OeNB Conference on European Economic Integration
Vienna, November 24-25, 2014

Summary: ‚Macroeconomic Imbalances and Economic Inequality in CESEE‘

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In most countries from Central East and South Eastern Europe (CESEE) disposable household income inequality as measured by the Gini index increased strongly during the transition crisis in the early 1990s and to a certain extent also throughout the bumpy recovery period in the late 1990s with its banking and exchange rate crises. Inequality stabilised throughout the boom period in the early 2000s and started even to decline a bit during the peak of the boom in the second half of the 2000s. Since the outbreak of the great recession inequality has stabilised again. While private sector wage inequality increased in both the boom as well as the bust period, the state had a stabilising function intervening in the field of public wages as well as pensions and transfers. Overall core CEE countries have inequality levels below the EU average, while the others have inequality levels above the EU average.

In what way was the general development of inequality as well as the marked differences in levels of inequality between the countries affected by macro-economic imbalances or had their impact on the building up of these imbalances? The initial rise in inequality during the transition crisis was strongly influenced by huge output and employment losses. Macro-economic imbalances indicated both by large current account deficits (build-up of debt) and surpluses (often reflecting consumption and hence import contraction) could be observed among the countries hit the most and longest by the crisis. These were predominantly economies with an ailing export sector and fixed exchange rates. Appreciated real exchange rates and higher levels of inequality in these countries have likely fuelled the development of credit bubbles during the subsequent boom period and have thereby reinforced macro-imbalances in the form of massive current account deficits (and thus capital inflows), such as in the Baltic States. With the outbreak of the Great Recession and the drying up of international capital flows the most exposed and unequal economies had to face a sudden stop and a forced shift from current account deficit to surplus.

The core economies from CEE have managed to develop in a more stable way with less extreme growth rates and fairly balanced current accounts. These countries have secured low levels of inequality. The common denominator being a large share of manufacturing industry providing for goods exports that can cover imports, offering high income to many who – in poorer countries with a less stable industrial sector - otherwise have to live on subsistence farming or petty trade. A large manufacturing sector allows also for a better organisation of social partnership (wage bargaining) arrangements which has again favourable repercussions on the balanced and equitable development of the economy.

Policy recommendations for unbalanced and unequal economies without a substantial manufacturing sector comprise measures of industrial policy including public infrastructure investment as well as the development of a cooperative social partnership system that has the potential to coordinate income distribution as well as real exchange rate policy under the premises of a fixed nominal exchange rate regime. This in turn would also help to reduce macro-imbalances.