THE ECONOMIC CRISIS IMPACT ON PUBLIC EXPENDITURES IN EU NEW MEMBER STATES

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This article analyzes the main trends of public expenditures in the New Member States 12 in the last decade. We develop a synthetic analysis of the total public expenditures and also an analytical inquiry of major categories of public expenditures according to COFOG. Based on data provided by Eurostat from 2000 to 2010 we try to capture the impact of global financial crisis on the major trends of the public expenditures for new member states. Our purpose is to reveal a global view of the state of public expenditures in this group of EU countries and also we try to make a comparison between Romania and these countries considering that the stance of public finance is quite similar to the new member states. The major findings of this study are the high increase of the public expenditures for all the countries especially in 2009, due to a huge increase of the social protection expenditures. In this context we underline some correlations between the public expenditures evolution and economic growth.
Keywords: public expenditures, fiscal policy; economic growth; budget deficit.
JEL Code: E51; H3; H61.

Introduction

The government role in now days is very complex and important through the major function accomplished by the public finance. The global economic and financial crisis has revealed once again the necessity of state intervention for rebalancing the economy and for recovering after the year 2008. The public sector and the state intervention have to be financed through taxation or if there are not enough revenues borrowing money. The state role increasing was accompanied by the public expenditures increase for the last years, because the public sector size has continuously extended. In this inquiry our purpose is to identify the impact of economic crisis on the public expenditures pattern for the new member states. We choose to realize the analysis only for this group of countries to have a clear view on Romania concerning the public expenditures comparative with similar countries. For this analysis we choose the share of public expenditures in GDP for a better comparative view between countries. Also we use the COFOG classification based on data provided by Eurostat for identifying the public expenditures structure. From this point of view is not only a global analysis, but also a structural analysis. The most important category of public expenditure is social protection with the highest share. The relationship between the economic growth rate and public expenditure is important because is reflecting the impact of economic crisis on the level and the composition of government expenditures.

Literature review

Any government intervention has to be financed through public expenditures. The welfare state existence is based on public revenues from taxes, fees and other forms. The ways in which the governments choose to finance the public sector have major impacts on the economic life.
Brumby, J. and M. Verhoeven (2010) consider that the global crisis has challenged countries to sustain spending that promotes future economic growth and poverty reduction. In particular, countries have made efforts to safeguard expenditure for health, education, and investment. As the crisis was unfolding, the need to support aggregate demand mitigated pressures on public

expenditures. But in the aftermath of the crisis, the need for fiscal consolidation will put renewed pressure on public expenditure in many countries.

The size of the public sector can be expressed by the level of public expenditures. In the last few years the public sector increases, especially in 2008 and 2009. The most important increase is registered for the social protection; for instance in 2007 is 17.6% from GDP and goes to 20% GDP in EU 27. Another important category of public expenditures is health and also we have an increase from 6.7% in 2007 to 7.5% from GDP in EU27, according to data provided by Eurostat Database (Mara, 2012).

According to Hall (2010) there has been a long-term trend for increasing levels of taxation and public spending in OECD countries. Public spending as a proportion of GDP has risen steadily, in line with economic growth, for 150 years. Tax and spending peaked during the two world wars of the 20th century, but the level of state spending and taxation then remained high and rose again in the years after World War II, until around 1990.

The economic crisis from 2008 caused an accelerated increase of public expenditures trend in most of all in countries affected by the crisis.

The social protection expenditures have the most important share in the total expenditures and for this category there is also the highest impact of economic crisis.

Busch (2010) underlines that the global economic crisis affects the funding of social security systems essentially via two channels: on the one hand, due to the higher unemployment, the expenditure of social insurance funds and the state is increasing, while on the other hand, their tax and contribution revenues are falling as a result of lower economic growth or lower wage increases.

Methodology and results

First step in our analysis is revealing the evolution of public expenditures as a % in GDP starting with 2001 until 2010 as average for European Union and for Romania. We choose to compute separately for EU 15 –the old member states and for the NMS 12 –the new member states. In the next figure this evolution is marked for the years of economic crisis when the trend of public expenditures is increasing. The maximum is registered in 2009, more than a half from GDP for EU 27 and EU 15. For the same year the share of public expenditures in GDP is 45% for NMS12 and more than 40% for Romania. For our country there is a different evolution because the trend of public expenditures is increasing before the crisis start, from 2005. After 2009 the governments through successful fiscal policy manage to reduce the public expenditure and this descending trend can be seen for all EU averages.

