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Economic Globalization and Welfare Spending in 23 Transitional Economies A Cross-Sectional Time-Series Analysis, 1990-2005

Introduction

The declining significance of communism is one of the most noticeable transformations at the end of the twentieth century. China's moving away from centrally planned economy, the collapse of the East European communist regimes, the disintegration of the Soviet Bloc and USSR are clear evidences of such transformation and signify the arrival of the post-communist era. Around the same time, another great transformation is exerting its formidable influence in every corner of human society: globalization in economics, politics, and culture. With the demise of Soviet-centered international regime, post communist societies found themselves either voluntarily or involuntarily pulled into the tidal waves of globalization, having to play by the rules in order to survive and prosper.

In the post-communist societies, economic restructuring tops the government's priority list. Directed by World Bank (WB) and International Monetary Funds (IMF)'s structural adjustment policies, post-communist states commenced fundamental shifts from a centrally planned economy to a market economy. United Nations thus created a new country grouping category: "economies in transition"[1] for the purpose of analytical studies in UN reports and World Economics Survey.[2] One of the keynotes of the structural adjustment policy is the adoption of neo-liberal economic practices, among which includes cut backs in government public spending so as to enhance the competitiveness of state's economy in an ever integrating global market. As a response, transitional economies began to slash welfare spending, and

[1] In this paper, "countries in transition" is referred to as "transitional economies" and is used interchangeably with "post-communist economies/societies".
[2]. This document is accessible at: http://unpan1.un.org/intradoc/groups/public/documents/un/unpan008092.pdf

started to transfer the responsibility of social welfare provision from the government to individuals and to more societized welfare provision mechanism.

Successful reform in social welfare provision has tremendous significance to the future of transition economies and in this chapter presented the big puzzle: as we entered the post-communist globalization era, when those former socialist states no longer need to offer cradle-to-grave social welfare programs to show socialist economy's superiority over capitalism, will these transitional economies continue this socialist welfare legacy? Or will they just bow to the pressure of economic globalization and simply sweep social welfare provision under the rug? If post-communist governments are inclined to slash welfare spending to keep down the labor cost, will the workers, whose avant-garde position is now overthrown still have a chance to protect and secure their welfare benefits?

Theoretical debates on globalization and welfare spending

Globalization here follows the popular definition among political economists, is defined in strict economic terms: increased cross-border flow of trade and capital. It is hereby used interchangeably with economic globalization. Economic globalization is quantified in terms of total trade, imports from low wage economies, foreign direct investment, and enhanced financial market integration (Garret and Mitchell 2001, Rudra 2002, Rudra 2004, Rodrik 2000).

What globalization has done to our society, especially the impact at nation state level has been extensively explored. The debate first started in the correlation between increasing economic interdependence and state's autonomy in formulating and executing its domestic economic policies. Cooper (1972) in his study on the economic interdependent and foreign policies among non-Communist developed countries argued that increased economic interdependence erodes the effectiveness of domestic policies, e.g. monetary policies, and hence threatens national autonomy in its economic objectives (Cooper 1972: 164). Later on, such debate extended outside the economic arena to social welfare polices.

Economic globalization and "efficiency" argument

During 1970s, the world witnessed two oil shocks and the end of gold standard. Under such circumstances, protectionist policies became less favorable among advanced Western democracies. Since then, neo-liberal economic practices and ideology championed by the U.S. became more and more popular among the welfare states. Gradually, a wide range of government activities, including welfare and public spending policies were to be evaluated by whether it is efficient and profitable. Social welfare programs thus redirected their mission from mitigating the affliction of the surplus labor to promoting efficiency and competitiveness in the global market. A salient characteristic of such transformation is the move from universal and publicly delivered benefits to market-oriented and private delivery of welfare provisions emphasizing on individual responsibility (Gilbert 2002: 4). There are ample examples of such transformation within classical welfare states in advanced industrialized countries. In U.S., workfare replaces welfare. In Sweden, partial pension privatization was initiated. Germany also encouraged citizens to open private pension accounts. Whether or not there exists a clear causal relationship between economic globalization process and welfare spending led to heated debates in the academia for over two decades.

