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MACROECONOMIC SCOREBOARD

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FEBRUARY 2022

INSIDE

Widening of the economic gap between the euro area and its main global competitors with the Covid crisis

Exacerbation of existing fiscal heterogeneities across EU Member States

Loss of competitiveness of firms of EU countries with the highest levels of government expenditure vs GDP

Excessive public debt goes against productivity growth and employment

Growing heterogeneity in current account imbalances across EU Member States

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CONTENT

This Eurofi Scoreboard highlights five 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-19 crisis has exacerbated the existing 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 productivity growth and employment.
- Fifth, the existence in the euro area of countries with large current account surpluses and countries with persistent current account deficits make the consistency of EU policies much more problematic.

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

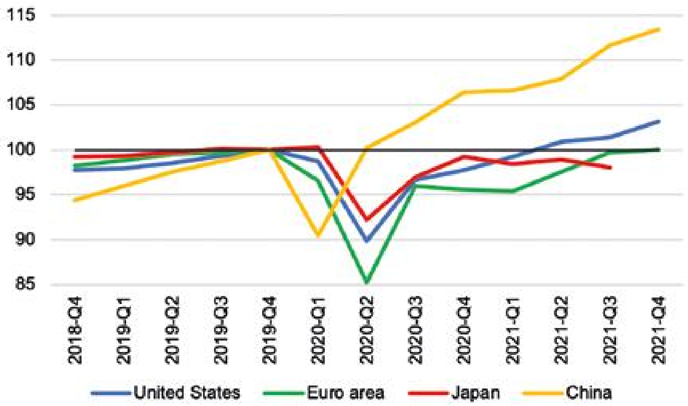
1.1 The economic crisis has been more severe in Europe than in the US, China and Japan

In 2020 the eurozone GDP fell by 6.3 percent, nearly twice as much as the US (-3.4 percent). Japan (-4.6%) and China (+2.3%) have also experienced a lower output fall.

CHART 1.

Real GDP Growth, 2019Q4 = 100, percentage change from previous period

Source: Eurofi, Eurostat and OECD data



1.2 Europe is recovering at a slower pace than the United States

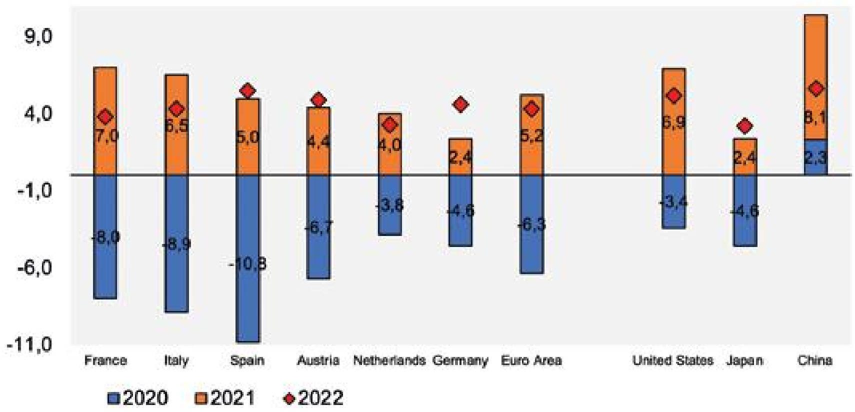
The rebound in growth of the eurozone in 2021 is estimated to be 5.2% against 8.1% in China and 6.9% in the United States, according to official data (*see Chart 2*).

CHART 2.

Real GDP Growth, % annual change

Source: Eurofi, with data from AMECO November 2021 Forecast and IMF October 2021 Forecasts

Notes: 2021 data for France, Germany, Italy, Spain, Euro area, United States and China are official. Data for the Netherlands and Austria are taken from European Commission forecasts released in November 2021. Data for Japan are from the IMF's forecast of October 2021. Projections for 2022 are taken from the EC for European countries, and from the IMF for non-euro area countries.



Thirteen euro-area Member States have returned to pre-pandemic quarterly levels of output by the end of 2021. In five[1] the gap is set to close in the course of 2022 and in one (Spain) at the beginning of 2023, according to the EU Commission[2].

1. These Member States are: Germany, Italy and Malta, Slovakia and Portugal.
2. "Communication from the Commission to the European Parliament, the Council, and the European Central Bank on the 2022 draft budgetary Plans: Overall Assessment", European Commission, 24 November, 2021.

Within the euro area, the recovery is uneven across Member States. Most of them have experienced a fast rebound in 2021, but their GDP growth is expected to slow in 2022. France, the Netherlands and Belgium are close to this situation, with their GDP nearing or exceeding their pre-pandemic levels as of the four quarter of 2021 (*see Chart 4*).

