TRANSITION REPORT 2019-20



### **BETTER GOVERNANCE, BETTER ECONOMIES**

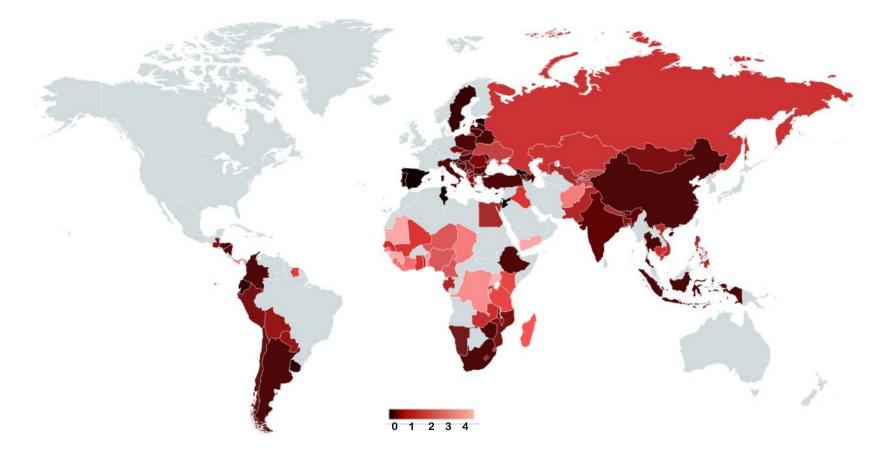


- Governance concerns authority, decision-making and accountability in all domains
- Governance is about the quality of institutions and the processes that they support
- Institutions are broadly "the rules of the game in a society" (North, 1990)
- The *Transition Report* looks at governance
  - at the 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)

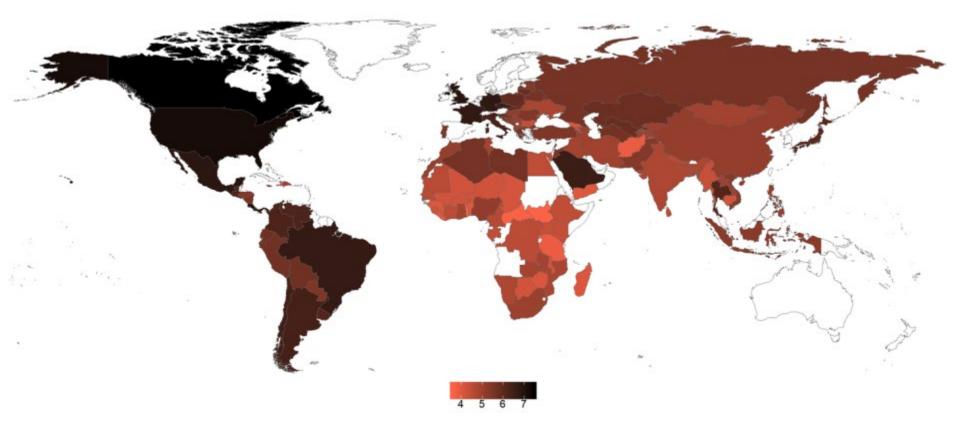
Enterprise Surveys: Average percentage of sales diverted to informal payments



TRANSITION REPORT 2019-20<br/>BETTER GOVERNANCE,<br/>BETTER ECONOMIESSource: Enterprise Surveys and authors' calculations. Data are for 2018-19 or the latest available survey for each economy since<br/>2006.

