

Central,
Eastern and
Southeastern Europe

Convergence: ARE WE THERE YET?



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IMF – Croatian National Bank
Conference
Dubrovnik, 11 July 2017





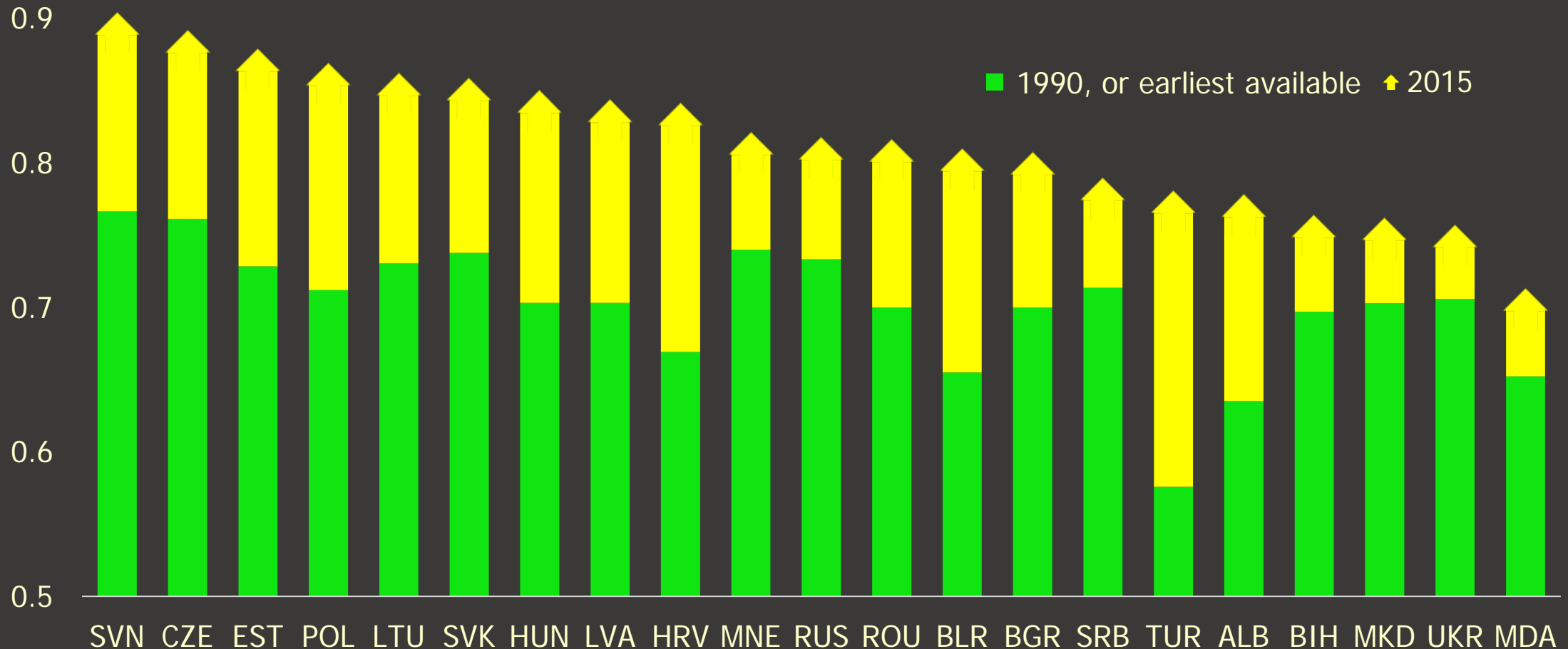
1990s



NOW

Substantial progress has been made since 1990

Human Development Index
(Index, 0 to 1)

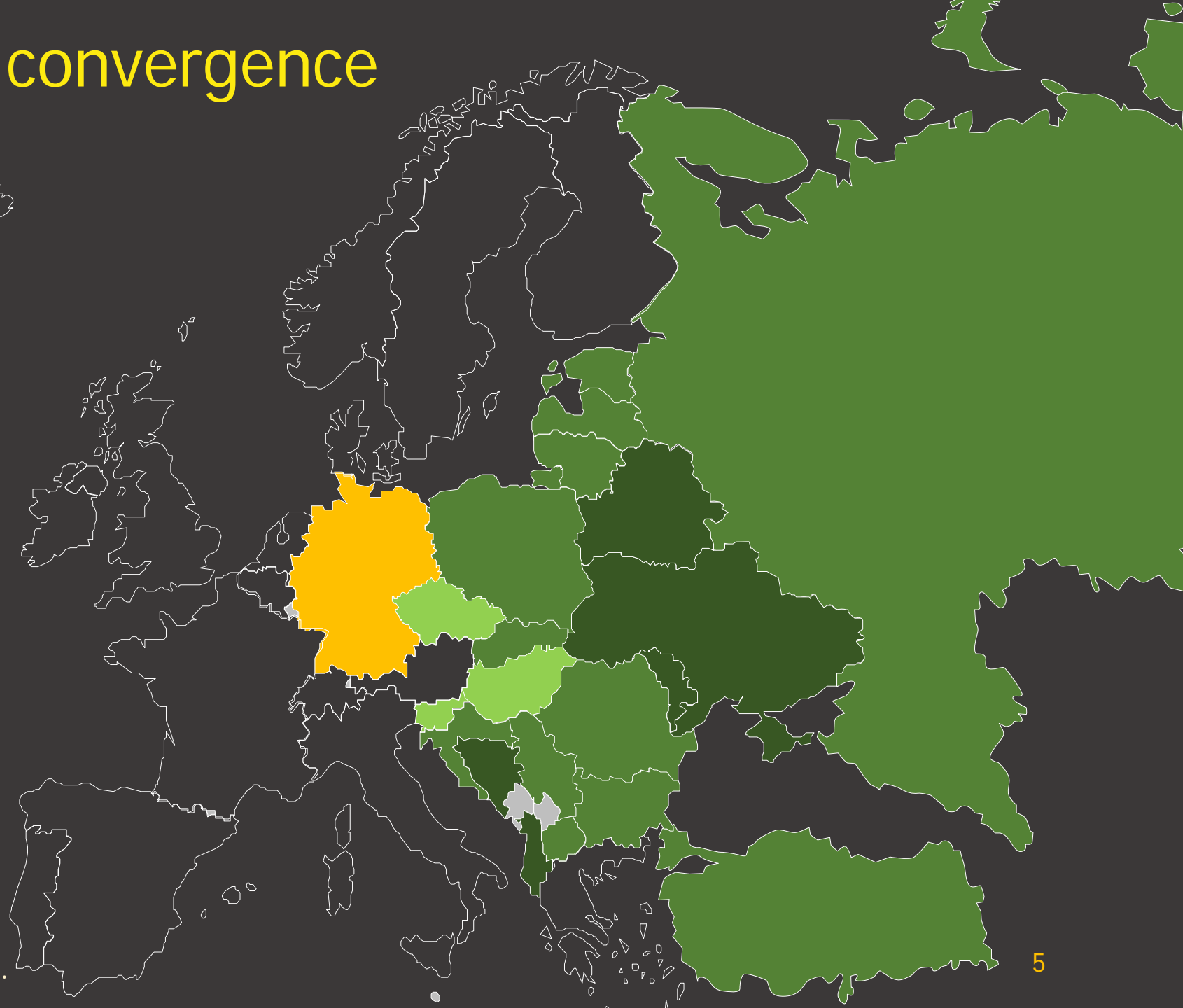
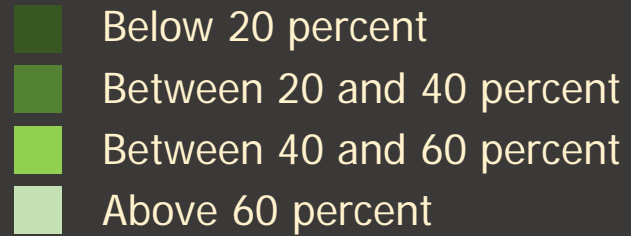


Source: UNDP Human Development Reports, Table 2: Trends in the Human Development Index, 1990-2015.

