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Emerging Europe: Refining the Growth Model to Support Sustainable Convergence

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4.1 Introduction

In the past decade, there have been marked differences across countries in Europe in real per capita GDP growth. Growth rates have ranged from close to zero in Italy and Portugal to more than four per cent in Albania, Lithuania, Moldova, Russia and Ukraine (Figure 4.1, Table 4.1). Countries in emerging Europe have generally grown faster than countries in advanced Europe – most of the countries on the left-hand side of Figure 4.1 are advanced countries, while those on the right-hand side are all emerging market countries. Emerging European countries grew rapidly as they adopted institutions similar to those in advanced Europe and benefited from higher investment rates, partly financed by intra-European capital flows.

The faster growth of emerging Europe is in line with economic growth theory, which suggests that poor countries should grow faster than richer countries, a process called ‘convergence.’ Growth theory identifies two factors that drive convergence: diminishing returns in the accumulation of capital, and cross-country knowledge spillovers. Poorer countries usually have a lower capital stock and therefore a higher marginal productivity of capital: increases in capital stock will thus have a large impact on output. Poorer countries can also boost output by imitating technologies already developed in richer and more advanced countries – a process that will raise total factor productivity (TFP).
Refining the Growth Model

The faster growth of poorer countries that we have seen in Europe is, however, not a pattern that is typically observed elsewhere in the world. At the global level, the link between the income level in 1999 and the growth over the subsequent decade has been very weak (Figure 4.2, top left). Looking at regions, there has been no sign of convergence in Latin America (Figure 4.2, top right) – poorer countries have not grown faster, on average, than richer countries. There is some evidence of convergence in Asia (Figure 4.2, bottom left), but Europe really stands out as the only region where convergence has been strong (Figure 4.2, bottom right).

While there is significant scope for further convergence, continued convergence is not automatic. Sustained, steady and fast growth is far from a usual occurrence. There are many examples of countries where rapid growth has petered out. Even in Europe, some countries have stalled in convergence. For example, Portugal and Italy, which were relatively poor, saw little growth in GDP over the last decade.

The question of whether rapid convergence will continue is particularly pertinent, given the severe boom-bust cycle that emerging Europe has gone through. Growth in emerging Europe was very rapid in the pre-crisis years, but part of the gains was lost during the crisis, as many countries went through very severe recessions.

This chapter will discuss what policymakers can do to ensure that convergence in emerging Europe will continue. Continued convergence will depend mostly on private sector actions – within market-based

Figure 4.1  European countries: average growth rate of real GDP per capita, 2001–10 (per cent)
Sources: IMF, World Economic Outlook database (September 2011); and IMF staff calculations.