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INSTITUTIONAL TRANSPARANCY COMPENSATORS AND FISCAL EXPANSION IN CEE COUNTRIES

Abstract

CEE countries demonstrate specific type of macrofiscal vulnerability. Functional convergence with so called «old EU» takes place with shift toward higher level of GDP redistribution through budget and higher level of public debt. Such fiscal expansion coexists with high CEE countries globalization level, real and institutional convergence. But, quality of institutions, for example government efficiency, is still low then in «old EU». Institutional convergence gap with reached fiscal convergence are challenging for further development in the region. CEE countries may choose between slower real convergence, narrowing fiscal reactions on shock, harder fiscal limits for investment into quality of institutions. It is stressed that CEE countries should choose «smaller government» that invests in quality of institutions. Such policy helps to avoid future debt unsustainability and support real convergence.

Key words:

CEE countries, fiscal expansion, quality of institutions, real convergence, institutional convergence, globalization.

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Introduction

The process of market transformation showed that the former post-socialist countries quickly lose homogeneity in a wide range of parameters. First, the extent and speed of liberalization, the scale of hyperinflation and budget deficits were criterial attributes differentiating their success on the path to reforms. After a period of continuous structural reforms (creating the fundamentals of market economy, the introduction of market-based instruments of macroeconomic policy, reforms of central banks and fiscal institutions, formation of market-based entities, entry to the WTO, etc.), a problem of heterogeneity became interpreted as how fast are European integration requirements are executed. The latter became quite powerful factor in the new generation of structural change in Central and Eastern Europe. It is no accident that the process of EU accession of former post-socialist countries is stretched over time and by waves, and in the light of controversial steps of European integration of Ukraine, Moldova, Georgia, this process is hardly seems to be complete. On the other hand, the acquisition of formal EU membership does not mean that structural changes are completed. They rather start on a completely different level, where global competitiveness, quality of policy and institutions, macroeconomic precision of regulators, market efficiency play a fundamentally different meaning.

Requirements for membership in the EU, just as the need to ensure the development of a more rigid framework of global competition, requiring investment in human capital quality and efficient public administration. Additionally, there should be made investments in quality institutions, without which today it is not possible to imagine effective adaptation to global shocks, FDI, compensation of European average factor productivity, which in the long run are converted to the fundamental determinants of potential GDP growth. In other words, CEE countries face a number of structural challenges that hold upward pressure on the level of government spending relative to GDP. Moreover, this upward pressure is not likely to be called structurally conditioned, particularly taking into account the EU membership requirements in sectorial regulation, quality public services, a common policy, and so on, all what require financing, which does not always correspond to the stage of real convergence of not only new members, but also the certain Mediterranean countries.

However, post-socialist countries have demonstrated that they have much lower level of GDP redistribution through the budget and redistributive doctrine tends to be less ambitious than in some European countries, not only for reasons of public preferences, as for the reasonable logic of market transformation. Within this logic, unit of GDP redistributed through the budget in developed countries and in transitive economy are not identical in its content. The structural configuration of the redistribution process, its recipients and beneficiaries, and allocation efficiency of the whole system of public finance in conjunction with the quality of institutions and relevance of regulatory policy significantly differ among specified groups of countries. This raises the question that the gap in levels of burden on the economy in 1990 in the EU and transition economies would be sufficiently significant and dependent upon a dismantling of inefficient redistributive model of public finances in the past and transfer it to the new allocation and distributive principles during the structural changes. But also one has to ask the question of how the process of real convergence relates with the changes in the volume of GDP redistribution through the budget in the light of institutional convergence. That is, if one can spectate the gap between the levels of burden in the EU and in the post-socialist countries, how it relates with the convergence of institutional quality and government quality policies to the EU average level, within which increase of the fiscal burden would not come out of a critical Laffer's point.

Why is this issue so important for the countries of Central and Eastern Europe and how it affects the homogeneity of the EU and its regional dimension? In terms of growing globalized openness, macro-financial vulnerability of post-socialist countries will increase, while tools for shock adapting will look more limited. Also, the global crisis has shown that success in the field of institutional convergence with the EU allows significantly better to overcome the crisis than in some countries of the old member states, which recently experienced a deterioration in the quality of institutions, the decreasing effectiveness of public administration, strengthening of structural preconditions of nominal rigidities that eventually led to the loss of global competitiveness and undermining of fiscal fundamentals for stable functioning of the euro area. Accordingly, the interaction of real convergence processes, the level of globalization, institutional effectiveness of government and fiscal variables should be in mutually compensated state in order the country could combine global competitiveness, macro-financial stability and social priorities. Thus, in this article the interaction between fiscal expansion and changes in the quality of institutions in post-socialist countries is analyzed.

Mainstream research areas of post-socialist countries of Europe in the context of fiscal policy and quality of institutions

Despite the fact that most modern studies are focused on the development of the Europe region, its Central and Eastern part is differ significantly from the period of market transformation to nowadays, we can say that nominal convergence in the EU as a whole and expansion of the euro affected the shift in emphasis towards analysis of the vulnerability in the new competitive environment, where the role of government policies are more significant. Vulnerability of exchange rate regime to capital flows with appropriate extrapolation to real shocks dominated in the analysis for the so-called «post-Asian period» (Corker R., Beaumont C., van Elkan R., Jakova D., 2000). However, as the A. Oslund points out, global financial crisis demonstrated how CEE countries are different in terms of reforms deepness, created adaptive mechanisms and macroeconomic regimes. He states that significant success of the first decade of reforms was not enough to survive during the global financial crisis without losses that have occurred in some countries, and the scale of the collapse in GDP shows as unnoticed drama (Corker R., Beaumont C., van Elkan R., Jakova D., 2000).

Significant differences in GDP loses after the crisis and in general, sensitivity to pro-cyclicality in the global macro-financial processes today clearly points out how a combination of macro policies with the regime institution quality become key factors for long-term sustainable development. In other words, aside from the problem of conditional selection of an adequate macro policy regime in favor of institutional quality, it can be assumed that such a regime is likely responsible for the degree of elasticity in the connection between the global pro cyclicality and domestic macro cycle, while the quality of institutions, including the effectiveness of public authorities, provide the speed in adapting to new equilibrium conditions and open the way for structural reforms that would meet the new configuration of global competitive pressures, but in same way minimize the loss of political and institutional consensus of society on necessary changes.

CEE vulnerability to global financial imbalances can be derived from the relationship between capital inflows and rapid build-up of foreign debt. For example, before the crisis, it was recognized that the region is probably the most vulnerable to a combination of exchange rate shock and shock in interest rates in the event of changes in the conditions of borrowing on global markets (Goldstein M., 2005). It is also remarkable in light of the CEE countries, among other emerging markets, are characterized by a combination of account deficit and capital inflows, and not payments surplus and exports of capital, as many other countries

with a similar level of development (Abiad A., Leigh D., 2007; Pipat L., Schandler S., 2007). The first combination may be considered more acceptable in terms of increasing social welfare that actually corresponds well with the macro basis of real convergence in the whole EU. Also, it can be argued that the first combination is the best reflection of institutional characteristics, compared to countries which experience a balance of payments surplus and export of capital. If the institutional factor here is the case, it likely reflects the expectations of institutional convergence with the EU, resulting in the region of Central and Eastern Europe continues to be attractive for investment flows, even in spite of real convergence.

