Beyond the Crisis: Prospects for Emerging Europe

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Comparative Economic Studies

Aims and scope

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Abstract

This paper assesses the impact of the 2008–2009 global financial and economic crisis on the medium-term growth prospects of the countries of Central and Eastern Europe, the Caucasus and Central Asia, which began an economic transition about two decades ago. We use cross-country growth regressions, putting special emphasis on a proper consideration of the crisis and robustness. We find that the crisis has had a major impact on the within-sample fit of the models used and that the positive impact of EU enlargement on growth is smaller than previous research has shown. The crisis has also altered the future growth prospects of the countries studied, even in the optimistic but unrealistic case of a return to pre-crisis capital inflows and credit booms.

Notes

1. The CEECCA countries that formerly belonged to the political and economic sphere of the Soviet Union have a common historical root but are rather diverse. Ten countries are members of the European Union (Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia and Slovenia). Seven countries in the western Balkan are either EU accession

candidates or potential candidates (Albania, Bosnia and Herzegovina, Croatia, the Former Yugoslav Republic of Macedonia, Montenegro, Serbia, and Kosovo under UNSC Resolution 1244/99, though we do not include Montenegro and Kosovo in our study due to lack of data). Among the 12 other former Soviet Union countries, five are major hydrocarbon exporters (Azerbaijan, Kazakhstan, Russia, Turkmenistan and Uzbekistan) while the other seven are not (Armenia, Belarus, Georgia, Kyrgyz Republic, Moldova, Tajikistan and Ukraine); most of these countries belong to the Commonwealth of Independent States (CIS) and we shall refer them accordingly. Mongolia is also a transition country, while Turkey – another EU candidate – is not, but we also include it in our study due to its geographical proximity.

2. See extensive analyses of the development model of the CEECCA region and assessments of its future potential in Bruegel and WIIW (2010), Cihák and Fonteyne (2009), Fabrizio et al. (2009) and Mitra et al. (2009).

3. We should highlight that forecasts for many explanatory variables are not necessary because these explanatory variables represent initial conditions that lag some years compared to growth, though there are some contemporaneous correlates as well. When it is only the regressand, the growth rate of GDP, which contains a measurement error due to the adoption of forecasts, it boosts the standard error of the estimate but does not distort the unbiasedness of the regression.

4. It was widely expected that countries undergoing transition would experience an initial decline in output and employment, but the depth and the length of the post-communist recession were unexpected (Fischer, 2002; Svejnar 2006). The literature has proposed various explanations for this phenomenon. Svejnar (2006) categorises them into six main themes. First, a disorganisation among suppliers, producers and consumers associated with the central planning; second, the dissolution in 1990 of Comecon (Council for Mutual Economic Assistance), which governed trade relations across the Soviet bloc; third, difficulties of sectoral shifts in the presence of labour market imperfections;

fourth, a switch from controlled to uncontrolled monopolistic structures in these economies; fifth, a credit crunch stemming from the reduction in state subsidies to firms and rise in real interest rates; and finally, tight macroeconomic policies may have played a role in the depth and length of the recession.

5. See Veugelers (2011) for a discussion of the different role of various factors for technological progress along the development path.

6. The cut-off values for the third country group, which are based on the average GDP per capita at PPP compared to the US in the 2000–2010 period, were determined on the basis of CEE10 countries. We calculated their minimum, 23.0% for Bulgaria, and maximum, 56.9% for Slovenia, and the standard deviation, which was subtracted from the minimum and added to the maximum to determine a possible range. However, we also include in this middle-income country group those seven CIS countries that have lower per capita income, as well as Mongolia, in order to be able to analyse all CEECCA countries using the same model.

7. Multicollinearity among some variables may also explain the difficulties in finding a single best model. Note that multicollinearity affects the parameter estimates and their standard errors, but it does not reduce the predictive power or reliability of the model as a whole.

8. There are clear differences within the CEECCA region, however. The CEE10 have reached the highest level of integration, followed by the countries of the western Balkans that have either EU ‘candidate’ or ‘potential candidate’ status. The six ‘Eastern Partnership’ countries, which were part of the Soviet Union, have reached a varying degree of integration with the EU15, while integration was generally minor for most of the other former Soviet Union countries.

9. Unfortunately, it is difficult to collect reliable data on migration for a wide range of countries and time periods.

10. For most CEECCA countries the available data start in 1989 with the exception of a few, for which data for earlier years are also available.

11. Falcetti et al. (2006) and Iradian (2009) use a discrete dummy variable to measure the same phenomenon. The dummy takes a value of 1 if output in a given year is below 70% of its 1989 value. Böwer and Turrini (2010) adopt a continuous variable to capture this effect and hence it is the closest to our variable: they define an ‘output loss’ variable as the ratio of current output to the average output during the period 1990–1995.

12. See detailed results of this exercise in Table 1 of Darvas (2010b).

13. The sample period of Böwer and Turrini (2010) covers actual data till 2007 and the spring 2008 forecast of the European Commission for 2008.

14. The income thresholds we applied were defined in the section ‘Methodology and model selection issues’. We did not include the four EU15 countries falling within the thresholds (Greece, Italy, Portugal and Spain). The 44 countries are: Albania, Algeria, Argentina, Azerbaijan, Belarus, Bosnia/Herzegovina, Botswana, Brazil, Chile, Colombia, Costa Rica, Croatia, Dominican Republic, Ecuador, El Salvador, Gabon, Iran, Israel, Jamaica, Kazakhstan, South Korea, Lebanon, Libya, Macedonia, Malaysia, Mauritius, Mexico, Namibia, New Zealand, Oman, Panama, Peru, Russia, Saudi Arabia, Serbia, South Africa, Taiwan, Thailand, Trinidad and Tobago, Tunisia, Turkey, Ukraine, Uruguay, and Venezuela.

15. For example, during the pre-crisis boom, rapid economic growth was accompanied by growing internal and external vulnerabilities in several

CEECCA countries, which would suggest a perverse relationship between vulnerabilities and economic growth.

16. Note that this close to zero cumulative growth from 2005 to 2010 is the product of high growth in 2006 and 2007 and a deep contraction from 2007 to 2010.

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