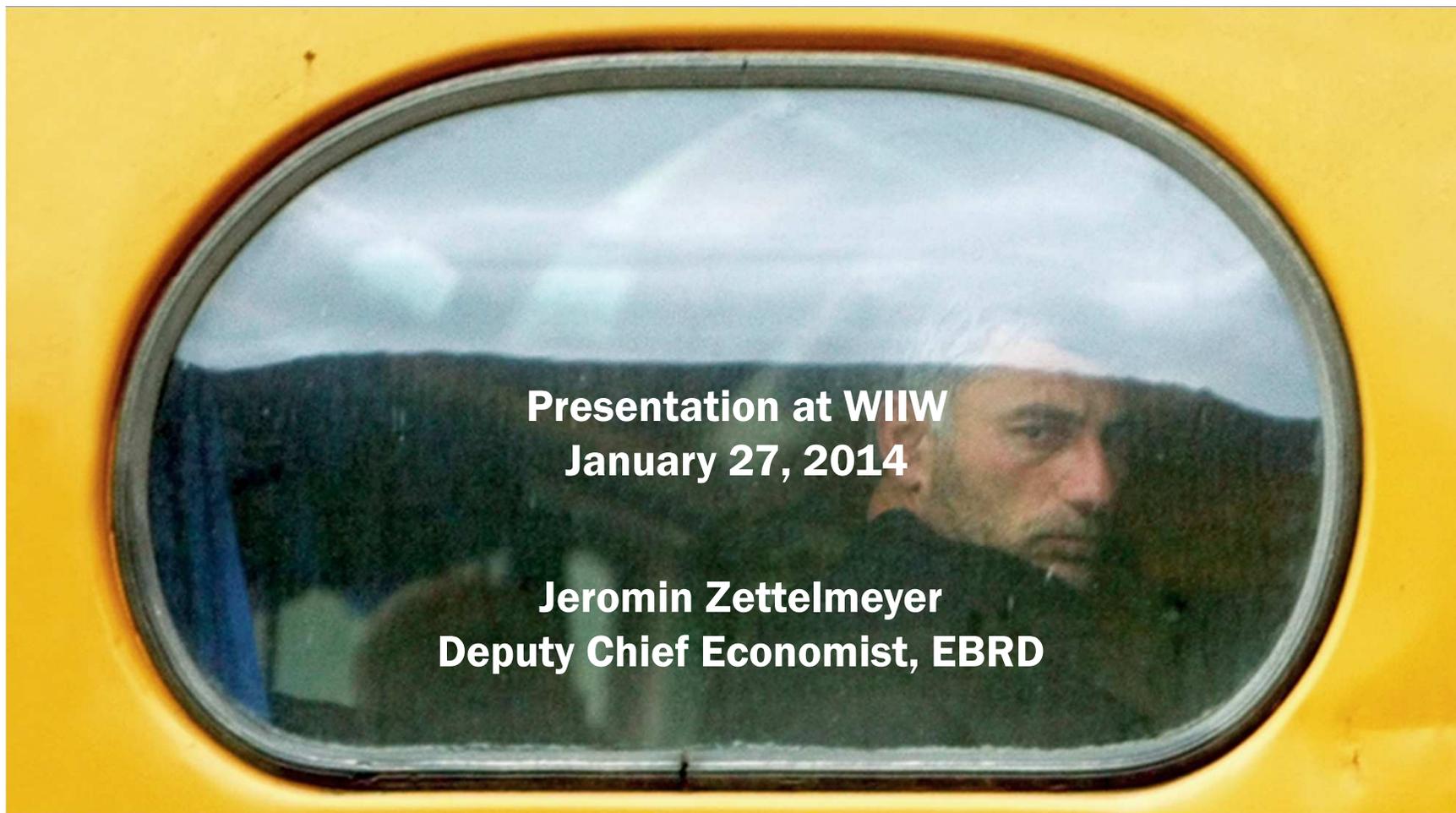




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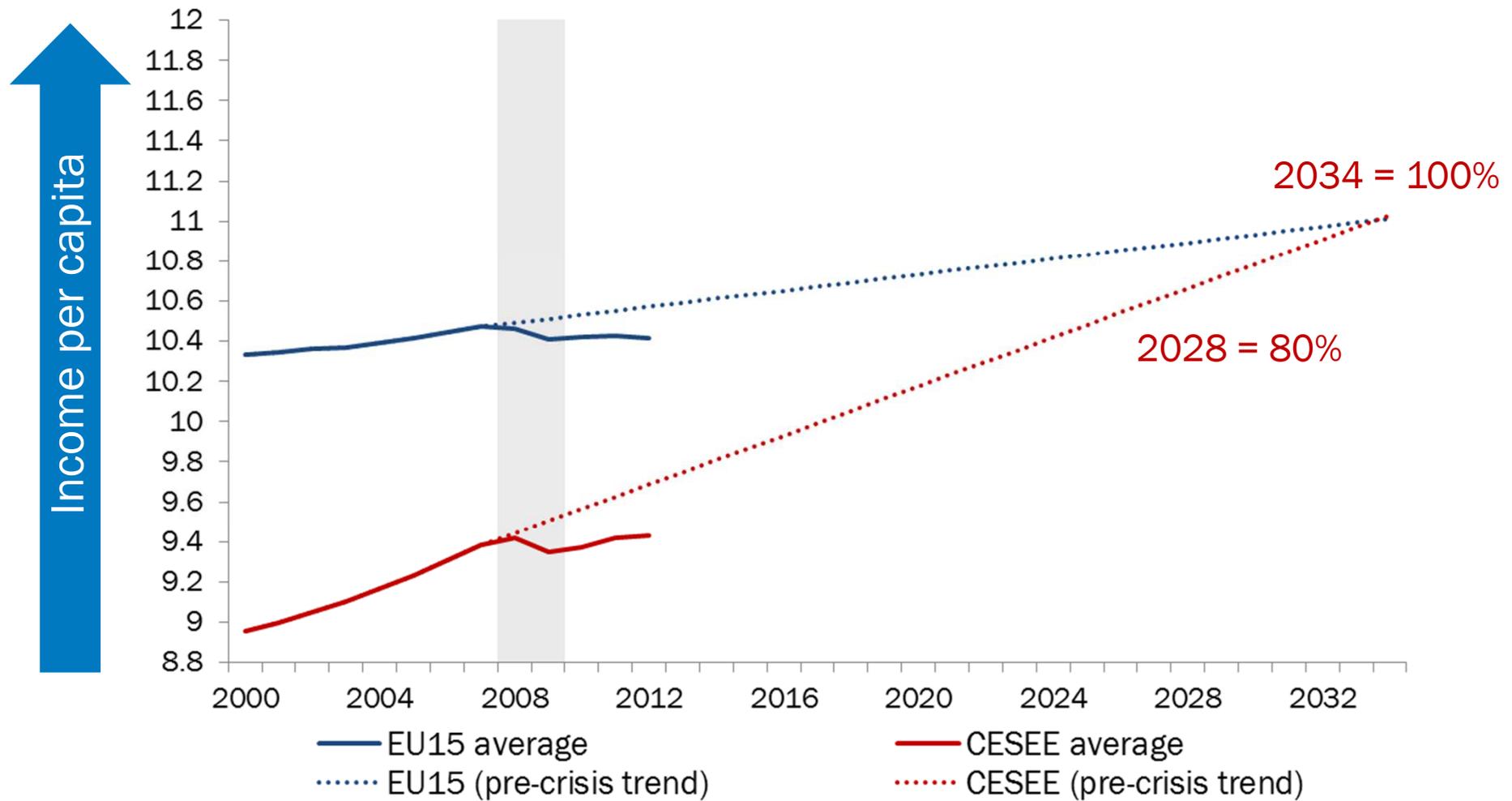
STUCK IN TRANSITION?



**Presentation at WIIW
January 27, 2014**

**Jeromin Zettelmeyer
Deputy Chief Economist, EBRD**

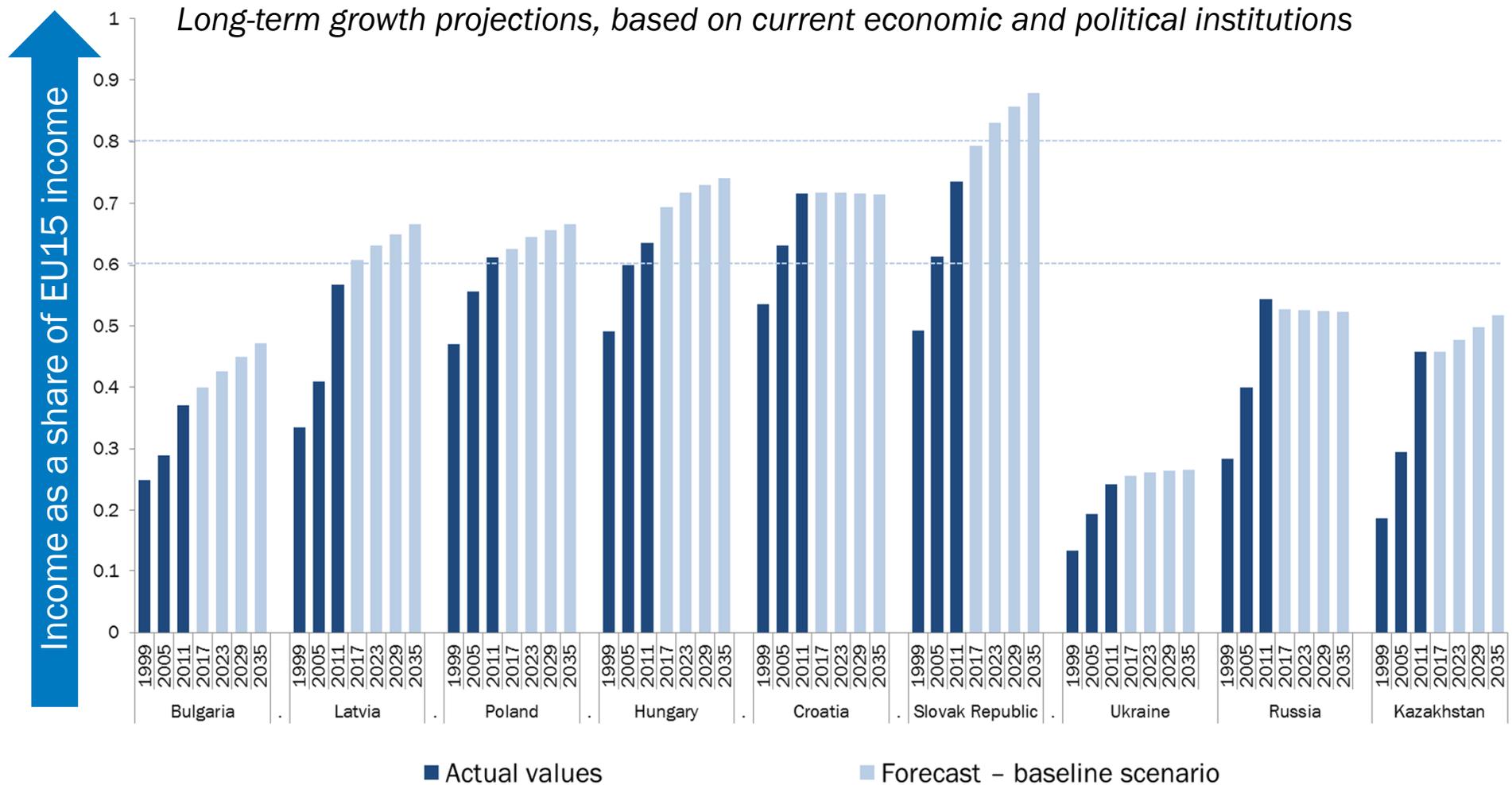
Motivation: will convergence resume?



