

TRANSITION REPORT 2019-20



European Bank
for Reconstruction and Development

BETTER GOVERNANCE, BETTER ECONOMIES



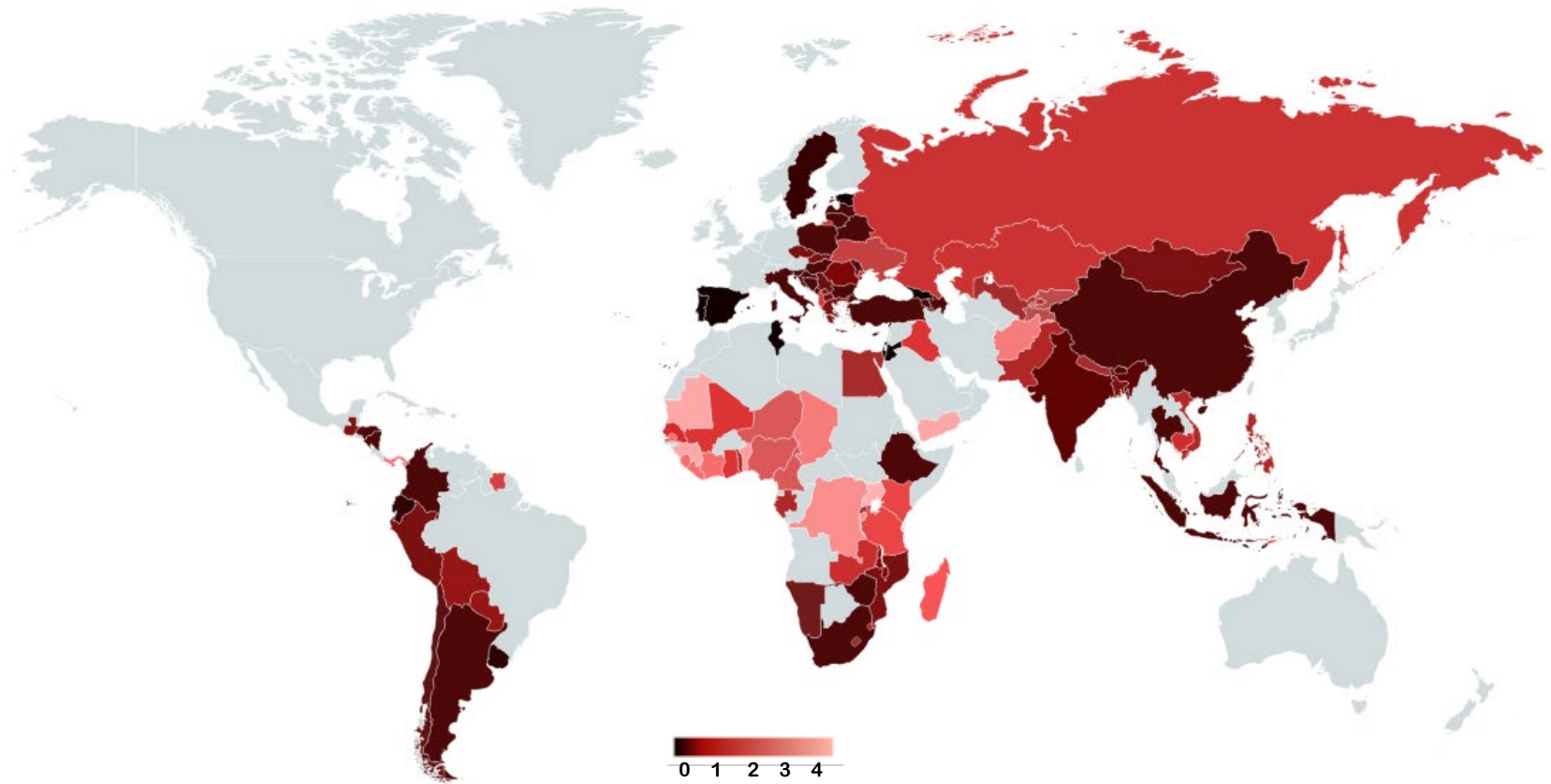
What is governance?

- Governance concerns authority, decision-making and accountability in all domains
- Governance is about the quality of institutions and the processes that they support
- Institutions are broadly “the rules of the game in a society” (North, 1990)
- The *Transition Report* looks at governance
 - at the national level
 - in subregions and municipalities
 - in firms
 - and also considers the green governance of firms

Data sources: Enterprise Surveys

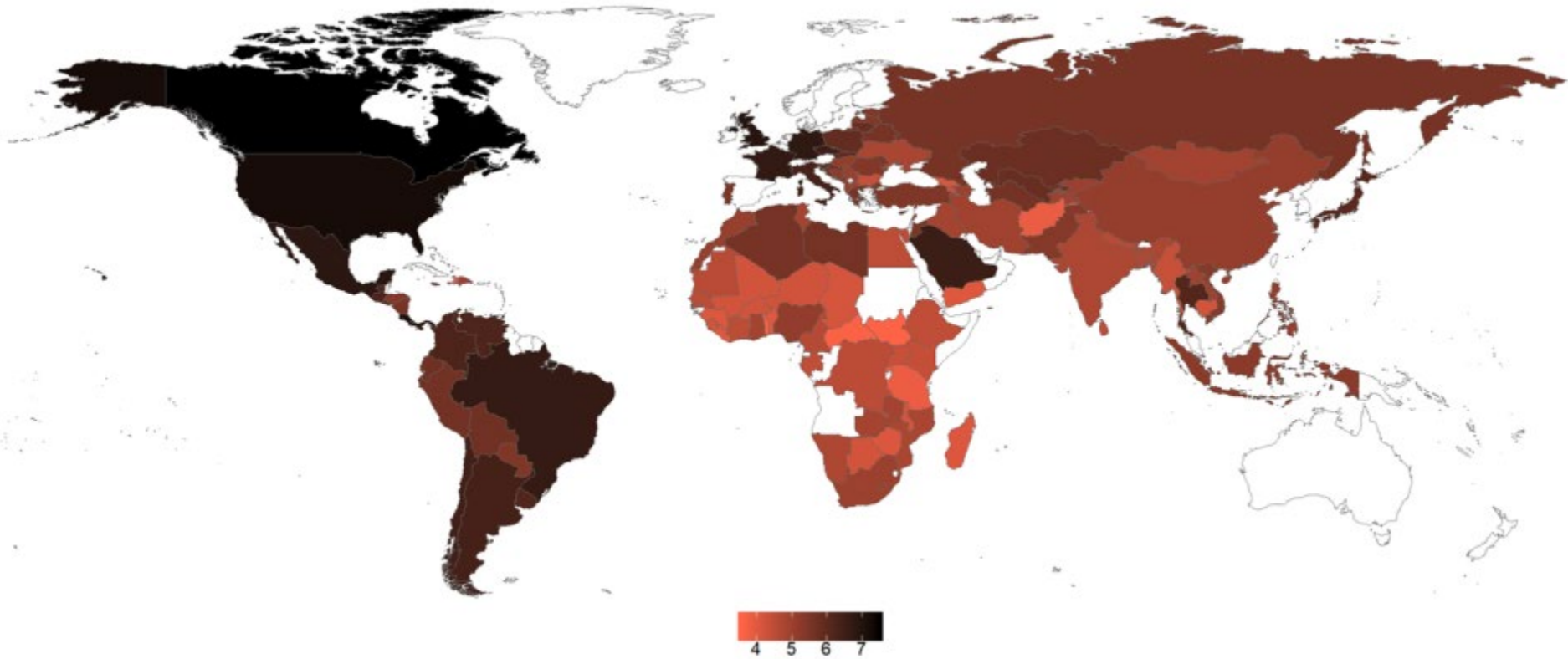
18,000+ firms surveyed in 2018-19 (previous survey rounds 2008-09 and 2011-14)