On the other hand, the current account deficit and sensitivity to macro-financial stability of capital that inflows rise another problem. CEE countries were extremely vulnerable to the global pro-cyclicality of the financial system, capital inflows, credit boom and inflation of asset prices, combined with process of real convergence have generated serious prerequisite for truly deep destructive impact of the crisis and the difficult dilemma of options to adapt to post-crisis conditions in which the search for activated drivers of global competitiveness came to the fore. This conflict between the procyclicality of capital flows, financial conditions, asset prices on one hand, and the current account deficit, rising real exchange rate and deteriorating competitiveness, on the other hand, is seen as a sign of macro-financial vulnerability of the CEE countries (Ceccetti S., 2010, Waysand C., Ross K., de Guzman, 2007; Brzoza-Brzezina M., Jacquinot P., Kolasa M., 2010). The same applies to the role of fiscal policy in the post-crisis conditions (except that restrictive budget bias is seen as a logical choice to constrain aggregate demand, warmed by financial boom): conduction of counter-cyclical stabilization orientation or budget compression under international tax competition and creation of more liberal state in comparison to average benchmarks of average European welfare state. However, fiscal choices are not as simple as it may seem for reasons of how mixed policy affects aggregate demand.

According to some researchers, focus on more counter-cyclical or less discretionary fiscal policy was the criterion for the differentiation of new Member States and candidate countries for accession after the global financial crisis (Cocozza E., Colabella A., Spadafora F., 2011). This phenomenon can be explained by the fact that some of the post-socialist countries reached a sufficient level of maturity and depth of markets which allows for counter-cyclical stabilization policy to be the main instrument of adjustment during the crisis. It also shows a functional convergence with the developed countries (Koziuk V. V., 2007) and to some extent unites with fiscal model that prevails in the EU-EMU where limited to the fiscal rules stabilization policy is an integral part of macroeconomic mechanism of integration formation. Concerning the modality of fiscal policy in terms of adjustment of the economy to the pro-cyclicality of the financial system, capital flows and financial cycles, the situation is not unique. For example, in a capital inflow and financial boom, fiscal restriction in reducing the costs can encourage the

expansion of aggregate demand, i.e., tax increases may seem a reasonable response to the overheated financial sector and deteriorating balance of payments, while the revaluation of exchange rate leads to the decreasing of export opportunities (Brzoza-Brzezina M., Jacquinot P., Kolasa M., 2010).

However, discussions in traditional style for the search of the optimal mix of policy, in which changes in the level of expenditures and taxes address the trajectory of aggregate demand, have largely ignored the issue of quality content changes in the value of government consumption and relevant objectives in revenues. Those or other expenditures to GDP can perform purely macroeconomic task, but may reflect typological features of the state on its priorities in the field of welfare and regulation. Given the fact that the costs are not flexible downwards, macroeconomic effects of budget increase (either with restrictive or expansive purpose) is not completely neutral on the structural characteristics of the public sector and government. They can be such only in a very small range of variation in the volume of budget to GDP, but then there will be issues about the ability to influence aggregate demand.

By no coincidence attention to institutional quality begins strengthened by largely functional convergence of CEE countries with the EU, during which the size of the gap in GDP redistribution through the budget is fulfilled or neglected. It is worth noting that the adequacy of institutions transplanting in the process of European integration is not convincing, especially when between formal institutions, generated in accordance with the formal process of institutional convergence and informal, that actually operate in the economy, there is a significant difference. This is empirical evidence: formal institutional convergence does not guarantee success in improving the quality of governance with positive consequences for growth. Reforms that would have affected informal institutions are more important to promote growth that most clearly demonstrated by the experience of the «Eastern Partnership» countries (Barlett W., Cuckovich N., imir Jurlin K., Nojkovich A., Popovski V., 2013). In turn, the analysis of the institutional quality impact on economic growth and growth in GDP per capita showed a mixed situation. On the one hand, before entry to the EU and beyond, there is clear evidence that the quality of institutions has a positive impact on growth and economic development. But during the global financial crisis the quality of institutions occurred in inverse relation to the magnitude of decline. The authors of this study concluded that countries with higher quality institutions were more deeply integrated with the EU and the global economy, thus more affected by the global financial crisis (Slevski T., Lazarov D., 2010). Other researchers point out that the level of institutional convergence in the new member states was not enough to make the enlarged EU looked more homogeneously in institutional terms (Rozmahel P., Kouba L., Grochova L., Najman N., 2013). In light of how the question is put in the competitiveness of the EU role in maintaining synchronization of business cycles, one could argue that if the lack of quality institutions have not compensated by other mechanisms that positively influence growth, the EU

will undertake permanent risk of divergence. Similarly, even achieving relatively high institutional quality cannot guarantee the reduction of vulnerability of the country to global stress, if it is perceived as an adequate immune from shocks and not amplified by other mechanisms that would allow to compensate gaps in factor productivity and increase revenue, i.e., to enable the process of real convergence without risk for competitiveness in the long run.

One can conclude from the last point that the inflow of capital, as evidence of a certain level of quality of institutions reached, and as an expression of the gap in returns on capital, cannot be regarded as an exceptional trait that characterizes global or European regional positioning of CEE countries. Further progress in the institutional plane and in real convergence, on the one hand, mutually enhances each other, on the other hand, the correlate of fiscal policy to mutually pressure on revenues and expenditures limited to a certain bar «scale of the state» is urgently needed. This is particularly important in light of the fact that, as noted in the above studies, CEE countries have not reached the level of quality and effectiveness of government institutions inside the EU, so the question is whether they can afford the same «scale of the state».

Conceptually, the issue raised in the theory of systems competition. Countries compete to attract production factors and tools as competition is quite different: from the cost of production factors, availability of infrastructure, to the value of the tax burden, quality of institutions, good governance (Sinn H., 2002; Sinn H., 2003; Huemer S., Scheubel B., Walch F., 2013). The proposed approach by ECB experts of institutional competition develops and formalizes the ideas systems competition theory. Institutional competition provisions how «institutional structure of society influences the various elements of the production function of the firm» (Huemer S., Scheubel B., Walch F., 2013). But its specificity relies on that it does not relate to price competition, and belongs to the plane of policy instruments available where fiscal burden, quality of governance, efficiency of regulation, investment in human capital, infrastructure, research, etc., are some of them. It is no coincidence that in the process of globalization fiscal policy appears particularly vulnerable, because the ability to increase revenues is limited by international tax competition and fiscal termites, while spending is under pressure in the direction of expansion, particularly towards investment in the quality of institutions (Wagner H., 2001; Tanzi V., 2000; Tanzi V. 2000; Tanzi V., 1998; Tanzi V., 1997).

Although, globalization is seen as a powerful factor of influence in relation to «fiscal policy – the scope of the welfare state», the dominant theoretical analysis of fiscal policy can be grouped as follows: the study of the links between reforms and deep budget role in achieving and ensuring macroeconomic stability on early stages of market transformation; identification of the role of fiscal policy in the process of ensuring the optimal trajectory of European integration and for the prevention of external vulnerability caused by massive capital inflows; diagnosing fiscal sustainability and sovereign solvency in light of the counter-cyclical

reactions in many CEE countries to the global financial crisis and adapting to post-crisis environment.

