



## **Economic and Social Convergence in the EU**

### **A Policy Note**

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## 1. Introduction

This policy note discusses the economic and social convergence of the Central and Eastern European (CEE) countries from the mid-90s to the recent years. Convergence is usually defined solely in economic terms and understood as the catching up of economically less developed countries towards more prosperous ones. Also, there is one generally accepted indicator to measure economic convergence, i.e. Gross Domestic Product (GDP). The combination of a clearly defined concept and a single representative indicator makes it easy to analyse and to understand economic convergence.

For social convergence there is neither such a clear concept nor is there a single generally accepted indicator to measure it. Only a brief look at the literature<sup>12</sup> reveals that there exist numerous theoretical and empirical frameworks to define and analyse social convergence. Studying these approaches one gets easily lost in them. As the term 'social' can be understood in many different ways, also the term 'convergence' changes in interpretation, and taken together, the concept 'social convergence' is so broadly defined in the literature, that referencing to it is of little help. For this policy note therefore, an individual definition of 'social convergence' has to be found.

Since the analysis is about convergence in EU countries, it makes sense that such a definition of 'social convergence' reflects an intrinsic and principal idea that is fundamental to the European project, and this is: 'the growing together of people and peoples in the EU'. Notably, this idea is consistent with the notion of 'economic convergence' in the EU. And, to apply it to the social sphere, it is interpreted as such that 'social convergence' is defined as the catching up in 'well-being' of the less favoured EU population. To avoid that 'well-being' is just an elusive concept and to pin it down to one single measurable indicator it is furthermore postulated that the major source of 'well-being' is income. It is clear that income is by far not the only source of well-being, yet is assumed that without income being available to satisfy basic needs for food, clothing, heating, health care, education or more advanced needs, these other sources of well-being soon lose in relevance.

Additionally, there is also the question why, if income is a measure for 'well-being', GDP is not used straightaway, as –inter alia- it also measures the total incomes earned in an economy. In that case economic and social convergence would be one and the same. Yet, GDP does not take into account the distribution of income in the population, and thus is not necessarily a good proxy for the income that people or households in an economy have at their disposal to satisfy their needs. There are more accurate measures for this.

From all this, this policy note addresses the issue of economic and social convergence in the CEE countries, by analysing the catching up process in terms of GDP and comparing it to the convergence of incomes that households have at their disposal. It thus will illustrate to what extent CEE households benefitted from the relatively strong economic convergence of their countries and to what extent they were able to catch up with Western European households in terms of living standards or levels of well-being. An important part of the analysis also deals with the distribution of incomes across households in the individual countries, both at the national as well as the regional level.

Section 2 of this note will present some stylised facts on economic and social convergence in the CEE and the Western European countries. Section 3 provides facts on the income distribution across

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<sup>1</sup> Norton A., de Haan A, 'Social Cohesion: Theoretical Debates and Practical Applications with Respect to Jobs', Background Paper for the World Development Report 2013.

<sup>2</sup> Jenson J, 2010, 'Defining and Measuring Social Cohesion', United Nations Research Institute for Social Development.

households at the national level, while section 4 covers the regional dimension. Section 5 summarises the results and develops conclusions for policy makers.

The data sources for the analysis are the DG ECFIN AMECO database, Eurostat as well as wiiw estimations based on the EU Survey of Income and Living Conditions (EU-SILC). The time span of the analysis covers the years 1995 to 2011 as some data are not available for more recent years. For the analysis three country groups have been built, firstly the CEE countries covering: the Czech Republic, Hungary, Poland, Slovakia, Slovenia, Estonia, Latvia, Lithuania, Bulgaria and Romania; secondly the EU-11 (i.e. 'Northern EU countries'): Austria, Belgium, Denmark, Finland, France, Germany, Ireland, Luxembourg, Netherlands, Sweden and United Kingdom; and finally the Southern EU-countries: Cyprus, Greece, Italy, Malta, Portugal and Spain.

## 2. Stylised facts of economic and social convergence

To begin with, the analysis of economic and social convergence starts with the most popular indicator of economic development, i.e. Gross Domestic Product (GDP). As GDP is defined as *'the sum of the values added by all activities which produce goods and services [in an economy], plus taxes less subsidies on products'*<sup>3</sup> it is the standard measure regarding the level and growth of economic development.

At the same time, GDP also equals the *'total of all incomes earned in the process of producing goods and services plus taxes on production and imports less subsidies'*<sup>4</sup>, so that it not only measures the level and change in economic activity in a country, but also the aggregate level of incomes and the changes therein. Thus, when using the GDP measure no difference is made between economic activity and incomes, and hence when analysing GDP convergence, economic and social convergence are synonymous.

In this respect, Figure 1 illustrates the growth of GDP per capita (GDP p.c.) in the EU-28 from 1995 to 2011. It shows the following stylised facts:

- From 1995 to 2011 GDP p.c. in the CEE countries grew well ahead of the GDP p.c. in EU-11 and by even more compared to the Southern European countries. On average, the annual average growth rate of GDP p.c. in the CEE was around 2 percentage points (p.p.) higher than in the EU-11 and 2.5 p.p. higher than in Southern Europe. Thus, this period was marked by quite solid path of convergence of the CEE countries.
- Despite this general pattern of convergence, there was a significant differentiation across countries. Foremost, convergence was strongest in the Baltic countries Estonia, Latvia and Lithuania, as in each country the average annual GDP p.c. growth rate was above 5 percent. In Poland and Slovakia the growth rate was above 4 percent, while in the other CEE countries growth rates ranges from 2.5 percent (Czech Republic and Hungary) to 3.5 percent (Romania)

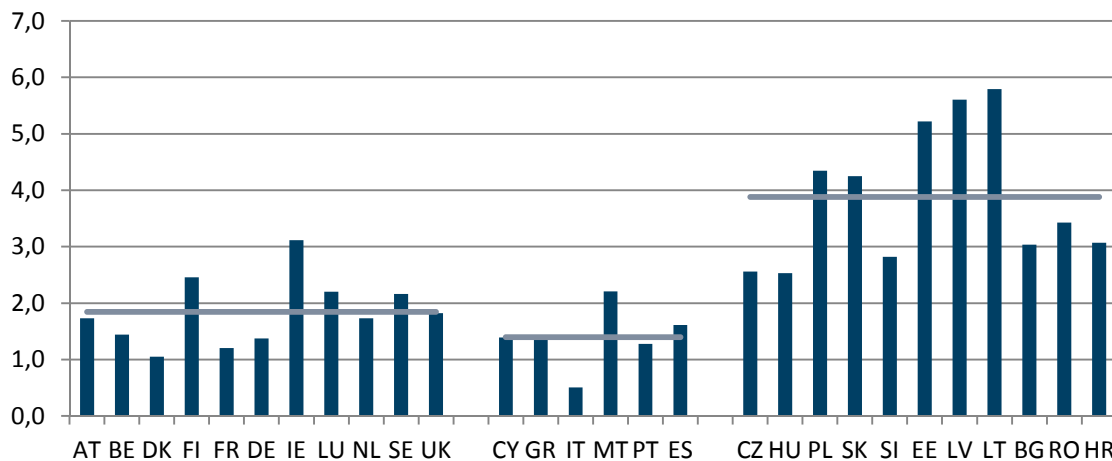
The economic crisis of the years 2008/2009 certainly had some impact on this convergence process, especially on the Baltic countries, where GDP dropped massively in 2009 (by 12 to 14 percent). However in most CEE countries, and again in the Baltic countries, there was also quite a strong rebound from this depression (basically starting in 2011), so that the crisis seemed to only interrupt but not to stop the convergence process. In this respect the CEE countries differ considerable from the Southern EU countries that had more difficulties to overcome the recession.

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<sup>3</sup> Eurostat, 2013, 'European system of accounts – ESA 2010', Publications Office of the European Union, 2013, p.54

<sup>4</sup> Ibid.

Figure 1. GDP per capita growth, annual avg. growth rate 1995-2011



Source: Ameco Database, own calculations

Another illustration of the strong convergence of the CEE countries over the last one and half decade is provided by Table 1 that shows the level of GDP per capita at Purchasing Power standards in terms of the EU-27 average (EU average = 100) for the years 1995 and 2011. It shows:

- Average GDP per capita in the CEE countries moved from 43.5 percent of the EU-27 average in 1995 to 62.5 percent in 2011, and thus improved by around 19 percentage points. By contrast, in the EU-11 and even more so the Southern EU countries GDP per capita declined in relative terms, from 121.5 to 116 percent of the EU-27 average in the EU-11 and from slightly above the EU average to below it in the Southern EU countries.
- Again, there is a strong differentiation across countries. While Poland, Slovakia and the Baltic countries saw a large improvement of their relative position as they moved between 22 and 33 p.p. closer to the EU-27 average, developments in other CEE countries were partly considerably slower, especially in the Czech Republic and Slovenia.
- In the EU-11 dramatic increases in the relative position in terms of GDP per capita happened in Ireland and Luxembourg. Both however are special (tax) cases, for which the GDP indicator to measure economic development is far than optimal as will be illustrated below.
- In the Southern EU countries Italy suffered a severe deterioration of its relative position, as in 1995 its GDP per capita stood at over 120 percent of the EU-27 average but reduced to 102 percent in 2011.

