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

IMF Macroeconomic Policy Seminar

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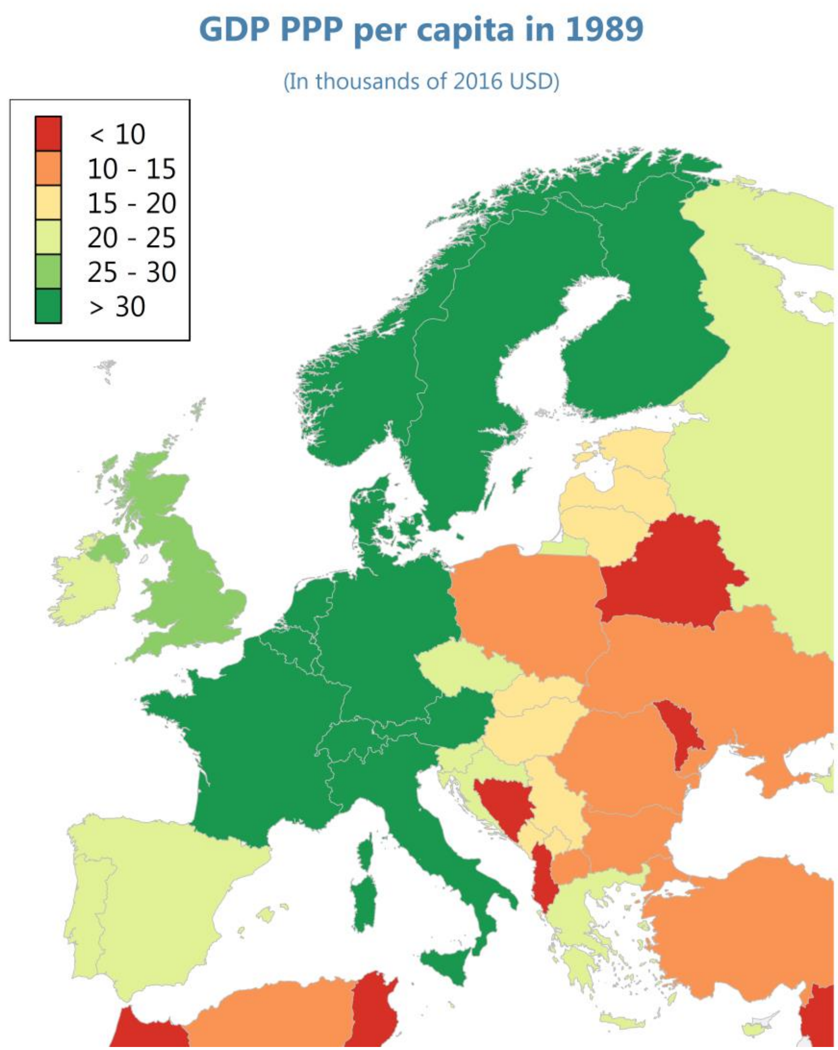
In 1989, CESEE countries were much poorer than Western Europe



Note: For BIH data for 1990.

Then communism was abolished

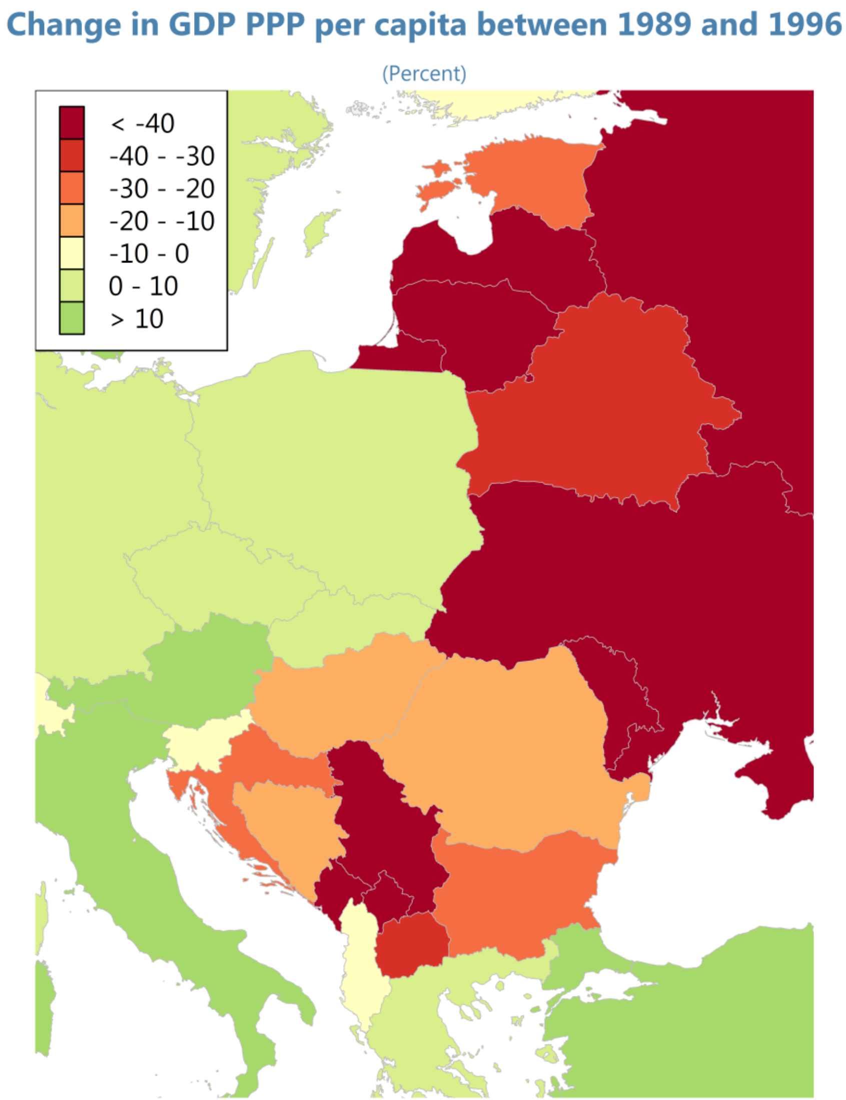
- What would we have expect to have happened?
  - Income differentials with Western Europe would become smaller
  - Poorer countries would grow faster than richer countries

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

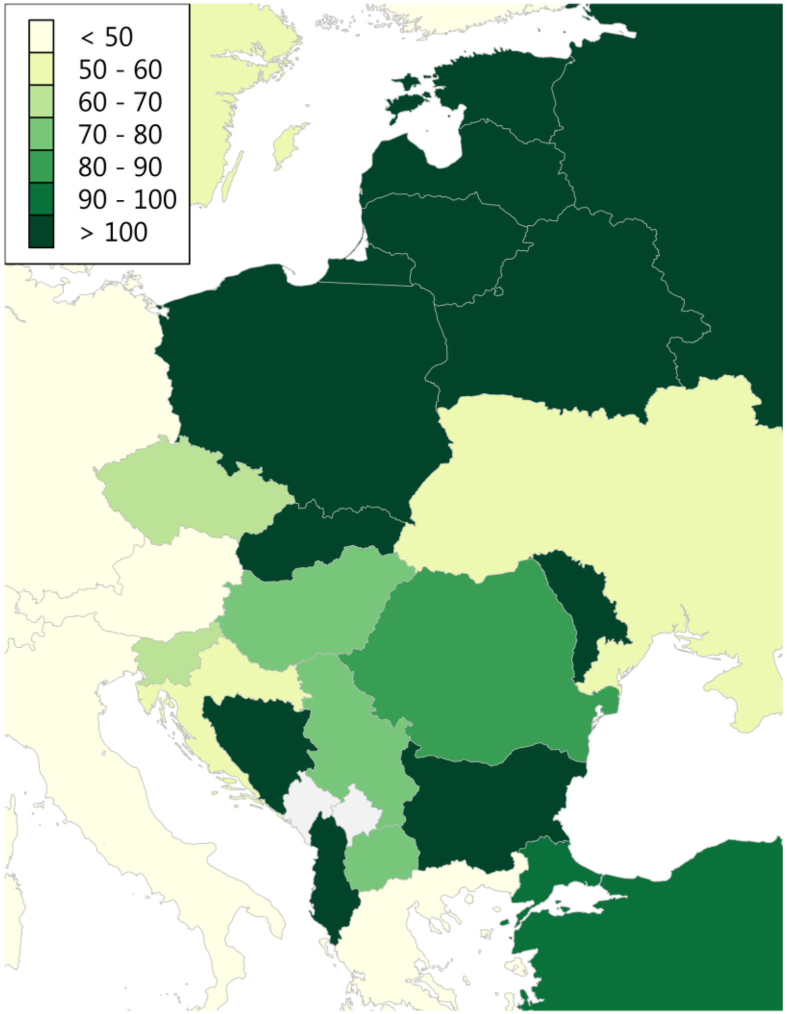


Note: For BIH data for 1990-1996

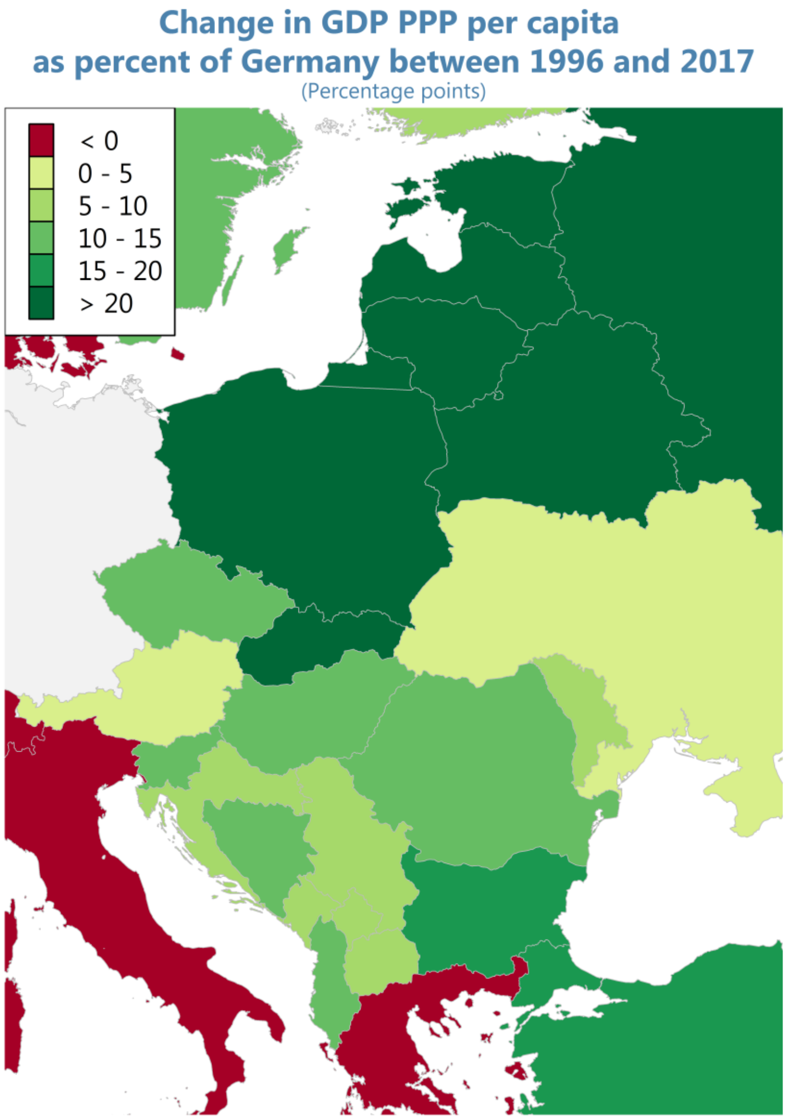
Most countries have grown strongly over the past two decades

Change in GDP PPP per capita between 1996 and 2017

(Percent)

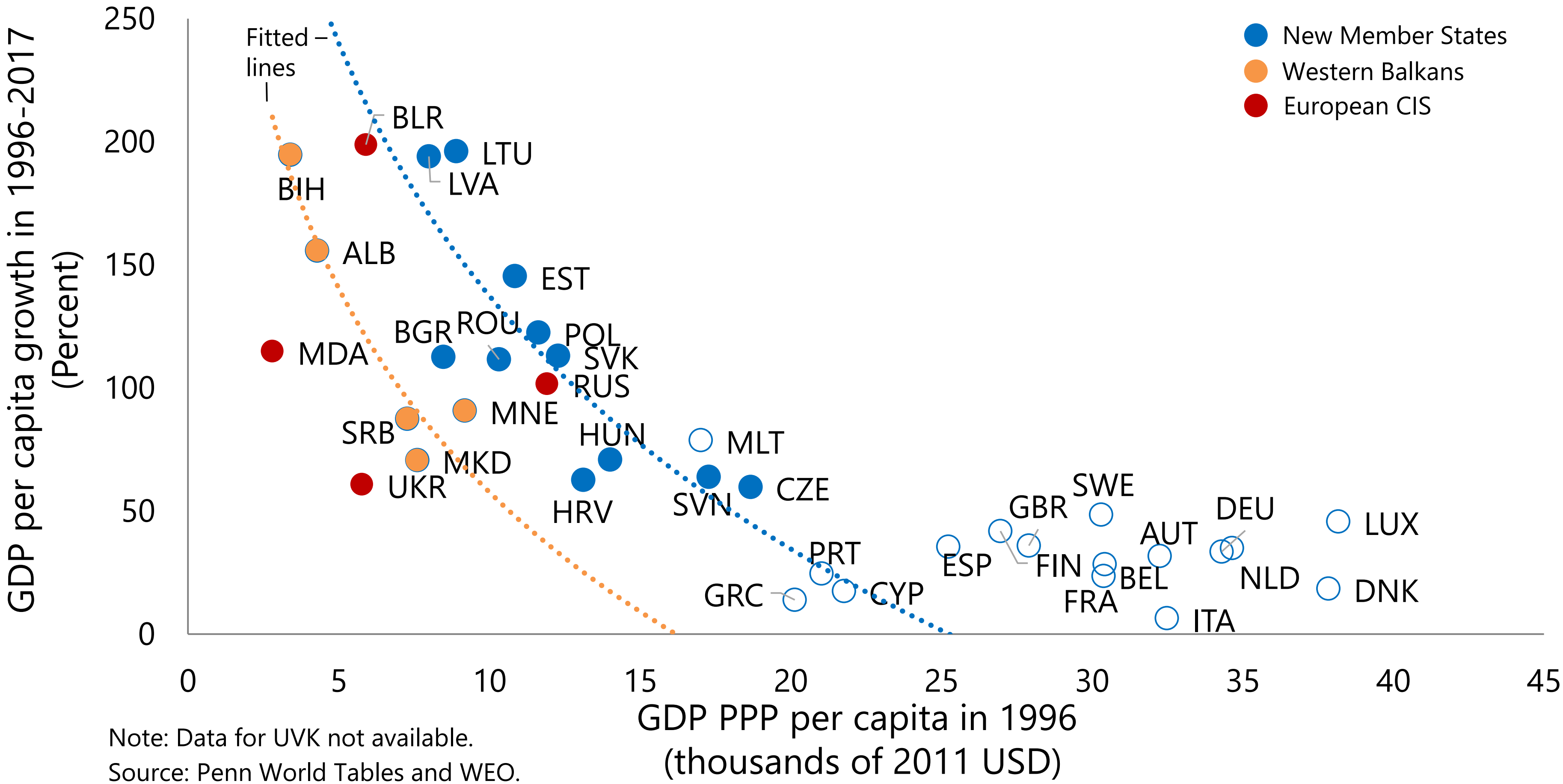


In the past two decades all countries have narrowed income differentials with Germany