Thus, according to earlier studies, the relationship between the pace of structural reforms and fiscal prerequisites for macroeconomic stability (elimination of fiscal dominance, central bank independence, the abolition of monetization of the fiscal deficit, etc.) considered as a basic prerequisite for CEE countries to follow the liberal orientation in sphere of «state scale» and the amount of government debt (Donbrovsky M., 1999; Buiter W., 1997; Tanzi V., 2000; Brada J., 2000; Coricelli F., Dombrovski M., Kosterna U., 1997). Slight GDP redistribution through the budget, the budget balance and insignificant state debt formed a certain stereotype image of fiscal policy in CEE countries, which still remain relevant. A look at fiscal policy in the process of European integration is more functional and is addressed primarily to the issues of policy mix in terms of capital flows, the execution of the Maastricht criteria, neutralizing overheated financial sector (Koziuk V.V., 2005; Kopych R., 2004; ECB Convergence Report, 2006).

However, the global financial crisis has changed the stereotype of fiscal policy model in the region, bringing to the fore the issue of fiscal sustainability and convergence in the field of automatic stabilization that is inherent for developed countries. Rapid expansion of public debt reflected on the fact that the principle of fiscal stability holds only for Bulgaria and Estonia. Poland, Latvia and Slovenia show risks for fiscal sustainability in the long run, while Hungary was already burdened by debt. However, if the early stages of transformation of CEE countries look more homogeneously grouped in terms of focus on fiscal discipline, the global crisis was a watershed, on one side of which fiscal positions in the region look heterogeneous (Zaidi A., Rejniak M., 2010; Euro Debt Crisis Contagion in Central and Eastern Europe, 2010; Stoian A., 2012; Stoian A., Campeanu E., 2010) . We should add that enhancing the role of automatic stabilizers in the design of fiscal policy in the new member states from a functional point of view is more close to the sample of developed countries, where stabilization reaction to the budget shock is in form of increasing social welfare (though within limits of already accumulated level of public debt) . Nevertheless, the problem of communication between the degree of globalization of CEE countries and fiscal correlates of governance effectiveness is not well investigated. This is especially true for triangle «degree of globalization – the quality of government policies – fiscal position», in which choices for each of its elements should compensate or reinforce each other's action. In this article we aim to demonstrate how openness, growth of «scale of state» and the quality of institutions must compensate each other to ensure the advantages in the competition of systems. Also in the article we hypothesize that without such compensation tough competition in the global economy and the requirements of EU membership may question the ability of the economy to grow together with fiscal stability and traditional CEE sovereign risk remaining at moderate levels.

Globalization of CEE countries as a prerequisite for conflict between scale and quality of state institutions

Rapid reforms in post-socialist countries clearly changed the structure of their economies, but they cannot overcome the limitations of a small open economy. The development of the latter in the context of globalization cannot be imagined without enough significant amounts of foreign trade and capital flows, which imposes significant constraints on macroeconomic policy options. On the other hand, the level of globalization is not as clearly interpreted as a source of updating «discipline effect». We can say that most «discipline effect» undergoes segmentation depending on what policy it is addressed, and at what stage is the global liquidity. The quality of institutions plays a significant role as an expansionary policy phasing expansion of global liquidity and enabling – without explicit redistributive conflicts – the phase of compression that is an essential prerequisite for an adequate mechanism of allocation mechanism and reduce volatility in growth and inflation. The quality of institutions is also important for reasons of domestic preconditions for creating elastic reallocation of resources inside the country in response to global or sectorial shocks. For CEE countries openness is high enough through the trade channels (Table 1), which makes the overall economic dynamics extremely sensitive to how the price and institutional factors of global competitiveness compensate or complement each other.

As it can be seen from the table 1, on example of a number of CEE countries can be traced theoretically predictable patterns. First, the increase in trade openness of post-socialist countries of Europe can be considered as a direct consequence of the transformation process by which their positioning in the global economy is changing by the extent of changes in the internal structure of production and institutional organization of society. Increase of openness can be considered as an integral part of market transformation. However, comparison of data from the increase in trade openness in the Central-East or South-Eastern region of Europe or the similar indicator for the euro area, whether in developed countries or in the rest of the world indicates approximately the same dynamics. The average level of openness doubled both in CEE and in general in the global economy. That market transformation has not created additional determinants to enhance the role of international trade in the economic development of post-socialist countries than those rooted in the very process of globalization. This means that the global economy, despite the dominance of the EU in the structure of foreign trade, increasingly determine economic conditions in the analyzed region of Europe.

Table 1

Trade openness of CEE countries in comparison to other world regions, export of commodities and services, % to GDP

	1990	2000	2012
Bulgaria	24,5	36,0	65,0
Croatia	–	37,0	42,0
Czech Republic	42,0	48,0	77,0
Estonia	–	62,0	88,0
Hungary	32,0	67,0	87,0
Latvia	–	42,0	59,0
Lithuania	–	45,0	77,0
Poland	21,5	27,0	45,0
Romania	16,4	33,0	40,0
Slovakia	55,4	54,0	92,0
Slovenia	51,2	50,0	73,0
Ukraine	–	62,0	51,0
World	16,2	25,0	30,0
Low-income countries	13,8	18,0	23,0
Middle-income countries	18,3	27,0	30,0
East Asia and Pacific Region	24,4	33,0	33,0
Europe and Central Asia	14,8	35,0	42,0
Latin America and the Caribbean	12,0	20,0	24,0
Middle East and North Africa	–	30,0	-
South Asia	9,0	14,0	22,0
Sub-Saharan Africa	21,0	34,0	32,0
High-income countries	16,0	25,0	30,0
Euro area	22,5	35,0	42,0

Source: World Bank Development Indicators Data Base (www.woldbank.org)

Second, the scale of the economy in general is inversely proportional to its openness, thus, the smaller the country, so the more open it is. Despite the fact that all countries in the region are small open economies, this pattern remains, albeit with some deviation. For example, the level of openness of Latvia was abnormally low, even compared to its Baltic neighbors. The highest level of openness in Slovakia sample can be explained by success in liberalizing the economy and the transition to the euro, which opened up new opportunities for the transfer of export-oriented country in global production.

Third, the speed and depth of reforms is not a significant driver of openness increase, i. e., qualitative changes in the structure of the economy are re-

flected not only in the general index of trade openness, as in the structure of trade and its institutional level. This means that the size of the country may prevail as the determinant in role of foreign trade in the economic development over the factors of market transformations, but it is not unconditional. In other words, radical structural changes not only pave the way for the transformation of global trade role in the determination of the economic development of post-socialist countries, but also modify the inherited comparative advantage so that new sectors and sectors that have experienced deep modernization, fit into the relief of global processes in different quality institutional level, thereby becoming the path of openness for competitive pressure. While the increasing openness through a reformed institutional sectors and weak economies means the activation of favorable growth drivers that correspond with the traditional sectors of specialization and did not bring anything other than rent-seeking, conservation of the economic structure and property stratification. If one neutralizes the overheated financial factor and significant vulnerability to global capital flows, we can see that the sensitivity to fluctuations in the global economy is much higher in economy where openness is determined by the traditional low value added exported and is accompanied by weak institutions.

A more integrated assessment of CEE countries indicates that they have such level of globalization that is fully comparable with the leaders of the developed countries and countries with emerging market. KOF-index (composed of three sub-indices: economic, social and political globalization) shows that these countries do not have a high level of trade openness, but rather tightly integrated with the global economy on a wide range of connected links (table 2).

It should be noted that the comparison of openness trade levels with rating of countries analyzed by KOF-index shows a clear lack of similarity. The level of globalization is determined by the depth of reform and priority of policy on the acceptable degree of liberalization of flows of goods and capital. The size of the country and depth of reforms basically inversely correspond with the level of globalization. However, clear patterns between general index and sub-index positions cannot be traced with the difference that the level of economic globalization for post-socialist countries is higher than social and political.