Enterprise Surveys: Average percentage of sales diverted to informal payments



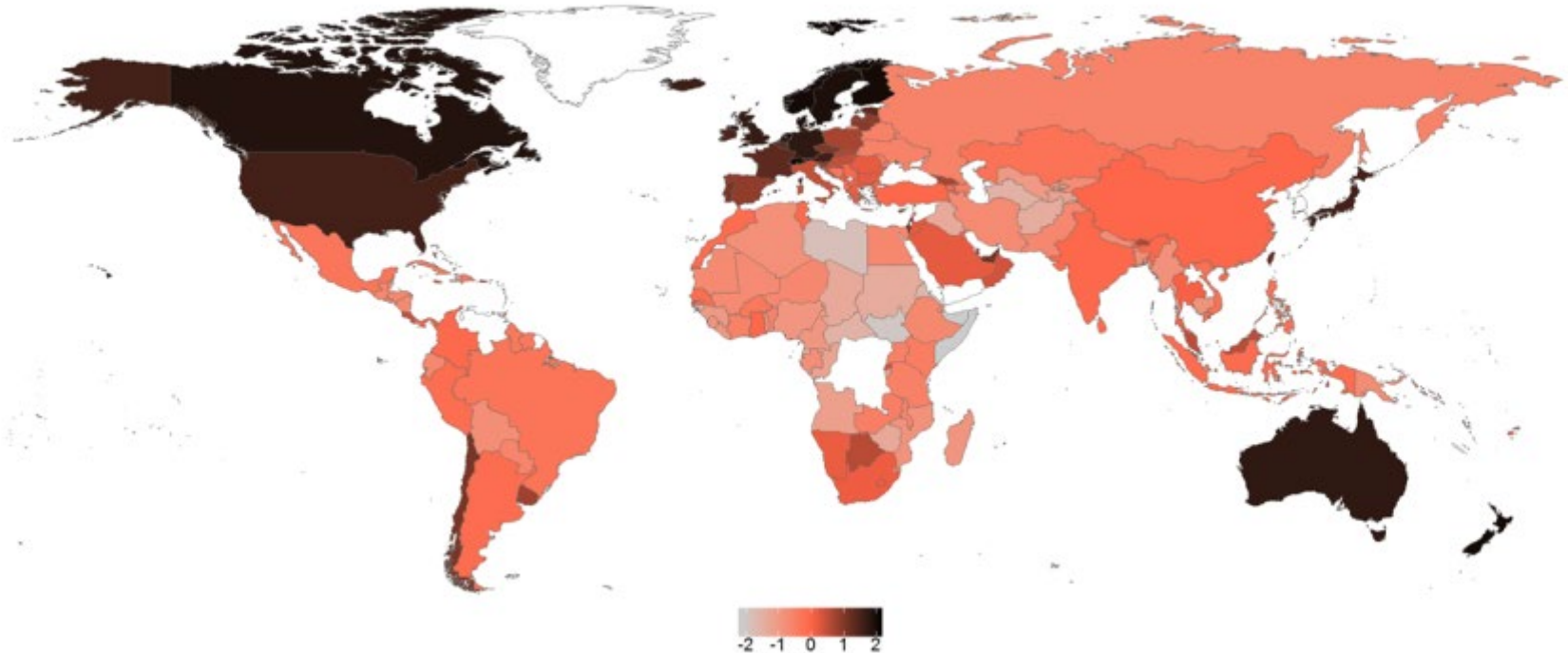
Data sources: Gallup World Polls, 2006-18

Gallup World Polls: Average life satisfaction, 2006-18, 0-10 scale



Data sources: Worldwide Governance Indicators

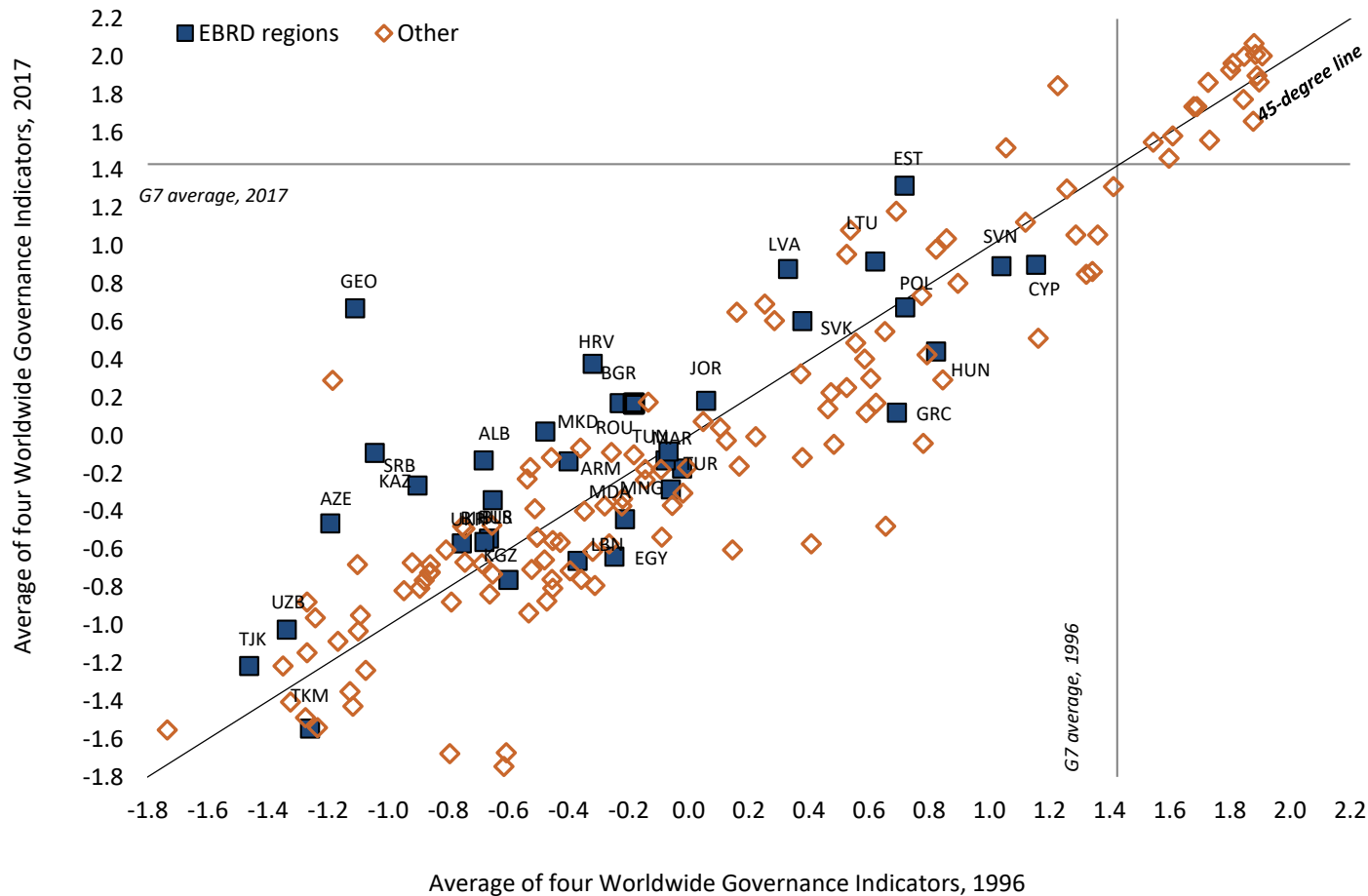
Worldwide Governance Indicators at a glance, 2017



