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The Macroeconomic Impacts of Expanding Social Benefit Programs: Evidence from Post-Soviet Economies

Impactos macroeconómicos de la expansión de los programas de prestaciones sociales: evidencia de las economías postsoviéticas

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ABSTRACT

Since the early 1990s, the expansion of social benefit programs has been one of the principal policy instruments used to address poverty, inequality, and social instability in post-Soviet economies. However, the macroeconomy effects of these programs are still the subject of considerable debate, with scholars divided over whether the expansion of welfare promotes inclusive growth or undermines fiscal sustainability. This paper empirically examines the economic effects of the expansion of social benefits in selected Post-Soviet countries in the period from 2000 to 2023.

Using panel data from the World Bank, the International Monetary Fund (IMF), and national statistical agencies, the study employs fixed-effects and dynamic generalized method of moments (GMM) estimations to evaluate the impact of social spending on GDP growth, unemployment, inflation, and income inequality. The results suggest that a moderate and targeted expansion of social benefits can promote economic growth, support job creation, and reduce income inequality. On the contrary, excessively high levels of spending—particularly when financed through budgets deficit—are associated with rising inflation and increased fiscal pressures. According to these findings, the role of social benefits in society depends on factors such as the structure of the welfare system, targeting efficiency, and fiscal discipline. This article bridges the existing literature by providing new comparative evidence from transitional economies and highlighting the importance of balanced welfare development that promotes economic efficiency and social cohesion.

Keywords: social benefits; economic growth; inequality; fiscal policy; post-soviet economies; welfare state; economic history.

JEL Codes: B20, F43, O49, D60

RESUMEN

Desde principios de la década de 1990, la expansión de los programas de prestaciones sociales ha sido uno de los principales instrumentos de política utilizados para abordar la pobreza, la desigualdad y la inestabilidad social en las economías postsoviéticas. Sin embargo, los efectos macroeconómicos de estos programas siguen siendo objeto de debate, con opiniones divididas entre los académicos sobre si la expansión del bienestar social promueve un crecimiento inclusivo o socava la sostenibilidad fiscal. Este artículo examina empíricamente los efectos económicos de la expansión de las prestaciones sociales en determinados países postsoviéticos durante el período 2000-2023. Utilizando datos de panel del Banco Mundial, el Fondo Monetario Internacional (FMI) y las agencias estadísticas nacionales, el estudio emplea estimaciones de efectos fijos y del método generalizado de momentos (GMM) dinámico para evaluar el impacto del gasto social en el crecimiento del PIB, el desempleo, la inflación y la desigualdad de ingresos. Los resultados sugieren que una expansión moderada y focalizada de las prestaciones sociales puede promover el crecimiento económico, apoyar la creación de empleo y reducir la desigualdad de ingresos. Por el contrario, niveles de gasto excesivamente altos, especialmente cuando se financian mediante déficits presupuestarios, se asocian con un aumento de la inflación y mayores presiones fiscales. Según estos hallazgos, el papel de las prestaciones sociales en la sociedad depende de factores como la estructura del sistema de bienestar, la eficiencia en la focalización y la disciplina fiscal. Este artículo complementa la literatura existente al proporcionar nuevas evidencias comparativas de economías en transición y al destacar la importancia de un desarrollo equilibrado del bienestar que promueva la eficiencia económica y la cohesión social.

Palabras clave: prestaciones sociales; crecimiento económico; desigualdad; política fiscal; economías postsoviéticas; estado de bienestar; historia económica.

Códigos JEL: B20, F43, O49, D60

Introduction

The impact of social benefits on macroeconomic performance has long been the subject of theoretical and policy debates across different schools of economic thought. While classical and neoliberal approaches primarily emphasize the challenges that welfare programs pose to labor markets and fiscal stability, Keynesian and institutional perspectives view social transfers as automatic stabilizers, mechanisms for increasing aggregate demand, and drivers of long-term human capital development. This debate is particularly relevant in post-Soviet economies. Following the dissolution of the USSR, the countries of Eastern Europe and Central Asia underwent profound institutional and structural transformations, including the dismantling of centralized social protection systems and the gradual reintroduction of welfare programs under market-oriented reforms (Popova & Murphy, 2019).