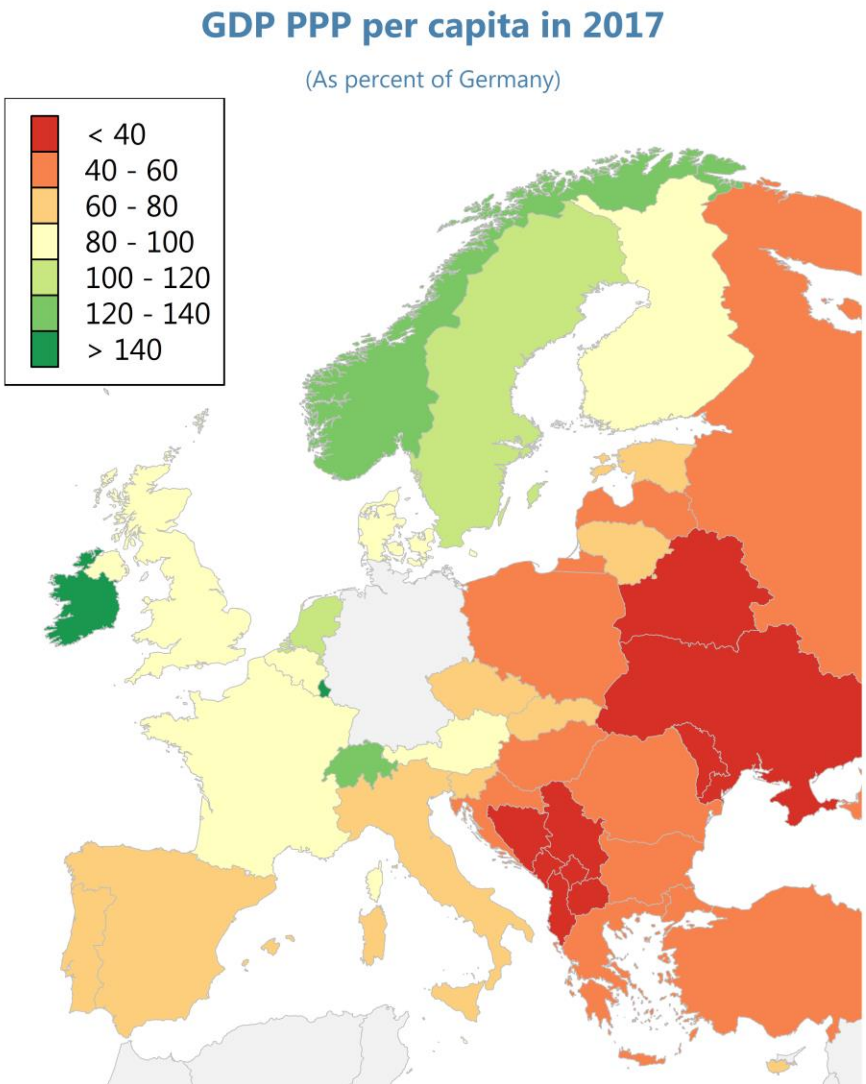
EU New Member States have done better than Western Balkans and CIS

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

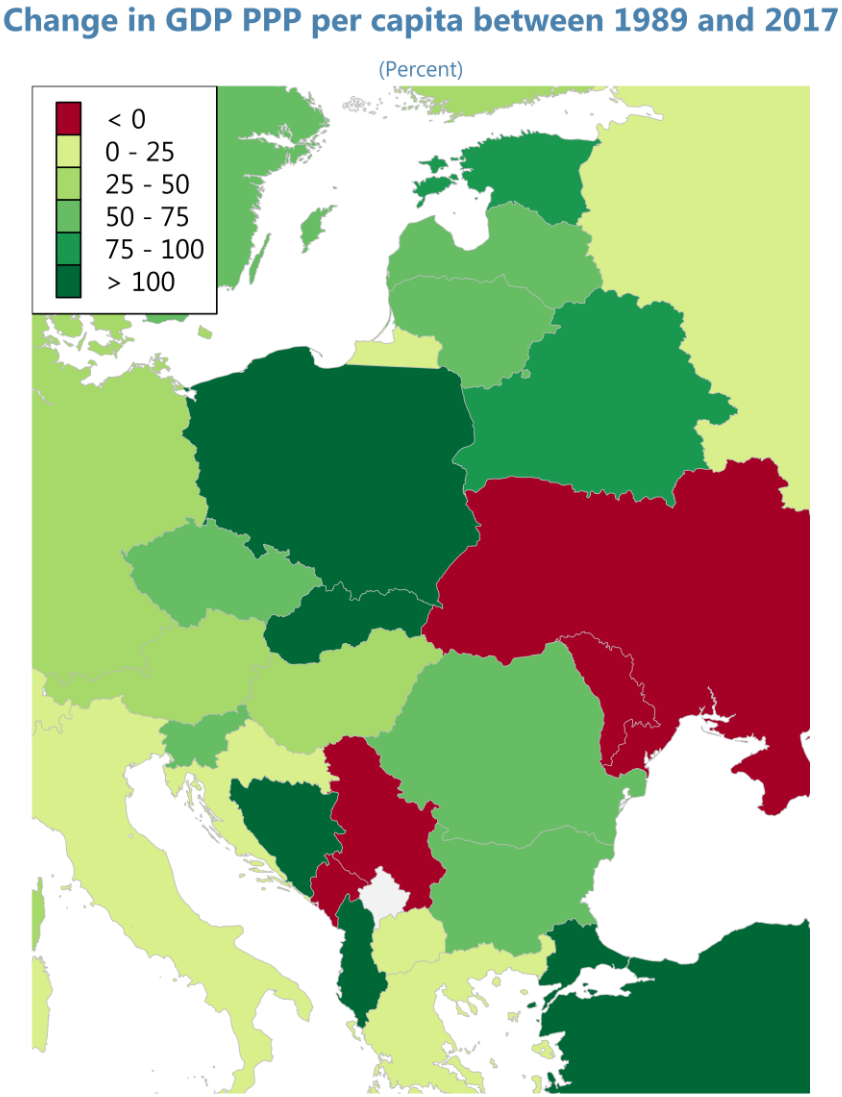


Note: Data for UVK not available.
Source: Penn World Tables and WEO.

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



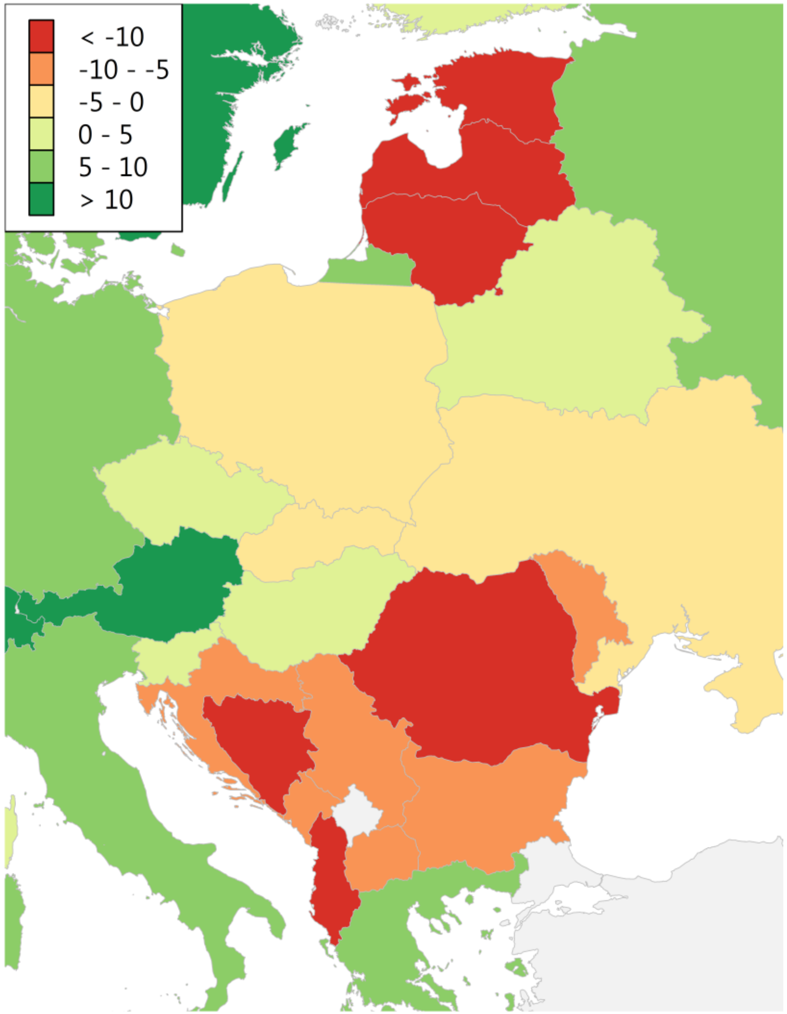
Most-but not all-countries are richer now than in 1989



There are also visible differences in emigration

Net Migration Rate 1990-2015

(Percent of 1990 Population)



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

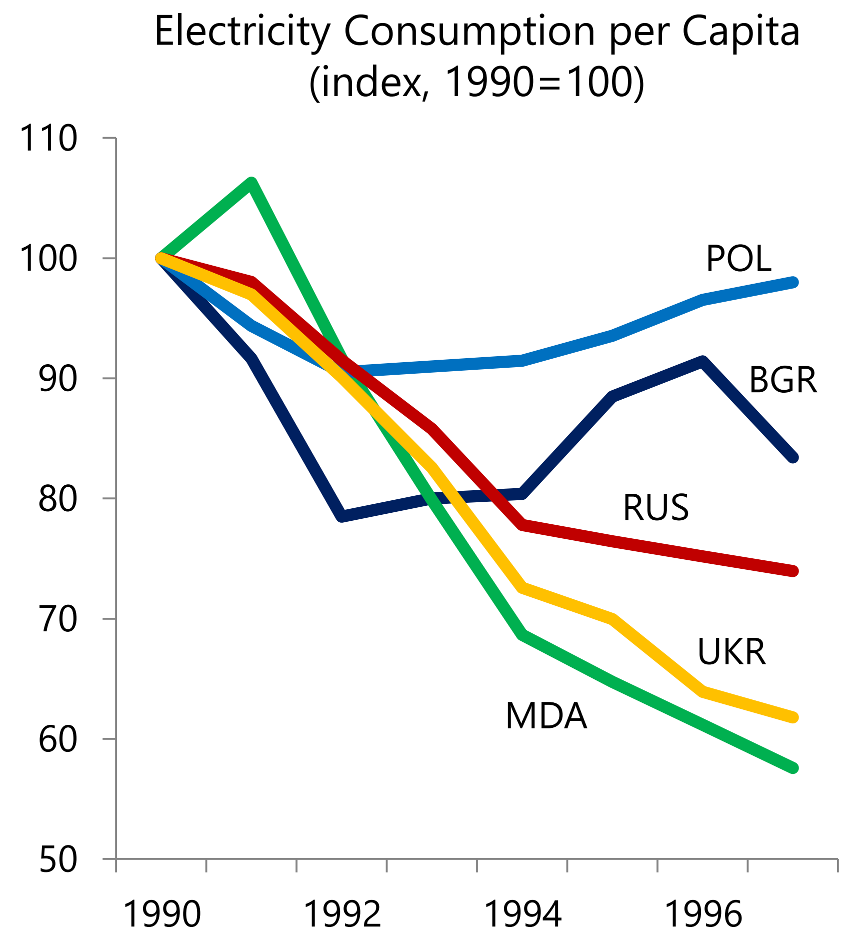
However, even if size of initial collapse was exaggerated, there clearly were large cross country differences

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.