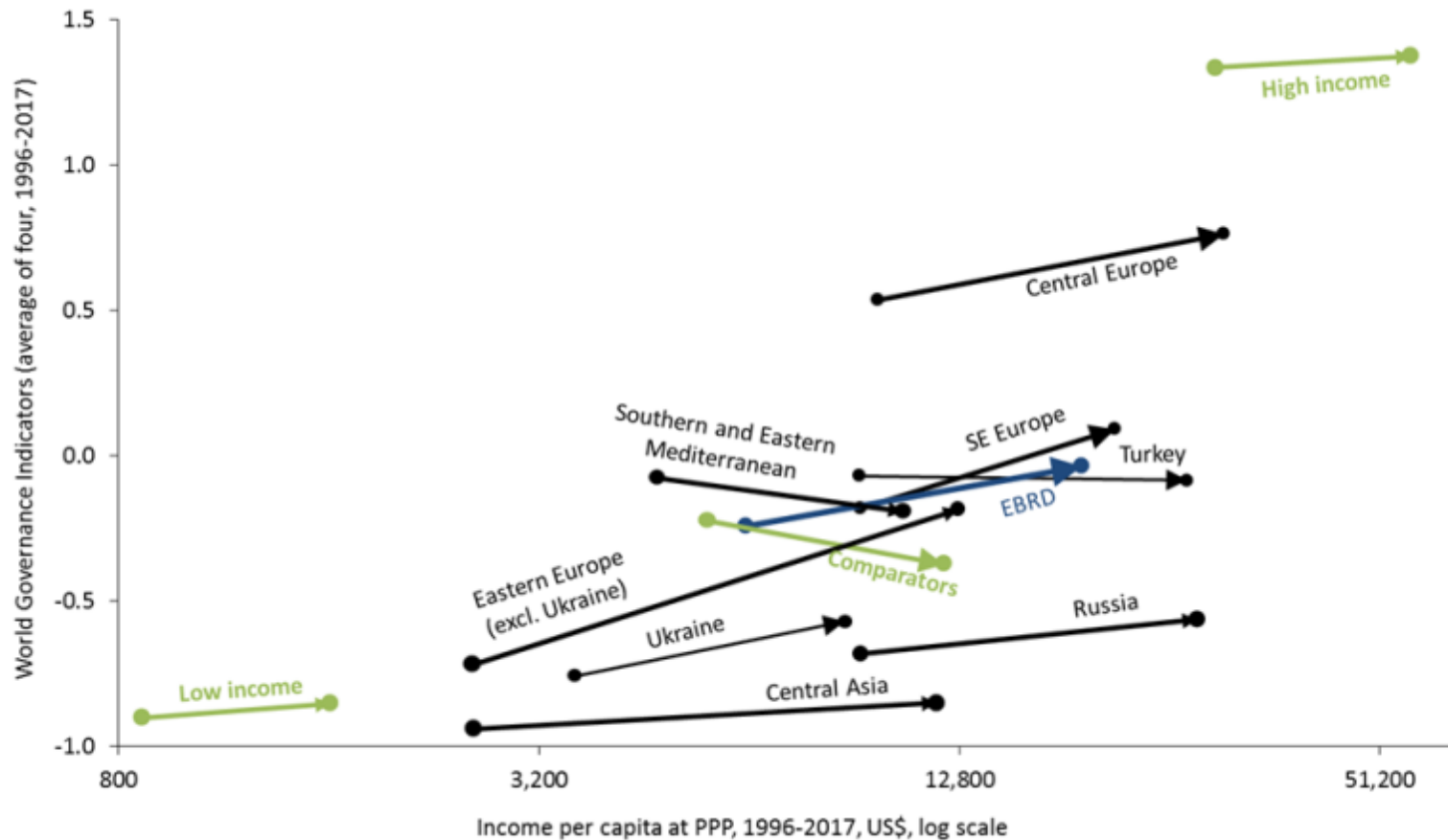
1 THE GOVERNANCE DIVIDEND



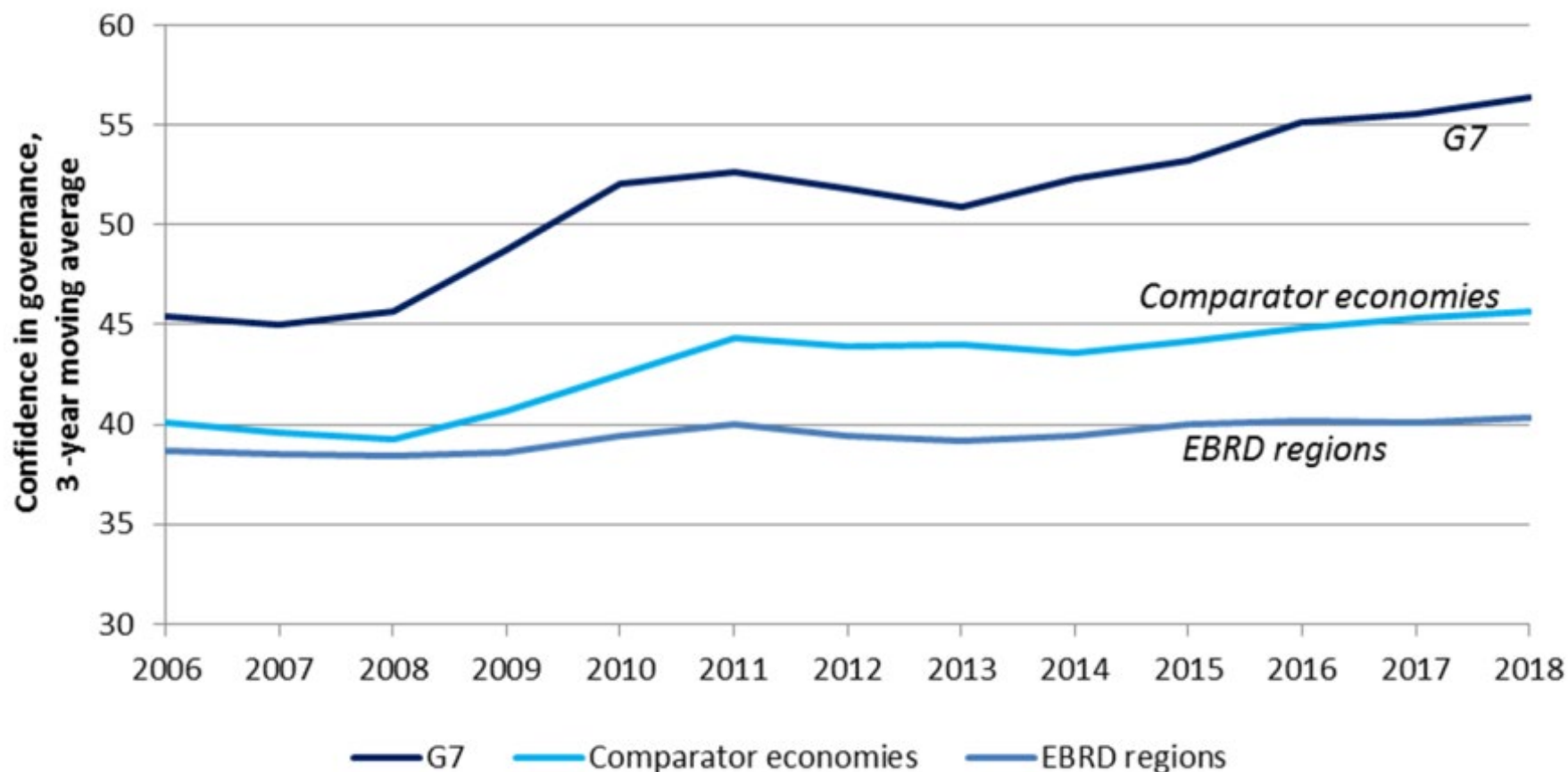
Weak governance in EBRD regions, mid-1990s (relative to advanced economies and many emerging markets)



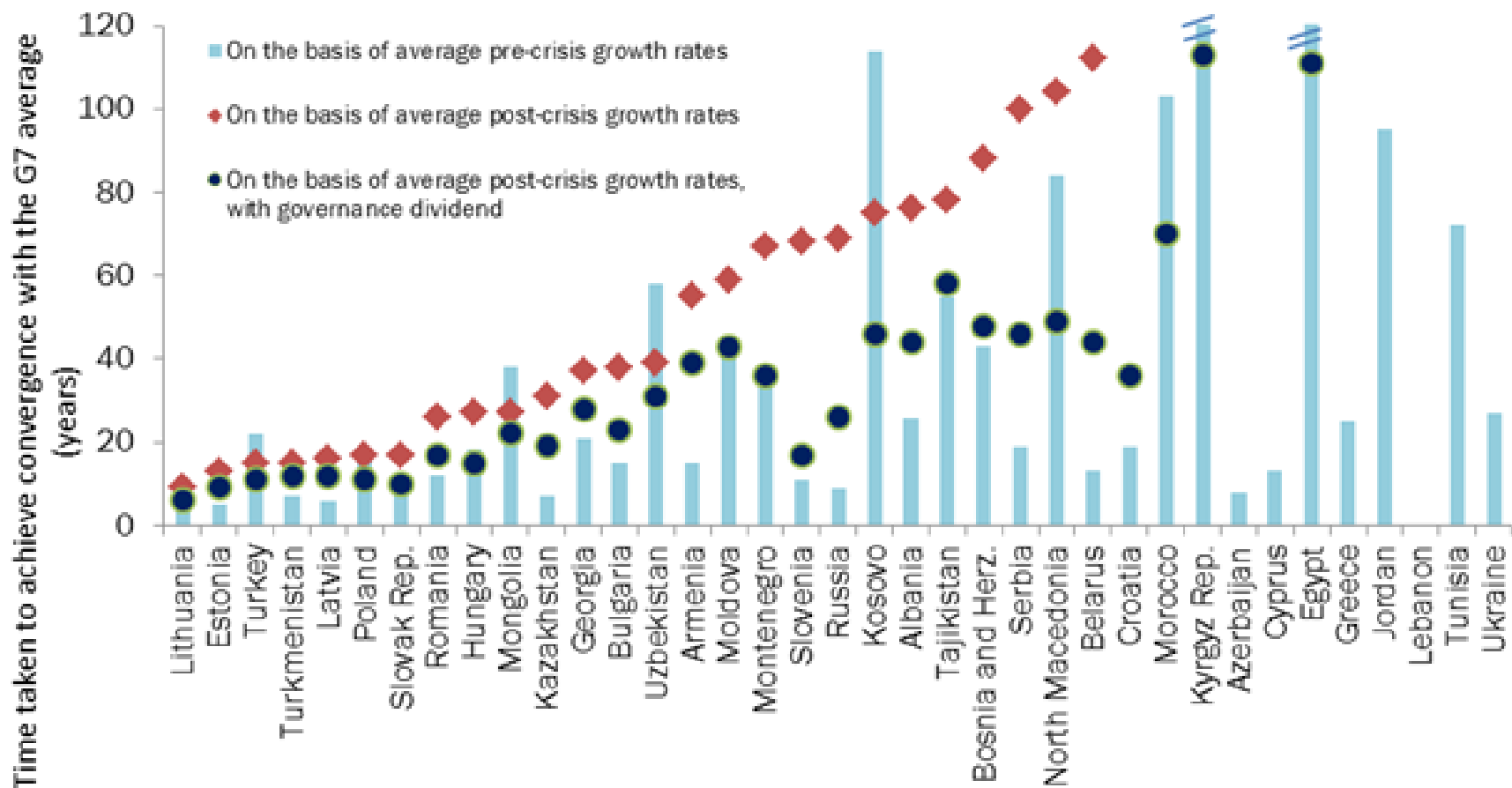
EBRD regions have improved governance faster than other emerging markets with comparable income levels