In this global economy, the cost of labor is the key to success for both capitalist and post-communist economies. In addition, increasingly mobile capital poses threat of "capital flight" to the states. It not only crippled states' ability to intervene in the "race-down-to-the-bottom" game, but also made governments less capable of sustaining social safety nets when tax revenue is no longer secured within the border. As a result, concerns over state's autonomy in continuing its welfare policies led to the heated debate over the "crisis of the welfare state," as policymakers reformulated the basic principles of social protections, and a dramatic drop in the welfare index[3] was observed in a number of advanced industrialized democracies (including the United States, England, New Zealand, Denmark, Finland, Norway, and Sweden) following the golden era (1960-1980) of welfare state expansion (Gilbert 2002: 12-13). Similar trend was also observed in Mexico and Latin America, in which left-wing parties reduced state-dispensed social protection programs and discontinued their long sponsorship on the full-employment and workers' benefits, leaving workers to their own devices (Solinger 2003a). There thus seemed to be evidence suggesting the declining role of the state and the primacy of the free-market ethos in shaping the future of welfare spending policies. This kind of retrenchment of the welfare state under globalization force, especially economic globalization is what's called the "efficiency" hypothesis (Garrett 2001, Garrett and Nickerson 2001: 3-4, Kaufman and Segura-Ubiergo 2001: 554).

Hypothesis 1: "Efficiency hypothesis" holds true also in transitional economies: there is a negative correlation between economic globalization and government welfare spending.

Economic globalization and "compensation" argument

This "efficiency" hypothesis however, constantly came under attack in and after the 1990s, when more and more scholars found evidences in organized labor movements that challenge the conventional wisdom about the retrenchment of welfare state, which had treated public spending and economic growth like a zero-sum game. As early as 1978, Cameron's study

[3] Welfare index is measured by accessibility, generosity, and quality of social benefits for children, the elderly, and the unemployed (Gilbert 2002: 12).

on the expansion of public economy in 18 OECD countries revealed extremely high correlation between the openness of the economy and the expansion of the public economy[4]. Using a flowing chart, Cameron (1978: 1256) argues that openness of economy leads to high industrial concentration, which results in high unionization and wide scope of collective bargaining. The result is a high demand in government spending on income supplements. This study has not lost its significance twenty-eight years later. Openness of economy and strength of organized labor are still key variables in many of the recent studies on the relationship between economic globalization and welfare spending.

In a more recent study, based on the experiences of 14 OECD countries, Garret (1998) also challenges the pessimistic visions of the capital dominance over labor and state's policy autonomy by arguing that through negotiation between political power of the left and organized labor, globalization could lead to social policies protecting the disadvantaged from the economic dislocations associated with globalization, thus reducing market-generated inequalities and external risks. Brady and his colleagues in their 2005 study describe this as the "globalization triggered political dynamics that result in generous welfare programs and corporatist labor market institutions" (Brady et. al. 2005: 923). This kind of argument on globalization and the expansion of welfare state is called the "compensation" hypothesis, since these countries aim at compensating the losers of the economic integration (Garrett 2001, Garrett and Nickerson 2001: 3-4, Kaufman and Segura-Ubiergo 2001: 554).

Hypothesis 2: "Compensation hypothesis" holds true in transitional economies: there is a positive correlation between economic globalization and government welfare spending.

[4] Openness of economy is measured by the sum of exports and imports as percentage of GDP. Public economy is defined by the extractive role of the government and measured by the revenue of public authority as percentage of GDP.

Democracy and welfare spending

Evidence challenging the conventional wisdom on globalization and domestic welfare policies were also found in the voting process within Western democracies. Using the data from Britain, the United States, Germany, and Sweden, Pierson (1996) highlights the importance of powerful interest groups, ultimately voters, as a combating force that explains the amazing resilience of welfare states in the economic globalization era. In addition, Brooks and Manza (2007) showed the importance of public opinions in persisting welfare states in democracies.