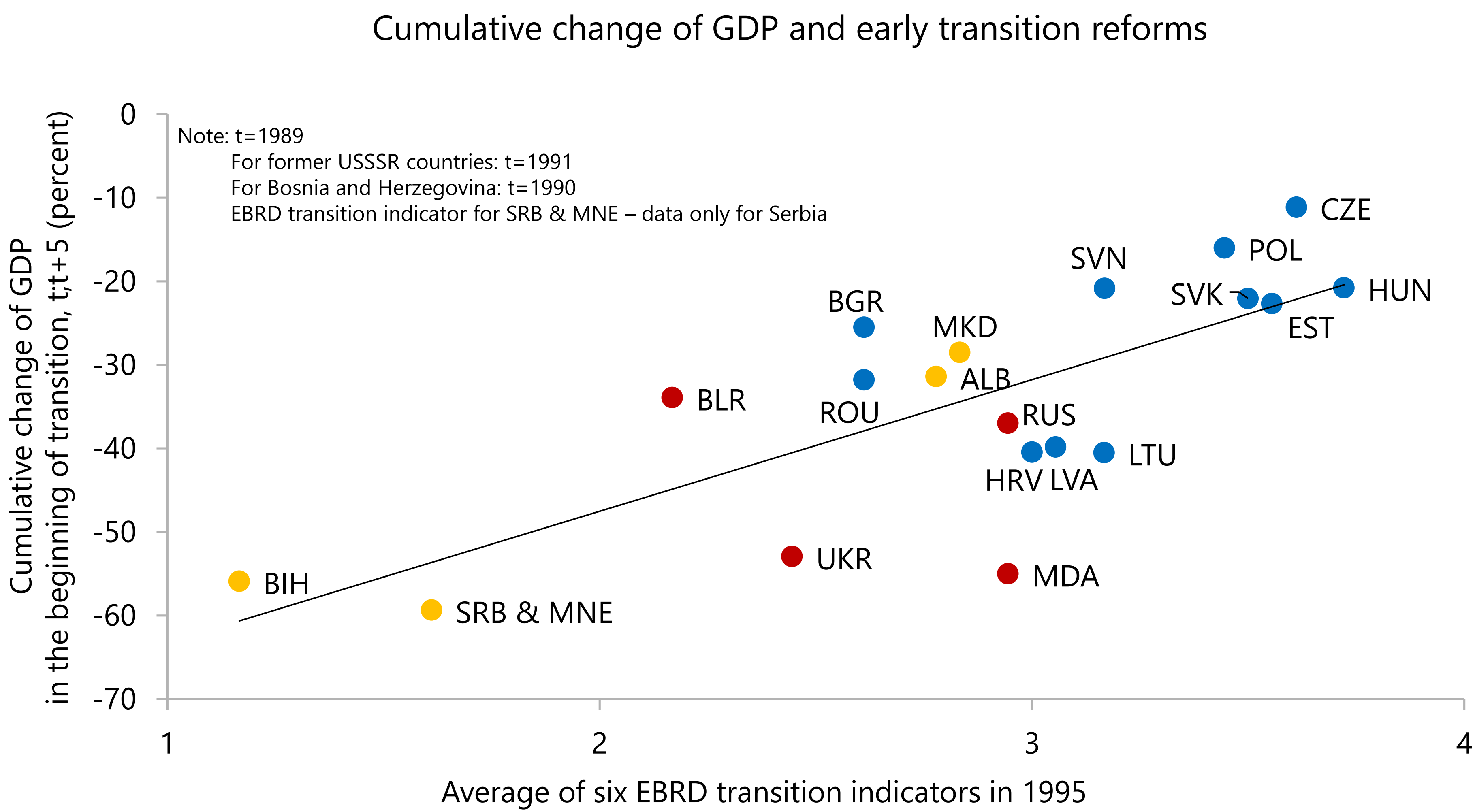


Both progress and cross-country differences can be seen in satellite pictures

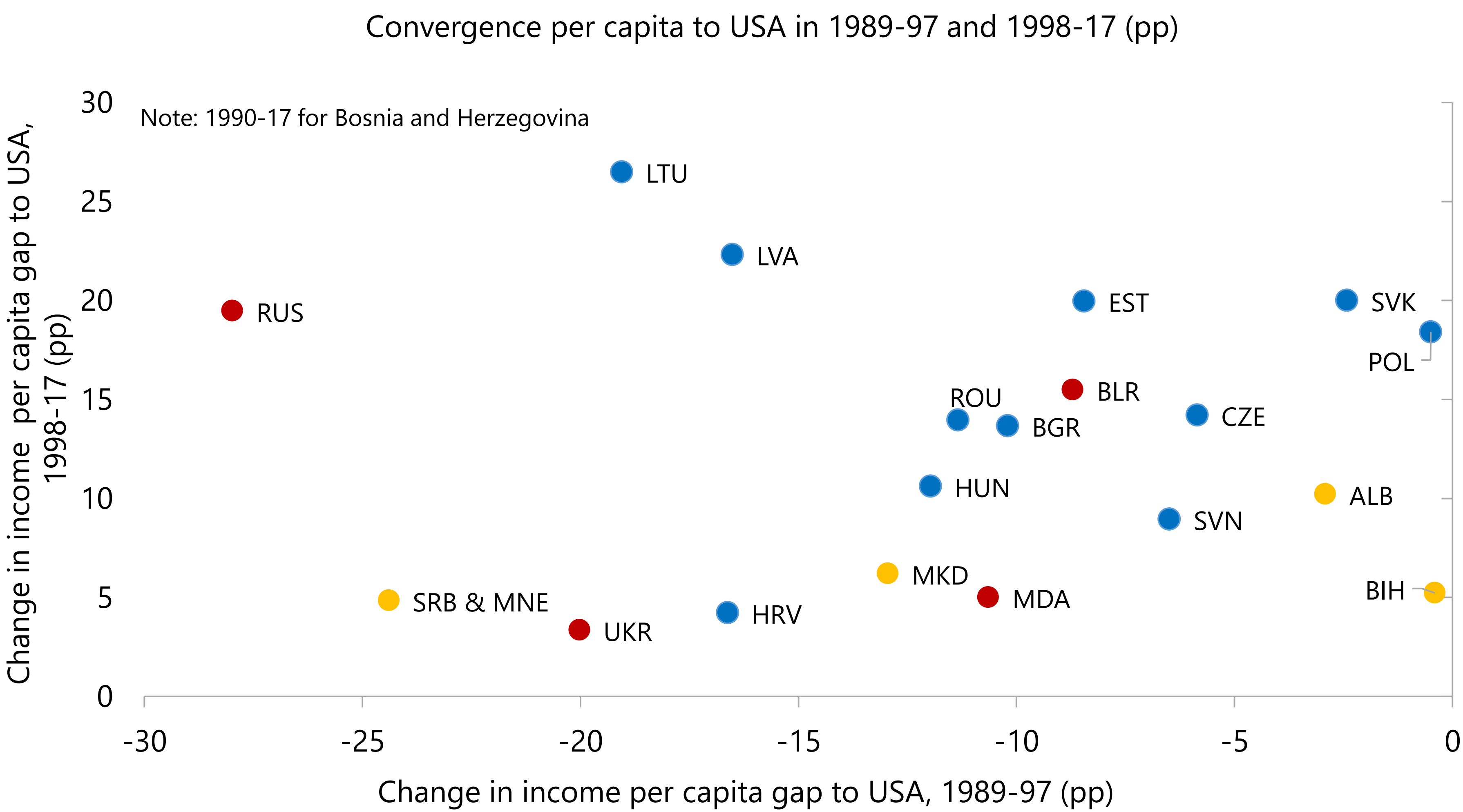
2. Early transition to market economy

- 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

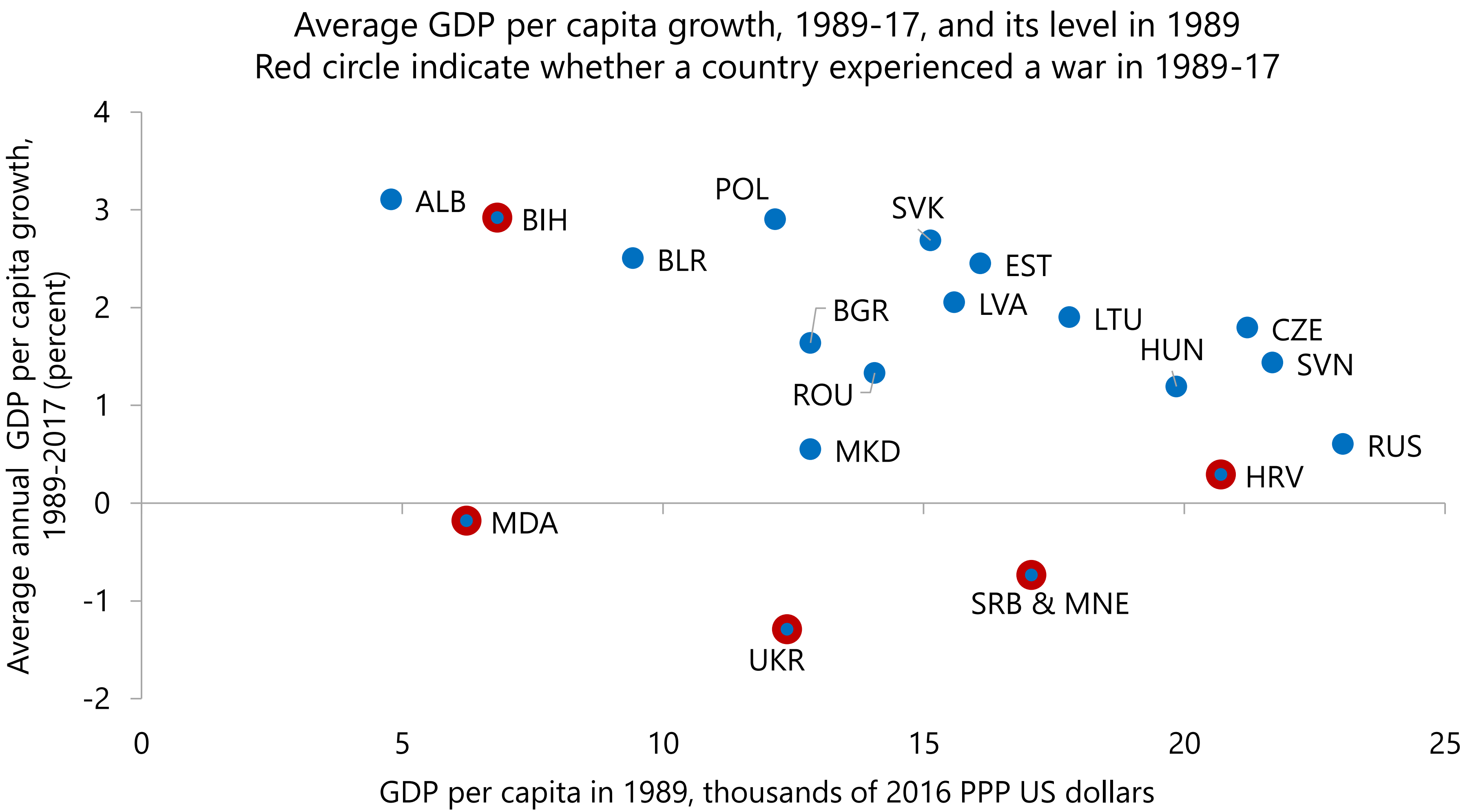
Countries that postponed reforms suffered deeper output losses



Weaker growth in early transition not compensated by faster growth later

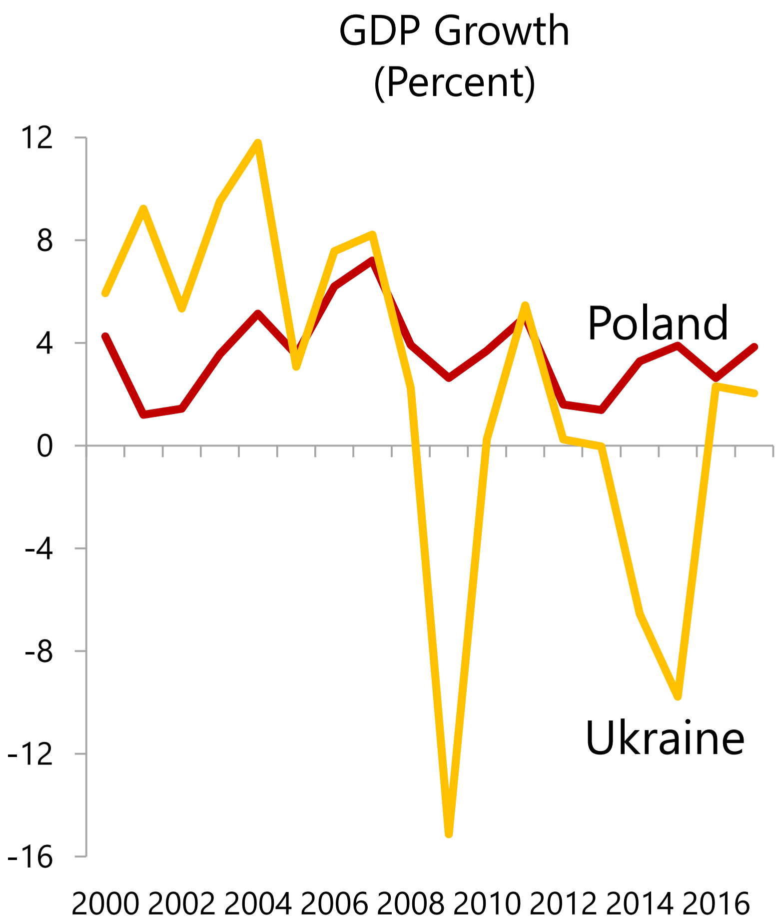


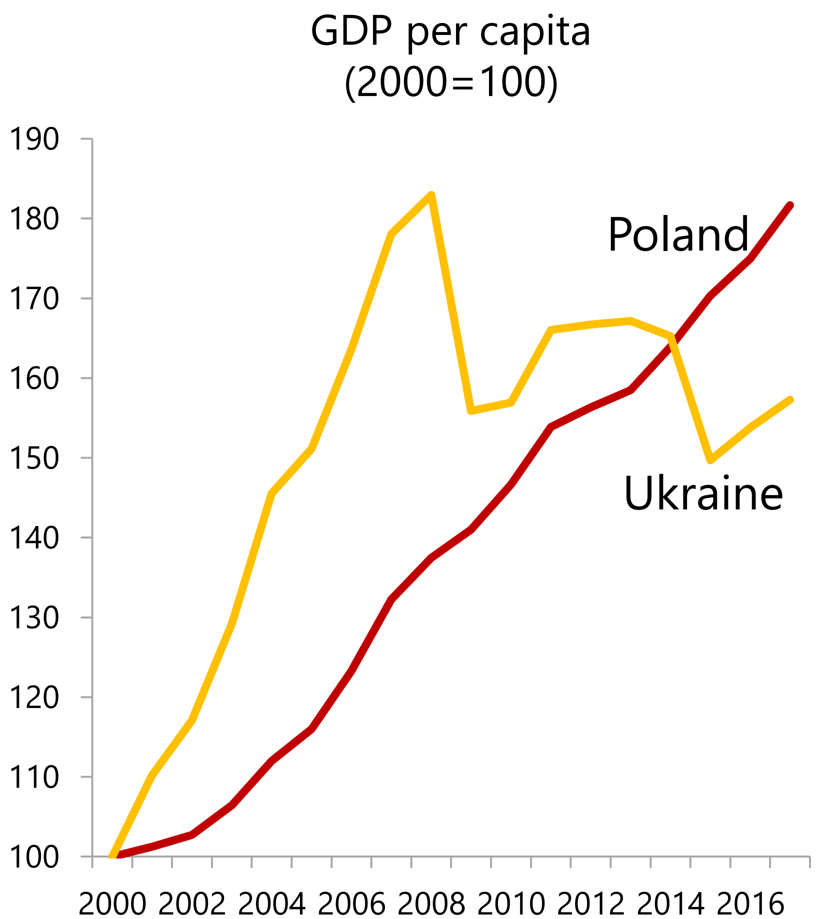
3. Wars and conflicts: the four countries with the lowest growth all had wars



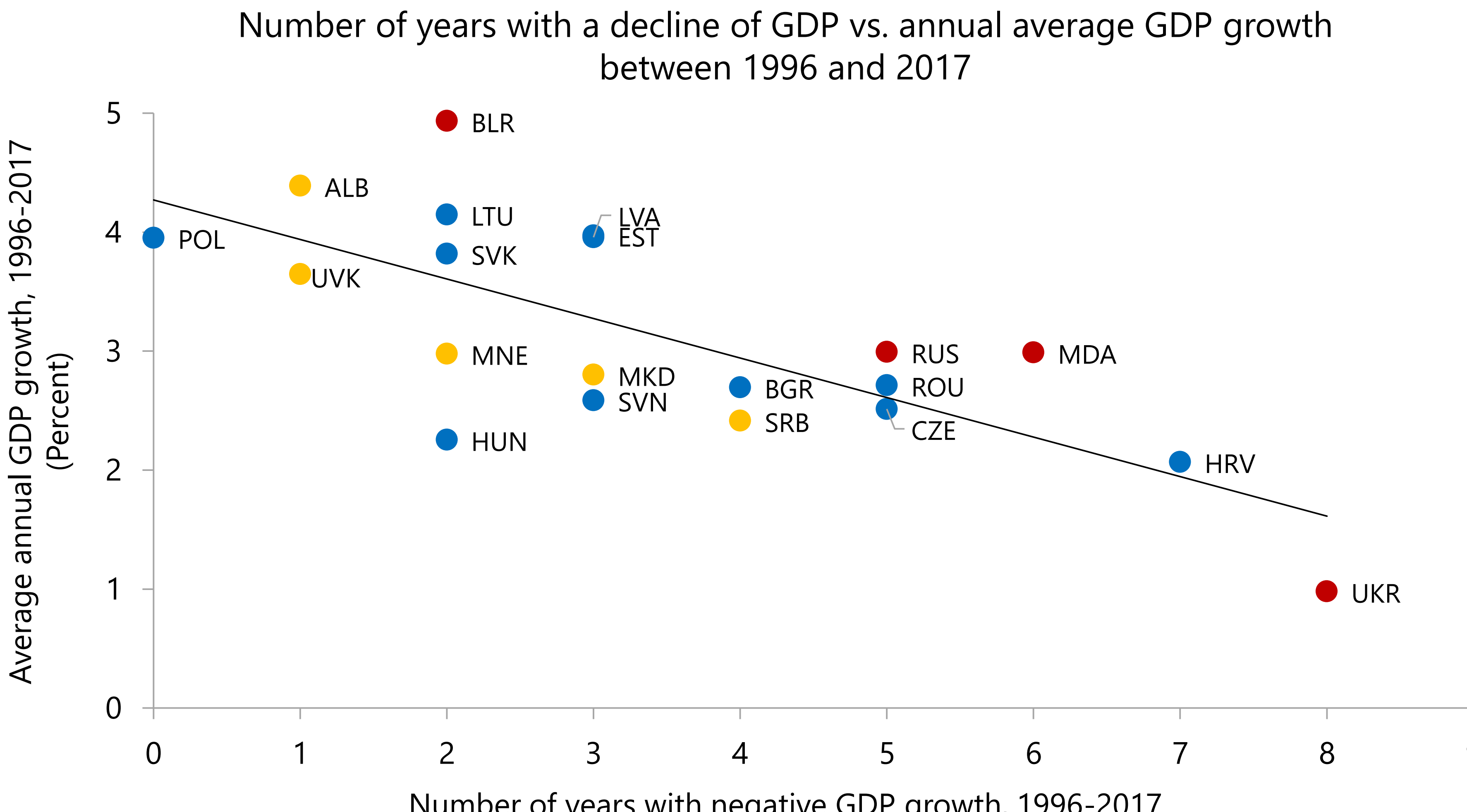
Note: 1999-2017 for BIH.

