JGPG (2018) 7: 21-32
DOI 10.14666/2194-7759-7-1-002

PAPER

Macroeconomic Populism
The Baltic Current Accounts

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Abstract The outstanding growth and the sudden stop of the Baltic economies in the 2000s arose the assumption that their textbook-like and disciplined economic policy had actually an expansionary and overheating impact on economic growth. A reinterpreted theory of political economy was assigned to this phenomenon. It is called macroeconomic populism. The following study tests the link between the current account imbalance and the real effective exchange rate. The methodology is an OLS regression analysis on current account balance including real effective exchange rate based on both HICP and unit labor cost. The hypothesis is that the real effective exchange rate has a significant impact on the current account balance. The results are significant and exclude autocorrelation. If the results are placed in the Baltic economic context, it can be concluded that the macroeconomic populism can be detected in the Baltic region.

Keywords: Baltic states; external imbalance; macroeconomic populism; real effective exchange rate; current account.

JEL classification: F32; F36; F41; G01

1. Introduction

The economic story of emerging Baltic countries seemed to be a success before 2007:small open economies with sustainable and low public debt, 5.11% permanent annual GDP growth rate, accession to the EU, and getting rid of the Soviet economic heritage. According to Benczes (2016), the transition economies had to cancel the laws of shortage economy, and create market economy by privatization, capital assets, fiscal and external balancing, and reform of the social services. Concerning the erosion of European growth potential, Halmai (2014) argued that while the growth potential of the USA was only temporarily hit by the global economic crisis in 2009, it made a durable negative impact for the euro zone. This analysis included the less developed EU member states. This region, too, has suffered long-term damage in their potential output capabilities as a result of the world economic and the European crisis. In the followings, we focus on the explanation of these damages in context of the Baltic case.

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The region seems to have been very disciplined in fiscal and monetary sense since they became independent. In the first half of 2000s they even produced a boosting economic growth and significant real convergence to the higher developed EU members. The region has proved to be attractive for capital investment. However, economic analyses have projected some structural problems in their external (im)balances. These countries with balanced policies suffered a sudden stop in 2007 which was even strengthened by the global crisis. If fiscal balance, debt sustainability and fixed exchange rate are secured, what else can undermine the growth potential? Behind the fine indicators considered to be important, the external imbalance of the Baltics showed increasing deficit year by year. Finally, the external indebtedness problem undermined the sustainable growth. Besides, the Baltic convergence signalized as well as the imperfection of the Baltic economic success. The currency-board-based economic policy produced more than excellent public finance and debt numbers which are directly under the influence of policy makers. But the inflation, as an indirect result indicator of policy, brought series of failure in monetary integration.

The study examines the political economy of current account imbalance in the Baltic countries, where the public finances seems to have meet the mainstream economics, and the pegged exchange rate has proved to be sustainable. All behind of the problem, the origin is assumed to be the macroeconomic populism. The Baltic states showed a weird form of populism, called 'new kind' in the study. In market economies without significant rent seeking opportunities from commodity resources, the private sector provides most of the income sources. In this way, the populist politicians will not be a generous spender, but an undisciplined delayer of restrictions. The commonality between the active generous spender and the passive delayer is that they want to favor electoral groups in the society by securing higher income, and none of them worry about long-term consumer and cost inflation undermining the sustainability of growth.

The study seeks the link between the current account imbalance and the appreciated real effective exchange rate (REER). The hypothesis is that the REER significantly determines the current account, and if this is considered in the Baltic economic context, the presence of macroeconomic populism can be established.