Austrian and German GDP contracted in Q4-2021, relegating the two countries at the bottom-end of the euro area performances.

CHART 3.

Real GDP Growth Trend, 2019-Q4 = 100

Source: Eurofi, with Eurostat data

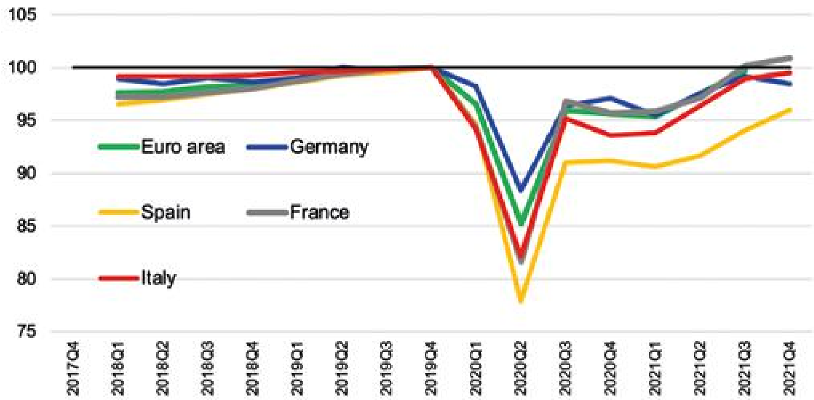
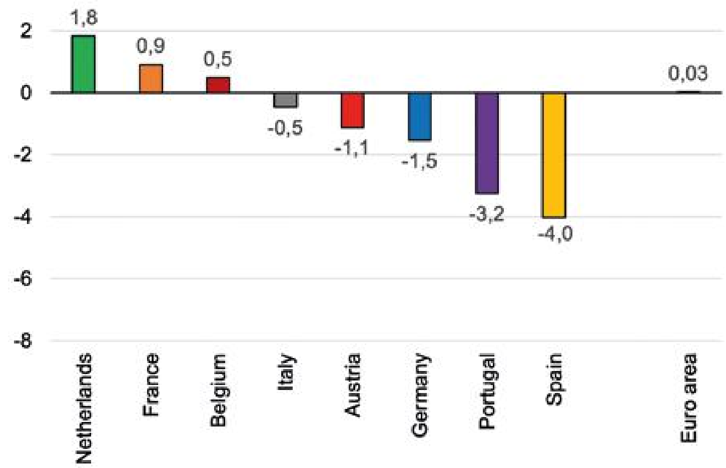


CHART 4.

Distance with 2019-Q4 GDP as of 2021-Q4, percentage points

Source: Eurofi, with Eurostat data

Note: All data are from 2021-Q4, except for the Netherlands, Belgium and Portugal, whose GDP growth figures are from 2021-Q3



1.3 Over the last few decades, real GDP growth in the euro area has failed to catch up with US and Chinese levels

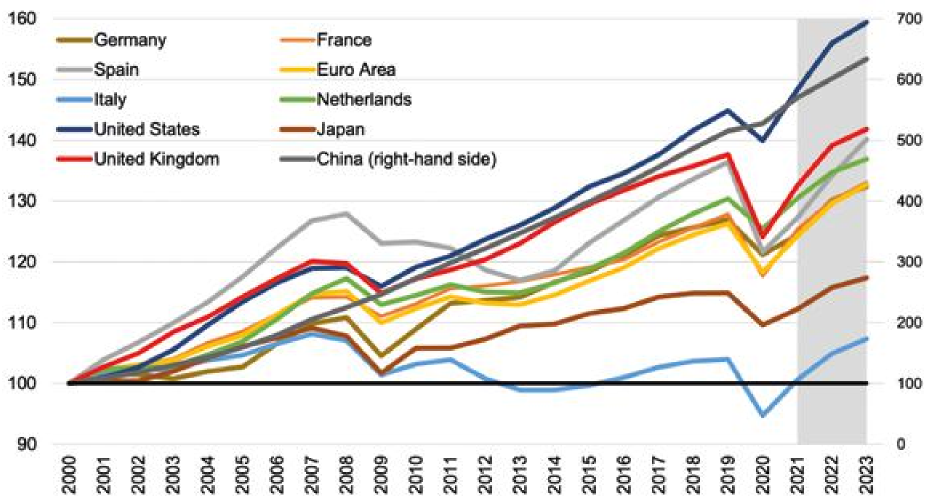
From 2000 to 2007, the EU economy (excluding Britain) grew by a decent 2.1% per year on average while America's grew by 2.5%. Between 2014 and 2019 the euro area GDP growth averaged 1.5% per year, against 2.4% in the US and 7% in China.

The bulk of lagging euro area performances is mainly attributable to Italy (0.4%) and France (1.3%).

CHART 5.