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



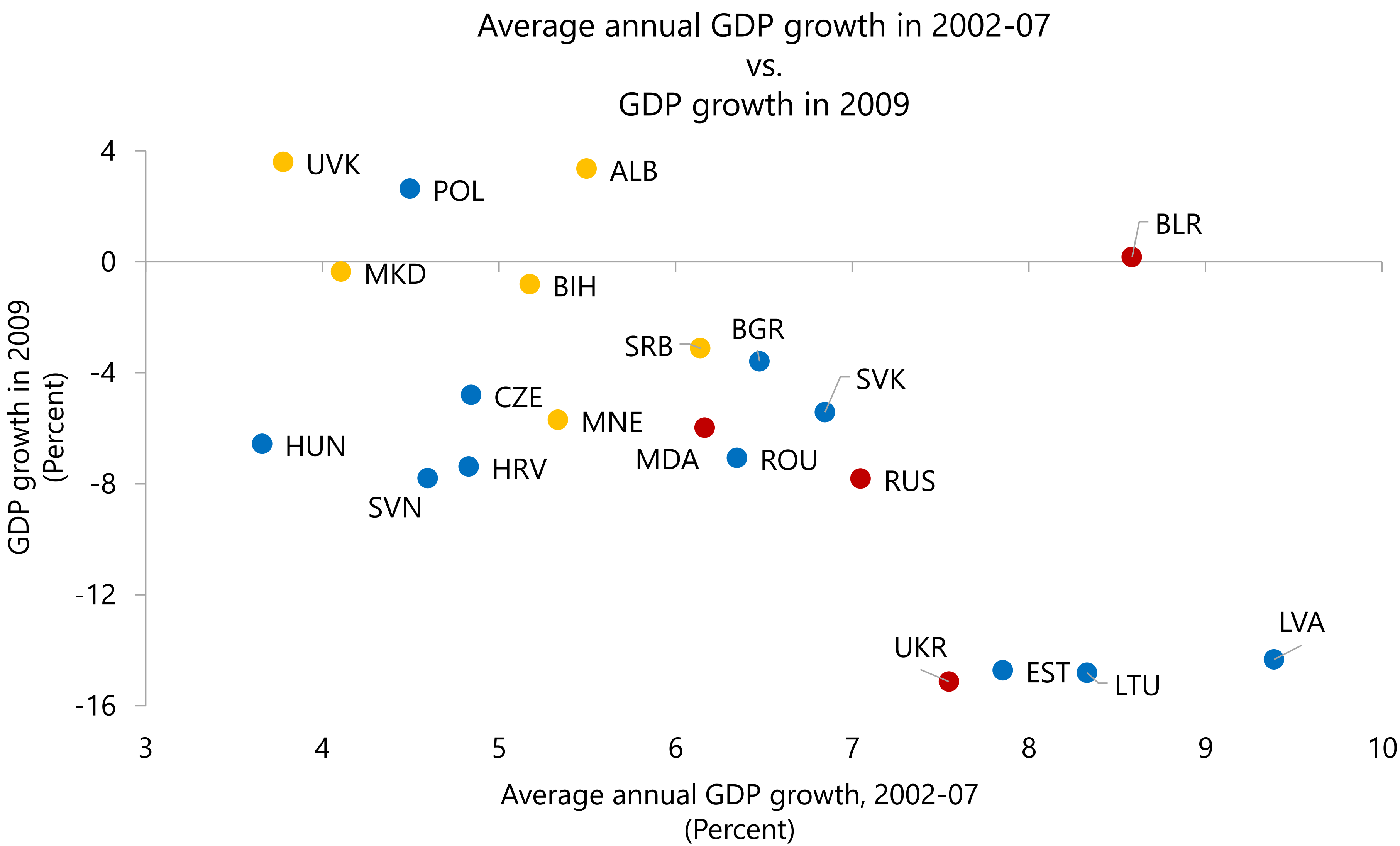


Countries with fewer recessions grew faster on average



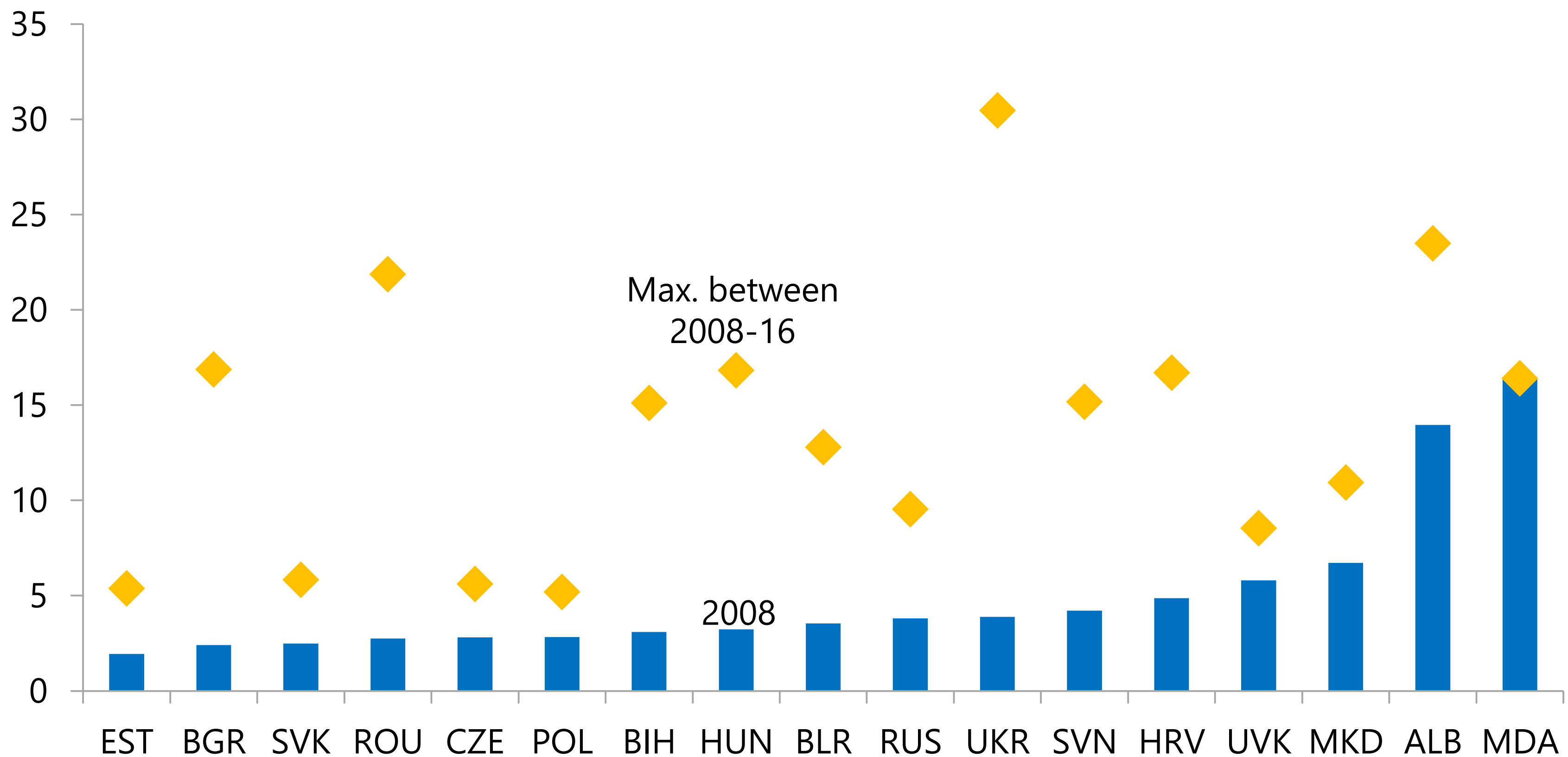
Note: for MNE and UVK: data for 2001-17; for SRB: 1998-2017.

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

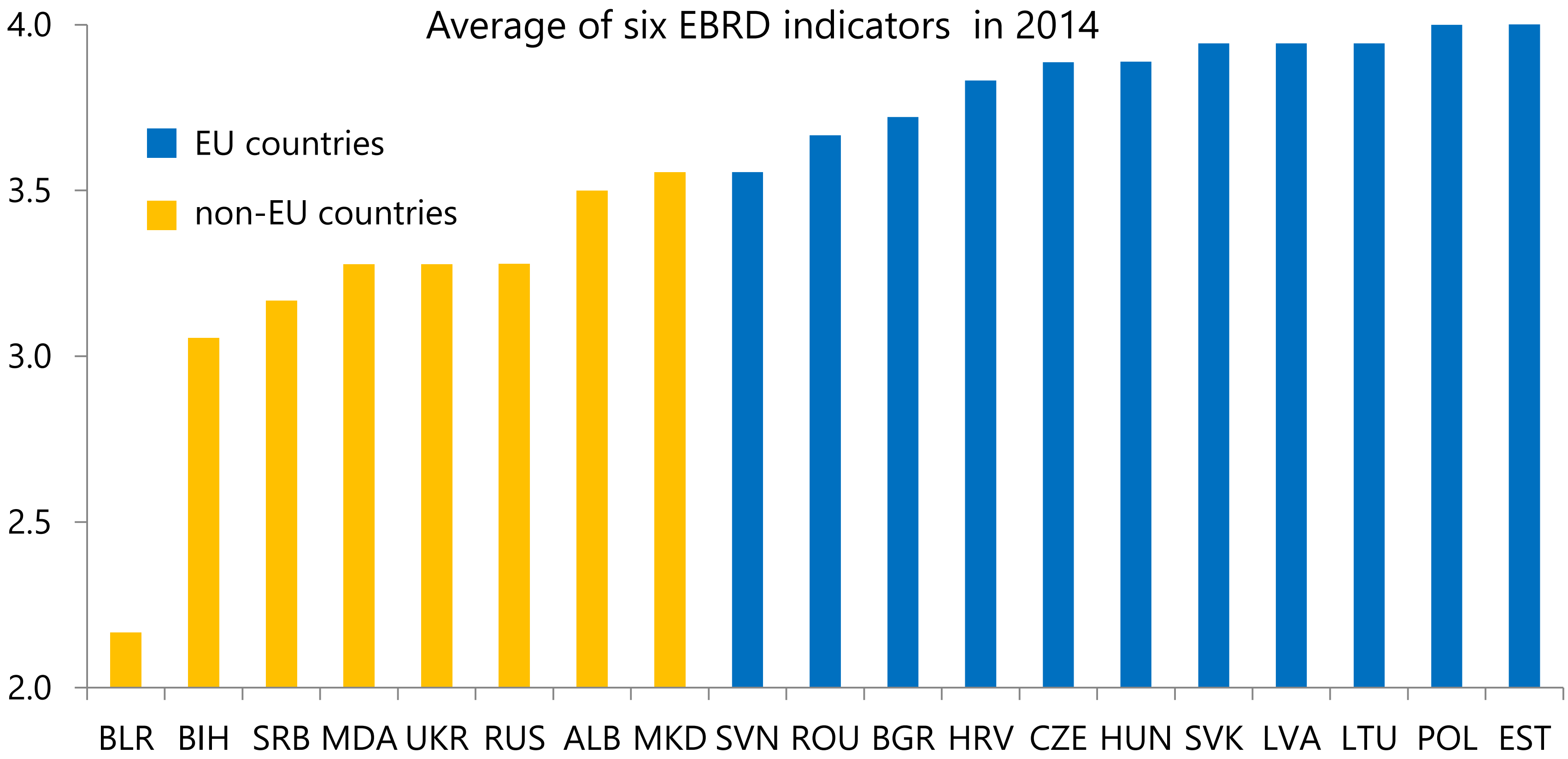
NPL ratio in 2008 and peak value between 2008-16
(Percent)



