



CROATIAN NATIONAL BANK

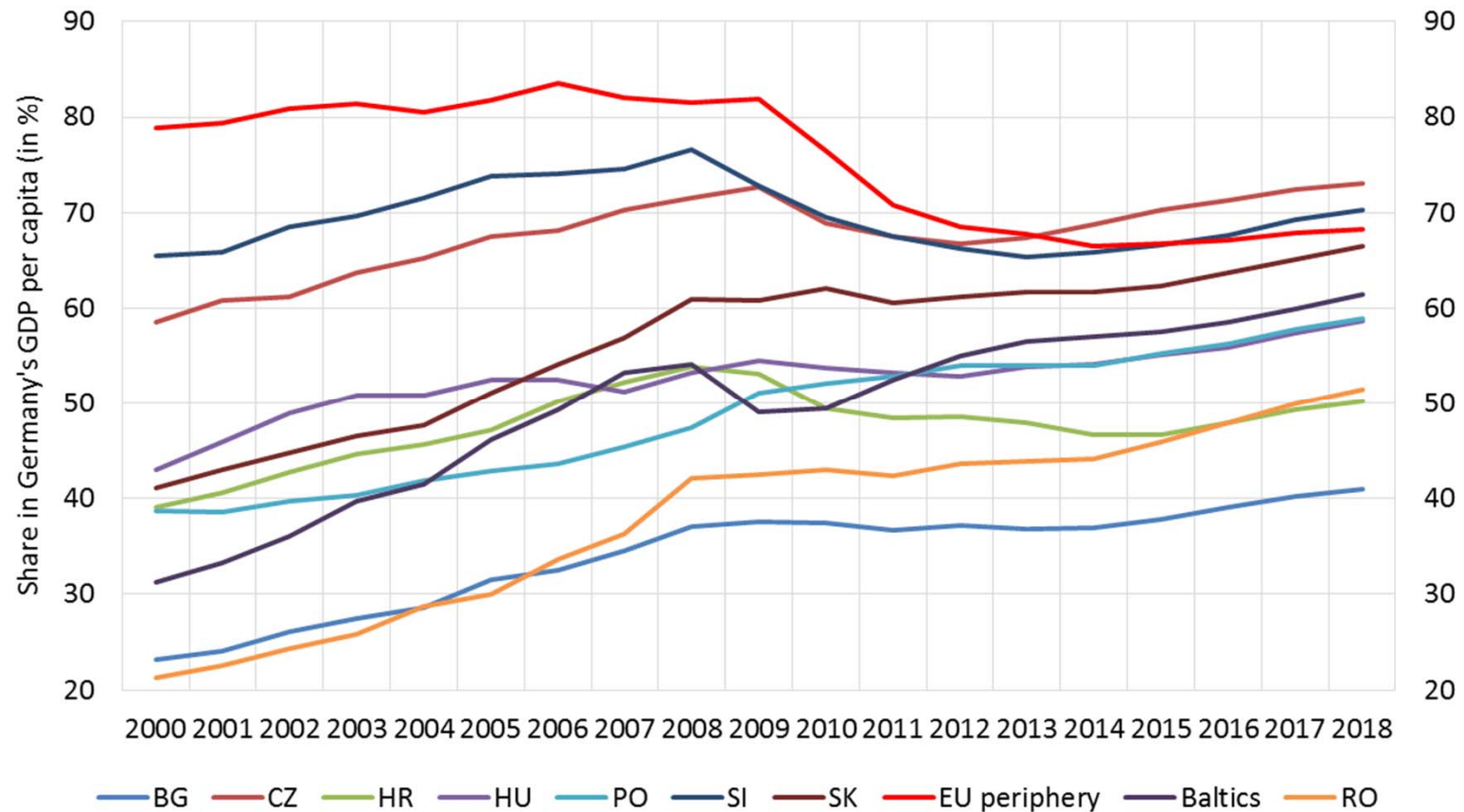
Institutional quality and sustainable economic convergence

October, 2017

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Has convergence been taken for granted?

