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EUROFI MACROECONOMIC SCOREBOARD

Jacques de Larosière and Didier Cahen
with the support of Elias Krief and Lea De Greef

AUGUST 2021

INSIDE

The Covid-19 crisis has widened the economic gap between the Euro Area and its main global competitors

The Covid-19 crisis has exacerbated existing economic and fiscal heterogeneities across the EU Members States

Countries with the highest level of government expenditure as percentage of GDP are those with the least competitive firms

Excessive level of public debt does not fuel GDP growth and employment

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This Eurofi Scoreboard highlights four key economic issues faced by EU Members States.

- First, the Covid-19 crisis has widened the economic gap between the euro area and its main international competitors;
- Second, the Covid crisis has exacerbated the existing economic and fiscal heterogeneities across EU Member States;
- Third, EU countries with the highest level of government expenditure as a percentage of GDP are those with the least competitive firms;
- Fourth, excessive public debt does not boost growth and employment.

1. THE COVID-19 CRISIS HAS WIDENED THE ECONOMIC GAP BETWEEN THE EURO AREA AND ITS MAIN GLOBAL COMPETITORS

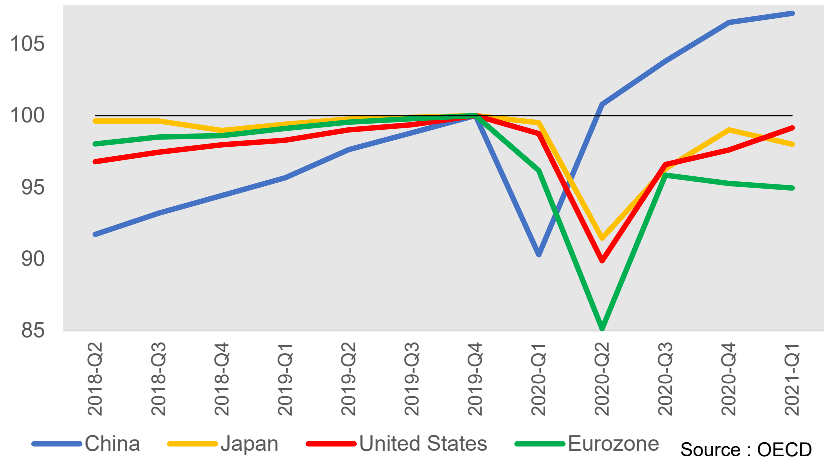
1.1 The economic crisis has been more severe in Europe than in the US, China and Japan

In 2020 the eurozone GDP fell by 6,8 percent, nearly twice as much as the US (-3,4 percent). Japan (-4,8%) and China (+2,5%) have also experienced a lower output fall.

CHART 1.

Real GDP Growth Q4 2019=100, Percentage Change from previous quarter

Source: OECD



1.2 Europe will be slower to recover than the United States

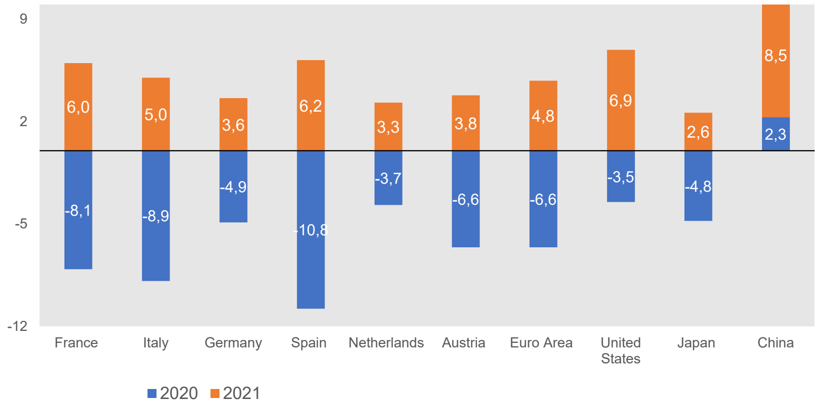
The rebound in growth of the Eurozone in 2021 is forecast to be only 4,8% against 8,5% in China and 6,3% in the United States according to the European Commission and the OECD.

CHART 2.

Real GDP Growth, % Annual Change

Sources: AMECO Summer Forecasts, OECD

Note : 2021 Forecasts for Japan, the US and China are taken from the OECD Economic Outlook of May 2021



In July 2021, the European Commission revised upwards its growth forecasts for 2021 and 2022: Eurozone GDP is expected to grow by 4. 8% this year, up from 4. 3% in May 2021, and by 4,5% in 2022, up from 4. 4% in May.