### Data sources: Gallup World Polls, 2006-18

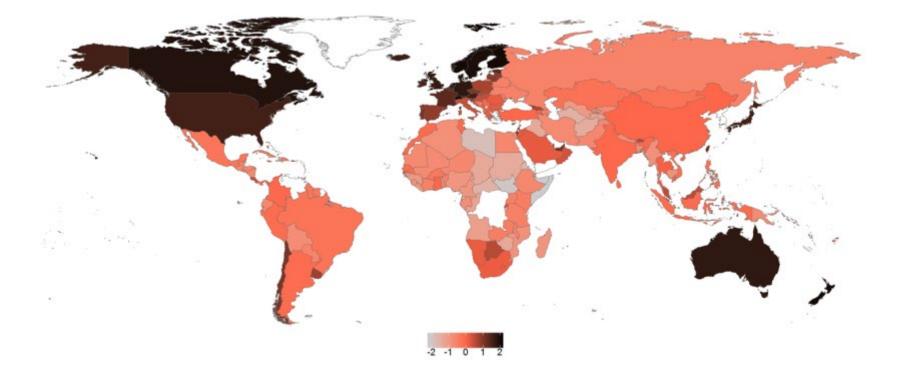
Gallup World Polls: Average life satisfaction, 2006-18, 0-10 scale



TRANSITION REPORT 2019-20 BETTER GOVERNANCE, BETTER ECONOMIES Source: Gallup World Polls and authors' calculations.

### Data sources: Worldwide Governance Indicators

Worldwide Governance Indicators at a glance, 2017



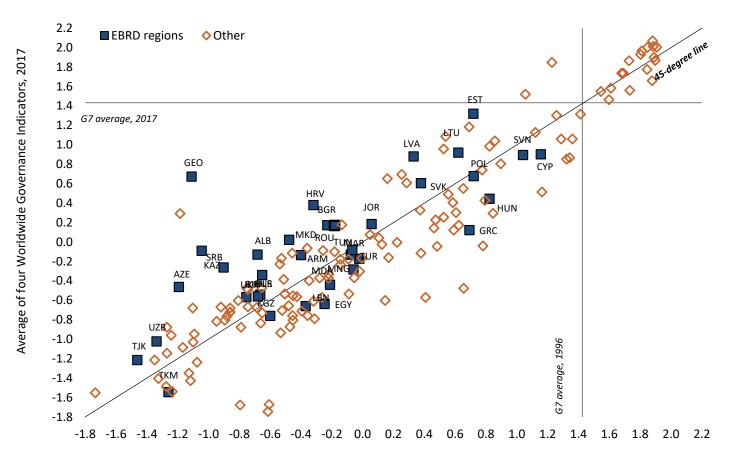
TRANSITION REPORT 2019-20 BETTER GOVERNANCE, BETTER ECONOMIES Source: World Bank, IMF and authors' calculations. Simple average of the Worldwide Governance Indicators of control of corruption, rule of law, regulatory quality and government effectiveness (scaled -2.5 to 2.5).

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# **1** THE GOVERNANCE DIVIDEND



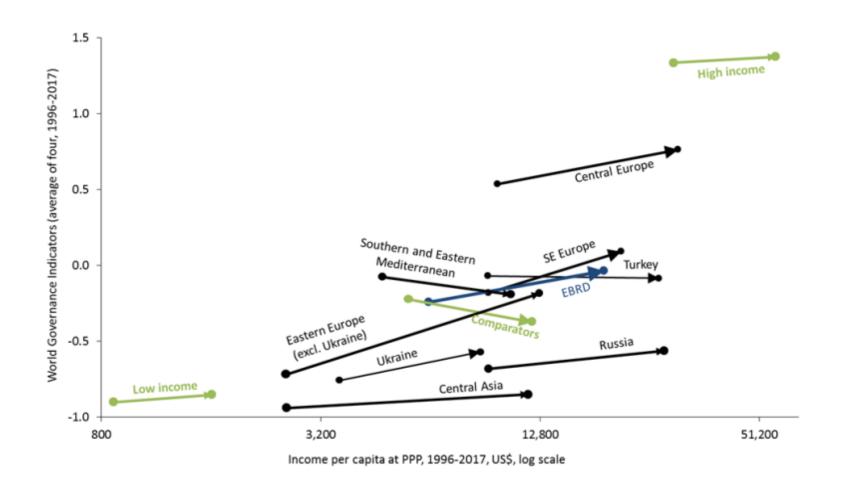
## Weak governance in EBRD regions, mid-1990s (relative to advanced economies and many emerging markets)



