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The Impact of the Great Recession on Social Spending in Romania

Emilia TITAN¹, Adrian OTOIU², Daniela MANEA³

Abstract

The paper attempts to do a comprehensive analysis on how spending patterns were affected by the most severe economic crisis since the oil shocks in the 70's. We have attempted to see which services have been significantly affected by the crisis, and whether social spending has risen and managed to counter the effects of the crisis. We have found that, despite generalized increase in social spending, the crisis had no major impact for some important social spending categories. Social protection revenue has increased and matched to a good extent social protection spending, which was also affected by a strong increase in the cohorts reaching retirement age. We also found that, contrary to other literature findings, spending on social services was countercyclical, increasing in the first years of the crisis, and declined afterwards. There is evidence that social spending managed to sustain a decrease in poverty and inequality during the crisis.

Keywords: crisis, social services, Romania, social protection expenditures.

Introduction

One of the major functions of the state is to take care of all its citizens, and provide the means for those in need and/or not able to provide by themselves for everything they need through redistribution of income and wealth, and financing and provision of social assistance services. Currently, financing and spending on social assistance programs are a major budget expenditure item, which is administered by a large part of the civil servant workforce.

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Taking care of citizens becomes more important in times of economic hardship. The Keynesian doctrine, developed in the years of the Great Depression, has enshrined the role of state as the major economic agent whose purpose is to counter or alleviate the negative effects of the economic cycle and ensure that the national economy operates as close as possible to its full potential. This is to a certain extent compatible with one of the main goals of the states, to provide for those in need.

However, while this role of the state is clear, reality may differ in several respects. In some cases the state was unable to provide for its citizens due to the limited financial resources. Major crisis events, such as the Great Depression, have resulted in massive unemployment and strongly reduced output, making adequate support for the unemployment and needy simply impossible. In other cases, some needs may simply go unaddressed due to existing policies and social protection mechanisms, which are mainly due to inappropriate design, or an inability to set up and maintain them.

The latest economic crisis, whose effects were felt in most countries, had a strength and magnitude that puts it against the major crises experienced in the past. Economic growth has stopped for a prolonged period, unemployment rates have risen and the fall of several major banks have put threats of the overall stability of the economies. Unfortunately, Romania has not been sheltered from the effects of this crisis. Strong economic growth came to a halt; while before Q4 2008 growth was over 9%, the next year GDP decline reached a quarterly average -6.8%, and stayed in the negative territory in 2010. Unemployment inched up by more than one percentage point in 2010 compared to 2008. Austerity measures aimed at keeping public spending under control and balance the budget was harsh: salaries of civil servants were cut by 25%, and VAT has increased by 5 percentage points, as mentioned by Oprea *et al.* (2012). Against this backdrop, it is interesting to see how provision and funding for social services has evolved during the Great Recession in Romania. In this article we will attempt to assess the evolution of different types of health care and social assistance before and after 2009 in terms of demand and use of services, and supply of funding. Our goals are to see which types of health care and social assistance spending have experienced increases after 2009 that can be attributed to the crisis, whether these increases have been adequately funded, and whether funding kept up with increased demand. Finally, we will attempt to see whether social service expenditures were effective from a societal point of view. We will also seek to single out the unusual observed evolutions and highlight their importance.

Literature review

The impact of crisis on social spending is very diverse, affecting many socio-economic areas: employment and unemployment, income assistance programs, family budgets, income support schemes, child and health expenditures. However, despite this diversity, it concentrates of two major dimensions: the demand for social assistance and health care on one hand, and the supply of public funds to finance it.

The demand for social assistance has increased as the crisis resulted in rising unemployment, even pay cuts (Oprea *et al.*, 2012). The social impact of crisis-induced unemployment is also highlighted by Bostan and Grosu (2010) which highlight some of its consequences: the social tensions generated by the increasing poverty of the population, fear of job loss; more and more families with serious financial problems, and return of immigrants. Apart from these effects, Stanculescu and Marin (2011) have pointed out to a reduction in the employed population, a decrease of the size of family budgets, and reforms of the social assistance services consisting in interruptions or downscaling.

With respect to labour income and employment, Vasile and Pisica (2011) point out that the recent crisis has increased employment in the informal sector, which acts as a buffer between the formal sector and the mass of the unemployed and those out of the labour force. This translates into higher volatility of income and working hours, with a direct impact on family budgets. An analysis of the health spending during this last recession done by Keegan *et al.* (2013) has shown that there is a negative relationship between health spending and the severity of the crisis, albeit preceded by a countercyclical response at its first stages. A comprehensive review done on the effects of crisis by Chowdhury *et al.* (2013) shows that, in addition to the effects on employment and working poverty, the last crisis brought about sizeable increases in malnutrition, hunger, suicide, domestic violence and child abuse. Authors find that policies matter in mitigating the impacts of the crisis and have a role in sustaining economic recovery.