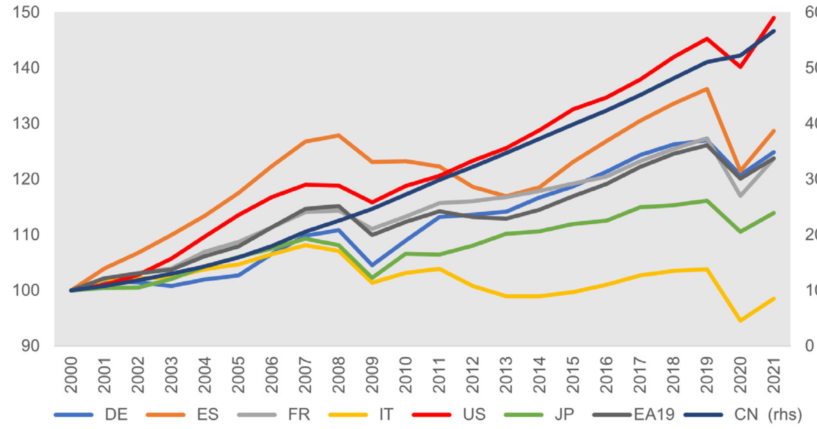
1.3 Over the last few decades, real GDP growth in the Euro Area has failed to catch up with the US and China

From 2000 to 2007, the EU economy (excluding Britain) grew by a decent 2,1% per year in average while America's grew by 2,5%. Between 2014 and 2019 the Euro Area GDP growth averaged 1,5% per year, against 2,4% in the US and 7% in China. The bulk of lagging Euro Area performances is mainly attributable to Italy (0,4%) in particular.

CHART 3.

Real GDP Growth, 2000=100

Source: AMECO



2. THE COVID-19 CRISIS HAS EXACERBATED EXISTING ECONOMIC AND FISCAL HETEROGENEITIES ACROSS THE EU MEMBERS STATES

2.1 The most indebted countries on the eve of the Covid-19 crisis have been the most severely hit in terms of output shortfall in 2020

During the post-financial crisis period, the public debt ratio of Spain, Italy and France has kept rising. Between 2012 and 2019, France increased its public debt in relation to GDP from 90% to 97%; Italy's jumped from 126% to 136%, and Spain's rose from 86% to 95%.

The continuous rise of public-debt-to-GDP ratio is due to the accumulation of yearly fiscal deficits. As shown in Chart 6, the average deficit of France and Spain has been exceeding 3% of GDP, the threshold of Maastricht fiscal rules between 2013 and 2019. At the opposite of Italy, the two countries have not even delivered any positive primary surplus since 2002 for France and 2008 for Spain (*see Chart 7 in section 2.2*). Their primary deficit reached 1,6% of GDP and 0,8% respectively, while even Italy secured a surplus before paying interests at the same year (1,6%).

During the Covid-19 crisis, Spain, which has been the most severely hit in terms of output lost, registered the highest increase of its public-debt-to-GDP ratio (+24,5 percentage points, against 14,1 pp for the euro area). Italy and France follow, as their GDP fell by 8,9 percent and 8,1 percent in 2020, and their public debt grew by 21,1 and 17,6 pp respectively (*see Chart 4*).

CHART 4.

Real GDP Growth, Change in Public Debt Ratio and Denominator Effect, 2020

Source: AMECO

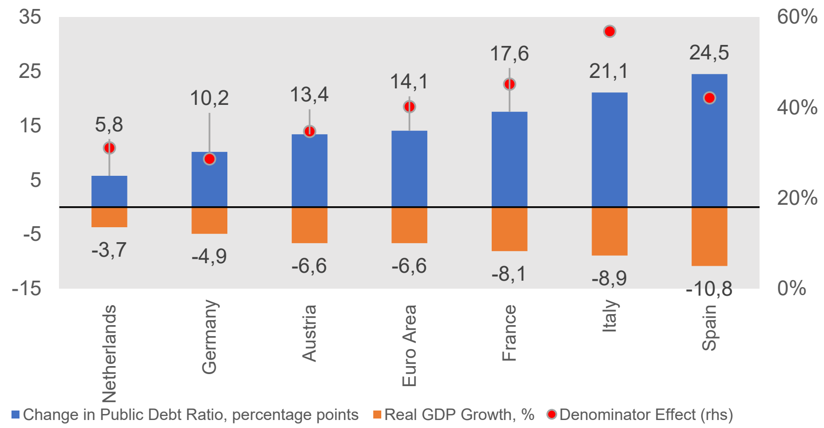
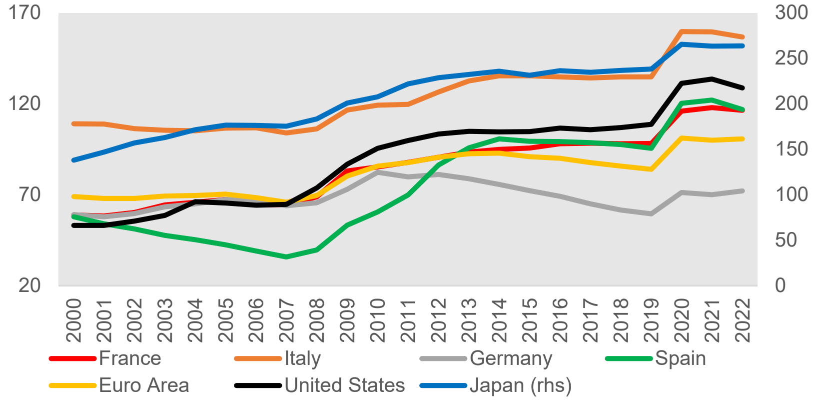


CHART 5.