Considering the absolutely comparable with developed countries level of globalization, the question arises about how the post-socialist region of Europe is moving closer to the so-called «old EU» by the criteria of public consumption scale. As already mentioned, globalization theory produces a restrictive effect on the expansion of the welfare state, and the combination of a high level of globalization with a high level of public consumption should be compensated by either high effectiveness of the latter, which is not possible without quality institutions, or the presence of other joints (deviation of the exchange rate from PPP, GDP per capita, etc.), or a combination of both in order to state the extent of activity that is corresponding with the possibilities of maintaining long-term growth in permanent strengthening of global competition.

Table 2

KOF index of globalization of CEE countries and others, 2014

	The overall index of globalization		Economic globalization		Social globalization		Political globalization	
	Place	Value	Place	Value	Place	Value	Place	Value
Hungary	9	85,91	9	86,82	23	81,08	22	91,69
Czech Republic	16	83,97	18	83,71	19	82,22	36	86,87
Slovakia	18	83,55	14	84,58	21	81,28	45	85,44
Poland	25	79,52	43	72,92	27	78,58	28	90,09
Estonia	27	79,38	7	88,04	35	73,81	72	75,43
Slovenia	29	76,86	33	76,24	39	72,67	51	83,81
Croatia	33	74,92	47	71,80	43	70,48	41	85,75
Lithuania	34	73,27	28	78,13	53	67,01	71	75,62
Romania	38	72,24	70	64,08	52	67,48	26	90,55
Bulgaria	39	71,38	36	75,54	74	58,48	48	84,37
Latvia	42	70,17	29	78,03	42	71,36	125	57,49
Ukraine	44	68,85	59	65,70	70	60,06	39	86,05
Ireland	1	92,17	2	93,69	2	91,55	25	90,94
Singapore	5	88,63	1	96,69	1	91,61	79	73,06
Sweden	7	87,39	12	85,09	14	84,41	7	94,92
Germany	26	79,47	58	65,73	15	83,71	19	92,44
US	32	74,94	87	59,19	28	77,96	18	92,47
China	72	60,50	116	50,72	92	52,42	40	85,87
Russia	56	65,42	114	51,56	59	64,77	42	85,66

Source: KOF Index of Globalization (www.globalization.kof.ethz.ch)/

Assessment of the global competitiveness of CEE countries, in turn, points to the fact that they are largely positioned as leaders. Structural reforms clearly improved the quality of institutions, but in the coordinates of global competition it is not as noticeable as other countries also carry out an active policy of improving the quality of institutions. Table 3 shows the change in the ranking of countries analyzed with the overall Global Competitiveness Index and sub-index of the quality of institutions.

Table 3

Ranking of CEE countries under the Global Competitiveness Index and sub-index of the quality of institutions

	2006–2007		2010–2011		2014–2015	
	The overall index	Sub-index	The overall index	Sub-index	The overall index	Sub-index
Bulgaria	74	105	71	114	54	111
Croatia	56	72	77	86	77	87
Czech Republic	31	55	36	72	37	76
Estonia	26	31	33	31	26	26
Hungary	38	45	52	79	60	83
Latvia	44	51	70	75	42	51
Lithuania	39	58	47	60	41	58
Poland	45	69	39	54	43	56
Romania	73	88	67	81	59	88
Slovakia	36	50	60	89	75	11
Slovenia	40	44	45	50	70	75
Sweden	9	13	2	2	10	12
Germany	7	8	5	13	5	17
Greece	61	41	83	84	81	85
US	1	20	4	40	3	30
China	34	42	27	49	28	47

Source: World Economic Forum, Davos.

According to the data in table 3, post-socialist countries of Europe do not constitute a homogeneous group neither in the coordinates for the ranking of global competitiveness, nor in respect to the ranking of quality of institutions. Similarly, their position in the ranking of the overall index and sub-index can vary greatly, as can vary the advantage in one or the other. Thus, according to the figures, for CEE countries it is difficult to compete with the most developed countries and China, that are actively filling the failure of institutional burden, although most of them are already ahead of Greece, which position was significantly shaken lately. In other words, even in the competitive world, active reforms do not guarantee receipt of unambiguous and fast advantages reaching, which is shown in the data of Table 4. Of course, the answer to the question on how to improve the ranking of global competitiveness will be addressed by the question of the relationship between fiscal policy and efficient governance through «the cost of maintaining the state» become institutional, but not macroeconomic feature.

Fiscal vulnerability of gap in institutional and real convergence

Despite the fact that the Laffer's point is another for different groups of countries, look at the «Old» and «new EU» from the standpoint of the state burden on the economy should take into account the effects of real convergence. If a country, which is in the early stages of real convergence, wants to continue to grow faster than countries with higher per capita income, it should be different from the latter, including the level of tax burden, which automatically affects the capacity of government spending (Bini Smaghi L., 2011). At a time when these countries are in economic (especially currency) union, rapid real convergence, especially if it is accompanied by discontinuities in the convergence of the quality of institutions, can lead to accumulation of significant imbalances and sovereign vulnerability when the extent of public consumption in both countries groups is aligned. It is no coincidence that the stereotype of the early period of transformation – CEE countries must maintain low levels of GDP redistribution through the budget and focus on low deficits and public debt – needs to be reviewed in the light of empirical data on shifts in fiscal positions of post-socialist countries (Table 4).

Table 4

Government expenditures in CEE countries, % of GDP

	2006	2008	2010	2012	2014	2018
Bulgaria	33,6	35,2	36,6	34,9	37,4	38,1
Czech Republic	42,0	41,1	43,7	45,1	43,3	42,6
Estonia	34,6	41,2	44,7	45,1	43,1	41,6
Hungary	52,2	49,2	49,8	48,9	51,7	51,2
Latvia	36,7	43,1	43,4	36,9	34,7	30,4
Lithuania	33,7	37,3	41,9	36,8	35,8	33,9
Poland	43,9	43,2	45,4	43,3	41,6	40,0
Romania	33,7	37,0	38,6	35,4	35,9	35,0
Slovakia	29,5	33,6	40,0	37,1	35,9	35,6
Slovenia	42,5	41,5	46,9	45,5	47,1	45,9
Ukraine	44,6	47,4	49,0	49,3	46,9	41,9
Developed countries	39,1	41,1	43,8	42,5	41,8	40,7
Euro area	46,6	47,2	51,0	49,8	49,2	47,6
Emerging market economies	26,9	28,5	29,6	29,7	29,1	27,7
European emerging market economies	34,8	36,8	38,8	37,5	37,1	35,4

Source: IMF Fiscal Monitor (www.imf.org).

As we can see from Table 4, post-socialist European countries in terms of the state burden on the economy is much closer to the developed European countries than the countries with emerging market. On the one hand, it indicates that the «old» and «new» EU functionally converge. On the other hand, the combination of real convergence with fulfilling the gap in GDP redistribution through the budget between the two groups of countries can generate additional risks for long-term growth. Note that the largest economies of the CEE, which is also characterized by a high GDP per capita, with the exception of Slovakia, have the values of public spending that is fully equivalent to the developed countries of Europe and higher than the average for developed countries. Estonia has greatly converged with this group of countries, while only Slovakia, Latvia, Lithuania, Bulgaria and Romania continue to practice the principles of «moderate states». If we take into account the forecasted data on general government expenditure to GDP, we can see there are some restrictions on further expansion of the state. The global financial crisis has caused a need to increase public spending, but the possibility of keeping it in the long run is unlikely for most CEE countries, and eventually for developed countries.