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

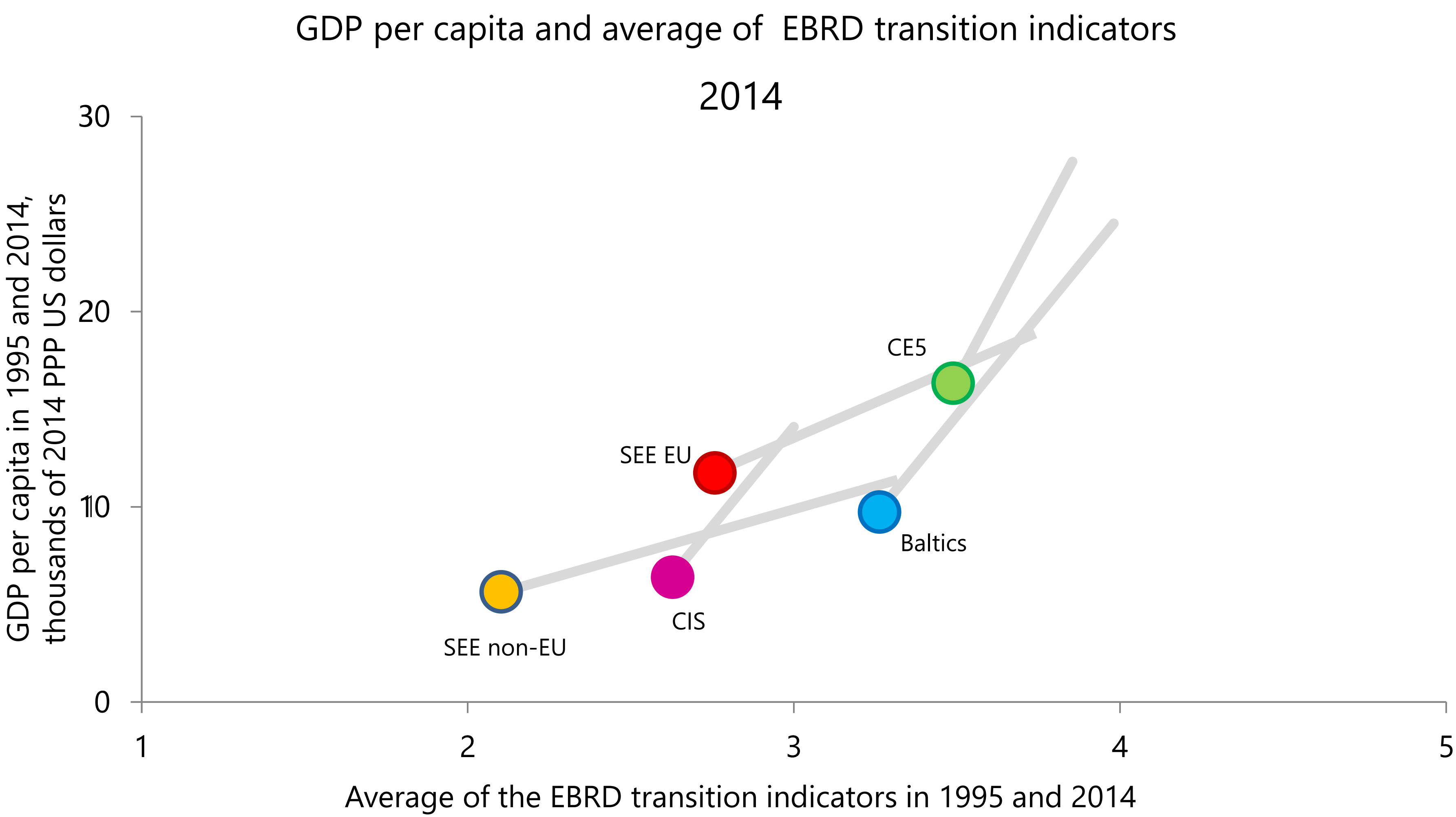
5. EU Membership

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



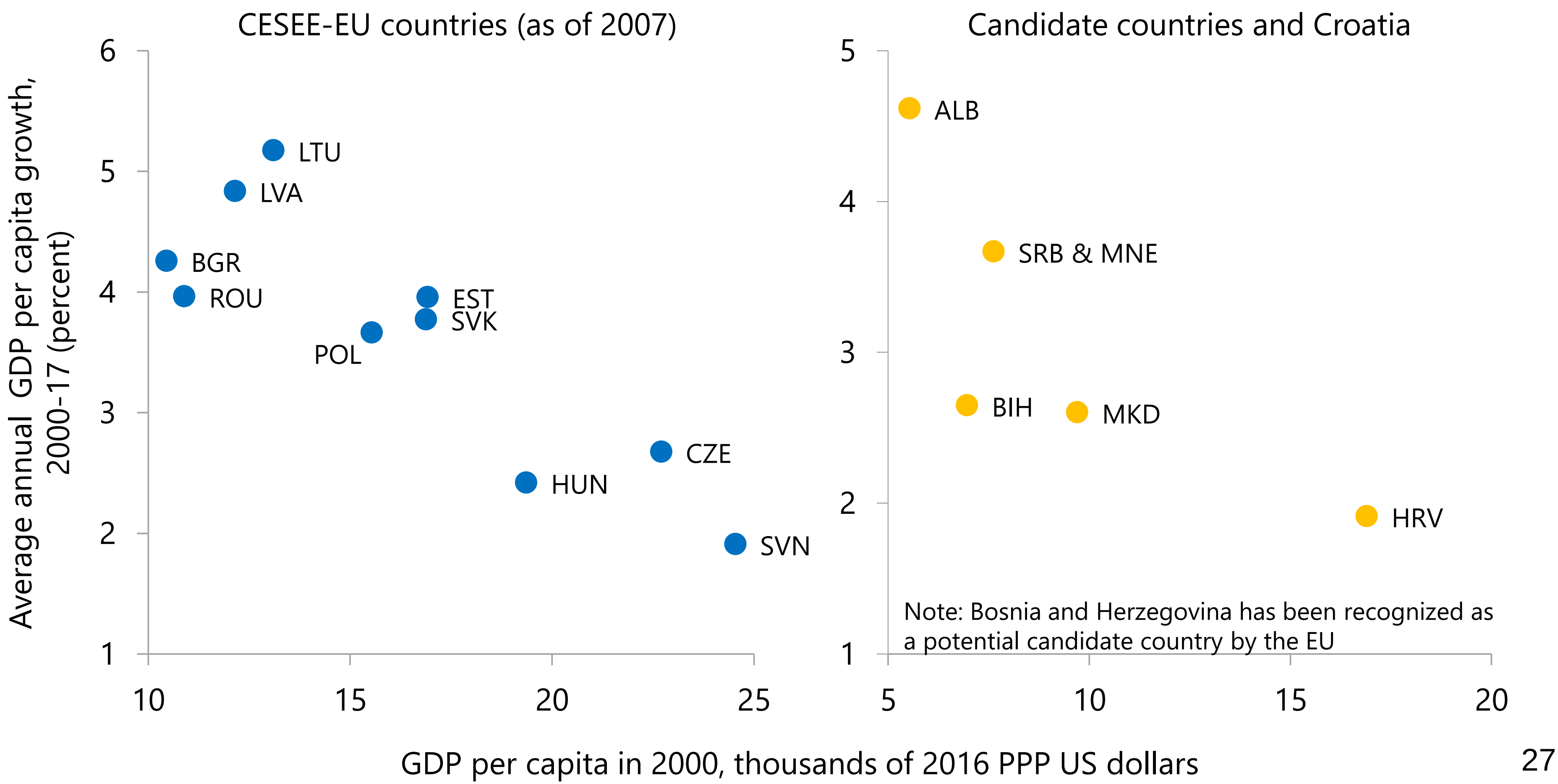
Note: 2007 for Czech Republic

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

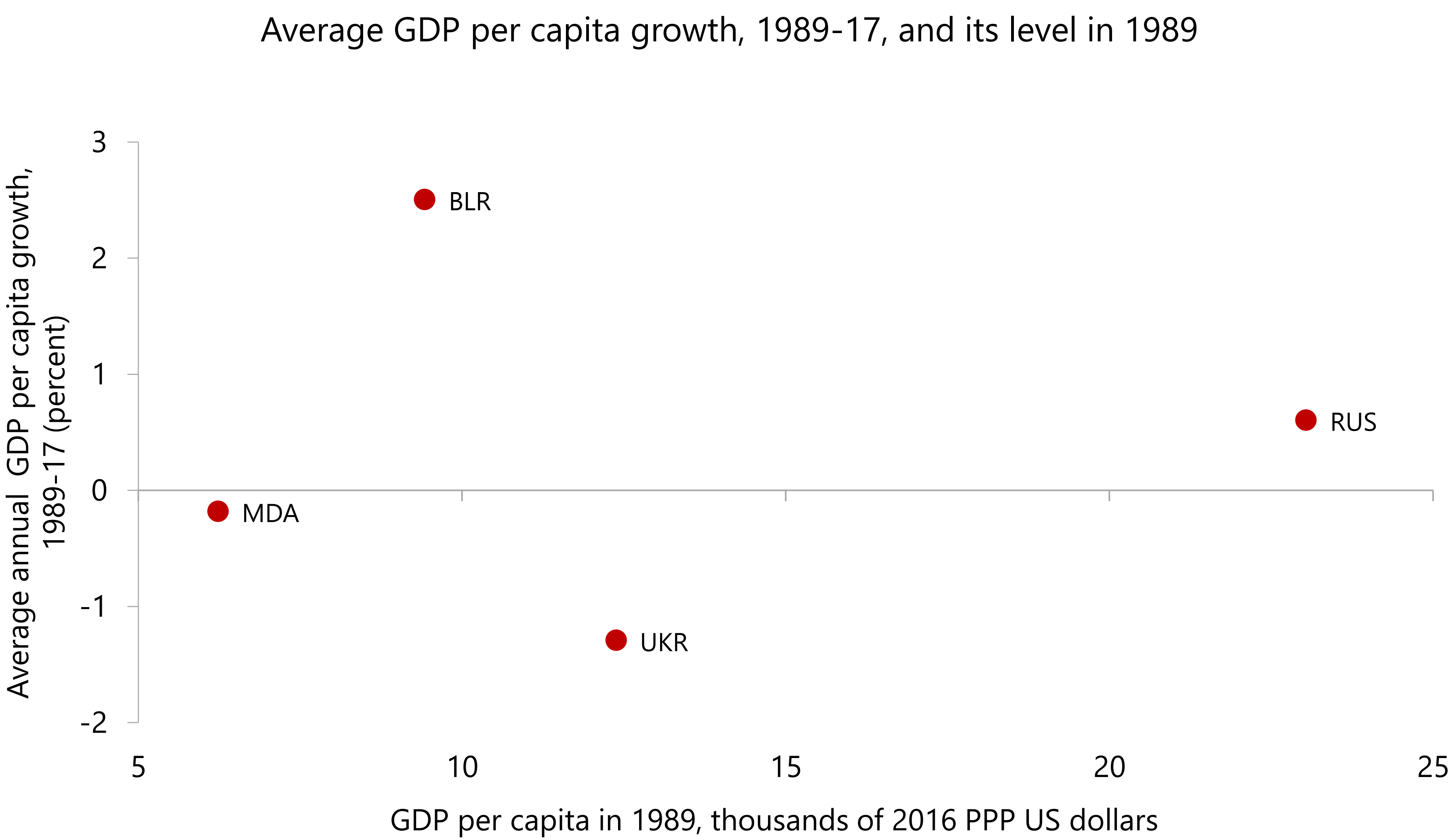


Rapid convergence in EU and EU candidate countries

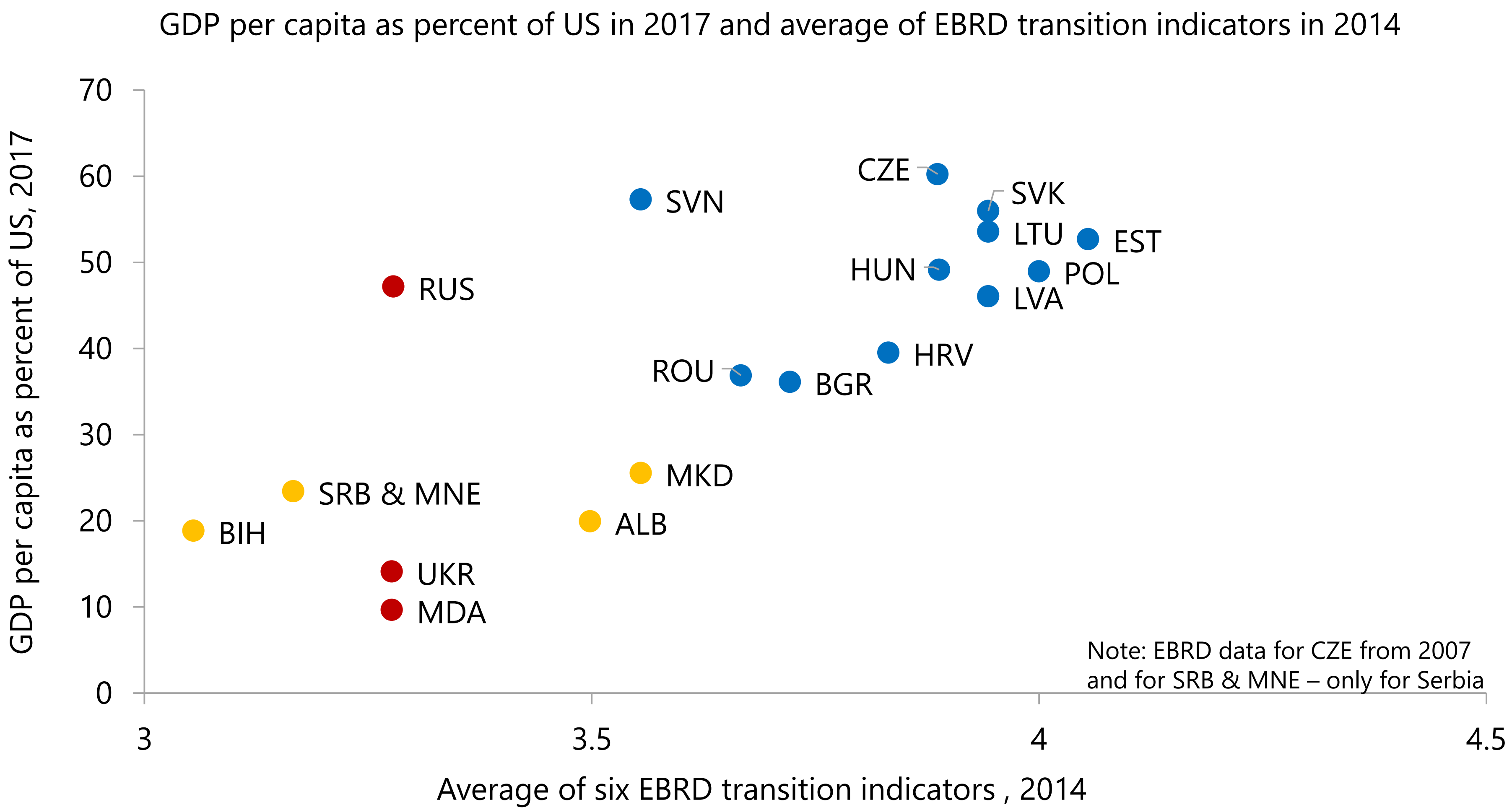
Average GDP per capita growth, 2000-17, and its level in 2000



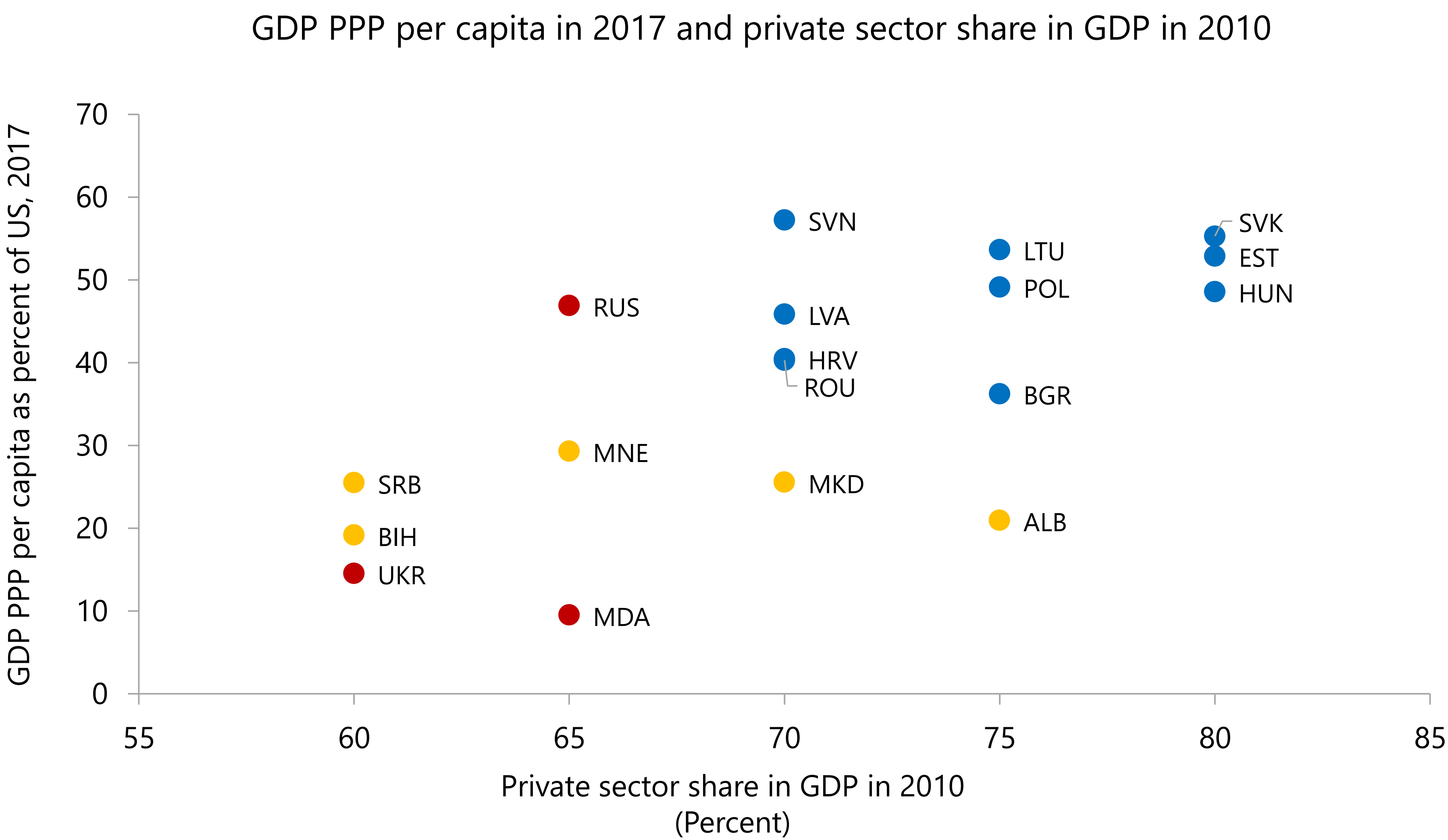
By contrast, no convergence in European CIS



