

## TWO PARADIGMS OF ECONOMIC DEVELOPMENT IN CEE COUNTRIES

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*The direction of economic development depends on the paradigmatic framework in which economic reality is perceived. In the framework of holistic paradigm also public and not only private goods are understood as economic goods. Correspondingly, the public sector is enclosed into economy. The individualistic approach presupposes reduction of economic reality to market and overtly or covertly negative attitude towards public sector as non-economic. The phenomenon of reflexivity is present here. Methodological holism and methodological individualism give birth to different strategies of economic policy and finally lead to different outcomes of economic development.*

*Keywords: paradigms, holism, individualism, private sector, public sector, economic development*

### **The Concept of “Economy” in the light of two competing paradigms**

By the paradigm we understand the metatheory, methodology, and “philosophy” which provide the widest possible framework for a set of theories, doctrines proved and/or believed in and which provide the whole panorama of different aspects of the world. In other words, a paradigm is “a screen” or a lens through which we perceive one or another aspect of reality. This “screen” could be more or less reliable or distorted, misty. A purely scientific, ideal paradigm should provide an exact picture of reality, but in reality pure science does not exist. It is mixed with our ideological and other beliefs and common sense.

There are two competing paradigms in both natural and social science-methodological ato-

mism (in social science-individualism) and methodological holism. The first is based on the premise that it is enough to understand the characteristics of an elementary part of reality to have a correct picture of this reality. In social science, the role of this elementary particle (part) belongs to a separate, self-interested rational individual (*homo oeconomicus*).

Holism in social science argues against the reduction of reality to the sum of individuals. It maintains that social reality is organised hierarchically (individual – family – community – global society), that the effect of synergy could be present in social activities.

One of the leading figures in the individualistic movement was Ludwig von Mises. He argued that in the holistic approach “society is an entity living its own life, independent of and separate from the lives of the various indivi-

duals, acting on its own behalf and aiming at its own ends which are different from the ends sought by the individuals. Then, of course, an antagonism between the aims of society and those of its members can emerge. In order to safeguard the flowering and further development of society, it becomes necessary to master the selfishness of the individuals and to compel them to sacrifice their egoistic designs to the benefit of society” [7].<sup>1</sup>

There are at least two weak points in this individualistic position. Firstly, even in the most collectivistic societies or communities like the tribes of our ancestors or kibbutzes in modern Israel, one can talk only about the relative independence of the collective (communal) dimension of human life from the individual one. Secondly, only in totalitarian societies coercive methods of implementation, imposition of “common” interests is prevailing. That is why in democratic society it is more appropriate to talk about differences rather than antagonism between individual and common interests and about the combination and accommodation of these interests through the political (and bargaining) regimes. Thirdly, Mises’s position implies that the individual is free from his/her social environment and that he/she is a creation of him/herself. This is a misunderstanding similar to the notion of sociality totally independent of the individual.

True, pure science serves the truth, not the power or material gains. It would base its knowledge on explicit, well-proved assumptions (premises). It would be open, critical and self-critical – ready to admit former mistakes and

blunders. Scientific knowledge would use clearly defined concepts. These concepts, together with a tightly knit system of postulates, would comprise the doctrine or theory. Theories would be organised into paradigms. Natural sciences in this respect could be a helpful example to economists and representatives of other social sciences.

With a small amount of so-called implicit pre-analytical (self-evident, taken by belief) basic assumptions, with a well-developed conceptual apparatus, with an elaborate system of methods and procedures natural science provides the epistemic community and society as a whole with quite a good panorama of the natural world. That is why these sciences are called “hard”.

If economic science is eager to prove its status of a “hard” science or at least “hardest” discipline among social disciplines, it should comply to the same requirements of open-endedness, conceptual and paradigmatic, methodological order, axiomatic discipline.<sup>2</sup>

Regrettably, our discipline suffers from the lack of *hardness* and excesses of *softness*. We, economists, disagree on most of basic assumptions of our scientific investigations. Moreover, the disagreeing parties (groups) do not communicate. Instead of investigating the arguments of opponents, in most cases they simply ignore them, closing themselves in the *intramural* discussion isolated from the outside criticism. That isolation from outsiders allows

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<sup>1</sup> There are followers of Mises in Lithuania. They claim that such holistic, collectivistic concepts as nation, state are purely mental constructs which exist only in the minds of institutionalists, functionalists, organicists and other holists [3].

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<sup>2</sup> Some methodologists assert that the most prominent economic theories suffer from the lack of paradigmatic order. For instance, S.C. Dows maintains: “Mainstream economics has evolved virtually independently of explicit methodological analysis” [4, p.73]. That means that the very importance of paradigmatic exploration is undervalued. On the other hand, as S. Rosen says, debates about methodology (or paradigm – P.G.) have opportunity costs. Most of economists prefer practical research to methodology Fall, 1997, [8, p. 150].

these groups to keep the ostensible consistency of the theories (doctrines) promoted by these closed groups but makes processes non-scientific, or even antiscientific; thus, not the search for truth but the drive for influence is the main motive of the process.