As confirmation that the CEE countries are more redistributive through the budget needs further clarification based on data of the budget deficit and public debt (Table 5).

The most common trend in the debt burden growth in CEE is that in the context of individual countries public debt increase significantly ahead of the one that emerged in countries with emerging markets in general and in European countries with emerging markets. As can be seen from the Table 6, Hungary and Slovenia have crossed the mark of 60% debt to GDP; most countries are exposed to a risk that they can cross it. It is obvious that the stereotype that states post-communist countries of Europe to maintain low levels of debt burden has been destroyed.

Data in Table 5 indicates the number of change patterns in positioning of the debt situation in the CEE countries compared to developed countries and countries with emerging market. First, in 2006, with the exception of Poland and Hungary, the level of public debt to GDP of these countries were much closer to the countries with emerging market as to a whole group. The situation has changed since 2008, when most of the CEE countries have begun to show signs of behavior that significantly bring them closer to developed countries. Secondly, the increase in public debt during the crisis and after it, as well as long-term trend changes in the level of debt burden significantly bring CEE countries towards developed countries. Although the level of debt will remain on the low mark, but the magnitude of the expected decline in the long run is much smaller than in the case of countries with emerging market as a group. Third, opportunities to expand the budget deficit during the crisis and maintain its moderate level after also are higher than it is actual for the group of countries with emerging market in a whole.

Table 5

The budget deficit and public debt in CEE, % of GDP

	2006	2008	2010	2012	2014	2018
Budget deficit («–» – means proficit)						
Developed countries	1,3	3,5	7,7	5,9	3,6	2,2
Euro area	1,3	2,1	6,2	3,7	2,5	0,8
Emerging markets countries	–0,3	0,1	3,1	2,1	2,5	1,6
European emerging markets countries	–2,5	–0,5	4,1	0,7	1,2	1,7
Estonia	–3,2	2,3	–0,4	0,2	–0,2	–0,1
Latvia	0,5	7,5	7,3	–0,1	0,5	0,3
Lithuania	0,4	3,3	7,2	3,3	2,7	2,3
Poland	3,6	3,7	7,9	3,9	3,4	2,4
Hungary	9,4	3,7	4,4	2,0	2,8	2,8
Czech Republic	2,4	2,2	4,8	4,4	2,9	2,4
Slovakia	2,6	2,0	7,7	4,3	3,8	3,2
Slovenia	0,8	0,3	5,4	3,2	3,8	2,4
Romania	1,4	4,8	6,4	2,5	2	1,8
Bulgaria	–3,3	–2,9	4	0,5	1,7	0
Public debt						
Developed countries	75,8	80,4	100,3	108,7	109,2	105,1
Euro area	68,6	70,3	85,7	93,0	96,1	89,9
Emerging markets countries	36,9	33,5	40,3	36,5	34,1	30,3
European emerging markets countries	26,4	23,6	29,1	26,9	27,5	26,9
Estonia	4,4	4,5	6,7	9,7	10,4	8,1
Latvia	9,9	17,2	39,7	36,4	34,6	26,4
Lithuania	17,9	15,5	38,4	41,1	42,3	41,6
Poland	47,7	47,1	54,8	55,6	50,0	49,9
Hungary	65,9	73,0	81,8	79,2	80,0	78,8
Czech Republic	28,3	28,7	37,9	45,9	48,9	50,4
Slovakia	30,5	27,9	41,0	52,1	57,5	59,1
Slovenia	26,4	22,0	38,7	52,8	75,3	77,8
Romania	12,6	13,6	31,1	38,2	38,1	36,2
Bulgaria	23,4	15,5	14,9	17,6	19,0	17,2

Source: IMF Fiscal Monitor (www.imf.org.).

These trends demonstrate the occurrence of specific situations where CEE countries reproduce patterns of fiscal policy in developed countries, especially the euro area, but at a lower level of debt burden. In other words, the transition to higher levels of debt burden is conducted in cascade form. Central and Eastern Europe is catching up to the scale of public debt accumulation of EU countries that were inherent in the process of fiscal convergence in the early phase of EMU. Thus, the first demonstrate more varied picture, indicating that structural features of each of them in conjunction with the nuances of the impact of the global financial crisis and the appropriate profile anti-crisis programs are beginning to play a more important role in the differentiation of fiscal macro strategies compared to earlier periods of market transformations, when such differentiation was determined by the pace of reforms.

The combination of data on public consumption and public debt shows that the CEE countries change their positioning in the frame of typological features of the state fiscal measurement of its activity. This also means that the explanation for these changes underlie in the frame of the structural changes and not in the frame of optimal fiscal policy options. Despite the fact that a significant number of works persuade that fiscal restriction within selecting the optimal policy mix is winning strategy (see above), the data in Table 4–5 proves the opposite: CEE countries moved to the position of the state with larger scale of government burden both in terms of expenditures and in terms of public debt, and thus lose the uniformity as a group, previously combined by post-socialist past and the early stage of market transformation.

The optimal choice between tax and debt financing of public activity becomes the traditional focus of fiscal policy analysis. However, neither from the positions of so-called optimal taxation, nor from the standpoint of building stabilization policy, we cannot see complications of typological mosaic «state» in which the combination of certain levels of GDP redistribution through the budget and debt to GDP reflects not much the actual «best fiscal option», as strong institutional component, social preferences, fiscal opportunism, etc. (Table 6). Also, a combination of variables on specified levels sufficiently demonstrates excellent position in the coordinates of economic development, adapting to shocks, macro-financial vulnerabilities, etc.

In the light of theoretical map, on which typological features of the state are positioned depending on the extent of the budget and public debt (Table 6), and according to the data on the Tables 4–5, one can see quite risky development trajectory of CEE countries. Despite the fact that after the global financial crisis, they have lost the homogeneity of fiscal positions, trend show us the movement toward higher volumes of state activity. The significant growth of public debt in these countries, as shown above, has signs of threats to sovereign solvency. The actual displacement from the quadrant, that is represented as a low fiscal pressure and moderate debt (out of band of macro stabilization transformation period), into the quadrant which is characterized by a high «scale of state» and the debt burden.

Table 6

Types of «scale of state» and macrofiscal vulnerability in relation to the size of GDP redistribution through the budget and public debt

		The public debt / GDP	
		Low	High
Redistribution of GDP through the budget (taxes, expenditures / GDP)	Low	«Minimum state» with unlimited sovereign solvency. A favorable situation for countries seeking to develop fast and minimize macro-fiscal risks. Vulnerability: In case of strong shock, opportunities to finance growing expenditures may be under doubt due to stereotype of efficiency of low taxes and minimal costs.	«The state is expanding in debt.» The advantage of the tax financing over debt financing. The positive option creates a favorable basis for rapid economic growth through low taxation and a significant investment in infrastructure (or liberal orientation state or gain on development). The negative aspect. Weak institutions cannot effectively collect taxes, while spending is growing under influence of groups. Vulnerability: High macro-fiscal vulnerability. Strong shock may undermine sovereign solvency despite the fact that the ability to collect taxes remains in doubt because of institutionalization, low taxation.
	High	«Responsible welfare state.» A high level of social security is balanced by minimizing macro fiscal risks. This is possible in an environment of high quality of institutions and self-responsibility of citizens in the democratic process. Vulnerability: High sensitivity to the quality of institutions. Opportunities to respond to strong shocks of real wages are limited.	Option A: «Expansionary welfare state» or «welfare state with social security bubble.» Permanent pressure on fiscal expenditure increases the burden of public debt. High sensitivity to cost efficiency and quality of institutions. Vulnerability: automatic stabilization efficiency is low. Expansionary stabilization may not be trustworthy. Risks of sovereign solvency. Option B: «Leviathan state with weak institutions,» as a result of dictate of the elite / oligarchy, there is a large-size redistribution of GDP through fiscal pressure, which is excessive for the representative economic agents, thus redistributive appetites satisfied by increased debt. Vulnerability: High macro-fiscal risks. Development is possible in terms of traditional exports

Note: own work.