6. Countries that have more completed transition are richer…

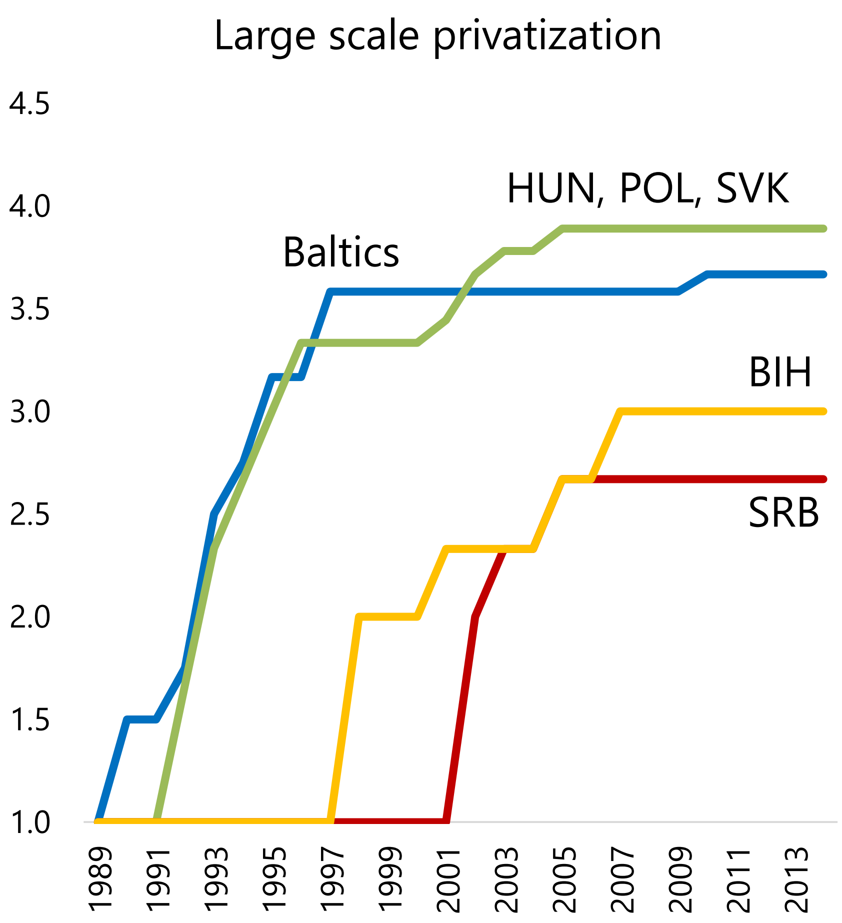


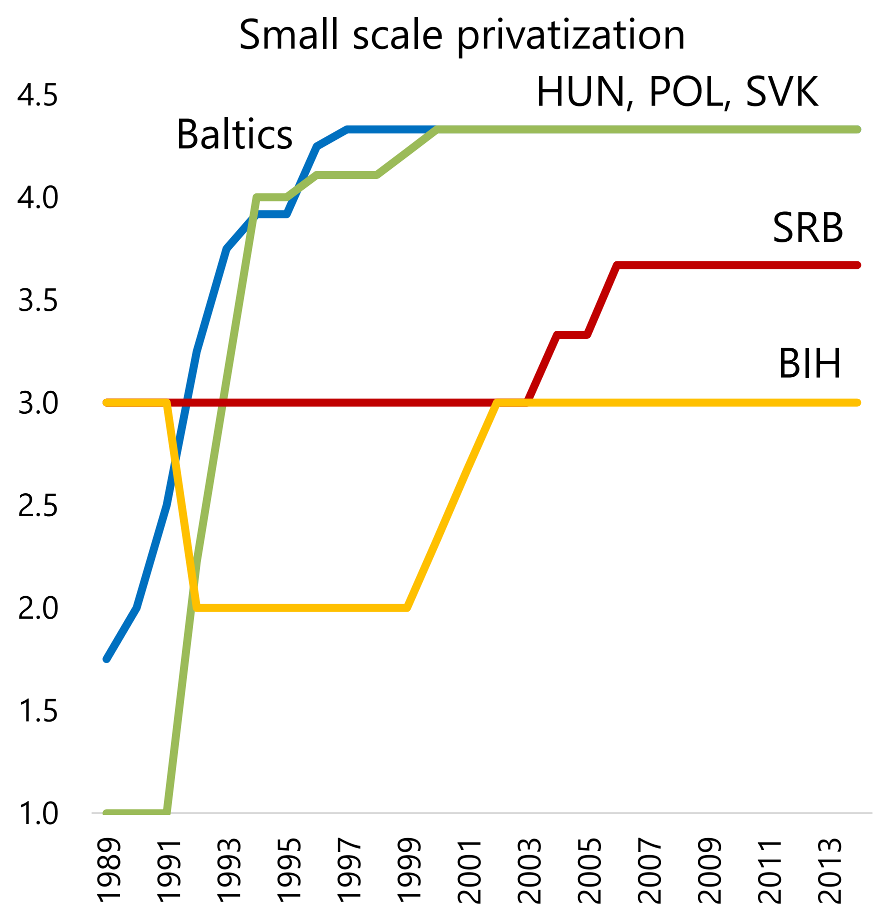
…as do countries where private sector is more vibrant



Limited privatization progres in Bosnia and Herzegovina and in Serbia stalled after the crisis

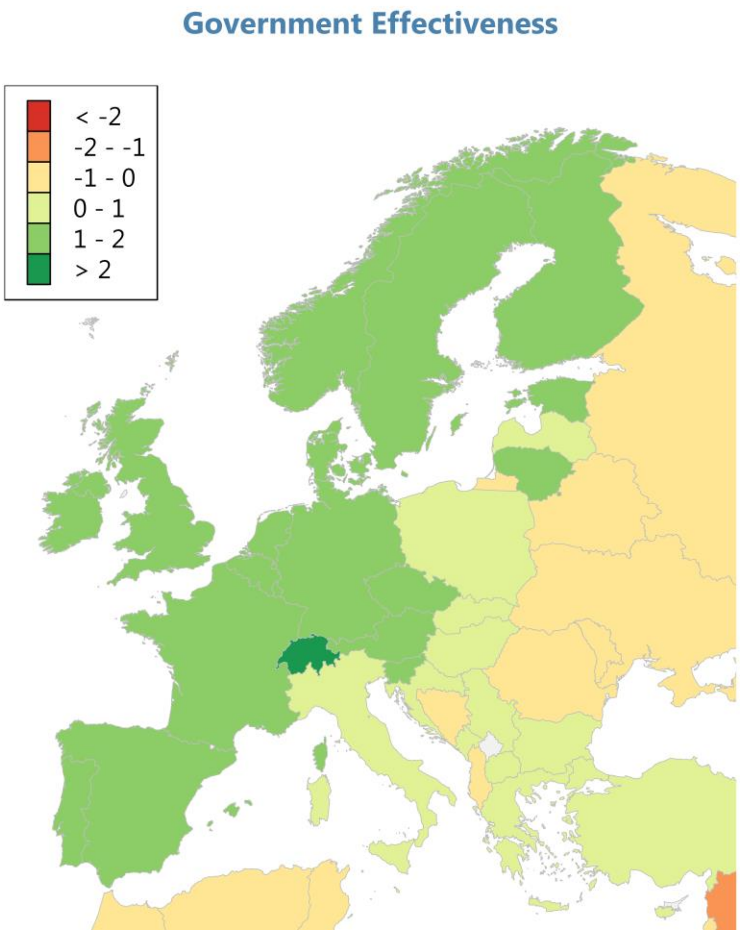
EBRD Transition Indicators

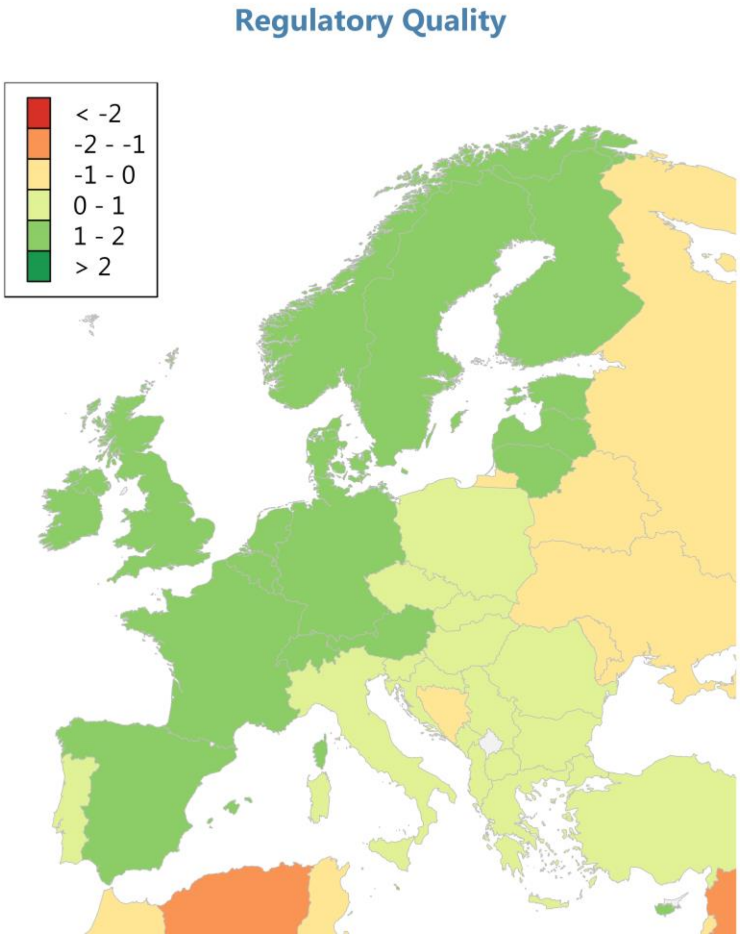




7. CESEE countries differ in the quality of institutions, e.g. in governance….

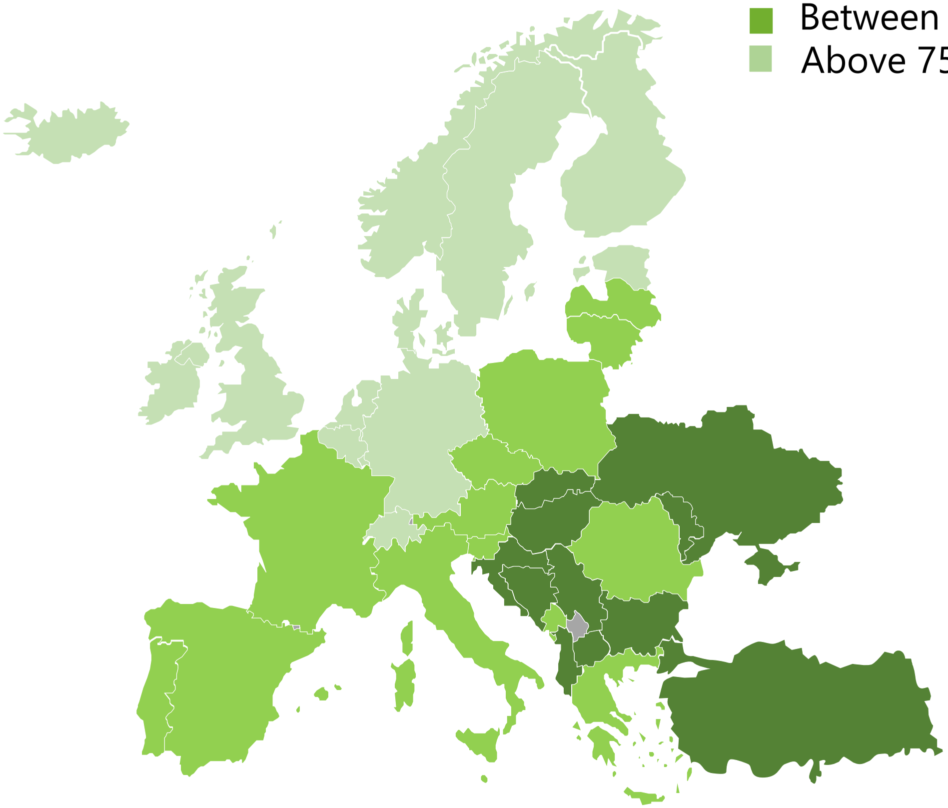
Worldwide Governance Indicators, 2016
(Ranges from -2.5 (weak) to 2.5 (strong) governance performance)



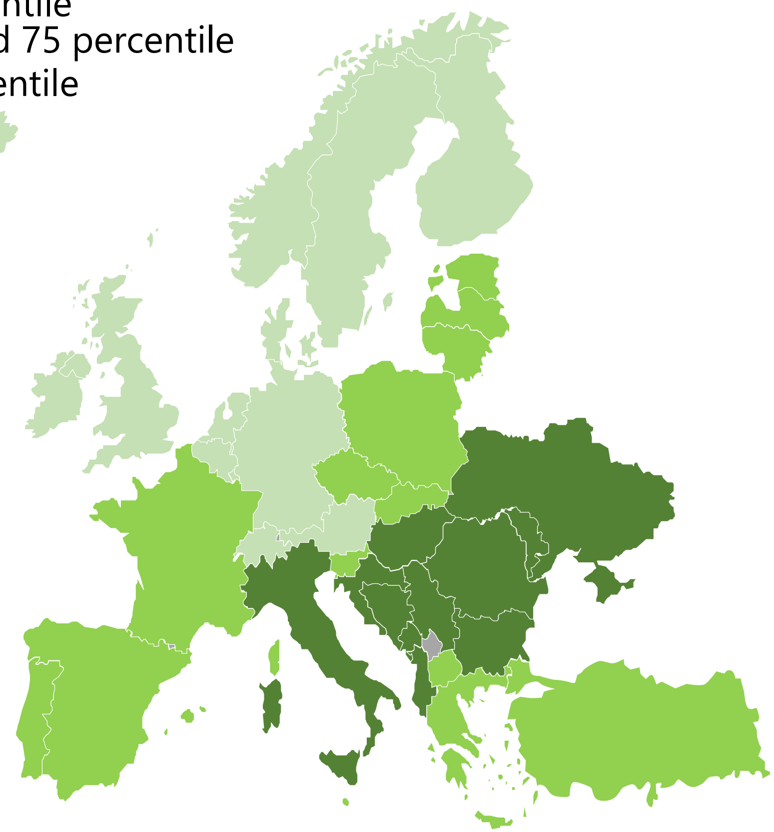


...and the judiciary.

Judicial Independence, 2015



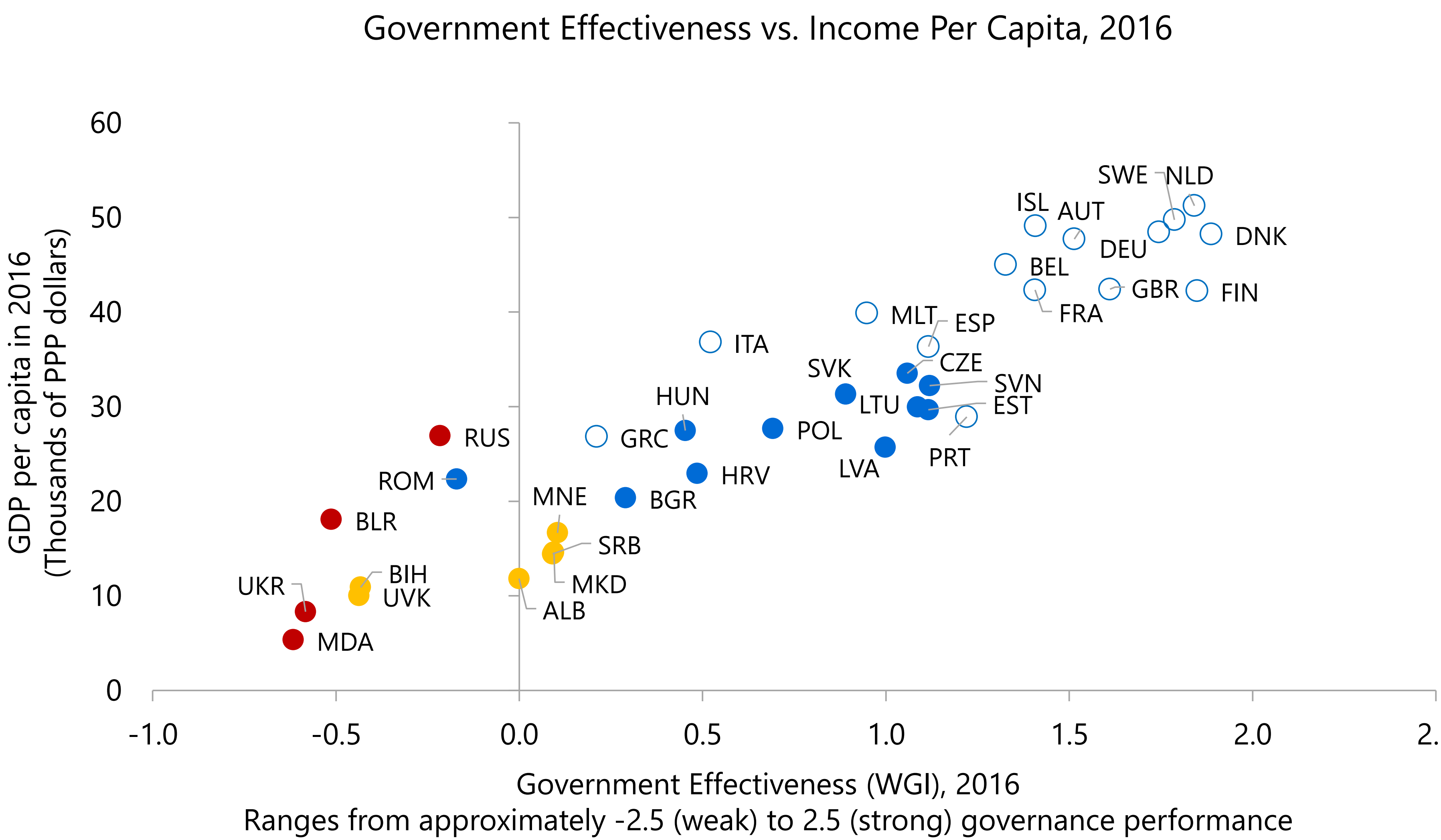
Impartial Courts, 2015



- 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)