A widening governance gap as seen by residents, in the Gallup World Polls



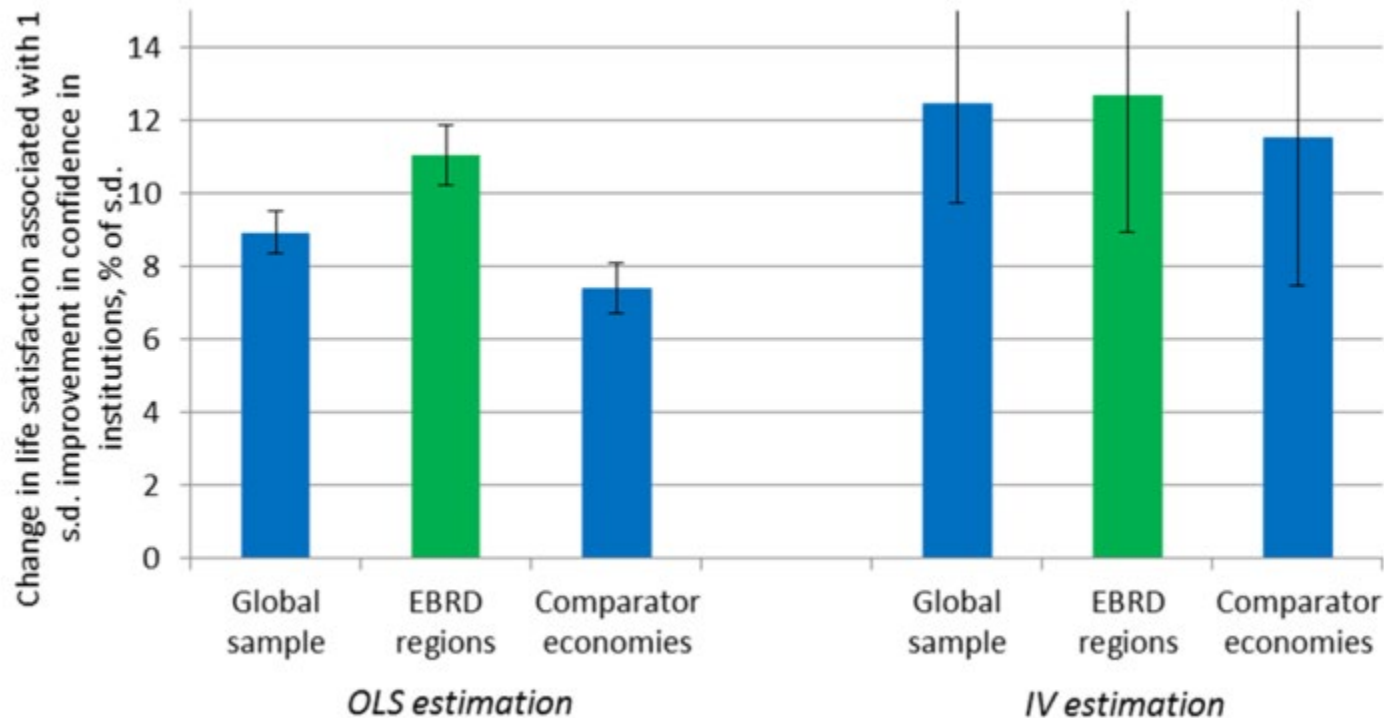
Growth dividend from narrowing the governance gap: difference of a generation in duration of income convergence



Poor governance affects well-being directly (as well as via growth)

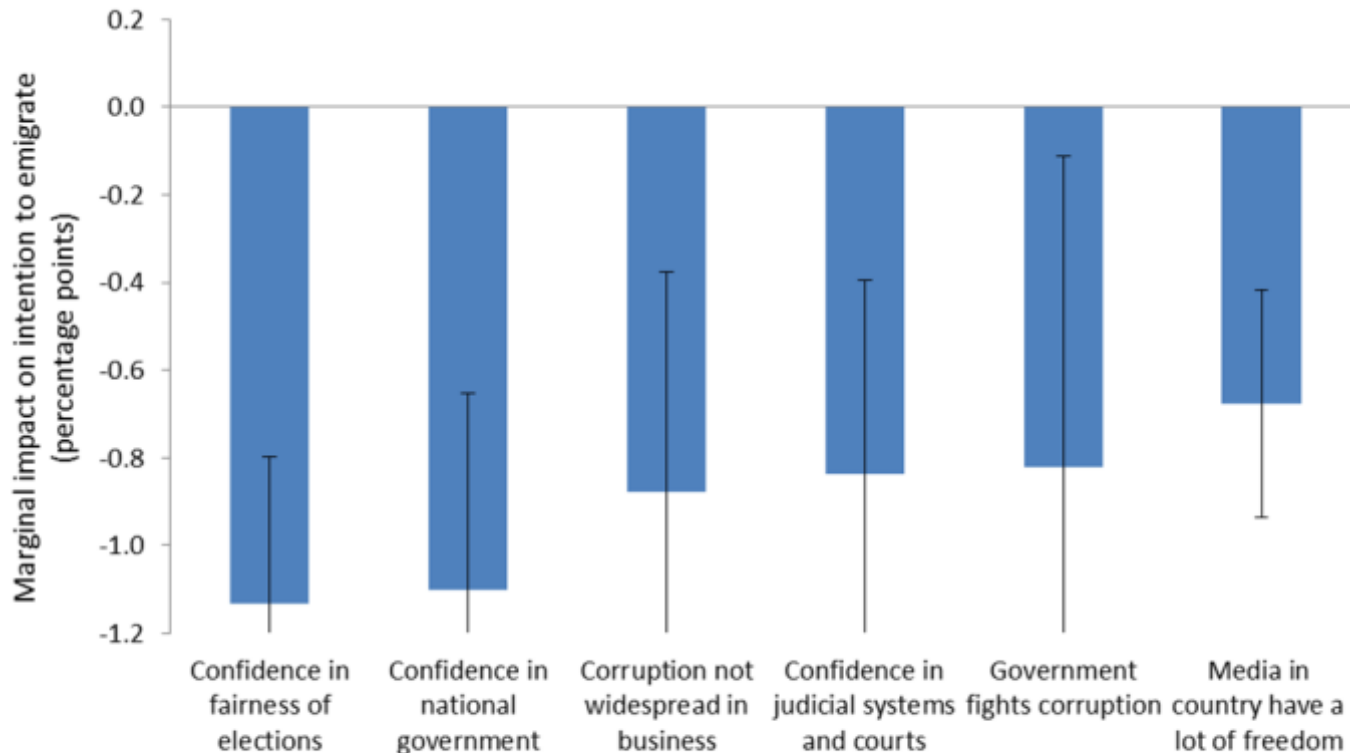
In Ukraine, a 1 standard deviation improvement in governance has the same impact on life satisfaction as an extra US\$ 270 per month

Closing half of the gap in governance relative to G7 is associated with closing 15 per cent of the happiness gap (8 percentage point direct effect)



Confidence in public institutions affects intentions to emigrate

In Albania, having confidence that the government is fighting corruption reduced intention to emigrate by as much as an **extra US\$ 400 per month**



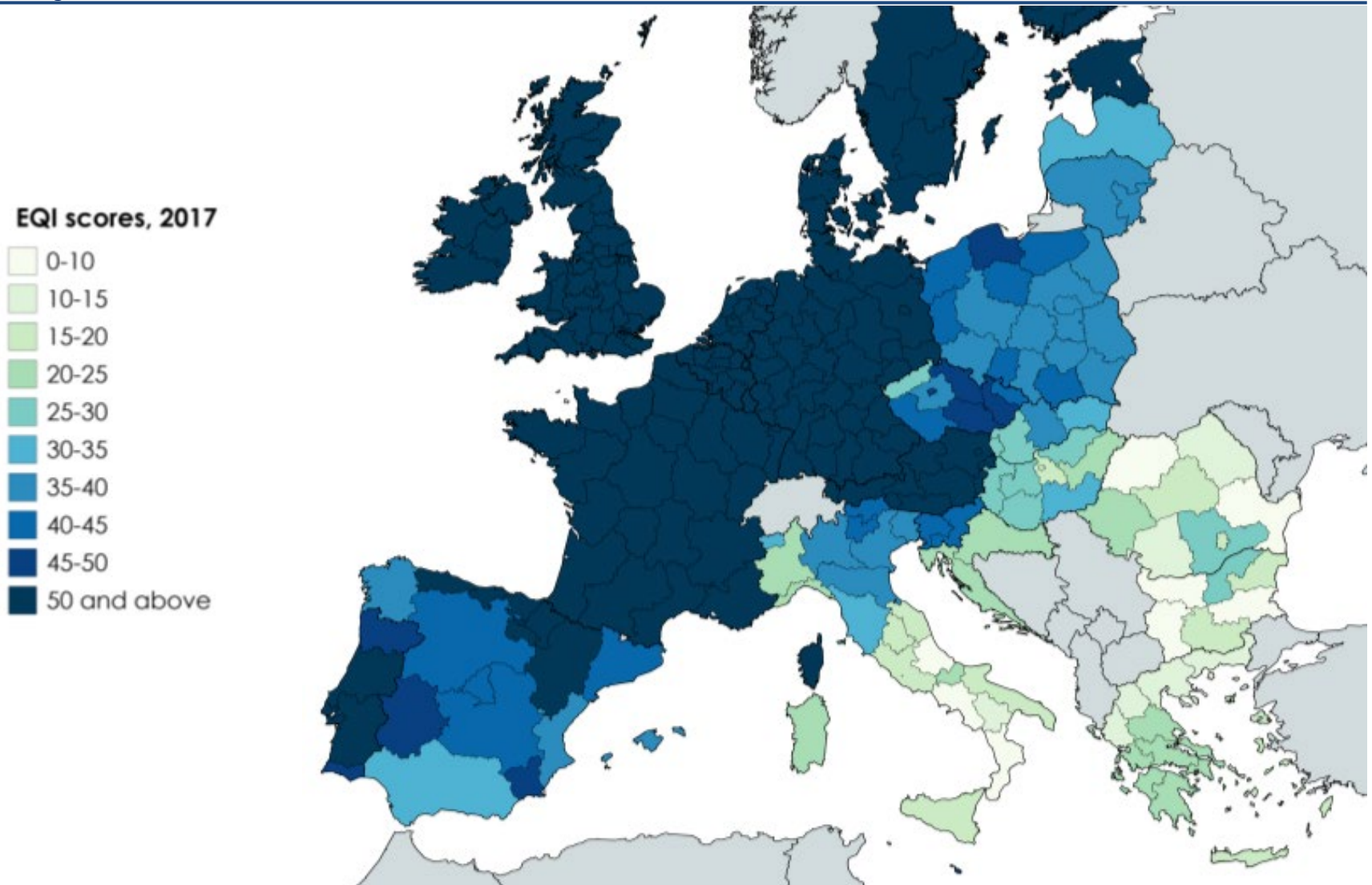
The governance gap at the national level remains large. It matters.

