

Marharyta Chabanna
National University of "Kyiv-Mohyla Academy"
chabanna@ukr.net

Government's policy during the financial crisis of 2008-2009 in Ukraine: mitigating the social impact of economic recession

*Polityka rządu w czasie kryzysu finansowego 2008-2009
na Ukrainie – minimalizowanie społecznych skutków
recesji ekonomicznej*

Summary:

The global financial crisis of 2008–2009 has played a significant role in the decline of financial and economic activity, affecting the real and financial sectors, as well as the reduction of real income households. Accordingly, the economic recession of 2008–2009 in Ukraine affected the main macroeconomic and social indicators. The negative social impact was escalated by the lack of social reforms. In such a situation, the growing government spending on social welfare and social benefits caused the increase in electoral support. This situation has led to an increase in nominal income of households in the short term, but impeded the social reforms and did not promote economic development in the long run.

Keywords: social policy, financial crisis of 2008-2009, government spending, social welfare, social benefits

Streszczenie:

Globalny kryzys finansowy z lat 2008-2009 odegrał znaczącą rolę w zmniejszaniu się aktywności finansowej i ekonomicznej, oddziałując zarówno na realną gospodarkę, jak i sektor finansowy oraz redukując rzeczywiste dochody gospodarstw domowych. Analogicznie, recesja z lat 2008-2009 na Ukrainie wpłynęła na główne wskaźniki makroekonomiczne i społeczne. Negatywne skutki społeczne spotęgował brak reform społecznych. W takiej sytuacji rosnące wydatki rządowe na pomoc społeczną i świadczenia socjalne skutkowały wzrostem poparcia wyborczego. Taka sytuacja dorowadziła do wzrostu dochodów nominalnych gospodarstw domowych w krótkim okresie czasu, ale utrudniła reformy społeczne i nie wspierała wzrostu gospodarczego w perspektywie długookresowej.

Słowa kluczowe: polityka społeczna, kryzys finansowy 2008-2009, wydatki rządowe, pomoc społeczna, świadczenia socjalne

1. Economic situation in 2008-2009: the social impact and public expectations

The global financial crisis of 2007–2009 has played a significant role in the failure of key businesses, a downturn in economic activity leading to the 2008–2012 global recession and contributing to the European sovereign-debt crisis¹. This financial crisis, as well as other global crises, has been accompanied by recessions in many countries². As a rule, economic recession is a period of “a significant decline in economic activity spread across the economy, lasting more than a few months, normally visible in production, employment, real income, and other indicators” which “begins when the economy reaches a peak of activity and ends when the economy reaches its trough”³. The global financial crisis of 2007-2009 meant a deep downturn, affecting the real and financial sectors “both in advanced and in emerging and developing countries”⁴. A liquidity crisis as the active phase of the financial crisis⁵, on the economists’ opinion, can be dated from August 9, 2007 in the USA⁶. Later there was “a domino effect on the entire US and the other countries’ stock markets”⁷, and the global financial crisis has spread since the fall of 2008, leading to a global downturn “of uncertain severity and duration”⁸. In social sphere, it affected on the housing mar-

¹ C. J. Williams, *Euro crisis imperils recovering global economy, OECD warns*, “Los Angeles Times”, May 22, 2012.

² As experts say, this pattern “is consistent with the historical record. Synchronized recessions have occurred in advanced economies several times in the past four decades—the mid-70s, early 80s, early 90s, and early 2000s. Because the United States is the world’s largest economy and has strong trade and financial linkages with many other economies, most of these globally synchronized recession episodes also coincide with U.S. recessions”. (S. Claessens, M. A. Kose, *What Is a Recession?*, “Finance & Development”, March 2009, p. 52, <http://www.imf.org/external/pubs/ft/fandd/2009/03/pdf/basics.pdf>, [last viewed: 11.05.2015]).

³ A definition given by The National Bureau of Economic Research (Ibidem, p. 52).

⁴ *The Implications of the Global Financial Crisis for Low-Income Countries*, International Monetary Fund, March 2009, p. vii.

⁵ E. Larry, *Three myths that sustain the economic crisis*, “The Guardian. Economics blog”, 5 August 2012, <http://www.theguardian.com/business/economics-blog/2012/aug/05/economic-crisis-myths-sustain>, [last viewed: 7.05.2015].

⁶ Ibidem.