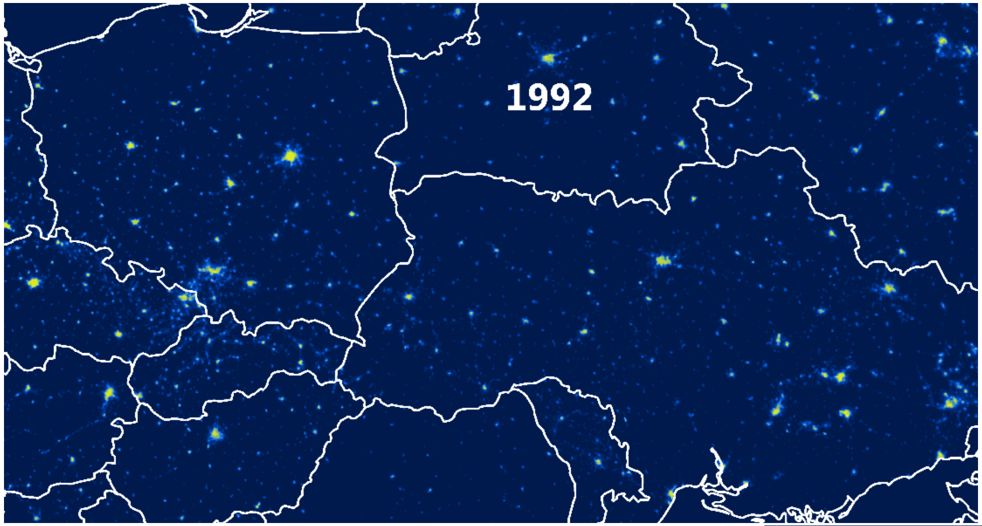
COUNTRY CASES

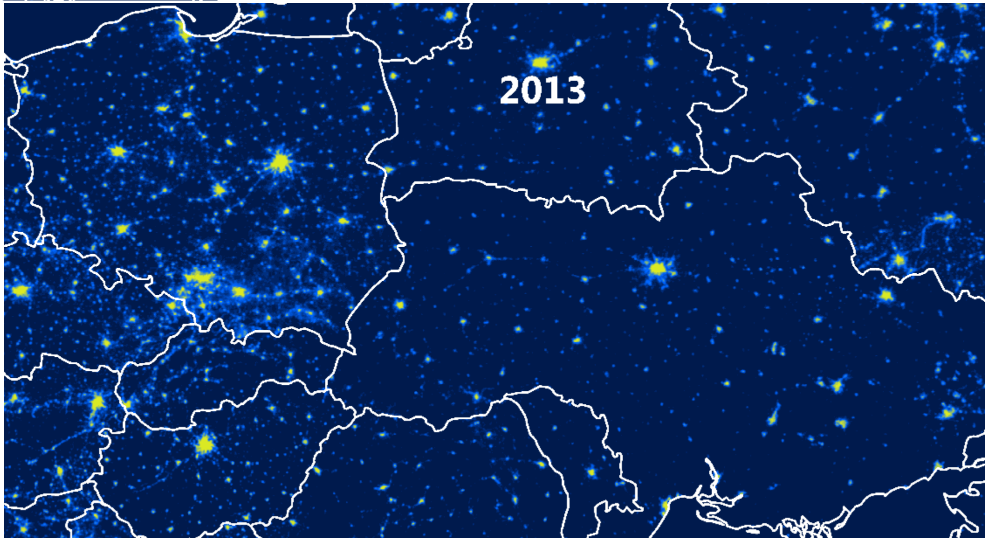
8. Country case (a) Poland vs Ukraine

- 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

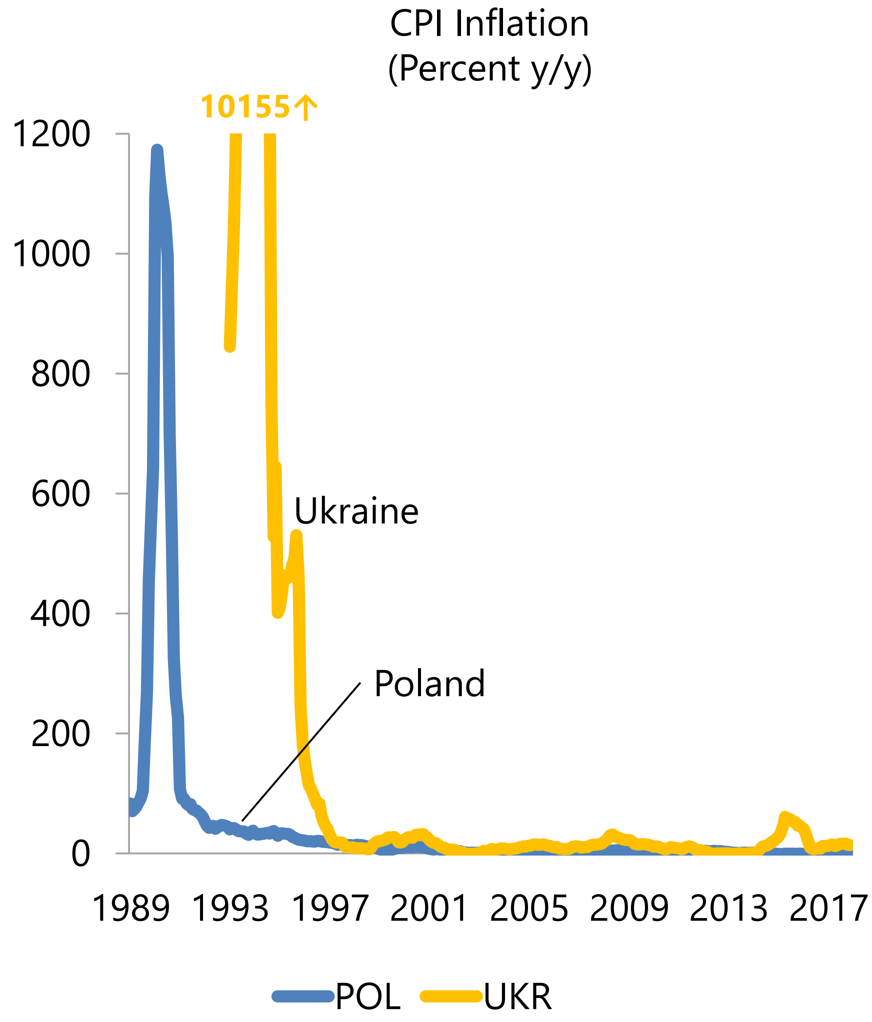
Difference is clearly visible on satellite pictures.

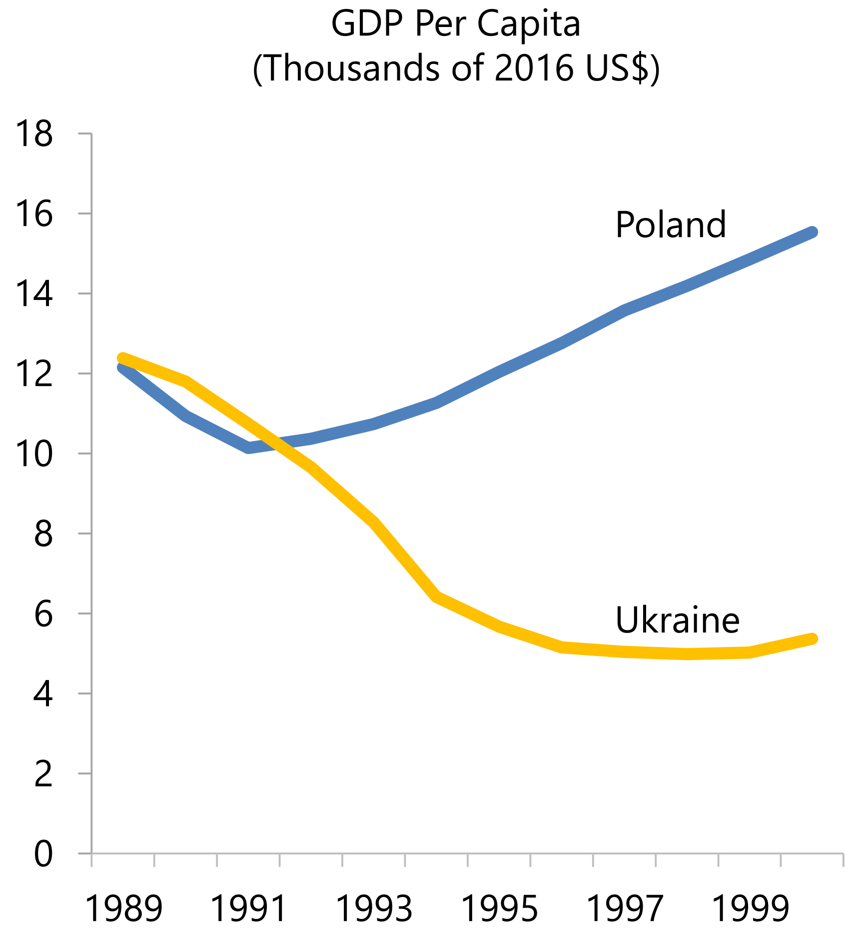
Nightlights intensity



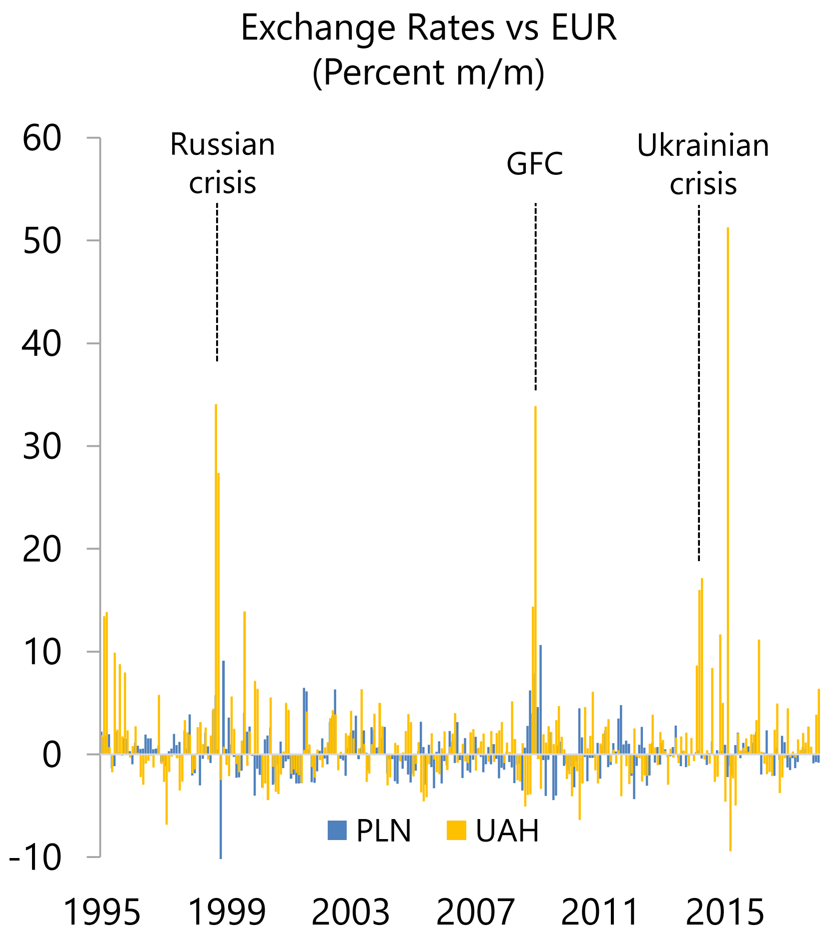


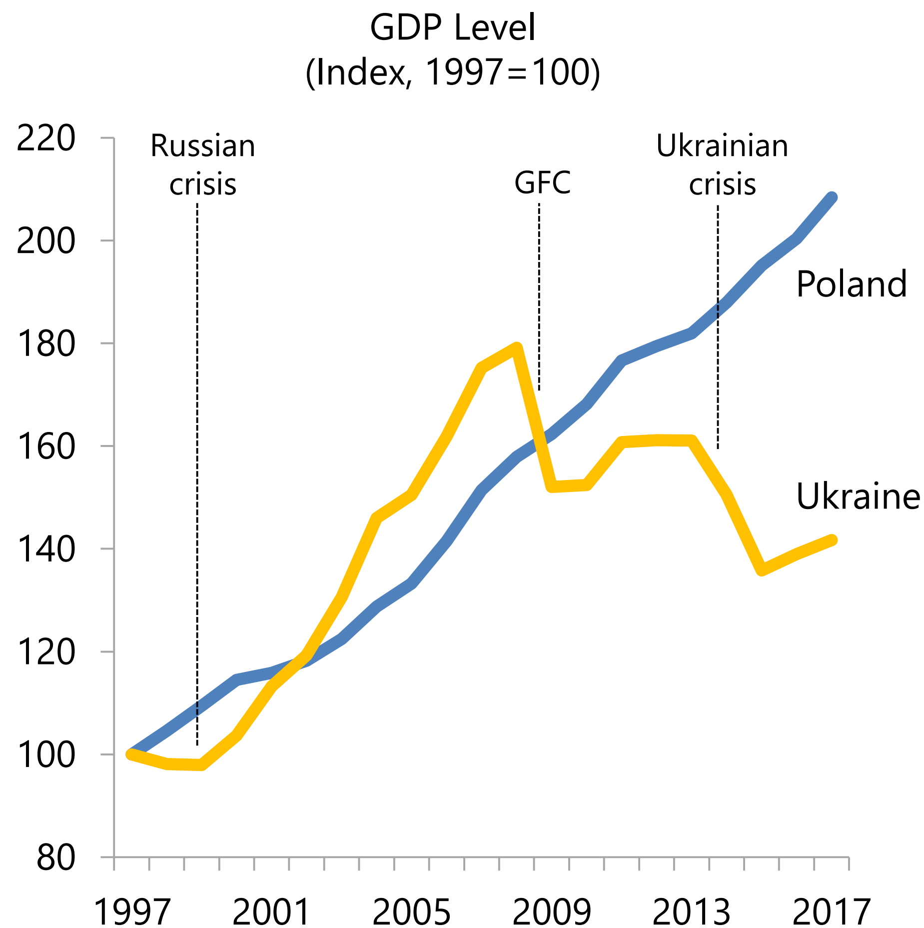
Macro-stabilization occurred much earlier in Poland.