2. Political economy of external indebtedness

By concluding from their Latin American observations, Dornbusch and Edwards (1989:2-5 and 1991:7) understood the macroeconomic populism as the heterodoxy of economic policy making. Namely, when the economy gets wind for a while, the policy makers start to do such policy actions which make them popular in the short term. But it does not mean simply spending money. The paradigm of macroeconomic populism results in interim increase in living standards through macroeconomic stimuli-just like excessive fiscal and credit policy and overvalued currency. The core element of the paradigm is the redistribution to get development without social conflicts. Meanwhile, the populists neglect the importance of the risk of inflation, the risk from deficit financing, the external constraints and the reaction of global market actors on non-market-like policies. This approach can result in a short-term growth

and a recovery period. Nevertheless, the policy makers ignore the fiscal and external constraints, and these bottlenecks cause recession and crisis in the medium term, as the constraints make the heterodoxy unsustainable. Finally, the long-term outcome of macroeconomic populism will be the '*plummeting of real wages*', '*severe*' difficulties in balance of payment, '*galloping inflation*', crisis and the '*collapse of economic system*'. These "developments" will enforce austerity and demand for external (IMF) aid. The authors emphasize the role of external imbalance (Dornbusch and Edwards, 1991:7-8).

Based on the observations by Darvas and Szapáry (2008) describing the economic trends and risks in the Eastern EU member states, Csaba (2008) discovered a similar but different kind of macroeconomic populism in the EU10 region. (Besides, the Southern members – Greece, Italy, Portugal, Spain – can be mentioned as bad practices of the Latin American kind of macroeconomic populism, as it was observed e.g. by Nemenyi and Oblath (2012: 596) that not only those countries who have been under excessive deficit procedure of the Community got into trouble. Baltic's sudden stop in 2007 or the Slovenian indebtedness problems in 2012 appeared in countries with sustainable budget balance. Divergences in inflation, competitiveness and relative wage cost were already observable among the euro zone countries.[1] Unlike the Latin American populist policy, Csaba (2009: 111-112) determines the '*new kind*' of macroeconomic populism as a policy making by delaying reforms and unleashing private demand financed by loan. Unlike, again, the Latin American heterodoxy, Csaba (2008:602) establishes, that the new kind correctly follows the simplified models of '*elementary economic textbooks*'. This characteristic is originated in the European economic circumstances, where typically there are no significant opportunities for rent seeking in public finances from natural row material resources. That is why, the European version of populism can mostly affect passively on living standards by not levying more taxes in the revenue channel or not blocking the private consumption in the regulation channel. This will result a short-term '*boom driven by the private sector and personal consumption*' (Csaba, 2008:603)

The initial condition of the macroeconomic populism is to have dissatisfaction from people and politicians about national economic performance in stagnation and to have expectations for better dynamics. Many times, public opinions connect the stagnation to earlier disciplined austerity in the spirit of conservative economics. In the first phase, as written by Dornbusch and Edwards (1991:11 and 1989:6-7) in their four phases model, the policy makers refuse the restrictive conservative paradigm and ignore the macroeconomic constraints, as there is a temporary possibility to loosen the policy conditions. The quick result of pegged foreign exchange, fiscal expansion, credit expansion, tax cuts etc. can be the high growth of real wages. Although, it ruins the export competitiveness, the government is not willing to devaluate the foreign exchange to avoid the inflation shock and the damage of living standards. But, in the second phase, the mentioned constraints as bottlenecks block the ongoing dynamic

[1] For example, the cumulated growth of ULC (unit labor cost) between 1999 and 2006 was 1,5% in Germany, but 25,2% in Greece, 23,2% in Spain, 27,7% in Portugal. (Nemenyi & Oblath 2012: table 1)

growth. The third phase is called the case when there are '*pervasive*' shortages, accelerating inflation and foreign exchange gap (overvaluation), characteristics initiating capital flight, demonetization in real economy transactions, increasing public deficit and after all unsustainable populist policy. Dornbusch and Edwards (1989) emphasize the role of external destabilization and vulnerability in the process of heterodoxy failure. Then comes the orthodox stabilization as phase 4.

The new kind of macroeconomic populism model can be implemented to the case of Baltic states. As Darvas and Szapáry (2008) argued about the Baltic countries, beside the high speed of growth of 2000-2006, they accumulated high annual current account deficit, their pegged foreign exchange strengthened the price convergence, and in 2007 they got into recession with high inflation. Also, it was recognized, that the euroization of their credit market (52-77%) got significant (Darvas & Szapáry, 2008:847). This characteristic severely reduced the influence of monetary policy on monetization, on the other hand, it proves the passivity of the populist policy. The euro credit got so popular, as it was based on the EURIBOR rate which was much below the Baltic rates. It also had positive economic results in form of interest rate convergence that could verify the policy makers' passivity. Darvas and Szapáry (2008:855) even supplement the origin of reduced monetary transmission by mentioning the competition in the banking sector in the years of 2000s which also lowered the credit rates.