It is worth noting that so far the key factors brought forth by scholars when debunking the conventional "efficiency" argument: well-organized labor, powerful interest groups, voters, are typical only in advanced democracies. Public opinions also matter most in a democratic environment. All these indicate a strong and positive relationship between a country's level of democracy and public spending.

Hypothesis 3: Transitional economies that score high in democracy ratings experience an expansion in welfare spending. In other words, there is a positive correlation between democracy rating score and government welfare expenditure.

Recent developments on globalization and the welfare states

Recently, a new trend on the relationship between globalization and welfare states emerged from several empirical studies: generous welfare states with highly globalized economy experienced welfare retrenchment, while less globalized nations with minimal welfare states witnessed expansion in welfare spending (Rodrik 1997, Huber and Stephens 2001). This trend implies that globalization process forces both high and low welfare spenders toward mean levels of welfare spending, suggesting convergence of welfare states (Scharpf 1997, Castles 2004).

There is still another group of scholars who are extremely skeptical about the causal relationship between economic globalization and the expansion/retrenchment of the welfare state. They argue that challenges toward the welfares state do not come from economic globalization, but rather "post-industrial shifts." Examples of these shifts include fiscal strain due to slower economic growth, maturation of governmental commitments, the transformation of household structures, and population ageing (Pierson 2001). Brady and his colleagues' (2005) recent study on the impact of globalization on affluent welfare states also challenge the bold claims about the globalization effect on the welfare state.

So far, the major thesis and antitheses of the relationship between economic globalization and welfare spending primarily derive from the experiences of the advanced industrial democracies, whose openness to the global market, the existence of well organized labor, powerful interest groups are taken as the background for governments' economic and political activities.

Starting from late 1990s, more researchers directed their attention to middle income countries (Garrett and Nickerson 2001), less developed countries (LDCs) (Rudra 2002, Rudra and Haggard 2005), and subgroups of LDCs like Latin America countries (Kaufman and Segura-Ubiergo 2001). Scholars try to find out which argument holds true in societies that do not enjoy the same level of democratic atmosphere and openness in major political and economic institutions, or blessed with the powerful organized labor and interest groups. Evidence in these studies showed unanimous support for the "efficiency" argument: international economic integration has a negative effect on aggregate social spending.

Furthermore, labor power which showed a strong and positive impact on welfare spending in advanced democracies is negatively associated with welfare spending in less developed countries (LDCs) (Rudra 2002). Within the category of LDCs, studies in 14 Latin America countries (Kaufman and Segura-Ubiergo 2001) found that such negative effect of globalization on welfare spending operates primarily in the area of pensions, but not human capital spending on health and education. The effect of democracy revealed a strong impact in both middle income countries (Garrett and Nickerson 2001), and in LDCs (Rudra 2002).

Recall that previous research in Western industrialized democracies showed a correlation between organized labor movement, especially unionization and high demand for government welfare spending. Union density, usually defined as the rate of union membership, thus is often used as an indicator of labor power in advanced democracies. However, it is not applicable in less developed countries or transitional economies. Not only are unions are not fully developed in young independent transition economies in central and eastern European countries, but unions are also described as "notoriously weak" in Latin America and other LDC countries as compared to Western Europe counterparts (Kaufman and Segura-Ubiergo 2001: 558), which is very similar to the union situation in transitional economies before transition started. Neither is union density a good indicator for labor power in China. Even though China has the highest union density in the developing world, this does not provide China's labor unions with matching bargaining power (Chan and Senser 1997). Without reliable data on union density, the most practical way to measure labor power in transitional economies will be the number of labor force in the population. Thus labor force will be one of the control variables in the models.

Significance of the study

This chapter situates the debate on economic globalization and welfare spending in transitional economies whose economic and political institutions are quite different from advanced democracies, middle income countries, or LDCs. Rudra (2002: 417) excluded transitional economies from LDC countries arguing that since these countries are undergoing a unique historical transition from a centrally planned economy to market economies, they have comparatively different functions for the state and welfare; and on average, maintain much higher levels of spending on welfare relative to GDP. Similarly, Garrett and Nickerson (2001) also view the large portion of government spending on pension, unemployment and sickness benefits in transitional countries as exceptional, and think it should be treated differently as compared with middle-income, or OECD countries. Thus the primary goal here is to fill in the void of lack of research on globalization's impact on welfare spending in transitional economies. In addition, the findings of this study derived from less globalized nations provide empirical evidence for one of the major theoretical debates on globalization and welfares state: whether or not globalization led to the convergence of the welfare state.