Overall the improvement of the CEE countries' relative position was quite sizable over this period of time. Still this table illustrates that the gap to the EU-27 average is still large for many countries, as in Bulgaria and Romania GDP p.c. is still only at 50 percent of the average and in 5 other CEE countries less than two thirds of it. Moreover, in a number of countries, like e.g. Latvia and Lithuania as well as in Bulgaria and Romania, the high growth rates of GDP per capita were only partly due to a rapid economic development. An important part of this growth in these countries was also due to a sizeable reduction of the population, due to outward migration. To illustrate, from 1995 to 2011 population declined by more than 1.1 percent per year in the two Baltic states and by around 0.8 percent per year in Bulgaria and Romania.

The table also shows that the more developed CEE countries, i.e. the Czech Republic and Slovenia, have some difficulties in closing the final gap to reach the EU average. This may be an indication that the convergence process slows down the more developed the countries become, and put into question whether a full convergence can be reached or whether this process stops before.

Furthermore, the results also indicate some significant differences in the CEE countries growth models, as in 1995 the Baltics as well as Bulgaria and Romania were at about the same level of GDP p.c., yet over this period of 17 years, the Baltics developed much more rapidly than the latter two countries (similar can be said when comparing Croatia to the Slovak Republic and Poland).

In general, GDP is a good indicator when measuring and comparing the level of economic activity and economic convergence across countries. Yet, it has some deficits when using it for the comparison of income developments and social convergence. As it is an aggregate measure, GDP does not take into account changes in the distribution of income in an economy. Although, by definition, it can be split up into operating surplus (i.e. profits) and compensation of employees (i.e. wages) plus taxes less subsidies on products, this split is not perfectly suitable to analyse income developments, especially those regarding households. This is because households' income consists of more than wages, as they also earn profits, if they are employers or own-account workers, and are receivers of property income and transfers, while at the same time they pay taxes and social security contributions.

Table 1: GDP per capita at PPS, 1995 and 2011; EU-27 = 100

	1995	2011	Difference 2011-1995
<b>Austria</b>	131.2	127.5	-3.7
<b>Belgium</b>	126.4	118.7	-7.7
<b>Denmark</b>	129.3	123.1	-6.2
<b>Finland</b>	106.7	115.9	9.2
<b>France</b>	114.6	107.4	-7.1
<b>Germany</b>	127.8	121.9	-5.9
<b>Ireland</b>	102.1	130.0	27.9
<b>Luxembourg</b>	226.0	259.3	33.3
<b>Netherlands</b>	126.6	133.3	6.7
<b>Sweden</b>	125.9	126.3	0.3
<b>United Kingdom</b>	116.5	106.3	-10.2
	<b>121.5</b>	<b>116.0</b>	<b>-5.4</b>
<b>Cyprus</b>	91.5	97.9	6.4
<b>Greece</b>	84.7	77.5	-7.2
<b>Italy</b>	121.5	102.2	-19.3
<b>Malta</b>	85.8	85.3	-0.5
<b>Portugal</b>	75.7	76.5	0.8
<b>Spain</b>	90.9	95.1	4.2
	<b>103.8</b>	<b>95.3</b>	<b>-8.4</b>
<b>Czech Republic</b>	76.3	81.9	5.6
<b>Hungary</b>	50.3	65.4	15.1
<b>Poland</b>	41.5	63.6	22.2
<b>Slovakia</b>	46.8	73.6	26.7
<b>Slovenia</b>	73.3	82.6	9.4
<b>Estonia</b>	35.0	67.7	32.8
<b>Latvia</b>	32.9	57.4	24.5
<b>Lithuania</b>	34.3	65.4	31.1
<b>Bulgaria</b>	33.9	46.5	12.6
<b>Romania</b>	31.6	50.0	18.4
<b>Croatia</b>	45.4	58.8	13.4
	<b>43.5</b>	<b>62.5</b>	<b>19.0</b>

Source: Ameco Database, own calculations

Additionally, GDP does also not take into account the factor incomes (i.e. wages and profits) earned abroad by country residents as well as the domestic income earned by non-residents.

For both points the System of National Accounts provides more appropriate indicators. The factor incomes earned abroad or paid to non-residents are taken account of by the Gross National Income (GNI), which is simply defined as GDP plus/minus net<sup>5</sup> factor incomes from the rest of the world. The distribution aspect is covered by the concept of Gross (National) Disposable Income (GDI). Aggregate GDI measures all income available to resident units for consumption and saving. It thus covers GNI and in addition also net transfers from the rest of the world (financial aid given to or received from foreign countries).

Additionally, aggregate GDI can be split up into the GDI of corporations, general government and households, showing the actual income available for these three units. This makes it valuable tool for the analysis of social convergence in the EU, as especially for household it allows showing consistently how their income developed over time.

Table 2. Gross Disposable Income per capita at PPS, 1995 and 2011

	<b>1995</b>	<b>2011</b>	<b>Difference 2011-1995</b>
<b>Austria</b>	130.2	127.7	-2.6
<b>Belgium</b>	128.5	119.0	-9.5
<b>Denmark</b>	126.4	124.0	-2.4
<b>Finland</b>	103.6	115.8	12.1
<b>France</b>	114.5	108.3	-6.1
<b>Germany</b>	126.6	124.2	-2.4
<b>Ireland</b>	94.3	104.2	9.9
<b>Luxembourg</b>	193.0	191.2	-1.8
<b>Netherlands</b>	128.0	132.0	4.0
<b>Sweden</b>	123.2	128.4	5.2
<b>United Kingdom</b>	115.2	106.7	-8.6
<b>EU-11 average</b>	<b>120.5</b>	<b>116.5</b>	<b>-4.1</b>
<b>Cyprus</b>	87.9	98.8	10.9
<b>Greece</b>	89.7	75.1	-14.7
<b>Italy</b>	120.3	101.2	-19.1
<b>Malta</b>	85.6	82.3	-3.4
<b>Portugal</b>	78.5	75.9	-2.7
<b>Spain</b>	91.1	92.7	1.6
<b>EU-South average</b>	<b>103.9</b>	<b>93.8</b>	<b>-10.2</b>
<b>Czech Republic</b>	76.7	75.2	-1.5
<b>Hungary</b>	49.1	62.2	13.1
<b>Poland</b>	41.5	61.9	20.4
<b>Slovakia</b>	47.3	71.8	24.5
<b>Slovenia</b>	74.2	82.2	7.9
<b>Estonia</b>	35.5	65.1	29.6
<b>Latvia</b>	33.8	58.8	25.0
<b>Lithuania</b>	35.1	65.0	29.9
<b>Bulgaria</b>	33.1	46.8	13.7
<b>Romania</b>	31.9	50.6	18.8
<b>CEE average</b>	<b>43.6</b>	<b>60.9</b>	<b>17.3</b>

<sup>5</sup> 'Net' in the sense that incomes received from abroad and paid to non-residents are netted out.

Source: Ameco Database, own calculations

The analysis continues however with a brief glance at the developments of aggregate GDI. These are illustrated in **Fehler! Verweisquelle konnte nicht gefunden werden.**, which shows the GDI per capita at PPS for the countries relative to the EU-27 average (EU-27 = 100). These facts are important to notice:

- Generally, the GDI pattern of convergence is very similar to the convergence pattern observed for GDP per capita. However, convergence in terms of GDI is a bit slower. This is indicated by the average improvement of the CEE countries, whose GDI per capita moved from 43.6 percent of the EU-27 average in 1995 to 60.9 percent in 2011, i.e. an improvement of 17.3 p.p. (for GDP this improvement was 19 p.p.)
- This slower convergence in income terms holds for most CEE countries, but not for all as the examples of Bulgaria, Latvia and Romania show. There GDI converged by more towards the EU average than GDP.
- The Czech Republic was the only country in the CEE where the relative position in the GDI deteriorated from 1995 to 2011.
- The Southern European countries lost more in terms of GDI than in terms of GDP. That is the incomes of the population suffered over-proportionally especially from the economic crisis.
- The relative position of Ireland in terms of GDI improved much less than in terms of GDP. For Luxembourg the GDI position relative to the EU-27 even deteriorated. This is because GDI in contrast to GDP takes into account net factor income flows from and to the rest of the world. As both countries are known for their favourable tax environment there is a considerable amount of profit shifting to both countries. This tends to increase their GDP dramatically, but as the profits are paid out (after taxation) to the original (foreign) owners, GNI and GDI tend to be reduced dramatically.

As mentioned, GDI can be split into the GDI of corporations, households and general government. For corporations GDI is a proxy for their profits after taxation and transfers, for households it represents the actual income they have at their disposal, while for the general government it effectively represents the available budget. For the analysis of income development and social convergence the focus is on corporations and households only. This is illustrated in Table 3, which shows GDI per capita at PPS for both corporations and households, relative to the respective EU-27 average (EU-27 = 100). There are a number of stylised facts:

- Corporations' profits in the CEE converged much faster than household incomes from 1995 to 2011. On average, CEE profits moved from 40 percent to 74 percent of the EU-27 average, which corresponds to an improvement by 34 p.p., while in the same period household incomes only improved by 14.5 p.p.
- For many CEE countries the convergence in terms of profits was enormous. This was especially the case in Bulgaria, where profits per capita increased from 10 percent in 1995 of the EU-27 average to 70 percent in 2011 (i.e. by 60 p.p.), but also in other countries like the Baltics, Poland and Romania the relative position improved by 40 to 50 p.p.
- More moderate improvements were seen in Slovenia, although profits were already at a high level in 1995, while in the Czech Republic as the only country in CEE the profits decreased in terms of the EU average.
- Except for Greece, the Southern EU countries experiences a decrease of their profits per head decreased in terms of the EU average from 1995 to 2011. Interestingly, in 2011 profits per head in Italy and Portugal are lower than in all CEE countries.
- As far as household incomes are concerned, there is some differentiation across CEE countries. In Lithuania and Slovakia household income converged in relative terms more than GDP per



capita, while in the Czech Republic, Latvia and Slovenia household disposable income and GDP improved at a similar rate. By contrast for the remaining countries, i.e. Bulgaria, Estonia, Hungary, Poland and Romania GDP convergence was higher than convergence of household GDI, especially so in Bulgaria, where despite of very low levels household incomes only improved from 37 to 42 percent of the EU-27 average over the 17 years period.

