TRANSITION REPORT
2020-21

THE STATE STRIKES BACK
1. How big is the state?

2. State-owned enterprises: Low risk, low return

3. The bright and the dark sides of state banks

4. The guiding hand of the state in the green economy transition
Government spending in the EBRD regions (at around 35% of GDP) is in line with their characteristics, including aging populations.
Declining state employment in post-communist economies:
45% in mid-1990s to 24% in mid-2010s, yet it remains 7pp higher than in comparator countries

Source: National authorities, ILO, EBRD, representative household surveys and authors’ calculations. Unweighted averages. 3-year moving averages. Comparators = outside EBRD regions / advanced economies, GDP per capita in excess of Tajikistan’s in 2019
As public share of employment has been declining, support for public ownership has been growing, reaching 45% in post-communist economies.

In other emerging markets, support surged to 53%.

Source: World Values Survey and authors’ calculations. 5-year moving averages for each age cohort. Agreeing 1-5 on a 1-10 scale with the statement that there should be more public ownership. Based on 45 economies covered in both waves, of which 20 in the EBRD regions.
Past experiences suggest support for public ownership may rise due to Covid-19

Previous epidemics dented trust in the economic institutions and democracy (Aksoy et al. 2020)

Those who reach adulthood during major recessions have a more positive view of public ownership and redistribution (Giuliano and Spilimbergo 2014)

Source: Authors’ calculations. Based on regressions of an indicator of support for public ownership on various individual characteristics, country survey effects and a measure of intensity of exposure to epidemics. 90% confidence intervals shown are based on robust standard errors.
State-owned enterprises (SOEs) have historically played an important role in the EBRD regions

SOEs account for almost **half of public sector employment**

SOEs are concentrated in **utilities**, **transportation** and **energy**

SOEs often receive subsidies to provide **affordable service** in remote areas and for low-income households

SOEs act as **automatic stabilisers** providing more stable employer in lagging regions and during downturns

But governments often struggle to run SOEs efficiently

**Employment at state-owned enterprises accounts for almost half of public-sector employment**

SOE provision of services is common where administrative capacity constrains private-sector options

Services can be provided by private companies, with government **subsidies** and **public service obligations** ensuring universal coverage.

Poor households facing large utility bills can receive means-tested benefits.

Fiscal transfers and targeted investment can attenuate regional disparities.

**Private-sector solution require capacity to set up and monitor such schemes, and to administer targeted means-tested benefits**

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Poor governance of state-owned enterprises in the EBRD regions

Need to **separate functions**:
- In almost half of countries SOE ownership and regulatory powers are combined
- In 19% of countries SOEs have regulatory powers

SOE management should be about **strategy, efficiency, not only compliance**:
- Many SOE Boards do not have adequate powers to approve even company budgets

**Disclose public service obligations** and their costs. Non-disclosure leads to vicious cycles of non-transparent subsidies, losses, bailouts, inefficiencies and more losses

No subsidised inputs or preferential taxes, to **ensure level playing field**

| % of EBRD economies that comply with OECD guidelines on corporate governance of SOEs |
|---------------------------------|---------------------------------|---------------------------------|---------------------------------|---------------------------------|---------------------------------|---------------------------------|---------------------------------|---------------------------------|
| 0                              | 10                              | 20                              | 30                              | 40                              | 50                              | 60                              | 70                              |
| State ownership                | Clearly defined objectives of state ownership | Centralized ownership function | Separation of ownership from regulation | Clear responsibilities of Boards | Merit-based Board nomination | Independent directors | Nomination based on qualifications | Disclosure of costs related to public policy objectives | No state support that confers unfair advantages | Transparency of cost and revenue structures | Risk-related reporting |
State banks in the EBRD regions have been growing assets almost twice as fast as private banks since mid-2000s

State banks own 50%+ of banking assets in Belarus, Russia and Ukraine as well as in China and India

Source: BankScope, BvD Orbis and authors’ calculations. Based on 32 economies in the EBRD regions, sample restricted to banks with at least 10 years of non-missing data on total assets during 2004-2018.
State banks tend to have less strict lending requirements and accept a lower return on assets and a higher level of non-performing loans.