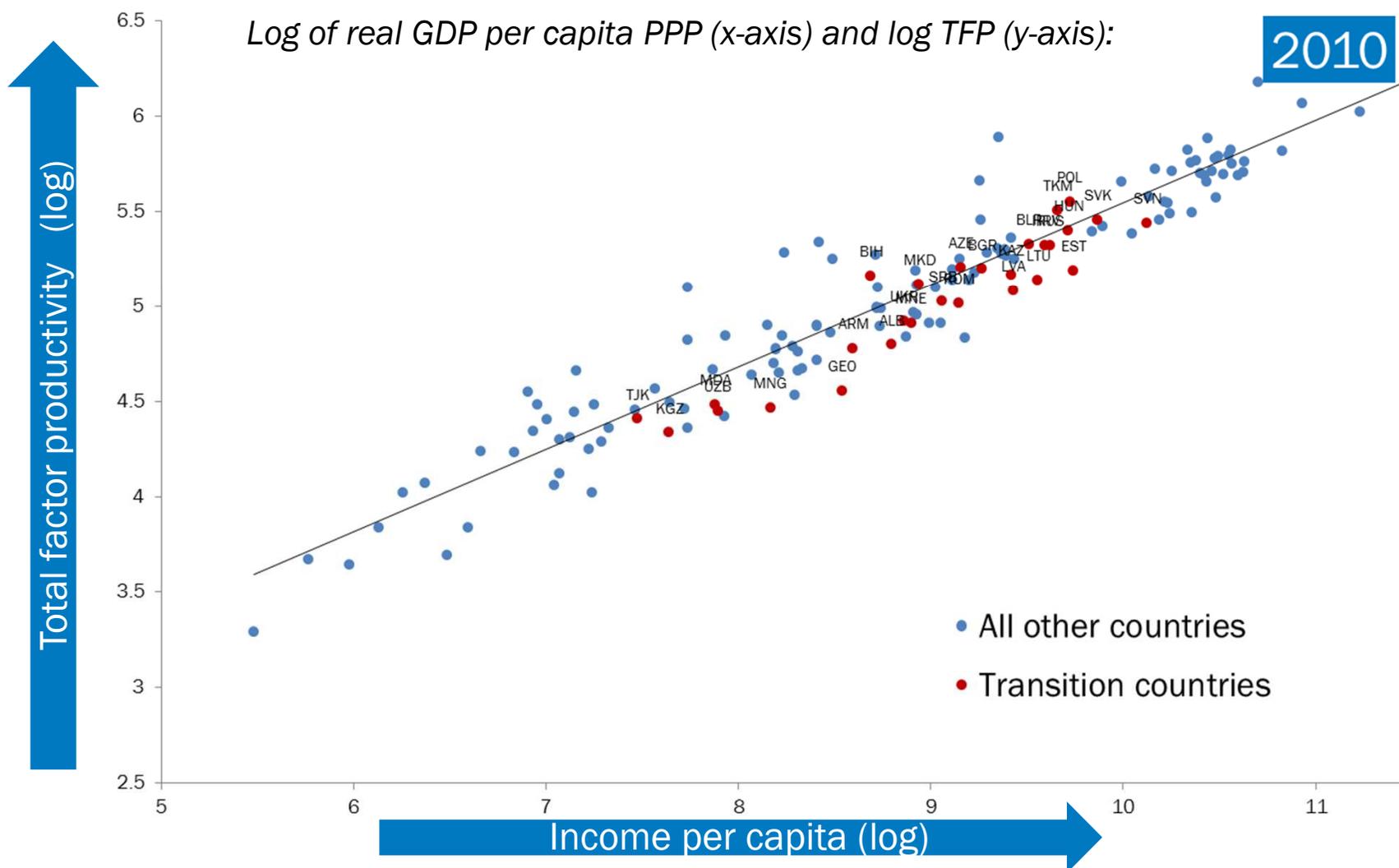
The narrative

1. Absent a new reform push, convergence will not resume, due to:
 - (1) the inherent transitoriness of productivity catch-up associated with transition;
 - (2) stagnation of reform since mid-2000s
2. One cause of stagnation is an under-reform trap involving autocratic or imperfectly democratic regimes, weak economic institutions, and low growth.
3. However, countries can break out of the trap.
 - In imperfect democracies, through moderate political shocks
 - More generally, through policies that allow improvements in economic institutions even in autocratic political systems.

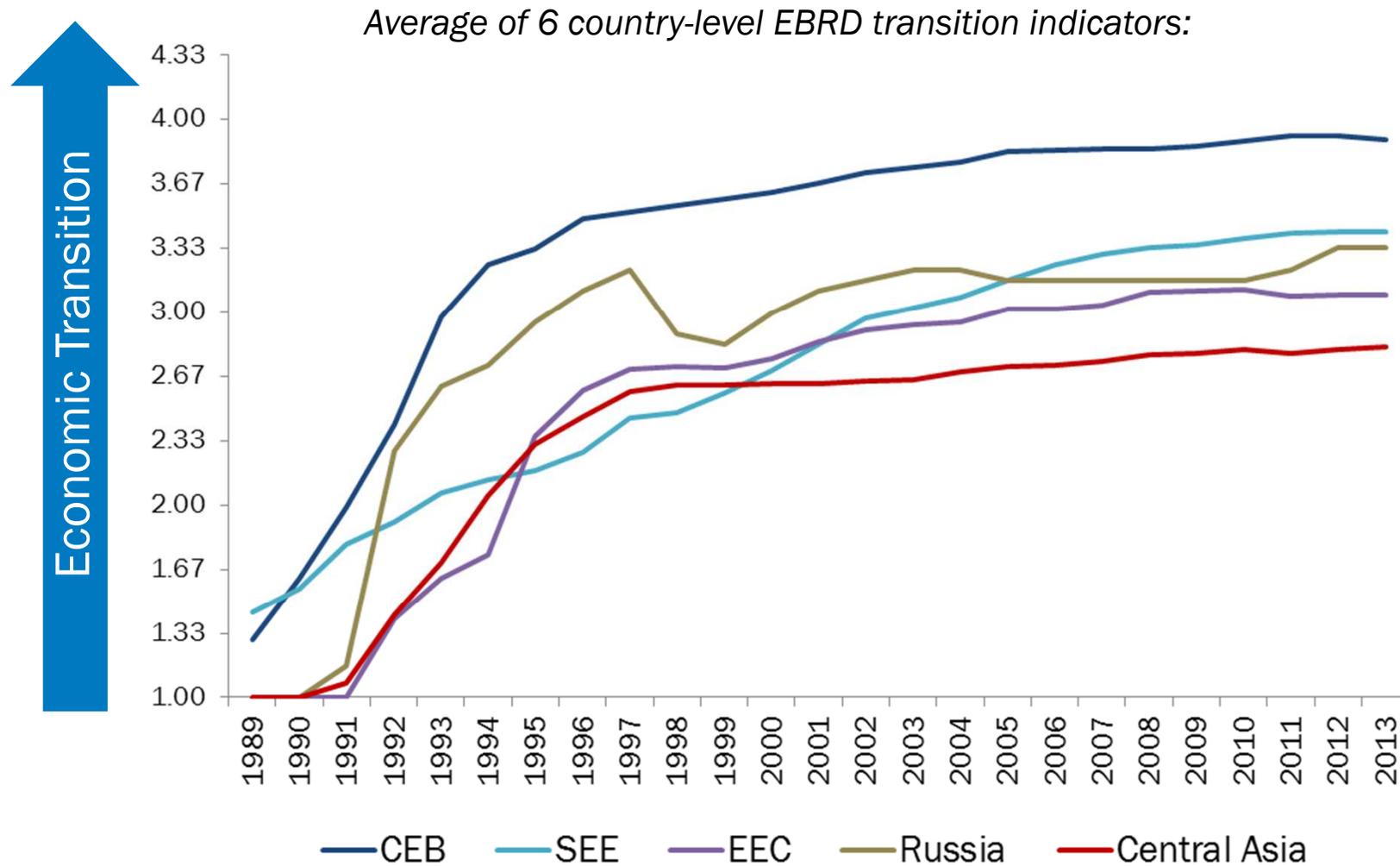
On current policies, convergence will mostly not happen



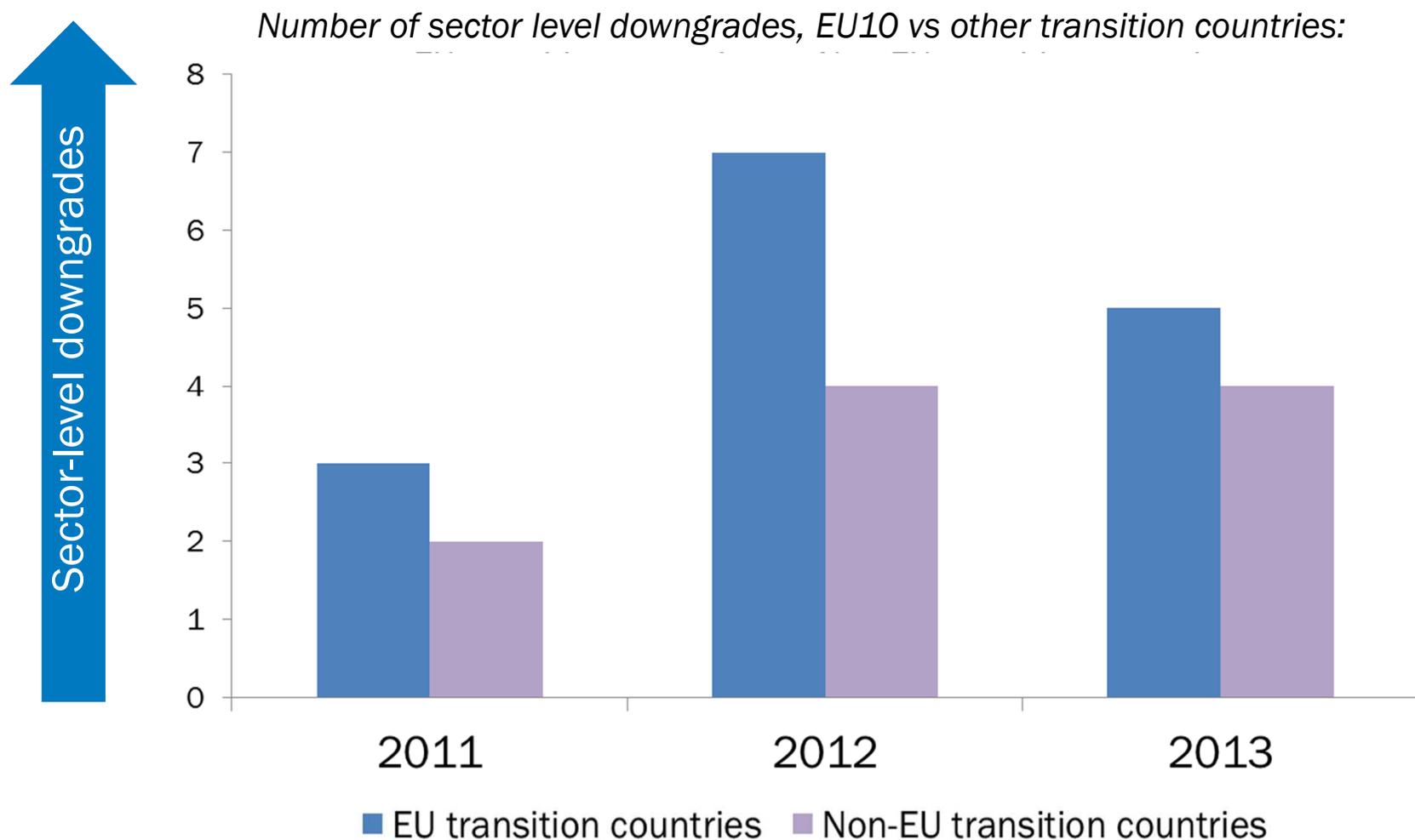
Post-communist productivity catch-up is largely complete