⁷ A. E. Torbat, *Global Financial Meltdown and the Demise of Neoliberalism*, “Global Research (Centre for Research on Globalization)”, October 13, 2008, <http://www.globalresearch.ca/global-financial-meltdown-and-the-demise-of-neoliberalism/10549>, [last viewed: 11.05.2015].

⁸ “The impact of financial sector turmoil on real activity has become increasingly evident, propagating beyond its initial epicenters to affect other advanced economies, emerging markets, and LICs [Low-Income Countries]”. (*The Implications of the Global Financial Crisis for Low-Income Countries*, International Monetary Fund, March 2009, p.1).

ket, resulting in evictions, foreclosures and prolonged unemployment⁹ as well on the declines in consumer wealth.

In 2008 Ukraine met the situation when the financial markets have been tumbling; industrial production, as well sales, has been declined; company profits have been falling; economic activity has been downturned; real income has been reduced; and the unemployment has been rising. Ukraine's financial crisis of 2008-2009 has been deepened, in particular, by the decline in steel prices, reduce in export¹⁰, local banking difficulties, inflation expectations, as well lower foreign direct investment, etc. It is worth to say that the difficulties in metallurgy and engineering as in key industries were caused by the pre-crisis economic policy. At the beginning of the crisis it resulted in export decrease, decline in industrial production, and unemployment.

For a long period due to the lack of economic and social reforms, Ukrainian government needed to increase budget spending to protect the poor, which raised debt service costs. While the 2008-2009 recession was rooted in financial market problems, such impacts of crisis as difficulties of corporations and households in meeting their debt obligations, and reducing investment and consumption, have led to a decrease in economic activity. Therefore, the social sector has been collapsing.

While we pay attention to social policy, in order to analyze the economic effects, we use the terms of Gross domestic product, employment, inflation, consumer price index, household income, nominal and real wages, etc. First of all, we mention that the crisis (a corresponding reduction in GDP and inflation) has affected the reduction of real wages and a decline in consumer demand. At the same time, related inflation rate can be explained by monetary and fiscal policy in the previous period.

Table 1. Inflation, GDP deflator in Ukraine, 2000-2010 (annual change, %).

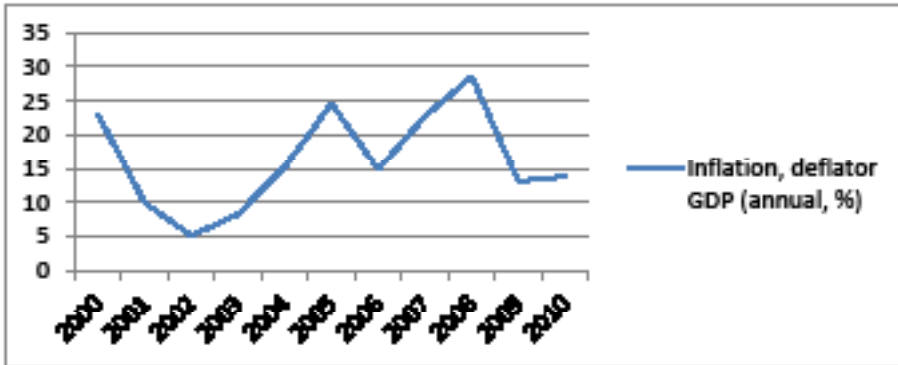
	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Inflation	23,1	9,9	5,1	8,2	15,2	24,6	14,9	22,8	28,6	13,1	13,8

Source: *World Development Indicators*,

<http://search.worldbank.org/data?qterm=Ukraine+inflation&language=&format=>, [last viewed: 27.05.2015].

⁹ C. J. Williams, *Euro crisis...*

¹⁰ The crisis significantly impacts export-oriented countries through reduced demand for their exports. See: *The Implications of the Global Financial Crisis for Low-Income Countries*, International Monetary Fund, March 2009, p. vii.

Figure 1. Inflation, GDP deflator in Ukraine, 2000-2010 (annual change, %).

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Table 2. Nominal and real wages in Ukraine, 2006-2010.