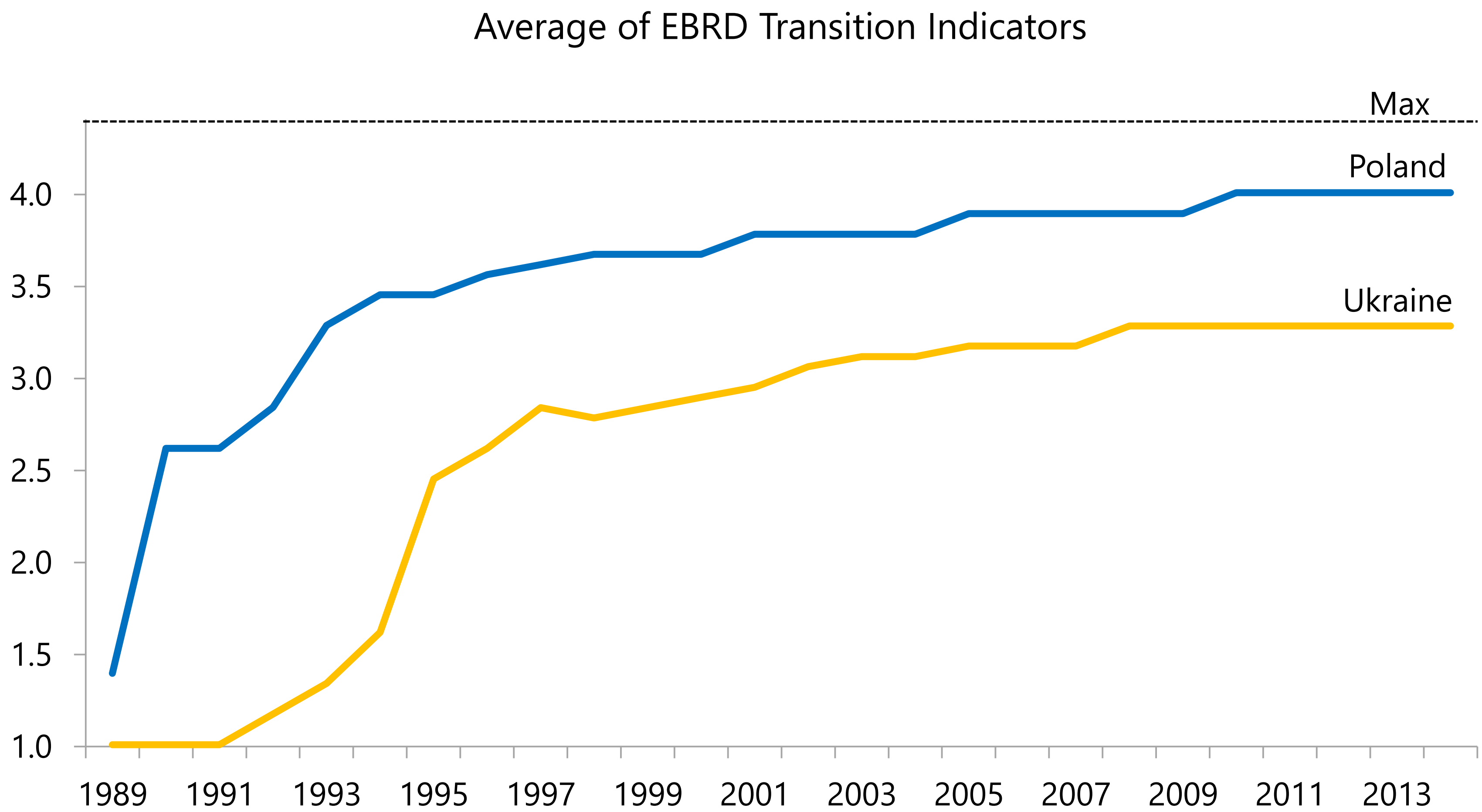


Poland has not had any crisis; Ukraine has had three



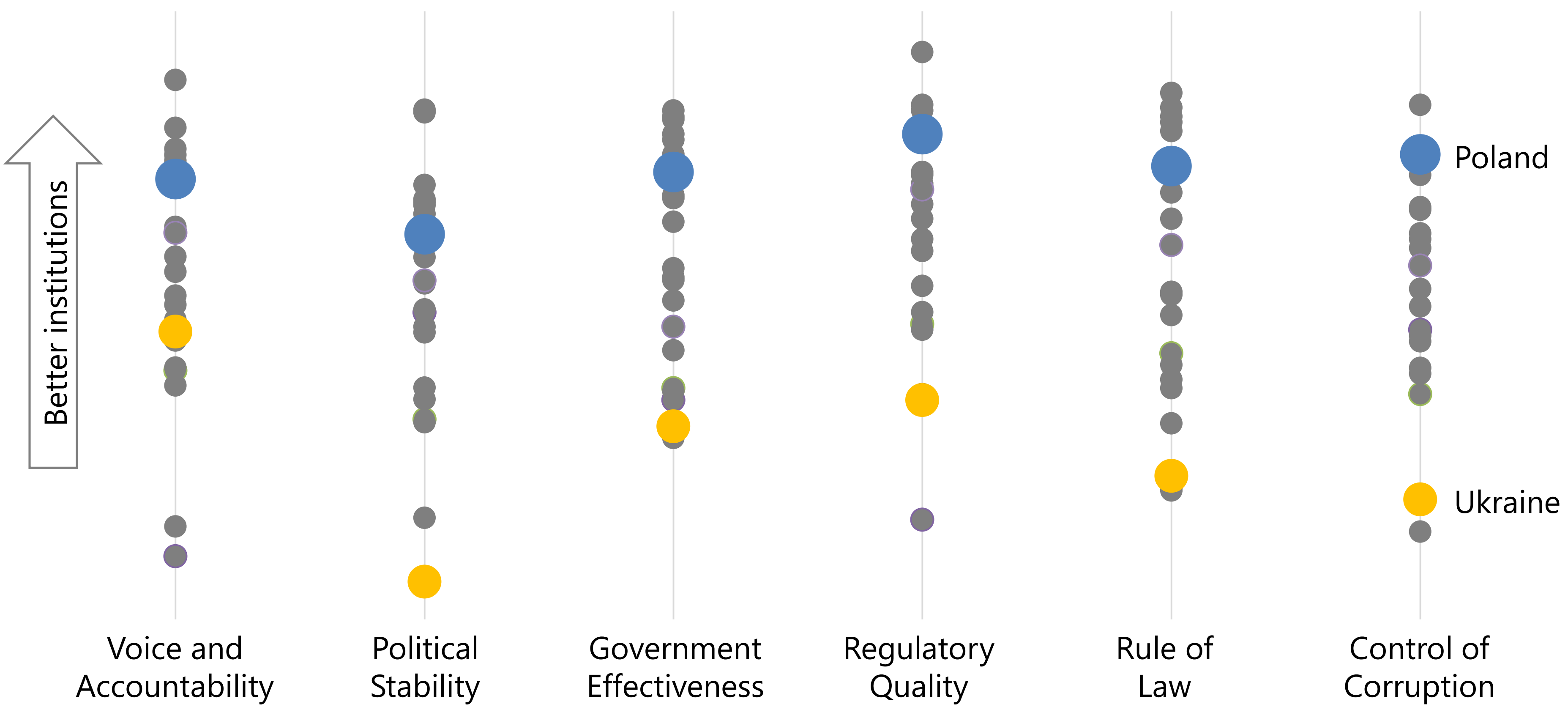


Poland reformed earlier and deeper



Poland has much better institutions

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



CONCLUSION

Why have some countries done better than others?

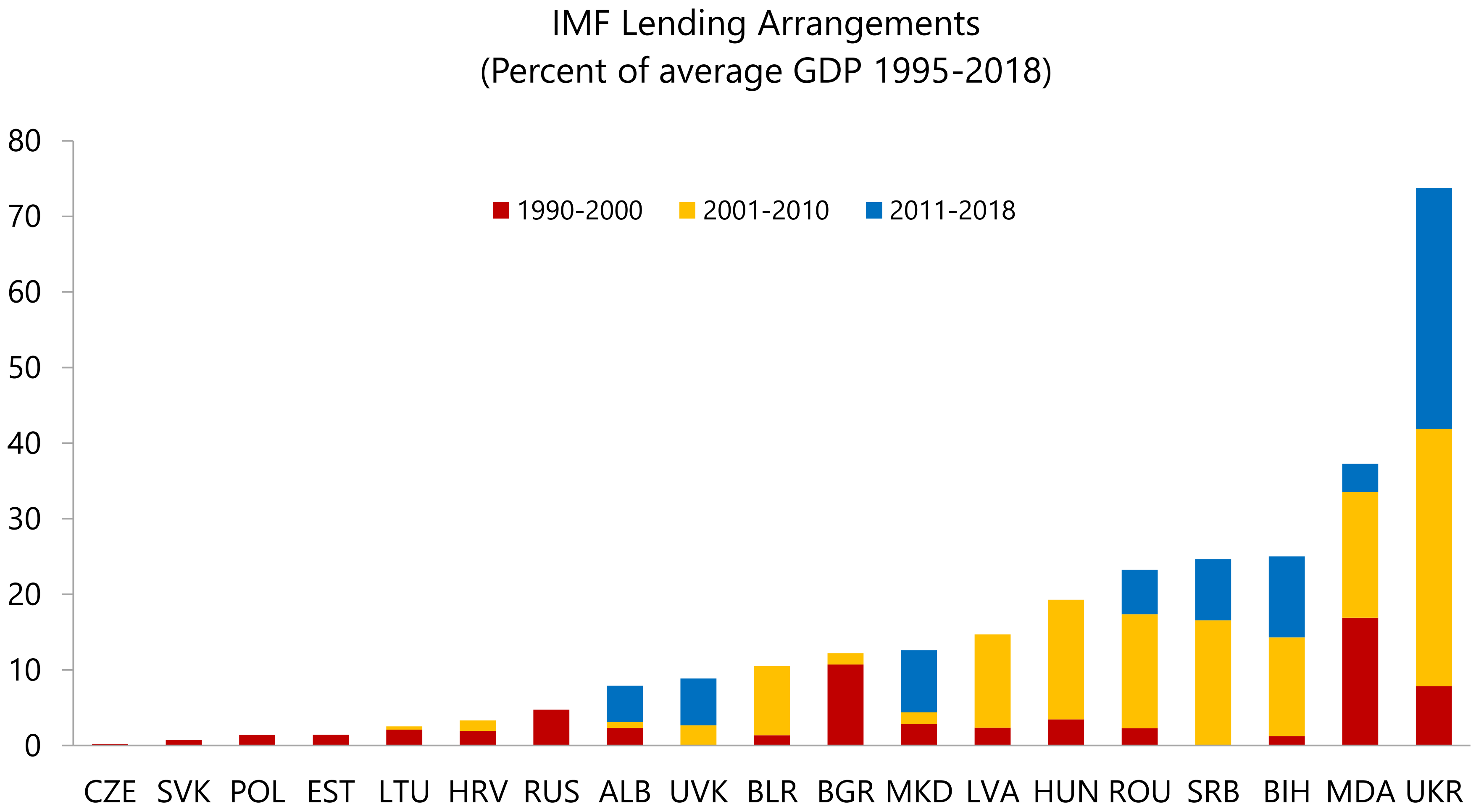
- Part of it is good luck
  - No wars
  - EU membership (due to geographical location)

- But policies also played a role

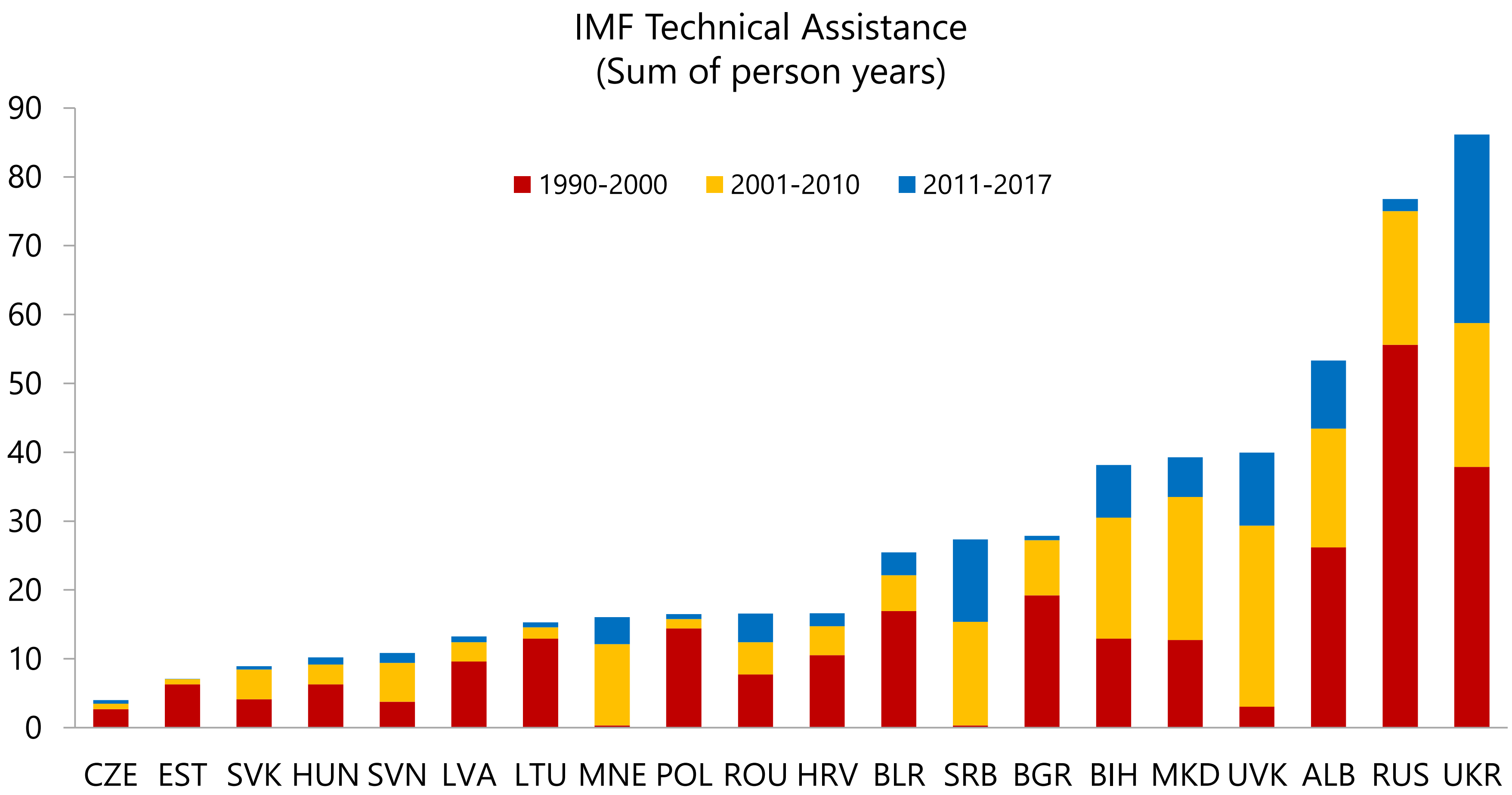
Good policies help

- 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…



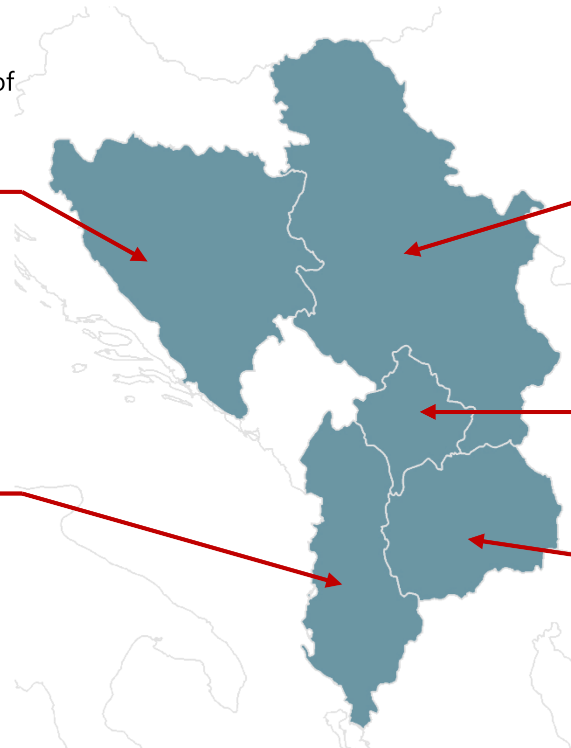
...and with technical assistance.



Western Balkans have long history of IMF-sponsored programs

IMF Lending Arrangements in Western Balkans, 1990-2018

Facility	Years	Amount (millions of 2018 USD)	In percent of GDP
Bosnia and Herzegovina			
EFF	2016-2020	641.2	**3.6**
SBA	2012-2015	942.1	**5**
SBA	2009-2012	1813.4	**8.9**
SBA	2002-2004	119.4	**1.3**
SBA	1998-2001	188.4	**2.4**
Albania			
EFF	2014-2017	478.5	**3.4**
ECF/EFF	2006-2009	15.3	**0.1**
ECF	2002-2005	49.4	**0.8**
ECF	1998-2001	89.9	**2.4**
ECF	1993-1996	95	**4**
SBA	1992-1993	46.3	**3.3**



Facility	Years	Amount (millions of 2018 USD)	In percent of GDP
Serbia:			
SBA	2015 - 2018	1379.4	**3.5**
SBA	2011 - 2013	1658.3	**3.2**
SBA	2009 - 2011	4681.0	**9.5**
EFF	2002 - 2006	1147.9	**5.2**
SBA	2001 - 2002	352.6	**2.1**
Kosovo:			
SBA	2015 - 2017	217.5	**3.2**
SBA	2012 - 2013	153.6	**2.1**
SBA	2010 - 2012	161.9	**2.4**
Macedonia:			
PCL	2011 - 2013	732.9	**6.1**
SBA	2005 - 2008	96.2	**1.2**
SBA	2003 - 2004	37.5	**0.6**
ECF	2000 - 2001	19.3	**0.4**
EFF	2000 - 2001	45.0	**0.8**
ECF	1997 - 2000	111.6	**1.9**
SBA	1995 - 1996	52.1	**0.7**
STF	1994 - 1994	27.9	**0.5**

EFF - Extended Fund Facility
ECF - Extended Credit Facility
SBA - Standby Arrangement
STF - Systemic Transformation Facility
PCL - Precautionary and Liquidity Line

Thank you