

## The Elements of Economic Growth

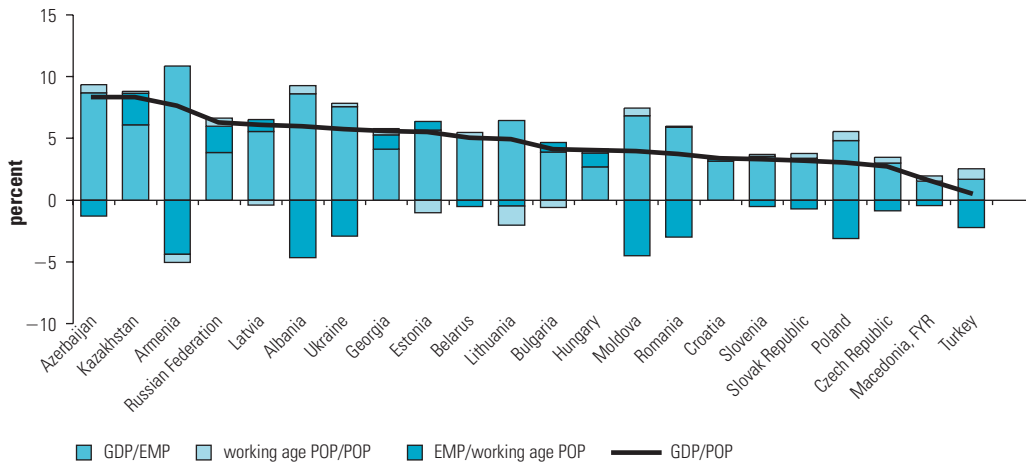
The improvements in living standards in the transition countries between 1998 and 2006 need to be placed in the context of economic growth and employment generation (figure 1.1). The Baltic states (Estonia, Latvia, and Lithuania) and many Commonwealth of Independent States (CIS) countries have enjoyed growth in GDP per capita averaging 5 percent or more a year, reflecting their recovery from a deep transitional recession, which had taken GDP per capita in the CIS countries in 1998 to an estimated 55 percent of its 1990 level. Growth in the Czech Republic, Poland, the Slovak Republic, and Slovenia and in Southeastern European countries such as Bulgaria, Croatia, and Romania, averaged less than 5 percent. Eastern Europe had experienced a shorter and shallower transitional recession, which had seen GDP per capita in 1992 fall to an estimated 85 percent of its 1990 level.

The recovery in GDP per capita since 1998 owes much more to growth in aggregate labor productivity than to increases in the employment rate, with demographic change generally contributing little over this short period.<sup>1, 2</sup>

Aggregate labor productivity fell following the onset of transition in a number of countries of the former Soviet Union, reflecting an inability to reduce employment in line with the sharp collapse of output. But it recovered strongly thereafter because output could be

FIGURE 1.1

## Average Annual Growth Rate in GDP per Capita and Its Components, 1998–2006



Source: ILO LABORSTA database and World Bank World Development Indicators Database.

Note: Growth in GDP per capita during 1998–2006 is decomposed into (1) growth in GDP per employed person, or aggregate labor productivity, (2) growth in employment as a share of the working age population, or the employment rate, and (3) growth in the share of the working age population in the total population. The relationship used is

$$\frac{GDP}{POP} = \left( \frac{GDP}{EMP} \right) \times \left( \frac{EMP}{WorkingAgePOP} \right) \times \left( \frac{WorkingAgePOP}{POP} \right),$$

where POP is the total population, EMP is the employed population, and Working Age POP is the working age population. All data are for 2006, except for Armenia, Georgia, Kazakhstan, and the Russian Federation, which are from 2005.

increased without a commensurate rise in employment in such countries as Armenia, Azerbaijan, Kazakhstan, Moldova, Ukraine, and the Baltic states, and also in Albania and Romania. The analysis of productivity growth and its correlates occupies Chapters 2 and 3.

The employment rate, which fell everywhere in the early years of transition, reflecting declining labor force participation and unemployment, rose considerably in the Russian Federation, where its contribution to growth was nearly as large as that of aggregate labor productivity, and in Kazakhstan, Estonia, and Latvia. The employment rate rose after 1998 in all the European Union countries except the Czech Republic, Poland, Romania, and the Slovak Republic (figure 1.2). Indeed, except in the Baltic states, employment rates in Eastern Europe tend to be lower than in the CIS and lower than the Lisbon target of 70 percent in most of the new member states of the European Union. The determinants of employment are explored in Chapter 4. The connection between poverty, productivity, and labor market status is developed in Chapter 5

BOX 1.1

Country Groups

The countries of Eastern Europe and the former Soviet Union are classified in four groups in this book.

EU8 countries: Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovak Republic, and Slovenia.