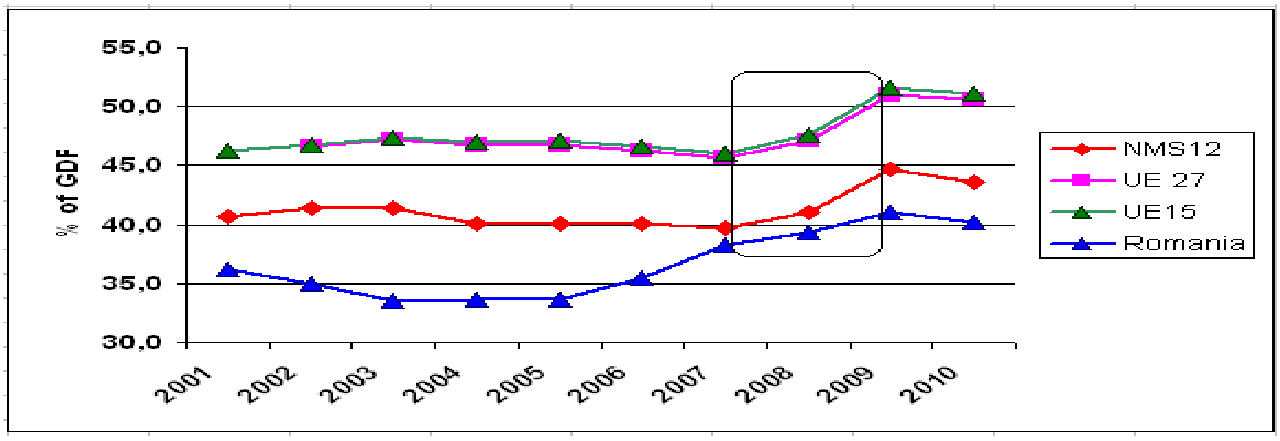

Figure no. 1. Public expenditures evolution in European Union
Source: realized by author

Considering the particular analysis for every new member states we can observe different trends between these countries. The highest level of public expenditure as percentage in GDP is in Hungary, more than 50%. Also countries like Slovenia and Slovakia registered highest increase of public expenditures in the economic crisis time.

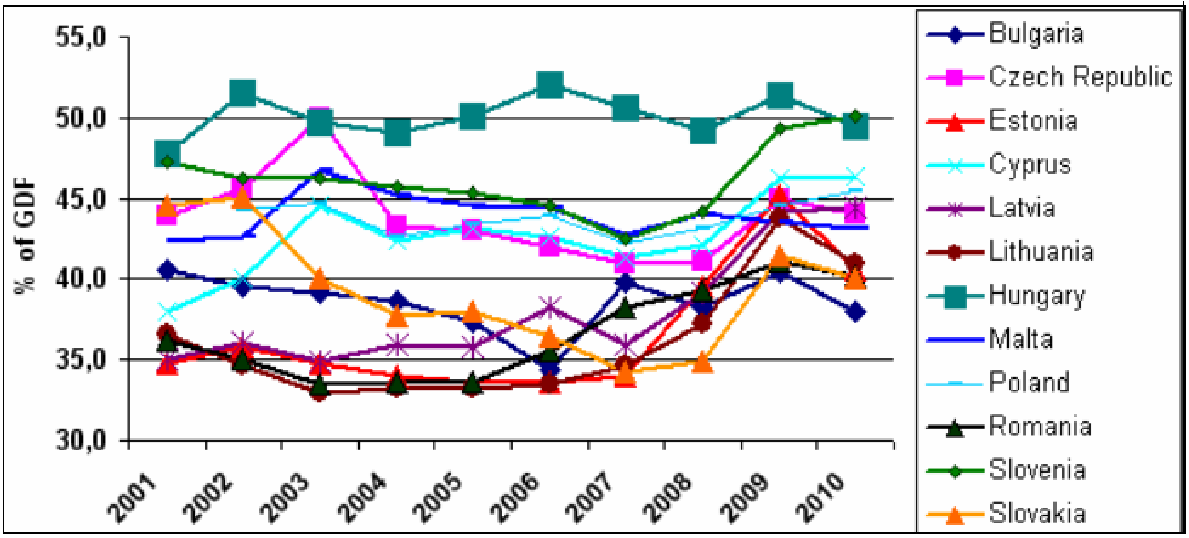

Figure no. 2. Public expenditure evolution in new member states
Source: realized by author

To explain this evolution we have to consider the structural analysis of public expenditure. This structural analysis is based on COFOG classification and data provided by Eurostat for the last decade as average for the NMS 12. In next figure are revealed categories of public expenditures and their evolution. It is important to note that the social protection expenditures count the highest share and starting with 2008 this share is increasing. Two major causes explain this continuously increases: the population ageing and the unemployment increase. Other four major categories follow on this rank: health, education, general public services and economic affairs with similar amounts. First category –social protection – is considered unproductive expenditure, while the last categories are considered productive expenditures. For this reason concerning the economic growth is not an incentive the increase of social protection expenditures, only the other expenditures mentioned above.

