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 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

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

GDP per capita growth in 1996-2017 (Percent)

GDP PPP per capita in 1996 (thousands of 2011 USD)

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

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 and early transition reforms

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.
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 (Percent)

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

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

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

GDP per capita in 1989, thousands of 2016 PPP US dollars

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

Government Effectiveness

Regulatory Quality
...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.
Poland reformed earlier and deeper

Average of EBRD Transition Indicators

Poland

Ukraine

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

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The map highlights the lending arrangements in various countries, with arrows indicating the years and amounts involved.
Thank you