Gross Public Debt in Selected Advanced Economies, % of GDP

Source: AMECO



However, about 40% of the surge in public-debt-to-GDP ratio in 2020 is due to the fall of GDP by itself in the euro area. For instance, taking into account the “denominator effect”, 42,1% of the rise of the Spanish public debt ratio is related to the fall of GDP. The figure reached 56,8% in Italy -the highest level in the eurozone- and 45,1% in France. It accounted for 31,1% in the Netherlands, 28,6% in Germany 34,7% in Austria.

2.2 By contrast, the EU countries that have best managed their public finances after the Global Financial Crisis (2008) and the EU Sovereign crisis (2011-13) are those that have suffered the least from the Covid-19 shock

In 2019, the Netherlands and Germany, after several years of efforts to reduce their public deficit and debt, brought back their public finances in line with the EU fiscal rules. Indeed, between 2014 and 2019, they ensured an average public surplus of 1,2% and 0,04% of their GDP, respectively. Such fiscal efforts allowed them to gradually reduce and stabilize their public debt, at respectively 59,6% and 48,7% of GDP in 2019, from 81,1% and 66,7% in 2013. Austria also made such efforts over that period, contributing to reduce its public debt burden by nearly 11pp to 70,5% of GDP in 2019.

Thanks to the fiscal discipline hold since 2013, Germany and the Netherlands have much contained the shock induced by the Covid-19 crisis. At 4,2% of GDP and 4,3% respectively, their 2020 public deficit has remained mainly below the Eurozone average of 7,2%. This dynamic contrasts with the close to double-digit levels France (-9,2% of GDP), Spain (-11%) and Italy (-9,5%) have experienced during the crisis (*see Chart 6*).

CHART 6.

General Governement Budget Balance; % of GDP

Source: AMECO

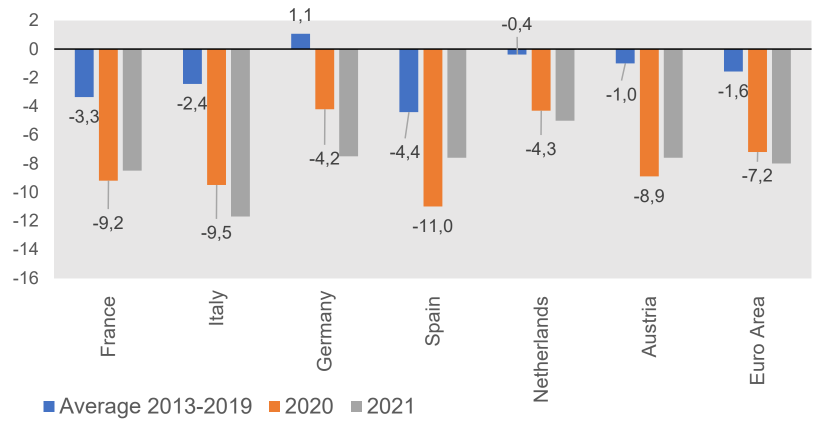
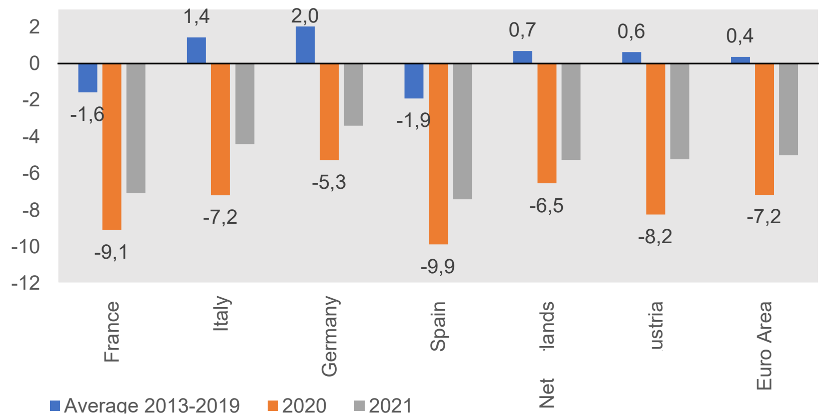


CHART 7.

General Governement Primary Budget Balance; % of GDP

Source: AMECO



2.3 For 2021, a greater fiscal heterogeneity is expected across the EU members in terms of public-debt-to-GDP ratios

The ratio is set to end up ranging from 21,3% of GDP in Estonia to 208,8% in Greece. Within this range, two groups of countries can be distinguished in the European Union (*see Chart 8*).