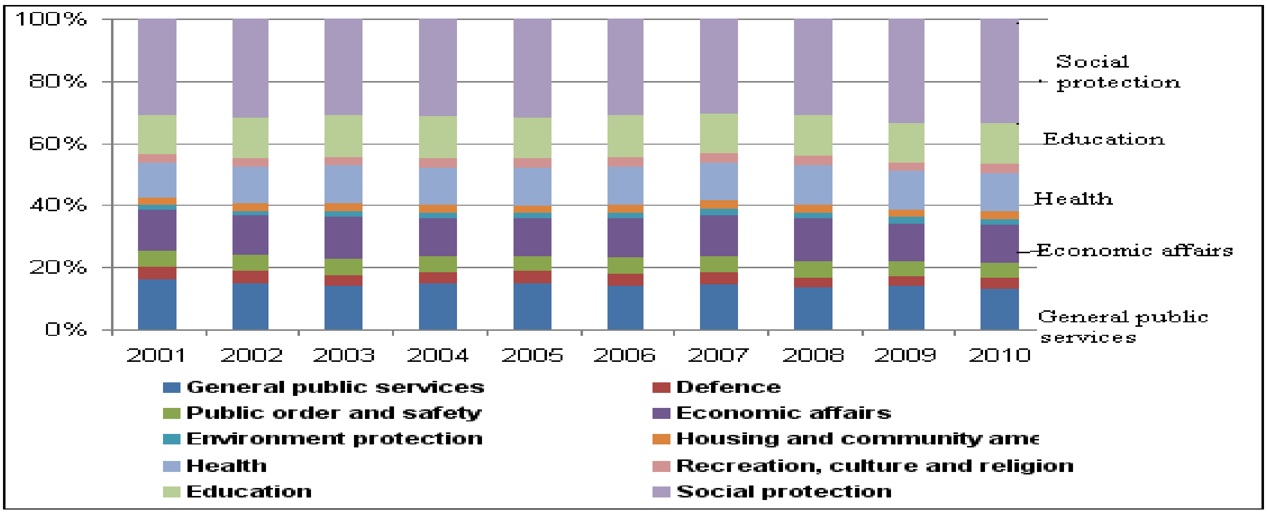

Figure no. 3. Structure of public expenditures in NMS 12
Source: realized by author

Expenditure on social protection consists mostly of payments for social protection benefits, which are transfers to individuals or households covering a set of risks or needs. This category of expenditure includes social benefits, operating expenditure and other expenditure incurred by social protection schemes.

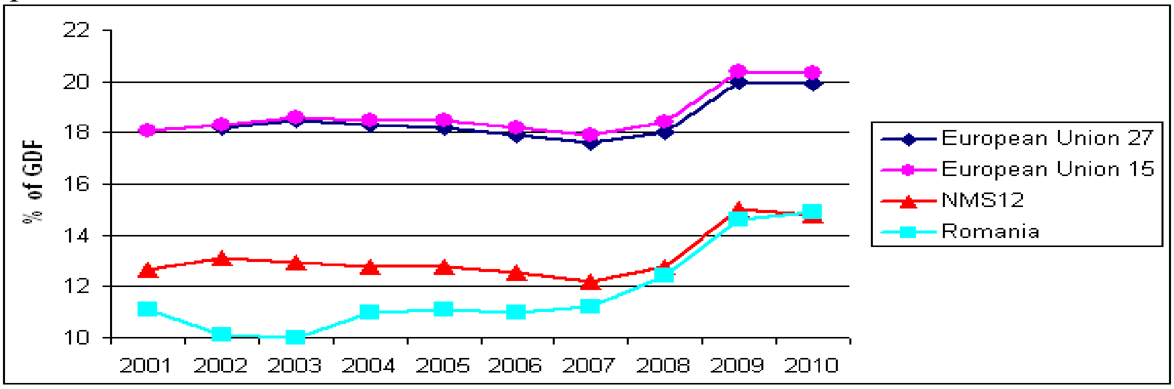

Figure no. 4. Social protection expenditures in EU
Source: realized by author

The lowest ration of public expenditures is in Cyprus and Slovakia and the maximum can be finding in Slovenia and Hungary in 2010. But for all NMS 12 the level is below the averages for EU 27 and EU 15. In the EU 15 is the highest ratio because the ageing of population is stronger comparative with NMS 12. Also the welfare state in EU 15 provides plentiful pensions and unemployment allowances comparative with NMS 12.