Average of four Worldwide Governance Indicators, 1996

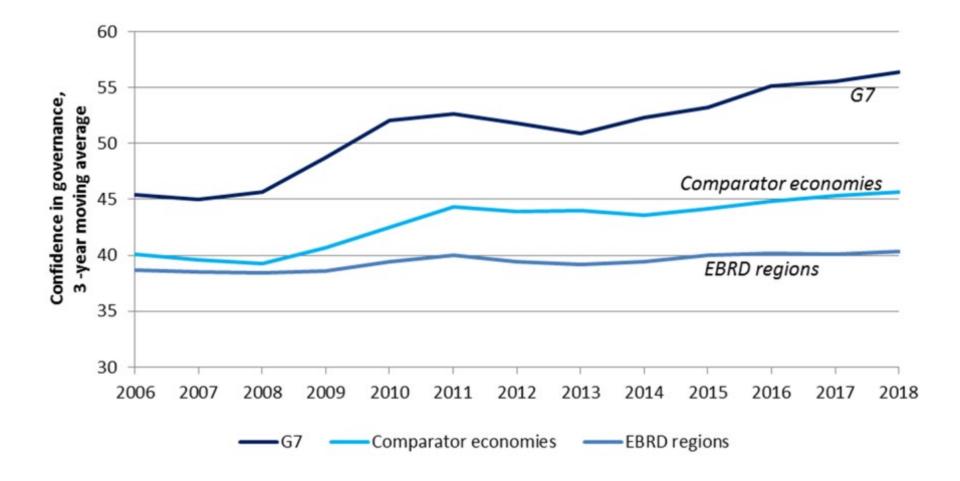
TRANSITION REPORT 2019-20 BETTER GOVERNANCE, BETTER ECONOMIES Source: World Bank, IMF and authors' calculations. Simple average of the Worldwide Governance Indicators of control of corruption, rule of law, regulatory quality and government effectiveness.

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



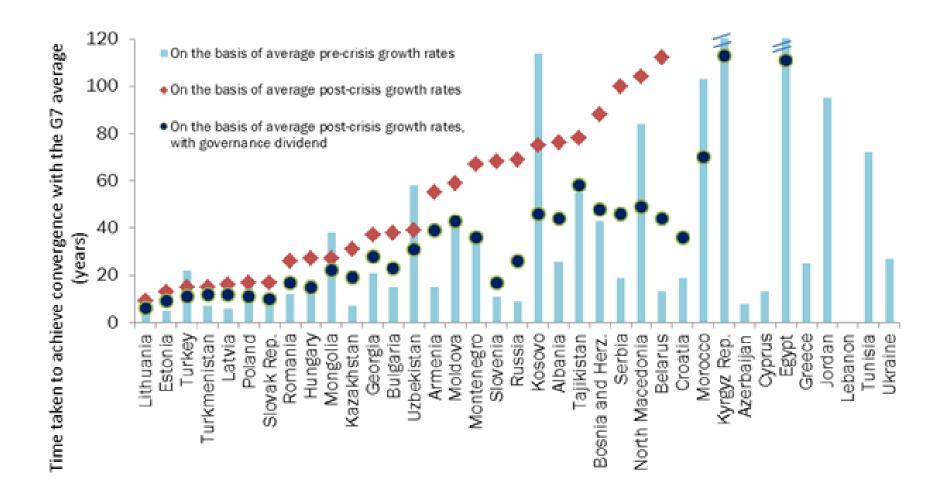
TRANSITION REPORT 2019-20 BETTER GOVERNANCE, BETTER ECONOMIES Source: World Bank, IMF and authors' calculations. Average of the Worldwide Governance Indicators of control of corruption, rule of law, regulatory quality and government effectiveness. Comparators = average of 94 countries; low-income = below Tajikistan's income at market exchange rates in 2017; high-income = above Slovenia's income.

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



TRANSITION REPORT 2019-20Source: Gallup World Poll and authors' calculations. The index is based on six questions covering trust *that* corruption *is* not<br/>widespread throughout the government or business, confidence in the national government, the judicial system, the courts, the<br/>fairness of elections and the freedom of the media.