Reforms have stagnated since mid-2000s



Sector-level reform reversals, particularly in EU countries

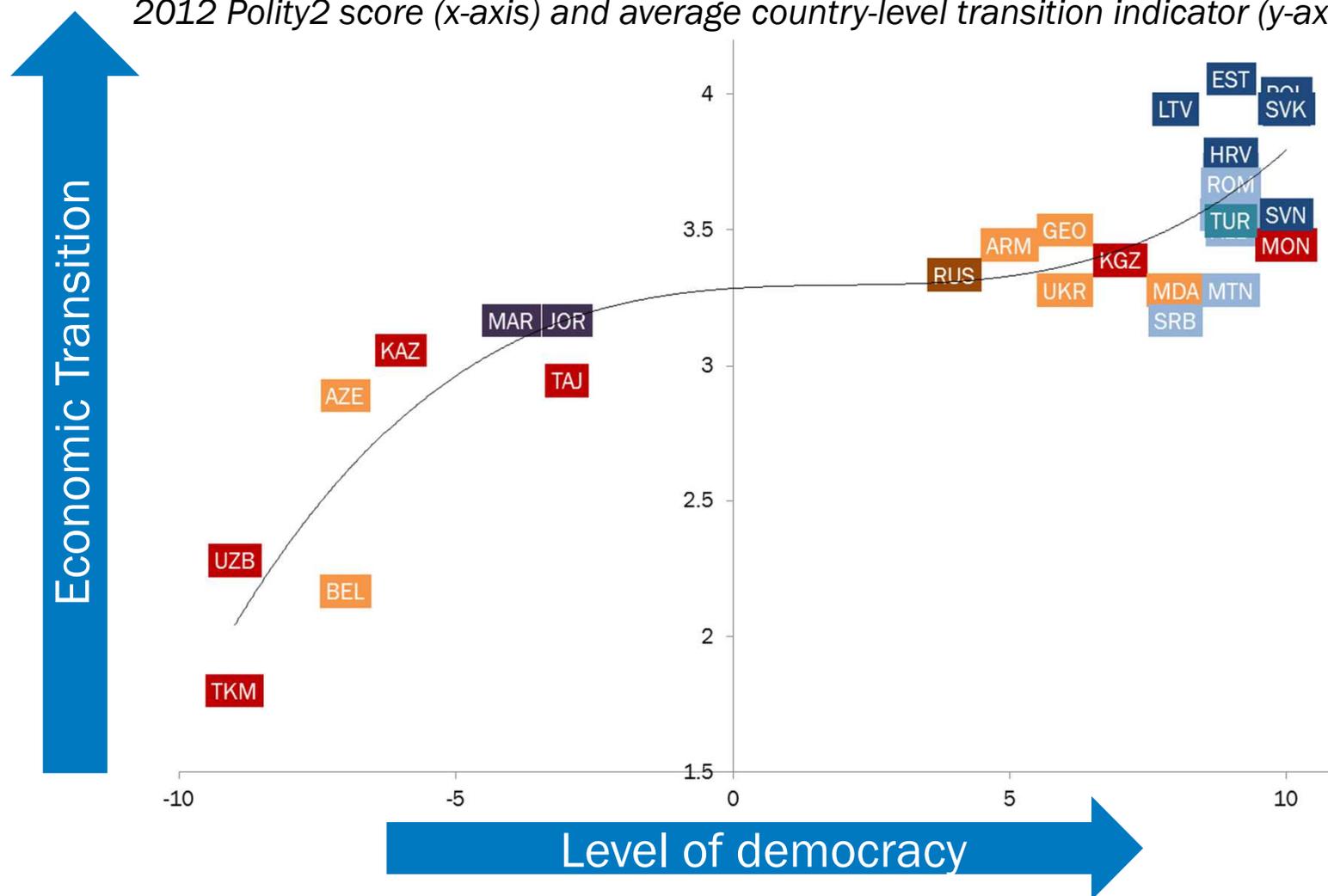


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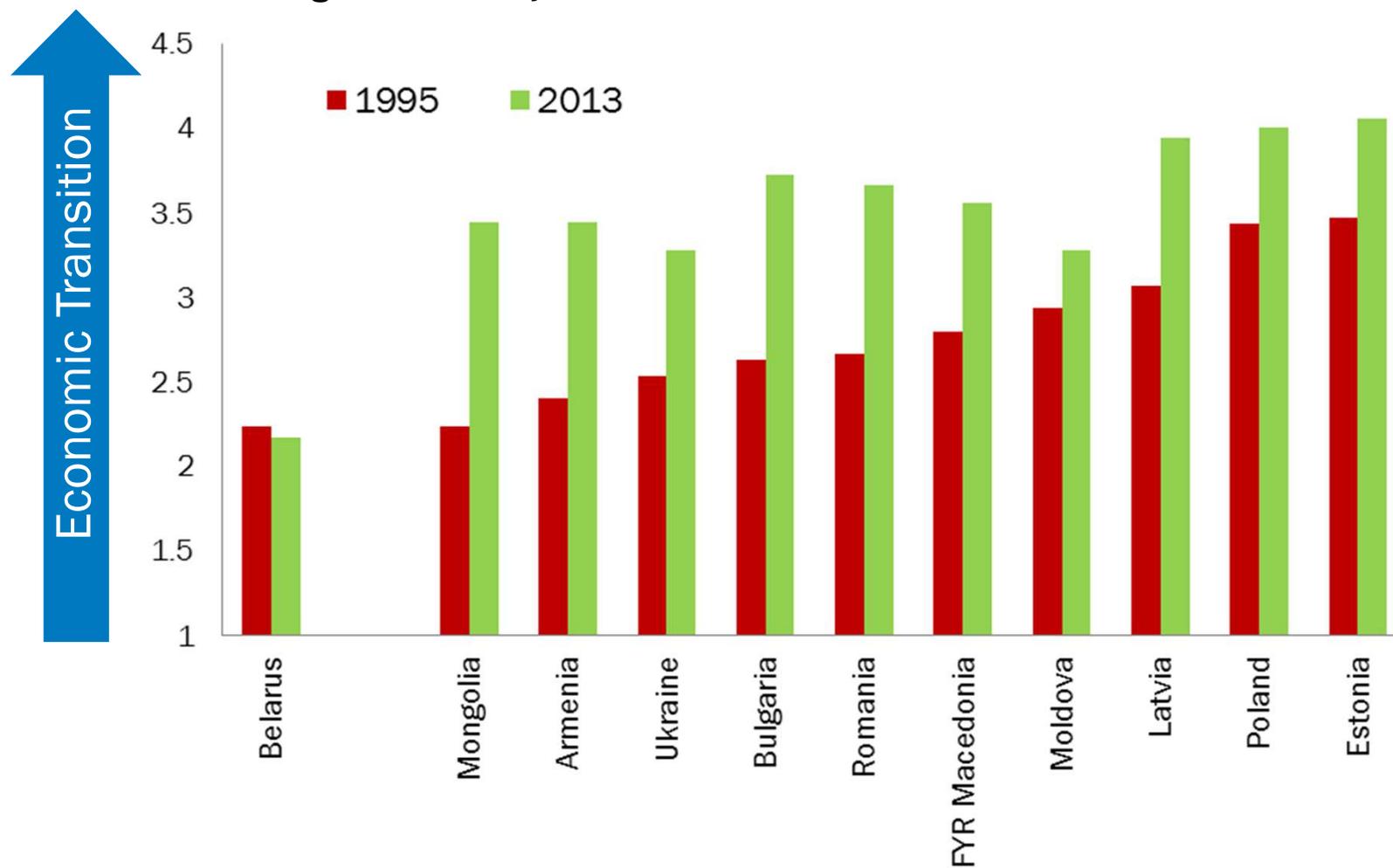
Democracy and reform are highly correlated in the transition region