The phases of macroeconomic populism described by Dornbusch and Edwards (1991) are valid for the Baltic countries too. The Soviet era and the first half of 1990s were the period of strongly repressed consumption, thus the households desired more. During the growth period of the region which global financial instruments made it possible, significant share of Baltic consumption and investment got financed from foreign sources. Of course, politicians did not want to obstruct the increase of welfare from external credit as it raised the placidity of people. Besides the toleration of low monetary transmission, the Baltic policies targeted low public duties. Csaba (2008) summaries the failure of macroeconomic populism in the Baltic (and East-Central European) region as follows: (1) cuts on public duties, (2) passivity in overheated economy, (3) focus only on fiscal balance, (4) delay of structural reforms, (5) no political consensus, (6) winner-takes-it-all behavior in politics, (7) elemental break-through of private demand after decades of repressed consumption. This process caused an enormous current account deficit and high inflation (see below Reveres Balassa-Samuelson effect). Finally, bottlenecks appeared in the Baltics, too.

After the collapse of the Soviet Union, one of the few advantageous heritages of Baltic countries was the very low level of public debt, around 5 percent of the GDP. This could have created a robust room for maneuver for fiscal populism, however, the Baltic governments avoided to use it to the fiscal easing and political populism. This opportunity was utilized to reform the system of social services and to shift the Baltic society and economy toward a liberal (Anglo-Saxon) social model with private financing.[2] Economic growth and the welfare were based on influx of foreign

[2] About liberal social model see: Sapir (2005)

direct investments and other capital sources. Nevertheless, the public balance and the monetary stability were not enough to bring along a quick success in the monetary integration, as they did not have enough impact on inflation. Since companies and households have accessed to cheap foreign loan, none of the budget surpluses and central bank rates could control and restrict the national consumption and investment and their impact on inflation. Constantly missing the inflation target criterion, the Baltic monetary integration slowed down. Meanwhile, their euroization reached high level through loans. In the end of 2006, the financial euroization of loan market was approximately 52 percent in Lithuania, 76 percent in Latvia and 79 percent in Estonia (Chitu, 2012:chart1). These data strengthens the thesis that monetary transmission has been very week in the Baltics.

The Baltic internal economic balances originated in the primacy of monetary policy which targeted exchange rate stability first of all. In case of Estonia and Lithuania, the currency board system has been applied, and the Latvian monetary policy also targeted pegged rate with some adjustment cases. The currency board is in a quasi-single currency position, as there is no exchange rate volatility at all (toward the euro), and actually the monetary policy is very strictly bounded without room for non-harmonized maneuver by the exchange rate target. Basically the currency board is credible if the national inflation keeps pace with the reference region. It is concluded from the interest rate parity model that the policy on interest rate and money supply must be subordinated to the rigid target of foreign exchange. Moreover, for the financial market equilibrium depending on GDP and real interest rate, the equilibrium of money demand and supply must be controlled by the fiscal revenue and spending items. As Baltic countries use strict pegging, their case has been very similar to the single currency zone members in sense of external adjustment without revaluation of foreign exchange. The latter eurozone accession[3] was just a technical shift for Baltic countries into the real single currency zone, since they were successful in sustaining the currency board.