Real GDP Growth Trend, 2000 = 100

Sources: IMF October 2021 Forecasts; AMECO November 2021 Forecast



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

2.1 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 finance in line with 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 stabilise 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 11 pp to 70.5% of GDP in 2019.

Thanks to the fiscal discipline achieved 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 that France (-9.1% of GDP), Spain (-11%) and Italy (-9.6%) have experienced during the crisis (*see Chart 6*).

For 2021 and 2022, the level of fiscal balance across EU Member States is expected to converge towards its pre-crisis configuration. Countries with healthy public finances during the pre-crisis period are set to register fiscal imbalances not exceeding 3% of GDP, in line with EU fiscal rules, as soon as 2022. Indeed, Germany, the Netherlands and Austria in particular, are projected to deliver a total fiscal deficit not exceeding 2.5% of their GDP. By contrast, the figure is set to remain above 5% in Spain, France and Italy for 2022.

CHART 6.

General Governement Budget Balance, % of GDP

Source: AMECO November 2021 Forecast

Notes: Labels relate data for 2021; the transversal black line is associated to the right-hand side axis

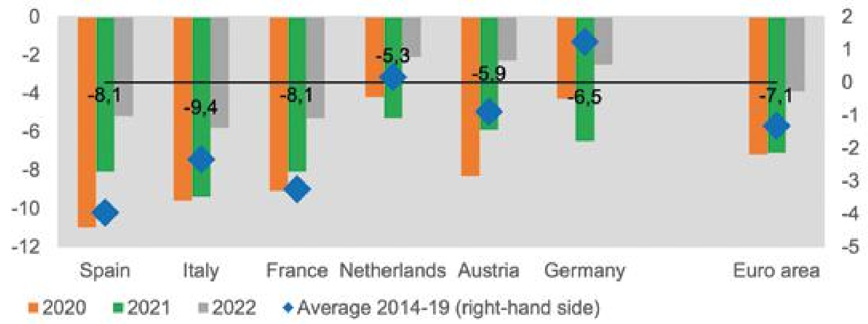
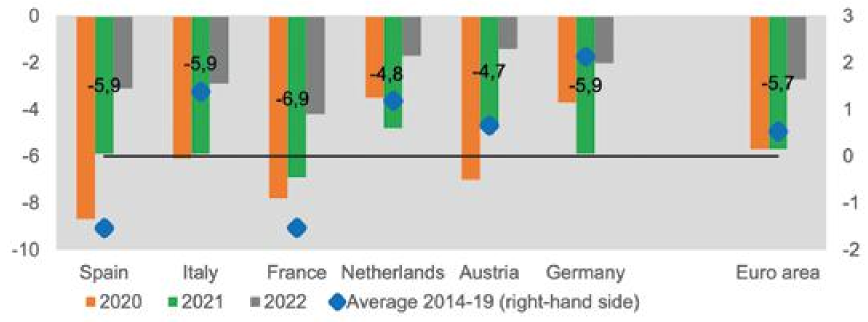


CHART 7.

General Governement Primary Budget Balance, % of GDP

Source: AMECO November 2021 Forecast

Notes: Labels relate data for 2021; the transversal black line is associated to the right-hand side axis



2.2 By contrast, 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-Global 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 in these three Member States is mainly 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 2014 and 2019. Unlike Italy, these two countries have not delivered any primary surplus, since 2002 for France and 2008 for Spain. Between 2014 and 2019, their average primary deficit reached 1.5% of GDP, while Italy secured a primary surplus at the same period of 1.4% (*see Chart 7*).

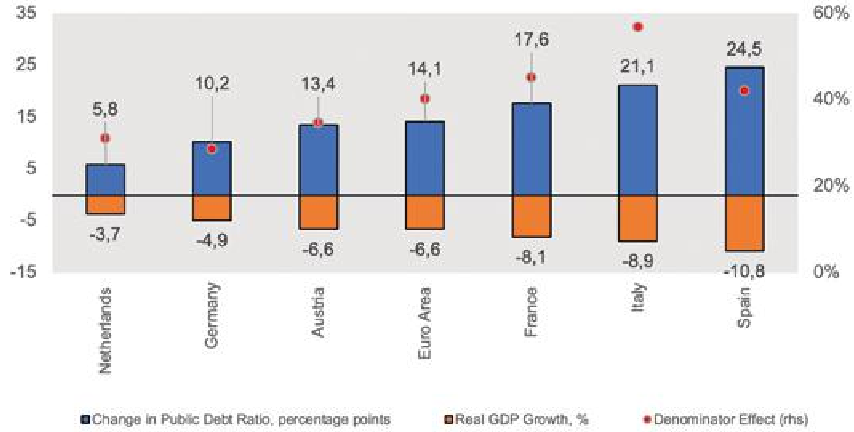
During the Covid-19 crisis, France, Italy and Spain have been the most severely hit in terms of output shortfall in the euro area. In 2020, GDP in Spain fell by 10.8%. It collapsed by 8.9% and 8.1% in Italy and France, respectively. With public finances already deteriorated on the eve of the crisis, the three countries registered the strongest increase of their public debt-to-GDP ratio in 2020. Spain experienced the highest rise (+24.5 percentage points, against 14.1 pp for the euro area). Italy and France followed, as their public debt grew by 21.1 pp and 17.6 pp respectively (*see Chart 8*).

