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Geneva

UN/ECE releases its first 2000 Economic Survey of Europe

Are the standards of living of west Europeans catching up with those of north Americans? Are the standards of living of the inhabitants of countries with economies in transition reaching west European levels? Is there any convergence between all these countries in terms of per capita GDP? Those are some among the many questions which are answered in chapter 5 of the latest release of the *Economic Survey of Europe 2000, No. 1* just published by the United Nations Economic Commission for Europe (UN/ECE).

"The issue of convergence is not only important in the context of west European economic and monetary integration", stresses Paul Rayment, Director of the Economic Analysis Division of the UN/ECE, "but also for the wider European integration process. One of the strategic goals of the transition economies is to achieve sustained and high rates of economic growth that would enable them to catch up with – to converge upon – the living standards of the developed economies of western Europe. And many of them regard EU membership as instrumental to promote this process."

Western Europe and North America - the widening gap

"Since the early 1950s" comments Dieter Hesse, a senior economist and head of the market economies section of the UN/ECE, "there has been a long-run tendency for the inequality of real per capita GDP across developed market economies of the region to decline over time. This so-called "sigma convergence", however, was most pronounced during the period 1950-1973, also known as the Golden Age of post-war economic growth. In contrast, there was a marked slowdown in convergence in the post-1973 period." The progress in convergence in the period 1950-1998 reflects a tendency for countries with below average per capita GDP in the initial period to experience a faster rate of growth thereafter. The speed of convergence is, however, very slow.

Using the per capita GDP of the United States as a benchmark, the feature in western Europe was for strong convergence on the United States' real GDP per capita in the period 1950-1973, but this catch-up process then slowed down markedly. "On average, there was little further progress in closing the real income gap relative to the United States after 1973; in fact, the gap widened slightly in the 1990s" stresses Dieter Hesse. Thus, despite considerable progress since 1950, there remains a large difference between real per capita GDP in the United States and in western Europe: the gap amounted to some 40 per cent for the aggregate of 19 west European countries and some 33 per cent for the EU in 1998 (see table 5.3.2).

TABLE 5.3.2

Real GDP per capita, 1950-1998
(United States=100)

	1950	1960	1973	1990	1998
France	52	63	74	77	74
Germany[a]	43	73	76	81	77
Italy	36	52	63	72	68
United Kingdom	69	73	69	70	70
Austria	38	57	66	74	73
Belgium	54	59	70	74	74
Denmark	66	72	77	76	80
Finland	42	53	63	72	69
Greece	18	25	42	40	40
Iceland	..	58	65	77	74
Ireland	34	36	39	50	74
Luxembourg	..	90	90	105	122
Netherlands	57	67	72	71	73
Norway	53	60	63	77	87
Portugal	19	24	37	43	45
Spain	28	34	50	52	53
Sweden	67	74	77	75	69
Switzerland	92	108	108	93	79
Turkey	17	20	19	21	22
Canada	75	77	80	82	76
United States	100	100	100	100	100
Japan	19	33	64	79	75
Western Europe	45	57	62	65	61
European Union	46	60	67	71	67

Source: See annex 1 to this chapter.

Note: Figures are rounded.

[a] 1950-1990: west Germany.

The available evidence suggests that the process of convergence to US per capita income levels (and also convergence within western Europe) reflects to a large extent productivity catch-up and technical change. The notable weakening of the tendency for convergence in western Europe after 1973 may be due to the adverse impact of successive shocks on macroeconomic stability and longer-term growth expectations. These, in turn, reduced the stimulus to fixed investment, which is the main vehicle for technical change. Greater cyclical volatility can also influence the longer term growth performance *via* its impact on "learning by doing" and, therefore, on human capital formation, both of which may slow down in periods of low growth or recession.

Progress in convergence has been uneven across countries (notably at the European periphery) and over time, reflecting the specific interactions between domestic and international factors and their impact on the growth of individual countries. This suggests that the longer term growth performance of each country is essentially unique, and therefore difficult to replicate. Ireland is a prime example of convergence: its real per capita GDP rose from some 60 per cent of the EU average in 1960 to 110 per cent in 1998. But the Irish success has been the result of the favourable interaction of a host of specific factors (such as conducive changes in the western European and global economic environment and a skilful policy designed to attract foreign direct investments (FDI)) which is unlikely to be repeated elsewhere. Convergence petered out into broad stagnation in Greece after 1973 and catch-up never really took off in Turkey. In contrast, the performance in Portugal and Spain has been more pronounced, although whether the outcome could have been even better remains an open question. The more favourable outcome for Portugal and Spain compared with Greece after 1973 has been associated *inter alia* with a greater emphasis on institutional adaptation, macroeconomic stabilization, structural reforms and trade liberalization in the former two countries, which together created a more conducive environment for foreign direct investments (FDI).