These elements are present in natural science as well, but the extent of this detraction from the search for truth is considerably smaller.

A proof of the “softness” of economic science is the appalling negligence of the importance of the *concept of economy*. For several decades from the beginning of our personal scientific career we are surprised and shocked at how easily most economists take this concept for granted as self-evident. They behave as if the concept is very simple and does not require special scientific efforts to understand it. But firstly, in our view, it is not that simple, and secondly, this concept is of fundamental importance, because it defines the boundaries of economic *thinking* and economic *actions*. A different understanding of what economy is implies a different economic worldview (paradigm) and concomitantly different economic policy conclusions, different economic strategies for the individual or society as a whole, and

finally different outcomes of implementation of these strategies<sup>3</sup>.

Many economists mostly implicitly, without a proper investigation approach the problem and hold that “economy” and “market” are synonyms. If so, all non-market factors are or should be excluded from economic investigations as exogenous. In this case, for instance, budget as a non-market regime logically would fall out of the economic domain. That is the individualistic approach.

Practically, this is the case with the whole public sector, which at best could be included into economic analysis only as a *burden* to economy. This “economy equals market” approach does not recognise the existence of public goods or reduces their diversity to national security, lighthouse<sup>4</sup> and several other items. It is a logical consequence of such an understanding of the basic concept of our science. If economy means market and market produces private goods, then naturally economic science shouldn’t bother itself too much with exogenous phenomena like public goods.

This would be consistent view, if some “outsiders” wouldn’t challenge it by asking what the place all in all is left for public goods. By many economists they are implicitly treated as *free goods*. The famous saying “there is no such thing as free a lunch” should support such a perception. In reality, public goods belong to the group of *economic not free goods*, because they are produced using limited, scarce resources.

But if public goods are economic goods, then they deserve an appropriate place in the system of economic concepts. However, it is

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<sup>3</sup> One has to keep in mind the phenomena of *reflexiveness* characteristic of social life (Are you here referring to the concept of ‘reflexiveness’ as used by Anthony Giddens?). Social knowledge is a reflection of realities of our life. But this reflection in turn can influence the very reality. In other words, individuals and social entities can change reality according to their understanding of the world. Our knowledge (everyday or scientific), our visions, programmes, plans or prophecies change social reality. The Marxist understanding finally gave birth to the Soviet experiment – a costly deviation from the normal course of history. Some people say that the individualistic approach threatens the very foundations of modern society and could turn into an even greater disaster than the Soviet system or fascist Germany.

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<sup>4</sup> In our country until recently the term *public good* was almost absent in the public economic discourse. On the other hand, in the economic courses delivered at our universities this concept is, though modestly, presented to our students.

in contradiction with the position according to which market and economy are synonymous terms. The market is not destined to supply public goods, its mission is production of private goods. If so, logically, there is no place for public goods in the conceptual kit of economic science.

We face here a clear antinomy. On the one side, public goods as being produced in the conditions of scarcity are economic, not free goods and should belong to the system of economic concepts, on the other – public goods fall out of the sphere of economic reality, because the market which encompasses economy does not provide these goods. This antinomy could be hardly resolved in the framework of the above-presented individualistic worldview.

There exists an alternative holistic approach towards the problem of the definition of “economy”, which allows us to avoid the antinomy mentioned above. The basic assumption of this approach would be that economy is the aspect of social reality that reflects the flow of wealth comprised of private and public goods. This approach could be derived from the classical tradition and first of all from Adam Smith’s seminal works.

If we assume, though it would mean heresy to many, that national wealth consists of both private and public goods, that would open the opportunity to legitimise inclusion of public goods and, correspondingly, of public sector into the realm of economic phenomena. This wider interpretation of wealth and economy automatically would mean a widening of the scope (subject matter) of economic science and the domain of economic policy (decision-making).

Both in the fields of scientific research and economic policy, inclusion of economic problems encompassing both cost and benefit aspects of education, health care, security, etc.

into the economic explorations and political decision-making would be legitimised. But we shouldn’t be confused here. Even in the framework of an individualistic understanding of economy it is practically impossible to circumvent the economic aspects of different branches of the public sector. However, in these cases mainly costs of their financing are discussed, while benefits are left for other social sciences – educology, political science and so on – as non-economic.

Another remark concerning a wider interpretation of economy seems to us relevant. The structure of wealth in the last two centuries has changed substantially. In the times of A. Smith or D. Ricardo material goods, so-called “secondary nature” or socialised nature, comprised the bulk of the rapidly growing national wealth. That is why these classics concentrated their efforts on this part of wealth, i.e. on private goods and on the market as a most efficient regime of production of these goods.