However, about 40% of the surge in public debt-to-GDP ratio is due to the fall of GDP by itself in the euro area, for 2020. 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 that year. 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 and 34.7% in Austria.

CHART 8.

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

Source: AMECO

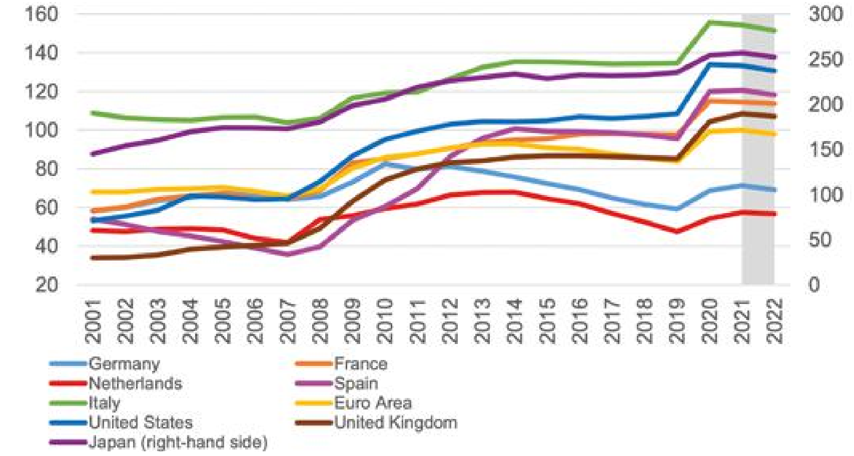


After the Covid-19 crisis, the public debt-to-GDP ratio is projected to stabilise at elevated levels in these EU Member States. For 2022, the ratio will fall marginally in France from 114.6% of GDP in 2021 to 113.7%. It will drop by 2.4 pp in Spain (from 120.6% to 118.2%) and by 3 pp in Italy (from 154.4% to 151.4%), according to the EU Commission[3] (*see Chart 9*).

CHART 9.

Evolution of Gross Public Debt to GDP ratio in Major Economies (in %)

Sources: IMF October 2021, AMEC November 2021



The volume of French debt increased by 400 billion between March 2020 and September 2021, while those of Germany and Italy increased by 343 and 273 billion euros (ECB data).

2.3 For 2021 and 2022, a greater fiscal heterogeneity is expected across EU members in terms of public debt-to-GDP

The level of public debt is set to end up ranging from 18.4% of GDP in Estonia to 202.9% in Greece in 2021. Within this range, two groups of countries can be distinguished in the European Union (*see Chart 10*).

A first group contains seven Member States that will have their public debt remaining above 100% of GDP in 2021-22. With Greece, it is forecast to remain above 150% of GDP for Italy (154.4%) and above 110% for Portugal (128.1% of GDP), Spain (120.6%), France (114.6%), Belgium (112.7%) and Cyprus (104.1%).

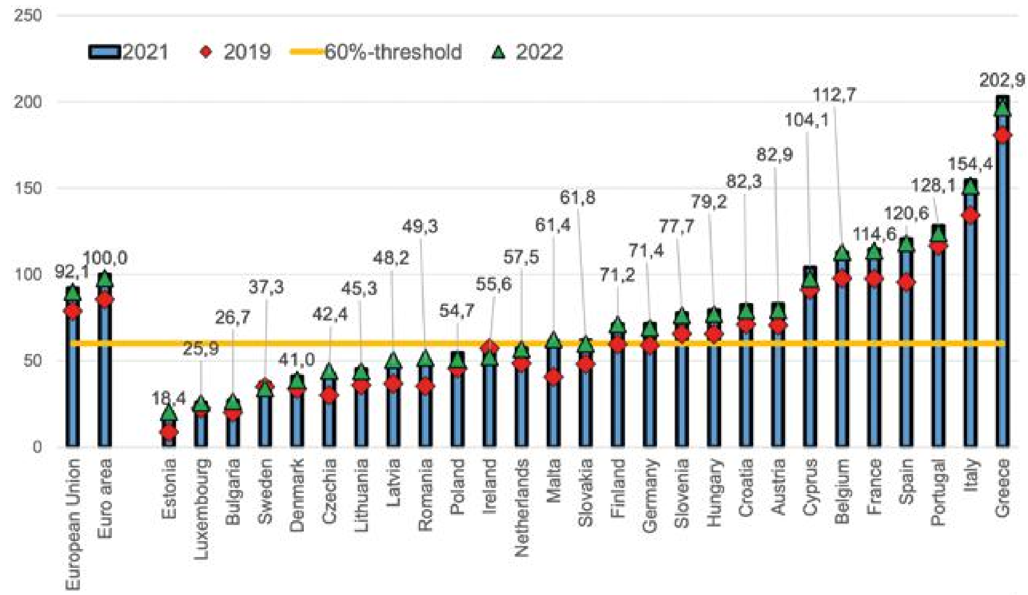
On the other hand, sixteen EU countries will keep their ratio below 75% of GDP in 2021. Among them, Germany and the Netherlands will see their public debt hovering at 71.4% and 57.5% of GDP in 2021, respectively.