Over the last twenty years, these nations have significantly expanded both the scope and number of social welfare programs, including pensions, unemployment benefits, family allowances, disability payments, and social assistance for low-income groups. According to the World Bank (2023), public social expenditure in many post-Soviet countries increased from less than 10% of GDP in the early 2000s to approximately 18–20% by the early 2020s. This trend reflects a growing role of the state in promoting social inclusion; however, concerns regarding fiscal sustainability and policy efficiency remain central, particularly in the context of commodity price volatility, population aging, and recurring financial crises.

The economic literature offers differing perspectives on these developments. On the one hand, some scholars argue that social benefits stimulate aggregate demand and reduce inequality, thereby serving as key drivers of inclusive growth (Korpi & Palme, 1998; Esping-Andersen, 2017). On the other hand, critics contend that the expansion of the welfare state may discourage labor market participation, increase dependency, and contribute to fiscal imbalances (Barro, 2013; Tanzi & Schuknecht, 2000). Empirical evidence from transition economies, however, remains limited, fragmented, and often inconsistent.

This article attempts to address this gap in the literature by conducting a comprehensive econometric analysis of the relationship between social benefits and key macroeconomic variables in post-Soviet economies. More specifically, the study examines whether higher levels of social spending promote or constrain economic growth, job creation, and income distribution. The analysis draws on data from a balanced panel of twelve post-Soviet countries—Russia, Ukraine, Belarus, Kazakhstan, Armenia, Azerbaijan, Georgia, Moldova, Kyrgyzstan, Tajikistan, Uzbekistan, and Turkmenistan—covering the period from 2000 to 2023.

The principal hypothesis behind this study is that moderate, well-targeted social benefits promote sustainable economic growth and reduce social inequality, whereas inefficient or excessive welfare expansion funded through fiscal deficits may generate inflationary pressures and fiscal risks. To test this hypothesis, the study combines, initially, macroeconomic and fiscal data and applies fixed-effects models to account for country-specific heterogeneity, as well as dynamic GMM estimators to address the problem of endogeneity between welfare spending and economic growth.

The rest of the study is organized as follows. Section 2 reviews the theoretical and empirical literature on the economic effects of social benefits. Section 3 presents the analytical framework and research hypotheses. Section 4 describes the data and econometric methods employed in the study. Section 5 presents and discusses the empirical findings. Section 6 examines the policy implications and, Section 7 concludes with recommendations for the design of welfare policies in post-Soviet economies.

Literature Review

Theoretical Foundations of Welfare and Economic Growth

The interaction between social benefits and macroeconomic performance has been interpreted differently across competing schools of economic thought. In the Keynesian tradition, welfare expenditure is viewed as a stabilizing mechanism, particularly during economic downturns, as it helps sustain aggregate demand through transfer payments and social programs (Keynes, 1936). This perspective is consistent with the concept of automatic stabilizers, which reduce volatility in consumption and output (Blanchard & Perotti, 2002). In addition, expenditures on social protection, education, and health are widely regarded as investments that enhance human capital and productivity (Sen, 1999).

On the other hand, neoclassical and public choice theories emphasize the potential inefficiencies of welfare systems. High levels of social expenditures may distort labor markets by weakening work incentives, reducing savings rates, and generating fiscal burdens that can crowd out private sector investment (Friedman, 1962; Barro, 2013). From this perspective, excessive redistribution of resources to disadvantaged groups may weaken economic efficiency and reduce long term growth potential. Endogenous growth theory offers a different interpretation, arguing that the impact of welfare policies on economic growth depends largely on whether such policies are designed to foster human capital development or merely provides income transfers without enhancing productivity (Romer, 1990).