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

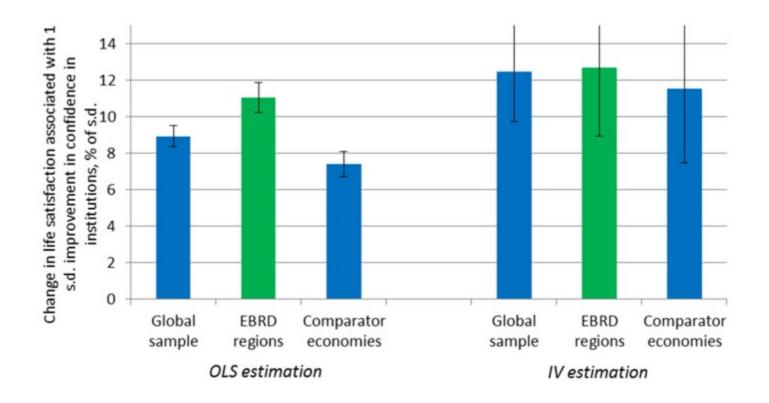


TRANSITION REPORT 2019-20 BETTER GOVERNANCE, BETTER ECONOMIES Source: IMF and authors' calculations. Based on income levels measured at PPP. Where data are missing, no convergence is expected on the basis of observed growth rates.

## 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

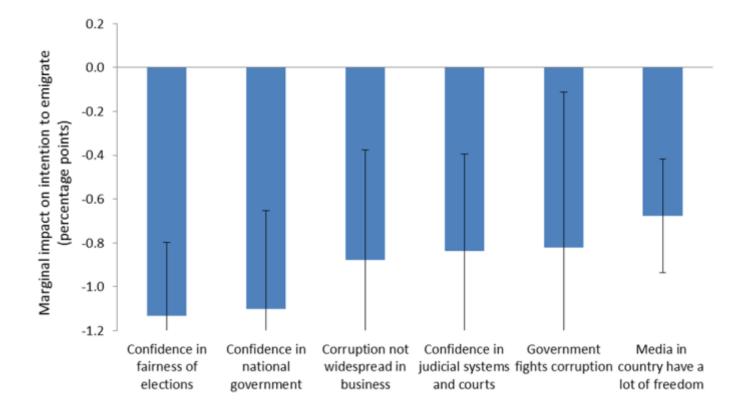
Closing half of the gap in governance relative to G7 is associated with closing 15 per cent of the happiness gap (**8 percentage point direct effect**)



TRANSITION REPORT 2019-20Source: Gallup World Poll and authors' calculations. Perception of governance is instrumented using average of randomly<br/>selected subsample of observations in the same region (1/2 of total number), which are excluded from the main sample.<br/>Controlling for propensity to complain.

## 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** 



TRANSITION REPORT 2019-20 BETTER GOVERNANCE, BETTER ECONOMIES Source: Gallup World Poll and authors' calculations. Calculated by regressing intentions to emigrate on each governance indicator in turn, using a linear probability model with survey-weighted observations. All regressions take account of demographic characteristics. 95 per cent intervals

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

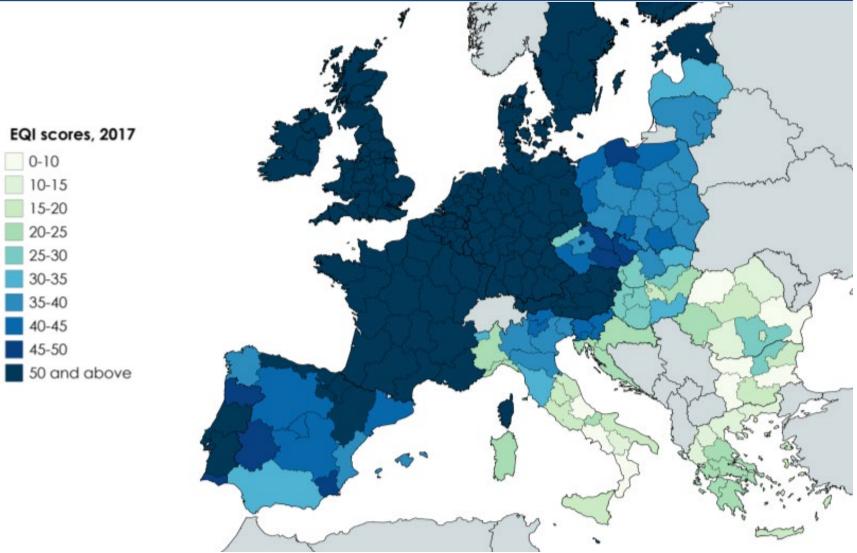
- EBRD regions entered the 1990s with relatively strong skills but weaker governance
- Considerable improvements in governance can be tracked in country indicators, Gallup Surveys and the latest enterprise surveys
- Yet evidence of slower progress (or even reversals) in the last decade in a way that 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