3. EC Forecast of November 2021.

CHART 10.

Gross Public Debt of EU Member States, % of GDP

Source: AMECO November 2021 Forecast

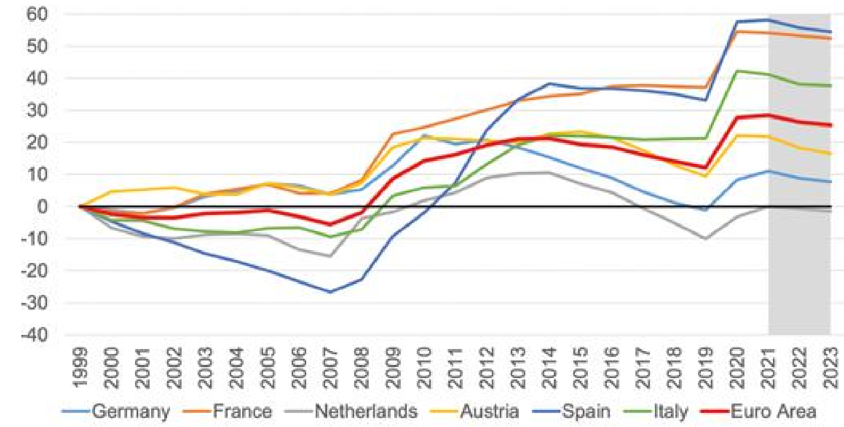


The heterogeneity in the level of government debt relative to GDP across euro area Member States has significantly increased since the creation of the euro area in 1999. As shown in Chart 11, the public debt-to-GDP ratio has prudently increased by 11 pp in Germany, 21.8 pp in Austria and even dropped in the Netherlands by 0.03 pp over the past two decades until 2021. In the meantime, the level has risen by 41.1 pp in Italy, 54.1 pp in France and 58.1 pp in Spain.

CHART 11.

Cumulative Change of Public Debt to GDP Ratio since 1999, percentage points

Source: AMECO



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

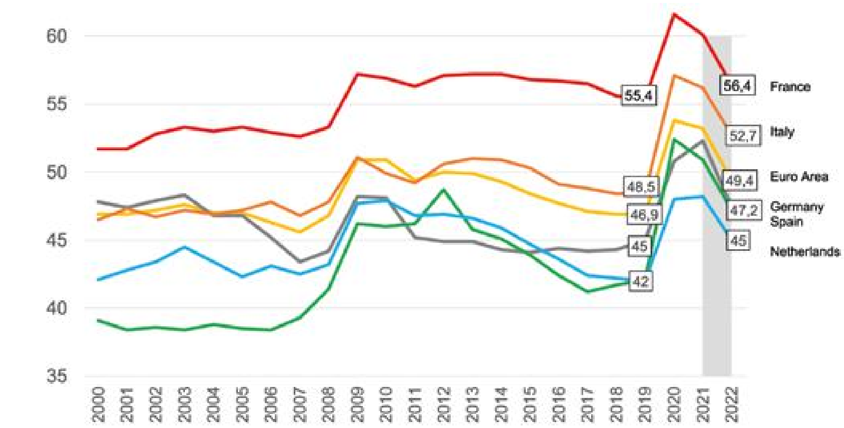
3.1 With 55.6% of its GDP in 2019, France holds the record high in terms of level of public spending in the EU

Finland (53.2%) and Belgium (52.1%) follow, as the only countries in the Union whose public expenditures-to-GDP ratio exceeds 50% of GDP. By contrast, the level of public spending in Germany, the Netherlands, Spain and 16 other EU members remained below the euro area average of 47% of GDP in 2019 (*see Chart 12*).

CHART 12.