Substantial income convergence has been achieved

PPP GDP per capita compared to Germany's

1995

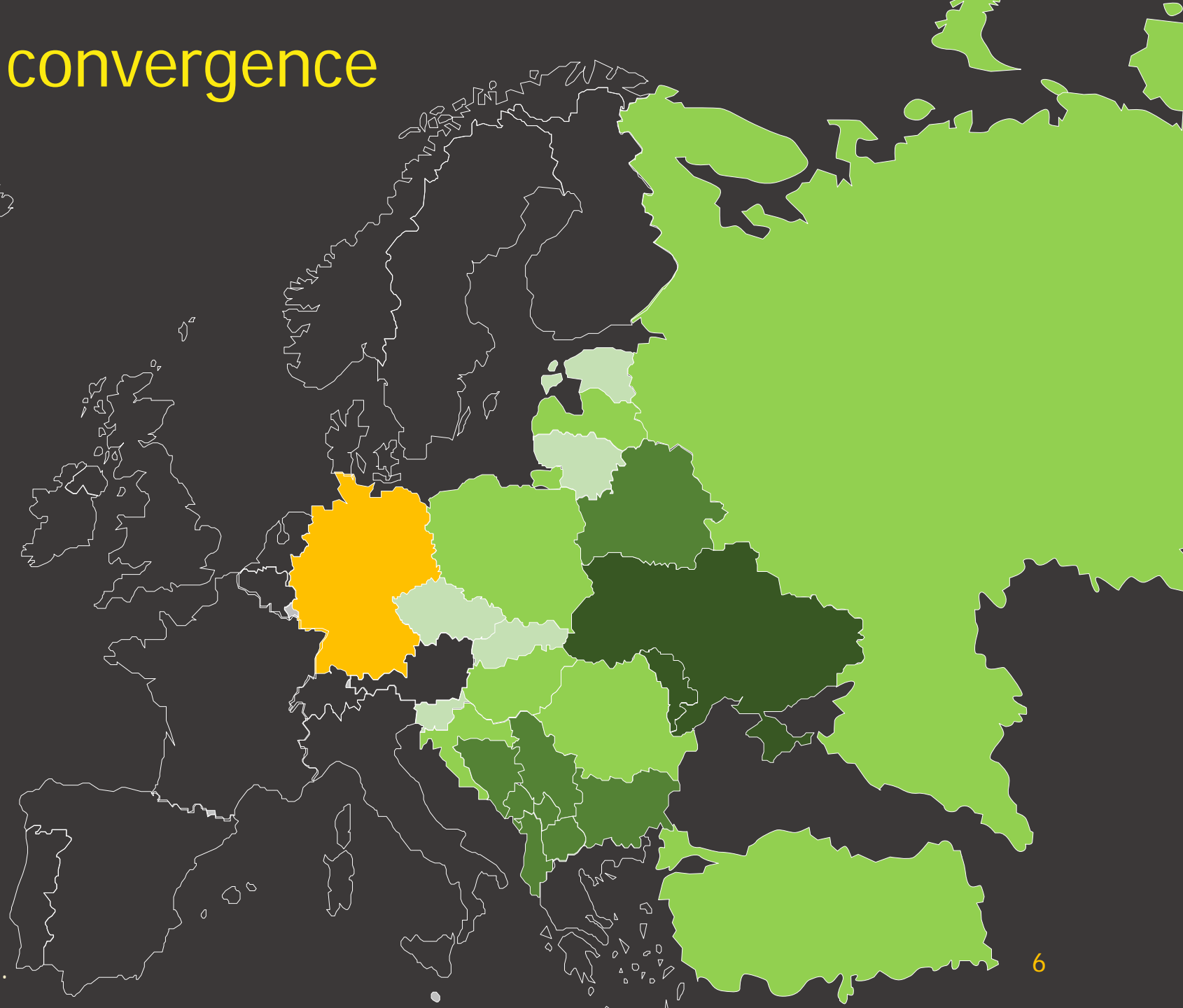


Substantial income convergence has been achieved

PPP GDP per capita compared to Germany's

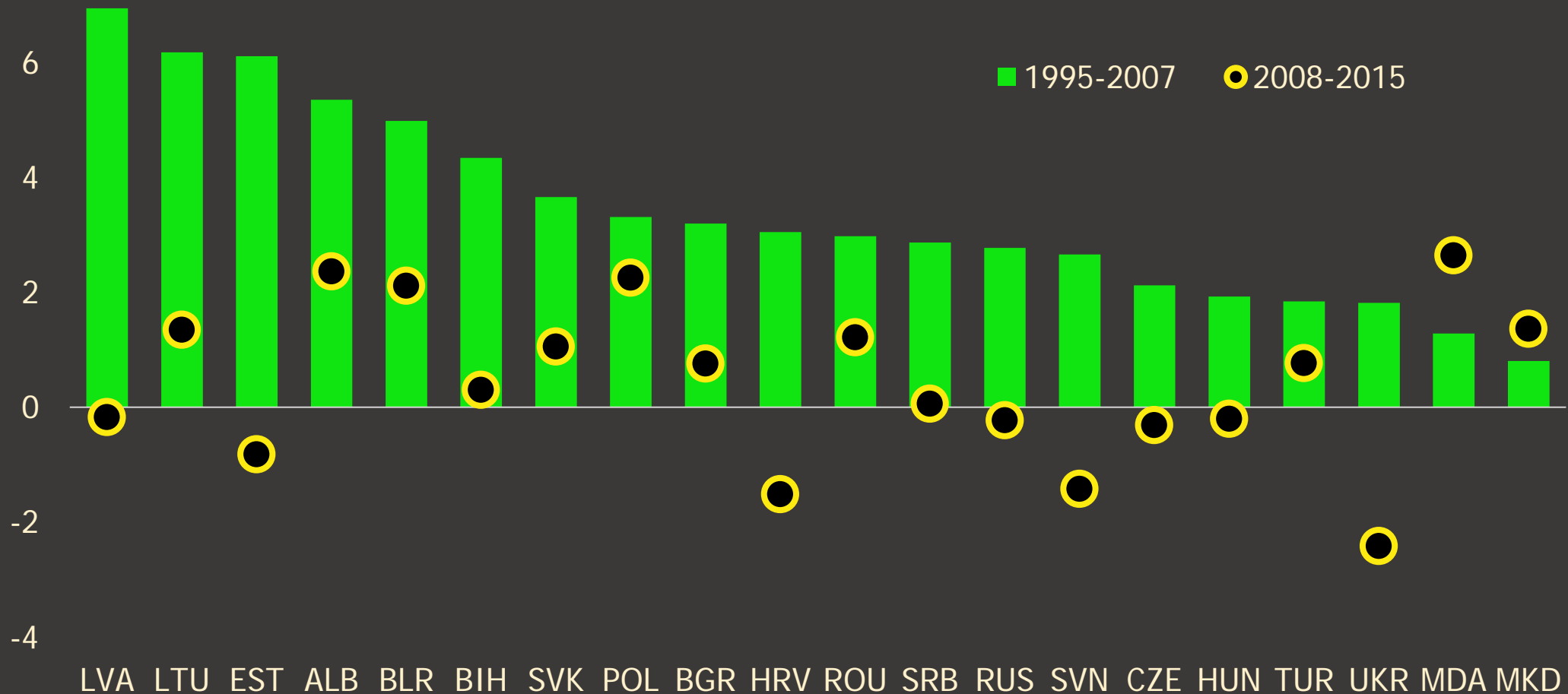
2015

- Below 20 percent
- Between 20 and 40 percent
- Between 40 and 60 percent
- Above 60 percent



But convergence has slowed. Some divergence

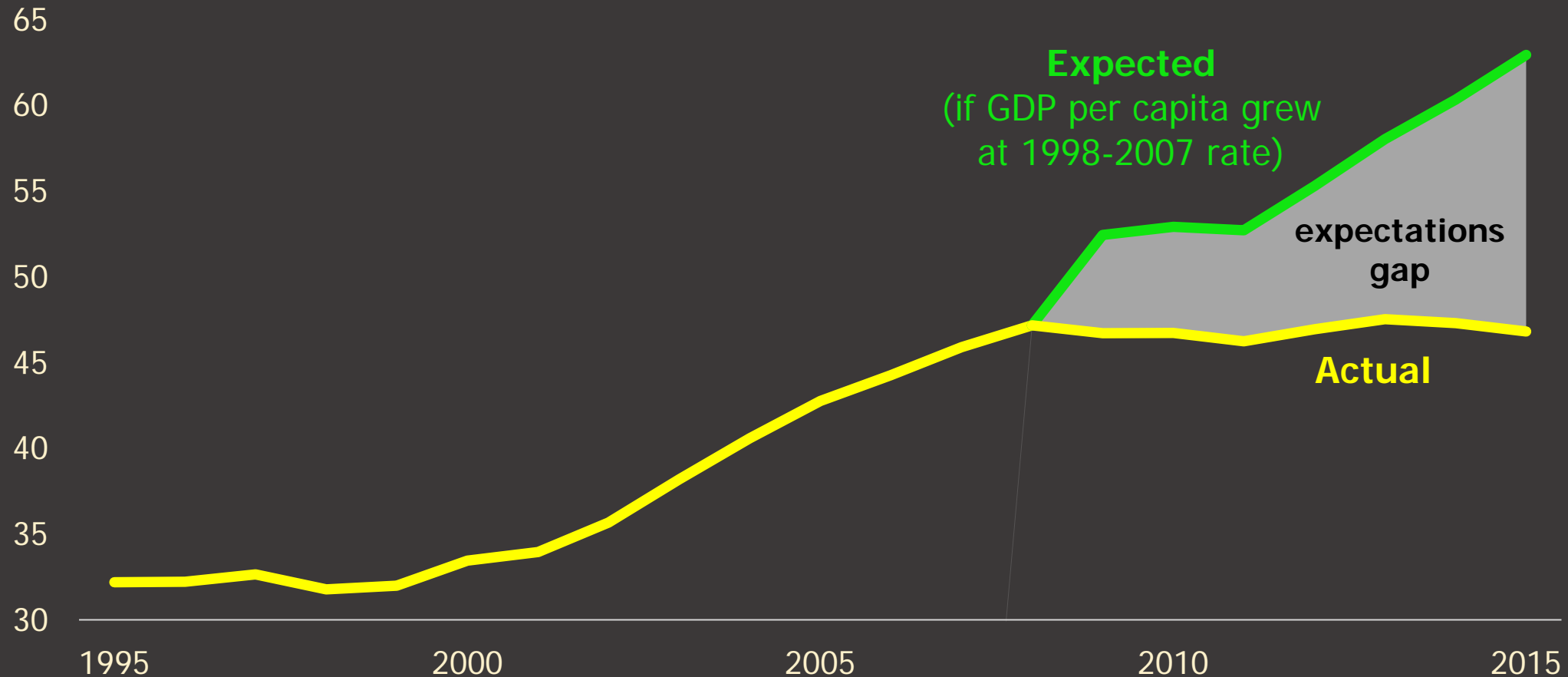
Growth Differential Before and After the Crisis
(Difference in average PPP GDP per capita growth with Germany)



Sources: World Bank Development Indicators; and IMF staff calculations.