2012 Polity2 score (x-axis) and average country-level transition indicator (y-axis):

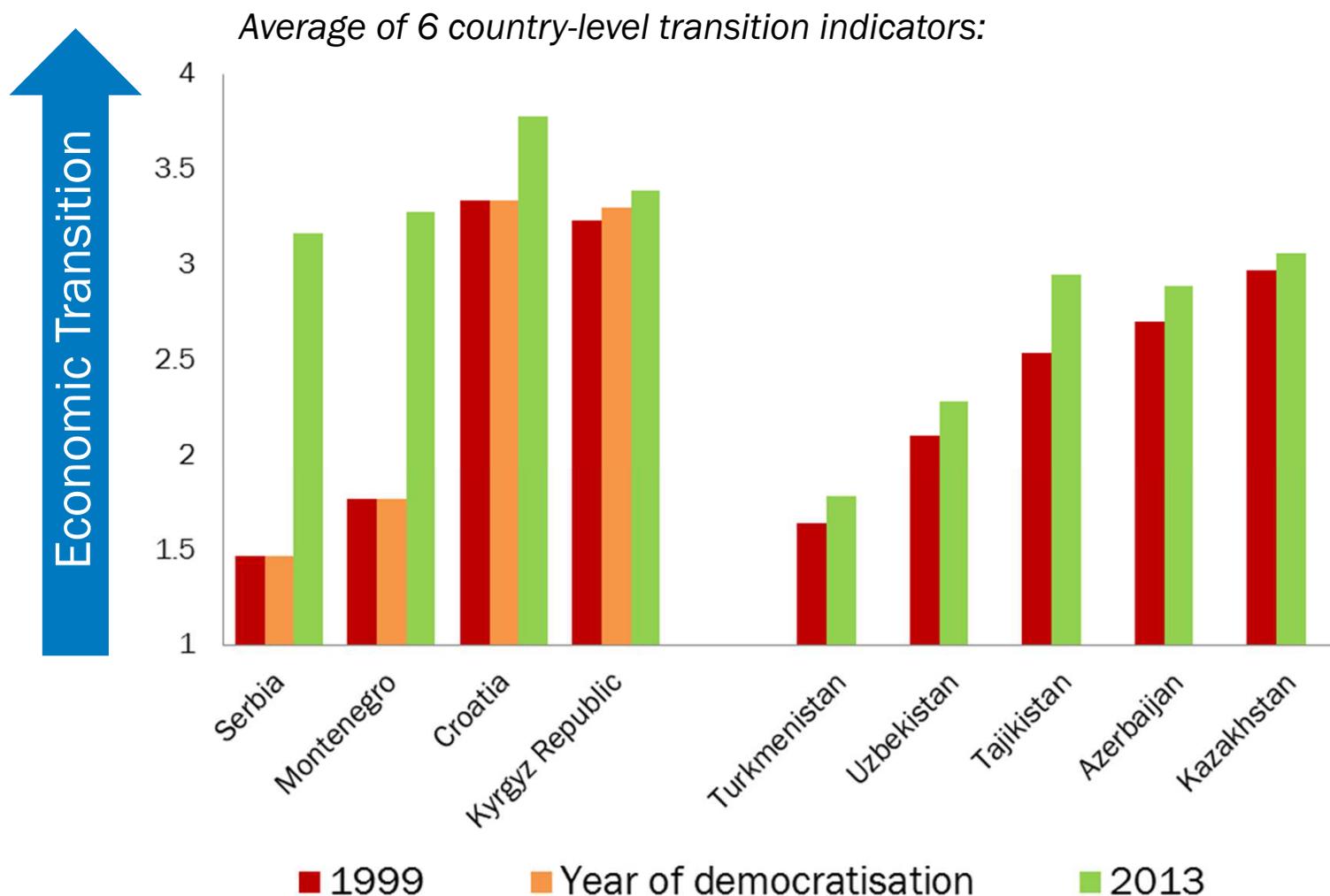


Causality from (lack of) democracy to reform: the case of Belarus

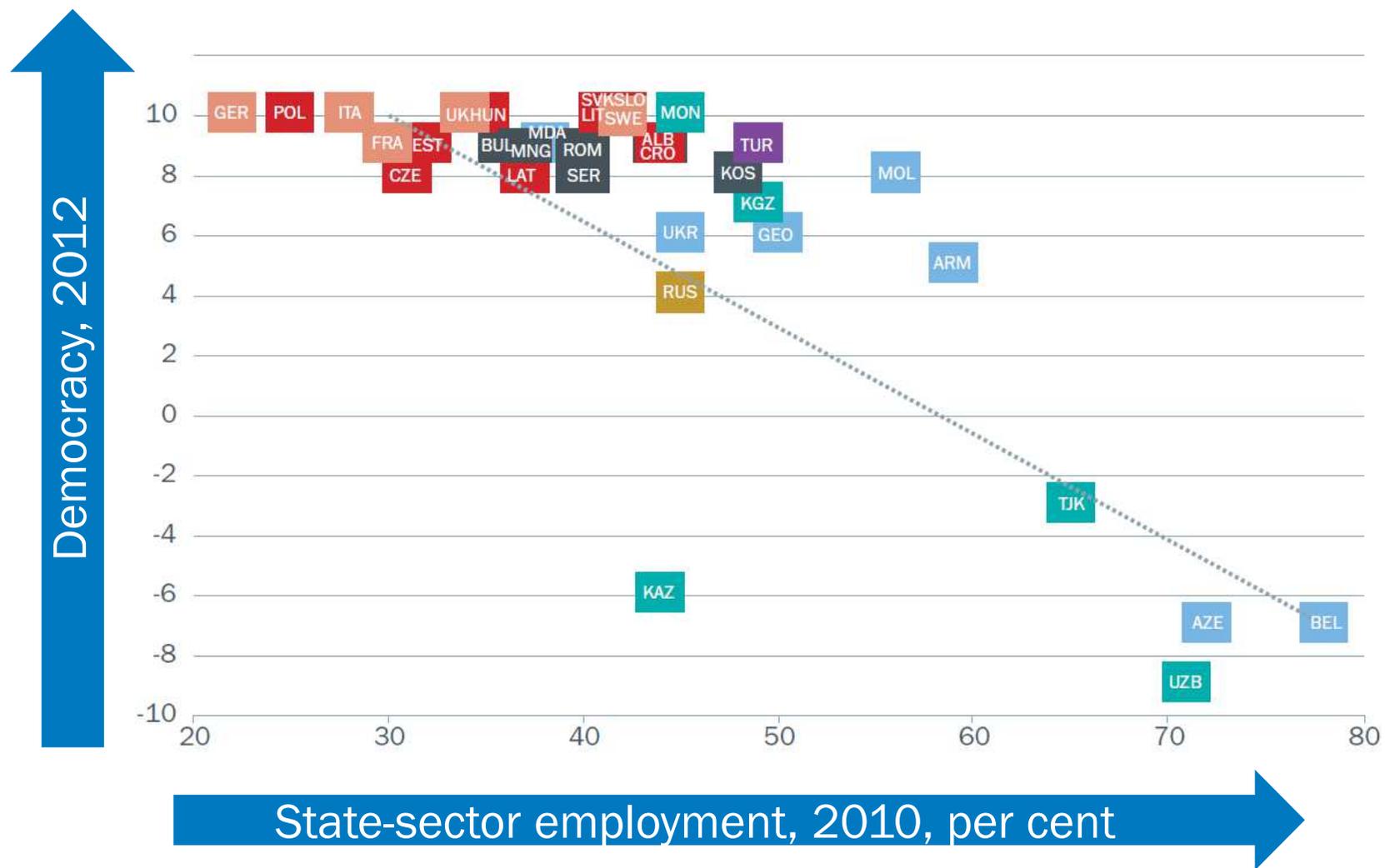
Average of 6 country-level transition indicators:



(Imperfect) causality from democratization to reform: Serbia and Montenegro, Croatia, Kyrgyz Republic



Causality the other way: resulting from higher levels of state employment in less democratic countries

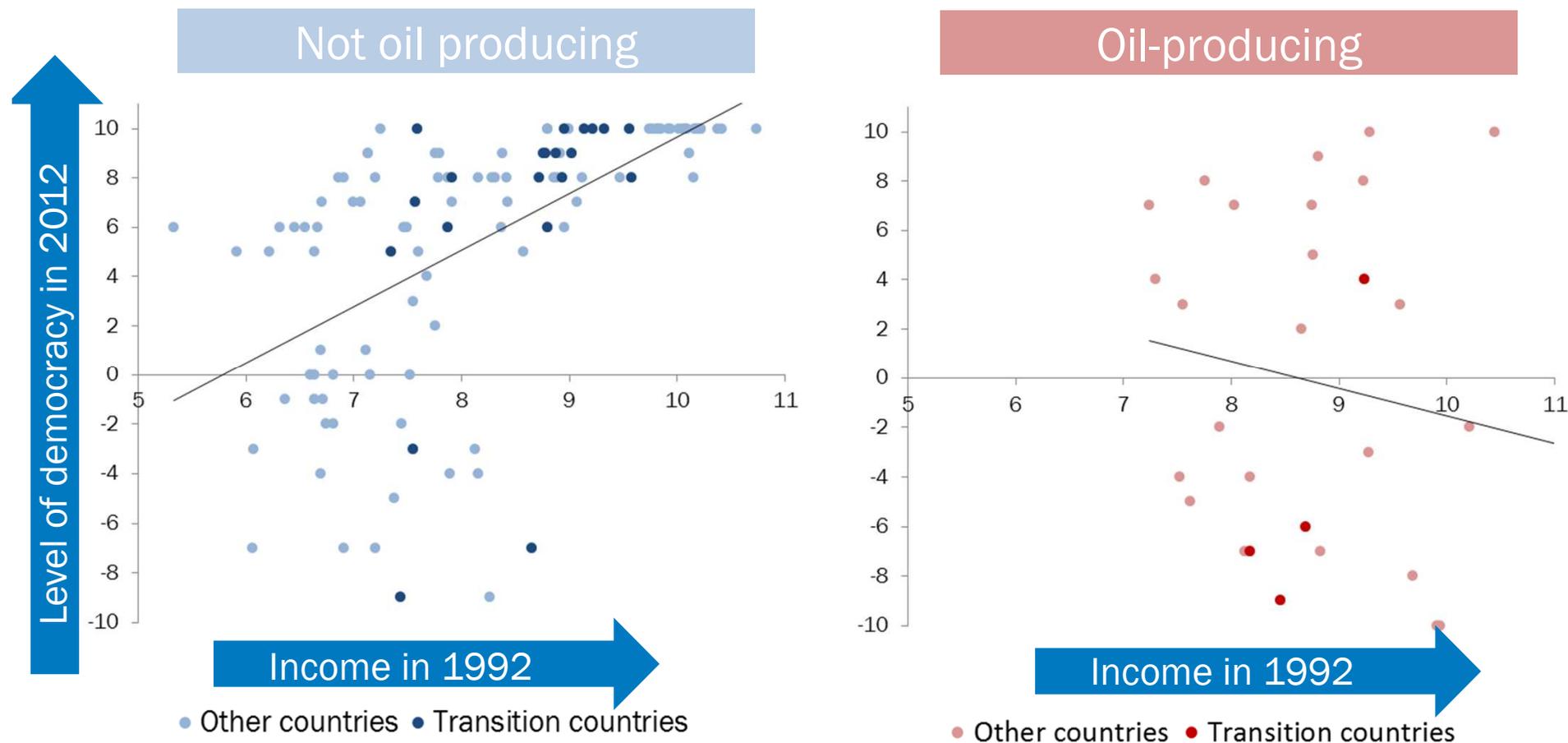


Causality the other way: economic development and reforms help democracy

- Economic development – measured in terms of growth in per capita GDP, expansion of the middle class, industrialisation, urbanisation – has led to advances in democracy both globally and in the transition region (with diminishing returns).
- Reform can help democracy:
 1. By making societies richer and fostering the growth of the private sector (especially small businesses), leading to demand for democratic reform
 2. By creating competition and weakening special interests opposed to democracy; reducing inequality

A caveat: natural resources may break the link between rising incomes and democracy

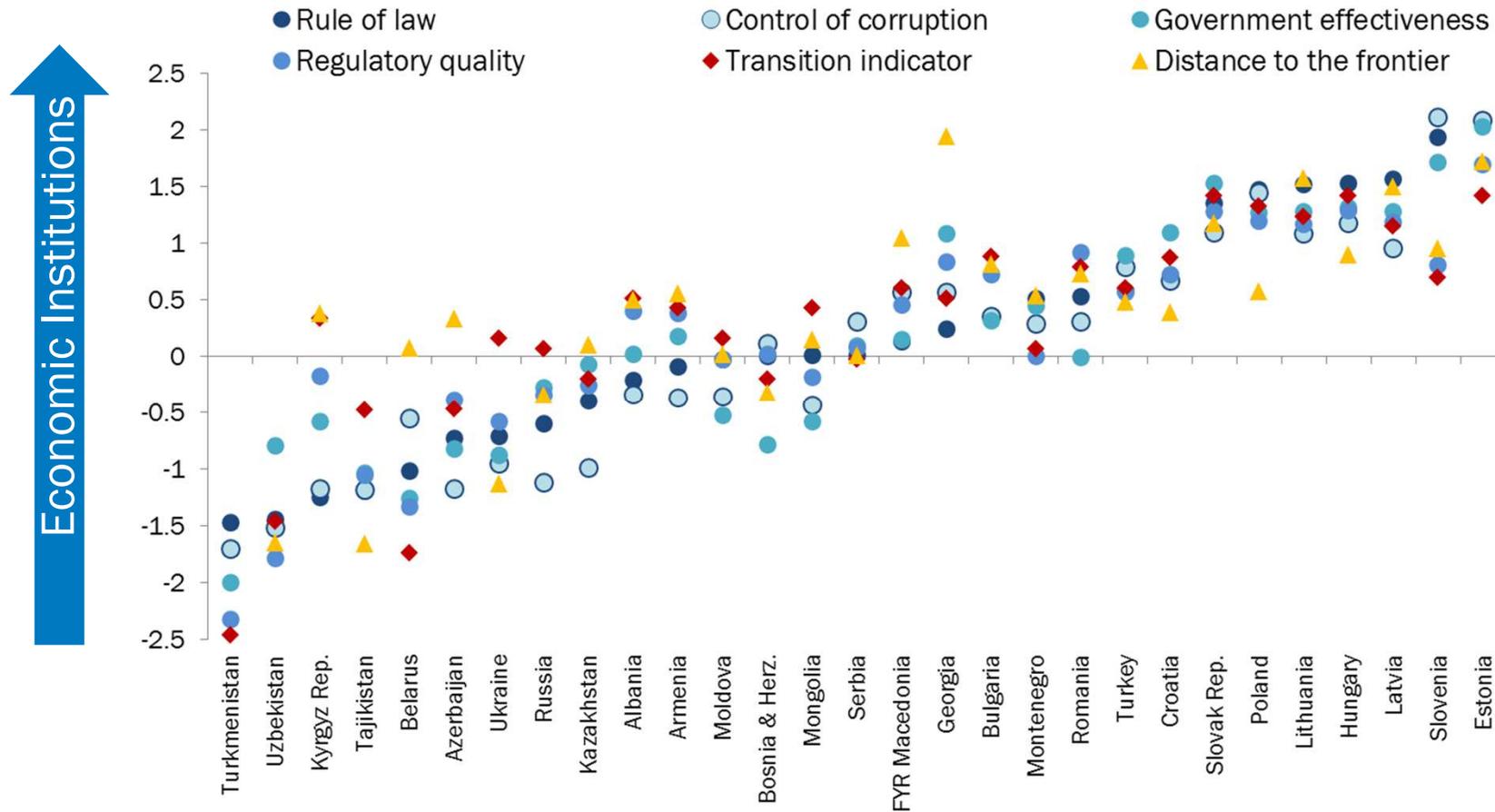
Log per capita income 1992 (x-axis) and Polity 2 score 2012 (y-axis):



The narrative

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What we mean by “economic institutions”