Total Public Expenditure, as % of GDP

Source: AMECO November 2021 Forecast



The expected drop in expenditure-to-GDP ratio in 2021 (compared to 2020) is the result of the removal of emergency measures in the numerator and the relatively higher level of GDP in the denominator. Accordingly, the figures are set to converge towards their pre-pandemic levels, although they will remain slightly elevated notably in France and Italy (*see Chart 12*).

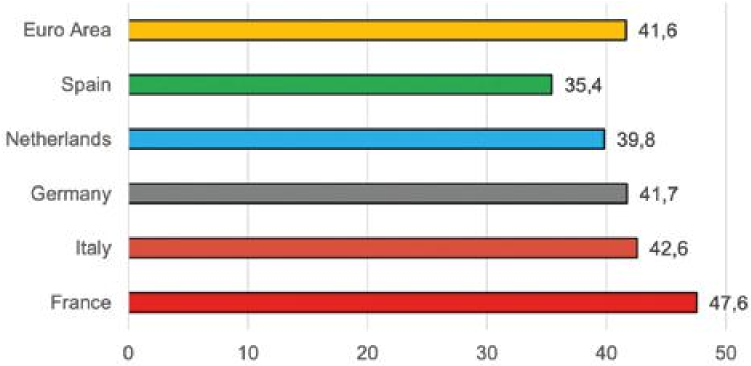
3.2 High levels of public expenditures imply high tax pressures on firms, lifting their production costs and so deteriorating their competitiveness

In this field, France is leading the European Union. Its current tax burden — or amount of tax collected on firms and households[4] — accounted for 47.4% of GDP in 2019. That is nearly six percentage points higher than the Euro Area average (*see Chart 13*).

CHART 13.

Current tax burden in 2019, % of GDP

Source: AMECO



High taxation contributes to erode the competitiveness of domestic firms. With a level of taxes on production and imports exceeding the euro area average by 3.7 points in 2019 *(see Table 1*), France has been suffering of a permanent deficit of its trade balance (*see Chart 14*) and more broadly of its current account balance since 2007 (*see Chart 15*). Within the EU, eight other members experienced a negative current account balance on 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%).

TABLE 1.

Breakdown of Tax Revenue by Country and by Detailed Tax Categories in 2019, % of GDP

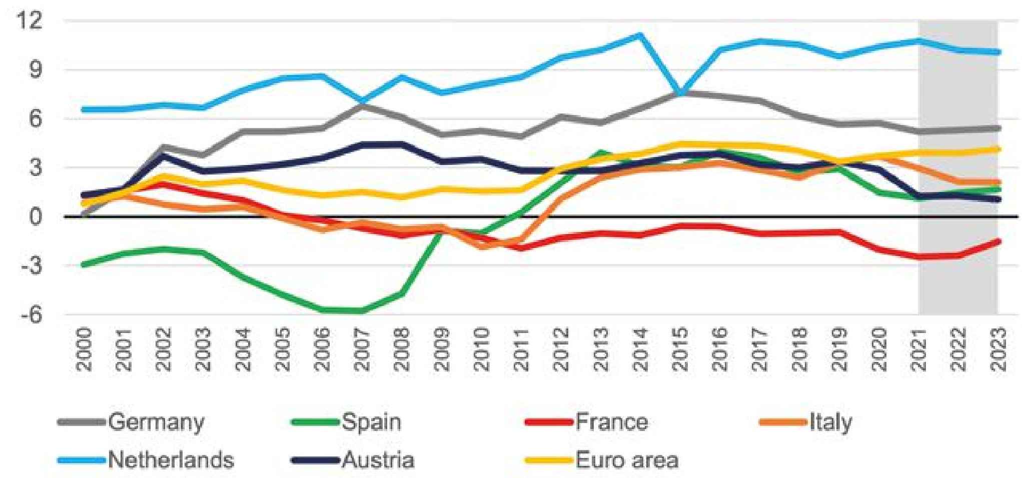
Source: Eurostat

	Taxes on production and imports	Current taxes on income, wealth etc	Capital taxes	Net social contributions	Total
France	17,0	13,1	0,6	16,8	47,6
Italy	14,6	14,4	0,1	13,5	42,6
Germany	10,9	13,3	0,2	17,3	41,7
Netherlands	12,5	13,2	0,2	14,0	39,8
Spain	11,7	10,4	0,4	12,9	35,4
Euro Area	13,3	13,0	0,3	15,1	41,6

By contrast, countries with a level of taxation below the euro area average present the most competitive firms of the area. With tax revenue on production and imports accounting for 10.9% of GDP in 2019, Germany delivered the second highest current account surplus, behind the Netherlands; that is also characterised by a relatively low level of tax burden (12.5% of GDP).

CHART 14.