The empirical evidence also emphasises the inter-relatedness of short-term cyclical developments and longer term economic growth. In fact, the growth performance of this group of developed market economies was rather uneven over the period 1950-1998, with episodes of weaker growth followed by more or less long periods of sustained dynamism (or *vice versa*). This points to the role of country-specific characteristics, including (positive or adverse) shocks and policies in determining long-term growth patterns apart from common factors such as technological change. Thus, adverse cyclical conditions and arduous structural adjustments led to the virtual stagnation of real per capita GDP in Sweden and even a small decline in Switzerland in the 1990s.

Eastern Europe and the CIS: Divergence during the Transition

"Despite all the methodological difficulties and data problems, over the long run (during the 50-year period between 1950 and 2000), it is clear that there is little evidence of catching up by the former centrally planned economy countries (CPEs) and their successor states on the per capita income levels of the EU-15", says Rumen Dobrinsky, a senior economist in the transition economies section of the UN/ECE. On the contrary, a comparison of per capita GDP in the initial and final years reveals instead evidence of falling behind; the latter is especially pronounced in the successor states of the Soviet Union after 1990. The only evidence, which was found, of absolute convergence in per capita income levels within the former CPEs as a group and in relation to some of the west European economies was during the 1950s and 1960s. Starting from the 1970s the gaps in income levels started to widen again.

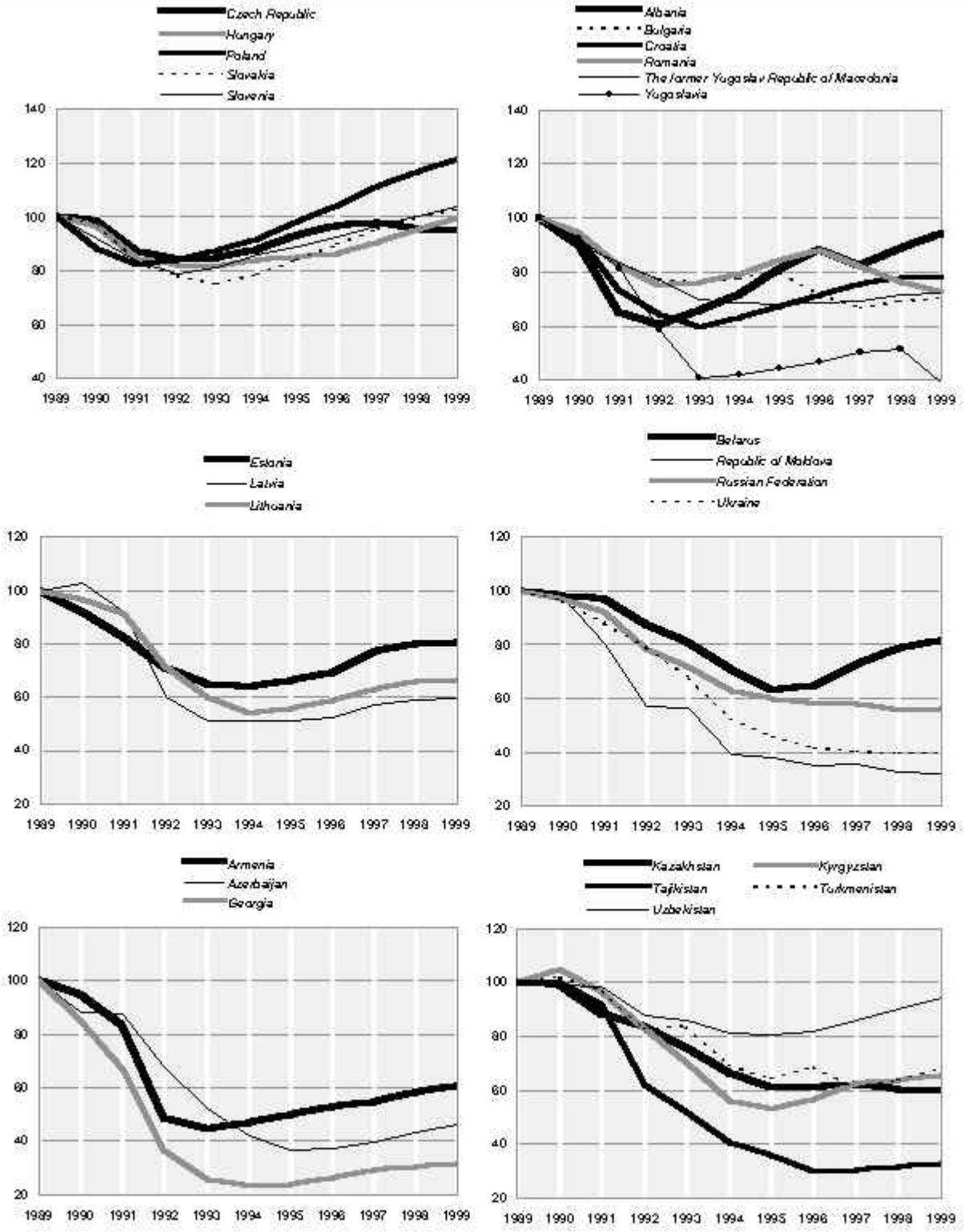
"One striking result of our study is that the eastern part of the continent was already characterized by high and increasing economic heterogeneity by the end of the 1980s. This finding is at odds with the widespread view that central planning and economic cooperation within the CMEA had instigated a relatively high level of economic homogeneity and a leveling of per capita income levels within the group", adds Rumen Dobrinsky. In fact, the *Survey* shows that the general slowing down of economic growth in the 1970s was followed by a rapid divergence during the 1980s.