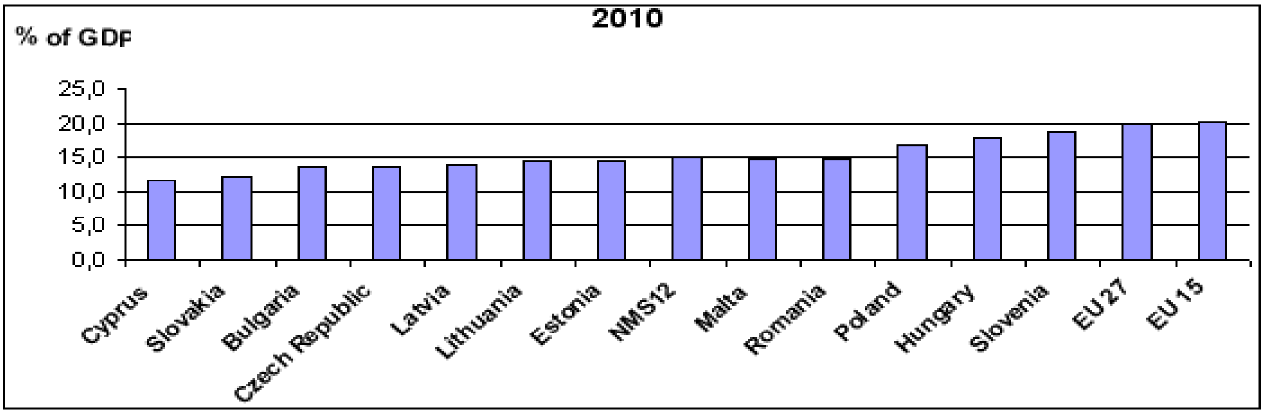

Figure no. 5 Social protection expenditures in 2010
Source: realized by author

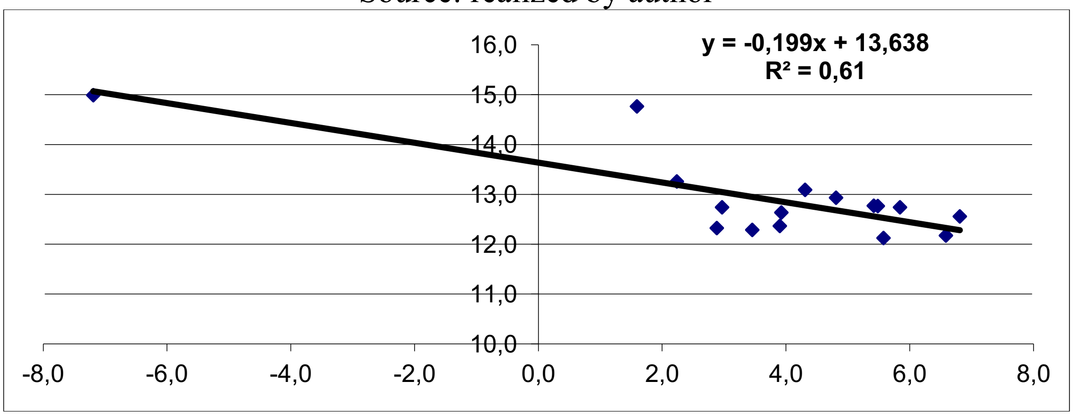

Figure no. 6. Correlation between social protection expenditures and economic growth rate in NMS12
Source: realized by author

For revealing the economic crisis impact we correlate expenditures ratio with the economic growth rate. We choose to test this correlation between the social protection expenditures and economic growth rate using data provided by Eurostat since 1995 until 2010. For NMS 12 are computed the average ratios. Based on the above figure there is a quite powerful correlation of 61% and there is an indirect correlation, fact that confirms the negative impact of economic crisis on this category of expenditure.