A first group contains seven Member States that will have their public debt to remain above 110% of GDP in 2021-22. With Greece, it is forecast to remain above 150% of GDP for Italy (156,6%) and above 110% for Portugal (127,2% of GDP), Spain (116,9%), France (116,4%), Belgium (115,3%) and Cyprus (112,2%).

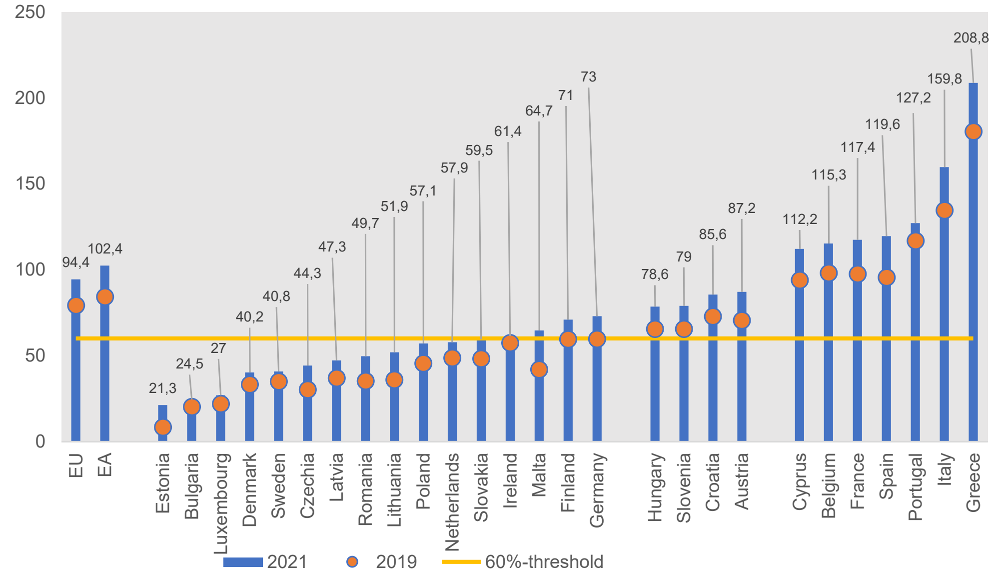
On the other hand, sixteen EU countries will keep their ratio at or below 75% of GDP in 2021. Among them, Germany, the Netherlands will see their public debt hovering at 72,1% of GDP, 56,8% in 2022, respectively.

Within this second group, twelve countries will still maintain a level of public debt in line with the Maastricht threshold limited to 60% of GDP.

CHART 8.

Gross Public Debt of EU Member States, % of GDP

Source: AMECO



3. COUNTRIES WITH THE HIGHEST LEVEL OF GOVERNMENT EXPENDITURE AS PERCENTAGE OF GDP ARE THOSE WITH THE LEAST COMPETITIVE FIRMS

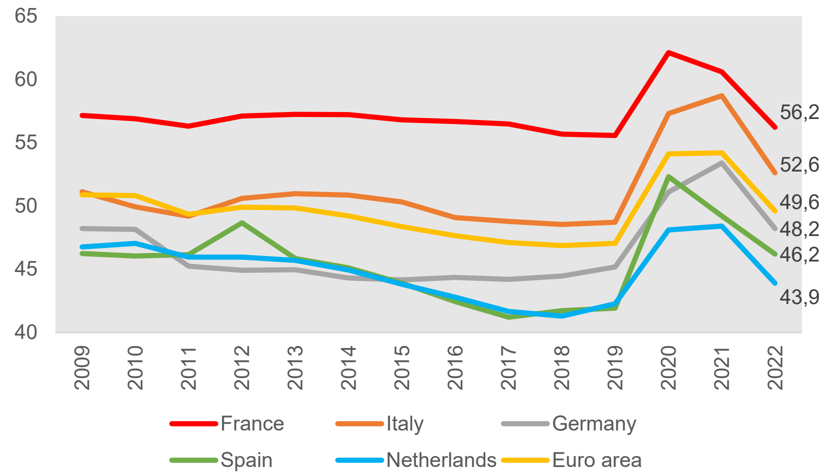
3.1 With 55,6% of its GDP in 2019, France holds the record in terms of level of public spending in the EU

Finland (53,2%) and Belgium (52,1%) follow, as the only countries whose public expenditures to GDP ratio exceed 50% of GDP. By contrast, the level of public expenditures in Germany, Netherlands, Spain and in 16 other EU Member States has remained below the euro area-average of 47% of GDP in 2019 (*see Chart 9*).

CHART 9.