State banks in the EBRD regions have lower return on assets...

...and higher levels of non-performing loans.

Source: BankScope and authors’ calculations. This sample covers 32 economies in the EBRD regions and is restricted to banks with at least 10 years of data on ROAA and the ratio of NPLs to gross loans over the period 2004-14.
State banks greater risk appetite can soften the impact of crises and give young firms access to credit

Unlike private banks, state banks increased lending during the Global Financial Crisis

Share of collateralised loans in Turkey is lower for first-time borrowers at state banks

Source: BankScope and authors’ calculations. This sample covers 32 economies in the EBRD regions and is restricted to banks with at least 10 years of data on ROAA and the ratio of NPLs to gross loans over the period 2004-14.
State banks may misallocate credit due to electoral cycles

Before local elections, state bank lending increases by more than private bank lending in provinces where an incumbent mayor is aligned with the ruling party and faces a close election.

Closely contested provinces get relatively less credit from state banks if the incumbent mayor is from opposition.

Tactical redistribution of state bank lending around the time of local elections in Turkey

Source: Banks Association of Turkey, authors’ calculations. Triple difference-in-differences regression estimates with yearly bank credit data at the level of bank type (state or private) and province. Each plotted coefficient comes from a single regression; 90% confidence intervals.
THE STATE AND THE GREEN ECONOMY

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Emission reduction targets in the context of Paris Agreement lack the necessary ambition.

Nationally determined contributions commitments in the EBRD regions mostly imply an increase in overall emissions between 2010 and 2030.

Source: Nationally Determined Contributions Registry, EU (2018), Climate Analysis Indicators Tool (CAIT), IMF and authors’ calculations. Economies shown in red bars have intensity target reductions in 2030.
Green policies and laws are estimated to have reduced EBRD regions’ emissions by 12%, but more action is needed.

Source: Authors calculations. Based on regressions of greenhouse gas emissions per unit of GDP on various controls and introduction of green laws and policies interacted with the Worldwide Governance Indicator of the rule of law, country and year fixed effects.
## The guiding hand of the state is needed to build a green economy

<table>
<thead>
<tr>
<th>Short term</th>
<th>Medium term</th>
<th>Longer term</th>
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<tbody>
<tr>
<td>Retrofit government-owned buildings</td>
<td>Getting (energy) prices right:</td>
<td>Integrate environmental policies into a wider industrial strategy aimed at achieving clean growth</td>
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<tr>
<td>Invest in:</td>
<td>• Eliminate fossil fuel subsidies</td>
<td>Continue subsidising R&amp;D in clean technologies</td>
</tr>
<tr>
<td>• Energy-efficient residential buildings</td>
<td>• Apply cost to carbon pollution</td>
<td>Foster the diffusion of clean technology</td>
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<tr>
<td>• Infrastructure</td>
<td>Improve the dissemination of information about green technologies and associated funding options</td>
<td>Strengthen social safety nets and provide targeted support to displaced workers</td>
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<tr>
<td>• Renewable energy</td>
<td></td>
<td>Provide adequate social protection for low-income households</td>
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<tr>
<td>• Energy management systems</td>
<td></td>
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<tr>
<td>Spend on R&amp;D (general or in the area of clean energy)</td>
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<tr>
<td>Free energy audits for firms, with access to subsidised financing</td>
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Conclusions

The EBRD regions find themselves at the crossroads

- Optimistic scenario: the Covid crisis will lead to improved governance and the caring hand of the state will guide countries through low carbon transition

- Pessimistic scenario: the grabbing hand of the state will lead to corruption & nepotism; increased state presence in the economy will tilt the playing field against the private sector