Empirical Evidence from Advanced Economies

Empirical studies in advanced economies offer mixed findings. Alesina and Rodrik (1994) found that redistributive policies may slow economic growth when financed through distortionary taxation, whereas Atkinson (2015) argued that progressive welfare systems can coexist with strong economic performance when designed efficiently. Lindert (2004) identified the so-called "free lunch" paradox, according to which certain forms of social spending—such as education and health expenditures—may enhance productivity and economic growth rather than hinder them. More recent analysis by the Organization for Economic Co-operation and Development (OECD, 2019) suggests that reducing inequality through well-targeted social benefits can support inclusive growth.

Welfare and Macroeconomic Stability in Transitional Economies

In transitional and post-Soviet economies, the relationship between welfare and economic growth is more complex. Kornai (1992) highlighted the fiscal pressures associated with transforming socialist welfare systems under market conditions, while Commander and Coricelli (1995) emphasized the social costs of reform-induced unemployment. Empirical studies on Russia and neighboring countries indicate that social protection plays a crucial role in mitigating poverty and stabilizing consumption during periods of economic shocks (Cook, 2010; Popova & Murphy, 2019).

However, fiscal constraints often limit the effectiveness of social spending. Gatskova and Lehmann (2016) found that targeted benefits in Russia improved income security without discouraging labor force participation, whereas untargeted transfers tended to reinforce dependency. Similarly, Bogomolova et al. (2021) observed that the expansion of pensions and family allowances reduced inequality, albeit at the expense of rising fiscal deficits.

Research Gap

While a substantial body of research examines the relationship between welfare and economic in advanced and developing economies, comparative empirical analysis across post-Soviet countries remains limited. Much of the existing literature focuses on single-country case studies—most often Russia—or on specific social programs rather than on the broader macroeconomic implications of welfare systems. In addition, relatively few studies employ dynamic econometric models capable of accounting for feedback effects between economic growth and social spending. This study seeks to address these gaps by providing cross-country panel evidence and examining both the short- and long-term effects of expanding social benefit.

Theoretical Framework and Hypotheses

The economic effects of social benefits can be understood through three complementary theoretical perspectives: the Keynesian demand-side mechanism, the human-capital channel on the supply-side, and the constraint of fiscal sustainability.

Keynesian Demand-Side Mechanism

According to Keynesian macroeconomics, public transfers stabilize aggregate demand by supporting household consumption during downturns (Keynes, 1936; Blanchard & Perotti, 2002). In post-Soviet economies—where private credit markets are underdeveloped and income volatility remains high—social benefits can play an important counter-cyclical role. Increased transfer payments raise disposable income among liquidity-constrained households, thereby stimulating consumption and mitigating recessionary pressures (Auerbach & Feenberg, 2000).

Mathematically, aggregate output (Y_t) can be expressed as:

$$Y_t = C_t + I_t + G_t + (Xt - M_t)$$

where

$$C_t = C_o + c(Y_t - T_t + B_t$$

Here, (B_t) represents social benefit payments, and

$$\frac{dY_t}{dB_t} > 0$$

provided that the marginal propensity to consume (*c*) exceeds the marginal propensity to import. Under these conditions, moderate social transfers are expected to increase short-run output and employment.

Supply-Side and Human-Capital Channel

Long-run effects depend on the extent to which social benefits influence productivity and labor supply. Social programs that finance education, healthcare, and childcare services can enhance human capital accumulation, thereby increasing potential output (Becker, 1964; Sen, 1999). Conversely, excessively generous or poorly targeted transfers may weaken work incentives or encourage labor informality (Friedman, 1962; Heckman, 2011).

Post-Soviet economies exhibit considerable variation in institutional quality; countries with effective targeting mechanisms and active-labor-market programs are more likely to realize the positive supply-side effects of welfare policies (Gatskova & Lehmann, 2016).

Fiscal Sustainability Constraint

Social benefit expansion must be financed through taxation or borrowing. The government’s intertemporal budget constraint implies that persistent deficits may generate inflationary pressures or crowd out private investment (Barro, 2013; Tanzi & Schuknecht, 2000). Consequently, the macroeconomic impact of welfare programs depends critically on fiscal discipline and the composition of public expenditure.