Evolution of Public Expenditures, % of GDP

Source: AMECO Projections



3.2 High levels of public expenditures imply high tax pressures on firms, lifting their production costs and so deteriorating their competitiveness

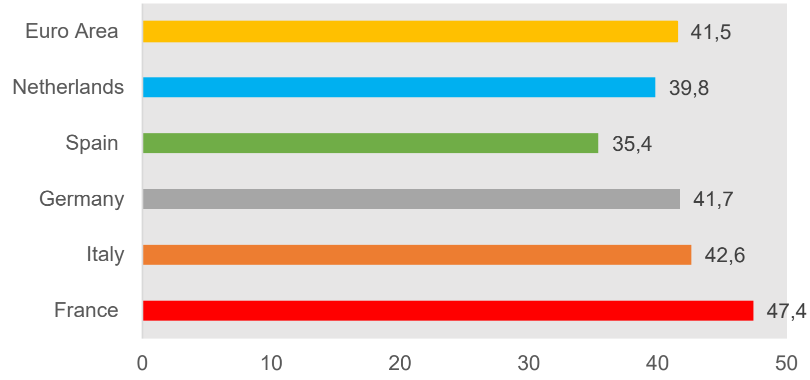
France is leading the Union. Its current tax burden – or amount of tax and social contributions collected on firms and households[1] – accounted for 47,4% of GDP in 2019. That is nearly six percentage points higher than the Euro Area average (*see Chart 10*).

1. The current tax burden of total economy is the sum of indirect taxes (VAT, imports production), direct taxes (income and wealth) and social security contributions (actual and imputed), according to the AMECO definition.

CHART 10.

Current Tax Burden in 2019, % of GDP

Source: AMECO



High taxation contributes to erode the competitiveness of domestic firms. In this respect, France has been suffering of a permanent deficit of its current account balance since 2007 (*see Chart 12*). Within the EU, eight other Members experienced a negative current account balance in average between 2013 and 2019. Among them, Cyprus has the highest deficit (-3,7% of GDP), followed by Romania (-2,3%) and Greece (-1,5%) in particular.

CHART 11.

Net Exports , as % of GDP

Source: AMECO

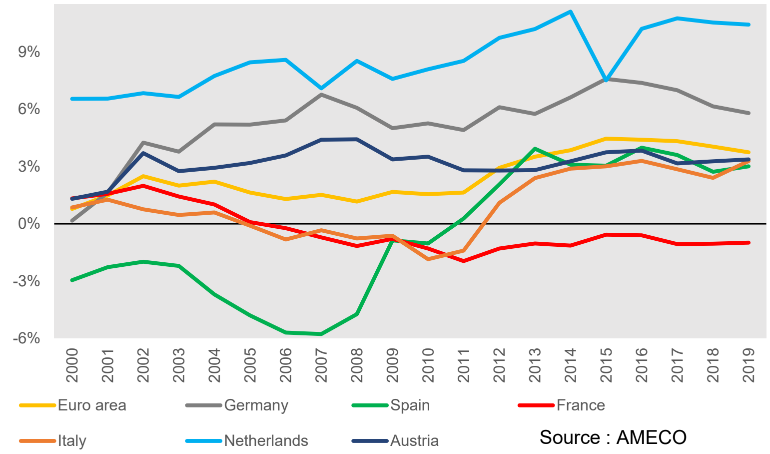
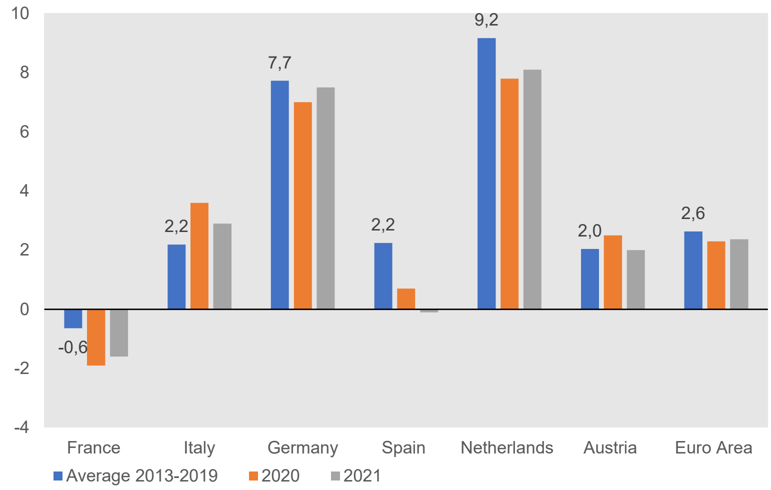


CHART 12.

Current Account Balance, % of GDP

Source: AMECO



3.3 Most of the public expenditures are allocated to social protection, health and public services instead of productive investment

In average, the EU members allocated nearly 42% of their public expenditures to social protection in 2019, totaling 19,8% of GDP. As percent of GDP, France provides the second highest share, with 23,9%, behind Finland (24%). It is followed by Denmark (21,4%) and Italy (21,2%). Health is another most prominent function of public spending in the EU (15% of total expenditure in 2019), then followed by general public services (12,4%).