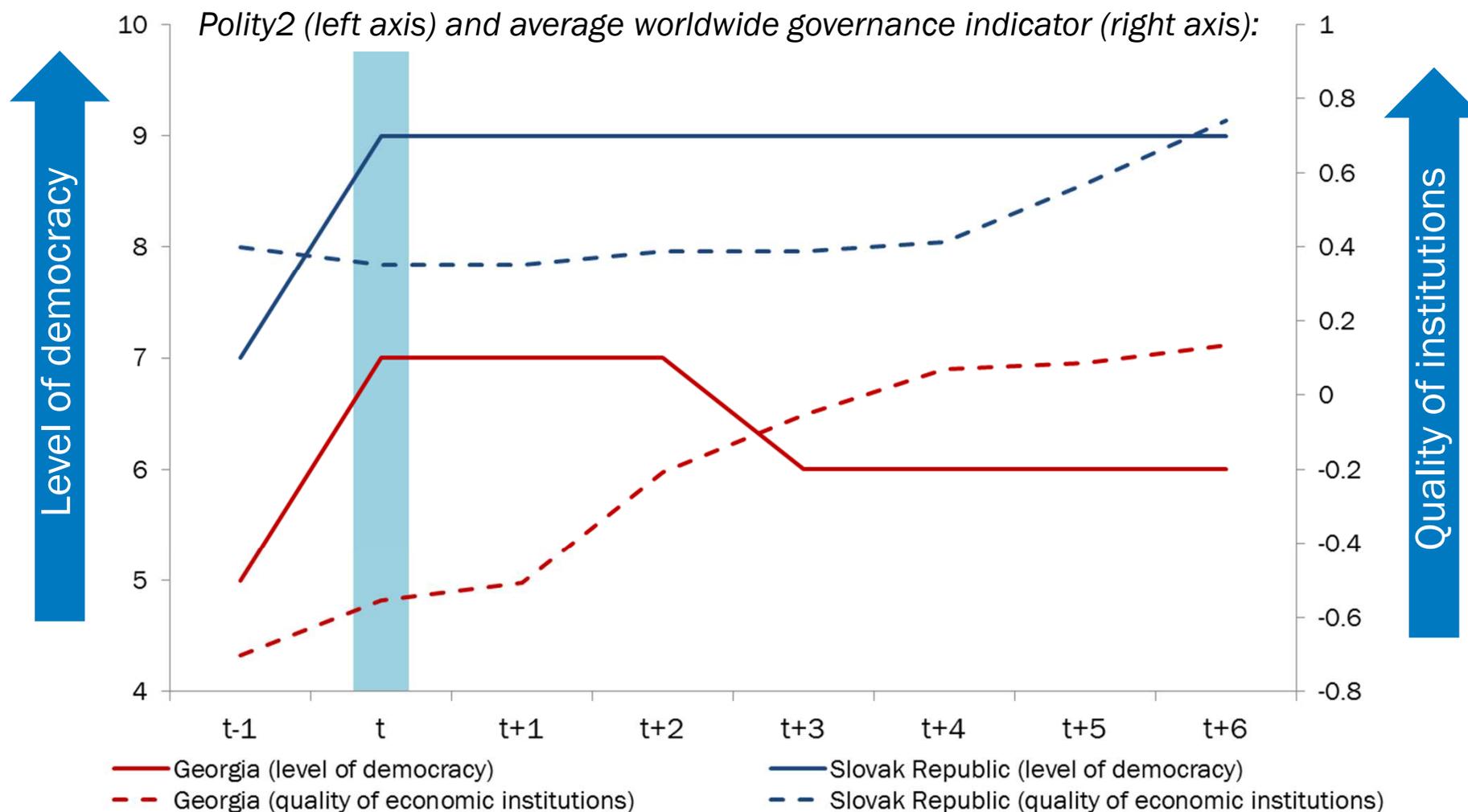


- Worldwide Governance Indicators (survey based)
- ▲ Doing Business “distance to the frontier” (laws and regulations)
- ◆ EBRD transition indicators (cumulative market reform)

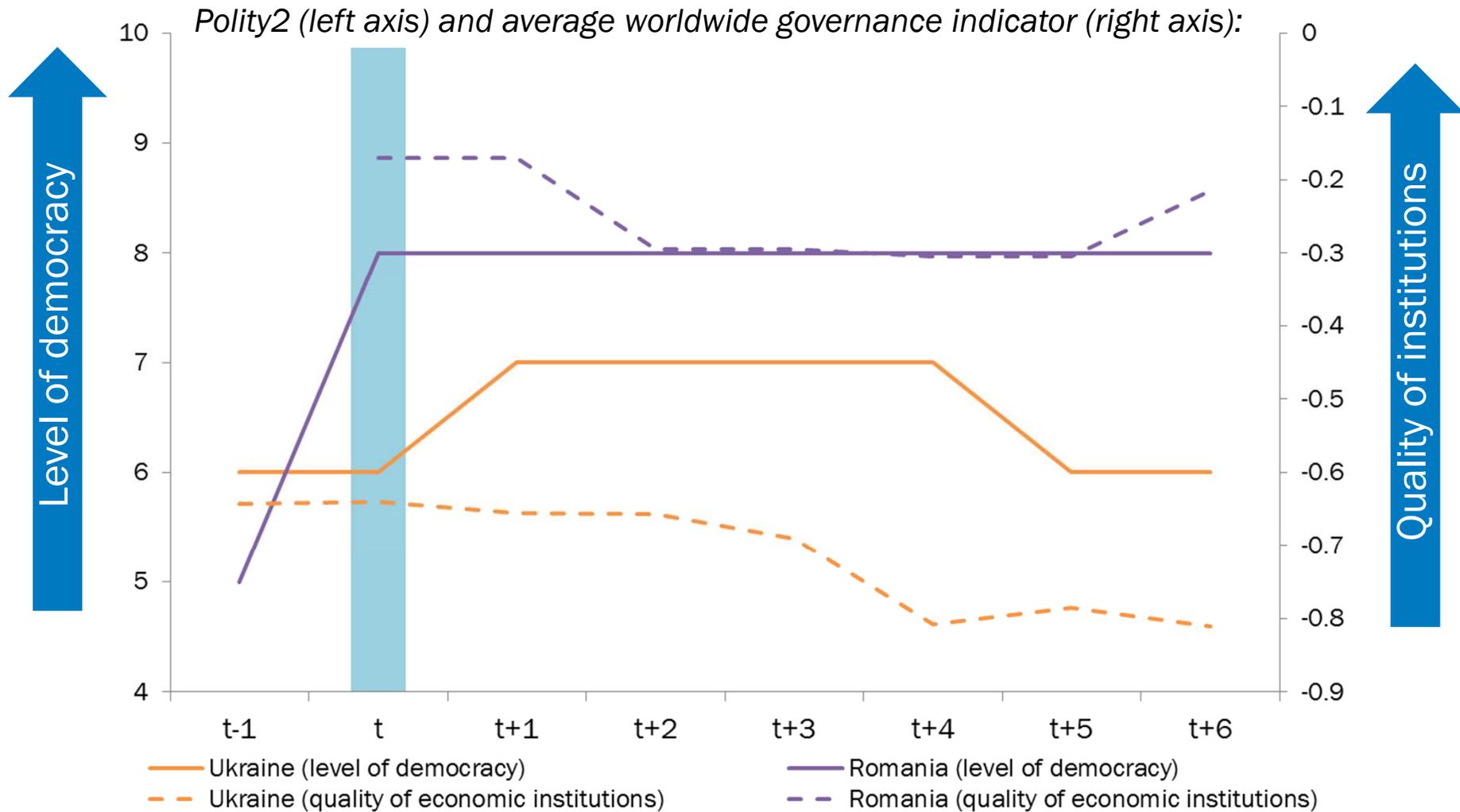
Getting out of the political under-reform trap

1. In imperfect democracies, political shocks can *sometimes* trigger large improvements in economic institutions.
 - Comparative study of four cases: Romania (pivotal election, 1996); Slovak Republic (pivotal election, 1998), Georgia (Rose Revolution, 2003) , Ukraine (Orange Revolution, 2004).
2. Some policies can trigger or facilitate improvements in economic institutions almost regardless of the political system.
 - “Feasible political reform” – particularly at local/regional level
 - Openness to trade and FDI
 - Education, particularly higher education

Windows of opportunity leading to better economic institutions: Slovak Republic and Georgia



Missed opportunities: Romania (1996), Ukraine (2004)