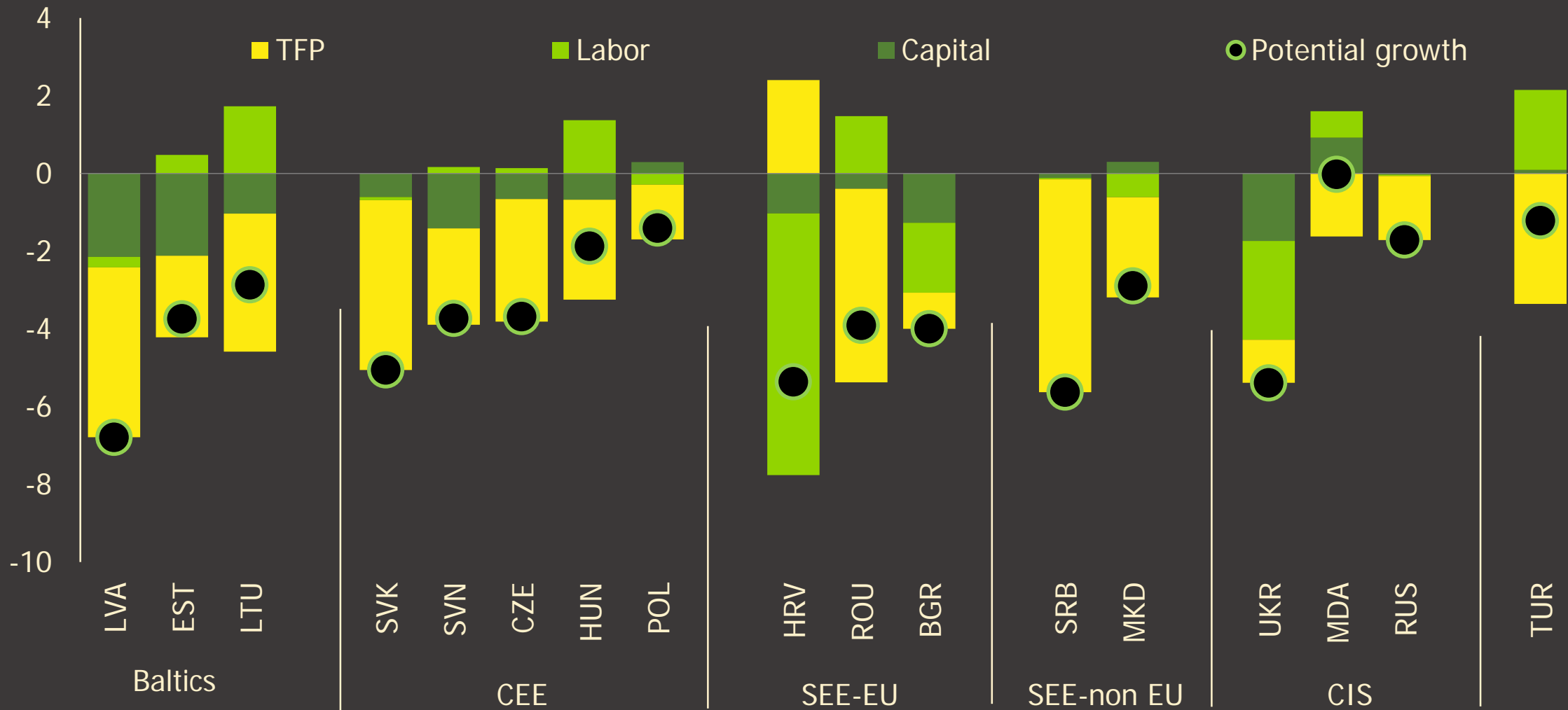
People have been disappointed

CESEE: GDP per Capita Relative to Germany' GDP per Capita
(In percent)



TFP behind the growth slowdown

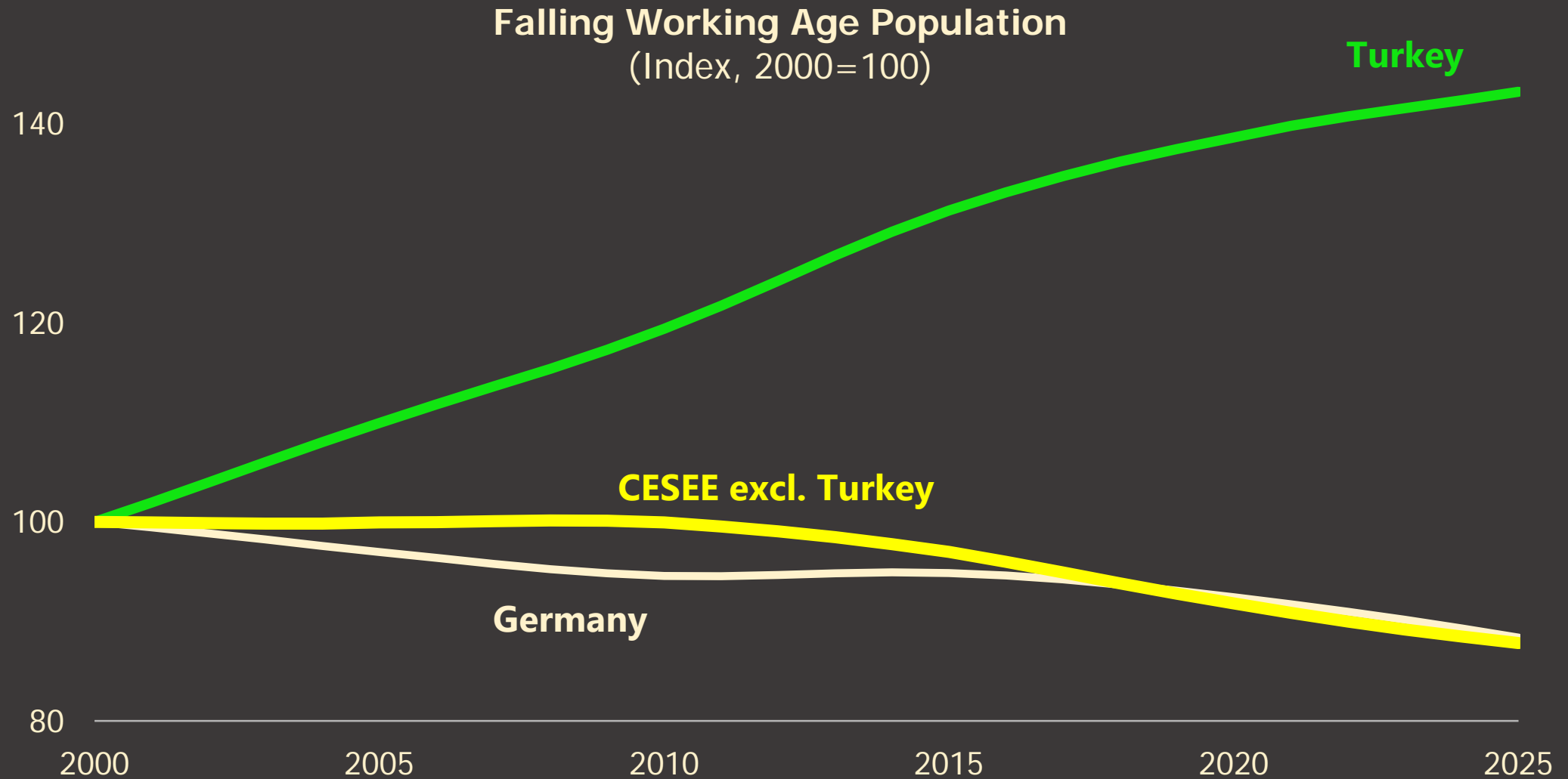
Change over 2013-15 versus 2002-08
(Percentage points)



Sources: Penn World Tables, Version 8.1; Haver Analytics; and IMF staff calculations.