TABLE 1.

Major Functions of Public Expenditures of Selected EU Member States, % of GDP (2019)

Source: Eurostat

	General public services	Health	Education	Social protection	... Total
Euro Area	5,8	7,2	4,6	19,8	47,0
Italy	7,5	6,8	3,9	21,2	48,7
France	5,5	8,0	5,3	23,9	55,6
Germany	5,7	7,4	4,3	19,7	45,2
Spain	5,5	6,1	4,0	17,4	42,3
Netherlands	4,1	7,7	5,0	15,4	41,9
Austria	5,7	8,3	4,8	20,1	48,4

Considering the determinants of health expenditures, public pensions account for the highest proportion. At 11,6% of GDP in the EU in 2019, its level is mainly linked to the average effective labor market age. Excluding Italy, the earlier working-age people retire, the higher is the level of pensions expenditures in most EU countries. Having one of the lowest average labor market exit age in the EU (62,3), France spends the most on pensions schemes, representing 14,8% of its GDP in 2019, compared with 11,6% in the EU average. The issue is even more worrying in the context of ageing demographics, at which a growing number of elderlies will face a declining working-age population. By 2025, the share of 65+ in total population is projected to increase by 2 points to 22,3% in France, while the prime-age population ratio (25-64) will fall to 36%, from 37,5% in 2019 according to Eurostat.

Considering the case of Italy, the pension system remains one the most onerous for the government in terms of GDP despite the relatively high average effective labour exit age in the EU. There are three key reasons for this situation:

- **The generosity of the system:** the replacement rate - or percentage of an individual's annual employment income that is replaced by retirement income when they retire - was 20 pp higher than the EU average in 2019 (66,9% in Italy against 46,2% in the EU).

- **The persistent low level of employment rate:** In 2019, 59,1% of the 15-64 were employed. This is the second lowest employment rate in the EU, just 3pp above Greece (56,3%), and 12pp below the EU average (68,4%).

- **The population ageing problem.** The Italian downward demographics trend is one the most salient in the EU. In 2019, 23% of the Italian population was aged 65 or over. This is the highest level in the EU (20,4%). This figure contributes to further deteriorates the old-age dependency ratio - the number of dependents aged over the age of 65, compared with the total population. At 58,5% in 2019, the ratio is projected to reach 70% by 2030.

CHART 13.

Gross Public Pensions, as % of GDP in 2019

Source: European Commission

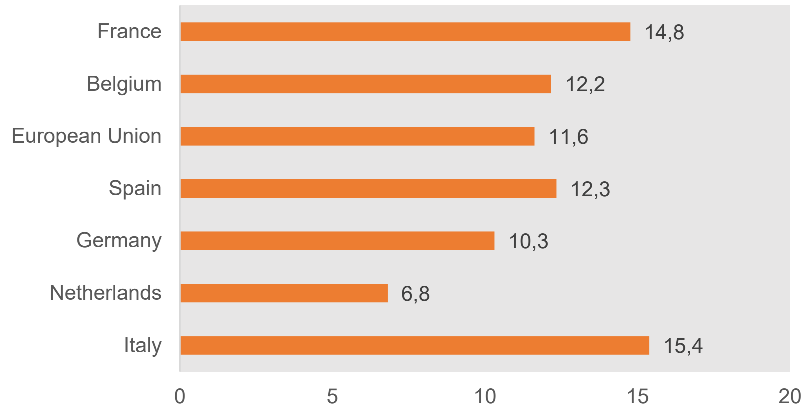
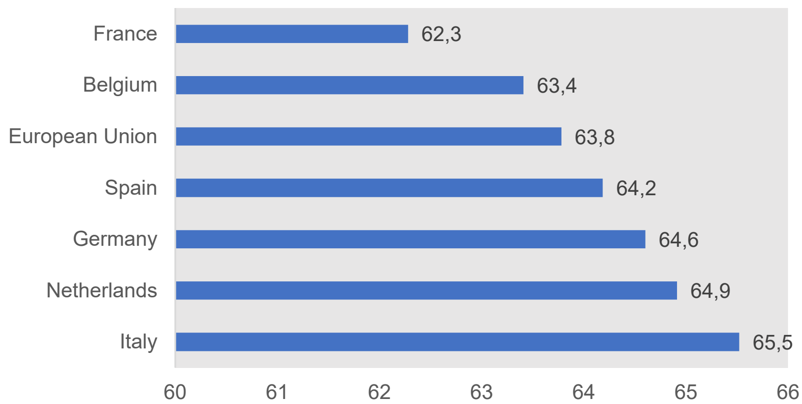


CHART 14.

Average effective labour market exit age, 2019

Source: European Commission



Such levels of public expenditures may have been done at the expense of productive investment, hence negatively contributing to the formation of gross capital formation.