This displacement is conducted at the background of a high level of openness and real convergence. This means that the sensitivity to global competitive pressures the more will rise, the greater per unit of GDP per capita will account current and pending government consumption. In other words, in the global competitive environment the possibilities to match the real convergence with economic development require a situation, where volumes of state activity are high enough, which, as noted, already corresponds to the level of developed European countries, should be compensated through quality institutions.

The scale of state, globalization and problems of institutional compensators

In itself institutional convergence is extremely necessary. However, as mentioned above, the CEE countries have lag behind the EU average in institutional quality, but close to the average indicator of expenditure to GDP and partly debt to GDP. The difference in wages will for a long time allow growing faster than developed countries, but stable real convergence will require additional efforts. In case, when the fiscal incentives of real convergence in the form of a low state activity will be spent, and the growth of public debt will raise the risk of sovereign solvency, CEE countries will find themselves in a difficult situation. Either the real convergence should be more gradual, or the institutional convergence more accelerated. However, the theory has not been fully elucidated issues whether improving of the quality of institutions sensitive to fiscal limits, or it has endogenous nature. In the first case, institutional convergence becomes limited to collect taxes and fiscal space. In the second – is extremely sensitive to social capital. In both cases, the higher will be the amount of state activity, the more sensitive will be economic growth to the extent of how allocation efficiency of public consumption would be dependent on quality of institutions, or in a narrower sense – the effectiveness of government spending.

It follows with a very important connection between what is the effectiveness of public spending, or in a broader sense the effectiveness of governance, and the «value of the state». We can assume that the effectiveness of governance cannot be related to the magnitude of the state activity, in which the typological features of the welfare state underlies. However, in the case of CEE countries it has crucial importance.

First, for reasons of systems competition and international tax competition, attractiveness of production factors will shift to those countries that can immediately combine high quality institutions and, consequently, the high effectiveness of the government, with low state activity. Naturally, this is the theoretical maxima. This does not mean that countries with high GDP redistribution through

the budget immediately find themselves in a worse situation. The quality of institutions compensates tax burden. Also, these countries are generally characterized by a number of specific characteristics. The phenomenon of Nordic Model (conventional expression in world literature, which means not fully successful translation – «Nordic Model», which in Soviet literature often referred to as a «Scandinavian model») is a clear indication of this (The Nordic Way, 2012). Although, for countries that are in the process of institutional convergence, but not reached a level of quality of institutions of neighboring countries, the absence of such a compensator tax burden as quality institutions requires either slowdown in GDP per capita (gradual real convergence), or reject from the course of the PPP downwards, it is hardly possible from the point of the continuing inflow of capital and the introduction of the euro in some of them.

Second, in the light of the experience of post-socialist, it is hardly to expect that improving the quality of institutions is exclusively the result of endogenous growth in the value of social capital. In other words, the institutional quality needs investment. In light of the fact that improving the effectiveness of governance of countries that are in the process of real convergence is impossible without additional pressure towards the expansion of government spending, while slowdown of «expansion of the state» and institutional convergence may appear to be contradictive goals. In addition to significant needs for upgrade of deteriorating infrastructure and the age structure of population, the pressure for upward spending looks natural. If we take into account the worsening debt position in most CEE countries, the data trend can be described as inter temporal optimization: improvement the «quality of state» now (particularly in debt) for higher efficiency state (and therefore for tax solvency) tomorrow. But the closer the content of the fiscal strategy meets features of this optimization, the more sensitive will be the future growth and global competitiveness to succeed in the field of institutional convergence. Considering the risk of fiscal populism and opportunism, political environment cannot guarantee the expected movement in the direction of «effective state», but only for indeed very high cost of social capital that will show a clear understanding of the necessity of rational choice in favor of improving the effectiveness of government.

Third, membership of CEE countries in the EU affects the choice of profile institutional convergence at least on grounds of the so-called «common policy», «common values» and so on require additional expenditures, which compete with investments in the quality of institutions. Induced buildup of investment in the quality of institutions and, consequently, improvement of the effectiveness of government may look quite restricted on grounds of harder budget constraints and limits related to social capital, at least those aspects of it, which are responsible for removing the «institutional incorrect behavior» of the authorities. High transparency within the EU also imposes a corresponding impact on the choice of the optimal trajectory «expansion of the state» in the new member states. Membership in the EU does not eliminate global competitive pressures, rather enhances it. Achieving higher quality institutions

and lower levels of «burden of the state» in such circumstances can be considered as adequate compensators of global competitive pressures, but membership in the EU on the one hand, accelerates positive institutional changes, on the other – complicates political and economic choices about how to combine the right functional, institutional and real convergence at lower trajectory of «expansion of the state» in comparison with the old EU members.

Fourth, the effectiveness of government is the satisfaction of citizens by socio-political continuum in which they are located. One can see a direct relationship between the effectiveness of the government and the level of democracy, fundamental result of which is political stability and social trust. The level of social trust in CEE countries is almost 2 times lower that the level of social trust in the countries of Nordic Model and almost 1.5 times than continental EU (The Nordic way, 2012). In addition, the level of social trust has a direct economic correlative – the cumulative magnitude of transaction costs in the economy, which directly determines the degree of satisfaction of corporate institutions and political and administrative institutions of democracy. At the higher level of «the burden of the state», dissatisfaction with government and political model of society leads to marginalization, which significantly reduces the social base of the formation of political coalitions oriented towards responsible reforms. In the case of CEE countries in which «democracies qualified as young ones», the lack of social consensus due to a gap in the perception of government effectiveness and value of the tax burden may impair the ability to continue reforms aimed at long term.

To identify the links between risk of distortion of GDP redistribution through the budget and effectiveness of the government, we should conduct a theoretical analysis of the options, in which we will combine high and low values of the parameters that will help us to interpret empirical data. Table 7 shows the correspondence between the theoretical explication of «scale of state» and the government effectiveness.

One can suggest that presented in the table 7 maxims do not take into account a wide palette of intermediate options, so that even countries with similar parameters of «public burden» and the quality of institutions can demonstrate significant differences both in terms of economic growth and in adapting to global competitive pressures. However, as one should theoretically assume that even with increasing variability of CEE countries in terms of their fiscal strategies (as mentioned above), it should not be ruled out that their trajectory of institutional development should be close together, because EU membership requires appropriate reforms and compliance standards, though not exclude sufficient institutional differences. In other words, in light of the fact that the EU itself is enough varying in terms of institutional quality and, accordingly, good governance, CEE countries for a long time can be in the soft institutional convergence, in which the result will vary much more, than content of political and economic steps in the institutional convergence. It is no coincidence that this could be explained that the new EU members do not make convergence more homogeneous in institutional terms, as shown in empirical research (Rozmahel P., Kouba L., Grochova L., Najman N., 2013).