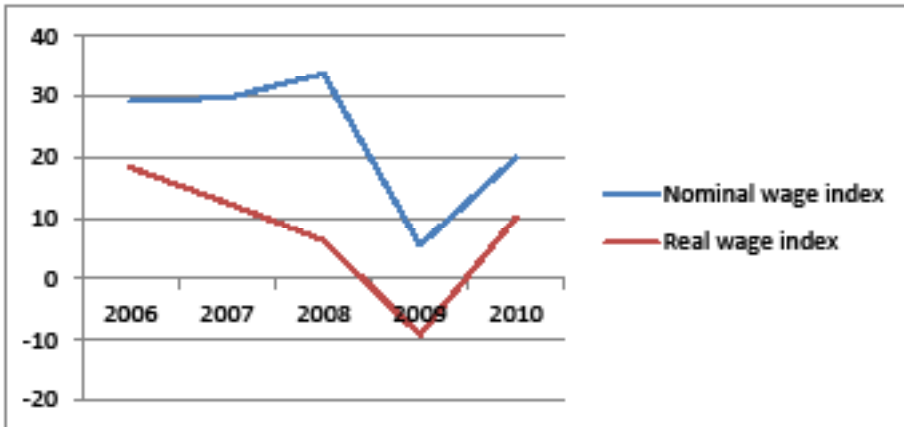
	2006	2007	2008	2009	2010
Nominal wage index	129,2	129,7	133,7	105,5	120,0
Nominal wage change, %	29,2	29,7	33,7	5,5	20,0
Real wage index	118,3	112,5	106,3	90,8	110,2
Real wage change, %	18,3	12,5	6,3	-9,2	10,2
Changes in real income, % (in the corresponding period of the previous year)	11,8	14,8	7,6	-10,0	17,1

Source: Основні показники соціально-економічного розвитку України, e-text: <http://ukrstat.org>,

[last viewed 27.05.2015], *World Development Indicators*,

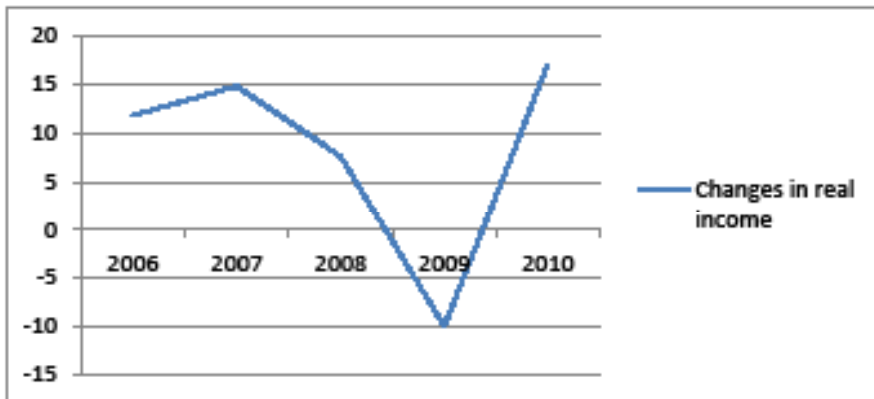
<http://search.worldbank.org/data?qterm=Ukraine+inflation&language=&format=>, [last viewed: 27.05.2015].

Figure 2. Nominal and real wage changes in Ukraine, 2006-2010 (%).



Source: Основні показники соціально-економічного розвитку України, e-text: <http://ukrstat.org>, [last viewed 27.05.2015], World Development Indicators, <http://search.worldbank.org/data?qterm=Ukraine+inflation&language=&format=>, [last viewed: 27.05.2015].

Figure 3. Changes in real income (in the corresponding period of the previous year [%]).



Source: Основні показники соціально-економічного розвитку України, e-text: <http://ukrstat.org>, [last viewed 27.05.2015], World Development Indicators, <http://search.worldbank.org/data?qterm=Ukraine+inflation&language=&format=>, [last viewed: 27.05.2015].

If we look at the data of Consumer price index, we can notice that it was 24,6 in 2005; 14,9 in 2006; 22,8 in 2007; 28,6 in 2008; 13,1 in 2009; and 13,8 in 2010¹¹. Accordingly, changes in consumption was 12,4% in 2006, 13,6% in 2007, 9,0% in 2008 (less than the previous year), and - 12,2% in 2009, 6,4% in 2010 (lower than the rate in 2008).

According to the opinion polls, in 2008 the financial-economic crisis hit 77,1% of Ukrainians, 12,7% said they were not affected by it, and 10,3% of respondents were undecided¹². It is worth noting that before the crisis 94,2% of people negatively assessed the economic situation, 39,4% considered that their welfare has decreased, and 18,2% - significantly decreased¹³. In this situation, social protection and appropriate government policies can be an effective method to deal with the effects of the crisis.