As share of GDP, public investment has not exceeded 4% of GDP in Europe since 2010. Investment in Research and Development is also a concern. On this issue, most of EU members dedicate less of their spending than the OECD average (2,5% of GDP in 2019). Only Germany and Austria stand out, with levels close to the US and Japan (*see Chart 15*).

CHART 15.

Gross domestic spending on R&D, % of GDP (2019)

Source: OECD

Notes: Gross domestic spending on R&D is defined as the total expenditure (current and capital) on R&D carried out by all resident companies, research institutes, university and government laboratories

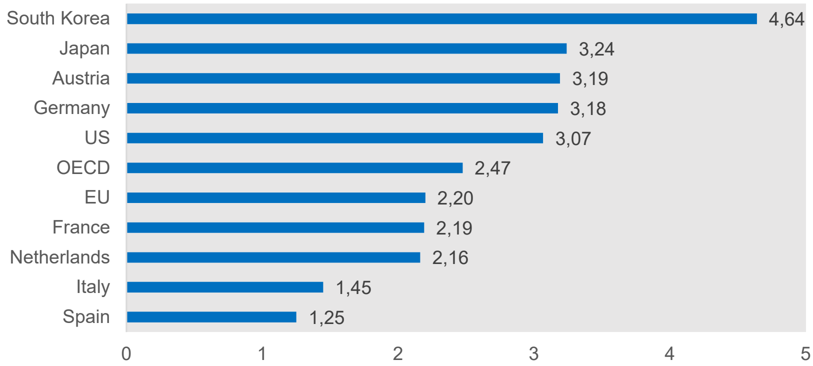
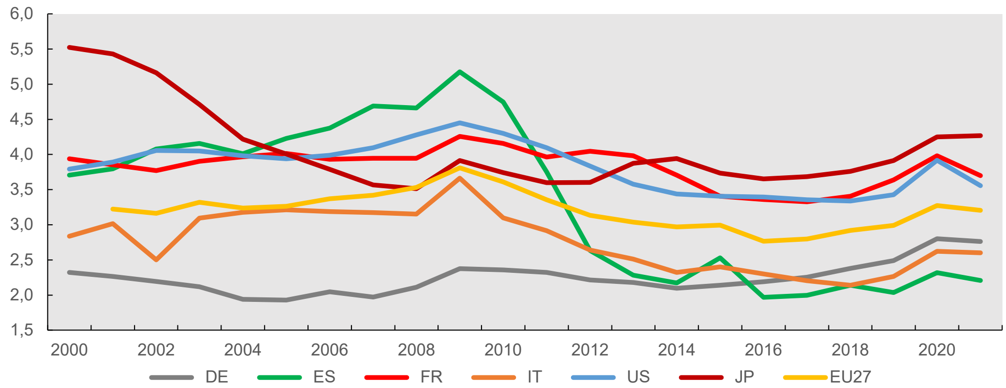


CHART 16.

Gross fixed capital formation of public sector, % of GDP

Source: AMECO



4. EXCESSIVE LEVEL OF PUBLIC DEBT DOES NOT FUEL GDP GROWTH AND EMPLOYMENT

4.1 The most indebted countries, as France and Italy, have achieved the lowest growth performance of the eurozone since 2013

CHART 17.

GDP growth performance of Selected Eurozone Countries, 2012 = 100

Source: AMECO

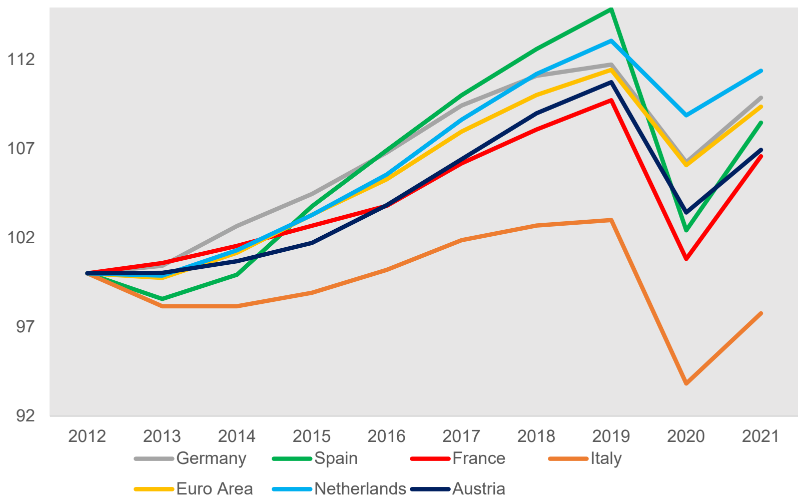
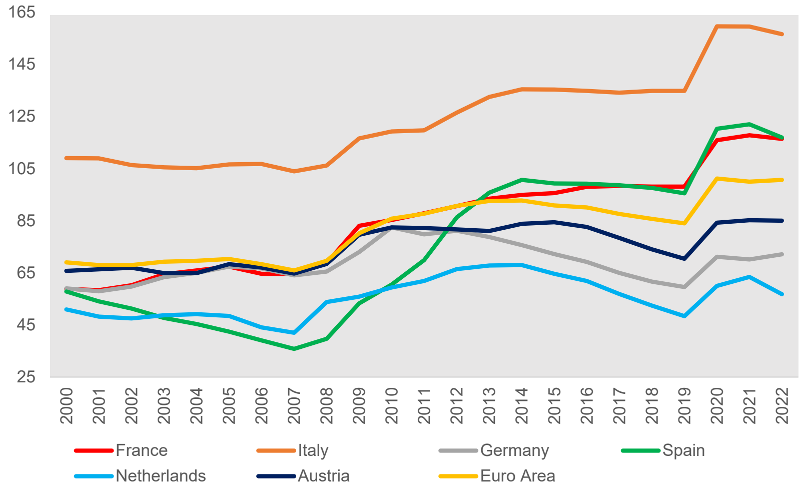