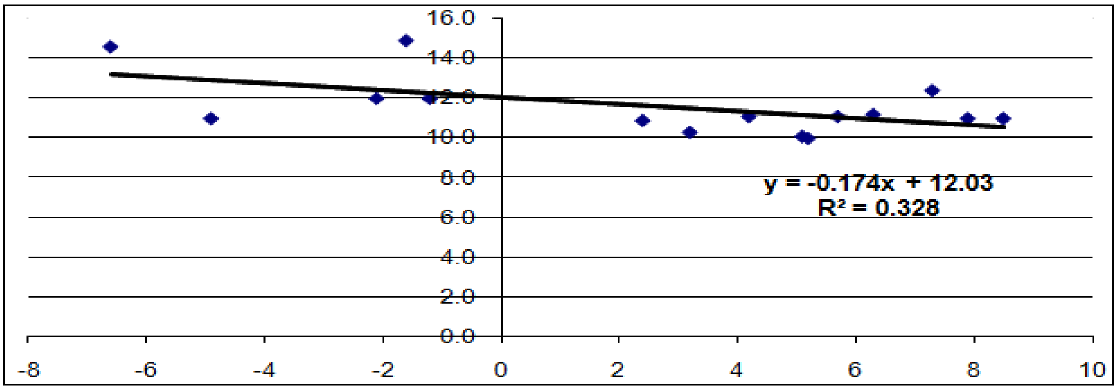

Figure no. 7. Correlation between social protection expenditures and economic growth rate in Romania

Source: realized by author

The same correlation is tested also for Romania for the same time; similar negative impact of economic crisis can be observed but no so powerful like for the average of NMS 12, only 32%.

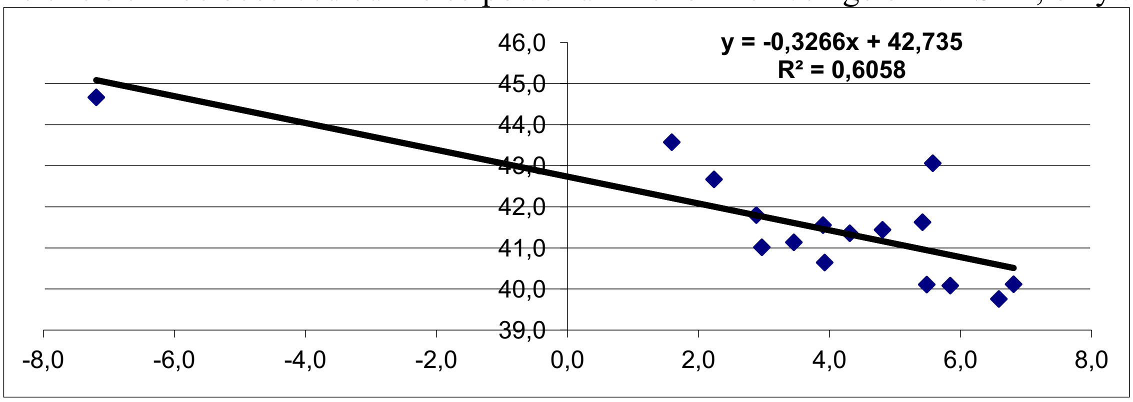

Figure no. 8. Correlation between total expenditures and economic growth rate in NMS12

Source: realized by author

Concerning the impact of economic crisis on the share of total public expenditures in GDP we can observe similar correlation as in previously case, almost 61% and also a negative impact manifested by increasing of spending on crisis.

Conclusions

The concluding remarks underline this increasing trend of the public expenditures due to economic and financial crisis for all new member states of EU starting with 2008, with a maximum pick in 2009. This evolution is explained by the increasing trend of social protection expenditures –the most important component of total expenditures according to COFOG classification. Another unwanted effect of economic crisis is decreasing of tax revenue because the taxable base (personal income, consumption, profits) was reduced. The major effect of this evolution is revealed by the huge levels of budget deficits of new member states and also increasing the public debt.

In this context the governments try to find solutions for increasing the tax receipt, especially increasing VAT rates for not affecting the economic growth rate and in the same time to reduce the public expenditures. Some countries choose to reduce public expenditures like general public services (Bulgaria with 4.3 percentage points in 2010 comparative with 2007), economic affairs (Romania and Malta).

But for all EU member states the only solution was to increase the public debt for covering the huge budget deficits, because the impact of global financial crisis was too powerful and unexpected for the national budgets. The economic crisis should be a valuable lesson for the present and future fiscal policy whose coordinates must first be based on a balanced budget to cope with the challenge of future crises.

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