As there has been neither an individual devaluation nor a federal bail-out mechanism, the unsolved external imbalance can result in divergence, regression and degradation of externally indebted countries. This is the so-called *reverse Balassa-Samuelson effect*. (see Grafe & Wyplosz 1997; Jakab & Kovács 2000:144, Kutasi 2013). The original Balassa-Samuelson effect derives the higher inflation of catching-up countries from the development of productivity in the catching-up tradable sector, causing a wage increase and thus inflation pressure in the non-tradable sector (Balassa 1964). The reverse Balassa-Samuelson effect, however, claims that the relative change of price leads to divergence of productivity in the following way: In the eurozone, the quick convergence of interest rates imposed an overheating in consumption in periphery economies of the eurozone. The expectations of households based on sharply decreasing interest rate were unfounded, and resulted in a quick private indebtedness particularly through the consumption of non-tradable services. This latter impact raised the wage demands in the local non-tradable sector that spilled over to the tradable (export) sector. Thus, the export competitiveness deteriorated, meanwhile the local inflation rose by the higher

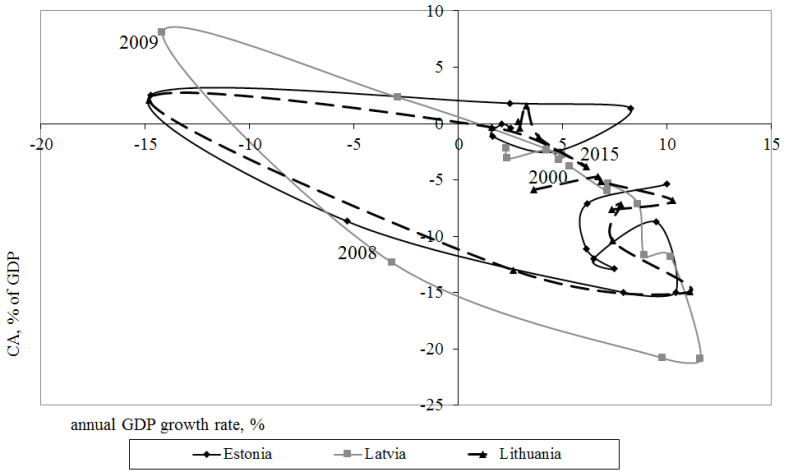
[3] Estonia in 2011, Latvia in 2014, Lithuania in 2015.

wage cost (Mongelli & Wyplosz 2008; Nemény & Oblath 2012).

In the Baltic case, where euroization of credit market was supported by policy makers and thus made a significant part of influence on monetary processes to be lost, the Baltic private debtors calculated with the euro rates. The multi-level inflation with a single interest rate of ECB has preferred the countries with higher inflation as a counter-selection in the loan market, but for their fate, this also has discouraged the private savings in these countries. The upward deviation from the eurozone inflation, Estonian value was between by 1% and 7.3% in each year of period 2004-2008 based on the Eurostat data. In case of Latvia, the deviation was between 2.8% and 4.7%. The exemption of Lithuania appears again in the Baltic group as her deviation from the average was negative and became positive only after 2009. This indicates already, that we should expect something different in case of Lithuania from the test results.

Figure 1 indicates the core symptom of macroeconomic populism in the Baltic countries: High economic growth companied with increasing current account deficit and then quick adjustment in both indicators. Between 2000 and 2006/2007 these countries had regionally outstanding economic growth apart from an extremely negative and deteriorating current account balance. Only the GDP contraction shock could have the Baltic economies to break the deteriorating trend of external imbalance. However, after the annual flow surpluses of contraction years, namely 2009-2010, as economic growth returned to the region, current account turned into a moderate deficit again. The thesis, i.e., that these economies were overheated by foreign money can be verified by output gap data. The Baltic output gap was massively positive (beyond the potential) before the global crisis, according to the AMECO database of DG-ECFIN.[4]

Figure 1. Baltic GDP growth rates and the balance of current accounts (% of GDP), 2000-2015



Source: IMF World Economic Outlook, 2015 April, download 09.07.2015, 2013 and later years are IMF estimation

[4] The impact of euro zone on Baltic growth and their business cycle harmonization is detailed by Fidrmuc and Korhonen (2006) together with several other Central and Eastern European economies.

3. Methodology and quality of data

Analyzing the processes of nominal effective exchange rate, real effective exchange rate, nominal unit labor cost (ULC) by country in database of Eurostat and DG-ECFIN AMECO, it is clear that the growth period of Baltic EU membership of 2004-2007 resulted in a measurable relative appreciation of Baltic prices and production costs. The crisis years made change in the trend. The same is true for REER based on ULC – except Lithuania (See Kutasi 2014).