Data and methods

Sample

This study explores the impact of economic globalization on welfare spending with a panel of 23 transitional economies from 1990-2005. Initially, based on the "Country Groupings and Sub-groupings for the Analytical Studies of the United Nations World Economic Survey and other UN Reports", twenty-six transitional economies including seven countries in Central and Eastern Europe (Albania, Bulgaria, Czech Republic, Hungary, Poland, Romania, and Slovakia); four of the successor states of the Socialist Federal Republic of Yugoslavia (Bosnia and Herzegovina, Croatia, Slovenia, the Former Yugoslav Republic of Macedonia); three Baltic States (Estonia, Latvia and Lithuania), and twelve Commonwealth of Independent States (CIS) (Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyzstan, Republic of Moldova, Russian Federation, Tajikistan, Turkmenistan, Ukraine, Uzbekistan). However Armenia, Bosnia and

Herzegovina, FYR Macedonia, and Turkmenistan are taken out of the sample, because up till 2005 they were not members of IMF and thus government expenditure statistics are not available for these countries. In addition, even though China and Vietnam are still considered socialist countries and not on the official list of transitional economies, a probe into their present mechanism of economic coordination would reveal the opposite: state intervention is being replaced by market allocations. Like other transitional economies in eastern and central European and former Soviet Union, centrally planned economy is no longer the determining feature of the national economy in China and Vietnam. That's why I also see include China and Vietnam in the study. Altogether there are twenty-three countries in the sample.

Variables

Dependent variable

The dependent variable of this study WELFARET refers to government's spending on welfare and social protection[5] within a country in a year. This spending is divided by government total expenditure to reflect its relative importance in governments' spending commitment.

[5] From 2001 and on, spending on welfare and social protection is renamed to "social protection". Government outlays on social protection include expenditures on services and transfers provided to individual persons and households and expenditures on services provided on a collective basis. Collective social protection services are concerned with matters such as formulation and administration of government policy; formulation and enforcement of legislation and standards for providing social protection; and applied research and experimental development into social protection affairs and services. Welfare and social protection are allocated to the following groups: sickness and disability, old age, survivors, family and children, unemployment, housing, social exclusion, R&D social protection, and social protect n.e.c. The last item: social protection n.e.c refers to welfare and social protection refers to administration, operation or support of activities such as formulation, administration, coordination and monitoring of overall social protection policies, plans, programs and budgets; preparation and enforcement of legislation and standards for the provision of social protection; production and dissemination of general information, technical documentation and statistics on social protection. Includes: provision of social protection in the form of cash benefits and benefits in kind to victims of fires, floods, earthquakes and other peacetime disasters; purchase and storage of food, equipment and other supplies for emergency use in the case of peacetime disasters; other social protection affairs and services that cannot be assigned to the categories mentioned earlier (IMF 2001:106-110).

Independent variable

The independent variables include both economic globalization variables and control variables.

Globalization variables

Trade and Foreign direction investment (FDI)

Following the mainstream globalization literature, economic globalization in this study is quantified by the amount of cross-border trade and capital flows. So far, cross-border trade and foreign direct investment (FDI) are the two most widely used indicators of economic globalization. By measuring the volume of cross-border flow goods and services as well as inflow and outflow of financial capitals, these two variables reflect a country's overall openness and integration into the global economy. In the analytic model, TRADE denotes the value of cross-border flow of goods and services, divided by GDP. FDI is the absolute amount of investment capital (both in and out of the country) as percentage of GDP.