Table 3. Gross Disposable Income per capita at PPS – Corporations and Households, 1995 and 2011, EU27=100

	Corporations			Households		
	1995	2011	Difference 2011-1995	1995	2011	Difference 2011-1995
<b>Austria</b>	128.9	142.9	14.0	135.7	122.6	-13.1
<b>Belgium</b>	151.2	131.3	-19.9	127.3	110.6	-16.7
<b>Denmark</b>	219.3	180.8	-38.5	102.2	94.9	-7.4
<b>Finland</b>	142.2	108.8	-33.4	92.9	106.3	13.5
<b>France</b>	96.9	78.3	-18.6	113.6	110.8	-2.8
<b>Germany</b>	118.6	121.8	3.2	130.1	124.5	-5.6
<b>Ireland</b>	.	126.9	.	.	101.9	.
<b>Netherlands</b>	213.6	204.4	-9.2	109.3	102.7	-6.6
<b>Sweden</b>	223.6	156.1	-67.6	97.0	100.7	3.7
<b>United Kingdom</b>	132.7	118.1	-14.7	114.3	110.0	-4.2
<b>EU-11 average</b>	<b>130.5</b>	<b>118.8</b>	<b>-11.6</b>	<b>118.8</b>	<b>113.7</b>	<b>-5.1</b>
<b>Greece</b>	61.3	79.4	18.1	96.2	87.3	-8.9
<b>Italy</b>	94.0	70.1	-23.9	137.0	110.0	-27.0
<b>Portugal</b>	80.3	59.6	-20.7	84.4	85.1	0.7
<b>Spain</b>	99.6	95.8	-3.8	91.5	97.8	6.3
<b>EU-South average</b>	<b>91.7</b>	<b>79.3</b>	<b>-12.4</b>	<b>113.4</b>	<b>101.6</b>	<b>-11.9</b>
<b>Czech Republic</b>	106.6	81.8	-24.8	65.4	70.7	5.3
<b>Hungary</b>	38.5	67.6	29.1	51.0	60.8	9.8
<b>Poland</b>	27.3	68.6	41.3	45.7	61.0	15.3
<b>Slovakia</b>	65.7	88.2	22.5	40.5	71.0	30.5
<b>Slovenia</b>	70.1	80.9	10.8	73.9	82.9	9.0
<b>Estonia</b>	30.3	74.9	44.6	31.3	59.1	27.8
<b>Latvia</b>	39.5	82.9	43.3	28.6	53.0	24.4
<b>Lithuania</b>	26.2	75.1	48.9	33.6	66.3	32.6
<b>Bulgaria</b>	10.3	70.8	60.5	36.8	41.7	4.9
<b>Romania</b>	39.0	80.0	40.9	33.3	45.7	12.5
<b>CEE average</b>	<b>40.5</b>	<b>74.2</b>	<b>33.7</b>	<b>44.0</b>	<b>58.5</b>	<b>14.5</b>

Source: Ameco Database, own calculations

The differences in convergence of per capita household disposable incomes and profits are further illustrated by their respective growth rates in Table 4. For comparison reasons also the growth rates of per capita GDP, GNI as well as aggregate GDI have been added, too. Table 4 shows these stylised facts:

- On average, it was a common feature throughout the EU-11 as well as the CEE countries that company profits grew at a higher rate than disposable income of households in the period from 1995 to 2011.
- The differences between profit growth and household income growth was much more pronounced in the CEE, where profits grew at double the rate (i.e. by over 7 percent per year)

of household disposable income, which grew on average by 3.5 percent per year. In the EU-11 profits grew by 2.3 percent while household income by 1.4 percent.

- The growth differential between the EU-11 and the CEE countries in terms of profits was thus 5 p.p., while in the case of household incomes it was 2 p.p. The EU-11/CEE growth differential for household incomes was a bit lower than the growth differential for GDP per capita, indicating that social convergence was by a margin slower than economic convergence.
- On average, in the CEE disposable income of households grew 0.5 p.p. slower than GDP per capita. However there was a significant differentiation across countries. Latvia and Slovakia were the only two countries where household income grew ahead of GDP per capita. In the Czech Republic, Estonia, Lithuania and Slovenia growth of household incomes was only slightly lower than growth of GDP, while in Bulgaria, Hungary, Poland and Romania the difference in annual average growth rates was quite substantial and ranged from 0.7 p.p. (Hungary) to 1.4 p.p. (Bulgaria).
- The Czech Republic was the only country in the CEE where household incomes grew ahead of company profits. On the other side in the most extreme cases annual average growth rates of profits were 6 p.p. (Poland) to 13 p.p.(Bulgaria) than household income growth rates.

Table 4: Growth of GDP, Disposable income –total: corporations, households – per capita, annual average growth rates 1995-2011

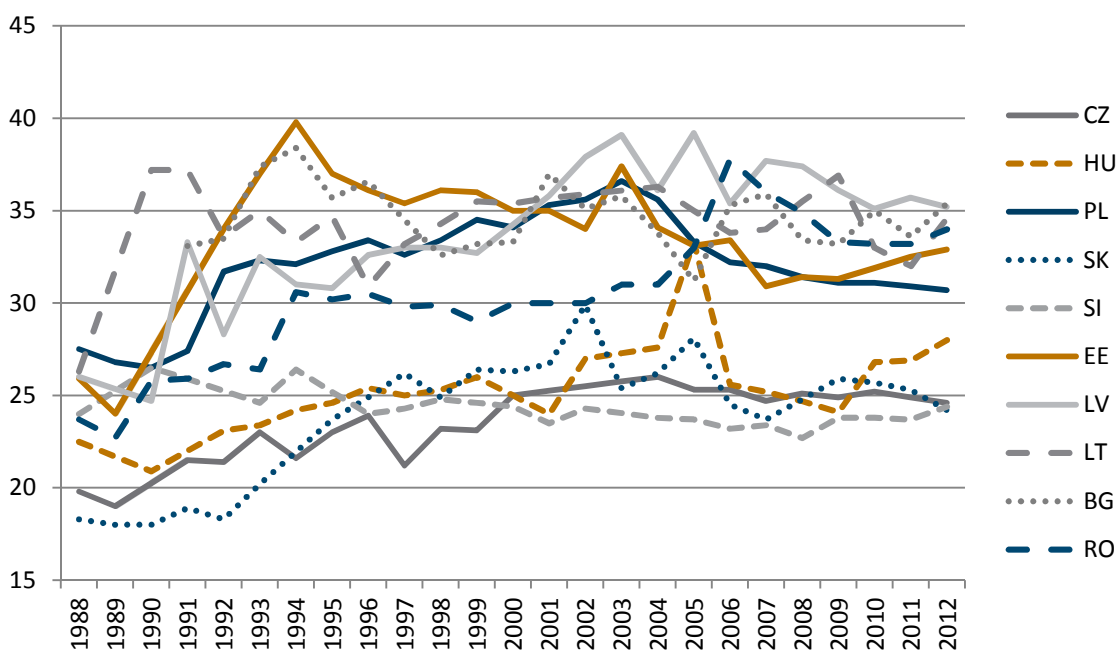
	<b>GDP</b>	<b>Disposable income - total</b>	<b>Disposable income - companies</b>	<b>Disposable income - households</b>
<b>Austria</b>	1.7	1.8	3.9	1.1
<b>Belgium</b>	1.4	1.4	2.2	0.8
<b>Denmark</b>	1.1	1.3	1.4	0.7
<b>Finland</b>	2.5	2.7	1.5	2.6
<b>France</b>	1.2	1.3	1.6	1.3
<b>Germany</b>	1.4	1.6	3.1	1.2
<b>Ireland</b>	3.1	2.3	.	.
<b>Luxembourg</b>	2.2	1.3	.	.
<b>Netherlands</b>	1.7	1.6	2.4	0.8
<b>Sweden</b>	2.2	2.4	1.2	2.2
<b>United Kingdom</b>	1.8	1.9	3.0	2.0
<b>EU-11 average</b>	<b>1.7</b>	<b>1.8</b>	<b>2.3</b>	<b>1.4</b>
<b>Cyprus</b>	1.4	1.7	-2.8	2.1
<b>Greece</b>	1.4	0.8	4.9	1.1
<b>Italy</b>	0.5	0.5	1.0	0.0
<b>Malta</b>	2.2	2.0	.	.
<b>Portugal</b>	1.3	1.0	0.6	1.1
<b>Spain</b>	1.6	1.5	2.4	1.6
<b>EU-South average</b>	<b>1.2</b>	<b>1.1</b>	<b>1.2</b>	<b>1.2</b>
<b>Czech Republic</b>	2.6	2.0	1.7	2.4
<b>Hungary</b>	2.5	2.4	5.8	1.8
<b>Poland</b>	4.3	4.2	9.0	3.2
<b>Slovakia</b>	4.3	4.0	4.6	4.8
<b>Slovenia</b>	2.8	2.7	4.3	2.6
<b>Estonia</b>	5.2	4.8	8.2	4.8
<b>Latvia</b>	5.6	5.5	8.1	5.7
<b>Lithuania</b>	5.8	5.6	9.8	5.8
<b>Bulgaria</b>	3.0	3.2	15.3	1.6
<b>Romania</b>	3.4	3.4	6.4	2.3
<b>CEE average</b>	<b>4.0</b>	<b>3.8</b>	<b>7.3</b>	<b>3.5</b>

### 3. Changes in the income distribution across households

This section focusses specifically on the distribution of disposable income across the households in the EU and especially in the CEE countries. Hence it analyses the status quo and the evolution of inequality of households' disposable income, using the several variations of the Gini index as inequality measures. The analysis is mainly based on data from the EU Survey of Income and Living condition (EU SILC).