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### **2** GOVERNANCE IN MUNICIPALITIES AND REGIONS

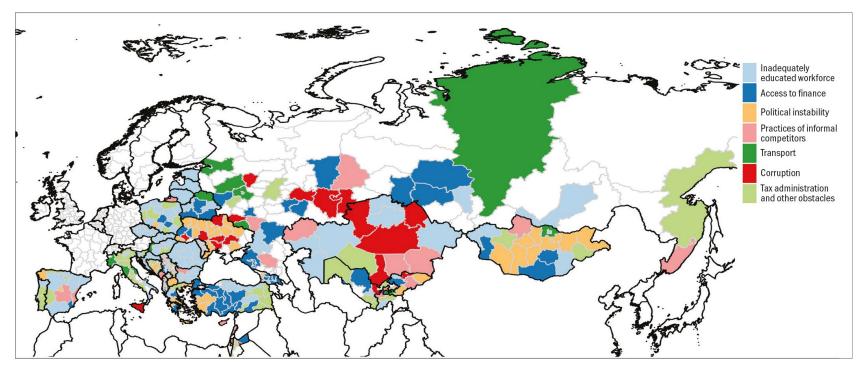


### Quality of governance varies significantly not just across countries, but also within them



TRANSITION REPORT 2019-20 BETTER GOVERNANCE, BETTER ECONOMIES Source: European Quality of Government Survey of individuals (by University of Gothenburg) and authors' calculations. NUTS2 regions where available or NUTS 1. Higher values (0-100 scale) correspond to better governance.

## Regional variation in most important obstacles to firms' operations

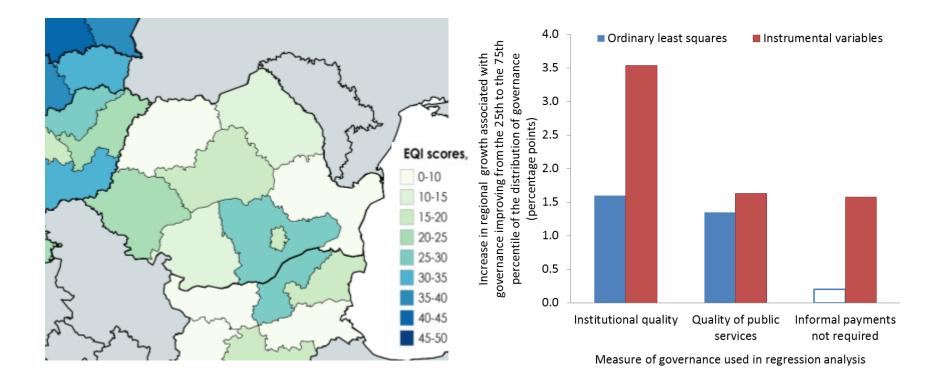


Skill shortages are seen as the key obstacle in Mogilev (Belarus) or East Kazakhstan Access to finance in many regions in Central Turkey or Minsk (Belarus) or Tomsk (Russia) Political instability in Kyiv and many regions of Ukraine, many regions of Mongolia, the West of Turkey Practices of informal competitors 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  $\rightarrow$  Spain or Serbia  $\rightarrow$  Poland



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Source: Enterprise Surveys, Eurostat, European Quality of Government Survey of individuals (by University of Gothenburg), OECD, World Bank, authors' calculations. NUTS 2 regions where available (or NUTS 1). 0-100 scale.