Real convergence, PPS, Germany=100

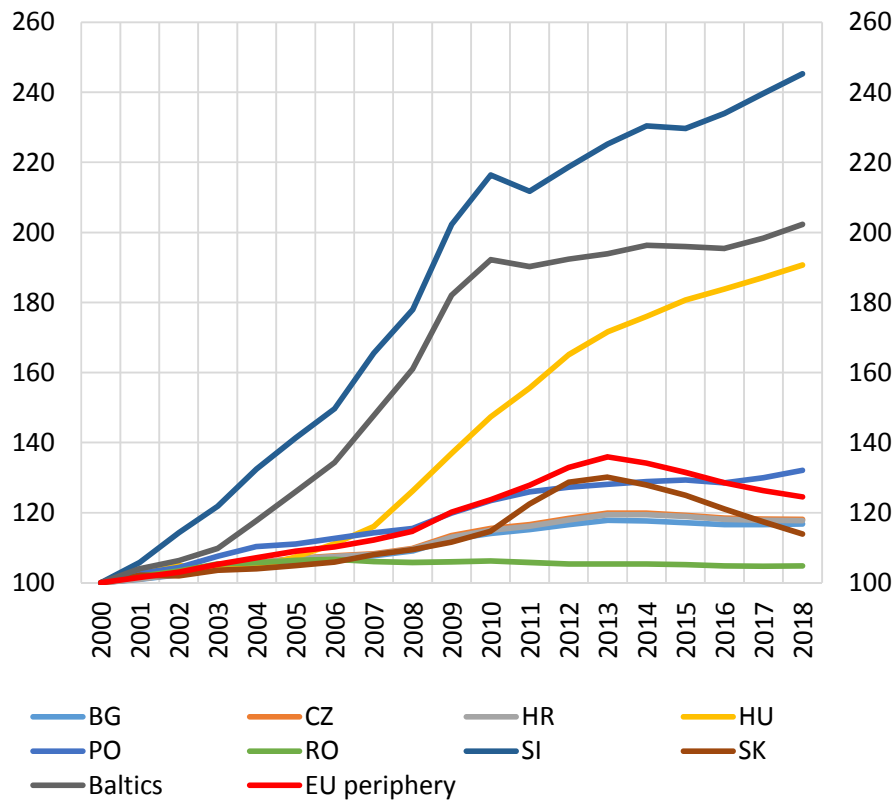


EU periphery – Italy, Spain, Portugal, Greece

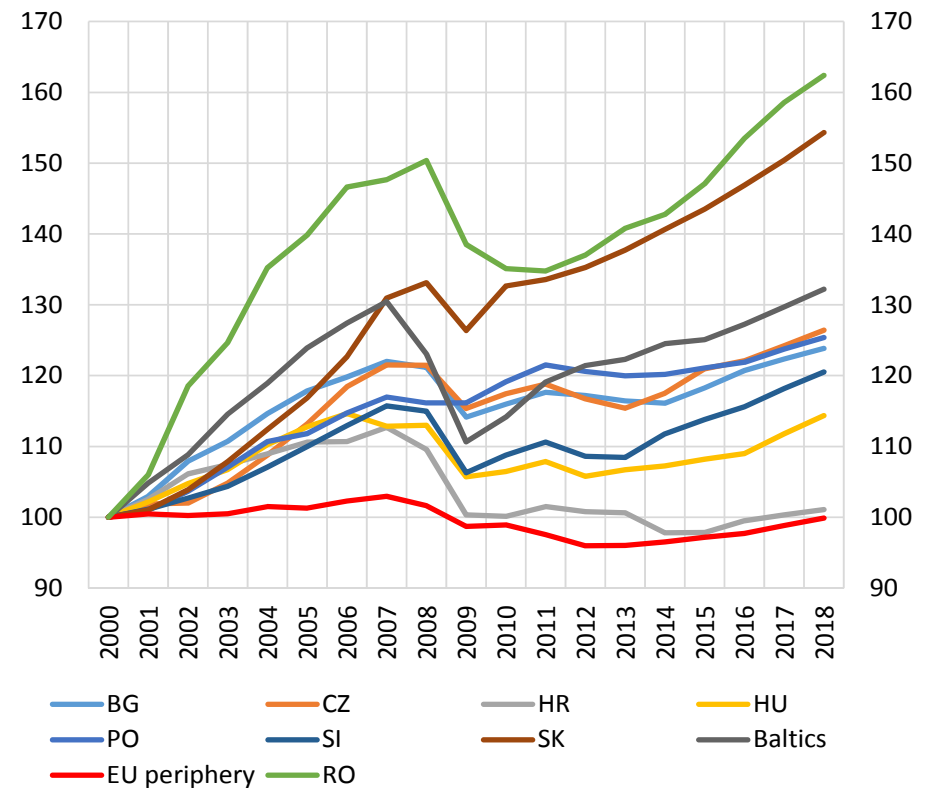
Source: AMECO

What do we know about the TFP?

