CONVERGENCE AND INSTITUTIONS

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European Department
October 5, 2017
The fast pace of convergence before crisis ...

CESEE and Korea: GDP per Capita
(Percent of per capita GDP of the U.S. at PPP)

Data for CESEE countries are for 2000-2008 and are shifted back in time to comparable level of development of Korea.
… leveled off since 2009

CESEE and Korea: GDP per Capita
(Percent of per capita GDP of the U.S. at PPP)

Data for CESEE countries are for 2000-2016 and are shifted back in time to comparable level of development of Korea.
Lower TFP behind the growth slowdown

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

Baltics
CEE
SEE-EU
SEE-nong EU
CIS

Labor
Capital
TFP
Potential growth
Major demographic headwinds ahead

Falling Working Age Population
(Index, 2000=100)

Turkey

CESEE excl. Turkey

Germany

Large emigration from the region impacts growth

Cumulative Emigration Flows by Region
(Millions of people)

Emigration Impact on Real GDP Growth
1995-2012
(Percentage points)

Due to skilled emigration
Due to unskilled emigration
Low domestic savings and insufficient investment

CESEE: Gross Investment, 2016
(Percent of GDP)

CESEE: Gross Domestic Saving, 2016
(Percent of GDP)
Rule of law challenges for many European countries. A lot of progress in CESEE countries but remaining gaps.

Rule of Law 2016

Protection of Property Rights 2015

- Below 25 percentile
- Between 25 and 75 percentile
- Above 75 percentile

Lighter green = better

Darker green = worse

Worldwide distribution excluding LICs
Room for improvement especially in judicial independence and impartiality

Judicial Independence 2015

Impartial Courts 2015

- Below 25 percentile
- Between 25 and 75 percentile
- Above 75 percentile

Worldwide distribution excluding LICs

Darker green = worse

Lighter green = better
CESEE’s judiciary efficiency good but challenges in perceived independence

Resolution Rate: Insolvency Cases, 2014 1/

- Min-max range
- Mean
- Coefficient of variation

Perceived Independence of Courts, 2017 2/

- Min-Max range
- Average

1/ Values higher than 100 indicate that more cases are resolved than received, and suggest higher efficiency.
2/ Percent of responders that ranked independence of courts in their country fairly or very good.
CASE STUDIES:

BOSNIA AND HERZEGOVINA
CROATIA
ESTONIA
POLAND
ROMANIA
SERBIA
Factors Facilitating Reform
(Index = 0 to 10, 0=worst, 10=best)

Estonia

Romania

Rule of law
Judicial independence
Protection of property rights


### Comparison of factors facilitating reform

| A. Initial Conditions: | • Estonia: Vibrant civil society; clean break from communism  
• Romania: New government still connected to old regime |
|------------------------|----------------------------------------------------------|
| B. Distribution of Resources: | • Estonia: Inclusive privatization; economy opened up quickly  
• Romania: Privatization lead to concentration of resources and delayed liberalization |
| C. Transparency: | • Estonia: Media freedom and e-government  
• Romania: Freedom of Information Law promoted by EU helped civil society |
| D. State capacity: | • Estonia: New judges were chosen based on merit  
• Romania: Stop-and-go reforms but some improvement |
| E. Role of the EU: | • Estonia: EU provided benchmarks for high standards  
• Romania: EU membership acted as a catalyst for reforms |
Key messages

• Strengthening institutions a priority for next generation of reforms
• Some countries successfully reformed, though reversals also occurred
• Distributional factors key to successful judicial reforms; privatization and opening up had notable effects
• Strengthened transparency and accountability conducive to improvements in judicial effectiveness
• The quality of the public administration was another critical factor
• The EU was a strong external anchor but sustainability of reforms appears to depend mainly on domestic factors
ADDITIONAL SLIDES
Upgrading institutions key for moving to a higher growth path

CESEE: Estimated Efficiency Gains from Institutional Reforms
(Percent; potential improvement in TFP)

- Easing business regulation
- Lowering restrictions on FDI
- Property rights
- Upgrading judicial system

Upgrading institutions key for moving to a higher growth path.
The Fund’s Recommendations on Governance and Institutions

- Independent anti-corruption agency
- Improve oversight of procurement
- Improve oversight of SOEs
- Enhance transparency of capital projects

Legal systems a challenge for many European countries with high NPLS. 
IMF SDN 15/19 “A Strategy for Resolving Europe’s Problem Loans”.

- Creditor rights
- Improve recovery of collateral
- Speed up debt resolution
- Contract enforcement
- Reduce corruption and inefficiency in courts
Factors Facilitating Reform, 1993
(Index = 0 to 10, 0=worst, 10=best)

**Estonia**
- Educational equality: 10
- Health equality: 8
- Absence of gov. censorship: 6
- Justification of policies: 4
- Strength of civil society: 4
- Equal distribution of resources: 6
- Freedom of information: 4

**Romania**
- Educational equality: 10
- Health equality: 8
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## Factors Affecting Institutional Quality

<table>
<thead>
<tr>
<th></th>
<th>Judicial independence</th>
<th>Protection of property rights</th>
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<tbody>
<tr>
<td>Equal distribution of resources</td>
<td>2.225***</td>
<td>0.143</td>
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<tr>
<td></td>
<td>(1.076)</td>
<td>(0.846)</td>
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<td>Freedom of the press</td>
<td>0.0096</td>
<td>0.0114***</td>
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<td></td>
<td>(0.0026)</td>
<td>(0.00443)</td>
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<tr>
<td>Impartial public administration</td>
<td>0.875***</td>
<td>0.507***</td>
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<td>(0.224)</td>
<td>(0.171)</td>
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<td>Lower barriers to trade</td>
<td>0.194***</td>
<td>0.573***</td>
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<td>(0.0715)</td>
<td>(0.0972)</td>
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<td>Institutional quality of trading partners</td>
<td>0.396***</td>
<td>0.109</td>
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<td>(0.131)</td>
<td>(0.106)</td>
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<td>Old age dependency ratio</td>
<td>-0.0685***</td>
<td>-0.0459***</td>
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<td></td>
<td>(0.0291)</td>
<td>(0.0178)</td>
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<td>Control of corruption in politics</td>
<td>0.425***</td>
<td>0.349***</td>
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<td>(0.114)</td>
<td>(0.107)</td>
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<td>GDP per capita, constant PPP</td>
<td>0.578***</td>
<td>0.840***</td>
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<td>(0.244)</td>
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<td>Freedom of the press x Equal distribution of resources</td>
<td>-0.0612*</td>
<td>-0.0965***</td>
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<td>(0.0342)</td>
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<td>-0.0203***</td>
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<td>Constant</td>
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<td>Time effect</td>
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Robust standard errors in parentheses

*** p<0.01, ** p<0.05, * p<0.1