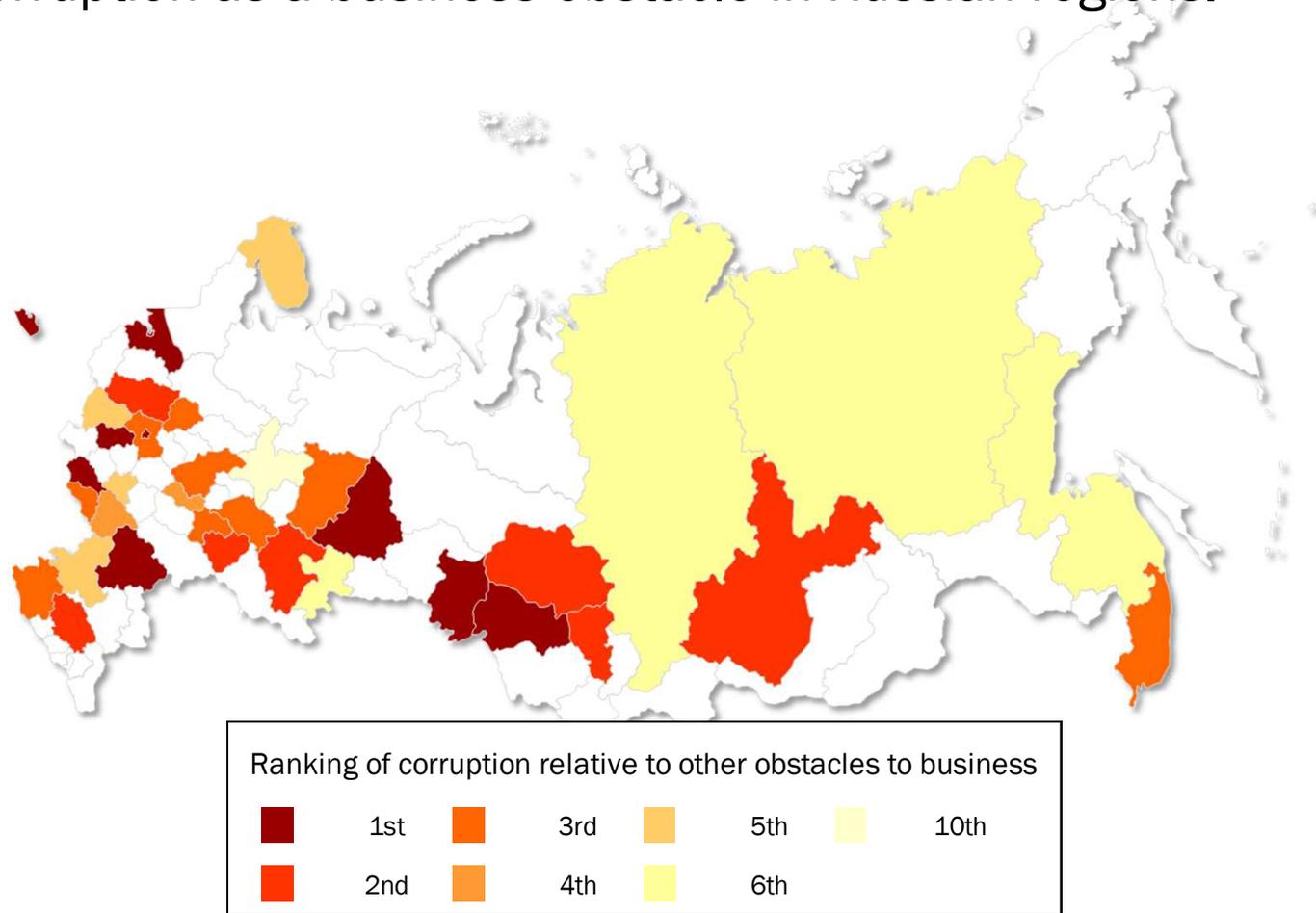


Factors shaping the success of windows of opportunity

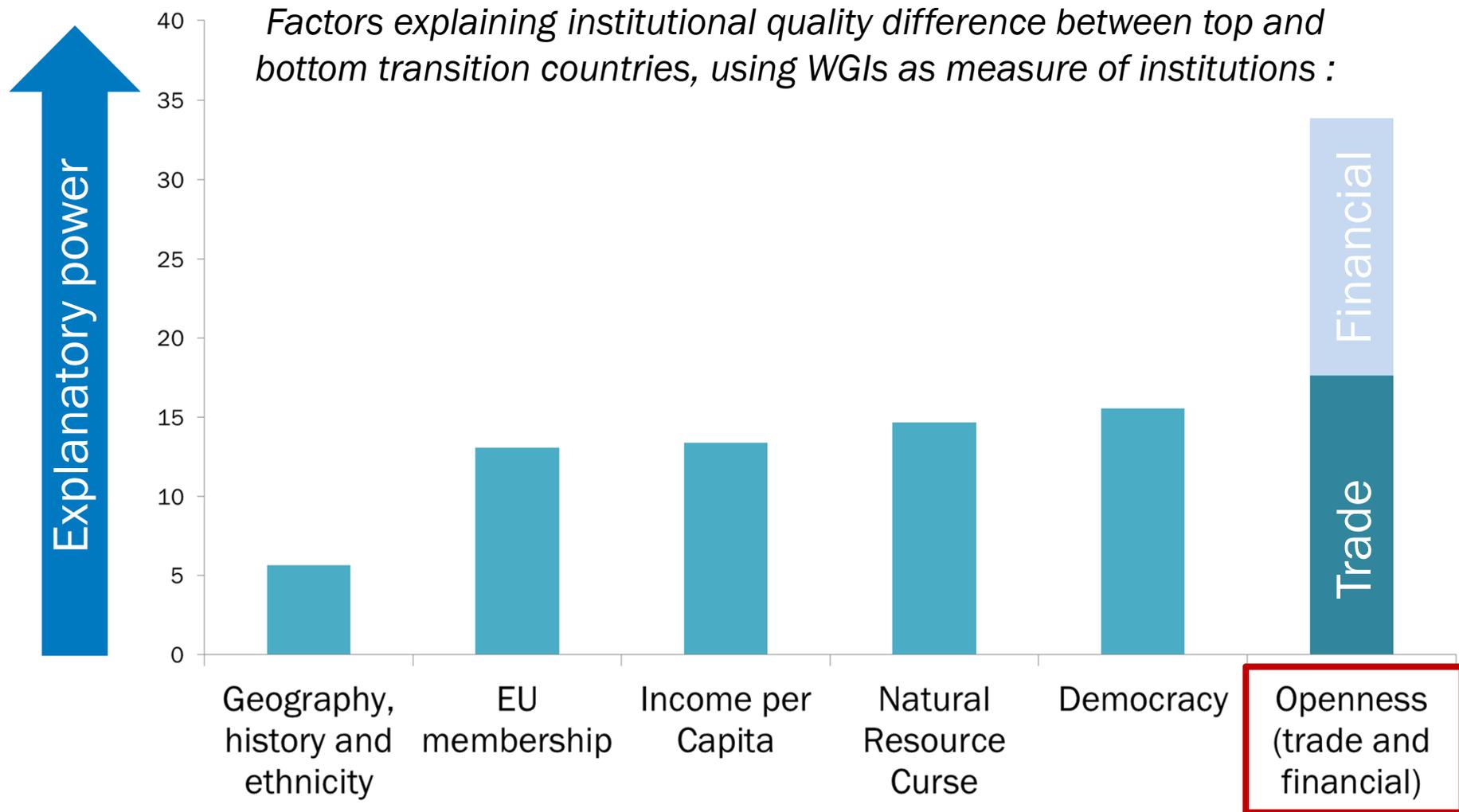
1. *Early transition histories* – where powerful vested interests arose after the collapse of central planning, they impeded reform.
2. *Political Polarisation* – restricted reformers' ability to initiate and sustain change.
3. *Leaders' priorities* – in some countries foreign-educated leaders backed reformist agendas and tackled corruption.
4. *External anchors and support* – the prospect of EU membership spurred reform, as did foreign financial and technical assistance

Large variation in business environment at regional level

- e.g. corruption as a business obstacle in Russian regions.

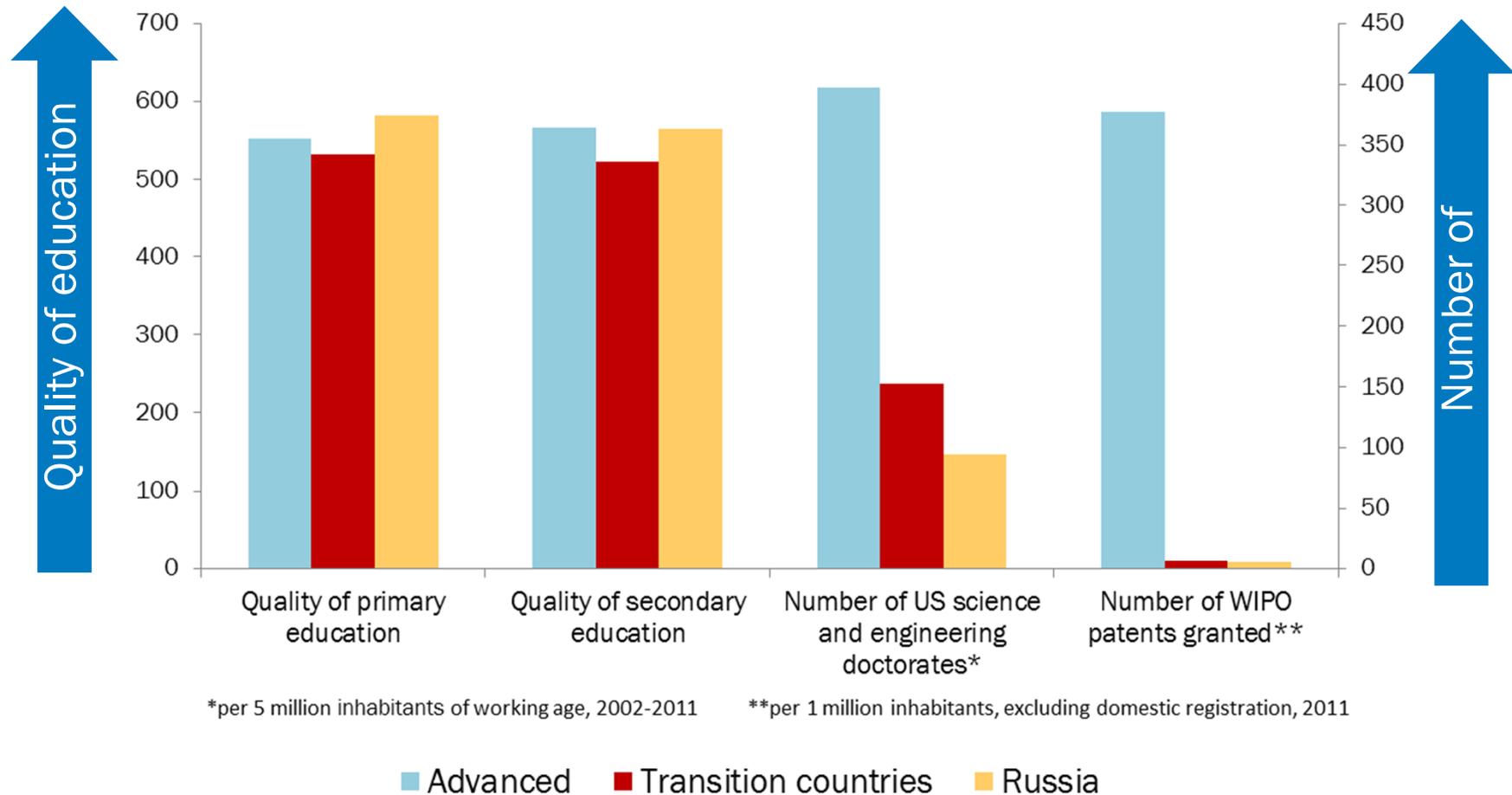


International integration comes with good institutions



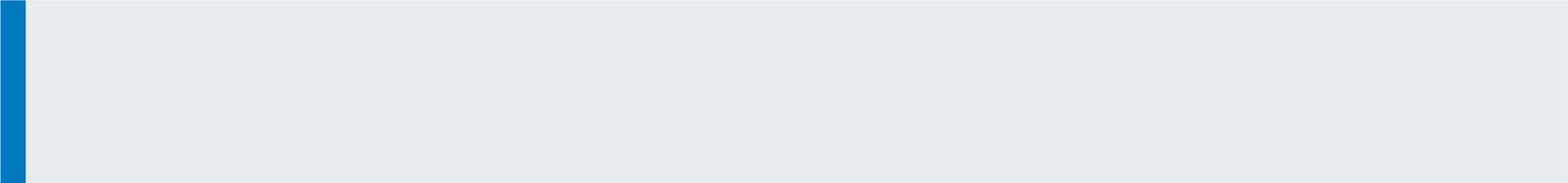
Much scope for improving quality of tertiary education

Comparison of human capital in Advanced and Transition countries:



Conclusion

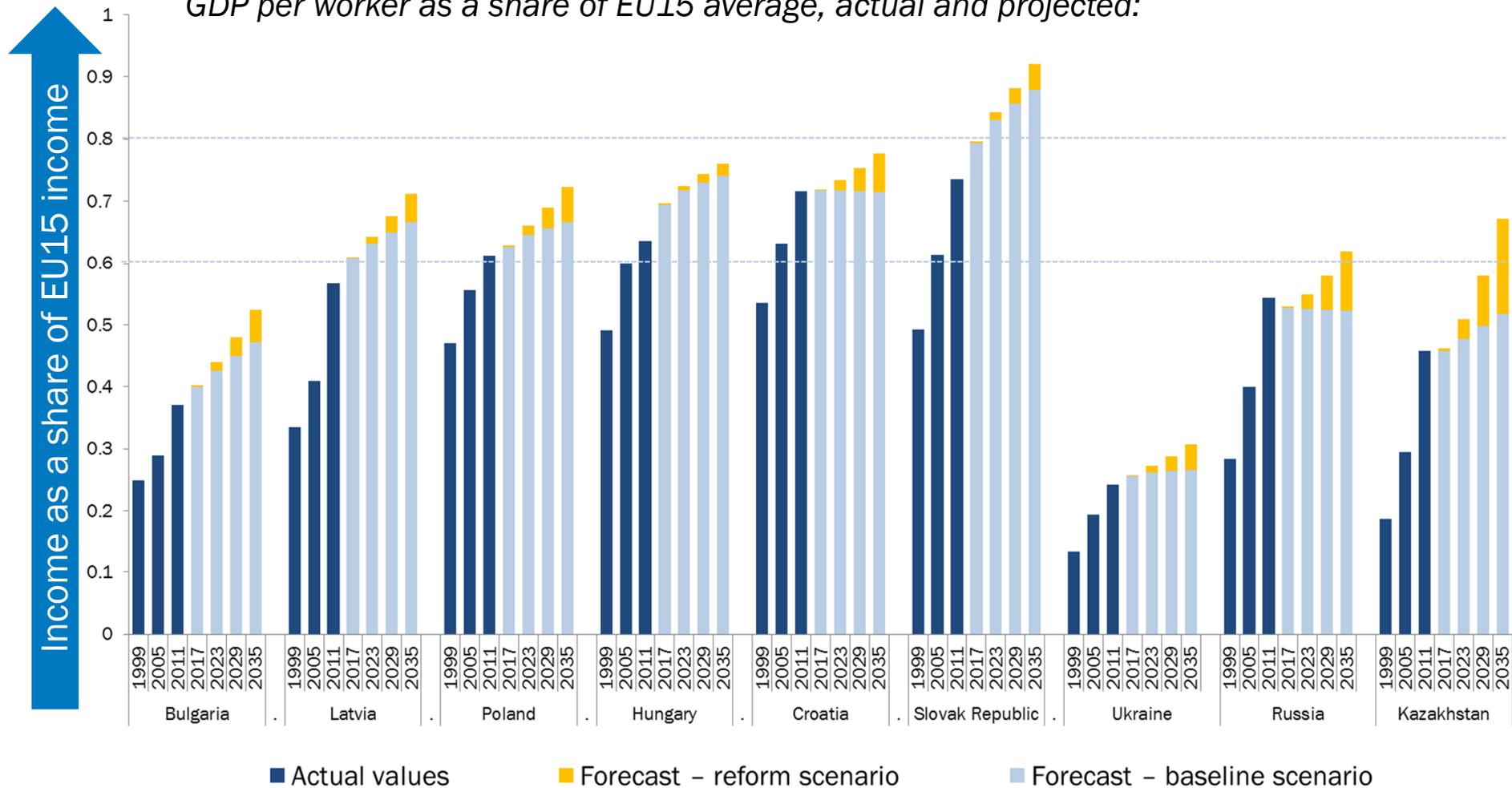
1. Time is on the side of democracy and reform
2. But the process can be slow, and some factors – like natural resource abundance – can hold it back.
3. In the meantime, some reforms may be feasible in democratic and less democratic countries alike:
 - Allowing international integration
 - Improving transparency and accountability at local levels
 - Improving and opening education
4. International community can help by promoting international integration (trade and financial), supporting diversification, and supporting education.