Net Exports of Goods and Services, % of GDP

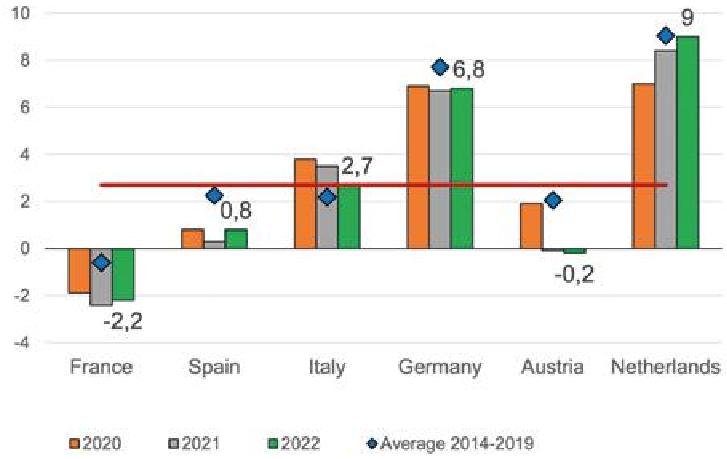


4. The current tax burden of total economy is the sum of indirect taxes (VAT, imports production), direct taxes (income and wealth, and capital) and social security contributions (actual and imputed), according to the AMECO definition.

CHART 15.

Current Account Balance, % of GDP

Source: AMECO November 2021



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

On average, euro area members allocated 19.8% of GDP to social protection in 2019 (*see Table 2*). As percent of GDP, France presents 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 2.

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 social protection, 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 labour market exit age. Excluding Italy, the earlier working-age people retire, the higher is the level of pensions in most EU countries. Having one of the lowest average labour 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% for 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 (aged 25-64) will fall to 36%, from 37.5% in 2019.

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 people aged 15-64 were employed. This is the second lowest employment rate in the EU, just 2.8 pp above Greece (56.3%), and 9.3 pp below the EU average (68,4%).
- **The ageing population 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 (whose average is 20.4%). This figure contributes to further deteriorate the economic old-age dependency ratio; that is the number of inactive dependents aged over 65, compared with the total employed population aged 20-64. At 58.5% in 2019, the ratio is projected to exceed 70% by 2035.

CHART 16.

Gross Public Pensions, as % of GDP in 2019

Source: Eurofi, with Eurostat data

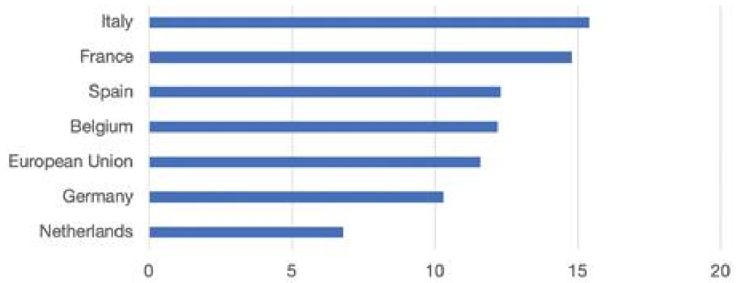
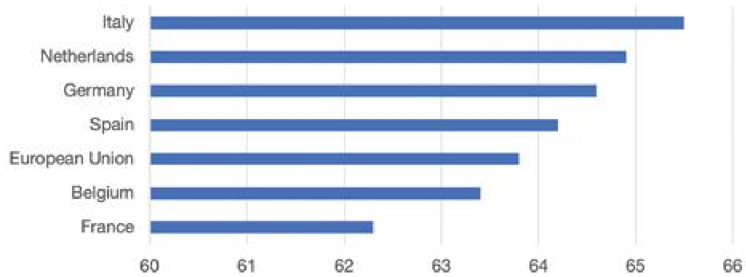


CHART 17.

Average Effective Labour Market Exit Age, 2019

Source: Eurofi, with Eurostat data



Such levels of public expenditures have been reached at the expense of productive investment, hence weakly contributing to gross capital formation[5]. As share of GDP, public investment has not exceeded 4% of GDP in Europe since 2010. Moreover, against the backdrop of rising public expenditures, the share of public investment in total public spending fell in Europe between 2007 and 2019 (*see Chart 20*).

Research and Development (R&D) is also a concern. On this issue, most of EU members dedicate less of their spending than the OECD average (of 2.5% of GDP in 2019). Only Germany and Austria stand out, with levels close to the US and Japan (*see Chart 18*).

CHART 18.

