1993 1995 1997 1999 2001 2003 2005 2007 2009 2011 2013
Poland has much better institutions

Worldwide Governance Indicators, 2016
(CESEE countries in global ranking)
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
IMF has helped too, both with financial support...

IMF Lending Arrangements
(Percent of average GDP 1995-2018)

- 1990-2000
- 2001-2010
- 2011-2018
...and with technical assistance.

IMF Technical Assistance
(Sum of person years)

- 1990-2000
- 2001-2010
- 2011-2017

Countries: CZE, EST, SVK, HUN, SVN, LVA, LTU, MNE, POL, ROU, HRV, BLR, SRB, BGR, BIH, MKD, UVK, ALB, RUS, UKR
Western Balkans have long history of IMF-sponsored programs

IMF Lending Arrangements in Western Balkans, 1990-2018

<table>
<thead>
<tr>
<th>Facility</th>
<th>Years</th>
<th>Amount (millions of 2018 USD)</th>
<th>In percent of GDP</th>
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<td>Bosnia and Herzegovina</td>
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EFF - Extended Fund Facility
ECF - Extended Credit Facility
SBA - Standby Arrangement
STF - Systemic Transformation Facility
PCL - Precautionary and Liquidity Line
Thank you