EUROPEAN POLICYBRIEF

SPINTAN – Policy Brief No. 10

Structural changes in public expenditures in the European Union since 2008 – with special regard to New Member States*

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	SUMMARY
Objectives of the research	Since the global financial crisis the public expenditure ratio to GDP in EU28 has risen significantly. The paper analyses the reasons for the growing size and the change in the structure of public expenditures in the European Union since 2007, with special regard to the New Member States.
Scientific approach/ methodology	By using the standard decomposition technique, the increase of expenditure-to-GDP ratio will be separated to 1) the impact of GDP change and 2) the effect of the change of actual public expenditures. In the second part, by constructing time series datasets the change in the structure of public expenditures are analysed.
New knowledge and/or European added value	In 2009, mainly the fall of GDP was responsible for rise in the expenditure ratio, i.e. the „automatic stabilizer" was dominant over the demand-boosting actions. Taken, however, the entire period since 2008, the higher expenditure ratio in 2014 can exclusively explained by the effect of higher actual expenditures.
Key messages for policy-makers, businesses, trade unions and civil society actors	In the New Member States the increase of public expenditure ratio was more moderate between 2008-14 than in the old members. Contrary to the old members, the share of expenditures on social protection decreased since the global crisis but there is a great variety among countries.

* This Policy Brief is based on the SPINTAN Working Paper No. 14. É. Palócz, Z. Matheika and P. Vakhal (2016): "Structural changes in public expenditures in the European Union since 2008 – with special regard to New Member States" available on the SPIINTAN website http://www.spintan.net/c/working-papers/.

Objectives of the research

After the global financial and economic crisis struck, the public expenditure ratio to GDP in EU28 spectacularly rose: from 44.9% of GDP in 2007 to 50.3% in 2009. Although after 2009 the ratio of fiscal expenditures decreased slightly, in 2014 it still exceeded the ratio of 2007 by 3.3 percentage points.
Except for Romania and Lithuania, the public expenditure ratio was **in every single EU states** higher in 2014 than it was in 2007. In Finland and in Cyprus the rise of the ratio was even over 10 pps).

One of the aims of the paper is to analyse, to what extent these changes are due to changes in GDP on the one hand, and to the nominal changes in expenditures on the other. To put it differently: to what extent the generous government spending accounted for the rising expenditure-to-GDP ratio, and how much of this rise can be attributed to the change in the GDP.

The second objective of the paper is to determine how the structure of public expenditures changed in this period. What items of expenditures benefited from the growing expenditure ratio and what similarities and dissimilarities can be observed in the New Member States?

Scientific approach / methodology

In the first part of the paper we use the standard decomposition technique, in order to separate 1) the impact of the change in GDP and 2) the effect of the change of actual public expenditures. The formula of *expenditure effect* informs about the magnitude of the change that would have taken place had the nominal GDP in current period been identical to that of the previous period, that is, the extent of the change in the expenditure-to-GDP ratio that is *independent* from GDP change. The *GDP effect*, on its turn, assumes away the change in nominal expenditures. A positive value at any of the two components indicates that they had an upward effect on the GDP rate of expenditures; a negative value indicates a downward effect. Values are calculated at current prices.

In the second part we constructed time series datasets of COFOG statistics, in order to observe the change in the structure of public expenditures. We use the indicator of the percentage share of individual expenditure items in GDP.