- EBRD regions entered the 1990s with relatively strong skills but weaker governance
- Considerable improvements in governance can be tracked in country indicators, Gallup Surveys and the latest enterprise surveys
- Yet evidence of slower progress (or even reversals) in the last decade – in a way that the “governance gap” with respect to advanced economies is almost as large as it was
- This is more problematic than before: **Good governance matters more for innovation-led growth**
- Narrowing the gap would yield a sizeable growth dividend for countries and firms, and it makes residents happier and less likely to emigrate

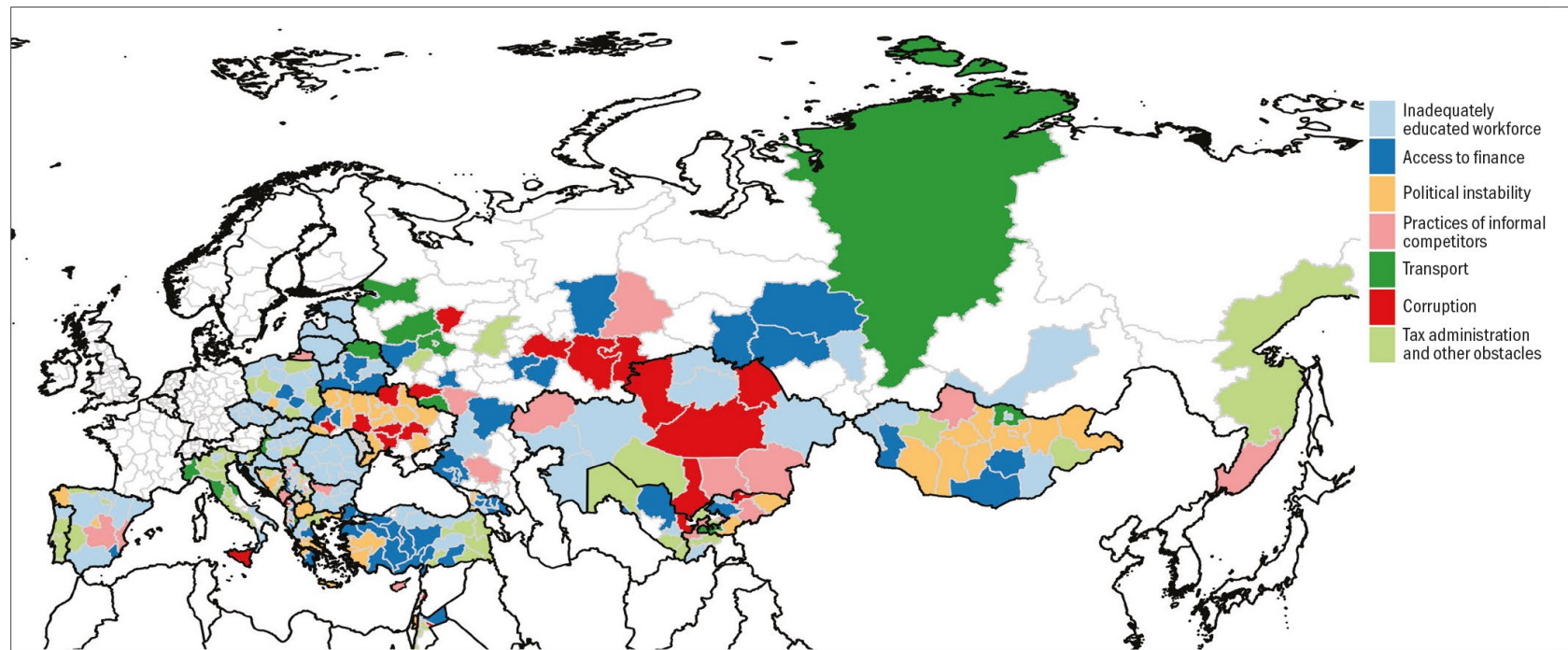
2 GOVERNANCE IN MUNICIPALITIES AND REGIONS



Quality of governance varies significantly not just across countries, but also within them



Regional variation in most important obstacles to firms' operations



Skill shortages are seen as the key obstacle in Mogilev (Belarus) or East Kazakhstan

Access to finance in many regions in Central Turkey or Minsk (Belarus) or Tomsk (Russia)

Political instability in Kyiv and many regions of Ukraine, many regions of Mongolia, the West of Turkey

Practices of informal competitors in Kaliningrad (Russia) or Almaty (Kazakhstan)

Tax administration in the East of Turkey – and much of Italy

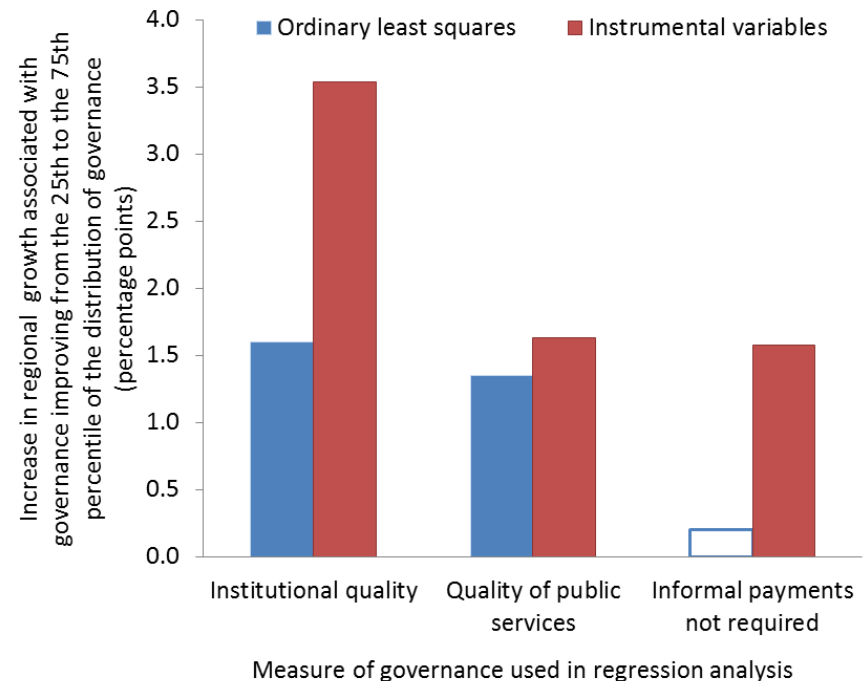
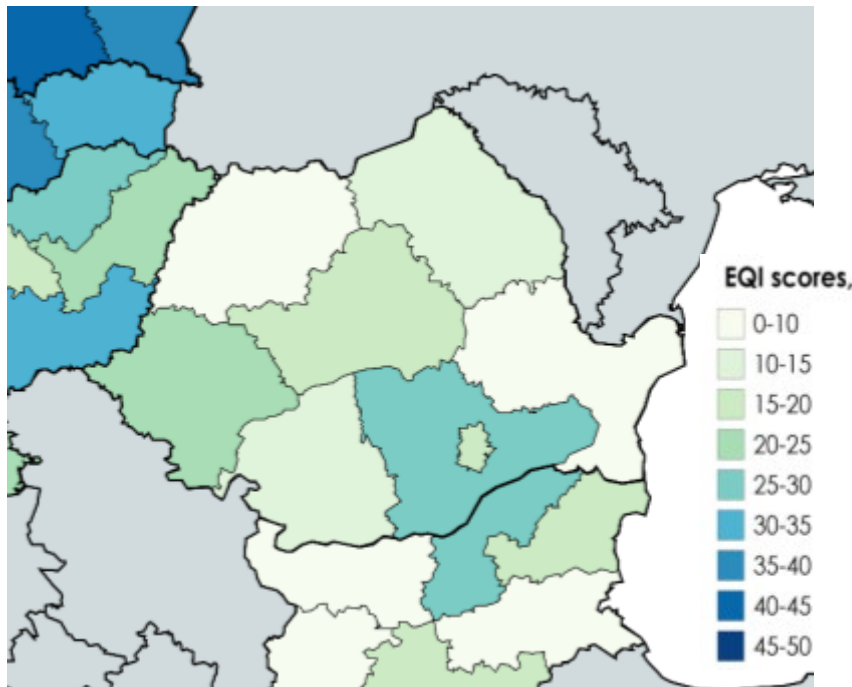
Transportation in Krasnoyarsk (Russia) or Vitebsk (Belarus) or Piedmont (Italy)

Corruption in Chernihiv (Ukraine) or Karaganda (Kazakhstan) or Sicily (Italy)

Regional-level governance has large effects on regional growth

Improving governance from the level of Romania's worst-scoring region (Sud-Est/South-East) to best (Sud Muntenia, surrounding Bucharest) yields **1.7 per cent point higher annual growth**

Over working life (45 years), per capita income-wise this means **Hungary → Spain or Serbia → Poland**