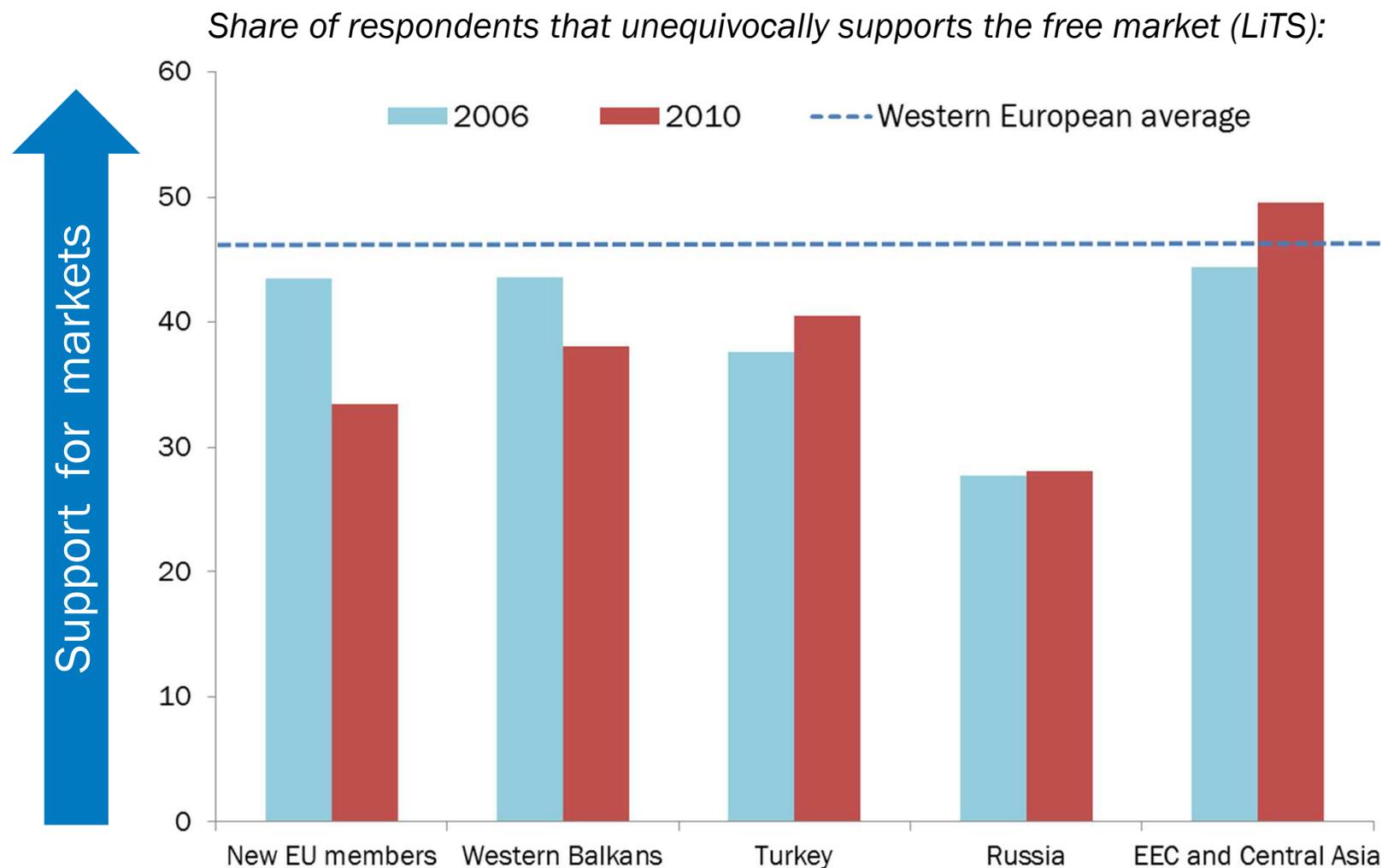
Backup slides

How convergence might change if reform is invigorated

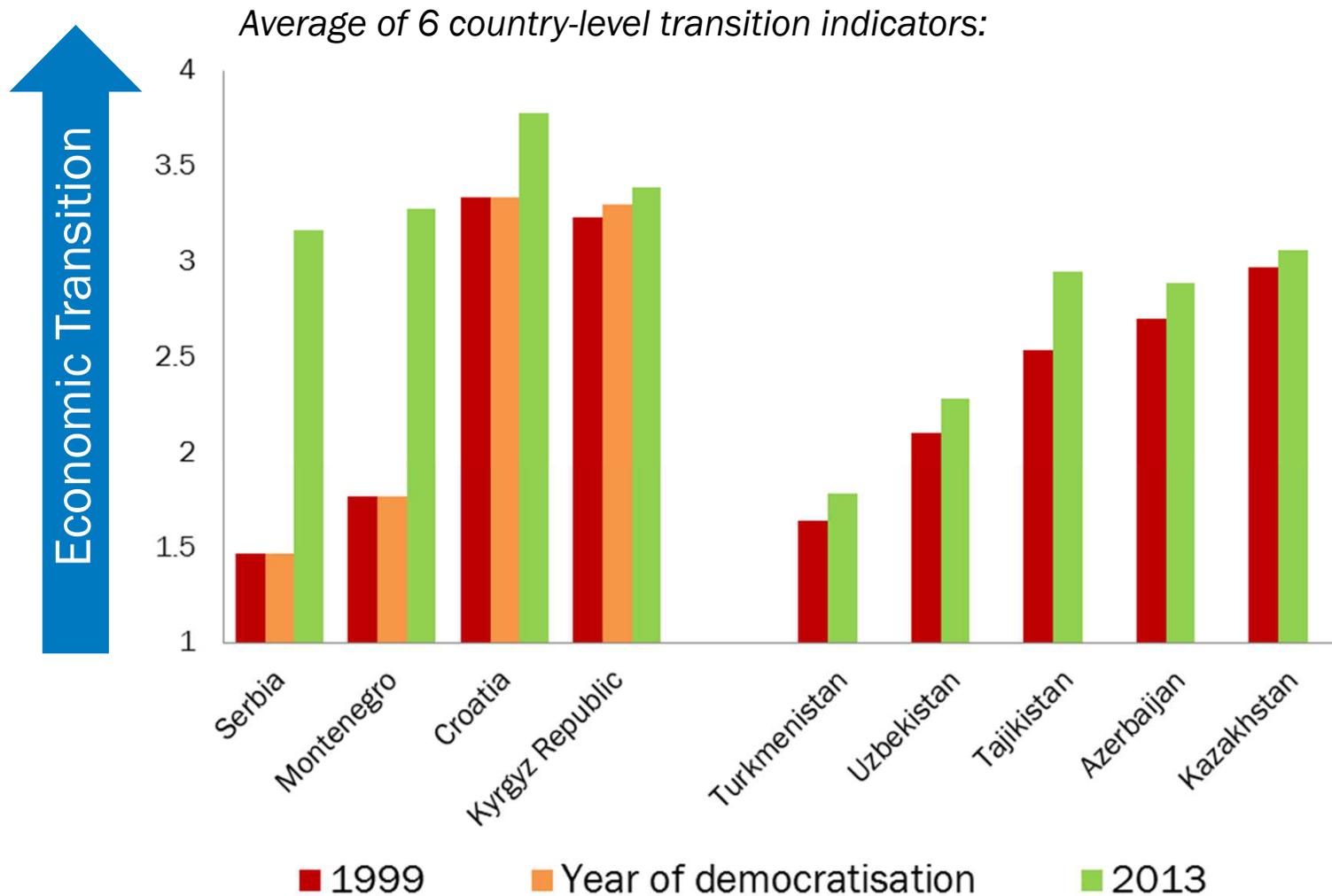
GDP per worker as a share of EU15 average, actual and projected:



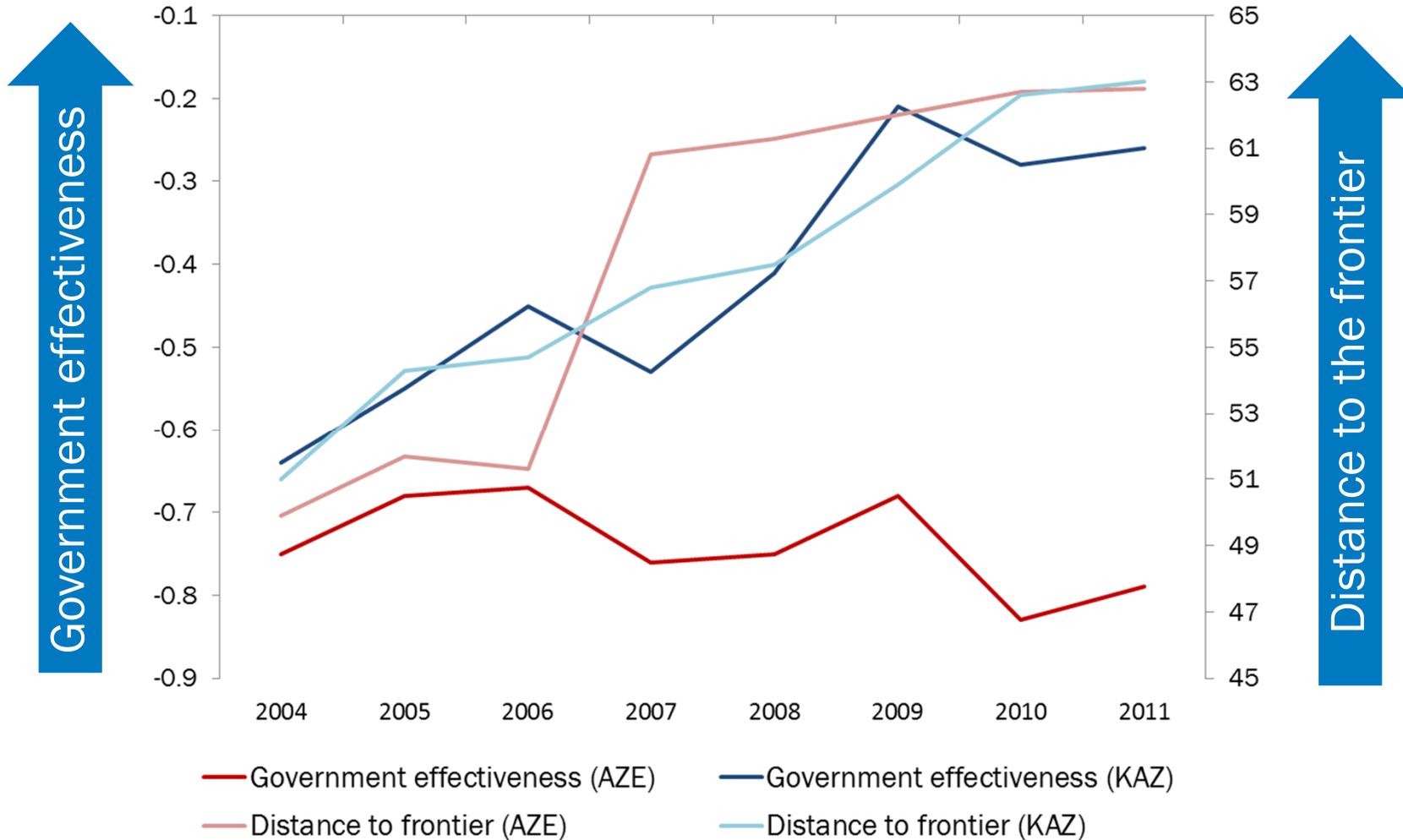
In more advanced transition countries, attitudes shifted against the market after the crisis