The impact of spending on social services and health care is found to be linked to the level of development of the country and the severity of the crisis. While both the Keynesian and neoclassical schools agree that spending on social services should not be cyclical, they differ in the role of social spending, as pointed out by Prasad and Gerecke (2010). The authors observed that many developing countries have adopted a procyclical policy, as Romania did, for reasons pertaining to their revenue volatility and poor governance. In Romania's case, it appears that strong economic growth has enabled governments to open the public purse and distribute some of the fiscal revenues to the one in need, often in the wake of the electoral cycles, as pointed out by Oprea *et al.* (2012). This has left Romania with less room for maneuver as public spending on social services was already high, and

could not have been increased further. Oprea *et al.* (2012) also point out that in Romania, the recent crisis has brought about fiscal consolidation, resulting in a wage cut of 25% for civil servants, and a VAT increase of 6 percentage points. However, the authors also point out that budgetary revenues were relatively stable throughout the crisis period, falling only in 2009.

An interesting finding was the evolution of budgetary spending on social services during the crisis. Bourget (2003) cited by Prasad and Gerecke (2010), finds that social spending increases initially during crisis, and falls afterwards due to a shortage of funding, fact consistent with the research on health spending done by Keegan *et al.* (2013). However, other authors cited by Prasad and Gerecke (2010) point out to a resilience of social spending during crises, which exhibit a high degree of countercyclicality.

Romania’s Social and Health Services during the Great Recession

The crisis had a mixed impact of social and health services, differentiated across the entire spectrum of services. The most direct impact of the crisis has been felt in terms of unemployment, as shown in Figure 1. Thus, total unemployment rate, after exhibiting a clear downward trend from 11.8% in 2000 to 4% in 2007, rose sharply in 2009 to 7.8% and remained above 5% after 2010, matching the pre-crisis levels of 2005 and 2006. The youths were the most impacted by the crisis, with unemployment rates reaching all-time highs during the crisis: 32.7% for the 15-19 age group in 2009 and 22.6% for the 20-24 age group in 2011. The same happened for the youths aged 25-29, with unemployment rising to an all-time high of 10.7% in 2012. A similar pattern was observed for older workers; unemployment rates for all age groups experienced all-time highs during the crisis, but did not surpass the total unemployment rate. Unemployment of the core age groups showed a high degree of resilience; the increase during crisis was not above 2005 pre-crisis levels.

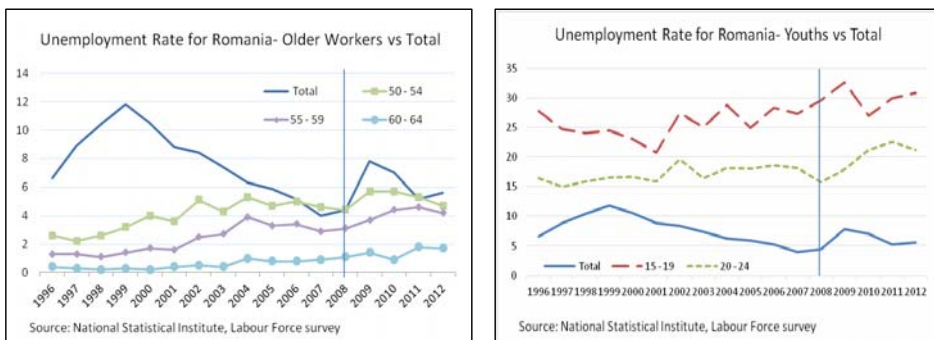


Figure 1. Romanian Unemployment, Total and Age Groups

Rising unemployment has triggered other adverse effects, noted by many authors. Among them, Stanculescu and Marin (2011) point out to increased poverty, a larger number of at-risk of poverty individuals, increases in informal employment, and job losses among vulnerable groups such as youths and roma. Fleser and Criveanu (2012) show that crisis brought about smaller or stagnating salaries, increased the attractiveness of emigration, and worsened the perception of poverty of the population. However, data on poverty is available only since 2007, thus we do not have a reference period long enough to assess the effects of crisis.