Net capital stock per person employed, 2000 = 100



Total factor productivity, 2000 = 100

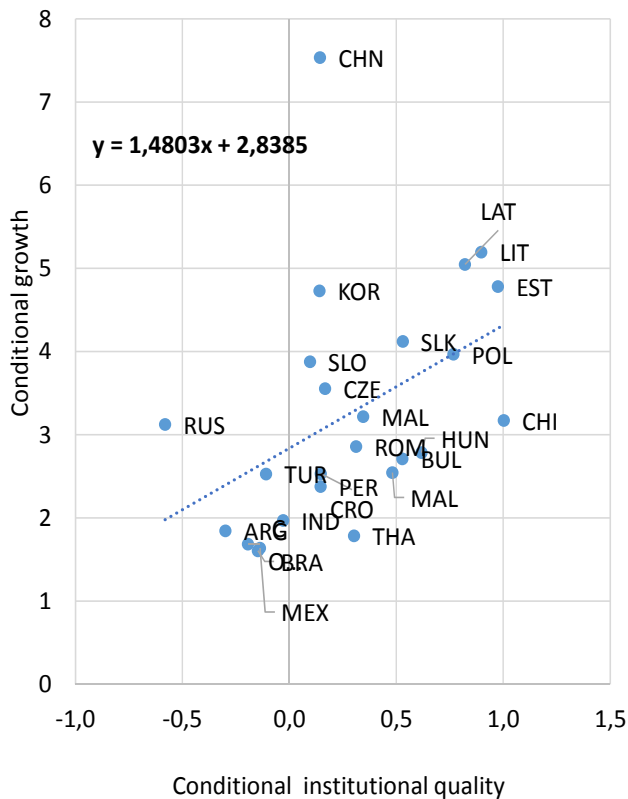


EU periphery – Italy, Spain, Portugal, Greece

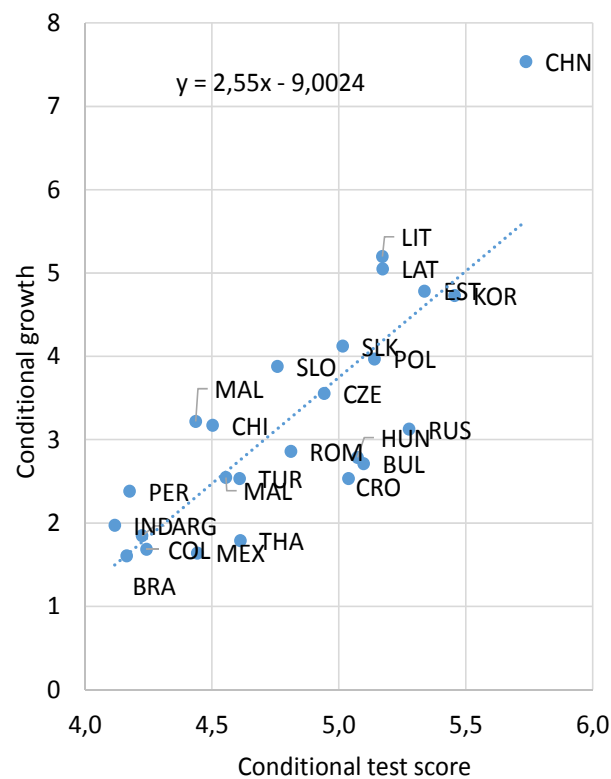
Source: AMECO

Total factor productivity – is the truth out there?