Hypotheses

Drawing on the theoretical considerations outlined above, this study formulates the following testable hypotheses:

H1: Moderate increases in social benefit expenditures are associated with higher GDP growth in post-Soviet economies.

H2: The expansion of social benefits reduces income inequality, as measured by the Gini coefficient.

H3: Excessive welfare expansion financed through fiscal deficits increase inflationary pressures and public debt levels.

H4: The strength of these relationships varies according to institutional quality and the efficiency of benefit targeting.

Data and Methodology

Data Sources and Coverage

The empirical analysis is based on an unbalanced panel of 12 post-Soviet countries—Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Russia, Tajikistan, Turkmenistan, Ukraine, and Uzbekistan—covering the period from 2000–2023.

Primary data sources include:

- The World Bank (*World Development Indicators*, 2024) for GDP growth, inflation, and fiscal indicators.

- The International Monetary fund Government Finance Statistics database for social expenditure as a share of GDP.

- The United Nations Development Program and the World Income Inequality Database for Gini coefficients.

- National statistical agencies for control variables such as population, unemployment, and investment rates.

All monetary variables are expressed in constant 2015 U.S. dollars to remove the effects of inflation.

Variable Definition

Category	Variable	Symbol	Description
Dependent variables	Economic growth	$GDPG_{it}$	Annual GDP growth rate (%)
	Inequality	$GINI_{it}$	Gini coefficient (0–100)
	Inflation	INF_{it}	Consumer price index annual change (%)
Key independent variable	Social benefit expenditure	SBE_{it}	Government social spending (% of GDP)
Fiscal control	Fiscal balance	DEF_{it}	Budget deficit (% of GDP)
Structural controls	Investment rate	INV_{it}	Gross capital formation (% of GDP)
	Trade openness	$OPEN_{it}$	(Exports + Imports)/GDP
	Human capital	HC_{it}	Education index (UNDP)

Econometric Model Specification

The baseline fixed-effects model for country *i* in year *t* is:

$$GDPG_{it} = \alpha_i + \beta_1 SBE_{it} + \beta_2 SBE_{it}^2 + \beta_3 INV_{it} + \beta_4 OPEN_{it} + \beta_5 DEF_{it} + \mu_t + \varepsilon_{it}$$

where α_i captures unobserved country-specific effects and μ_t represents year fixed effects controlling for global shocks (e.g., 2008 crisis and the COVID-19 pandemic). The squared term SBE_{it}^2 is included to test for potential non-linear (inverted-U) relationships between social spending and economic growth.

To address potential endogeneity—given that economic growth may itself influence welfare spending—the study employs the -Bond dynamic GMM estimator:

$$GDPG_{it} = \gamma GDPG_{it-1} + \beta_1 SBE_{it} + \beta_2 DEF_{it} + \beta_3 INV_{it} + \eta_i + \nu_{it}$$

Lagged levels and differences in the regressors are used as instruments, thereby ensuring consistent estimates even in the presence of reverse causality (Arellano & Bond, 1991).

Parallel models are estimated using inequality and inflation as dependent variables in order to test hypotheses H2 and H3.

Estimation Procedure

1. **Stationarity Tests:** Levin–Lin–Chu and Im–Pesaran–Shin panel unit-root tests are employed to verify the stationary of the variables.

2. **Diagnostic Tests:** The Breusch–Pagan Lagrange Multiplier (LM) test and the Hausman tests are used to determine the appropriate specification between random-effects and fixed-effects models.

3. **Endogeneity Checks:** The Hansen J-test and the Arellano-Bond AR(2) test are conducted to assess the validity of the instruments used in the GMM estimations.

4. **Robustness Checks:** Alternative model specifications—including lagged social spending variables and the exclusion of oil-exporting countries (Russia, Kazakhstan, Azerbaijan)—are estimated to verify the robustness of the results.