To begin with, Figure 2 shows the changes of CEE household income inequality in the years from 1988 to 2012, thus highlighting the distinct developments that took place in the early phases of transition as well as latest developments.

Figure 2: Gini index of equivalised disposable income p.c.<sup>6</sup> in the CEE NMS, 1988-2012



Source: Eurostat, UNU-WIDER World Income Inequality Database, own calculations

Figure 2 shows the following stylised facts:

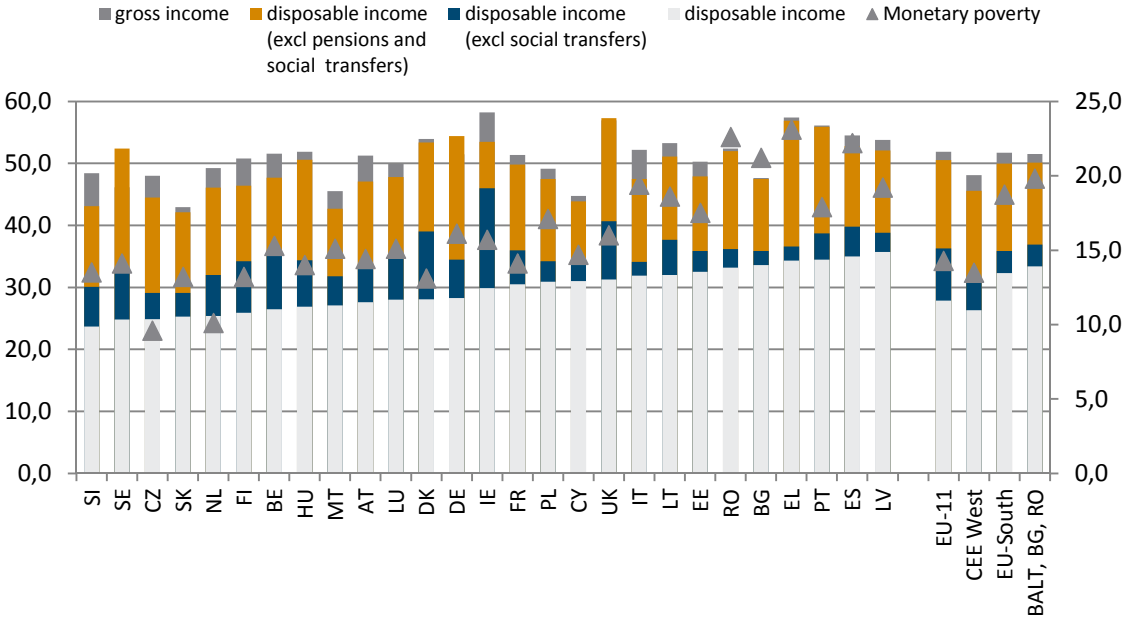
- At the onset of transition a strong rise of per capita income inequality is observed in the Baltic countries, Bulgaria, Poland and with some delay also in Romania.
- A more subdued increase took place in the Central European countries of the Czech Republic, Slovakia and Hungary, while in Slovenia it even declined slightly.
- The peak of income inequality to date was attained for the whole CEE countries in the early 2000's, while in the period of strong GDP growth thereafter the rise in employment (rates) was a main driver of a general decline in inequality. The financial and economic crisis increased inequality levels considerably only in Estonia and Hungary.

The dispersion of equivalised disposable household income in a country is obviously not only influenced by the pay of the household members, but by the structure and of the national tax system and the welfare system or more narrowly, by the distributive impact of monetary transfers at the

<sup>6</sup> Total gross household income including all transfers minus direct taxes divided by equivalence size (calculated applying the OECD equivalence scale: 1 for the first household member, 0.5 for all further adult household members, 0.3 for further household members below 14 years.)

personal and household level. This is indicated in Figure 3 that shows in total four different Gini indices for all EU-27 countries and the year 2011. In detail, Figure 3 contains the Gini indices for a) gross income, b) disposable income, excluding pension payments and social transfers, c) disposable income excluding social transfers only, disposable income (i.e. including pensions and social transfers) as well as a measure for monetary poverty, i.e. the share of population below the (national) poverty line.

Figure 3: Gini index of equivalised income p.c. in EU countries and country groups, 2011;  
 Left hand scale: value of Gini indices; right hand scale: percent of population below the poverty line



Source: Eurostat, EU SILC 2012, own calculations

Figure 3 presents a lot of information. The highlights are:

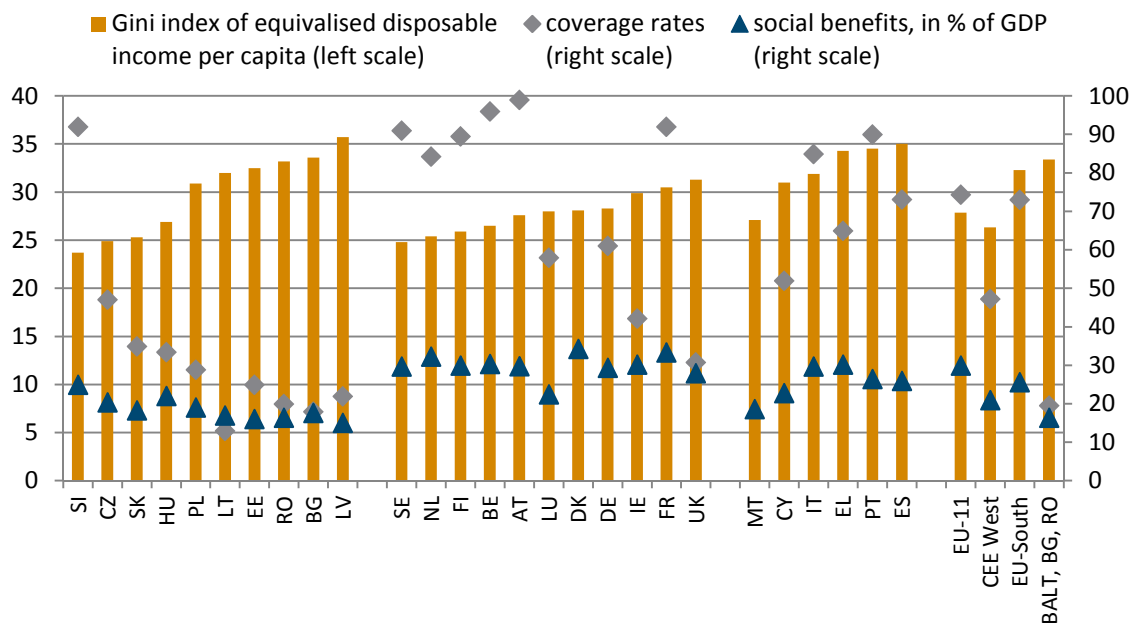
- The Gini coefficient of disposable income ranges between 25 in Slovenia and 35 in Latvia. The Western CEE countries (Slovenia, Czech Republic, Slovakia, Hungary and Poland) have on average (unweighted) the lowest levels of inequality, while the country group comprising the Baltic States, Bulgaria and Romania reports the highest values. In the EU-11 inequality is lowest in the Scandinavian countries, while the South EU countries inequality levels are amongst the highest in the whole EU.
- The Gini coefficient of market incomes of households, i.e. gross incomes is more pronounced in the EU. Gini values range from 45 in Cyprus to about 58 in Ireland. In short, the difference in disposable income inequality and gross income inequality illustrates the extent to which the welfare state reduces inequality, by redistributing income via taxes, social contributions and transfers from higher to lower income groups.
- Direct taxes on household income (including social security contributions) and wealth have a minor effect on income distribution in all EU countries. This is indicated by the difference between the Gini index for disposable income, excluding pension payments and social transfers and the Gini index for gross income. Direct taxes have the least effect on inequality in the EU-11, and the highest in the Western CEE countries. In the latter, direct taxes reduce the Gini coefficient by 2.5 points.
- Social transfers of the welfare state however strongly reduce income inequality, particularly the public pension system. In the EU-11 the Gini coefficient declines thus by around 15 points

on average, in the Western CEE countries by 14 points and in the Baltics, Bulgaria and Romania 13 points because of pension payments.