The fact that crisis led to a reduction in the provision of social services has been noticed by some workers in social assistance, as pointed out by Stanculescu and Marin (2011). Similar trends were noticed for developing countries, as pointed out by Prasad and Gerecke (2010). There is limited data to explore these trends in detail for Romania. However, an analysis of the capacity of social canteens shows a marked decrease of 7 thousand places, or 22%, from 2008 to 2011, with a small upturn noticed only in 2012 (Figure 2). It is hard to believe that increases of unemployment and perceived increases in poverty have not increased the need for social canteens for those in needs.

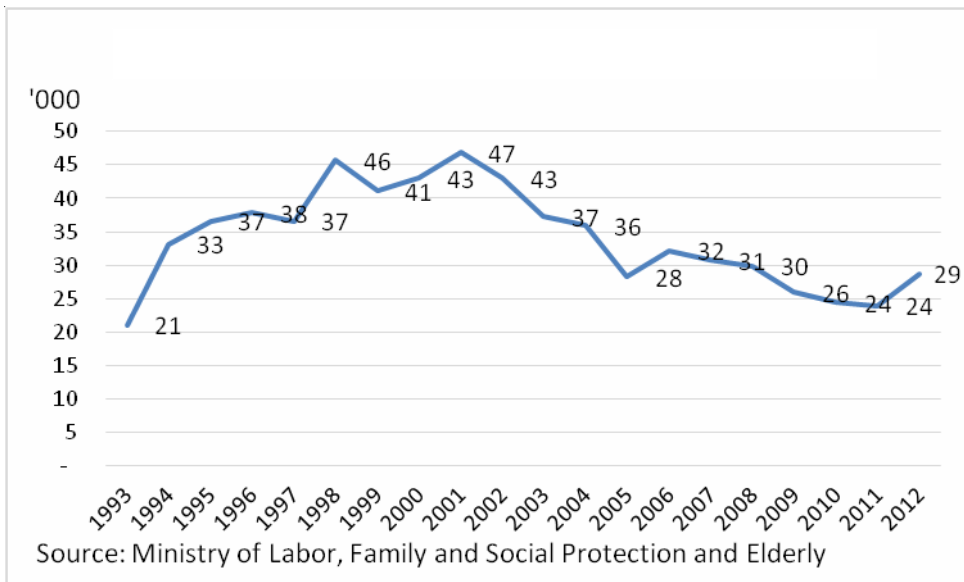


Figure 2. Capacity of Social Assistance Canteens

The analysis of health care provision using hospital discharge data shows that for most major disease categories, the crisis had no sizeable impact (Figure 3). Respiratory and digestive diseases showed fluctuations in line with pre-crisis levels, while the increasing trend of heart and circulatory diseases continued. Nutrition and infectious diseases showed a decreasing trend during crisis year, and, equally surprising, there was no upsurge of mental diseases, usually associated with unemployment and economic hardship, as noted by Layard *et al.* (2005). However, it is hard to say whether these evolutions have not been negatively impacted by changes in hospital funding in Romania as shown by Bulgariu (2012).

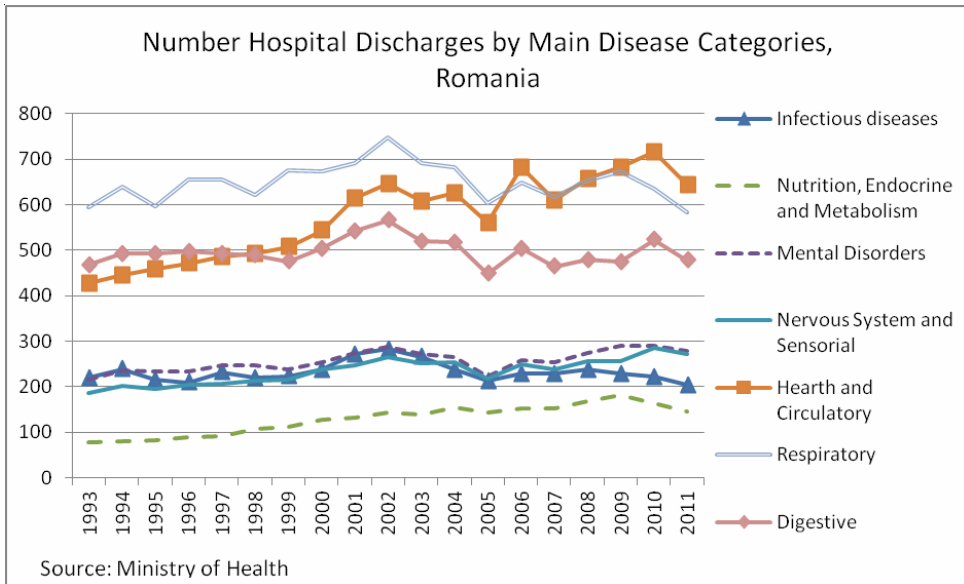


Figure 3. *Hospital Discharges*

The analysis of expenditures on social protection helps us make a unified analysis of the key developments in social and health services before and during the crisis, and overcome the lack of data, or its limited availability, for the assessment of the basic needs of the individuals for such services.