Table 7

Options «scale of state» and the government effectiveness: theoretical analysis

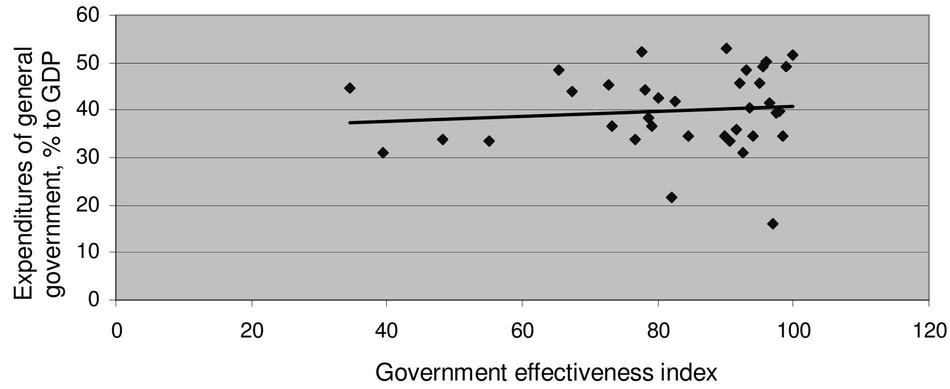
		Government effectiveness	
		Low	High
Expenditures of the general government to GDP	Low	A typical example of «poor country» in which the ability to collect taxes is low, and the yield on the debt markets is limited. Institutional weakness constrains opportunities to increase well-being in terms of the functioning of public finances and improvement of the effectiveness of government. Potential economic growth is low and rely on traditional exports	A typical example of a liberal economy with strong institutions. The combination of a high taxation and moderate «public burden» with the effectiveness of government creates conditions for increasing economic growth potential and welfare
	High	Typologically reflects clan-redistributive state. Significant tax burden put on people who cannot minimize it, and is intended to fund significant expenditures that are a financed through rent seeking. Institutional weakness combined with the «privatization institutions», in which the latter becomes repressive. Potential growth may be high (as the country shows a significant tax collection potential), but depressed and biased towards traditional exports	A typical example of the welfare state, in which a high level of «public burden» is compensated by institutional quality. Effectiveness of government is the direct source of well-being of citizens and their satisfaction with life in the light of significant proportions of GDP redistribution through the budget. Potential growth is moderate to high-income countries

Extrapolation of theoretical analysis (table 7) on empirical data (Figures 1–4) shows that in the case of the CEE countries one can find the same pattern observed in relationship between public spending and government effectiveness. It is true in the case of a larger sample, but with a number of differences.

Based on data of 36 European countries, adding the US, Canada, Australia, Japan, Hong Kong, New Zealand (Figures 1–2) and on data of 12 post-socialist countries (Figure 3–4), we can identify a number of patterns.

Figure 1

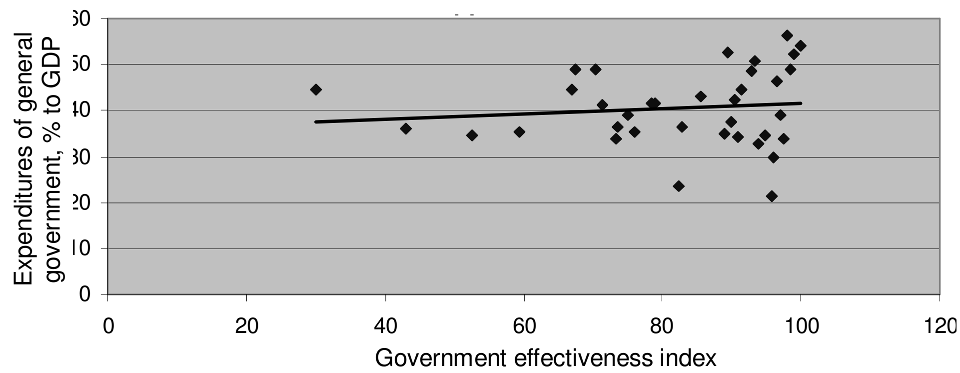
Index of government effectiveness and government expenditures, 2006



Source: data on expenditures– IMF Fiscal Monitor (www.imf.org), data on index of government effectiveness – World Bank (www.worldbank.org).

Figure 2

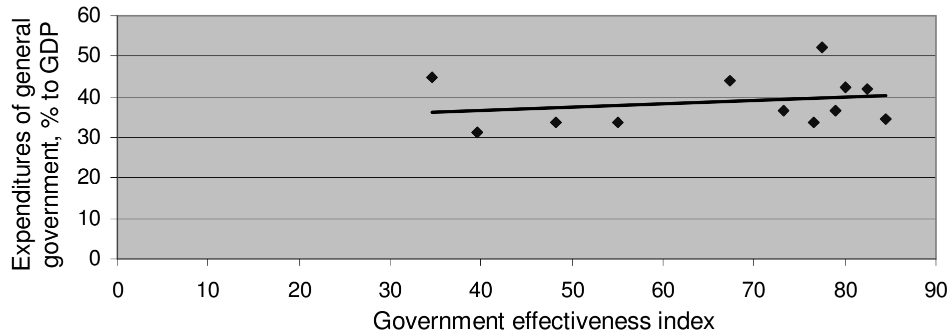
Index of government effectiveness and government expenditures, 2013–2014



Source: data on expenditures– IMF Fiscal Monitor (www.imf.org), data on index of government effectiveness – World Bank (www.worldbank.org).

Figure 3

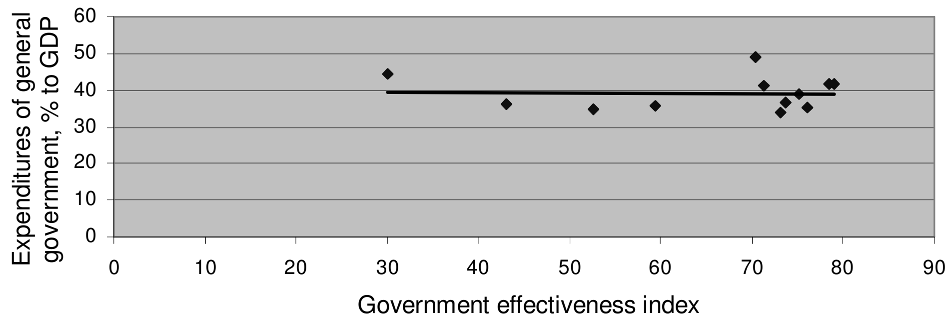
Index of government effectiveness and government expenditures in post-socialist countries, 2006



Source: data on expenditures– IMF Fiscal Monitor (www.imf.org), data on index of government effectiveness – World Bank (www.worldbank.org).

Figure 4

Index of government effectiveness and government expenditures in post-socialist countries, 2013–2014



Source: data on expenditures– IMF Fiscal Monitor (www.imf.org), data on index of government effectiveness – World Bank (www.worldbank.org).

First, from 2006 to 2014 years, there is no definite progress towards improving the quality of governance in all countries. In this case, during the specified period there was an unambiguous convergence by the criterion of the effectiveness of government, especially those for which value is above average. This equally applies to the entire sample (Figures 1–2) and to post-socialist countries (Figures 3–4).

Second, the example of the whole sample shows that there is a correspondence between the increase of «scale of state» and increase of government effectiveness, which indicates the overall institutional progress in most developed countries. Also, the example of the whole sample shows that countries with expenditures to GDP below trend line, defined by regression function, also demonstrate bias toward higher government effectiveness. This implies a clear conclusion that heterogeneity regarding typological features of the state (by the principle of opposing, welfare state – liberal state), a measurement of which is the level of public expenditure, is preserved, if not amplified, and homogeneity concerning the demand for better institutions and efficient governance is growing. This pattern can be explained by the growing importance of ensuring the effectiveness of government spending unit under pressure from the international tax competition and globalization. In particular, society may agree to «more power» in exchange for its effectiveness, while others seek to ensure social mix «small state» with high-quality institutions.