2. Social welfare and the role of government spending (the economic effect of political motivations)

Social policy of the Ukrainian government (as a central authority responsible for economic and social reforms) implemented in 2008-2009 showed tendencies inherent in a period of economic prosperity, as opposed to the needs of social regulation in times of crisis.

Furthermore, the lack of social reforms by 2008 has reinforced the economic crisis of 2008-2009. In general, government's attention to social policy in 2000-2008 was significant. But as scholars noticed, there was a considerable contradiction between the objectives of economic and social development when social policy had to mitigate the negative effects of active economic development. Thus, it caused constrain of economic development, investment, innovations, and development of private business. The insufficient social effect of economic development was proved by a low GDP calculated by purchasing power parity (lower than in the EU in 4 times). At the same time, social standards in Ukraine are lower compared to social standards in the EU¹⁴. The contradiction between economic and social development in the pre-

¹¹ Data for Consumer price index (2010=100). Source: *World Development Indicators*, <http://search.worldbank.org/data?qterm=Ukraine+inflation&language=&format=>, [last viewed: 27.05.2015].

¹² *Economic crisis hits most Ukrainians, survey shows*, Interfax-Ukraine, <http://en.interfax.com.ua/news/general/3168.html>, [last viewed: 27.05.2015].

¹³ See: Економічні орієнтації населення (дані опитування населення): за результатами опитування населення України, проведеного Центром соціальних досліджень "Софія", www.sofia.com.ua/page3.html, [last viewed: 11.05.2015].

¹⁴ *Україна в 2005-2009 рр.: стратегічні оцінки суспільно-політичного та соціально-економічного розвитку*, за ред. Ю. Рубан, Київ 2009, с. 146-147.

crisis period were related to high social spending, the lack of reforms in the management of social sphere, low wages which caused staff outflow, mainly fiscal financing public expenditures, etc. Hence, in times of economic growth and the corresponding rise in inflation, the government continued to direct budget revenues to finance social spending, but not economic development.

We can notice the discrepancy social and economic indicators in official government documents and policies as well as political party programmes and public activity of politicians. Social deformations, low wages, lack of reforms inspired politicians to include social populist slogans in election programmes. Accordingly, politicians used the level of voters' earnings as a selection criterion, when candidates and political parties have been offering populist ideas for low income population. So, voters' wish to improve (nominal) incomes led to the government's attempt improving such economic indicators as subsistence minimum, nominal wage, etc. in the short term. In election programmes of political parties and candidates (Parliamentary elections of 2006, 2007, 2012, and Presidential elections of 2010) the main social ideas were related to the issues of wages and pension rise, cheap housing for the poor, youth employment, and increasing social spending and benefits.

In such situation, government policy was aimed at increasing the nominal amount of social spending. Therefore, during 2004-2009 the amount of social budget spending has been increased, together with that the index of real wage decreased. Also, the growth rate of nominal and real wages was slowed. In 2008 28,2% of people belonged to the poor, and 15% of people remained below the poverty line¹⁵.

Concerning social standards, it is worth to mention the attempts to increase of the minimum wage determined by the state. For a long period the minimum wage was lower than the subsistence minimum for the working age population. In 2000-2005 more than 30% of Ukrainian people had a monthly income below the subsistence minimum. After introducing in 2006 a new method of calculating the subsistence minimum number of people with incomes lower than the subsistence minimum was 12,1% in 2008, and 6,5% in 2010¹⁶. At the same time, the system of calculating the subsistence minimum remained non-transparent that caused low social benefits.

¹⁵ Ibidem, p. 162.

¹⁶ О. Чирва, *Аналіз споживчого попиту населення на продовольчі товари*, "Економіка: реалії часу. Науковий журнал", 2012 vol. 2(12), с. 71, <http://economics.opu.ua/files/archive/2014/n2.html>, [last viewed: 27.05.2015].

Table 3. Wage rates in Ukraine, 2000-2012.

	2000	2005	2006	2007	2008	2009	2010	2011	2012
minimum wage, UAH per month (December)	118	332	400	460	605	744	922	1004	1134
subsistence minimum, UAH per month (December)	287	453	505	568	669	744	922	1004	1134
average wage, UAH per month (December)	230	806	1041	1351	1806	1906	2239	2633	3026

Source: Основні показники соціально-економічного розвитку України, http://ukrstat.org/uk/operativ/operativ2009/mp/op/op_u/op1209_u.htm, [last viewed 27.05.2015], A. Ревко, Купівельна спроможність заробітної плати як базис розвитку людського потенціалу, “Науковий вісник Ужгородського університету. Серія Економіка”, 2014 vol. 1(42), с. 291.