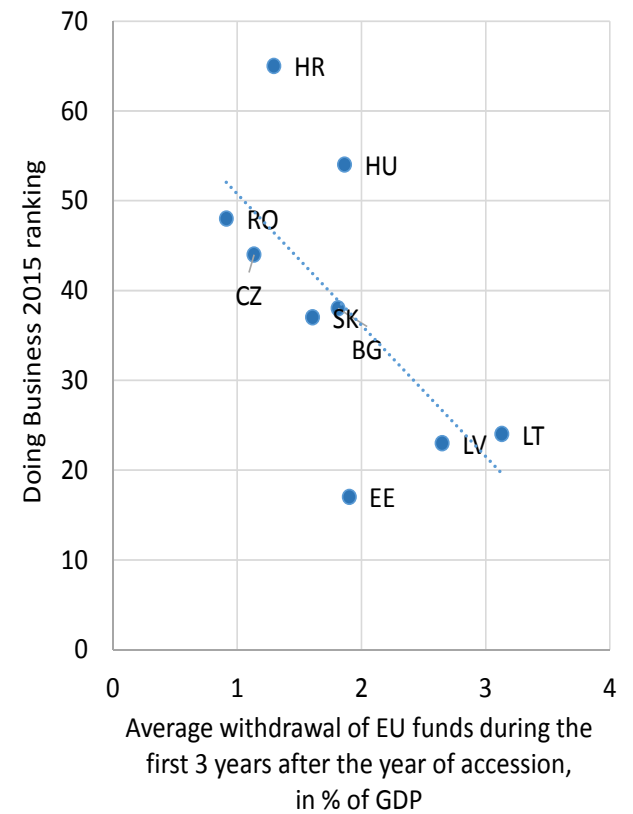
Institutions quality vs growth



Human capital vs growth



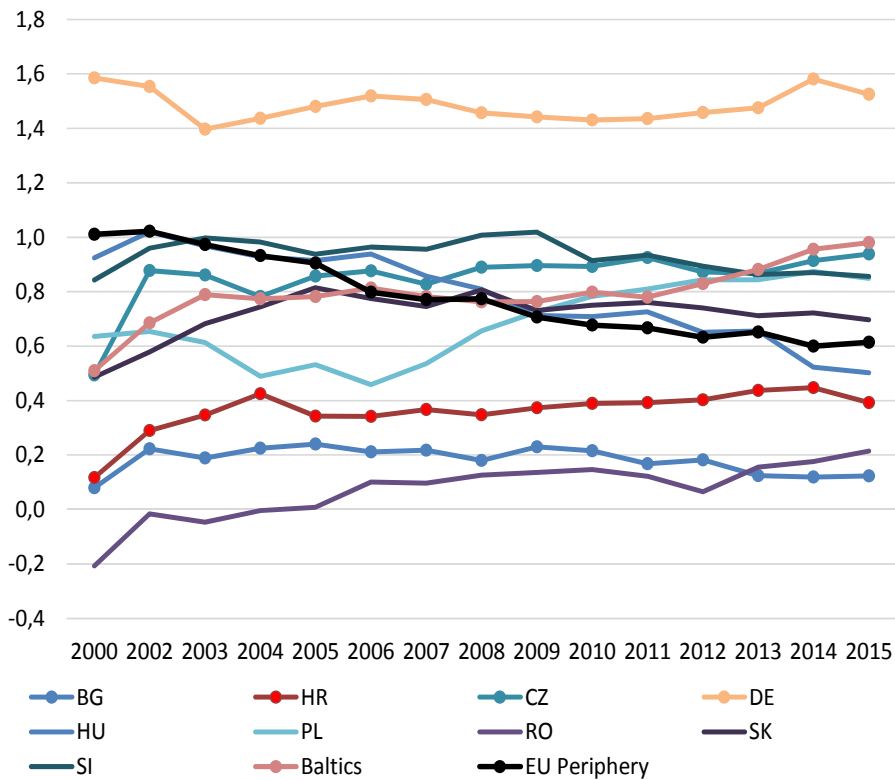
Institutions quality and EU funds withdrawal