In the following, the analysis concentrates on time series regression about current account and real effective exchange rate. The current account is determined by several factors. But now, the hypothesis is that there is a new kind of macroeconomic populism in the Baltic economies which can be indicated by the current account deficit deteriorated by the appreciated real effective exchange rate. Namely, if it can be proved that the REER determines the current account imbalances beside the path of Baltic current accounts and GDP growth ratios, then it can be concluded that the Baltic policy-making delayed the action to counterbalance the increasing prices and labor cost. The following regression function is applied:

$$CA_t = \beta_0 + \beta_1 * REER_{t-1} + \beta_2 * CA_{t-1} + \varepsilon \quad (1)$$

where CA_t is the current account balance, CA_{t-1} is the lagged value of the dependent variable and $REER_{t-1}$ is the real effective exchange rate in the previous period.

The analysis uses two versions of REER. First version calculation is based on consumer price index ($REER_{hicp}$) by deflating with HICP which expresses the price competitiveness, the second one is based on nominal unit labor cost ($REER_{ulc}$) which indicates the wage competitiveness. Because of autocorrelation, the lagged dependent variable cannot be missed from the model, since Durbin's autocorrelation indicator signalized existence of autocorrelation in any calculation lacking the previous period variable. In case of REER, more periods were tested. The first lag (t-1) resulted in the best significance. Two different measures of current account balance against the rest of the world was used to confirm the test result: percentage of GDP and million euro in current prices. The REER data are from the European Commission, DG-ECFIN Price and Cost Competitiveness statistics, the current account data are from the Eurostat. All data are in quarterly breakdown. The time-period structure of the data is the following: all of the REER data, both in calculation base and in national base, are since first quarter of 1995 until the forth quarter of 2017. That is why the current account data are determinant for number of observation. All current account data series end in forth quarter of 2017. The current account to GDP starts in the first quarter of 1995 for Estonia, in first quarter of 2000 for Latvia, in first quarter of 2004 for Lithuania. The current account in million euro at current prices begins in the first quarter of 2004 for Estonia and Lithuania, and in the first quarter of 2000 for Latvia.

The model was tested for autocorrelation at 5% of significance. The indicator is Durbin's h. The null hypothesis is that there is no autocorrelation against the 2-sided

alternative of autocorrelated errors, at a 5% level. If Durbin's h is $-1.96 < h < 1.96$, then we do not reject the null hypothesis, namely, there is no autocorrelation.

4. Analysis and results

The results of the OLS estimation are presented in tables 1 – 4. The lagged dependent variable is typically significant, namely the presence of path dependency is indisputable in the model. An interesting outcome is that, in the case of the Estonian current account to GDP, the significance prevails only at 10%. The Estonian coefficient of the lagged current account balance both in million euro and to GDP is less explanatory than the lagged REER both in any type of current account and in type of REER used in the analysis. From the lagged REER values, it can be established that it is always significant for Estonia and Latvia. It is valid for the other two countries, too, in case of current account in million euro, at 1% significance, except Latvian $REER_{ulc}$ at 5% significance. In case of Lithuanian REER coefficient, the HICP and the ULC case should be assessed separately: The $REER_{hicp}$ is significant in 1% in both cases. The $REER_{ulc}$ did not reach any significant level which is acceptable statistically. Nevertheless, in these cases, the coefficient of constant is neither significant. This result in the Lithuanian conclusion, that the wage cost did not affected on the current account and that is why the macroeconomic populism did not prevail through the wage policy.

In the regression of variables in million euro, the lagged REER coefficients are bigger with order of magnitude. Although, in the regression of values in GDP-ratio, the lagged dependent coefficients have advantage, but the scale is the same. Namely, the weight and importance of REER is comparable to the lagged current account balance.

The published function results meet the goodness of fit. The best adjusted R^2 values were achieved in case of the Latvian regression functions. All beyond 0.8 which means an excellent goodness of fit. In case of the Estonian R^2, the GDP-ratio analysis values are around 0.64, and the analysis in million euro resulted in 0.72 – 0.74, which still indicates good fit of function. The Lithuanian goodness of fit is acceptable, yet, although, its R^2 values move between 0.53 and 0.63. All the published results are free from autocorrelation in 5% significance according to the Durbin's h values.