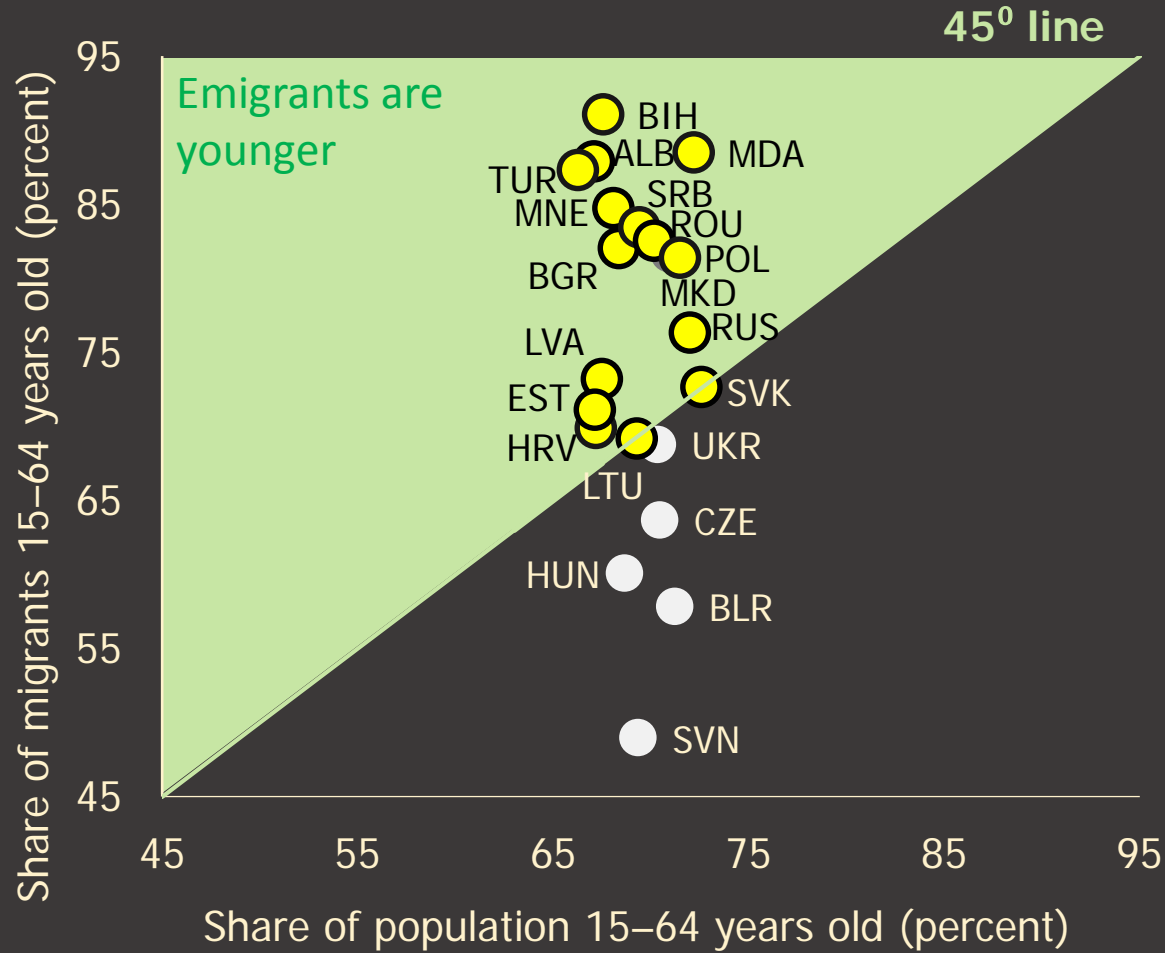
Major demographic headwinds ahead



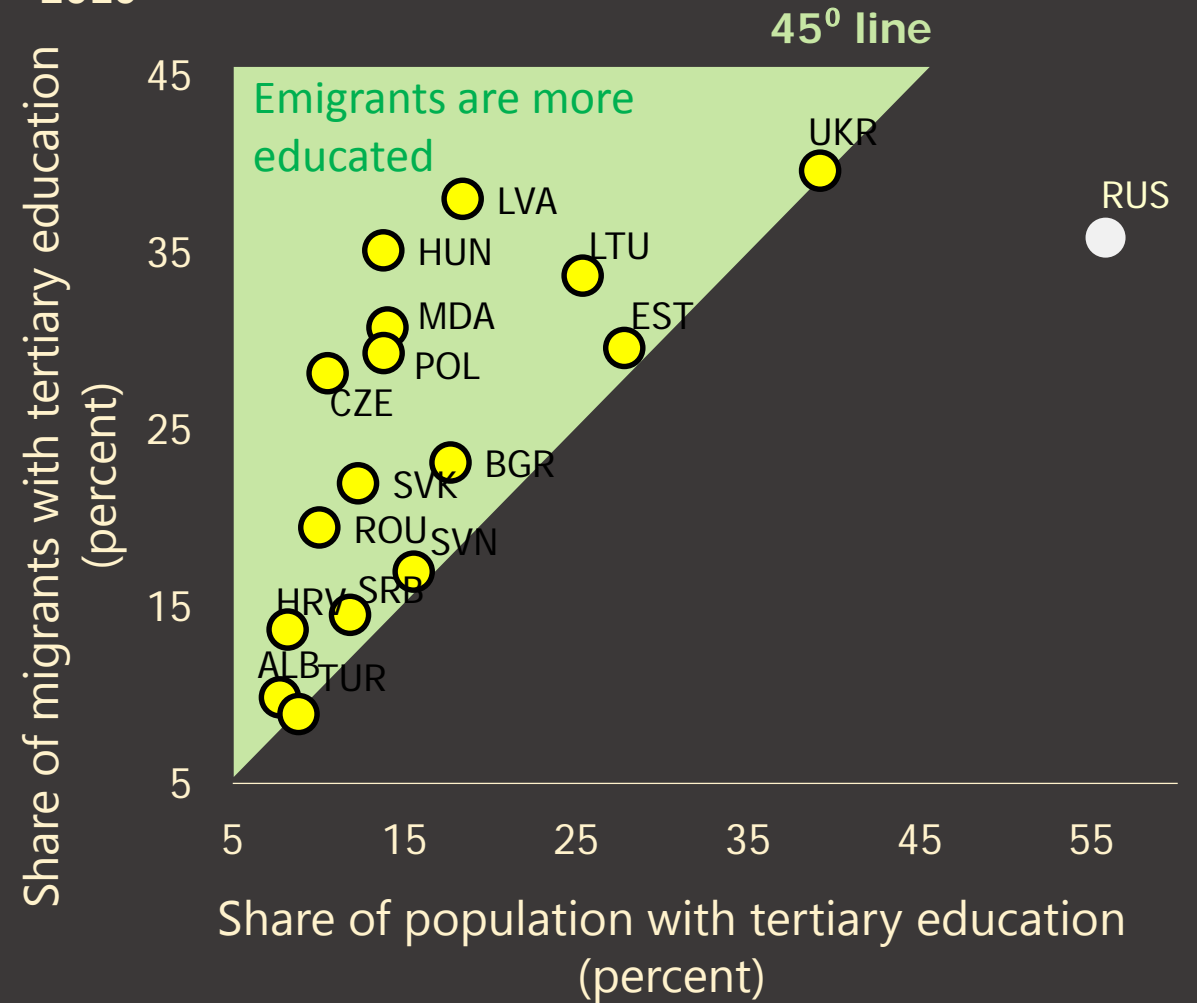
Source: United Nations World Population Prospects (2015).

Will emigration continue?

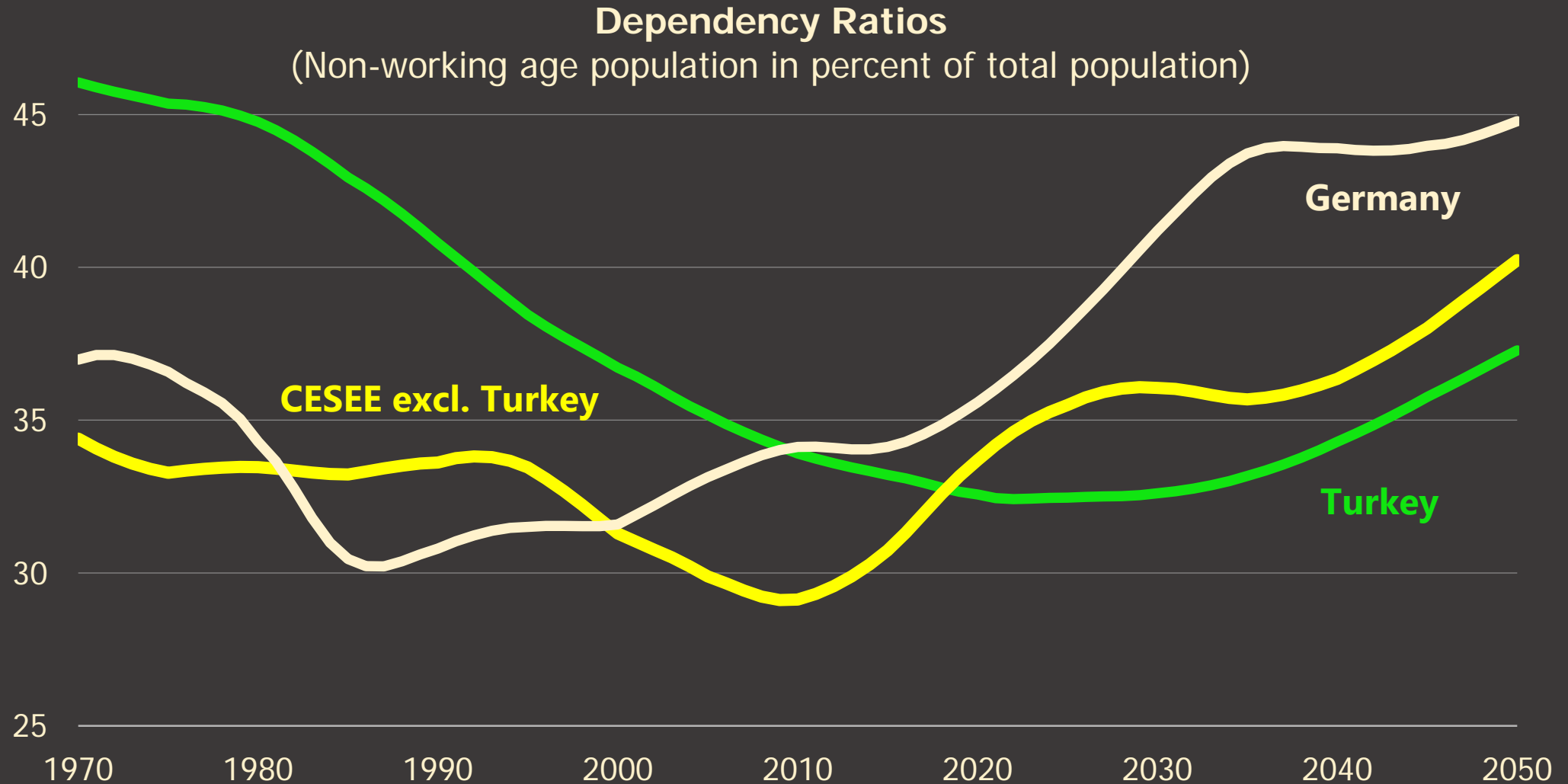
Age of Migrants and Sending Country Population, 2010