- Additional social transfers (including personal transfers like unemployment benefits and household transfers like family allowances, etc.) reduce inequality by on average 3.5 points in the Baltic States, Bulgaria and Romania alike in the South European countries. In the Western CEE countries the decline is even stronger (5 points) and highest in the EU-11, where inequality declines by 7.5 points because of social transfers.
- Income inequality is strongly positively correlated with monetary poverty, i.e. the share of persons with an income below 60% of the national median income. In EU-11 and the Western CEE countries on average less than 14% of the population accrue incomes below the poverty threshold, while in the Baltic States, Bulgaria, Romania and the South European countries close to 20% are at risk or in a situation of monetary poverty.

The reasons for inter-country differences in income inequality in the European Union are manifold. Differences in household structures and educational attainment rates, structural differences of the economy, the importance of income from finance, rents, inheritance, etc. can substantially influence the distributional outcome in a country. Here the focus is only on two but interesting macro level explanatory factors for inter-country differences of income inequality between the countries of the European Union, namely the coverage rate with respect to collective agreements in the EU countries as well as the size of social benefits (in terms of GDP). This is illustrated in Figure 4.

Figure 4: Gini index of incomes, coverage rate of collective agreements and social benefits, 2011



Source: Eurostat, EU SILC 2012, own calculations

Figure 4 shows the following:

- Collective agreements tend to strengthen the position of employees versus employers in wage bargaining. Moreover they reduce income inequality levels by arranging for minimum wage regulations. The levels of coverage of the workforce by collective agreements are found to be strongly correlated with levels of the Gini index particularly in the EU-11 countries and the Western CEE countries.
- Furthermore, inequality levels tend to be lower in those countries where the level of social expenditures is higher as expressed by shares in GDP. In the EU social benefits range between

15% in Latvia and more than 35% of GDP in Denmark. In general, New EU Member States tend to have lower social expenditure levels compared to the “old” Member States. However the Baltic countries, Bulgaria and Romania spend with 16.5% of GDP much less on welfare compared to the Western CEE countries (21%). Accordingly the EU-11 countries invest on average much more in their social infrastructure (30%) compared to the South European countries (25.7%).

#### **4. Regional trends in economic and social convergence**

Having analysed the trends in economic and social convergence both at the national and the household level, the analysis finally turns to the level of EU NUTS-2 regions in order to provide a geographically more disaggregated view on convergence patterns. It has to be noted, however, that the results of the national and regional analysis are only of limited comparability. This is because of data comparability reasons: the AMECO national accounts data used in Section 2 are based on the ESA<sup>7</sup> 2010 system, while the regional data from Eurostat is still based on the ESA 1995. This implies partly strong deviations from the national data compared to the data available at the regional level. To illustrate, on average GDP levels at the national level, which are calculated according to the ESA 2010, are 3 percent higher than GDP levels at the regional level (calculated according to the ESA 1995). The differences are even higher with respect to the level of GDI of the household sector. Here, national GDI from AMECO is on average 9 to 10% higher than the GDI from Eurostat’s regional database. This creates some problems in connecting the national analysis above and the regional analysis in this section, which have to be taken into account when interpreting the results. Nevertheless, some of the regional results are quite spectacular making it worthwhile presenting them in this note.

The regional analysis starts with a comparison of the CEE countries’ convergence in terms of GDP and GDI of households, both in per capita PPS terms relative to the EU average. In contrast to the national analysis the data is only available for the period 2000-2011, making a comparison even more difficult. The results are illustrated in Figure 5 in the form of box plots for those CEE countries that have more than one NUTS-2 region, whereby the boxes represent the range of values over the regions in the respective country. The results suggest:

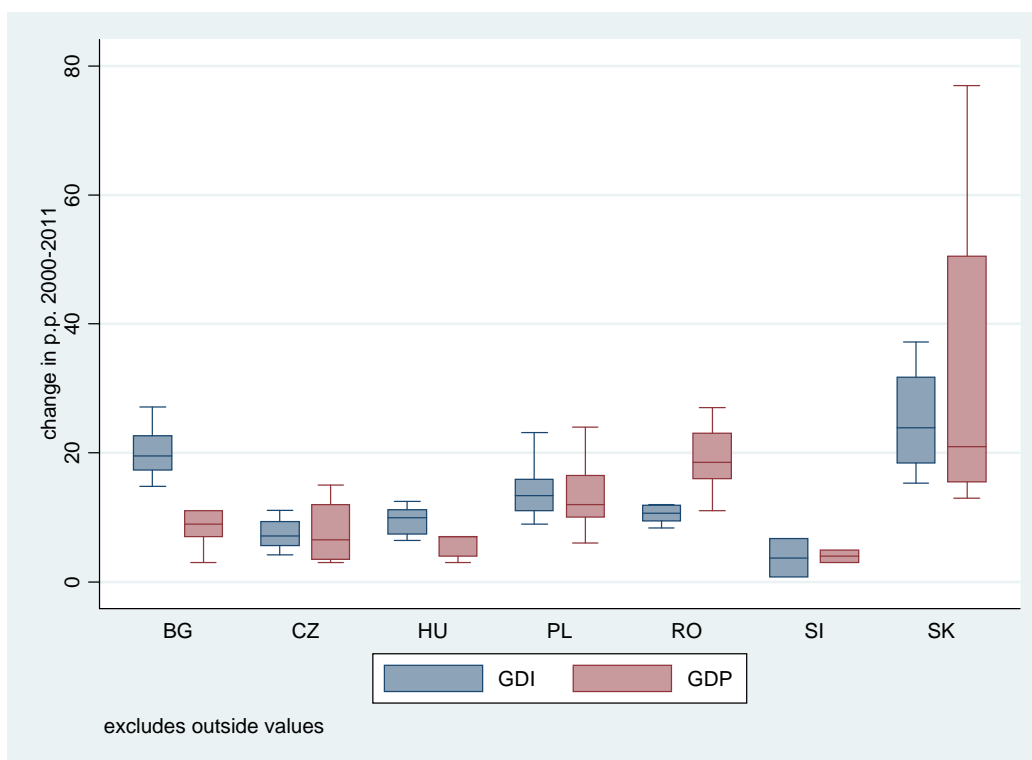
- The convergence of regional GDP and GDI of households was strongest in Slovakia. At the median level regions caught up around 24 p.p. to the EU average in terms of household GDI and 21 p.p. in terms of GDP. Thus household income for most regions converged by more than GDP. The exception is the capital city Bratislava, where household GDI gained 37p.p. relative to the EU average and thus much more than other Slovak regions, but GDP even gained 77p.p. relative to the EU average.
- Convergence of regional GDP and household GDI was moderately strong in Poland. At the median level the regions’ household GDI caught up by around 13p.p. to the EU average and thus a bit more than GDP, which caught up by 12 p.p. at the median.
- In Bulgaria and Romania the convergence experience was mixed. In Bulgaria, regional GDI of household converged much faster (by around 20 p.p.) the GDP per capita levels (which is, however, at odds with the national data – similar to the Hungarian result), while vice versa in Romania, GDP caught up by 8p.p. more than household GDI.
- In the Czech Republic and Slovenia both convergence in GDP and household GDI was slowest among the CEE countries. In Slovenia both convergence measures caught up only around 4

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<sup>7</sup> European System of Accounts

p.p. relative to the EU average, while in the Czech Republic household GDI moved 7p.p. closer to the EU average and GDP by 6.5 p.p.

Figure 5: Change in regional GDP and household GDI, 2000-2011, in p.p. of the EU average



Source: Eurostat, own calculations

The regional convergence in terms of household GDI and GDP per capita (at PPS) can also be expressed in terms of inequality indices, measuring the dispersion of either variable across regions within a country or a group of countries. Calculating these indices over time thus shows whether the differences in regions GDIs and GDPs increased (suggesting divergence) or decreased (suggesting convergence). For the analysis, the Coefficient of Variation (CV)<sup>8</sup> is used because it is robust with respect to the numbers of regions (and differences therein across countries). Table 5 shows the CV for all EU countries (except Croatia) with more than one NUTS-2 region. The group and EU averages however contain also those single NUTS-2 region countries. It shows the following:

- The regional dispersion in terms of disposable household income is generally lower than the dispersion of regional GDPs. This holds for all countries and country groups in all of the observed years.
- At the level of the EU, dispersion of regional household GDI tended to decrease more than the dispersion of regional GDP, suggesting that social convergence progressed more than economic convergence (this is in contradiction to the country results above). Interestingly, the dispersion of household income also declined during the crisis (from 2007 to 2011), which was not the case for regional GDP.
- Dispersion of household income also decreased for the regions in the CEE countries as a group. This was not the case for GDP. Disparities in GDP per head even increased from 2000 to 2007, only to reduce approximately by the same margin in the course of the crisis, so that from 2000 to 2011 there was in effect no change in regional GDP dispersion in the CEE.

<sup>8</sup> The CV is defined as the ratio of the standard deviation ( $\sigma$ ) and the mean ( $\mu$ ):  $CV = \sigma/\mu$

- The situation in the CEE countries was more mixed. Thus, the dispersion of household GDI across regions increased strongly in Romania and to a lesser extent in Bulgaria and Slovakia. Oppositely, Hungary and Slovenia saw some reduction in GDI disparities, while in Poland and the Czech Republic GDI disparities nearly stayed constant from 2000 to 2011.
- Contrastingly, all CEE countries experienced an increase in dispersion of regional GDPs per head over this period of time. This trend was especially strong in Bulgaria and Romania but also the Slovak Republic.
- In general, the regional convergence or divergence process was much more dynamic in the CEE countries compared to the EU-11 and also the Southern EU countries.