Southeastern European countries: Albania, Bosnia, Bulgaria, Croatia, Macedonia, Romania, and Serbia and Montenegro.<sup>a</sup>

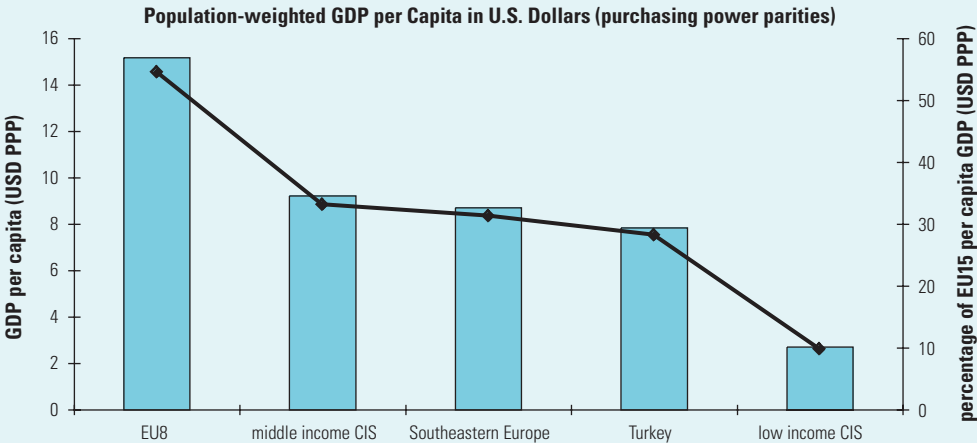
Middle income CIS countries: Belarus, Kazakhstan, the Russian Federation, and Ukraine.

Low income CIS countries: Armenia, Azerbaijan, Georgia, Kyrgyzstan, Moldova, Tajikistan, and Uzbekistan.

The developed market economies of the European Union prior to its eastern enlargement in 2004, or the EU15, are Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxemburg, Netherlands, Portugal, Spain, Sweden, and the United Kingdom.

Within the EU15, the cohesion countries are Greece, Ireland, Portugal, and Spain.

GDP per capita in the transition country groups in 2006 and as a proportion of GDP per capita in the EU15 are shown below. As a proportion of GDP per capita in the EU15, they range from 10 percent for the low income CIS to 55 percent for the EU8.

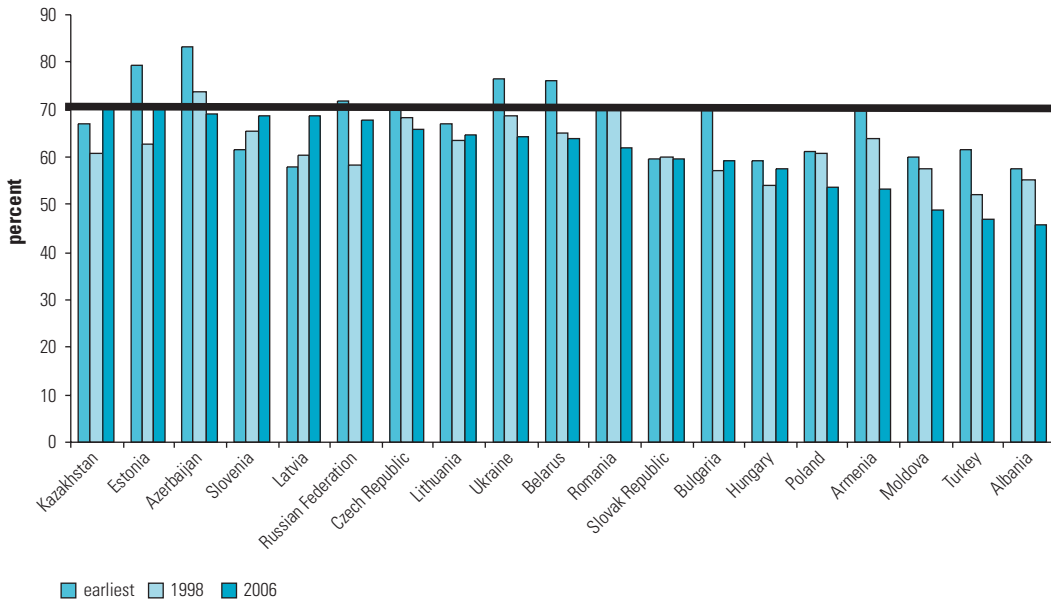


Source: World Bank World Development Indicators Database.

Note: Regional aggregates are weighted by population.

a. Serbia and Montenegro are not shown separately since the latest year for the analysis in this book is 2006, when they were a single country.

FIGURE 1.2

**Employment Rates: Early Transition, 1998 and 2006**

Source: ILO LABORSTA Database.

Note: The earliest data are for 1990 for Azerbaijan, Belarus, Bulgaria, Estonia, and Turkey; for 1992 for Hungary and the Russian Federation; for 1993 for Armenia, Czech Republic, Kazakhstan, Poland, and Slovenia; for 1994 for Albania, Lithuania, Romania, and Slovak Republic; for 1995 for Moldova and Ukraine; and for 1996 for Latvia. The latest data for Kazakhstan are for 2004.

The ratio of the working age population to total population rose in Albania, Azerbaijan, and Turkey, which saw increases in the working age population, and in Moldova, where the total population declined. The ratio fell in Armenia, where there was a large increase in the total population, and in Bulgaria, Estonia, and Lithuania, because of aging populations. The evolution of the share of the working age population due to aging and its likely consequences are examined in Chapter 8.

The region's economic recovery has been accompanied by its reintegration into the global economy. Chapter 6 examines development in trade in goods and services, while Chapter 7 is devoted to international migration.

## Endnotes

1. Similar results hold if total factor productivity is used instead. Thus, World Bank (2008a) also finds that total factor productivity growth, rather than growth of labor or capital, accounted for most of the growth during this period.

2. To help keep these gains in measured productivity in perspective, note that the CIS, recovering from a deep transition recession after 1998, witnessed a rapid increase in capital stock utilization during this period. Thus, while World Bank (2008a) ascribes 5.8 percent of the annual growth rate of 6.5 percent in the Russian Federation during 1999-2005 to growth in total factor productivity, an adjustment for capacity use, which has the effect of the used capital stock growing faster than available capital stock, lowers the growth in total factor productivity to 4.2 percent.