But today we have a radically different situation. We entered the age of information society and knowledge economy. At the same time we face the economisation of ecological problems. Only part of the problems and dilemmas of this *new* economy could be settled in the framework of market regimes. Others, and we dare say most of them, should be dealt with using public regimes, which include not only government, but communities (both territorial and functional) as well.

### **The public sector**

The attitude towards the public sector is one of the dividing lines between individualists and holists. Individualists look at the public sector, with suspicion and their main strategic goal vis a vis this sector is privatisation. Usually they

do not elaborate on the limits of such a privatisation, but in fact, the principle “the more the better” works here.

Some individualists assume that in the public sector the same market principles and regimes work. The most vivid example of such a position is *public choice theory*. James Buchanan and other representatives of this doctrine argue that public figures in the public sphere act like homo oeconomicus in the market place: their main motive is self-interest, and competition is the main driving force here. Therefore they readily talk about the political marketplace.

Public choice theorists usually are not inclined to talk about “cooperative games” in the public sector, or so-called “market failures”, though they are enthusiastic about discussing “competitive games” and “government failures”.

To the methodological individualist, the public sector is the burden to economy in terms of tax raising needed to finance it. Tax raising not only distorts prices of factors of production and consumption articles. It is like a penalty for more productive segments of economy smothering, reducing the incentive to invest. It crowds out private investment as well. This position prevails in our region. For instance, the economic adviser to Macedonian government Sam Vaknin in his article “Public sector economies in transition” says: “The two sectors – the private and the public – compete on the same, limited amount of resources. Every dinar (local monetary unit – P.G.) paid to the tax collector is one dinar less invested in the formation of new businesses and one dinar less invested in private consumption” [17]. And further he says: “We can safely state that taxes inhibit economic growth and increase unemployment” [17]. Finally he crowns his position by saying: “The public sec-

tor is fat and sluggish. It has no right to continue to exist” [17].

We could easily find the proponents of such or similar position in any CEE country, Lithuania included. The Lithuanian Free Market Institute (LFMI) is the most outspoken in this respect <sup>5</sup>.

It is possible to view the public sector from a different, *holistic* perspective. Through the holistic lens the public sphere could be seen as a producer of public goods, of human and social capital and thus contributing to the development of economy.

In the framework of holistic thinking, the private and the public sectors aren't necessarily only competing for limited resources. They complement each other, they work for each other. The private sector “feeds” the other with material goods. The public sphere provides the former with “intangibles”, such as political and legal order, social cohesion, educated labour, scientific knowledge. Notwithstanding the fact that in some cases private enterprises produce part of these economic goods themselves, the public sector remains and will remain despite of various ideological swings the main producer of “intangibles”, which in most cases are public goods.

In the case when the public sphere is seen as a producer of valuable goods, it does not seem deserving the name of a burden on the economy. Then tax raising in not *ex ante* perceived as a penalty for entrepreneurs and as a factor inhibiting economic growth. Develop-

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<sup>5</sup> Often the position of LFMI takes extreme forms. For instance, it could claim that there is a clear alternative between free medical care as non-care and private health service. In other words, public health service is announced as providing no service [12]. Similarly, absolutely negative is the Institute's attitude towards public financing of higher education [13].

ment of the public sector means new job opportunities for people. Thereby it wouldn't be blamed for unemployment. Moreover, the public sector's development being not cyclical has a stabilising effect on employment and economy at large.

Into the holistic framework would comfortably fit the concept of A. Wagner's law. According to this German economist of the end of the 19<sup>th</sup> century, the development of the market regimes requires appropriate changes in the systems of education, legislation and law enforcement. The latter means an increase in public spending and, in turn, in tax revenue.

So far, history confirms the validity of this concept. Market developments were accompanied by growth of all branches of the public sector – education, science, health care, social safety nets, etc. The share of national product redistributed through state budget increased correspondingly from approximately 8–10% at the end of the 19<sup>th</sup> century to 30, 40 and even more than 50% at the end of the 20<sup>th</sup> century. For individualists this tendency is “unnatural”, “falls out” of the “normal” economic picture, represents not the economic law, but an economic anomaly. That is why, despite this trend being empirically evident and based on hard facts, the individualist turns a blind eye on it.

For an objective researcher a fundamental question would rise: Should we extrapolate the trend to the future? What are the factors of a possible reversal of the tendency?

These questions have not only a theoretical importance. Answers to them would influence policies in the sphere of public finance. We are not going to discuss this issue at greater length and confine ourselves only to a few remarks.

Firstly, the economic life (even if we reduce it to the functioning of the markets) evol-

ves as more and more complex. The variety of the economic goods is increasing. This leads to an augmenting diversity and number of economic actors. The web of interconnections and interdependencies is getting more and more dense. This web is getting ever more fragile, sensitive to destabilising internal and external impacts. Market forces alone, without legal, political, moral and other regulatory regimes, which belong to the public sector, are unable to cope with this increasing turbulence of economic life<sup>6</sup>.