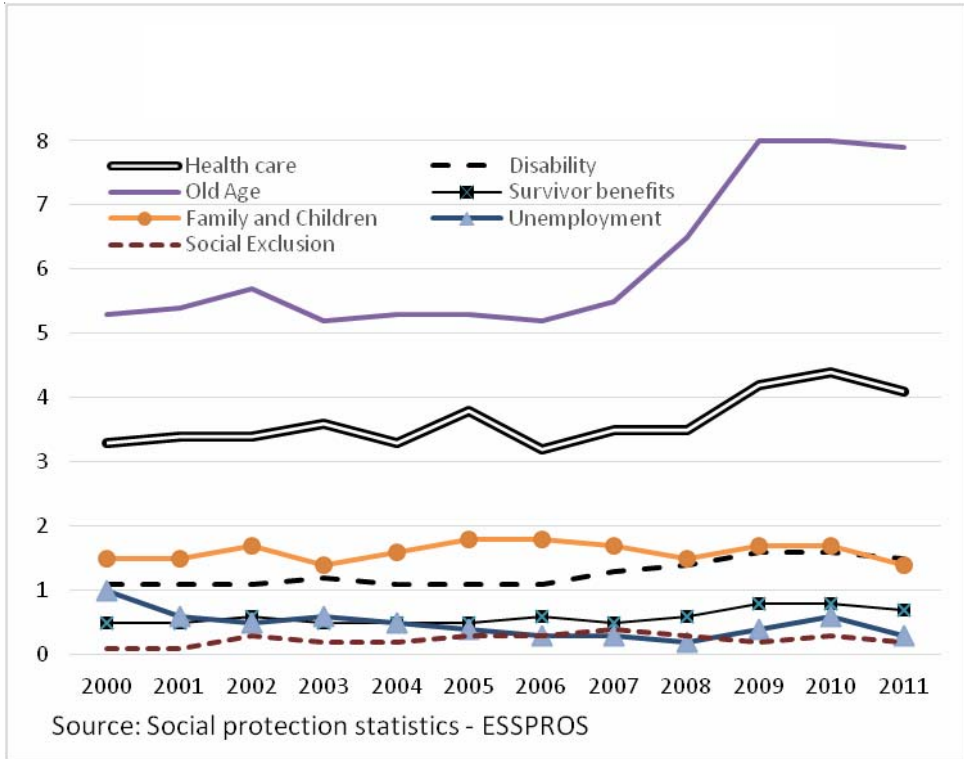


Figure 4. Social Protection Spending, Before and After the Crisis

Figure 4 shows that for many social services, spending has increased markedly during the first two years of the crisis, and decreased in 2010. Between 2008 and 2010, health care expenditures increased above the trend that began in 2006, and reverted to it in 2011. Thus, it seems that the relationship observed for European countries by Keegan *et al.* (2013), showing an initial countercyclical response also applies to Romania.

Unemployment-related spending resumed the decreasing trend in 2008, and tripled its share of GDP by 2010. Survivor benefits increased markedly since 2008 by about 1/3rd; spending on family and children services also increased during the first year of crisis, but began to decrease after 2010.

Old age benefits reached a historically high level in 2009. This is mostly due to aging of the population; since 2006, the cohort of the 60 year olds, age at which over 80% of the population receives pension income (National Statistical Institute, 2013), has jumped from 183,000 to 282,000. This explains a 7.7% increase in the number of old age pension recipients, from 3.1 million in 2006 to 3.4 million in 2012. However, we cannot rule out the fact that some of these retirements may

have in fact been boosted by adverse economic developments, which enticed the elderly to resume employment and retire.