Education of Migrants and Sending Country Population, 2010



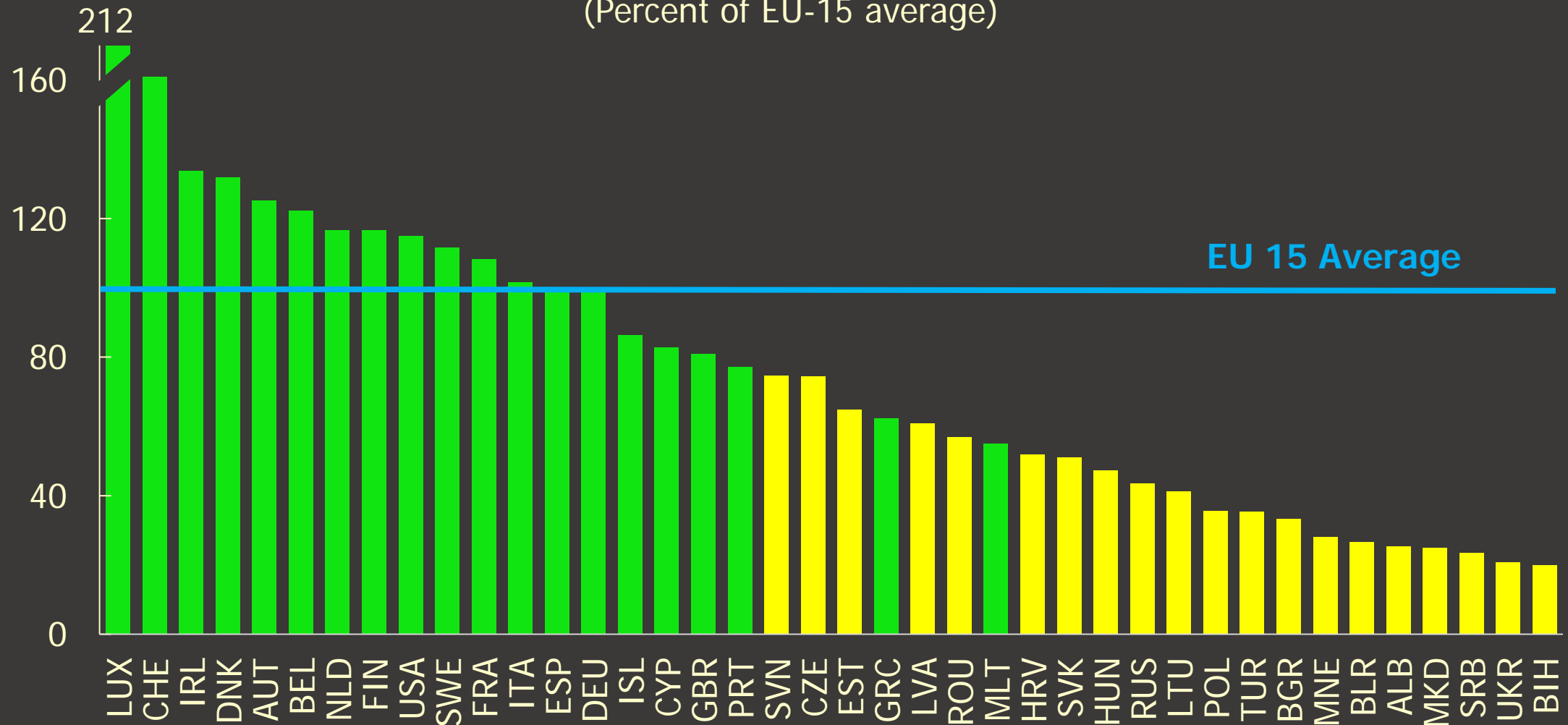
Rising dependency ratios lower saving



Source: United Nations World Population Prospects (2015).

Investment is likely to remain weak

Capital Stock, Per Capita, 2015
(Percent of EU-15 average)

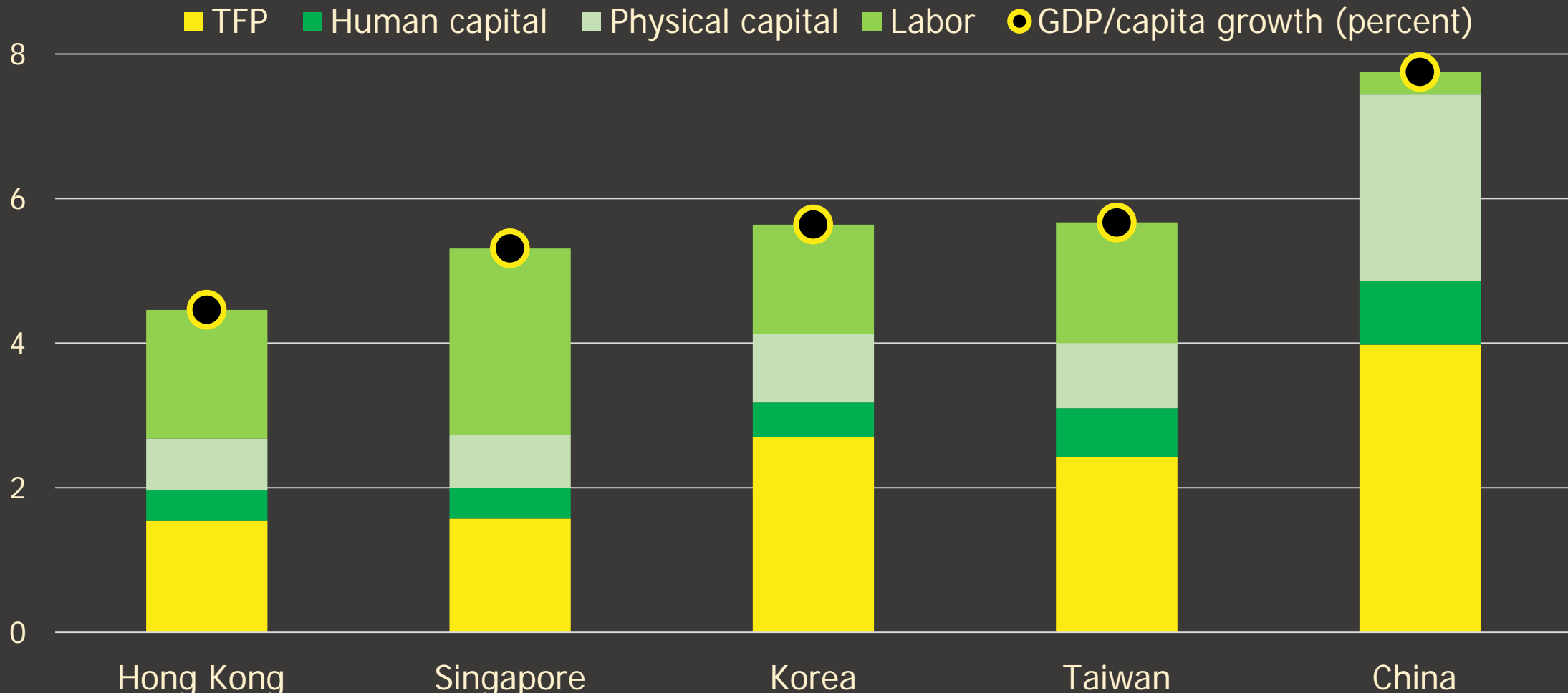




Examples of convergence from Asia

Sustained convergence requires robust TFP growth

Growth Success in Asia
(Contribution to GDP growth)



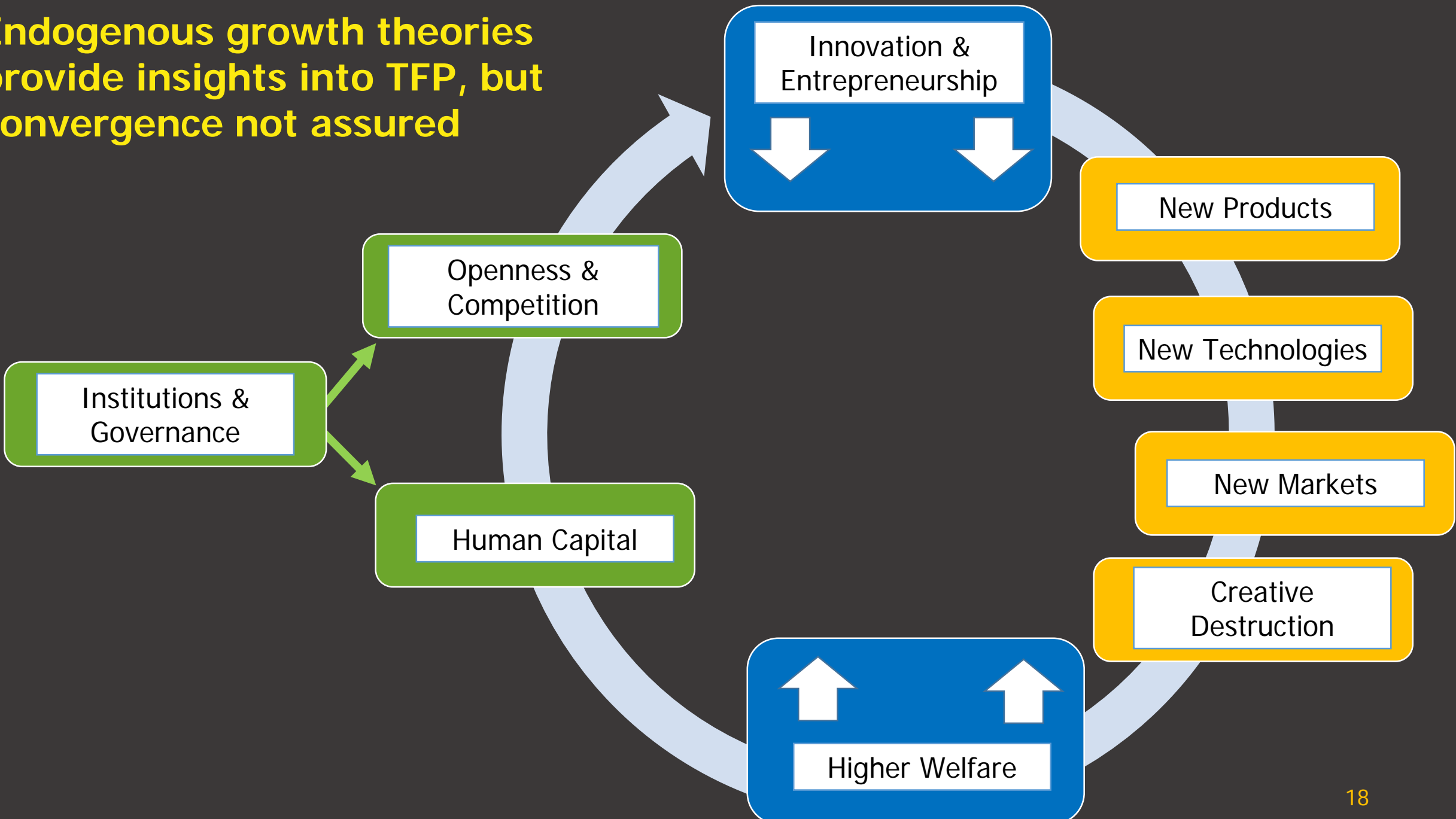
Sources: Aiyar and others, 2013, "Growth Slowdowns and the Middle Income Trap", IMF WP/13/71; and IMF staff estimates.



