

Chart of the month



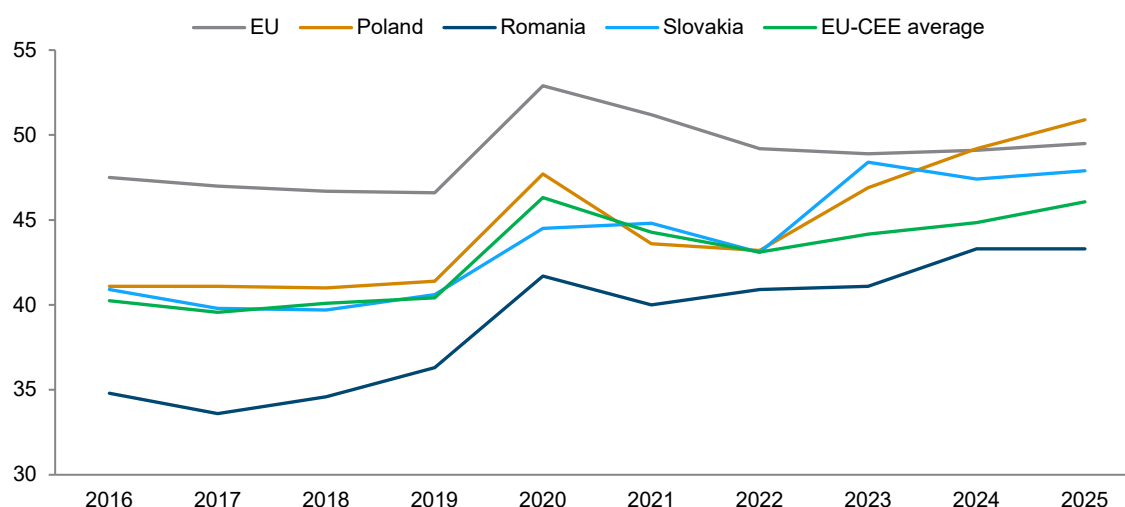
EU-CEE NOW HAS A BIGGER STATE, BUT HASN'T YET WORKED OUT HOW TO PAY FOR IT

by Richard Grieveson, wiiw Deputy Director

Government spending has risen sharply across EU-CEE since 2019, reflecting not only higher defence expenditure but a broader expansion of the state's role in the economy. With much of this increase financed through persistent fiscal deficits, governments now face difficult choices over taxes, spending priorities and how to make the bigger state work more efficiently.

In 1998, Dani Rodrik [showed](#) that the more exposed an economy is to trade, the bigger its government tends to be. Voters demand insurance against the volatility that openness brings, and the state supplies it through spending. Yet during its decades of rapid catch-up with Western Europe, EU-CEE never fitted this pattern. Despite having some of the highest external trade-to-GDP ratios in the world, until recently the region spent most of the time post-1989 with unusually lean states. This reflected a mix of post-communist shock therapy and Washington Consensus orthodoxy, competition for FDI through low taxes, and the fiscal discipline demanded by EU accession.

Figure 1 / General government expenditure, % of GDP



Note: EU-CEE average is simple average of 11 countries.

Source: Eurostat.

In the last five years, though, this has changed, driven by two main developments: the pandemic and Russia's 2022 full-scale invasion of Ukraine. In 2019, government spending as a share of GDP in the 11 EU-CEE countries averaged 40.4%. The following year it jumped to 46.3%. Although it then fell back somewhat, it again rose to 46.1% in 2025 – almost the same level as at the peak of the pandemic (Figure 1).

In some parts of EU-CEE, the increase has been even stronger. In 2022, the Polish state was the twentieth highest spender in the EU relative to GDP; by 2025 it was sixth. At 50.9% in 2025, the Polish government expenditure/GDP ratio is now higher than in Germany, Sweden and Denmark. Other parts of EU-CEE have also seen a rapid increase, with the steepest rises (after Poland) in Romania and Slovakia.

Part of the reason for the increase in spending has been defence. Poland and Romania are frontline states as the EU finds itself under hybrid attack from Russia. Poland now spends around 5% of GDP on defence. Yet the data show that in most EU-CEE countries most of the increase in spending relative to GDP (including in Poland) has not been on defence: the state in general now plays a bigger role in the economy. In a sense, that is EU-CEE catching up with what Rodrik's logic would have predicted all along – albeit with some delay.

And it is likely that the high degree of openness of EU-CEE economies is at least part of the explanation. EU-CEE's openness leaves it exposed both to pandemics and to their after-shocks in terms of dislocated supply chains. The region's openness also leaves it badly exposed to the global trade war, China 2.0 shock, high energy prices and the stagnation of German industry. The fact that these things have clearly affected EU-CEE economies, and have contributed to a need to find new drivers of growth, is likely to be at least part of the explanation for why the state has stepped in. And indeed that probably partly explains why the region has been more economically resilient than Western Europe over the past few years. This is a bigger, fundamental shift than just a knee-jerk response to a pandemic or a war.

The problem is that very few EU-CEE countries have decided how to pay for the bigger state sustainably. Some of the increase is being financed through higher taxes, with the Baltic states looking to be the most successful so far on that score. But in most of the region the gap is simply being deficit-financed: Poland's shortfall has averaged over 5% of GDP a year since 2020, while Romania's has averaged 7.8% of GDP over the same period. Romania already finds itself in a vicious cycle of harsh austerity measures that are hammering GDP growth. It is feasible that EU-CEE could quickly find ways of generating much bigger multipliers from its increased defence spending – for example, by spending more on domestically produced weapons and equipment, rather than on imports. If it can, much of the increased state spending will pay for itself via higher growth. But if it can't, then something will eventually give: either taxes will have to rise sharply, or more countries will be forced into the austerity currently being experienced by Romania.

There is a second, uncomfortable layer to this. Rodrik's insurance mechanism assumes that the state translates revenue into welfare-enhancing spending reasonably efficiently. But that assumption is less watertight where institutions are weaker. A structurally bigger EU-CEE state, in countries where governance indicators are still relatively low, allows more scope for patronage and misallocation. Across EU-CEE, institutional quality differs widely. With the state now playing a much bigger role in the economy, these institutional quality differences are likely to be an ever more important predictor of economic outcomes in the region in the future.