Secondly, mankind is experiencing the processes of relative deindustrialisation and deagrulturisation and a growing influence of knowledge economy. Only part of the products of the latter are commodities, private goods. Others are public goods produced in the public sector.

The sustainable development of the fragile knowledge producing and consuming economy is impossible in the context of the deteriorating quality of social and human capital, which are reproduced mainly by public but not market regimes. Better educated, healthy, morally trustworthy citizens who understand the importance of social cohesion and contribute to it are able to produce more public goods of higher quality and to contribute more to the development of social order.

Thirdly, our economic growth becomes more and more unsustainable, especially in terms of the worsening ecological situation, which hardly could be improved by using market regimes alone.

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<sup>6</sup> For instance, empirically evident is the tendency of a growing demand and supply of new law. The increasingly complex legal system is more costly. The cost of the legal aid system in England and Wales has risen by 25% in the past three years [15]. We think that the trend is applicable to the CEE countries where the price of justice is rising as well.

## **From the Soviet past to the future: a holistic view**

The Soviet past could be seen through different paradigmatic lenses. A lens provides different economic panoramas of the system we lived in and leads to different conclusions.

If we watch the Soviet system through the individualistic cognitive lens explicitly or implicitly confining economy to market, the traditional picture of the soviet economy opens. This economy is usually – deservedly, of course – criticised for its deficiencies coming from the suppression of private interests and private ownership, for its anti-market policies, for excesses of centralization, formalization and command regimes. That suppression and excesses smothered the individual and local initiative, gave birth to voluntaristic, economically detrimental programmes and decisions leading to inefficient, non-optimal allocations of re-sources.

In case we use another, holistic lens, we have a wider vision of economy. Some additional elements, sections of economic life in the Soviet past can be seen and additional conclusions can be drawn.

First of all, with the introduction of public goods it is possible to present the Soviet system as driving for abolition of private goods. In doing so, market regimes had to be replaced by public regimes. Concomitantly, economic egoism (the core of the classical homo oeconomicus) eventually had to give way to economic altruism.

It is a great misunderstanding to assume that the whole mass of material goods could be produced by *public* regimes based on a direct motivation. This cognitive blunder leads to a vicious circle – an irrelevant worldview suggesting that private material goods could be effectively produced by altruistically and direc-

tly motivated people who while producing these goods are striving for public, common interests; this proves to be false for the most of cases, though exceptions are possible, and production of material goods becomes ineffective; the shortage of the private goods becomes more and more pressing; in the conditions of permanent material shortages the real motives of the economic agents become even more egoistic despite the mighty pro-public and pro-altruistic propaganda; it enhances the development of shadow informal market regimes which encompass all spheres of life and all layers of society including party nomenclature; the gap between Soviet ideology and economic realities widens, the double – formal and informal – standards of behaviour become even more obvious and pervasive; all this translates into a deepening of internal contradictions and tensions which finally lead to the demise of the Soviet system.

However, it is only part of the story. Another part is connected with the public sector, which produces public goods. As we have already mentioned, according to Soviet doctrine the whole economy had to be public. But in fact it was not. On the informal side of it a vast shadow market based on *de facto* private interests flourished.

The public sector *per se* officially was based on the principles of democracy and justice. It had to provide immaterial goods (not commodities) to society. Ironically enough, the public sphere itself was treated as non-productive, non-economic. It belonged, according to the Soviet doctrine, to so-called superstructure, the development of which is determined by the economic base – production of material goods. As we can see, such a position totally coincides with the position of individualists, who adhere to the same principle of distinction between productive and non-productive

spheres of society. Irony calhy enough, Soviet collectivists and individualists share the same fundamental premise of economic thinking. Both camps excluded intangibles, spiritual goods from the subject matter of economic science, and this had a negative impact on the development of this sphere.

Furthermore, Soviet economic theory didn't use the concept of public good, even after Paul Samuelson in 1954 introduced the term. Isolationism, closeness and contempt for everything that comes from the West played here its role.

With time it was more and more clear that the Soviet system became not able to produce the required quantity and quality of public goods such as democracy, justice, knowledge, especially social knowledge, etc. We are talking about true democracy, true justice, true knowledge and true art. The spiritually incapacitated system finally collapsed.

With the demise of the Soviet system, opportunities opened to correct the paradigmatic distortions and to create the cognitive environment favourable to the least costly transition from the past to the future.

Fifteen years elapsed. Historically it is too short a time to make solid evaluations of the transformations CEE countries underwent. Nevertheless, they are ample and most of them are made in terms of individualistic doctrines. Neo-liberals, economic orthodoxy in general argue that the only possible direction of transformations had to be marketisation of the Soviet economy. This process had to be as rapid as possible. The so-called shock therapy was considered by them as the most appropriate scenario.