Sources: World Bank; OECD; EC

Large room for improvement but progress has been slow

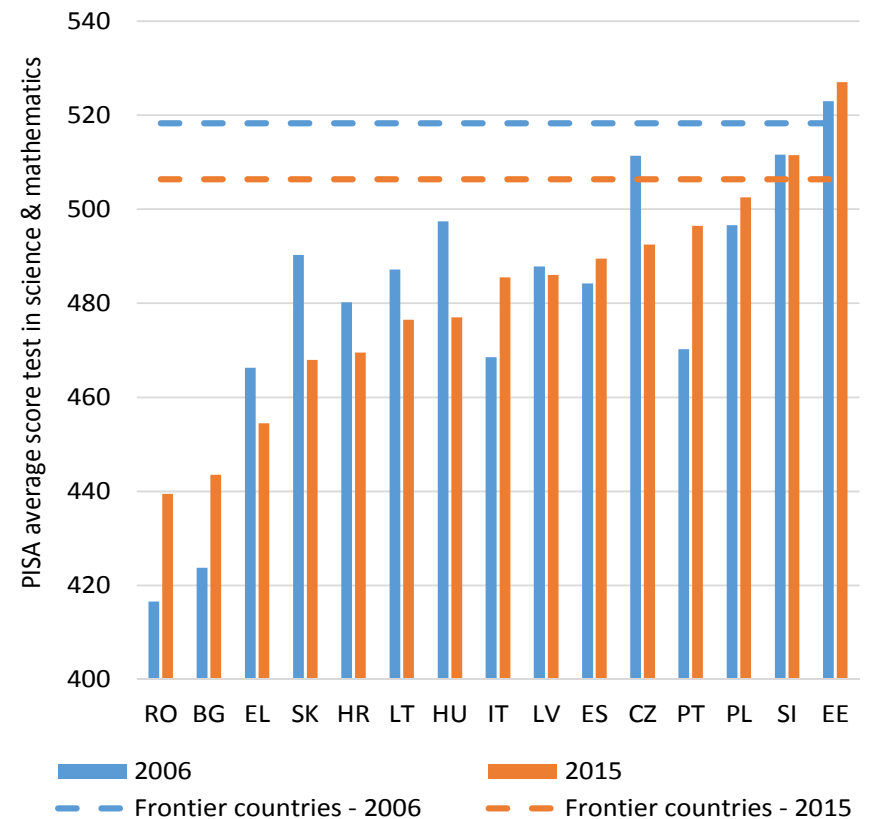
Quality of institutions – no convergence



Note: Estimate of governance performance ranges from -2.5 (weak) to 2.5 (strong).