It can be established from the regression analysis that the REER is decisive for the current account balance. In case of Estonia and Latvia, it is determinant in calculation based on both prices (HICP) and wages (ULC). Meanwhile, the Lithuanian regression analysis resulted valid REER coefficient only in case of HICP-base. If these results are placed in the Baltic context of the appreciating REER indices, the deteriorating current account, the robust economic growth, and finally the sudden stop and rapid, but sharp adjustment happened after all, the REER coefficients can be considered the sign of new kind of macroeconomic populism in the Baltic economies. However, the Lithuanian results in case of REER based on ULC enforce to distinguish the country in the region, and to maintain a degree of doubt about validity of macroeconomic populism in the country. As the calculations based on ULC failed to indicate the impact on current account, populism in wage policy cannot be concluded.

Table 1. OLS-regression test, dependent variable: current account to GD in %, lags = 1, coefficients, REER based on HICP

	Estonia	Latvia	Lithuania
constant	−8.00996 (−2.110) **	−24.7765 (−3.764) ***	−40.2235 (−3.293) ***
lagged $REER_{hicp}$	0.709493 (9.493) ***	0.246430 (3.692) ***	0.396025 (3.232) ***
lagged dependent variable	0.0702004 (1.788) *	0.763146 (12.35) ***	0.546916 (4.999) ***
number of observation	91 (1995Q1-2017Q3)	71 (2000Q2-2017Q4)	55 (2004Q1-2017Q3)
adjusted R^2	0.638320	0.823835	0.627775
Durbin's h	−1.806171	−0.540073	−0.659409

source: author's calculation from Eurostat data, using Gretl.
note: t-value in parenthesis. *, **, *** denote significance at 10%, 5%, and 1%.

Table 2. OLS-regression test, dependent variable: current account in million euro in current prices, lags = 1, coefficients, REER based on HICP

	Estonia	Latvia	Lithuania
constant	−1095.77 (−2.857) ***	−880.740 (−3.011) ***	−2312.52 (−2.738) ***
lagged $REER_{hicp}$	10.7694 (2.847) ***	8.84020 (2.941) ***	22.8638 (2.679) ***
lagged dependent variable	0.659719 (6.773) ***	0.834990 (14.98) ***	0.629423 (6.044) ***
number of observation	55 (2004Q1-2017Q3)	71 (2000Q2-2017Q4)	55 (2004Q1-2017Q3)
adjusted R^2	0.719720	0.813547	0.587779
Durbin's h	−0.771933	0.334843	−0.105022

source: author's calculation from Eurostat data, using Gretl.
note: t-value in parenthesis. *, **, *** denote significance at 10%, 5%, and 1%.

Table 3. OLS-regression test, dependent variable: current account to GDP in %, lags = 1, coefficients, REER based on ULC

	Estonia	Latvia	Lithuania
constant	−7.79797 (−3.179) ***	−7.87989 (−3.122) ***	−10.2268 (−1.031)
lagged $REER_{ulc}$	0.0728209 (2.858) ***	0.0732259 (2.966) ***	0.0910663 (0.9532)
lagged dependent variable	0.681719 (9.051) ***	0.864136 (16.31) ***	0.773787 (8.397) ***

	Estonia	Latvia	Lithuania
number of observation	91 (1995Q2-2017Q4)	71 (2000Q2-2017Q4)	55 (2004Q1-2017Q3)
adjusted R^2	0.646164	0.812744	0.560665
Durbin's h	−1.852182	−1.038044	−1.277836

source: author's calculation from Eurostat data, using Gretl.

note: t-value in parenthesis. *, **, *** denote significance at 10%, 5%, and 1%.