Social exclusion expenditures confirmed the evidence gathered by Stanculescu and Marin (2011), showing a slight decrease after 2008. It seems that the crisis has indeed affected the capacity of providing services in this area. However, if we relate its relatively small size to GDP, about 0.2-0.3, with the strong increase in social protection revenues between 2008 and 2011, as shown in figure 5, we can conclude that their decrease from pre-recession levels of 0.4 and over is mainly due to the design of social protection system and the availability of funding from different state entities that are in charge for managing specific programmes. In sum, based on the evidence coming from different data sources, we can conclude that many categories of social expenditure have risen during the crisis, despite the fact that some rationalization may have occurred due to a limited delivery capacity and curtailed funding. The aggregate figures for social protection expenditures, with or without old age expenditures, show an overall increase during the 2008-2011 periods.

Romania's Public Finances during the Crisis. Has the State Fallen Behind?

The previous analysis shows that spending on social and health services has increased during the crisis, with an evolution that broke the existing patterns of the last pre-crisis years. But to what extent has the increase been sustained is our next research question, which sheds light on whether the Romanian government fiscal policy has been able to effectively meet this increase.

Despite the abrupt drop in real GDP growth, from 7.3% in 2008 to -6.6% in 2009, social protection revenues have increased markedly. Their share of GDP rose from 13.2% in 2008 to 16.1% in 2010, at levels high enough to match most of the increase in social protection expenditures, affected by a double whammy of increases due to both the crisis and a wave of retirements triggered by ageing. We can also argue that this made the increase of social and health services spending sustainable, as the highest gap between social expenditures and revenues was only 1.5% of GDP in 2010.

This observation is also true if we look at the evolution of social protection expenditures exclusive of old age expenditures. It seems that if we remove the direct effect of ageing, the share of social protection spending in GDP has increased by 1.5 percentage points in 2010 compared to 2007. This is below an increase of 3.1 percentage points in revenues during the same analysis period.

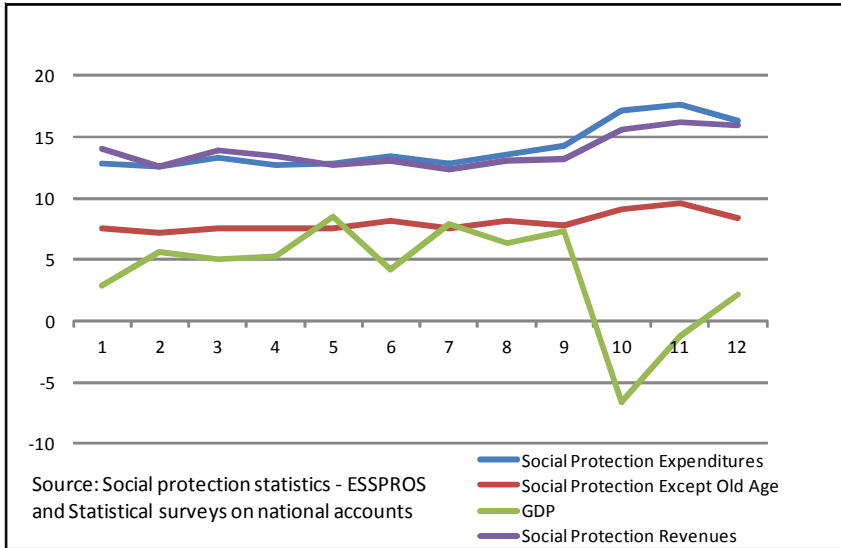


Figure 5. Evolution of Romanian Social Expenditures before and During the Crisis

Another remarkable development is that the evolution of social expenditures mirrored the path and severity of the crisis. Starting from 2011, both social protection revenues and social expenditures not related to ageing have started to decrease, one year after the GDP decline started to abate. This finding is consistent with the observations of Prasad and Gerecke (2010) and Keegan *et al.* (2013) and is merely related to the procyclicality of government spending in developing countries, a limited ability to provide services under economic hardship, and a tendency to promote fiscal austerity measures as pointed out by Chowdhury (2013).

However, this evolution should not be seen as a shortcoming, but rather as an appropriate response to actual social protection needs in time of crisis. Thus, the role of social assistance services during a crisis should be to alleviate the hardship and provide help to those in need, and not to create a class of socially-assisted people dependent on social assistance. Statistics on poverty and social exclusion show that the effect of adverse economic conditions has been contained by social protection expenditures. Thus, the relative at risk of poverty rate before social transfers has increased during the crisis by 2 percentage points, while the share of population at risk of poverty and social exclusion has decreased by throughout the crisis by 3.9 percentage points. Severe material deprivation has also decreased throughout the crisis by 3.3 percentage points, showing the fact that the reduction of poverty experienced by Romania after 2000 has continued even during adverse economic conditions. The evolution of the Gini coefficient also shows that crisis has not led to higher income inequality, and that despite a decrease or stagnation in wages, the fall in disposable income has affected the rich more than the poor.