Source: World Bank

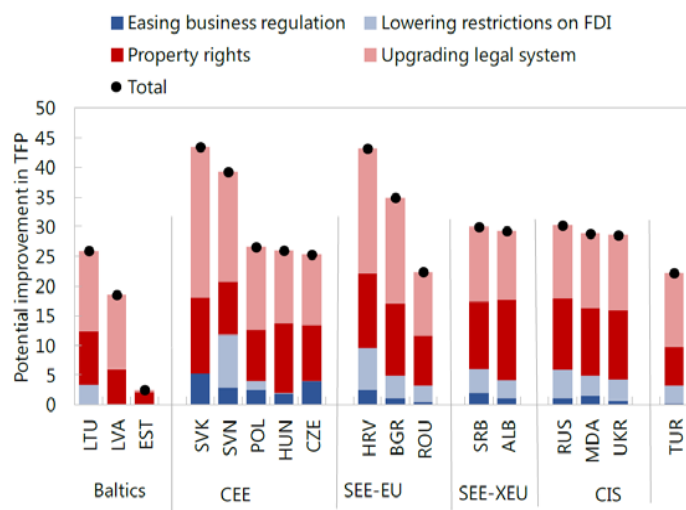
Human capital – still below frontier



Source: OECD

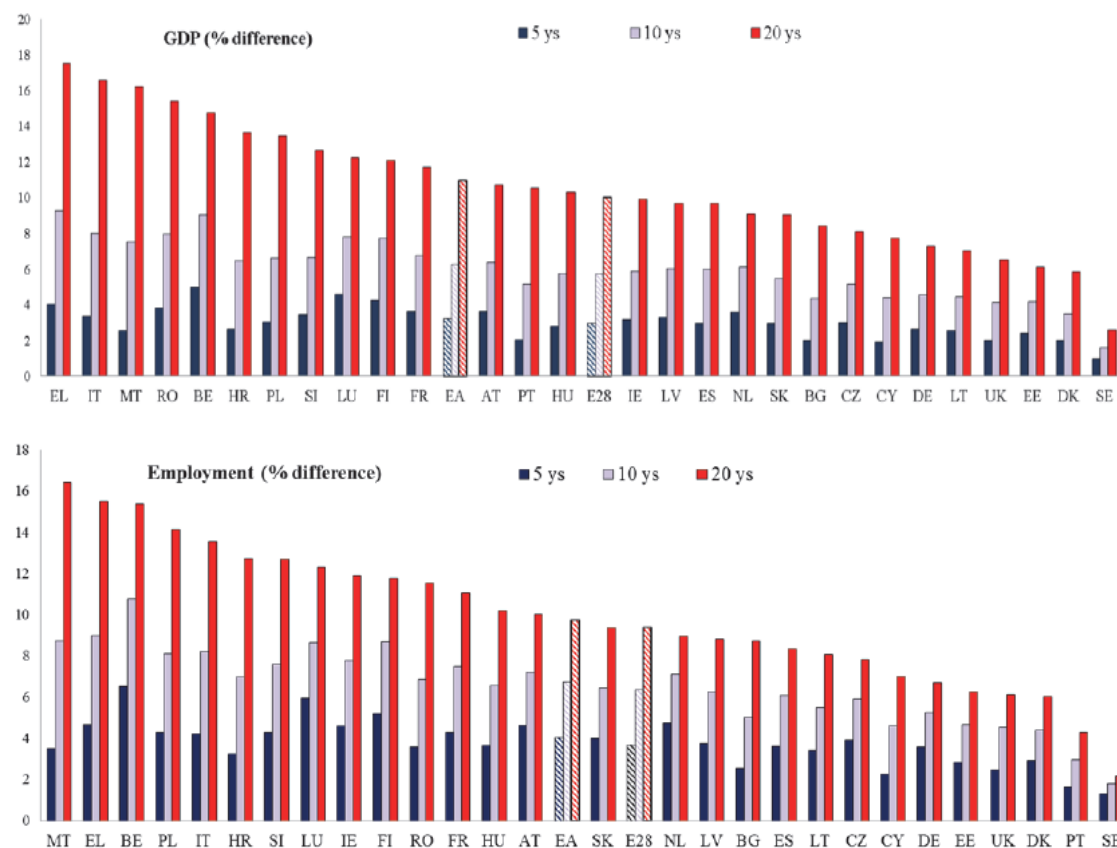
Potential gains from structural reforms are significant but...

Potential efficiency gains from structural reforms (Percent)



Source: IMF, CEESEE Economic Issues, May 2016

Macroeconomic impact of structural reforms (Stand-alone reforms, difference from baseline)



Source: EC (2014) The potential growth impact of structural reforms in the EU

...how to get them right?

- Two dimensions of structural reforms:
 - Moving closer to the efficiency frontier – reallocation of resources, more efficient usage of inputs.
 - Potential growth rate – expanding the efficiency frontier.
- But many policies:
 - Product market reforms, Competition policy, Labour market reforms, Public finance and taxation (including Social security system), Human capital development, Innovation policy, ...
- Do economist really understand all the mechanisms at play:
 - synergies and complementarities of reforms;
 - diminishing marginal effects of reforms?

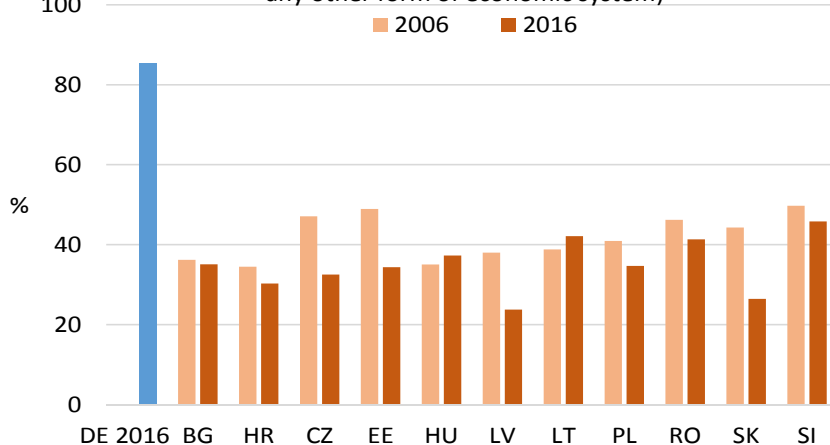
No guarantees, but reforms remain the safest bet