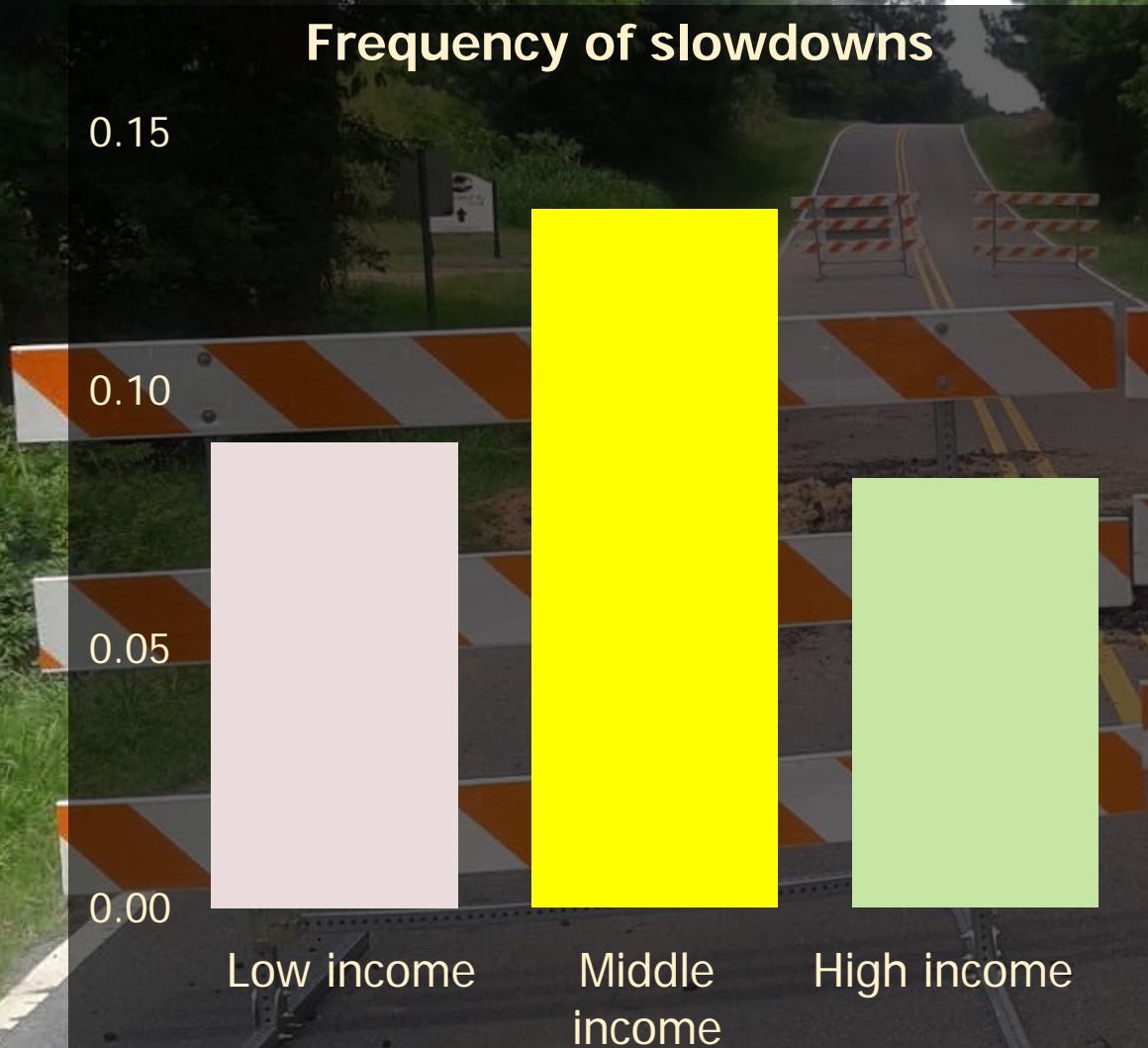
**HOW
TO INCREASE TFP?**

EXIT 13A SOUTH	13
EXIT 48 NORTH	48
EXIT 57 NORTH	57

Endogenous growth theories provide insights into TFP, but convergence not assured



IS THERE A MIDDLE INCOME TRAP?



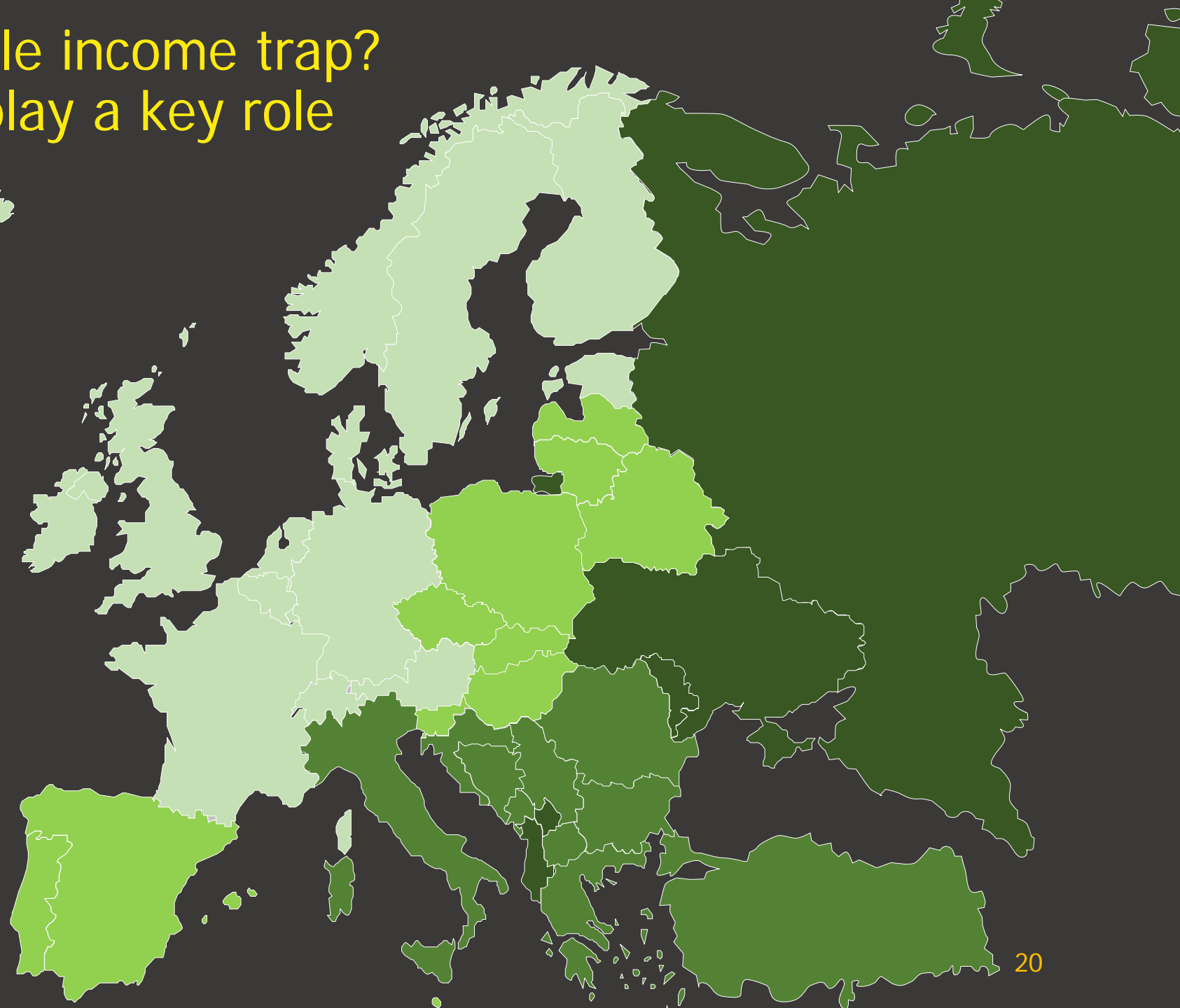
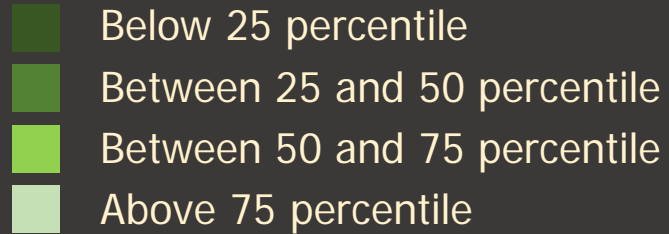
Source: Aiyar and others, 2013, "Growth Slowdowns and the Middle Income Trap" , IMF WP/13/71.



How to escape the middle income trap? Better governance can play a key role

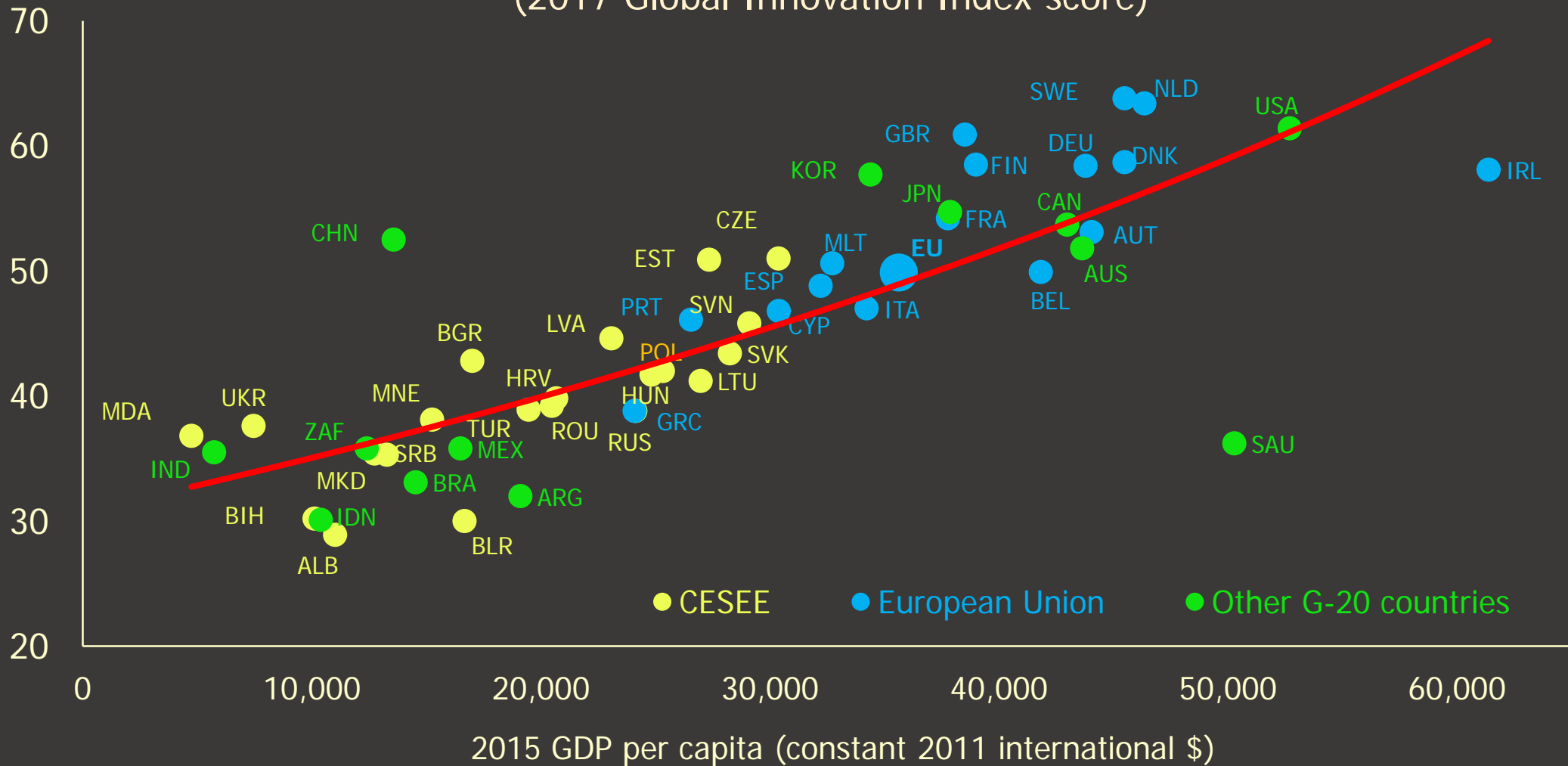
Rule of Law,
Worldwide distribution,
2015