In 1997-2007 decrease of the real minimum wage occurred in 2007, and peaks of growth occurred in 1999, 2002, 2005. In 2002 the increase of wages was by 38,7%, in 2003 - by 18,1%¹⁷.

As scholars mention, the proportion between minimum wage, the subsistence wage level of working-age population and poverty level¹⁸ in the pre-crisis period rose steadily (from 45,2% of subsistence wage and 89,5% of poverty level in 2002 to 79,2% and 93,2% of the same indicators in 2006 accordingly)¹⁹. The maximum correlation between minimum and average wages (44,4%) was observed in 2003²⁰. Later it has been decreased and in 2007 it was 30%²¹. That led to such negative consequences as: labor migration and poverty, including poverty among employed population. Due to growth of wages, the absolute poverty level dropped considerably, from 87,4% in 2000 to 21,4% in 2006²².

In order to eliminate the phenomenon poverty of the working population, it was necessary to reform the existing system of social protection: social insurance and pensions system. But for a long time the system of social protection experienced disadvantages typical for a country where the state authority tried to provide social support for a too large percentage of citizens, but “these attempts go far beyond the

¹⁷ I. Molodikova, *Trends in the field of social policies and welfare reforms in Ukraine and Moldova, Background Report 3/2008*, “Centro Studi di Politica Internazionale”, May 2008, p. 5, <http://www.cespi.it/WPMIG/BREPORT%20Ucraina.pdf> [last viewed: 28.05.2015].

¹⁸ 75% of median income level per capita on adult person.

¹⁹ I. Molodikova, p. 7

²⁰ Ibidem.

²¹ “No doubt that the interrelationship will be even lower, when data for December (month when traditionally average wage reaches its maximum) will be taken into account” (I. Molodikova, p. 7).

²² Ibidem, p. 8.

limits of state funds”²³; and where the amount of direct social payments did not avoid poverty. A high share of social transfers to the wages did not motivate people to economic activities and formed so called “a welfare mentality”²⁴. In 2001-2006 the share of welfare allowances in the aggregate income of citizens rose from 15 to 22%²⁵. According to the State Statistics Committee of Ukraine, by 2008 the level of wages was about 45% of household income²⁶. Thus, in pre-crisis period the amount of social transfers was increasingly grown.

Accordingly, at the beginning of world financial crisis the increasing nominal income of households exceeded the increasing of their real incomes because of government spending. The data on monetary incomes of households show that if in 1999 the component of wages was 34,1% in total income of households; in 2004 it has been increased to 45,2%, in 2005 – to 46,0%, in 2006 – to 48,4%, in 2007 - 50,6%, in 2008 – 49,4% of people’s total income, in 2009 it decreased to 47,9%, as well as in 2010²⁷. At the same time the component of social transfers has been raised from 16,2% in 1999 to 22,2% in 2004. In 2005-2008 its amount has been varied from 23% to 24% of total income of households. Compared to 2007 it increased to 23,1% in 2008, 26,0% in 2009, and 25,9% in 2010²⁸.

So, in 2008-2009 the amount of benefits, the social expenditures of the state budget had been rising. Since 2003 the growth in social benefits exceeded the wage growth (they were increased in 2,4 and 2,2 times)²⁹. At the same time, inflation rate wasn’t high. As some scholars mention³⁰, in this situation many people didn’t need a large amount of benefits, and extension of benefits was politically motivated.

The social and welfare system in Ukraine is poorly financially grounded, lavishes with promises, non-transparent and socially unfair³¹. Moreover, “record keeping of

²³ Ibidem.

²⁴ Ibidem.

²⁵ In 2001-2005 annual amount of social welfare allowances and benefits comprised 24 bln. UAH; in 2006 this sum increased 4,3 times and comprised 103,1 bln. UAH (Ibidem).

²⁶ Ю. Матіс, *Наочна ілюстрація соціалістичного устрою в Україні*, “Економічна правда”, 31 липня 2007, <http://www.epravda.com.ua/columns/2007/07/31/146907/>, [last viewed: 11.05.2015].