The much less audible minority insists that individualists had too simplistic an attitude towards transition and that it was disastrous to

apply it in practice. J. Eatwell and his colleagues think that transformation began at an unfortunate time when a cognitive (paradigmatic) shift from the Keynesian to the neo-liberal doctrine took place; this caused huge deficiencies of the process [5, p. 5–6]. Further they say: "The initial neglect of social issues derived not just from the paramount objective of creating a basic market economy and facing up to harsh budget constraints, but also from the neo-liberal bias of much outside advise, and, importantly, the unwillingness of many "first generation" democratic leaders to discuss social issues at all. The common view was that there is no such thing as a *social* market economy" [5, p. 20]. Some authors called the process "katastroika", because millions (by some estimations about 3 million) of lives were lost [6].

To add more than 80 million new poor in the region, the soaring unemployment, substantially increased numbers of asocial families, increased inequality, and we would have quite a gloomy, dismal picture of the outcomes of the process. Analysts stress the results of the first several years of transformation. Later a certain stabilisation and improvement of the situation began, especially in Central Europe. Lithuania is one of the several vivid examples of such a rapid improvement.

Concisely summarising the very process of transformation and its results from the point of view of holism, we would like to stress the following:

- the process hardly could be named a reform. Rather it was a quasirevolution. This term is most appropriate to the countries which despite huge losses of their economic potential (sometimes close to half of it) avoided massive bloodshed. This quasirevolution went far



beyond what Schumpeter would call creative destruction. Saying this we admit that the change of political and economic systems couldn't be costless. Especially it is the case for former Soviet republics like Lithuania;

- in the case of a different, less individualistic paradigmatic atmosphere in the West a more gradual and more socially sensitive scenario was possible. The legacy of the Soviet past was devastating (by apologetics and scholastics) for economic knowledge and as a result for almost totally disorientated people. We relied heavily on Western advice. Alas, this advice was biased, one-sided;
- this means that one of the main reasons for our sufferings was the lack of a specific public good-relevant conception of transformation. Most of CEE countries, Lithuania among them, were unable to produce that product, and the West supplied mainly one of the several possible versions of it;
- after fifteen years, at least those countries that avoided armed conflicts had to achieve a certain level of prosperity. Fifteen years of peaceful development are almost "long-term", and people are looking for results. There are achievements, of course, but people expected much more; and unfulfilled expectations breed disappointment, apathy and cynicism;
- in most of the CEE countries, limited success in economic development is expressed and could be explained by the problems in the public sector, such as the lack of understanding of the direction of the development of education, health care, social safety, difficulties en-

countered by our political regimes. The latter too slowly move from the procedural, formal democracy (free and fair election) to the real, comprehensive, participatory democracy, to a true authority of people, and suffers from the trend towards negative selection, corruption in the sphere of public administration, etc. All this impedes the economic development substantially.

### Dilemmas of public finance

People from the individualistic camp often openly call for reduction of tax revenues. One of their mottos is "The more the better: but not taxes" [16]. Articles of this sort in our press appear periodically. The message to general public from this camp is quite clear – welfare of the citizens would be higher if taxes are minimised. The concrete level of this minimum usually is not elaborated: should the "tax burden" be reduced to 20, 15 or less than 10% of GDP? Even the most radical individualists do not dare to call for total abolition of taxes. At least indirectly they admit that there are some needs and some goods in the society that an autonomous individual cannot produce and satisfy separately. In other words, they admit the existence of *res publica* (public affair, matter), although in the purely individualistic world *res publica* doesn't exist. Only *res individuuum* (individual matter, affair) characterises this world.

It is neither rational nor scientific to claim that the minimal "tax burden" is good for economy and society<sup>7</sup>. The same would apply to hypothetical calls (they simply do not exist) for tax maximization. A rational discourse on the

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<sup>7</sup> This is the position of Lithuanian Free Market Institute [see 16].

issue of “tax burden” should concentrate on the problem of the contingent level (and structure) of taxation. The *contingency view*, widely applied in management theory, would be helpful in solving this and many other economic problems.

The mission of economic and other social sciences here is to clear the discussion on the level of taxation of the “mists”, “fogs” of ideological, political or cognitive (common sense) origin, and provide the richest possible, consistent argumentation based on solid, scientifically scrutinised premises.

This scientific framework would allow us to rationalise our perceptions of public finance and eventually of the financial policies.

A fundamental importance in this respect is the issue of relevance of Wagner’s law to the economy of the 21<sup>st</sup> century. Empirically, statistically one could easily prove that this law held true for the 20<sup>th</sup> century: the ratio of tax revenue to national product was constantly increasing.