### Benefits of improving subnational governance

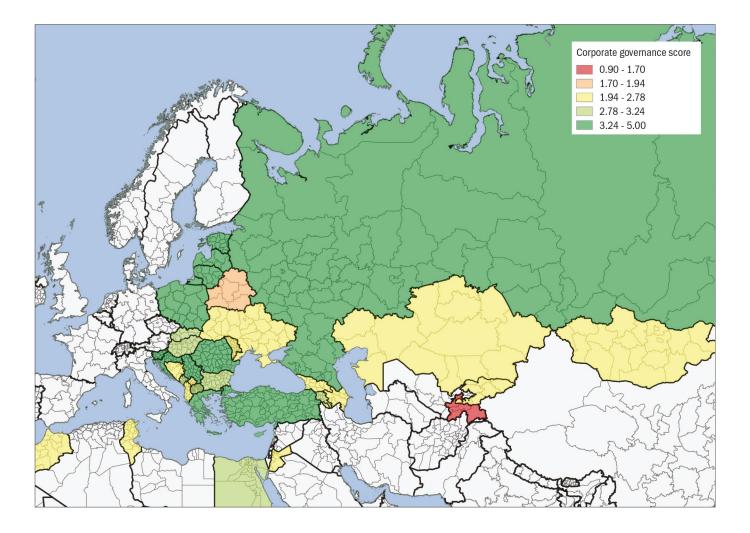
- The quality of governance varies significantly not just across countries, but also within them
- Within-country disparities in governance have been increasing; vicious circle of low quality of governance, weaker economic growth and outmigration of the skilled
- Improving regional or municipal governance 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

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# **3 FIRM-LEVEL GOVERNANCE**



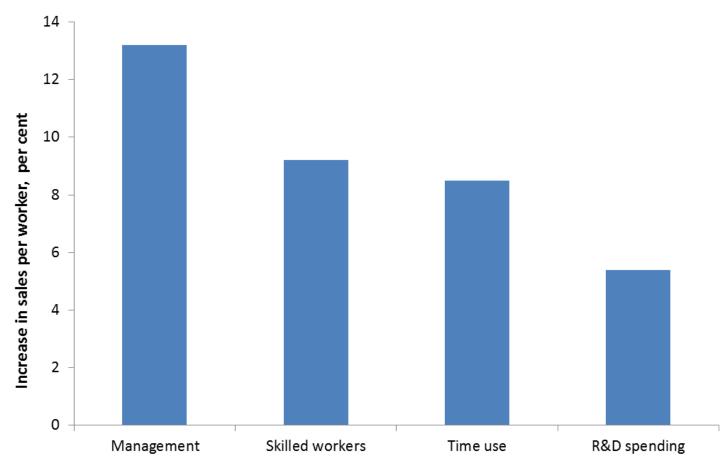
#### **Corporate Governance Sector Assessment scores**



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

TRANSITION REPORT 2019-20 BETTER GOVERNANCE, BETTER ECONOMIES Source: EBRD Corporate Governance Sector Assessment, conducted by the EBRD Legal Transition team. Range 1-5, average of 2.8. Governance in firm = rules/practices governing relationships between shareholders, directors, managers, employees.

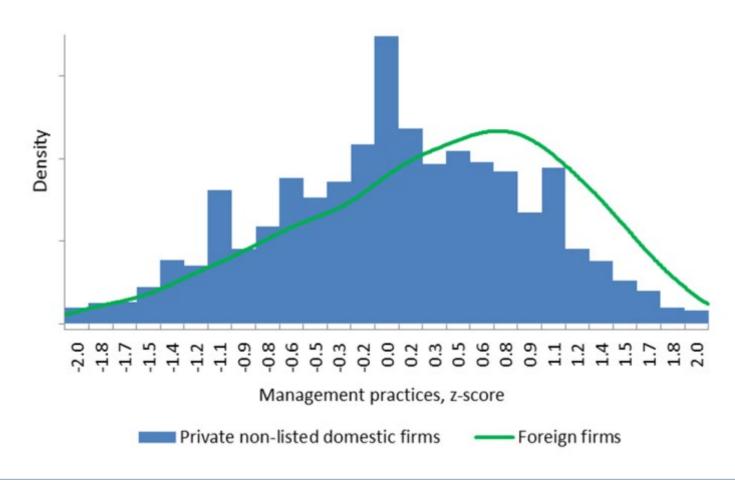
### Better managed firms are more productive