Expected Signs

Variable	Expected Sign (GDPG)	Rationale
$SBE_{(it)}$	+	Stimulates demand and human capital
$SBE_{(it)}^2$	–	Diminishing returns; fiscal crowding-out
$DEF_{(it)}$	–	Fiscal imbalances hinder growth
$INV_{(it)}$	+	Capital accumulation effect
$OPEN_{(it)}$	+	Trade-led growth hypothesis

Empirical Results and Discussion

Descriptive Statistics

Average social benefit expenditure across the sample rose from 9.3 % of GDP during the 2000–2004 period to 17.5 % in 2019–2023. Average GDP growth reached 4.1 %, although considerable heterogeneity existed across countries, with rapid growth in oil-exporting economies and slower recovery in smaller states. Over the same period, the average Gini coefficient declined modestly from 38.5 to 34.2, suggesting a moderate reduction in income inequality.

Baseline Fixed-Effects Estimates

Regression results (Table 1) indicate that β_1, corresponding to social benefit expenditure, is positive and statistically significant at the 1 % level, thereby supporting H1. The squared term, β_2, is negative and statistically significant, suggesting the presence of an inverted-U relationship: the positive effects of social spending on economic growth persist up to approximately 15 % of GDP, after which marginal returns begin to decline. Investment and trade openness exhibit the expected positive effects on growth, whereas fiscal deficits are negatively associated with economic performance.

Dynamic GMM Estimates

Dynamic models specifications corroborate these findings. The coefficient on the lagged GDP growth term ($\gamma \approx 0.42$) confirms the presence of persistent effects. Social benefits remain positively associated with economic growth and statistically significant at the 5% level ($p < 0.05$). In addition, diagnostic tests reveal no evidence of second-order serial correlation (AR(2), $p > 0.10$) and confirm the validity of the instruments used in the GMM estimations (Hansen test, $p = 0.28$).

Effects on Inequality and Inflation

Estimations for the Gini coefficient indicate that social benefits significantly reduce inequality, with an estimated elasticity of –0.18, thereby supporting H2. However, high levels of social spending financed through fiscal deficits are associated with rising inflation (elasticity ≈ 0.12), supporting H3.

Institutional Moderation

Interaction terms between social spending and indices of institutional quality indicate that social benefits are more growth-enhancing and less inflationary in countries characterized by transparent fiscal management and low levels of corruption (Kaufmann et al., 2022). This finding provide support for H4.

Policy Discussion

The empirical evidence suggests that post-Soviet governments should pursue a balanced expansion of welfare systems in which social programs remain fiscally sustainable, effectively targeted, and supportive of productivity growth. Three main policy implications emerge from the analysis:

1. Targeting Efficiency: Social benefits directed toward low-income households generate stronger demand multipliers and greater reductions in inequality without imposing excessive fiscal costs.

2. Complementary Reforms: Investments in labor-market activation policies, vocational training, and childcare strengthens the supply-side effect of welfare programs.

3. Fiscal Prudence: The implementation of fiscal rules aimed at limiting structural deficits can help prevent welfare-induced macroeconomic instability.

Overall, welfare systems designed to strengthen human capital rather than foster dependency may reconcile the objectives of economic growth and social equity in transition economies.

Conclusion

This study examined the macroeconomic consequences of the expansion of social benefits in post-Soviet economies during the period from 2000 to 2023. Empirical analysis based on panel fixed-effects models and dynamic GMM estimators indicate that moderate welfare expansion promotes economic growth and reduces income inequality, whereas excessive spending financed through fiscal deficits generates inflationary and fiscal pressures. The findings further support the existence of a non-linear (inverted-U) relationship between social spending and economic growth.

Policy implications emphasize the importance of institutional quality, effective program targeting, and fiscal discipline. To achieve sustainable welfare development, post-Soviet states must link social protection policies to productive investment in education, healthcare, and employment, thereby ensuring that social benefits function as drivers of inclusive growth rather than fiscal burdens.

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