Table 4. OLS-regression test, dependent variable: current account in million euro in current prices, lags = 1, coefficients, REER based on ULC

	Estonia	Latvia	Lithuania
constant	−572.908 (−2.862) ***	−324.949 (−2.673) ***	−739.388 (−0.9719)
lagged $REER_{ulc}$	5.57179 (2.849) ***	3.10048 (2.532) **	6.65552 (0.9041)
lagged dependent variable	0.697795 (7.871) ***	0.902427 (17.14) ***	0.781130 (8.049) ***
number of observation	55 (2004Q2-2017Q4)	71 (2000Q2-2017Q4)	55 (2004Q1-2017Q3)
adjusted R^2	0.738385	0.807933	0.538126
Durbin's h	−1.274213	0.023178	−0.453475

source: author's calculation from Eurostat data, using Gretl.

note: t-value in parenthesis. *, **, *** denote significance at 10%, 5%, and 1%.

5. Conclusions

In this study, the political economy model of macroeconomic populism was presented by the case study of Baltic countries. The model was supported with the economics theory of the reverse Balassa-Samuelson effect. The Baltic economic context of the study was that the process of income growth and quick catching-up of the Baltic economies were established on external financing. This phenomenon heated non-tradable inflation, as foreign savings were mostly channeled through credits and loans toward the household and corporate sectors. Finally, the external credibility of the region exhausted independently from the global recession, but not independently from the global credit money shortage. This turn caused a sudden stop, which demanded a quick and radical public and/or private adjustment in all of the surveyed countries.

It can be established, that even an impressively catching-up economy with internal balance and without heavy burden of public crowding out can fall into a recession or depression. The reasons of disappearance of economic growth are many, such as the political motivation to heat the economy by leaving more room for private sector to spend, the appreciation of real wage due to the fixed foreign exchange rate, the increasing

inflation from sharply growing income, and the permanently growing external imbalance.

For all three Baltic countries, the signs and effects of new kind macroeconomic populism can be detected, such as the balanced budget before sudden stop, the pegged foreign exchange rate and the deteriorating external imbalance during the impressive growth period. It was also concluded that before the sudden stop, the public indebtedness was low and stable, meanwhile private sector indebtedness was multiplied by the economic growth results. The inflation risk increased – except for Lithuania. The risk was increased by the external indebtedness and the share of foreign currency in total dept. Many indicators of export competitiveness showed deterioration before the sudden stop. The REERs indicated an appreciation of costs and prices of the Baltic production. Namely, the economic indicators of the Baltics strengthened the assumption, that the national economic policies postponed those actions which could have sustained the export competitiveness and the relative cost of regional workforce and production, even though, the public finance and monetary indicators were kept in balance. This way, the inflation of prices and wage cost gradually terminated the attractiveness of Baltic investment opportunities and export products. Meanwhile, the sharply increasing income and creditworthiness of Baltic households had negative impact on current account balance by increasing import and on wage competitiveness by pushing the wages up first in the non-tradable, then later on in the tradable sectors.

To prove the hypothesis, the analysis used OLS regression analysis on time series by countries about the correlation between current account balance and REER based on HICP and ULC of the three Baltic countries. The regression analysis confirmed that some REER indices strongly and significantly have determined the current account of Baltic countries. In practice, it means that the fixed foreign exchange rate caused overvaluation of Baltic prices and wages, and, thus, deterioration of competitiveness. Finally, the lost competitiveness kept on raising the current account deficit which enforced an austerity in welfare and income policies, namely, in the GDP, in the end.

The regression analysis resulted in significant coefficient and decisive power of lagged REER as a determinate component of current account balance. All of the models published in the study are meet the expectation of goodness of fit and freedom from autocorrelation. Placing the results in the Baltic economic context of the 2000s and 2010s, it can be concluded that the new kind of macroeconomic populism can be detected. In case of Lithuania, the wage channel did not prove to be significant, that is why, in her case, some degree of doubt should be maintained about the existence of macroeconomic populism.

This study focused on the Baltic region, however, the new kind macroeconomic populism as an explanatory factor can be extended to many emerging countries which build their growth on secondary and tertiary export and foreign direct investment among Eastern Europe and South-East Asia, which have suffered from sudden stop during dynamic economic expansion.

Acknowledgement

The work was created in commission of the National University of Public Services under the priority project KÖFOP-2.1.2-VEKOP-15-2016-00001.

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