#### One standard deviation increase in ...

TRANSITION REPORT 2019-20 BETTER GOVERNANCE, BETTER ECONOMIES Source: Enterprise Surveys and authors' calculations. Regressions control for firm age, listed status, foreign ownership status, and include two-digit ISIC industry and country fixed effects. Standardised beta-coefficients.

### Foreign-owned firms have better management practices



TRANSITION REPORT 2019-20 BETTER GOVERNANCE, BETTER ECONOMIES Source: Enterprise Surveys and authors' calculations.

## Strengthening corporate governance and management in firms

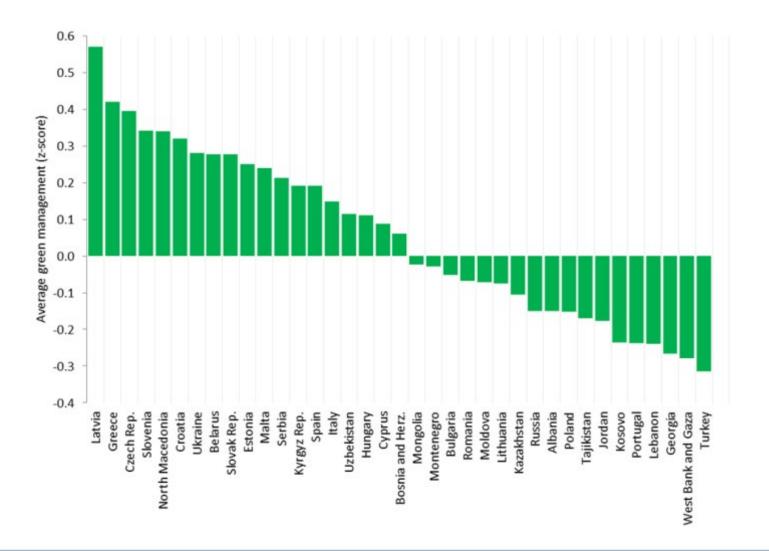
- Businesses tend to have better management practices in countries that score higher in the EBRD's Corporate Governance Sector Assessment
- Differences in firm performance are to a significant extent driven by differences in firm governance
- Foreign firms, exporters and firms in markets with stronger 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

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# **4 FIRMS' GREEN GOVERNANCE**