- ❑ No guarantees that convergence will gain momentum again
- ❑ Closest thing to a recipe for reducing probability of being caught in middle income trap:
 - High quality of human capital - education reform
 - Facilitate private sector investment in physical capital and know-how
 - Adequate access to finance for SMEs
 - Friendly business environment
- ❑ Keep in mind that political economy also matters

Limited political inclusiveness might hinder support for the reforms

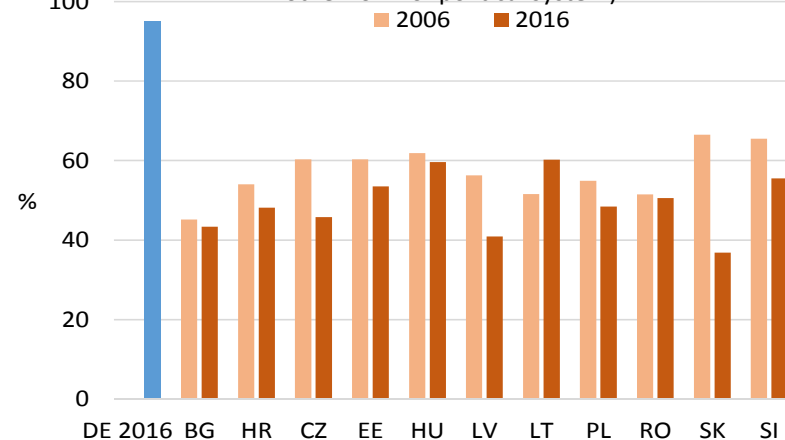
Market economy

(percentage of respondents who prefer market economy over any other form of economic system)



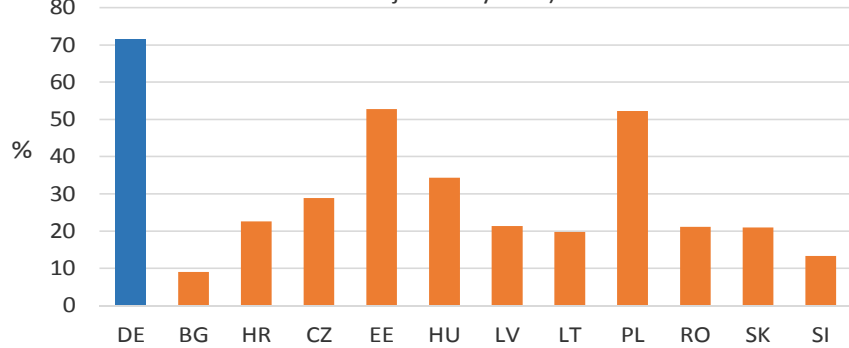
Democracy vs. autocracy

(percentage of respondents who prefer democracy over any other form of political system)



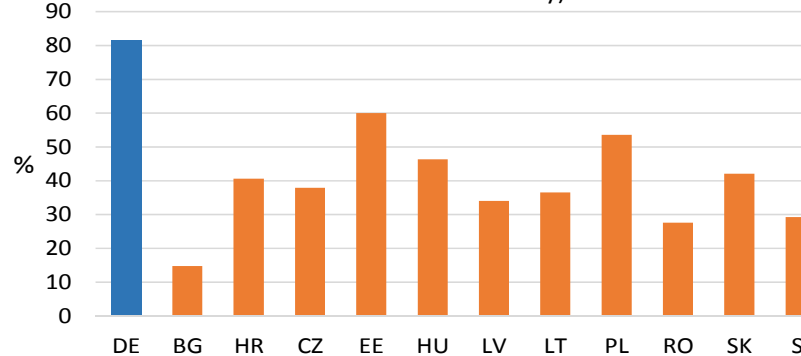
Fair justice system

(percentage of respondents who agree that the country has fair justice system)



Law and order

(percentage of respondents who agree that law and order exist in their country)



Source: EBRD Life in transition Report (2016)

Thank you!