Third, post-socialist countries do not show a radical switch from one quadrant connection between «scale of state» and the quality of governance in other quadrant, except Estonia and the Czech Republic, which reversed (Table 8), and, in fact, assure a clear division between leaders and outsiders. Ukraine, unfortunately, represents a situation where public spending is above the trend, while the quality of governance is the worst. Moreover, for the period from 2006 to 2013 the latter figure has declined. At the same time, new member states mostly were able to improve the quality of governance and slow the growth of GDP redistribution through the budget. Attention is drawn to the fact that, according to Figure 4, communication is no longer direct as in previous cases, but is the reverse, though with meager angle (unallocated regression equation on the graph confirms the tilting line approximation). This means that CEE countries are seeking to combine better institutions with at least not growing «scale of state». Also it shows the division to outsiders (Ukraine, Russia, Bulgaria and Romania) and leaders (Estonia, Latvia, Lithuania, Poland, Hungary, Czech Republic, Slovenia, Slovakia), among post-socialist countries situation is hidden, where outsiders preserve heterogeneity and leaders tend to homogeneity. Thus, among the outsiders only one country (Ukraine) has a level of public expenditure to GDP above trend, and the effectiveness of government – below the trend value in the respective index, while three others countries show lower value in the first indicator. Among the leaders at the general convergence, the quality of governance is approximately equally divides countries, where above average index of govern-

ment effectiveness and a corresponding as with higher, as with lower than the trend values «scale of state». However, the increasing homogeneity among leaders and a number of positive developments in Romania and Bulgaria do not mean that the correspondence will take place on the basis of a direct link between the increase in effectiveness of government spending and the amount at its disposal. The problem is just that the movement of both indicators can be multidirectional or unidirectional.

Table 8

The position of post-socialist countries on options of combination of «scale of state» and good governance

<table>
<tr><td colspan="2" rowspan="2"></td><td colspan="2">Good governance index, 2006</td><td colspan="2">Good governance index, 2013</td><td colspan="2" rowspan="2"></td></tr>
<tr><td>Below trend (< 60)</td><td>Above trend (> 60)</td><td>Below trend (< 60)</td><td>Above trend (> 60)</td></tr>
<tr><td rowspan="2">Expenditures of the general government, % of GDP in 2006</td><td>Below trend (< 40%)</td><td>Russia, Romania, Bulgaria</td><td>Estonia, Latvia, Lithuania, Slovakia</td><td>Russia, Romania, Bulgaria</td><td>Czech Republic, Latvia, Lithuania, Slovakia</td><td>Below trend (< 40%)</td><td rowspan="2">Expenditures of the general government, % of GDP in 2014</td></tr>
<tr><td>Above trend (> 40%)</td><td>Ukraine</td><td>Hungary, Poland, Czech Republic, Slovenia</td><td>Ukraine</td><td>Estonia Hungary, Poland, Slovenia</td><td>Above trend (> 40%)</td></tr>
</table>

Note: grouped by author based on figures 3–4.

Fourth, as it can be seen from the table 9, the pace of European integration should be qualified as a powerful driver of institutional reforms that uniquely affect the general trend to improve the effectiveness of government. Figures 3–4 and table 8 indicate the existence of a significant gap not only on indicators of «public burden» between the first wave of post-socialist countries joining the EU and the rest, but on the index of effectiveness of the government. That is about the same size redistributing GDP in post-socialist countries, which differs from developed countries where the variation of this indicator is much higher, the first ones demonstrate a significant difference in the effectiveness of government. How fast country joins the EU becomes a differentiation criterion. Also, with the exception of Poland and Bulgaria, we can see that the level of globalization af-

fects the differences in the effectiveness of government: the more globalized countries, the better position of the index they have.

Fifth, the stage of real convergence and scale of economy form a given pressure towards higher level of «public burden», even if the change in position of Estonia and the Czech Republic is difficult to explain on this basis. The choice of small economies in favor of lower levels of «public burden» can be explained solely for reasons of their higher vulnerability to global shocks and international tax competition, which is an additional factor in their desire to improve the quality of institutions. Higher levels of spending in the larger countries can be explained by the fact that the market capacity allows them to maintain a higher level of tax collection, and the depth of the financial sector – look more fiscally stable in a role of borrowers, so these countries may find themselves in gap between the quality of institutions and «consumption volume» compared with Western neighbors. Phase of convergence is also important. Higher levels governance effectiveness is the case in countries with higher GDP per capita, regardless of which group they belong for in terms of «public burden» size. Thus, when a «poor country» tends to spend a lot of public funds for the low effectiveness of government, the result will look negatively compared with countries that are richer, have better institutions and thus less exposed with «scale of state». We can definitely say that the combination of significant «scale of state» and low effectiveness of government determines the low levels of per capita GDP, because this combination underlies in nothing but clan-redistributive model of oligarchic economy that reproduces unequal income distribution, minimizes the role of democratic institutions that ensure political and economic progress, and thus makes it impossible to improve the effectiveness of government because authorities «privatized» as part of rent seeking behavior and shifting the tax burden. While the countries that search for better institutions, ensure a higher level of well-being, which later became the basis for subsequent investment in improving the quality of institutions. In these countries, «scale of state» will be increasingly determined by social preferences, albeit with restrictions, the nature of which is related to vulnerability to globalization.

The benefits of a more moderate tax revenue compared with the developed European countries in terms of global competitiveness is not crucial if we take into account the trend towards increasing labor costs and business expenses to pay social tax. The deterioration of the demographic structure in the post-socialist countries, although not to the extent as it is in the countries of «old EU», but does not contribute to the formation of the prerequisites for reducing the burden of social taxes. This clearly means that the effectiveness of public authorities in terms of «investment in quality institutions» increasingly depend on how the processes of real convergence and optimization of the tax burden will be combined. But it also means that the combination of both processes is possible only through structural changes that rely on the quality of institutions. That is effectiveness of the government should be endogenous in order to long-term eco-

nomic development to rely on the powerful compensators of growing «scale of state», which effectiveness has not yet reached the level of the main partner countries, and not had suffered to the limits of global competition pressure.

Conclusions

In the specific conditions in which post-socialist countries find themselves (real convergence, costs associated with EU membership, vulnerability to global shocks, the gap between government performance compared to the old member states equal level of «public burden», etc.), focus on further increasing of the share of GDP redistribution through public spending is risky. Following rigid requirements of EU membership and the global competitive pressure enhance the demand for compensators in form of growing need for redistributive activities of the state, so that real convergence could take place in a gradual exhaustion of the advantage of cheaper labor. Improving the quality of institutions and their more concrete expression – the effectiveness of governance – is one of these compensators. The choice in favor of «greater state activity» is theoretically possible when it is combined with the high effectiveness of the government. However, in the case of the CEE countries, where there is a gap in the quality of institutions with major trading partners, even improving the effectiveness of government should not be accompanied by a rise in the relative values of public spending due to the need of launch into action pressure compensators of globalization on processes of real convergence. The growth of public debt in many CEE countries is indirect evidence of how difficult it is to maintain moderate taxation in times of growing «investment in the quality of institutions». On the other hand, endogenous improvement of the quality of institutions, based on the increasing value of social capital, should be seen as the preferred option for good governance practice.

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