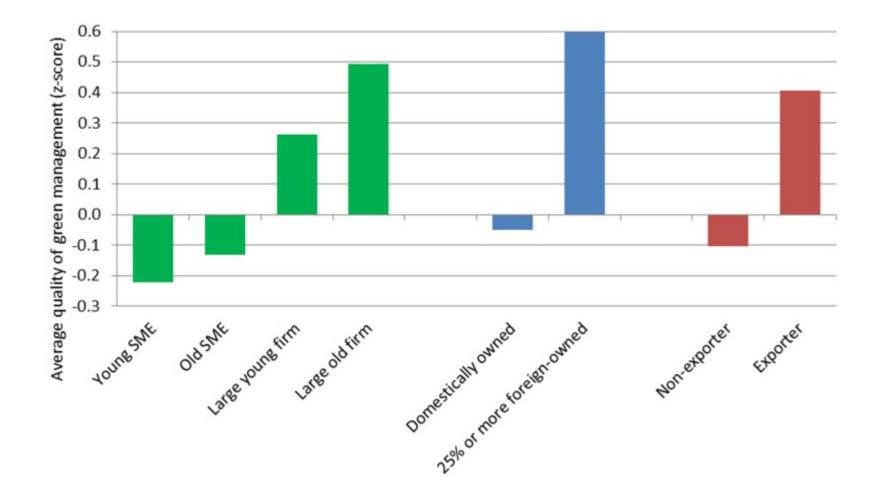


### Quality of green management varies across economies



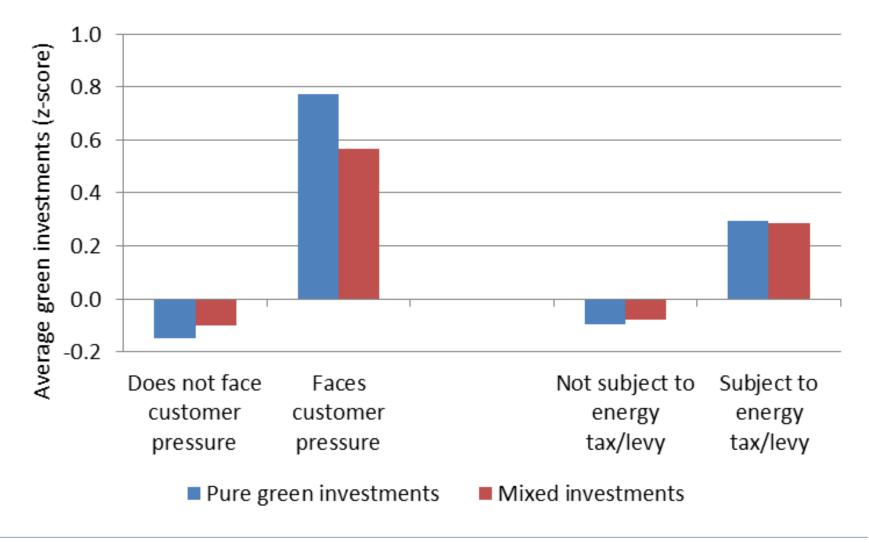
TRANSITION REPORT 2019-20 BETTER GOVERNANCE, BETTER ECONOMIES Source: Enterprise Surveys and authors' calculations. Green management: strategic objectives that mention environmental or climate change issues, manager responsible for environmental and climate change issues, monitoring and targets.

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



TRANSITION REPORT 2019-20 BETTER GOVERNANCE, BETTER ECONOMIES Source: Enterprise Surveys and authors' calculations. SMEs have fewer than 100 employees; young firms are less than five years old.

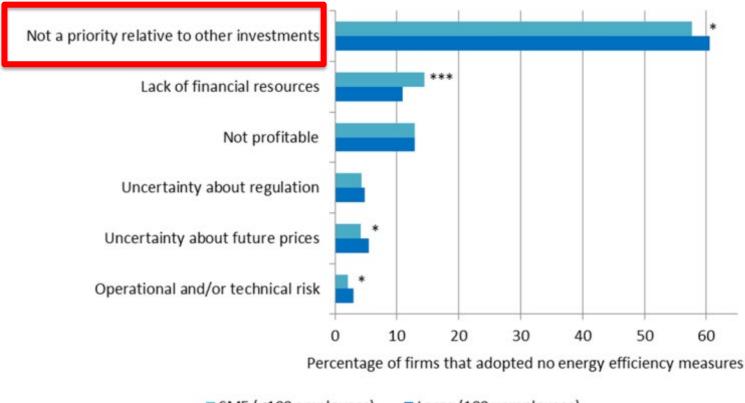
### Customer pressure, energy taxes boost green investments



TRANSITION REPORT 2019-20 BETTER GOVERNANCE, BETTER ECONOMIES Source: Enterprise Surveys and authors' calculations. Pure green investments include green energy generation on site, energy management, waste minimisation, recycling and waste management, and pollution control.

### Investment in energy efficiency is not viewed as a priority

#### Reasons for not adopting energy efficiency measures vary



SME (<100 employees)</p>

Large (100+ employees)

TRANSITION REPORT 2019-20 BETTER GOVERNANCE, BETTER ECONOMIES Source: Enterprise Surveys and authors' calculations. \*\*\* denotes statistically significant difference between average answers by smaller and larger firms.

## 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, greenenergy 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

- 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

### Acknowledgements

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