Table 5: Coefficient of variation for regional household GDI and GDP, per capita at PPS

	Household disposable income			GDP		
	2000	2007	2011	2000	2007	2011
<b>Austria</b>	7.0	3.1	2.6	21.5	19.7	19.2
<b>Belgium</b>	11.2	10.8	10.0	40.2	36.9	35.1
<b>Denmark</b>	4.3	2.3	3.5	18.9	18.3	20.5
<b>Finland</b>	14.7	8.5	11.6	24.5	21.8	21.3
<b>France</b>	7.7	6.7	6.6	18.1	18.0	21.5
<b>Germany</b>	8.9	9.4	9.2	25.3	23.6	21.5
<b>Ireland</b>	8.4	10.7	7.7	36.5	32.7	36.2
<b>Netherlands</b>	4.8	6.8	8.6	16.9	16.7	20.2
<b>Sweden</b>	9.9	6.8	7.8	18.7	17.9	18.5
<b>United Kingdom</b>	13.8	14.3	13.3	39.0	40.0	43.7
<b>EU-11 average</b>	<b>14.5</b>	<b>13.4</b>	<b>14.6</b>	<b>29.6</b>	<b>30.3</b>	<b>31.2</b>
<b>Greece</b>		12.1	9.9	16.2	19.1	21.5
<b>Italy</b>	22.4	20.3	19.5	25.9	24.7	26.0
<b>Portugal</b>	14.0	14.6	14.4	21.7	22.7	22.1
<b>Spain</b>	16.5	15.9	17.0	21.5	18.5	20.0
<b>Southern EU average</b>	<b>23.6</b>	<b>19.2</b>	<b>20.4</b>	<b>27.3</b>	<b>23.6</b>	<b>26.0</b>
<b>Czech Republic</b>	12.5	14.0	13.9	38.4	45.6	44.5
<b>Hungary</b>	21.0	20.5	14.3	35.0	42.0	42.8
<b>Poland</b>	14.0	13.5	15.5	22.0	24.3	26.5
<b>Slovakia</b>	24.6	28.9	28.0	56.9	65.0	68.6
<b>Slovenia</b>	13.1	7.0	7.4	23.3	26.5	24.5
<b>Bulgaria</b>	12.9	19.4	16.6	20.1	41.5	45.4
<b>Romania</b>	20.0	33.2	34.2	46.1	50.4	58.1
<b>CEE average</b>	<b>38.3</b>	<b>33.4</b>	<b>29.4</b>	<b>48.1</b>	<b>50.3</b>	<b>48.2</b>
<b>EU average</b>	<b>35.3</b>	<b>30.1</b>	<b>28.7</b>	<b>41.5</b>	<b>38.3</b>	<b>38.2</b>

Source: Eurostat, own calculations

In addition to variations of regional levels of disposable income of households between regions, Figure 6 presents the inequality levels of equivalised disposable income p.c. within the EU regions<sup>9</sup>. It shows:

- In most EU countries income inequality is highest in the capital city regions. Main exceptions are Romania, as well as Germany, Italy and Spain. Notably, in the latter three countries the capital cities are not the economically strongest regions amongst all regions in the respective

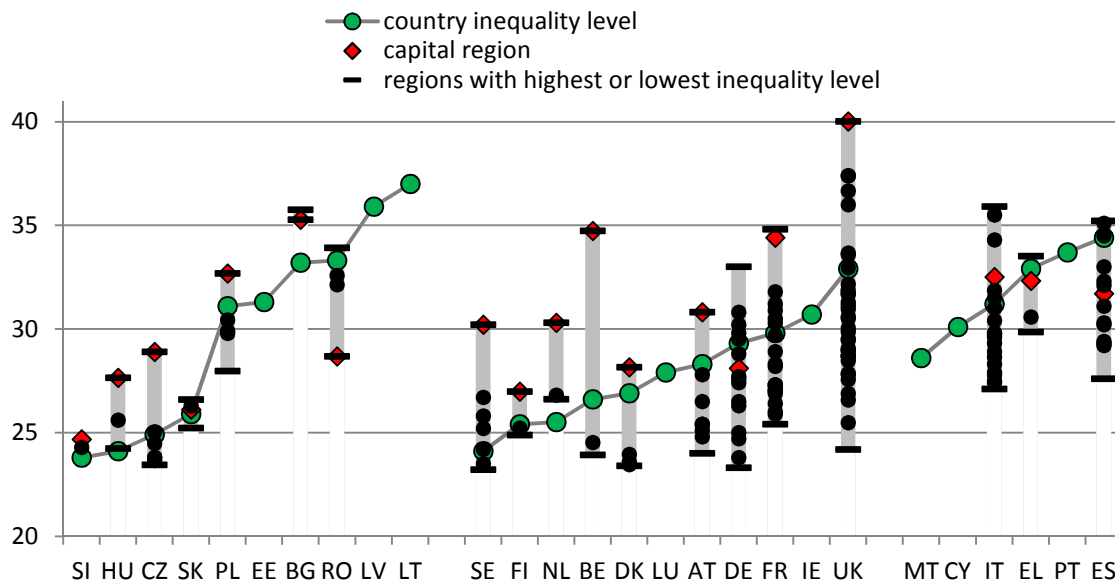
<sup>9</sup> For a number of countries data is only available at the NUTS 1 level of regions, i.e. Belgium, Germany, the UK, Hungary



country, while for all other countries capital cities are the regions with the highest income levels.

- As a trend, differences in regional inequality levels tend to be lower in the CEE countries compared to the EU-11 and the South-EU countries. Especially in the UK, but also in Belgium, Germany, France and Italy there is a wide dispersion of inequality levels across regions, which in part reflects the differences in economic performance of the regions in those countries

Figure 6: Gini index of equivalised disposable income p.c. at NUTS 2 level<sup>10</sup>, 2010



Source: Eurostat, EU SILC 2012, own calculations

To conclude the regional analysis there are two maps showing the distribution of household GDI per capita (at PPS) as well as its relation to regional GDP per capita for the NUTS-2 regions and the year 2011.

The first map (**Fehler! Verweisquelle konnte nicht gefunden werden.**) illustrates the regional GDI of households, with the reddish colours representing GDI values below the EU average and the bluish colours above the average. The maps show:

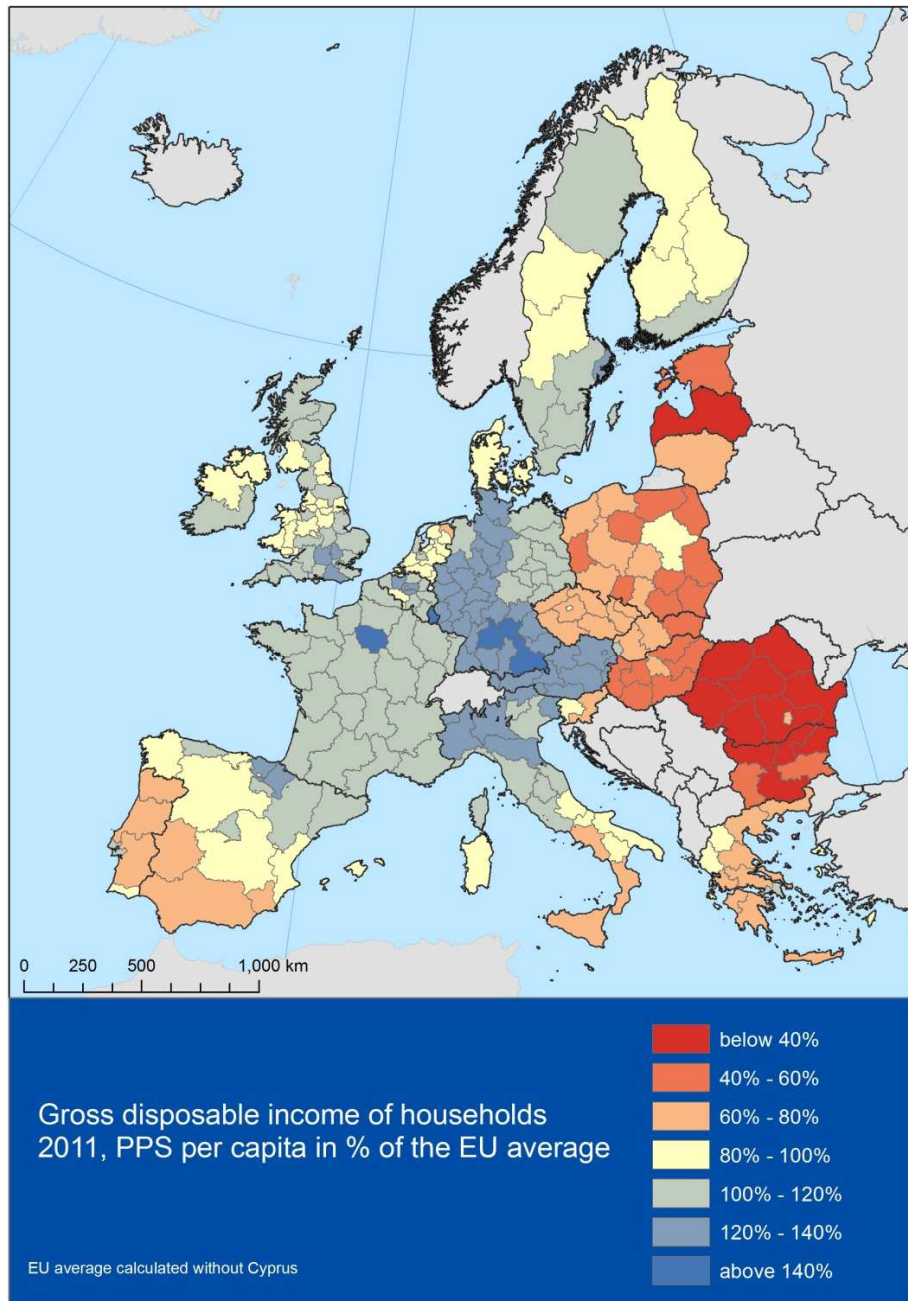
- In 2011, EU regional GDI levels are lowest, i.e. below 40 percent of the EU average, in most of the Romanian and Bulgarian regions (except for the capital cities and the Bulgarian regions around Burgas), as well as in Latvia.
- Low levels of household GDI are also found in most of the Hungarian regions (except Budapest), the Eastern Polish regions, in Estonia and Eastern Slovakia.
- The GDI levels of the Western Polish and Western Slovak regions, the Czech regions and Lithuanian regions are approximately at the level of the Portuguese and Greek regions.
- In general capital cities, especially but not exclusively in the CEE, tend to have higher GDI per capita levels than other regions. Thus, the Warsaw region in Poland as well as Prague are at around 90 percent of the EU average GDI per head, while Bratislava is the only region in the CEE where household GDI per capita is above the EU average.
- Most of the EU-11 regions are above the EU average in terms of GDI levels, in 2011, exceptions being Dutch and Danish regions as well as Mid-Western parts of the UK and some less populated Finish and Swedish regions.
- Nevertheless, there is also a certain differentiation between EU-11 regions, as highest GDI levels are found across German and Austrian regions (as well as in Paris and in and around