The answer to this question depends mainly on two factors: the amount and structure of public goods needed by society and on the cost of their production. If the quantity of needed goods that could be produced publicly, collectively is augmenting and the variety of them is increasing, the total cost of production of these goods is likely to be higher. Then the public through its democratic tools (which themselves are public goods) would have to decide whether to meet these costs. Society has at least to strategic options. It could choose to suppress some of public needs or could agree with a less costly collection (basket) of public goods (the lower quality risk should be evaluated in this case). If there is a substantive proof that the effectiveness of a system of all economic regimes, market included, and the nation’s welfa-

re wouldn’t decline as a result of suppressing, restraining some public needs, then there would be no reasons for keeping “tax burden” high.

We are in favour of the hypothesis that the number and diversity of public needs and correspondingly public goods is growing. This hypothesis, of course, requires a serious conceptual and empirical foundation, which could be provided only by an extensive, multidisciplinary investigation.

Therefore we will confine ourselves to naming several, in our view, the most substantive arguments enforcing the position that we should be very cautious in our attempts to underestimate the public sector.

Firstly, for several decades we witness the tendency of “dematerialisation” of economy. Services, intangibles like knowledge are playing a more and more important role in the economy. The portion of traditional sectors like industry is shrinking.

Humankind is experiencing the proliferation of different threats. There are new kinds of threats emerging – ecological, social, epidemiological, economic, criminal, political, informational, etc. Traditional military threats do not loose their weight, and a big part of these threats could be neutralised only collectively. Here we mean collectives of both individuals and states.

Thus, providing security to people in all these aspects would cost. There is no such thing as free security. If insecurity diversifies and proliferates, rational people would agree with a proper public financing of security systems even if it would mean an increase of taxes. Otherwise, if societies ignore the prospects of increasing and diversifying insecurity, the “shock therapy” or “shock learning” scenario is quite probable.

The second factor is the most controversial. We mean the factor of *governance*. As we have already mentioned, social order is the result of both spontaneous self-regulating and programming regimes. The market in its pure form represents the former and the state institutions are usually understood as programming. In fact, those institutions together with family, church, and NGOs function on the basis of a combination of programming and spontaneous, self-regulating regimes. For instance, law is the result of programmed, planned activities, but after its implementation, properly enforced, in most cases it works as any other automatic regulator of human behaviour.

Thus, economic governance is based on both *indirect* influence through conditions (i.e. on norm-creation and implementation) and on measures of *direct* influence.

The economy as a whole cannot sustain and develop without these regimes of governance. If we assume that economic systems are becoming more and more complex, one of the possible consequences of such a trend would be rising requirements for effectiveness. These requirements could be met by a relevant, arguably more complex and thus possibly more costly system of governance. We understand that this statement sounds hubristic in the context of the dominant economic paradigm which perceives government (state) as though inevitable but still an evil.

The last argument, which we want to suggest for a paradigmatic discussion concerning public finance, is a comparative analysis of the budgetary situation in different countries and regions of the world.

From Table 1 we can conclude that in Latvia and Estonia tax revenues were shrinking through the whole period of transformation. In Lithuania they remained more or less stab-

Table 1. Baltic countries: total tax revenue (as percentage of GDP)

	1993	1997	2001
Lithuania	30.3	31.5	< 30
Latvia	36.4	34.8	30.4
Estonia	39.3	37.6	34.5
OECD unweighted avg.	36.6	37.5	38.2 (2000)

Table 2. CIS countries: total tax revenue (as percentage of GDP)

	1993	1997	2001
Armenia	28.9	16.3	14.3
Azerbaijan	40.5	15.6	14.7
Georgia	–	12.7	14.3
Kazakhstan	21.1	12.2	22.0
Kyrgyz Republic	25.1	12.5	12.4
Moldova	22.8	29.9	22.4
Ukraine	42.7	35.6	29.9
Uzbekistan	35.3	27.7	23.2
Russia	36.2	33.0	33.4
Belarus	44.8	27.6	37.6
Tajikistan	–	–	14.1
Turkmenistan	12.8	18.6	25.1
CIS unweighted avg.			21.8
OECD unweighted avg.	36.6	37.5	38.2 (2000)

Source: [11].

le. But this contraction is not as dramatic as in some of CIS countries where the revenues decreased by half and even more (see Armenia, Azerbaijan, Kyrgyz Republic in Table 2). In some of CIS countries the ratio of tax revenues decreased to a lower extent. Russia, Belarus are the most vivid examples of this moderate decline.

In some Central European countries that underwent the milder, "velvet" scenario of transition, the ratio was rather stable and relatively high (39% of GDP in Czech Republic, 38.6% in Hungary). In other countries it decreased. For instance, in Poland from 1995 to 2000 it shrank from 39.6% to ≈35%. In some other CEE countries this drop was less moderate.