Lighter green is better



The link between institutions and innovation

Where does CESEE stand on innovation?
(2017 Global Innovation Index score)

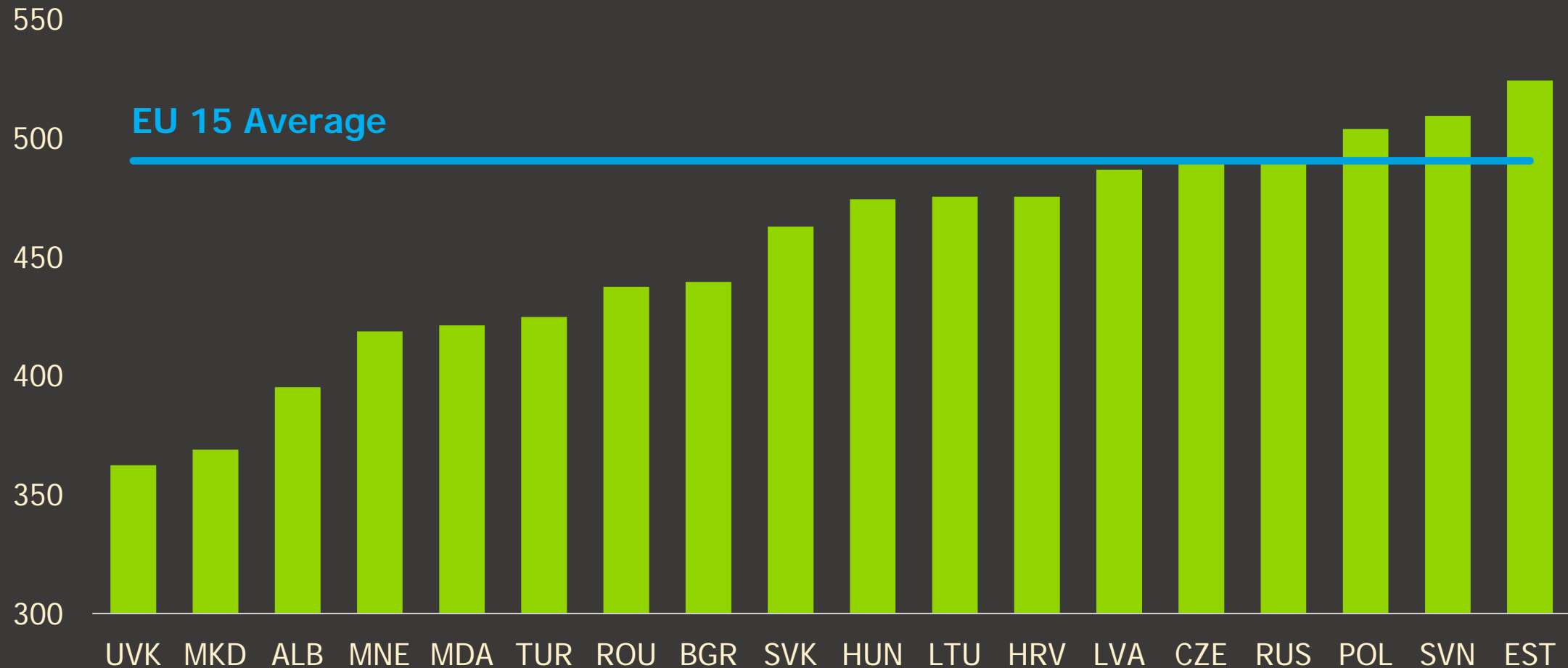


Sources: Global Innovation Index Report (2017); and World Bank Development Indicators.

Most of the region has a well educated labor force, which is more sensitive to institutions

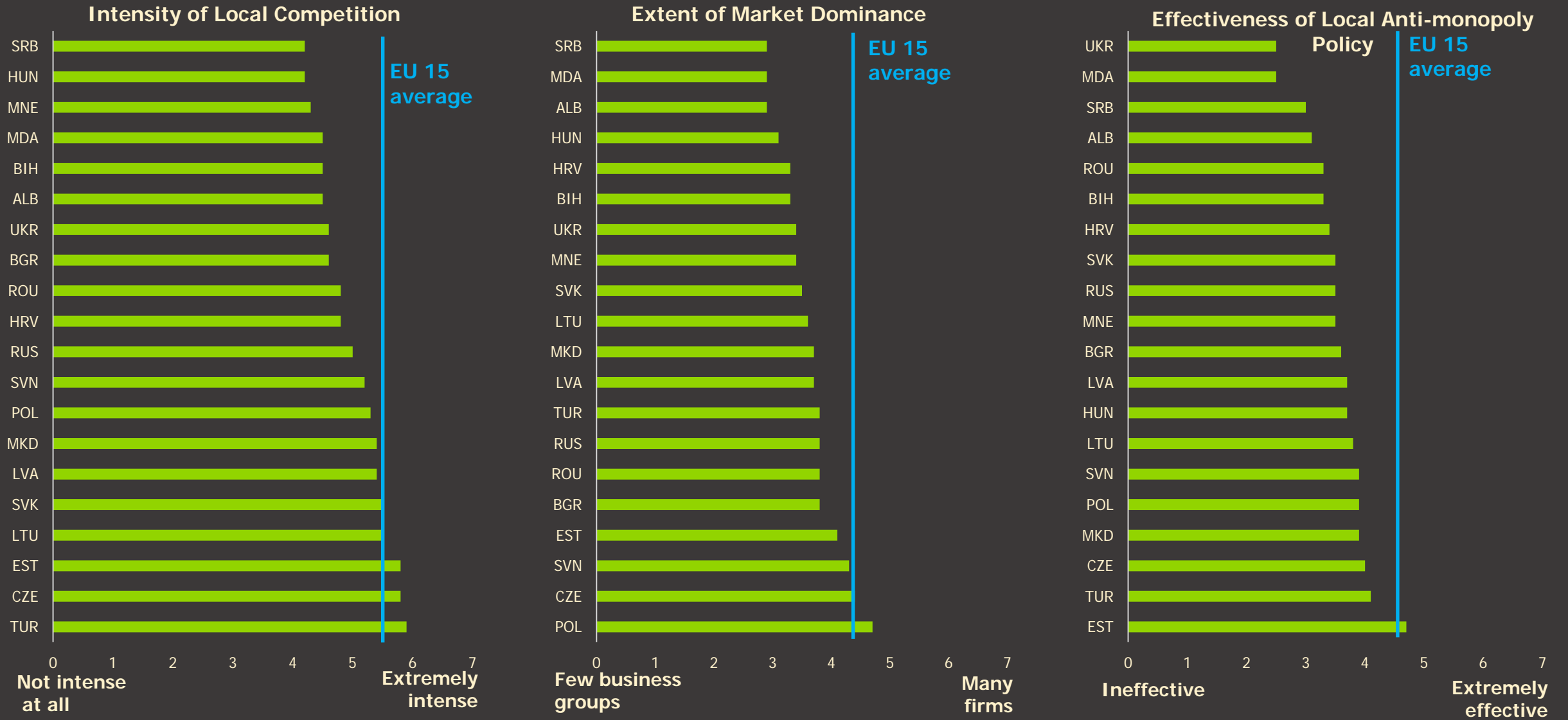
PISA Scores, 2015

(average of math, science and reading scores; min score=320, max score=565)



Source: OECD.