IMF financial flows

World Bank and IMF are the two most important international financial institutions behind economic globalization. It is no secret that the loans from World Bank and IMF come with "conditionality", frequently referred to as "structural adjustment policies." These policies require debtor governments to open up domestic market, privatize public utilities and publicly owned industries, favor multinational corporations, and allow access to the country's workers and raw materials at bottom prices. Structural adjustment policies result in the slashing of government budgets, cutbacks in spending on health care and education. As clearly stated in the World Bank Country Assistance Strategy (CAS) Report, World Bank in close cooperation with the IMF will continue to monitor macroeconomic policies, in particular fiscal management, measured by the success in *containing public expenditure* (World Bank 2002: 35). Thus, due to IMF's central role in facilitating the capitalist transition of the post-communist societies, it makes sense to see to what extent conditions attached to IMF's loans to these transitional economies affect governments' commitment to welfare spending. I am going to use three variables: net financial flows that are IMF concessional (IMFCG), net financial flows that are IMF non-concessional (IMFNCG), and other financial flows not related to IMF (OTHERG). All these three variables are divided by GDP when included in the model.

<u>Aid and external debt</u>

Countries that are less economically developed do not have a lot of resources to direct to welfare and social protection programs. Variable AID denotes the amount for foreign aid received per capita. Countries that are struggling are more likely to become the recipients of foreign aid. Variable DEBT (external debt) is also included in the model to see if external debt owed by a country would affect that government's welfare spending policies.

Control variables[6]

[6] Unemployment rate is a very important control variable. It is the indicator of the healthiness of economy, and affects government spending on social protection significantly. Unemployment rate, which was hidden before, becomes rampant during the market transition when mass lay-off becomes a common practice to enhance efficiency and increase productivity. Bloodletting mass lay-off has been observed in China since 1996 (Solinger 2003). Skyrocketing unemployment rate is also observed in central and eastern Europe including Russia, Hungary, and Poland. In countries where there is mass lay-off, there exists large pool of surplus labor, which according to Rudra (2002) significantly decrease the labor power in less developed countries. Governments are less pressured to maintain high welfare expenditure when there is less labor power. These are evidences supporting the "efficiency thesis". However, following the "compensation thesis", it is also argued in that high unemployment rate could lead to more welfare spending. This can offset the negative impact of labor power on government welfare expenditures. How will these two forces play out? Unfortunately, there are too many missing values on unemployment rates (54 out of 368 observations) in the data, thus unemployment rates are not put in the model. Exploration of the relationship between unemployment rate and welfare spending will remain a question till data become available in the future.

Economy size

Previous literature suggest that government spending on welfare and social protect is influenced by the size of a nation's economy, commonly measured by GDP or GDP per capita. It is not surprising that the most well developed welfare states invariably are those economically developed western democracies with very high GDP per capita.

In addition, studies on small European states' response to economic change suggest that state size could also affect welfare spending during increasing market integration (Katzenstein 1985, Moses 2000). What makes small states peculiar in the era of globalization has to do with three key factors: openness, diversity, and access to external capital (Commonwealth Secretariat/World Bank 2000). For small states, whose economies are less diversified than larger states, openness to the global market can be pricy. A high degree of openness makes small states susceptible to the fluctuations in international trade and capital flows with very limited resources to neutralize the negative impacts. In response, governments had to develop social policies to stabilize the economic security of and politically appease their citizens (Brady et. al. 2005: 923). Some of the transitional economies in the sample are quite "small" using World Bank's standards.[7] In 2003, Estonia's population fell below the "1.5-million" threshold. Albania, Latvia, Lithuania, and Slovenia's population are little above this threshold, between 1.5 million to 3.5 million. Here, instead of GDP per capita, I am going to use GDP per capita PPP to measure a country's size of economy. It is a better measurement to ensure the comparability across countries.

[7] World Bank uses the standard of a population of 1.5 million people or less to define a small economy (Commonwealth Secretariat/World Bank 2000:3).

Democracy

Previous literature has established a positive relationship between a country's level of democracy and commitment to welfare spending. In this study, democracy variable is measure by Democracy variable is measure by the Polity Scores reported in POLITY IV PROJECT: Political Regime Characteristics and Transitions, 1800-2004 (Marshall and Jaggers 2004). Polity score of (-10) means a complete autocracy, and a polity score of (+10) means a complete democracy.