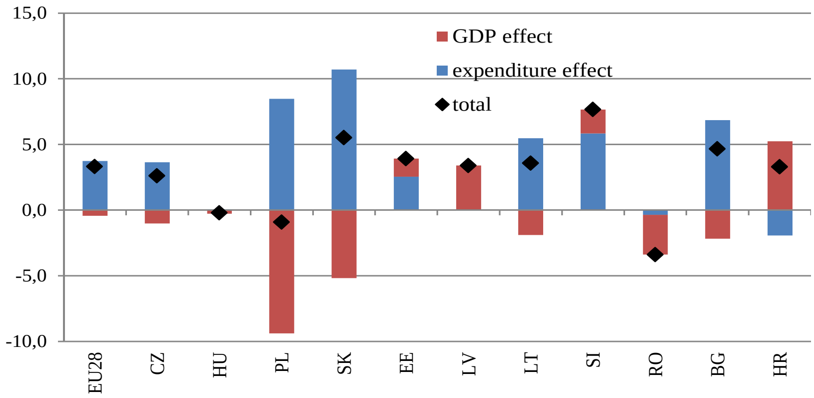
New knowledge and European added value

In the autumn of 2008 the EU urged the member states – at least the ones that could afford it – to "give free rein" to the fiscal deficit. According to our computation, however, in 2008-09 mainly the contraction of GDP, not the „runaway" spending of member states, was the decisive factor behind the immediate rise in the expenditures to GDP ratio: the effect of contracting GDP accounted for 63% of the rise in the ratio in 2008-2009, as opposed to the 37% due to the effect of raising expenditures. This means that the „automatic stabilizer" was more important in shaping the fiscal trends in the year of the acute crisis than the demand-boosting actions. In the following years the picture varies from year to year but taken the entire period, the "expenditure effect" exceeded the "GDP effect". I.e. the (slowly) growing GDP couldn't compensate the effect of faster growing expenditures.

The New Member States do not show a uniform picture. A remarkable similarity to the old member states is that in 7 from the 11 countries the public expenditure ratio significantly grew between 2008 and 2014 (by 3-7 pps); in Hungary it stagnated, in Poland declined slightly and in Romania definitely fell.

Concerning the components of this pattern, however, there is a great variety among NMS (as among the old members, too).

Chart 1. The cumulative effect of the changes in fiscal expenditures and GDP on the change in the expenditure-to-GDP ratio in the EU28 and in the New Member States, between 2008 and 2014

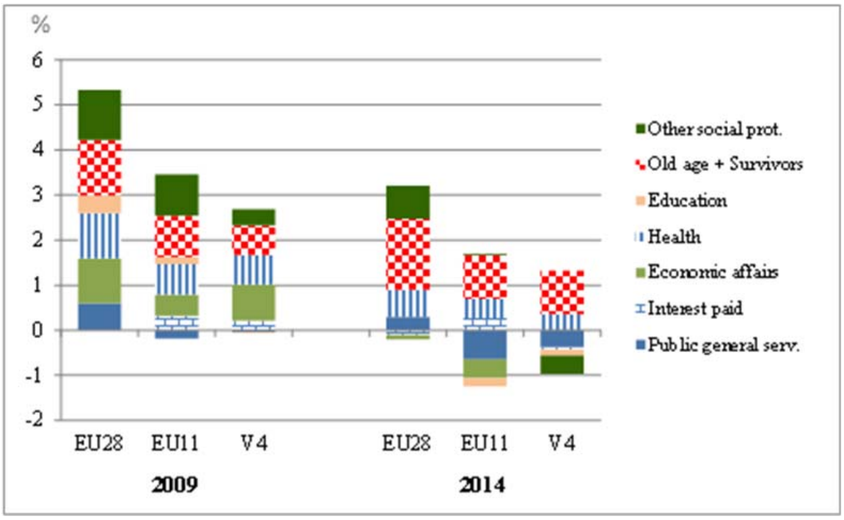


Source. Eurostat database Economy and Finance, Government Statistics.

Chart 2 demonstrates that in the EU28 on average the share of almost every main item of public expenditures in GDP grew between 2008 and 2014. In the entire period the major winners of higher expenditure ratio were, however, the social protection expenditures, mainly pensions (on chart 2 the item "social protection" is divided to pensions and other social protection) on the one hand, and health care expenditures on the other. The share of public spending on education stagnated and that on economic affairs declined.

In the NMS, as a whole, the change in structural pattern was more or less similar to that in the old EU members, only at a lower level. Common features are that the share of spending on pensions grew in every NMS (except for Romania) and the expenditures on education stagnated. At the same time, the share of items of social protection other than pensions, while markedly rising in EU28, decreased in 4 out of the 11 countries, most definitely in Hungary.

Chart 2: Cumulative change in the major expenditure categories between 2008-14, as a percentage of GDP, in the EU28 and in the New Member States (compared to 2007)



Key messages for policy-makers, businesses, trade unions and civil society actors

Public spending ratio-to-GDP has significantly grown in EU28 since the global financial and economic crisis. The higher expenditure ratio seems to be permanent, at least in medium term, since the moderate economic growth is unable to compensate the pressure to maintain higher spending. The higher rate of fiscal redistribution, coupled by the necessity to meet the Maastricht criteria, raises the need for more fiscal revenues, which might lead to a new, different phase of fiscal policy compared to the tendencies before the crisis.

Behind the average, there are rather different patterns in individual countries, both among the old and the new member states. Although there are common features in the components and items of growing public expenditures (e.g. the increasing share of expenditures on pension) dissimilarities in the structural change of public expenditures are significant, both in EU28 and among NMS.

SPINTAN – Smart public intangibles

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