The general picture of CEE countries concerning tax revenues is quite confusing. From the data presented in Tables 1 and 2 it is difficult to judge whether the leading, natural tendency is to a decrease or it is simply the result of a very turbulent political and economic transformation.

I think most of us would agree that developments, tendencies in the Western and first of all the OECD and EU countries represent more natural trends of changes in public finance. About these trends we could judge from Table 3.

Figures in Table 3 show quite a pronounced tendency of the growth of the portion of tax revenues in GDP. In the last quarter of the 20<sup>th</sup> century, practically all developed countries experienced both the absolute and the relative to GDP growth of the "tax burden", despite the fact that about two decades of this period are characterised by a retreat from the Keynesianism and the dominance of the neo-liberal approach.

These data give ground to those who argue that A. Wagner's law still works in the West. If

Table 3. OECD countries: total tax revenue as percentage of GDP

	1975	1990	2001
Canada	31.9	35.9	35.2
United States	26.6	26.7	≈30
Australia	26.6	29.3	≈31
Japan	21.2	30.1	≈30
S. Korea	15.3	19.1	27.5
Austria	37.4	40.4	45.7
Denmark	40.0		49.0
Finland	36.8	47.1	46.3
France	35.9	43.0	45.4
Germany	35.3	35.7	36.4
Greece	21.8	29.3	40.8
Italy	26.1	38.9	41.8
Sweden	42.3	53.6	53.2
United Kingdom	35.3	36.8	37.4
OECD total	30	35.1	≈38 (2000)
EU 15	33	39.5	≈42

Source: Revenue Statistics.

so, a possibility opens to review some individualistic, antipublic tendencies in our worldview, in flows, of information and economic policy. Is it justified to argue for a reduction of tax revenues when they are bigger both in relative terms and especially in absolute terms in more developed countries? We should ask ourselves: is not one of the explanations of Western economic, social, political etc. success the proper financing of the public sector, effective production of public goods?

In parallel, we could ask why most of Latin American countries living in the economic conditions where private ownership is dominating and formal conditions for market economy have been good for several hundred years experienced difficulties in their economic development? One of the holistic hypotheses is that the public sector was the main hindrance of their economic progress.

CEE countries entering the EU, signing the Social Charter of Europe will have to meet certain social, political, legal, ecological standards. To achieve these standards will require certain amount of funds and thus an adequate level of taxation. Together with this, appropriate measures of austerity and thrift will be needed to make the process less wasteful.

*The general level of taxation, however is not the only problem faced by CEE countries. The structure of taxes levied is another one.* In some of these countries, Lithuania among them, the pressure to reduce direct taxes, even to abolish them is considerable. The formal argument behind this drive is to encourage investment and the purchasing power of the society. Reduction of tax on profit has to enhance the former and reduction of individual income tax should favourably influence the latter.

However, the outcome of a sizable reduction of direct taxes is not so evidently positive.

First of all, it could lead to a reduction of the total amount of tax revenues and thus negatively influence the public sector<sup>8</sup>. On the other hand, the growing part of indirect taxes (VAT, excise, custom duties) would increase the *regressivity* of tax systems, implying that the increasing portion of tax burden is laid on the shoulders of the poor and the principle of vertical justice in taxation is ignored. Such a trend in the events would mean an increase of inequality, social exclusion and growing obstacles for the poor to participate in creation of social and human capital<sup>9</sup>. The prospects of deterioration of these kinds of national wealth would be highly probable.

Political consequences, not only in the long run but also in the foreseeable future, would be ambiguous at best. Social exclusion for many could mean massive political exclusion or self-exclusion, apathy mixed with political discontent, protest voting, growing political extremism.

There are major interconnected forces that push for reduction of direct taxes. One of them are interest groups together with their ideological partners. We mean, of course, business,

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<sup>8</sup> Proponents of tax cuts usually have in their minds the Laffer curve, i.e. they think that decrease in taxes could lead to a rise of total tax revenues. But they forget at least two things. Firstly, that only up to a certain point this is true. After this point the tax cuts mean contraction of general tax revenues. Secondly, Arthur Laffer himself fell the victim of the rash, hasty application of his invention, when the evidence of the 1980s didn't confirm the policy works.

<sup>9</sup> There are many *economic*, not only moral, political or ecological arguments in favour of reduction of inequality. One of them is from the sphere of health care. Healthy society is a more productive society, its human capital is of higher value. And equity here plays a substantial role. To astonishment of many, not the richest developed societies have the best health. The leaders among developed countries are those that have the smallest income differences between the rich and the poor [2, p. 111]. We think the same applies to education and other similar issues.

media and some of intellectual groups. It is a natural desire of entrepreneurs to get a bigger share of the profit earned, to reduce costs of production by paying smaller taxes on labour and thereby to increase assets for investment, personal income and consumption. The latter motive is often overlooked. However, if the conditions of human and social capital formation are neglected, the national business will be losing its advantages.