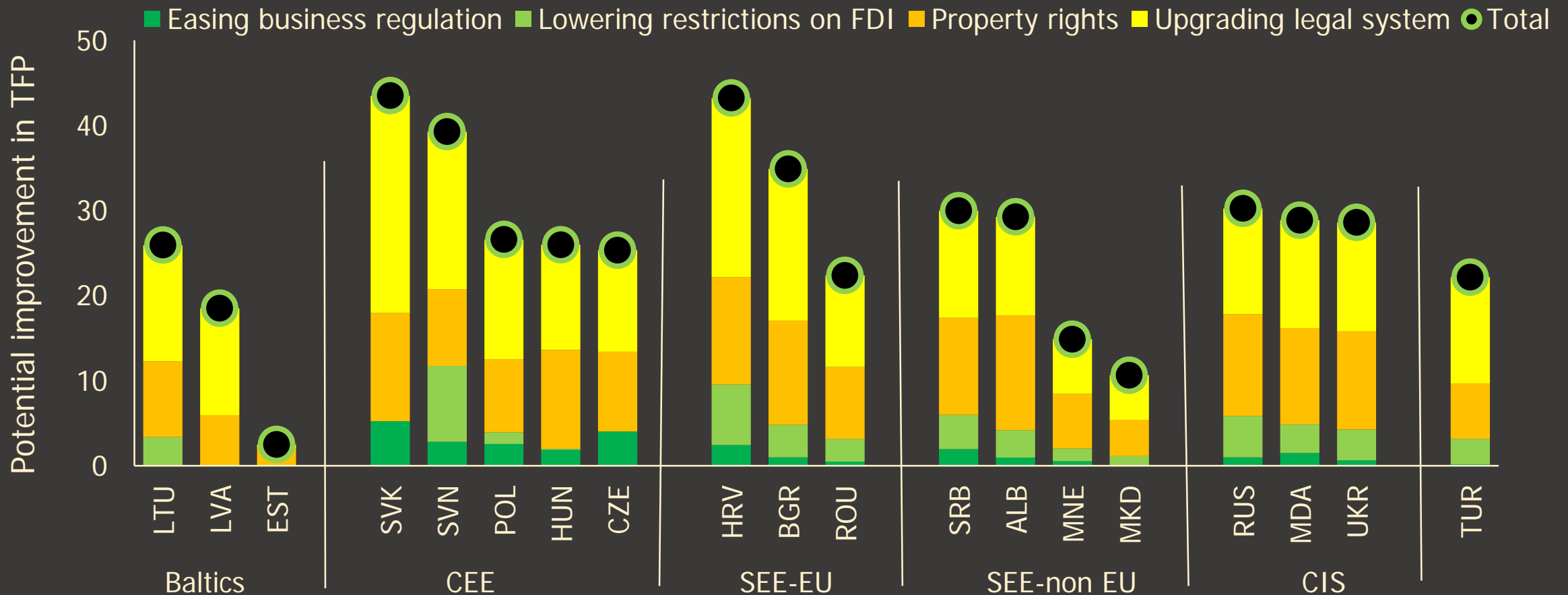
The importance of competition in fostering TFP



Source: World Economic Forum.

More effective legal systems key for moving to a higher growth trajectory

Potential Efficiency Gains from Structural Reforms
(In percent)



Sources: Penn World Tables, Version 8.1; and IMF staff calculations.

Key messages

■ A lot of progress achieved, but convergence not assured

■ Strong demographic headwinds ahead

■ Productivity growth needed for higher incomes

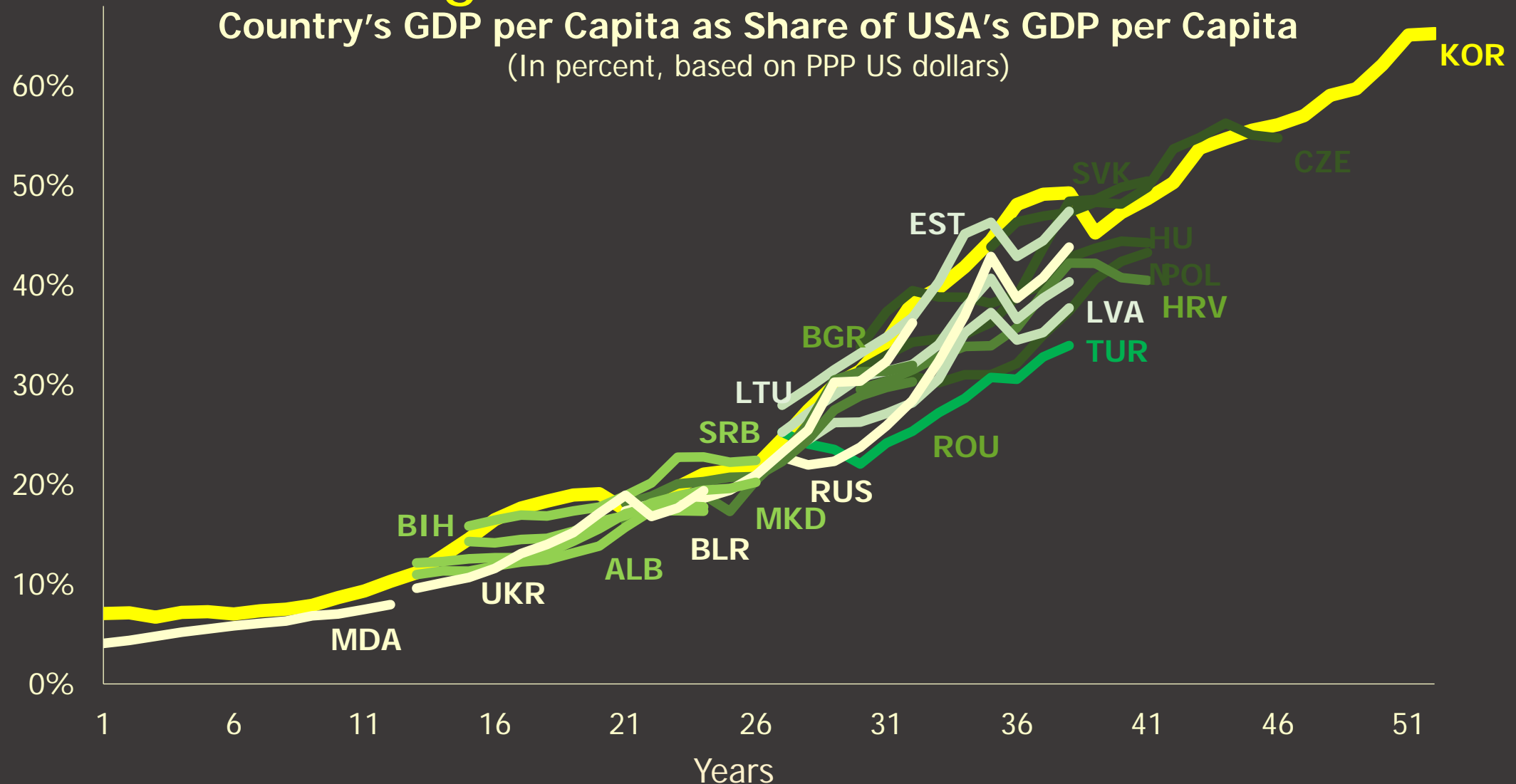
■ Better governance and institutions key to increasing productivity and spurring innovation

■ Retaining/attracting skilled workers and fostering competition are the main economic channels through which governance helps



Additional Slides

CESEE: Convergence

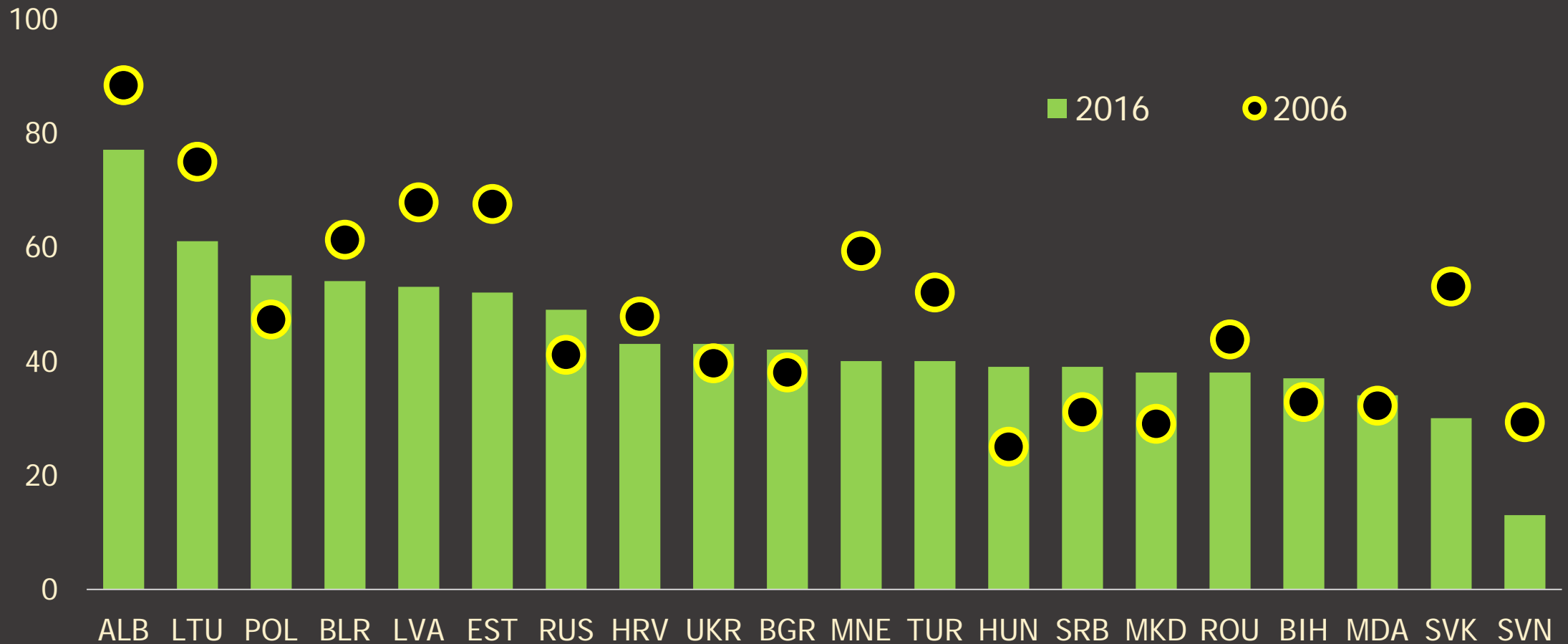


Sources: Penn World Tables, Version 8.1, Haver, and IMF staff.

Note: Each short line represents the transition path of a CESEE country over 2000-2011. The position of each CESEE line shows how its transition path compared to Korea's, when Korea was at the similar level of development. The x-axis represents years of Korea's transition from 1960 to 2011.

People have mixed expectations about the future

Will future generations have a better life than the current generation?
(Percent of respondents who agree)



Investment

Reported Adequacy of Investment in the Last 3 Years

(Percent of all firms who report investing about right or more)