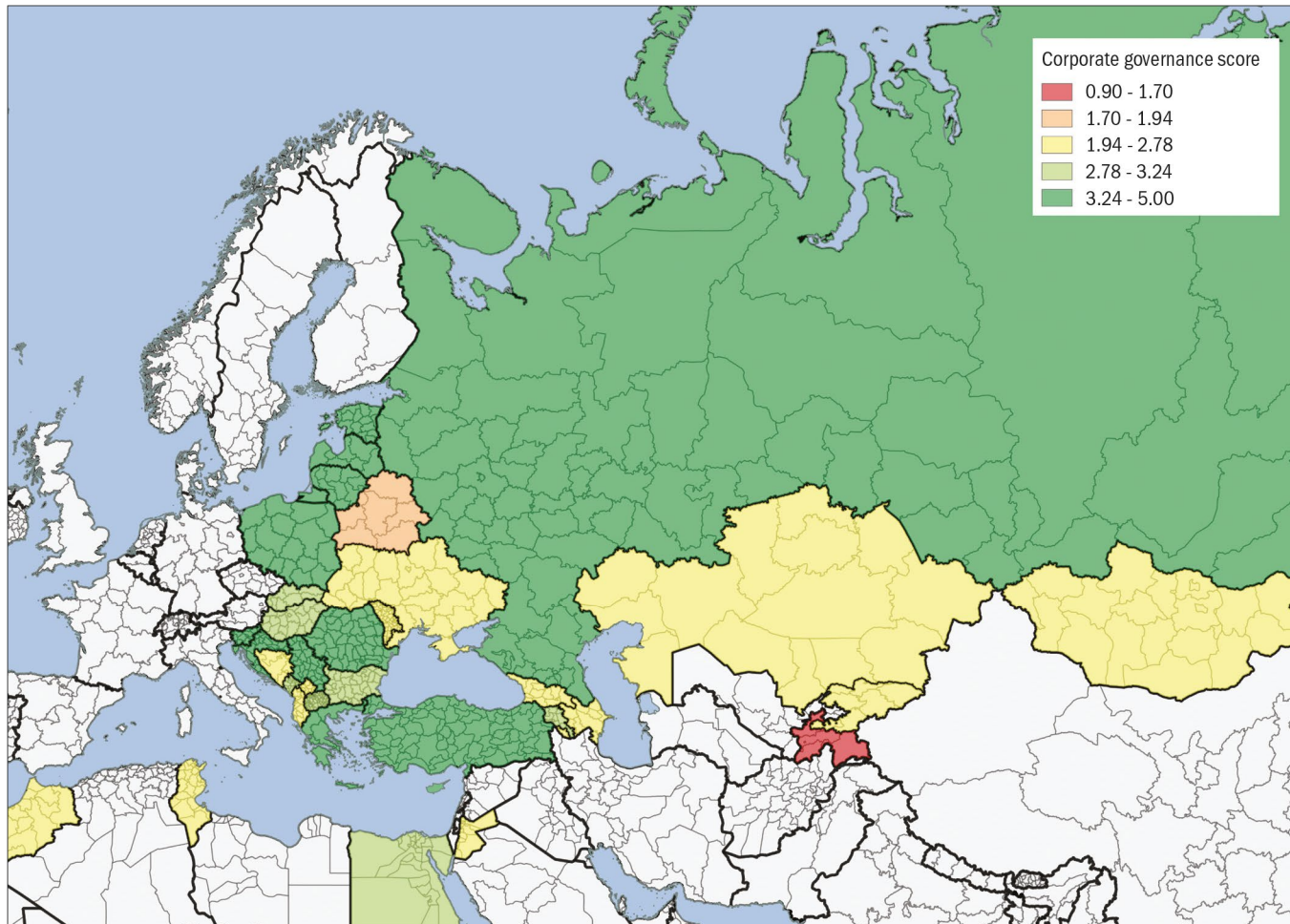
Benefits of improving subnational governance

- The quality of governance varies significantly not just across countries, but also within them
- Within-country disparities in governance have been increasing; vicious circle of low quality of governance, weaker economic growth and outmigration of the skilled
- Improving regional or municipal governance could add ≈ 1 percentage point per year to per capita regional income growth via better firm performance
- In the interregional competition for resources, better-governed regions attract more greenfield FDI projects