Demography

Size of the labor force and age dependency ratio are two closely associated variables. Together they have a huge impact on government welfare spending. Countries with bigger labor force tend to spend more welfare and social protection. Higher age dependency ratio mean less workers to support a pensioner, thus leading to heavier burden on government expenditure. The graying of population is a global trend. It poses as serious threats to the sustainability of social welfare systems throughout the world. Large chunks of government expenditure have to fill the holes of pension schemes in advanced Western democracies. Transitional economies are faced with the same challenge, but with different severities across countries. Taking the successors of the Soviet Union as an example, Ukraine, Belarus and Russia face the highest relative burden, whose dependency ratio is fewer than three potential workers per pensioner (2.49, 2.76, and 2.91 respectively) (Buckley and Donahue 2000: 260). On the other hand, the larger young labor force of Central Asia (Kazakhstan, Azerbaijan, Tajikistan, and Turkmenistan) could have helped making the Soviet old-age pension system viable for a longer period of time. With the fall of the Soviet Union, countries which face acute aging problems are left with their own devices.

Variable age dependency ratio (AGEDEP) and variable labor force (LABOR) capture the interactive relationship between population aging and size of labor force on government expenditure. Age dependency ratio (AGEDEP) is measured by dependents to the working population. Labor force (LABOR) is measured the total labor force as percentage of total population in a country.

Analytic Models

Here I also use pooled time-series model for the quantitative analysis. Pooled time series models best deal with situations in which one has observations on N units (such as individuals or countries) at T points in time (such as monthly, yearly, or every N years). There need not be the same number of time points for each unit of observation.

The standard linear regression model is written as:

$$Y_{it} = \alpha + \mathbf{X}_{it}'\boldsymbol{\beta} + \varepsilon_{it} \text{ with } i = 1,\ldots, N;\ t = 1,\ldots,T$$

where α is the intercept; vector $\mathbf{X}_{it}'$ contains K regressors for unit i at time t; vector $\boldsymbol{\beta}$ contains K regression coefficients to be estimated by assumption $E\{\varepsilon_{it}\} = 0$ and $Var\{\varepsilon_{it}\} = \sigma_\varepsilon^2$ (Nielsen and Gaddy 1999).

The main strength of longitudinal design in the time-series model is that it allows controlling for heterogeneity bias due to the confounding effect of time-invariant variables omitted from the regression model. Cross-national differences in the size of the welfare state are likely to be invariant over time, because they are influenced by structural conditions which develop slowly and work over very long period of time. Time series models solve this problem by taking into account the important distinction between the analysis of cross-national differences and the analysis of changes within individual countries over time. With the time series model, the causes of such differences are best assessed statistically through analyses in which the key explanatory variable (economic globalization, IMF financial flows, foreign aid and external debt) are expressed as long-term properties of the whole system.

However, times series models are known to suffer heteroskedasticity and serial correlation in the error term. To deal with these problems, I use robust regression to estimate robust standard errors clustered over countries. The inclusion of the year dummies also help to absorb temporal dependence in the data.

Results

Table 1: Models of economic globalization influence on government spending on welfare and social protections 1990-2005 (N=368)

	Model 1	**Model 2**	**Model 3**
Economic globalization variables			
Trade	0.07	0.08	0.05
Foreign direct investment	0.07	0.1	0.19
Net financial flows, IMF concessional	-518.70*	-629.3**	-111.17*
Net financial flows, IMF non concessional	239.93	255.51	313.18**
Net financial flows, others	74.28	7.37	-182.45
Aid		0.07	0.03
External debt		0.26	-5.82*
Control variables			
Year	0.53*	0.39	0.51*
GDP per capita PPP			.00
Democracy			.92*
Labor force			.00**
Age dependency ratio			-6.82
Constant	17.41	16.4	19.02
R^2	0.14	0.15	0.42

Note: ** p<0.05, *p<.10 (two tailed t-test)