CHART 18.

Evolution of Public-Debt-To-GDP ratio of Selected Eurozone Countries, %

Source: AMECO



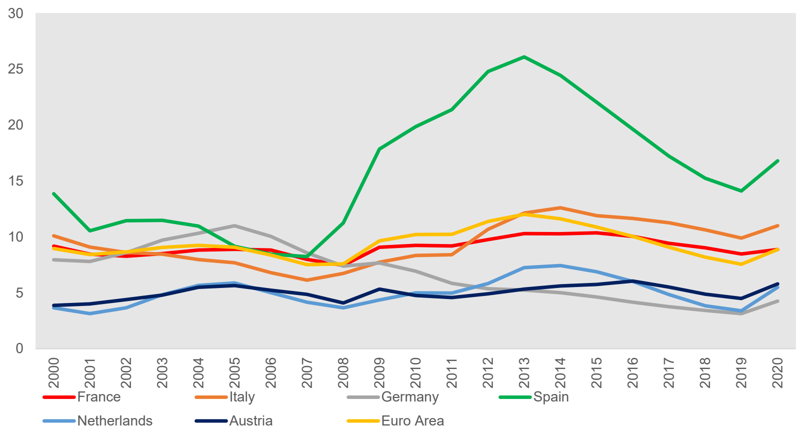
4.2 The most indebted EU Members have experienced a double-digit level of unemployment rate since 2007, as Spain (14,5% in 2019), Italy (9,9%) and France (8,5%)

Although French's unemployment rate declined slowly below 9 per cent until 2019, massive unemployment reveals a key structural labor market problem. The three selected countries are among those with the highest share of long-term and young unemployment rate. With 40% of the youth population in January 2021, Spain has the highest share of 15-24 years unemployed in the EU, followed by Greece (34%) and Italy (29%). Despite the record-high share of spending allocated to education and formation (5,3% of GDP in 2019, against 4,7% in the euro area), France is also mainly concerned (18% of youth unemployment rate, against 16,9% for the euro area). **Such high level in public expenditure may thus reveal the lack of domestic structural reforms.**

CHART 19.

Unemployment Rate, as % of Total Labor Force

Source: IMF



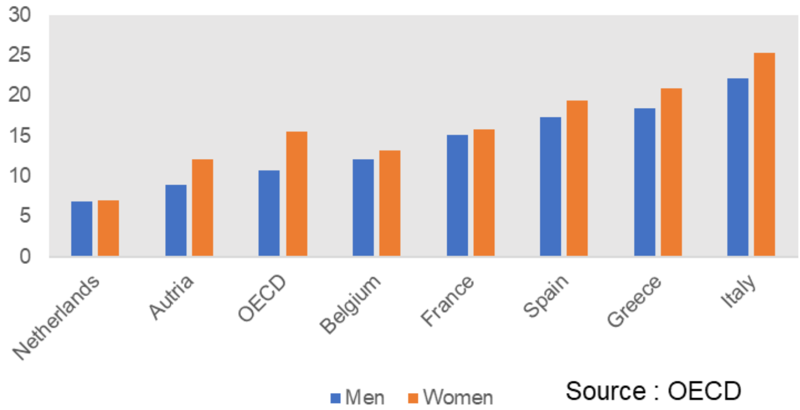
In 2019, 57% of the Italian unemployed people were in the situation of long-term unemployment[2]. France and Spain follow, with 38,8% and 37,1% respectively.

The significant share of youth unemployment rate in some EU countries reveals the existing difficulties in joining the labor market. Such failures favor the proliferation of the 'Neet' phenomenon, made of youth that are neither in employment, education or training. In Italy, more than 3 million young people aged between 15 and 34 are in this situation, the highest share among European Union countries.

CHART 20.

Share of 15-29 in NEET situation, % (2019)

Source: OECD



2. People staying unemployed for at least twelve consecutive months (OECD definition).

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