3 FIRM-LEVEL GOVERNANCE

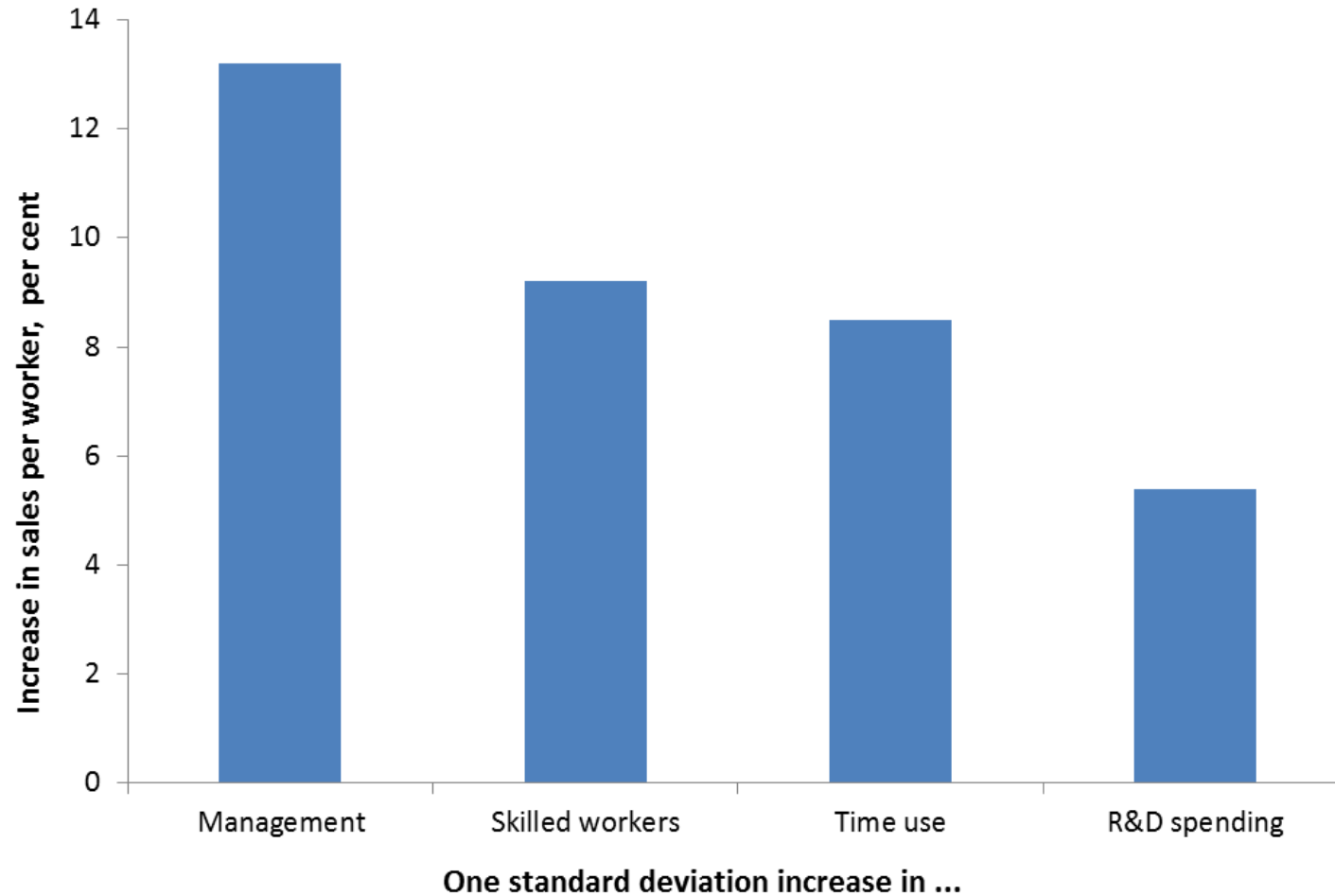


Corporate Governance Sector Assessment scores

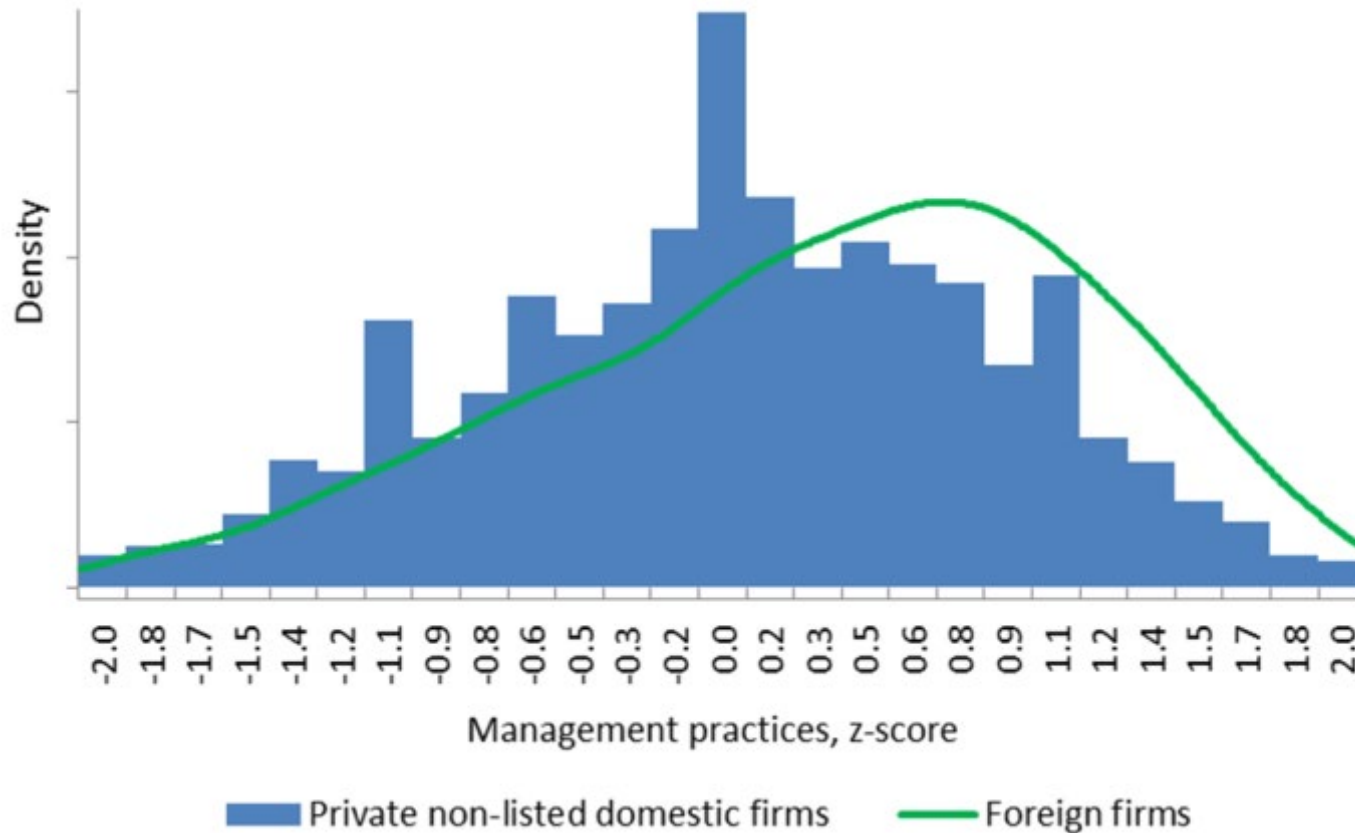


Management practices at the firm level are positively correlated with corporate governance scores

Better managed firms are more productive



Foreign-owned firms have better management practices



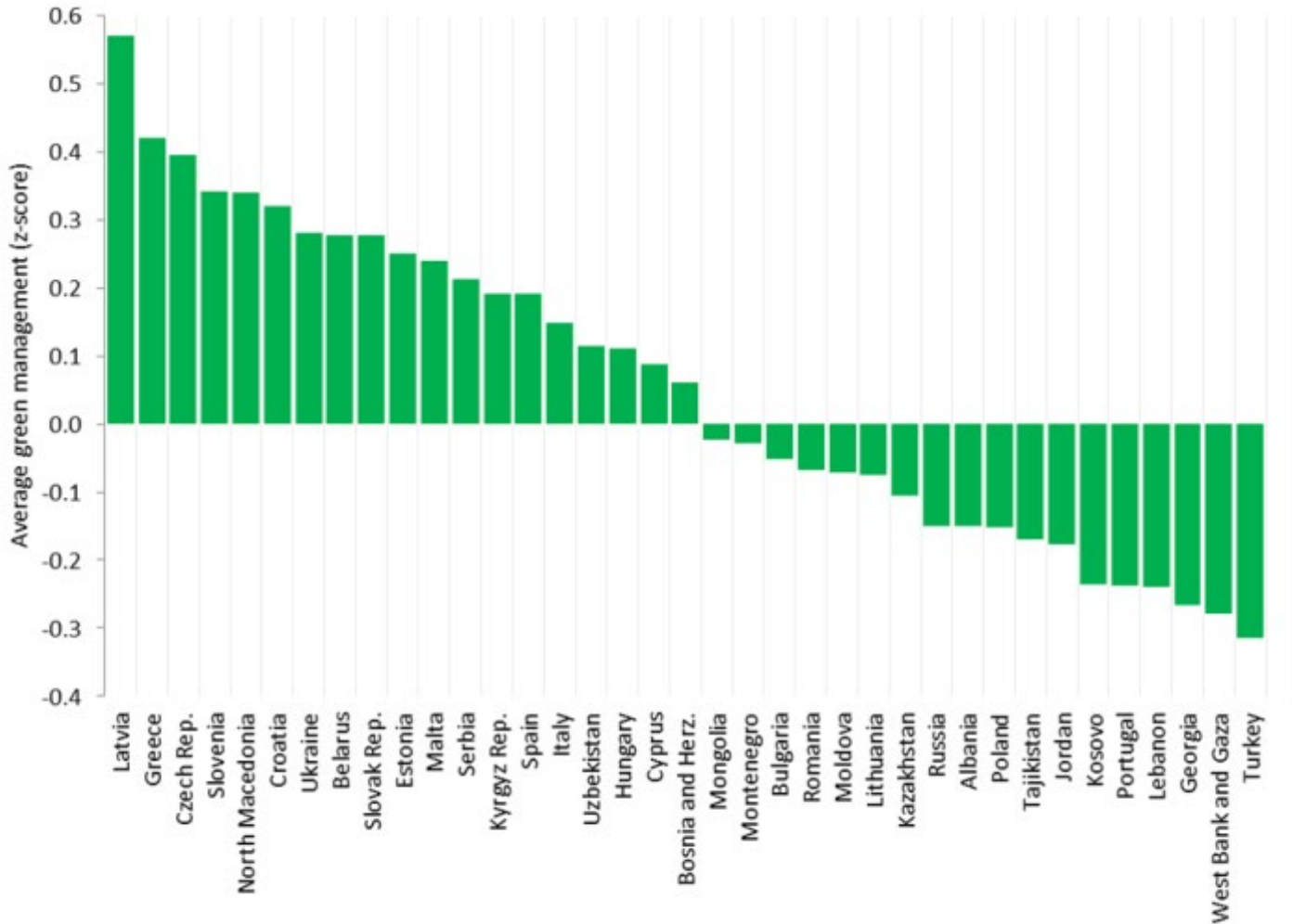
Strengthening corporate governance and management in firms

- Businesses tend to have better management practices in countries that score higher in the EBRD's Corporate Governance Sector Assessment
- Differences in firm performance are to a significant extent driven by differences in firm governance
- Foreign firms, exporters and firms in markets with stronger competition are better managed
- Firms with professional managers are better run but few family owners delegate – to a large extent this is due to weaknesses in national-level governance and a lack of trust