²⁷ Source: Структура сукупних ресурсів домогосподарств (1999-2003), http://ukrstat.org/uk/operativ/operativ2007/gdvdg_rik/dvdg_u/strukt_res2006_u.htm, [last viewed: 28.05.2015].

²⁸ Ibidem.

²⁹ Ю. Матіс, *Наочна ілюстрація соціалістичного устрою в Україні*, “Економічна правда”, 31 липня 2007, <http://www.epravda.com.ua/columns/2007/07/31/146907/>, [last viewed: 11.05.2015].

³⁰ Ibidem.

³¹ I. Molodikova, p. 3.

recipients who get various forms of welfare allowances is not established properly”³². And in considering period a lot of poor people did not receive public allowances they needed. For instance, rural populations who didn’t have access to relevant services were actually deprived of major types of social service³³.

In this situation expanding conditional cash transfer programs “that link cash transfers or subsidies to the receipt of health care or education can be an effective method of addressing potential losses in human capital”³⁴. And also some social benefits could be converted into money in order to be granted on the basis of clear target groups’ principles³⁵. But the potential effects of the necessary pension reform, public health reform, tax reform were limited by possible unpopularity among the population.

So, the tendency to increase budget costs and social standards has been lasting for 2008-2009. Notwithstanding the need for reforms, the government continued to increase the number of social transfers and the amount of social benefits. This policy contradicted the state budget opportunities. Besides, in a situation of growing poverty, the restriction of social spending and redirecting them to the economy was complicated.

As in a previous period, the social policy in crisis period includes an increase of the nominal amount of social spending. Such policy didn’t promote increasing real income of households and formation of the middle class. At the same time it caused inflation. But even under inflation the budget policy was socially oriented. After the creation of a coalition in the Ukrainian parliament in December 2008 the Prime Minister announced her intention to implement laws that guarantee high social spending, and reinforce responsibility for the delay of pensions, wages, stipends³⁶. This has shown that the government planned to continue using popular social slogans.

3. Conclusion

The impact of the global financial crisis of 2008-2009 on the Ukrainian economy and social indicators had caused the need to reform the system of social protection and social welfare, improve the efficiency of public spending. But overcoming

³² Ibidem.

³³ Ibidem.

³⁴ *The Implications of the Global Financial Crisis for Low-Income Countries*, International Monetary Fund, March 2009, p. 31-33.

³⁵ I. Molodikova, p. 18

³⁶ Тимошенко: Парламентська політична криза завершена, http://www.bbc.co.uk/ukrainian/domestic/story/2008/12/081210_yulia_gov_oh.shtml, [last viewed: 27.05.2015].

the consequences of pre-crisis' contradiction between economic growth and social development has required social reforms (such as the reform of the system of social benefits) that were potentially unpopular among the public.

In 2008-2009 President and Prime Minister emphasized the need for social reforms, improving public spending on social needs, reforming the system of social benefits, pension reform. But the government policies, implemented during the financial crisis, were aimed at conservation of social benefits and high level of expenses on social welfare. Therefore, the efficient allocation of budget expenditures has required potentially unpopular political decisions that could lead to a reduction in nominal income of households and could affect electoral results in 2010. In such situation political decision-makers (focused on elections) have preferred decisions that mitigate the effect of the financial crisis in the short term. For this reason, they continued increasing social spending and improve social standards.

Thus, social policy during the crisis was aimed at supporting the low-income population, mitigating the effects of the financial crisis on the labour market, maintaining nominal income of people. However, even socially oriented government policy aimed at minimizing the impact of the crisis on the labor market and lower level of household incomes hadn't reduced crisis effects. Despite increasing the proportion of social spending in the structure of budget expenditures and rising amount of social benefits; the level of minimal and average wages, as well subsistence minimum, remained low. At that situation we could observe a decreased level of income, an increase of paid services rendered by social institutions, the decline of the quality and accessibility of social services.

The contradiction between the huge amount of use resources and the lack of anti-crisis effect was typical for the state social policy in 2008-2009 in Ukraine. The majority of activities have had compensation effect. So they were aimed at the mitigation of crisis effects in the short term, but weren't aimed at system's institutional changes that would promote positive long-term economic results. Accordingly, the lack of reforms and orientation to nominal income growth, caused by an intention to increase electoral support, had negatively affected on socioeconomic development in 2008-2010.

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