<sup>10</sup> NUTS 1 level for Belgium, Bulgaria, Germany, Greece, Hungary, Ireland, the Netherlands, Poland and Romania.

London), while e.g. the GDI levels of the French regions is approximately at the same as for the East-German regions. This also holds for large parts of Sweden and the UK.

- The Southern EU countries, especially Spain and Italy show a highly differentiated regional pattern. Hence Northern Italian regions as well as the Pais Vasco and the Navarra region in Spain have GDI levels well above the EU average (above 120 percent), while the more one moves to the South the lower disposable household income gets.

Figure 7: Regional GDI of households, 2011, PPS per capita, in % of the EU average

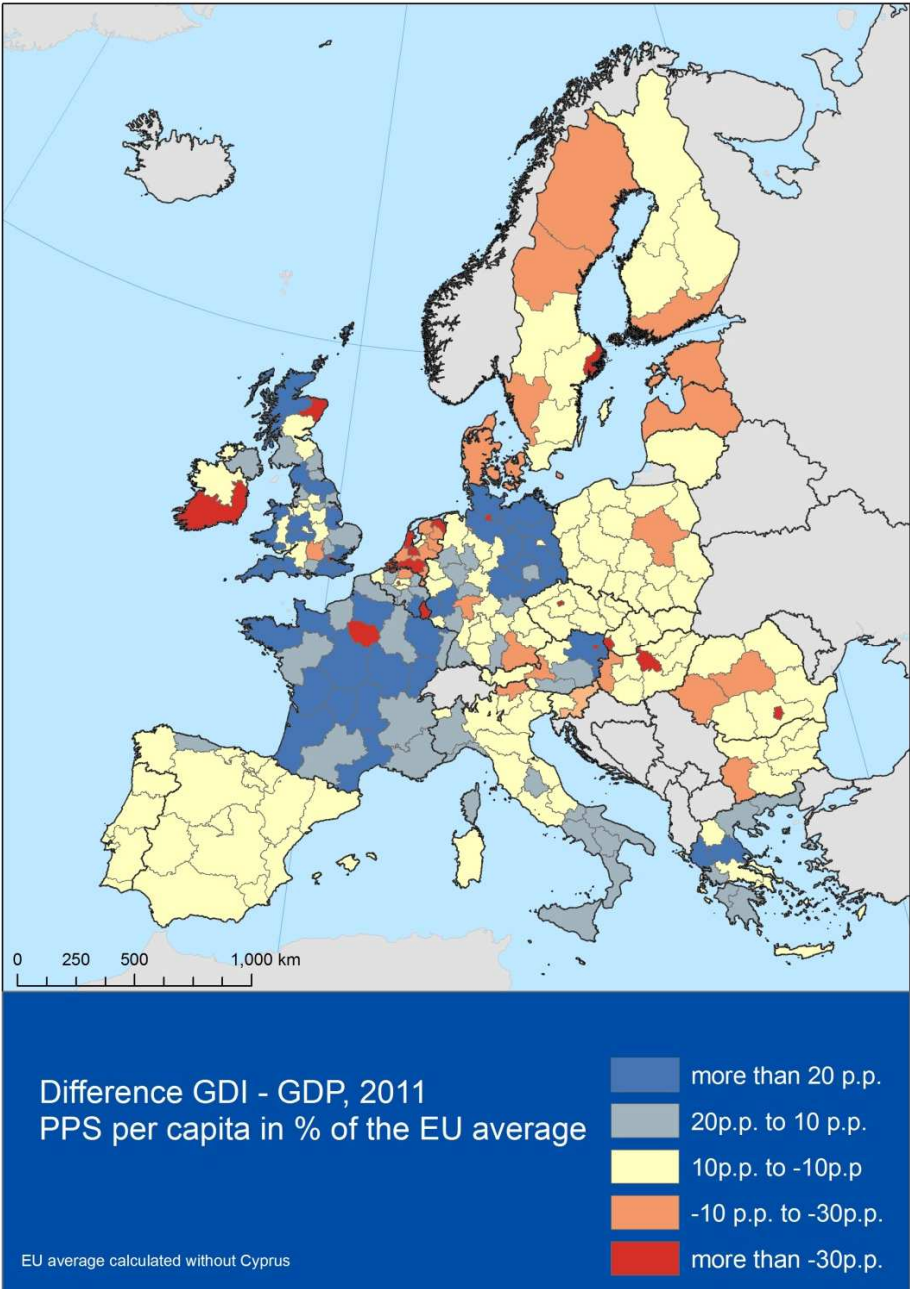


Source: Eurostat, map and calculations wiiw

The second map (Figure 8) shows the difference between regional household GDI and GDP per capita in relation to the EU average (both at PPS) for 2011. This map illustrates to what extent regional GDP data represents the actual income situation of households in the respective regions. In other words the map shows by how much the economic and social situation of households is over- or underestimated when only looking at regional GDP numbers. In this map reddish colours indicate that

GDP is higher than household GDI, while bluish colours refer to the situation where GDI is actually higher than GDP in terms of the respective EU average.

Figure 8: Differences in regional GDI and GDP per head, 2011, in p.p. of the EU average



Source: Eurostat, map and calculations wiiw

The most important result of this map refers to the capital city regions. For those, GDP per capita levels (relative to the EU average GDP) tend to be much higher than household GDI levels (relative to the EU average GNI). To illustrate, for Inner London GDP per head at PPS in 2011 is around 321 percent of the EU average, while GDI per head is ‘only’ 156 percent of the respective average. This gives a difference of 165 p.p. Similar for Brussels the difference is 118 p.p. and for Amsterdam 102 p.p. It has also serious consequences for the capitals in the CEE countries. Over the last years both Prague and Bratislava made considerable progress in terms of GDP convergence; in fact, in 2011 Prague has a GDP per capita level of 171 percent of the EU average and Bratislava even 186 percent, suggesting that in terms of economic development they overtook cities like Vienna. However, when looking at household GDI levels relative to the EU average, Prague is at around 90 percent and Bratislava around 100 percent

- (see **Fehler! Verweisquelle konnte nicht gefunden werden.** above). That is for both cities GDP per head is 80 p.p. higher than household GDI per head levels. Similar applies to all other CEE capital city regions, suggesting that GDP might not be representative to measure accurately the welfare situation of the population living in these cities.
- Interestingly enough, in the CEE these enormous differences between relative GDP and GDI levels are only seen in the capital city regions, while for the rest of the regions GDP and GDI are approximately at the same level, so that GDP is a much better representation of the households situation in the peripheral regions.
- GDP and household GDI levels do also more or less correspond for the Portuguese, most Spanish and a number of West-German and North-Italian regions.
- For all of the French regions (except Paris) as well as for Eastern Germany, as well as a number of UK, Greek and South-Italian regions, household GDI is higher in terms of the EU average than GDP (partly by more than 20 p.p.), indicating that GDP numbers eventually make households look poorer than they eventually are. Contrastingly, GDP is higher than GDI for many of the Dutch regions, as well as partly in Sweden, Germany and Austria.

## 5. Conclusions

The analysis has taken a very specific view on the social convergence of the CEE countries by defining it via the developments of the households' disposable income. With that it certainly left out many other aspects connected to social convergence or cohesion that would be worthwhile analysing. Yet, focussing on one aspect only allowed looking concisely at the social convergence from three different perspectives, i.e. the aggregate, the household and the regional perspective.