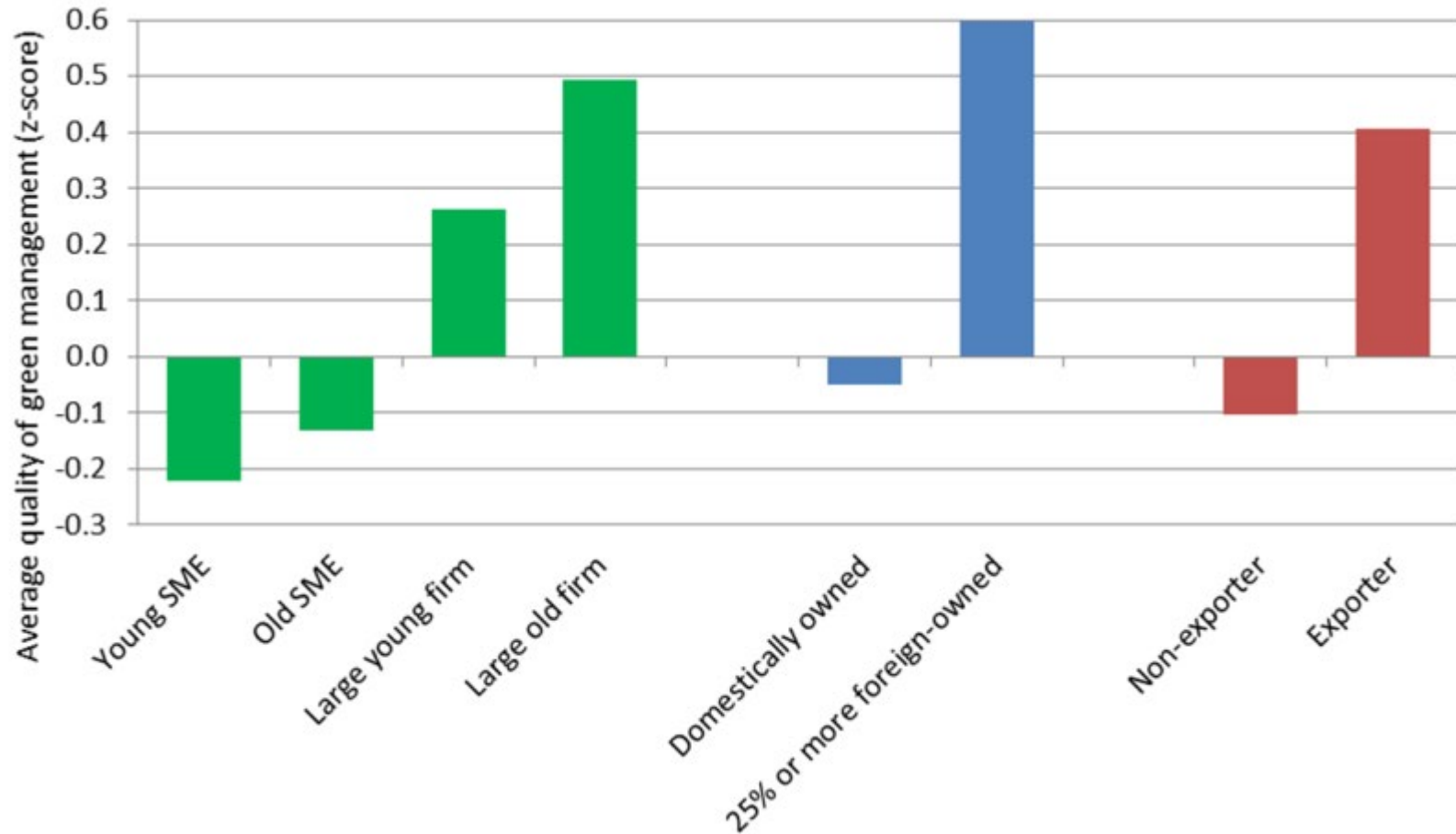
4 FIRMS' GREEN GOVERNANCE



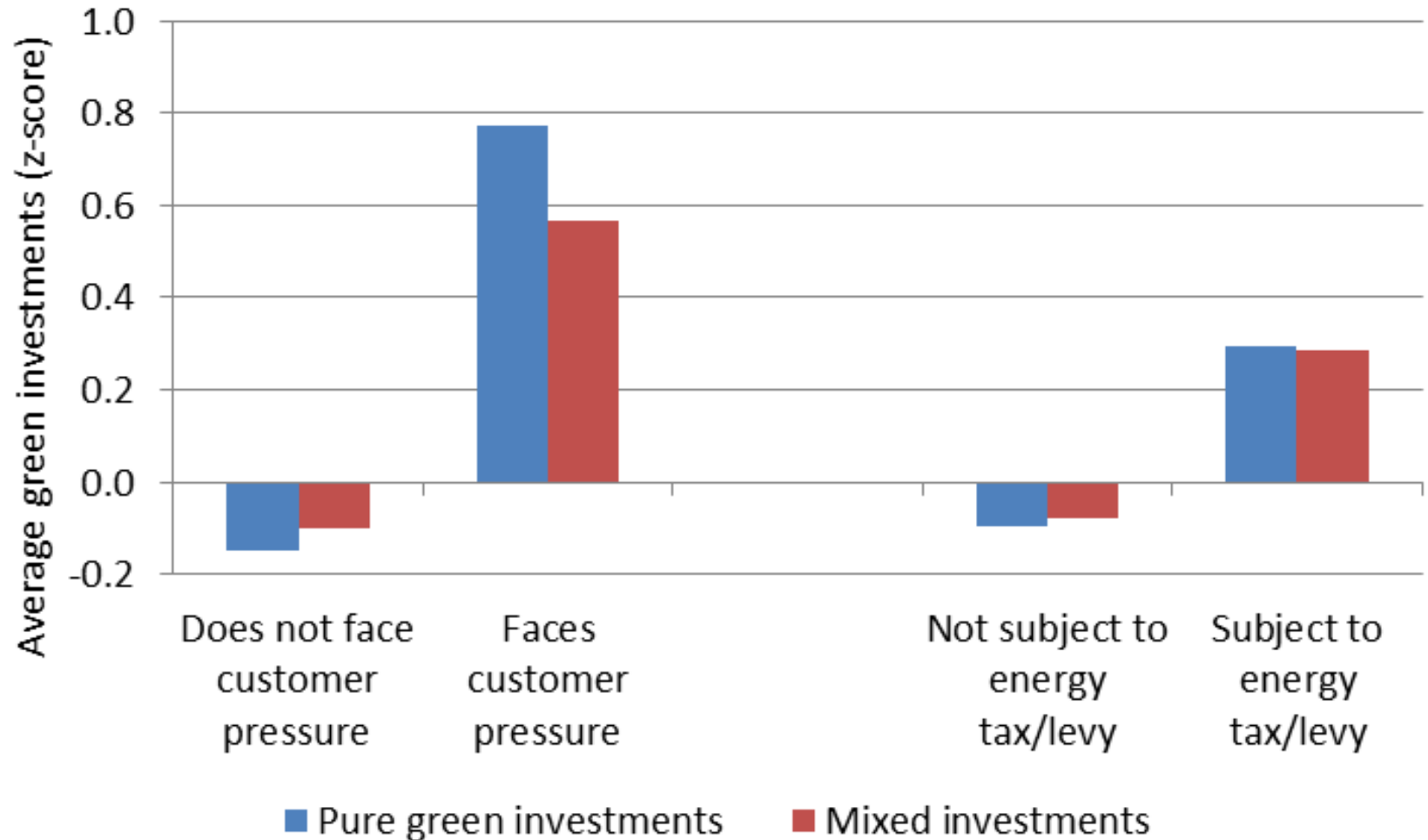
Quality of green management varies across economies



Older, larger firms, foreign firms and exporters have better green management practices

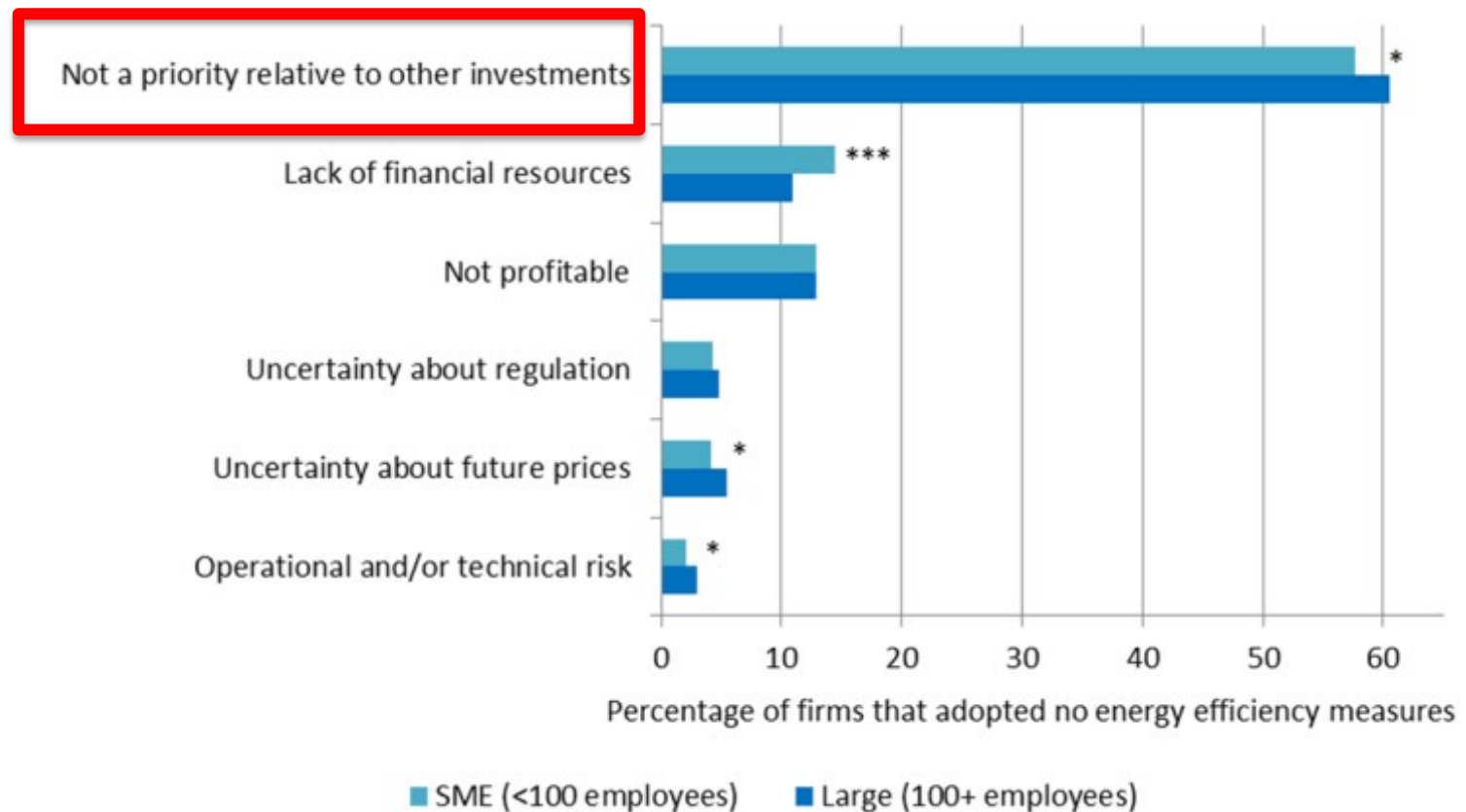


Customer pressure, energy taxes boost green investments



Investment in energy efficiency is not viewed as a priority

Reasons for not adopting energy efficiency measures vary



Green firms: Emissions in the EBRD regions have fallen since the 1990s but more progress is needed

- Evidence from Enterprise Surveys: there are firms with excellent green management practices in the regions, yet the majority lag behind
- Credit constraints slow firms' investments, including those with environmental benefits. Yet whether firms undertake improved energy management, green-energy generation, air-pollution controls and other purely green investment depends primarily on green management practices
- Firms tend to prioritise green management and investments when faced with extreme weather or pollution, or in response to customer pressure
- To give firms a “nudge” governments may have to use environmental standards, other regulation, subsidies that are contingent on the use of specific green technologies, support targeted green credit lines

Concluding remarks

- EBRD regions entered the 1990s with relatively **strong skills but weaker governance**
- Yet there is evidence of slower progress (or even reversals) in the past decade –the **“governance gap” with respect to advanced economies is almost as large as it was**
- This is more problematic than before: **good governance matters more for innovation-led growth**
- Narrowing the gap yields a sizeable growth dividend for countries and firms, and it **makes residents happier and less likely to emigrate**
- To give firms a **“nudge” to undertake green investments** governments may have to use environmental standards, other regulation, subsidies that are contingent on the use of specific green technologies, support targeted green credit lines

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