Table 1 presents the result of three models. Model 1 examines the impact of economic globalization on welfare spending. Among all three globalization variables, trade and foreign direct investment, two of the mostly commonly used indicators of economic globalization do not show any effect on welfare spending. However, net financial flows that are IMF concessional showed statistical significance. The coefficient indicates a negative relationship between IMF concessional financial flows and government welfare spending. There thus seemed to be evidence supporting Hypothesis 1: Efficiency hypothesis, meaning economic globalization leads to the retrenchment of the welfare state. IMF being the major advocator of economic neoliberalism does have huge impact on government welfare spending. The more concessional financial flows from IMF, the more constraints are put on transitional economies' public spending commitments.

Model 2 examines the impact of foreign aid and level of external debt on government welfare spending. Results showed no significant effect. Of all variables in model 2, net financial flows that are IMF concessional continued to show statistic significance and have negative association with welfare spending. Model 2 again showed statistical support for Hypothesis 1: Economic globalization leads to the retrenchment of the welfare state.

Model 3 is the full model that includes all variables discussed earlier. When I controlled for the size of the economy, democracy level, and demography factors, three of the economic globalization variables --- financial flows that are IMF concessional, IMF non-concessional, and external debt, showed statistic significance. Financial flows that are IMF concessional and external debt showed negative association to welfare spending, while financial flows that are IMF nonconcessional showed positive association to welfare spending. Evidence again showed support for Hypothesis 1: Economic globalization leads to the retrenchment of the welfare state. An interesting finding here is that financial flows that are IMF nonconcessional showed positive association with government spending.

Among all control variables, only democracy and labor force showed statistical significance. Coefficient of democracy showed positive relationship between a country's level of democracy and welfare spending, thus showed support for Hypothesis 3: Transitional economies that score high in democracy ratings experience expansion in welfare spending. In other words, there is a positive correlation between democracy rating score and government welfare expenditure. Coefficient of labor force variable showed very small, but positive effect on government welfare spending.

Discussion

Overall, the findings of this study supported the "efficiency hypothesis" in regard to the relationship between economic globalization and welfare spending within transitional economies. The most pronounced effect is that from IMF. Statistics showed that countries in transition, especially those received concessional financial flows from IMF are more likely to experience cut backs in welfare spending. Surprisingly, the socialist legacy of welfare provision could not continue when facing with the pressure from international financial organizations.

Second, since the full model explains less than half of the variance in the dataset, which suggests some part of the story is missing. One explanation could be the role of political globalization in directing government spending, which is not examined quantitatively in the models. Transitional economies that were formerly protected by the Soviet Union have to find a way to re-establish connection with the remaining sole superpower. Given that the United States is the dominant political power in the world, and given that United States is the major advocate of neoliberalism and economic globalization, we might argue that transitional economies are willing to cut public spending to show such gesture.

Third, the twenty-three transitional economies in the sample are not that homogenous as assumed. And it is very likely that the impact of predictors on welfare spending over time differs across countries. In order to delineate such heterogeneity within the sample, in the next stage of research, I am going to performing hierarchical linear model, in which the level-1 unit will be year; and level-2 unit will be country.

Limitation of the study and possible solution

The biggest limitation of this study has to do with the model design, namely the closed-economy bias. According to Moses (2000: 2), closed economy models concentrate on the domestic effects of macroeconomic policy decisions, largely ignoring the effects that these policies might have on the external balance, e.g. international trade and capital flows. This study acknowledges this close-economy bias. However, to quantify the intertwined relationship between domestic policy making and international pressure can be very complicated and messy.

The second limitation of this study is the peculiarity of China. Some of the explanatory variables in the model might not be applicable in China's case, for example, IMF concessional financial flows. IMF and World Bank never posed as international pressure for China to take neo-liberal economic practices. It was the Chinese government that voluntarily adopted these measures in order to be recognized in the international community, which was clear in the process of its ardent pursuit for WTO membership.

A possible solution is to conduct a country specific qualitative analysis that could reveal the intertwined relationship between domestic policy making and the international pressure. It will also help to unveil the complicated situations in countries like China.

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