Table 1. *Inequality and Poverty Measures for Romania*

	2007	2008	2009	2010	2011
Relative at-risk-of-poverty rate before social transfers, pensions included (%)	46.2	47.8	48.2	47.4	49.8
AROPE-at risk of poverty or social exclusion rate (%)	45.9	44.2	43.1	41.4	40.3
Severe material deprivation rate (%)	36.5	32.9	32.2	31	29.4
Gini Coefficient for Disposable income (1-100)	37.8	36	34.9	33.3	33.2

Source; *INSSE, Indicators of social inclusion, Eurostat*

In sum, we can conclude that the increase in the level of expenditures on social protection services has been adequately financed from the social protection revenues, even though the economic crisis has put a dent on fiscal revenues, and aging has led to a sizable increase in old-age expenditures (mainly pensions). This increase has been stronger in the first years of the crisis, and has abated as the economic decline has diminished. Sustainability of increases has been maintained throughout the crisis, with the deficit of social protection financing being less than 1.5% of GDP, or 9.7% of social protection revenues. The effectiveness of social protection could be seen in the poverty, material deprivation and income disparity statistics: while relative at risk of poverty rate before social transfers has increased, all other measures have shown a decline in poverty and inequality.

Conclusion

While the crisis has hit hard the Romanian economy, with strong effects on economic growth, unemployment and family income, the social protection and health spending were up to the challenge posed by the crisis.

Despite strong data limitations pertaining to the basic needs related to the social protection, social expenditure data shows a generalized increase starting from 2008. While old age spending has increased to an historically high level due to an increase in the number of people reaching retirement age, other expenditures have also surpassed pre-crisis levels: health care, unemployment, and disability. Other social spending has either increased slightly, back to pre-crisis levels (family and children expenditures), or actually subsided (social exclusion). These findings are consistent with some of the literature on the social protection spending by Prasad and Gerecke (2010) and Stanculescu and Marin (2011) and on health expenditure by Keegan *et al.* (2013) which observed that as crisis progresses, expenditures and availability for some social services has decreased due to a limitation of the resources available. However, spending on the majority of social protection items have invalidated the conclusions of some authors, Prasad and

Gerecke (2010), Chowdury *et al.* (2013), and Oprea *et al.* (2012), that in many developing countries, and particularly in Romania, public spending was procyclical, and that a relatively high level of public spending before the onset of the crisis has limited the ability to increase them during the crisis. Evidence has shown that, on the contrary, both social protection revenues and spending have increased, and their evolution was proportional to the strength of the economic downturn as shown by the evolution of GDP growth. Moreover, despite the austerity measures taken that characterized this crisis, pointed out by Chowdury *et al.* (2013), that drawn subsequent criticism as mentioned by Segol (2012), and anecdotal evidence related to a decrease in resources available for social assistance, Romania ran a deficit of social protection spending that was kept at sustainable levels and under control throughout the crisis. This fact is more laudable given the fact that ageing pressures have also kicked in at the same time as the crisis began.

Also, the variations in social expenditures during the crisis have shown a pattern of sustainability, with the strongest increases during the first two years, and smaller increases during the past two years. The reduction in the social protection deficit from 9% in 2009 to 2% in 2011 shows a commitment to keep a budget fairly balanced, and not to build up debt.

The effectiveness of the social spending is to a certain extent reflected in poverty and inequality measures. While the crisis has definitely increased the risk of poverty reflected by incomes before pension social transfers, other key poverty and inequality measures have shown a decrease in poverty and inequality that continued despite adverse economic conditions.

The conclusions above shed light on the functioning of the social protection system in Romania, and on the major limitations of the analysis shown above. Since in some cases, statistics on the provision of social and health services show decreases, while the corresponding social expenditure items show increases, an in-depth quantitative analysis targeted on specific social expenditure item(s) is recommended, in order to the relevance of existing data, and point out to major gaps in social and health service provision data. Thus, in the case of health expenditures, it may be that hospital discharges are not a good proxy for the evolution of health expenditures, and that trends specific to social provision fields may have a stronger explanatory power than evolutions in the social protection budgets and numbers of recipients in need.

Analysis of social protection spending and revenues shows a commitment of the governments towards ensuring sustainability of expenditures, and providing levels of social support that are able to match increases in demand due to adverse economic conditions and other major developments, such as the one caused by large increases in retirement numbers.

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