The start of economic and political transformation after 1989 generated high hopes and expectations on the part of the peoples living in the eastern part of the continent of fast improvement in their living standards and of catching up with those prevailing in western Europe. However, the past decade has been characterized by highly divergent paths of growth among the transition economies: while some of them have embarked on a path of sustained recovery, others are still struggling with the transformational recession (see chart 5.4.3). By 1999 the central European transition economies had either regained (Poland, Slovakia, Slovenia) or were close to their pre-transition GDP levels (Czech Republic, Hungary); at the same time in countries such as Georgia, the Republic of Moldova, Ukraine and Yugoslavia, GDP in 1999 was a mere one third of its pre-transition level.

CHART 5.4.3

GDP in the central European transition economies, 1989-1999

(Indices, 1989=100)



Source: UN/ECE secretariat calculations, based on national statistics.

In 1999 the average per capita GDP level (measured using purchasing power parities (PPP)) in the five central European transition economies was 46 per cent of the average per capita GDP level in the EU-15, and this proportion was almost unchanged from a decade ago, while in the seven south-east European transition economies average per capita income had fallen to 22 per cent of the EU-15 average from 39 per cent in 1989. In the three Baltic states the average per capita GDP in 1999 was 31 per cent of the EU-15 average while for the CIS countries as a whole this number was 24 per cent.

In general, the transition to a market economy has brought about turbulent changes and growing evidence of economic heterogeneity and divergence in per capita income levels in the former CPEs. At the same time there emerged subgroups of transition economies in which per capita incomes were more homogeneous. Some of them (notably central Europe during the second half of the 1990s) were also beginning to catch up on west European levels, but most of the transition economies continued to diverge from one another and to fall further behind the income levels of western Europe.

"Convergence in Europe, namely, the process closing of per capita income gaps between the transition economies and western Europe, is likely to be long and difficult" stresses Rumen Dobrinsky. "The time required for catching up can be estimated in decades, even for the more advanced transition economies and under optimistic growth scenarios". The main prerequisite for convergence in Europe is a rapid and sustained rate of growth of the transition economies. Although their past experience may not be very encouraging, the start of economic transformation has created an opportunity for breaking with the past and for establishing a favourable environment for growth and catching up.

Several proximate factors are however necessary for achieving high and sustained long-term economic growth. These are: investment in physical and human capital; investment in research and development and infrastructural development; openness to trade; the development and upgrading of financial systems; and maintaining a generally acceptable distribution of wealth within each country; as well as a range of institutional, social and political factors.

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