Before starting with conclusions it is useful to briefly summarise the main results of the analysis.

- From 1995 to 2011, the CEE countries were characterised by quite a solid – yet differentiated - pattern of economic (GDP) convergence. Over the same period, both in the EU-11 and the especially CEE countries, corporation profits grew at a higher rate than disposable income of households.
- On average, in the CEE disposable income of households grew 0.5 p.p. per year slower than GDP per capita in the period 1995 to 2011. A similar, though weaker trend was observed in the EU-11, where household income grew on average 0.2 p.p. less than GDP per capita.
- Corporation profits in the CEE converged much faster than household incomes from 1995 to 2011. CEE household incomes also converged slower than GDP p.c.
- Income inequality across CEE households increased strongly in the first half of the 1990s. Starting with the early 2000s household inequality generally declined, though the economic crisis 2009-2010 led again to an upswing in inequality, foremost in Estonia, Hungary and Slovenia.
- Within the whole EU, household income inequality levels tend to be lowest in the Central European CEE countries, while the Baltic States, Bulgaria and Romania are amongst the EU countries with highest inequality levels.
- Direct taxes on household income and taxes on wealth have a minor effect on income distribution in all EU countries. By contrast, social transfers strongly reduce income inequality, particularly public pension payments. Further social transfers (unemployment benefits, family allowances, etc.) reduce inequality by even more. In general, inequality tends to be lower in those countries where the levels of social expenditures are higher (in terms of their share in GDP).
- Collective agreements tend reduce income inequality levels by arranging for minimum wage regulations.

- At the regional level, the CEE economic and social convergence experience in the years 2000 to 2011 was mixed. Convergence was strongest in Slovakia, followed by Poland, Bulgaria and Romania. However, in Bulgaria (according to the available data) household income converged by much more than GDP p.c., while the opposite occurred in Romania where GDP p.c. converged strongly while household income staying behind.
- In all EU countries, the regional dispersion in terms of disposable household income is generally lower than the dispersion of regional GDPs.
- Over time and at the level of the EU, but also for the CEE countries as a group, dispersion of regional household income tended to decrease more than the dispersion of regional GDP.
- Within the individual CEE disparities in household income increased especially in Bulgaria and Slovakia, while they decreased in Hungary and Slovenia. By contrast, all CEE countries experienced an increase in disparities of regional GDPs p.c.
- Despite the progress being made in terms of economic and social convergence, the gap between CEE regions to the EU average is still considerable, exceptions being only the capital city regions.
- Regional GDP p.c. is not necessarily a representative indicator for the welfare levels of the households in the regions. This is especially the case for the capital cities, where GDP p.c. data delivers a much too optimistic picture of the households' situation if compared to data on disposable income.

The conclusions thereof focus on two major points.

First, there is a strong connection between economic (GDP per capita) and social (household income per capita) convergence in the CEE countries. Certainly, in this policy note this link is particularly strong because of the way social convergence has been defined, yet, even using other definitions this connection would remain strong. At the same, time this connection is very likely to be unidirectional, meaning that economic convergence is the basis for social convergence, but not vice versa. For this, the social situation of the households and people living in the CEE countries depends too much on the size of the income they earn, on whether they find employment or not and whether and to what extent social transfers and pension schemes are available. All these points are driven by the economy, and the faster it grows the faster will grow incomes, the more jobs will be created and the more funds are available for redistributive government policies and social systems. Given this primacy of economics, policies focussing on economic growth and convergence are also policies focussing on social convergence. From this, the role of explicit social policies regarding social convergence is not necessarily a minor one, but they are dependent on the outcome of the economic policies in place. Social policies in this context have more of a supportive character, fostering economic growth where possible and correcting misallocations where necessary.

This is what current EU social policies, manifested in the European Social Fund (ESF), are about. In fact, EU social policies are mainly geared towards getting people into employment by supporting inter alia:

- Access to employment for job-seekers and inactive people, including the long-term unemployed;
- Sustainable integration into the labour market of young people;
- Self-employment, entrepreneurship and business creation;
- Adaptation of workers, enterprises and entrepreneurs to change;
- Active inclusion, including with a view to promoting equal opportunities and active participation, and improving employability;

- Improving the labour market relevance of education and training systems<sup>11</sup>.

In total, out of the 17 priorities set out for the ESF for the period 2014-2020 (excluding priorities on institutional capacities) 14 priorities deal in one way or the other with assisting people finding employment and income. All these policies are reasonable and well chosen, and if appropriately put in practice also highly likely to strengthen the social convergence within the CEE countries and also within the EU. Yet, their success depends crucially on economic development and growth, because if growth is weak, helping people finding jobs when there are none is futile and the money spent on these priorities is wasted.

Secondly, the analysis has also shown that the connection between economic and social convergence is not straightforward. This means that economic convergence is faster than social convergence (profits grow faster than incomes). The difference may appear small, after all CEE household incomes grew just by 0.5 p.p. slower than GDP p.c. But this was the annual average over 16 years, meaning that each year household incomes grew by less than GDP, which over time accumulates to a significant gap. Maybe there is too much reliance on the GDP indicator as measure of the economic well-being of the population, and indeed the example of the capital regions in the CEE regions should be a warning sign in this respect, as they might be less developed as suggested by their GDP per capita levels. After all, using GDP alone offers no insight on how the benefits of economic growth in the CEE and also in the other EU countries were distributed across the population. The implicit assumption might be that if GDP grows the gains thereof are equally distributed over the population, so that everyone benefits in the same way. But this was not the case, as was shown by the analysis. There are winners and losers, may it be the corporations, individual households in a number of countries or individual regions. It might be a common fallacy when thinking about liberalised markets, that when they generate growth, this growth is distributed across the population in a fair way. After all, this distribution depends on economic and social power of individual groups and a number of institutional and historical factors. Those groups who have power can influence the distribution to their favour. The Baltic States, Bulgaria and Romania are a good example. Liberalising markets, putting everything under the primacy of economic development and competitiveness may work in terms of economic growth and convergence. It may even work in terms of social growth and convergence, if these countries were Germany or Austria and have a well-established system of collective agreements and a solid social system and other institutions ensuring that the economic growth is distributed in a more or less fair way. But if they do not, it is no surprise that inequality levels are amongst the highest in those countries.

The EU has no proper policy response for such tendencies and probably gladly leaves such issues to the national responsibility. But these trends are not only visible in the Baltics; they are visible in other EU countries, too. It may be questioned for how long people in the EU will and can accept that their incomes grow below GDP, while corporations' income grows at high rates. It may also be questioned for how long people will accept that part of these corporations pay little profit taxes and their owners evade taxation (like in the German example). For this, the EU should develop appropriate policy responses. Tax policies are one option, and there are steps taken to shut down tax havens recently. Still, some EU wide regulation of corporate taxation is missing. However, as the evidence has shown, taxation does not lead to a more equal distribution of economic benefits; this is achieved largely via social systems and collective agreements. Both of them are symbols of social solidarity in the society, the first for the solidarity of the people living in a country, while the second is a symbol for the solidarity between firms and workers. Yet, this is no issue in the EU.

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<sup>11</sup> Source: EU Regulation No 1304/2013 on the European Social Fund.

But maybe it should be, because the feeling is that under the primacy of economic development and convergence, social solidarity between the population within the countries, between firms and workers as well as between the EU countries is considered of little importance and sometimes even as a nuisance. Yet, making social convergence or, in EU terminology, social cohesion a more important issue in the EU and also making it more independent of economic cohesion, appears to be a logical step in the evolution of the EU. In 1950 Robert Schuman said *'Europe will not be made all at once, or according to a single plan. It will be built through concrete achievements which first create a de facto solidarity.'*<sup>12</sup> At that time Schuman's understanding of solidarity was that of an economic solidarity (especially between France and Germany), as to his mind it was fundamental to preserve peace in Europe. And the Nobel Peace Prize for the EU showed that in fact it was successful. Over the years and finding some upsurge in the wake of the economic crisis economic solidarity has grown strong in the EU. However, it did not prevent secessionist movements in Spain, Italy, Belgium, the UK (Scotland, as well as the whole UK), and also it did not prevent radical and populist movements to disappear – in fact they are growing stronger. Part of these trends may be indeed caused by relying too much on economic solidarity and disregarding that it also needs social solidarity to preserve the (social) peace. So, it is advocated that social solidarity and social convergence, aiming at a more equal and especially a fairer distribution of the economic benefits of the EU, is given a much more prominent role than it has now. It should not be about making everybody equal as sometimes is cynically remarked by people understanding 'social' as a form of 'communism'. It should be about giving everyone in the EU a fair chance to participate and benefit. One way towards that would be EU-wide standards for social systems and collective bargaining institutions and agreements. Fears that this may erode European competitiveness may arise because of that, but Germany and Austria are good examples that these fears are overrated. And after all, redistribution of incomes to the less advantaged will certainly increase effective demand, which will increase economic growth and economic development. Right now the EU has the Maastricht criteria determining whether or not an EU member state can adopt the Euro and thus enter an almost final stage of economic solidarity. Why not create 'social Maastricht criteria'?

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<sup>12</sup> The Schuman Declaration, 9 May 1950. [http://europa.eu/about-eu/basic-information/symbols/europe-day/schuman-declaration/index\\_en.htm](http://europa.eu/about-eu/basic-information/symbols/europe-day/schuman-declaration/index_en.htm)