All previous discussion is closely connected with another factor pressing for direct tax cuts. We have in mind the international tax competition. If the above discussed factors dwell on political, economic, cognitive and ideological motives, the latter is a product of the harsh global competitive reality, though also connected with cognitive and ideological influences.

With the globalisation of business, national governments have a big headache. They have difficulties with curbing, controlling tax-dodging and, on the other hand, with attracting foreign investments. One of the popular instruments of such attraction is reduction of corporate-tax rates. Some sources say that between 1996 and 2003 OECD countries cut these taxes by nearly seven percentage-points [1]. Ireland was the most aggressive in this sense, slashing corporate tax-rates by 23%.

CEE countries take an active part in this international tax competition. Estonia and Lithuania are among the most decisive pursuers of this policy. In our country this rate is 15%.

At the first glance it seems that the policy may have positive benefits. Nevertheless, one should keep in mind the possible disadvantages we have discussed above and other constraints on such kind of game, which could be called "who cuts first" (the so-called "race to the bottom").

Firstly, it is not a market game. It is a game played by governments in the sphere of public finance. Therefore it should not be acceptable for free market advocates. Secondly, many developed countries experience the problems of budget deficit, on the one hand, and pressures to keep the existing level of expenditure on the other. The aggressive tax competition from the CEE side will accumulate dissatisfaction in the "old" Europe. Politicians, business people, trade unions would realise that the "tax burden" is not distributed fairly, that "new" Europeans try to avoid a bigger financial responsibility. As a result, feelings of solidarity of Western Europeans vis-a-vis CEE countries would wither and resentment would grow – a very bad psychological turn for the future of Europe, breeding euroscepticism, unwillingness to contribute to the development of our infrastructures.

Thirdly, tax cuts could lead to weakened possibilities of self-financing of the development of our public sector, with all consequences discussed above.

If the countries reduce profit taxes *ceteris paribus*, they will have to increase other taxes. Today in some countries the ratio of profit taxes to GDP is low. For instance, in the year 2000 in Estonia it was 1%, in Latvia 1.7%, in Lithuania 0.7% [11]. To compare with OECD countries: in the United States, United King-

dom, Japan, France this percentage is about 3.5% (2001) [1]. It means that in the OECD countries business contributes to public infrastructure (education, science, roads, etc.) more than in many CEE countries.

## Conclusions

Economists employing different paradigmatic lenses see different economic panoramas, make different inferences and economic policy proposals. This applies to the issues of economic transformation in CEE countries. Individualists concentrate on improving the market regimes. For them, economisation means marketisation. It is a logical consequence of their paradigmatic assumption that economy and market are identical concepts. Then, naturally, all non-economic phenomena like public goods are excluded from the analysis of economic transformations in the region.

Those who instinctively or explicitly hold holistic position are more propublic, more socially and ecologically sensitive and are ready to discuss the role of the state without any negative prejudice. For them, all these factors could be endogenous to economy and complementary to the market. This paradigm automatically does not guarantee scientific or economic success, but opens a better, more adequate cognitive perspective for CEE countries.

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## DVI EKONOMINĖS PLĖTROS VRE ŠALYSE PARADIGMOS

Povilas Gylis

Santrauka

Ekonominių reformų programų kryptis, parametrai priklauso nuo to, kokiomis paradigmomis – individualistine ar holistine – remiamiesi mąsto ir veikia svarbiausi ekonominiai aktoriai (subjektai) bei galios centrai. Individualistinės paradigmos šalininkai savo dėmesį sutelkia į rinkos sektorių, o viešasis sektorius, jų manymu, nepriklauso ekonominei tikrovei, yra našta ūkiui ir t. t. Holistai, pripažindami ekonominėmis ne tik privačias, bet ir viešąsias gėrybes, suvokdami socialinio kapitalo reikšmę, į privatų ir viešąjį sektorių žiūri kaip į vienas kitą papildančius.

Vidurio ir Rytų Europos šalyse vykstant ekonominiams transformacijoms dominavo individualistinės pa-

radigmos šalininkai. Veikiant ideologinės šytuoklės principui iš vieno kraštutinumo – prievartinio kolektyvizmo, absoliutaus privačios nuosavybės bei rinkos neigimo ir pan. – buvo pereita prie kito, t. y. prie privačios nuosavybės ir rinkos reikšmės suabsoliutinimo bei viešojo sektoriaus vaidmens ekonominei plėtrai nuvertinimo.

Tokio negatyvaus požiūrio į viešąjį sektorių padariniai yra įvairūs. Vienas iš jų – spaudimas mažinti viešuosius finansus, vis labiau privatizuoti medicinos, švietimo ir t. t. sritis. Tačiau tokios tendencijos kelia grėsmę tvariai VRE šalių ekonominei plėtrai.

*[Iteikta 2004 m. rugpjūčio mėn.*