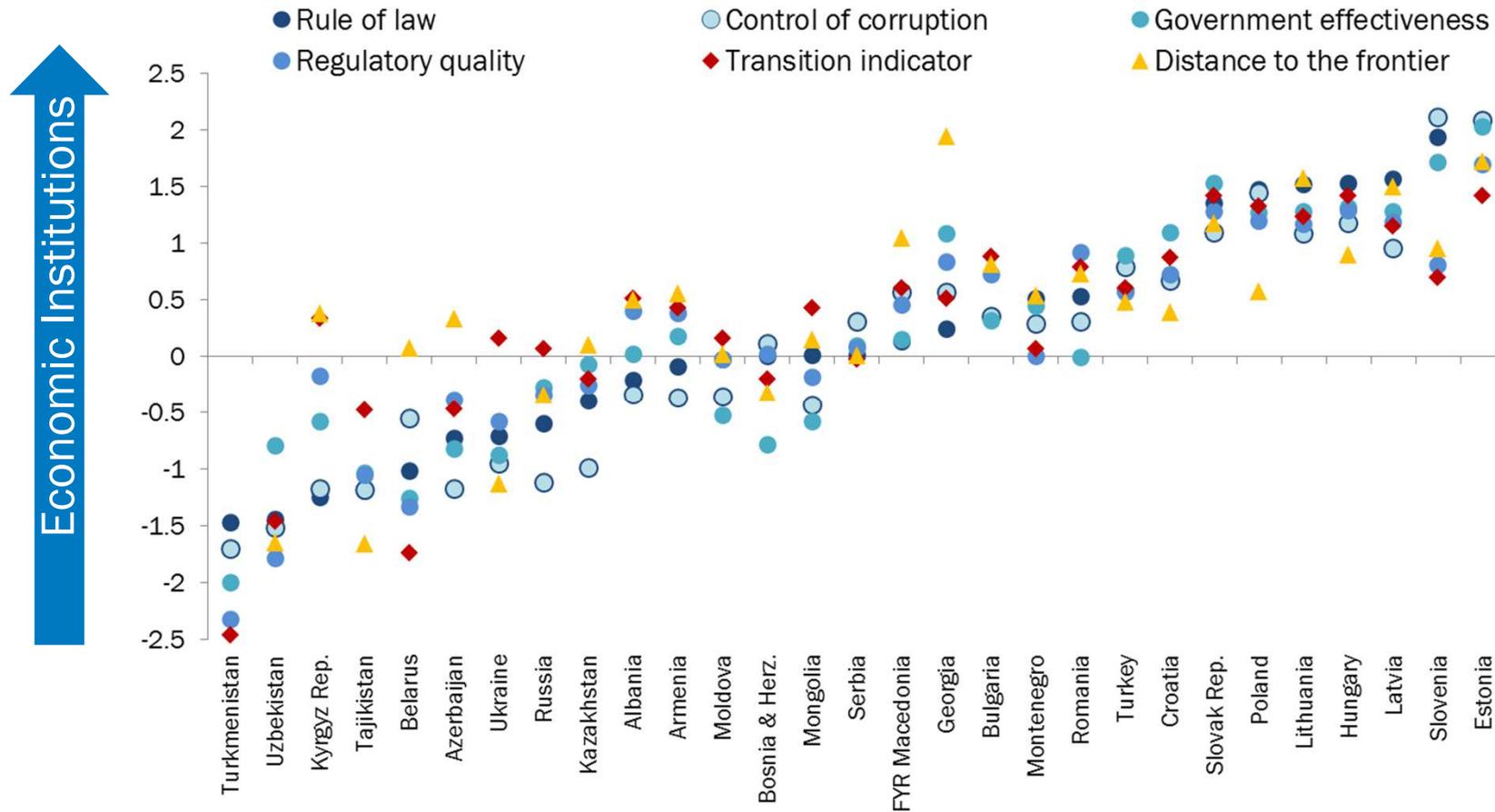
Democratisation has propelled reform – but not always



... but “distance to frontier” can still shrink

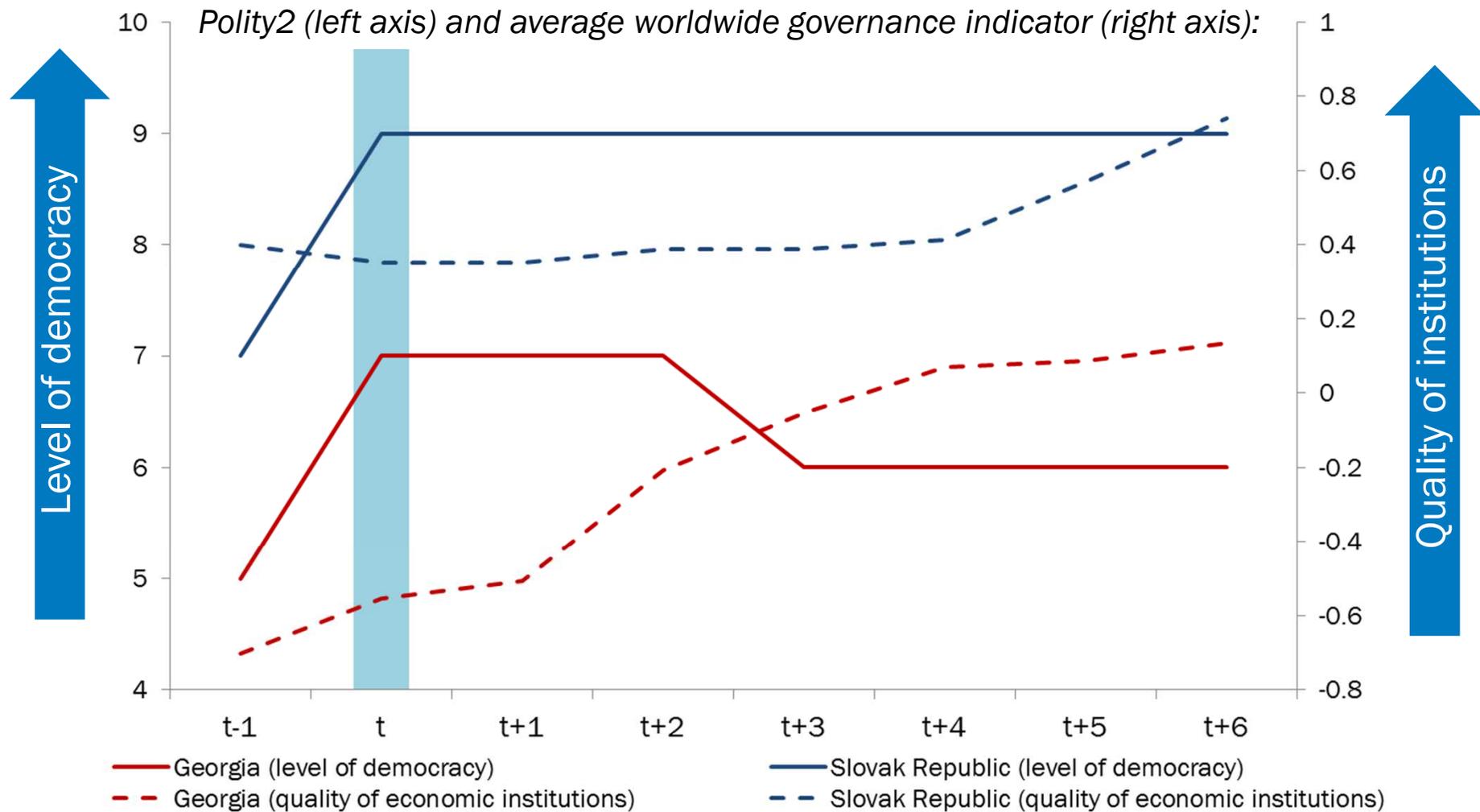


What we mean by “economic institutions”

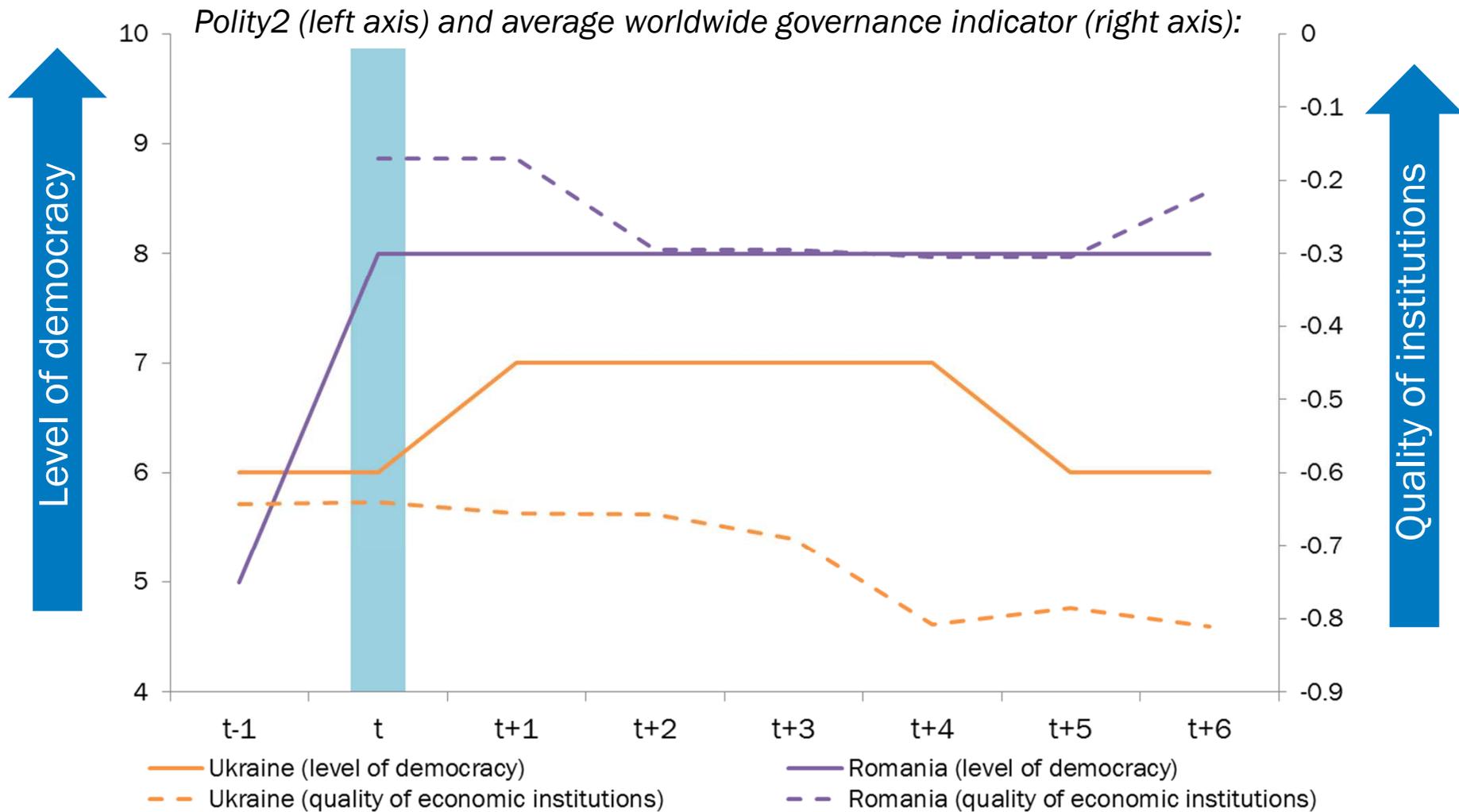


- World Bank Global Governance indications (survey based)
- ▲ Doing business “distance to the frontier” (laws and regulations)
- ◆ EBRD transition indicators (cumulative market reform)

Political change creates windows of opportunity which sometimes lead to better economic institutions...



... but opportunities are also sometimes missed



Factors shaping the success of windows of opportunity

1. *Early transition histories* – where powerful vested interests arose after the collapse of central planning, they impeded reform.
2. *Political Polarisation* – restricted reformers' ability to initiate and sustain change.
3. *Leaders' priorities* – in some countries foreign-educated leaders backed reformist agendas and tackled corruption.
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The role of economic inclusion

- Reforms sometime can be undermined by lack of inclusion: e.g. Egypt before revolution; privatisation in Russia ... (Euro area today?)
- Inclusion is correlated with, but not fully captured by, democracy and measures of institutional quality (e.g. rule of law).

This report

1. Initial attempt to measure economic inclusion “bottom up”: as inequality of opportunity (based on Life in Transition Survey)
2. Attempt to measure “inclusion gaps” across countries “top down”: by rating capacity of markets and institutions to create opportunities for women, young, and across sub-national regions .

Wide variations in inequality of opportunity with respect to wealth

Percentage variation in household asset index explained by pre-determined factors:

