

Mariya Hake (Oesterreichische National bank)

Income inequality and trust in national governments in Central, Eastern and Southeastern Europe

This paper provides evidence on the link between income inequality and trust in national governments for ten countries in Central, Eastern and Southeastern Europe (CESEE). Economic policy, such as the implementation of structural or tax reforms, crucially depends on the compliance and cooperation of the general public, which in turn depends on the public's trust in institutions. Trust in national governments is key for investor and consumer confidence or the channeling of finance. Recent policy discussions of leading international institutions (i.e IMF, World Bank, EBRD) have shown that trust in policy making is essential for durable and more widely-shared growth.

However, there is little evidence on the inequality trust nexus for the CESEE region in the empirical literature. Our paper aims at addressing this gap by using unique household data from the Euro Survey, conducted by the Austrian central bank (i.e OeNB), for the years 2009 until 2015. Our study enters uncharted waters in several aspects. First, we are able to construct different measures of national and sub-national (i.e regional) income inequality an endeavour undertaken for the first time for some of the countries in our sample. We apply standard techniques such as an estimation of a Pareto-shaped distribution of top incomes, imputations of missing values to correct for the item non-response and bootstrapping to get more reliable estimates of regional income inequality. Second, our data allow us to control for a multitude of factors that may impact trust such as socio-demographic characteristics and sentiments about past and future developments. Third, our study is one of the first to make use of comparable income data across countries and regions and over a longer period of time, including the 2008/09 crisis. Finally, we apply multilevel methodology in order to exploit the various dimensions of the data (i.e individual, regional, country-level).

Our main findings indicate that regional and country-level income inequality are negatively correlated with trust in national governments. This result is valid across different measures of income inequality and the negative link is more pronounced for the non-EU countries in our sample. In addition, more affluent individuals i.e occupying a higher position in the regional income distribution tend to trust more their national governments. We also show that positive perceptions of the future economic development of the country along with a strong rule of law and fiscal sustainability are shown to be key determinants of trust in national governments.

Exploring control variables at higher levels (i.e regional-, country-level) significantly contributed to the analysis by explaining up to 15% of the variance, suggesting that the use of multilevel-methods significantly enhances the explanatory power of the estimations. However, standard macroeconomic variables (e.g. GDP or inflation) have at best a weak explanatory power for trust in governments, which hints at a certain decoupling between the macroeconomic performance and trust since the crisis of 2008/2009. At the same time, the degree of economic convergence increases the probability to trust, *ceteris paribus*. Another important factor of

relatively low trust in national governments are the level of perceived corruption and low adherence to the rule of law. Regarding regional-level variables, sentiments about past events and future developments are not significant throughout most specifications with the exception of individuals expecting a better economic future for their country. On the individual-level, older respondents trust most (perhaps due to more wide-spread social trust before the fall of communism), whereas younger individuals also trust more (perhaps related to the uprise of populist parties in some countries, which increasingly attract younger voters. In addition, income inequality negatively correlates with trust in national governments especially for lower-skilled individuals and female respondents.