Gross Domestic Spending on R&D, % of GDP (2019)

Source: OECD

Note: 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

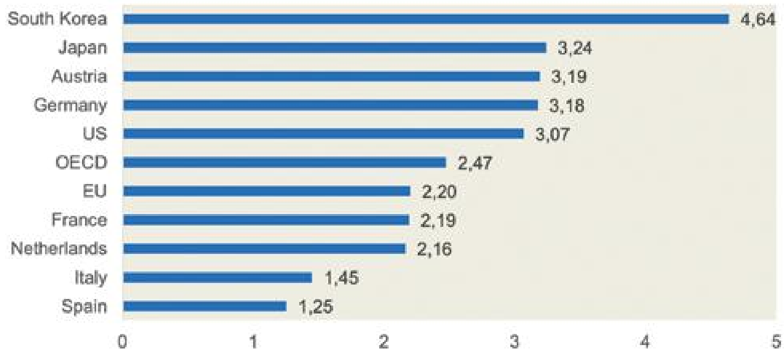
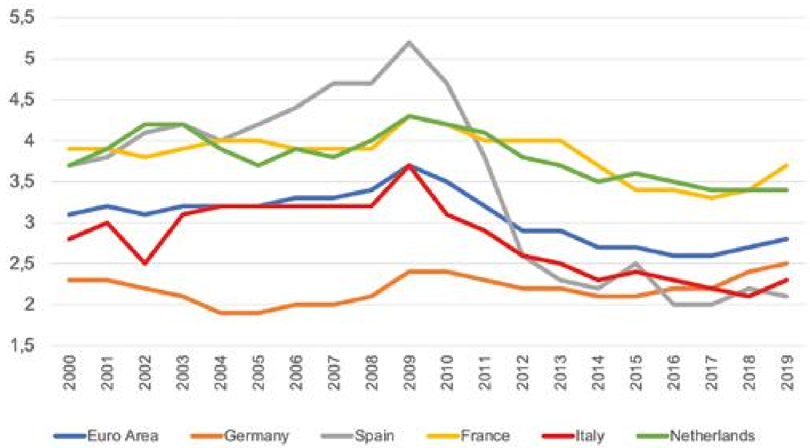


CHART 19.

Gross Fixed Capital Formation of Public Sector, % of GDP

Source: Eurostat



Although public expenditures rose in some key EU Member States, the share of public investments in total public spending globally shrank between 2007 and 2019 by 1 pp on average, to 6.5% (*see Chart 20*). During this period, only Germany saw an increase of the share of public investment in total spending, although its level of gross fixed capital formation remains one of the weakest in Europe (*see Chart 19*).

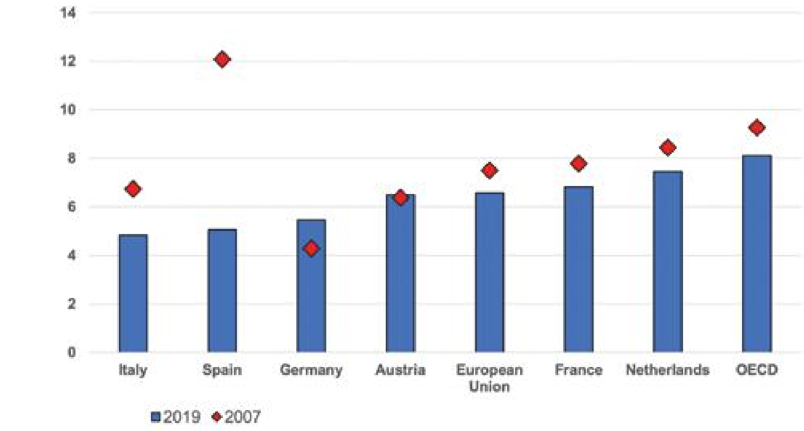
Chart 20 also underlines that the major EU economies have dedicated a share of investment in total public expenditure below the OECD average of 8.1% in 2019.

5. For government, gross fixed capital formation includes transport, office buildings, housing, school and hospital infrastructures.

CHART 20.

Share of Public Investment in Total Government Expenditure (in %)

Source: OECD



The European Commission 2021 Autumn Forecast projects an increase in the euro area aggregate public investment-to-GDP ratio (from 2.8% in 2019 to around 3.2% in 2022) as a result of higher funding from EU and national sources. A significant part of the increased EU funding is due to the use of Recovery and Resilience Facility grants. In the meantime, nationally financed investment is projected to be broadly preserved in 2022, as all Member States are expected to keep the share of nationally financed investment in GDP to at least a similar level as in 2021.

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

4.1 The most indebted countries of the eurozone have achieved the lowest productivity growth performance in the past two decades

Since 1999, the five EU Member States whose public debt to GDP have continuously risen to reach the highest levels among the eurozone Member States have achieved the lowest performances in terms of total factor productivity growth[6]. Indeed, productivity growth paths in France, Spain, Belgium, Portugal and Italy, have been declining or stagnating to low levels since 1999. Moreover, these economies have been diverging from the dynamic trend of the Netherlands, Germany and Austria, characterised by relatively lower levels of public debt to GDP ratio and steadily higher productivity growth trends (*see Chart 21*).

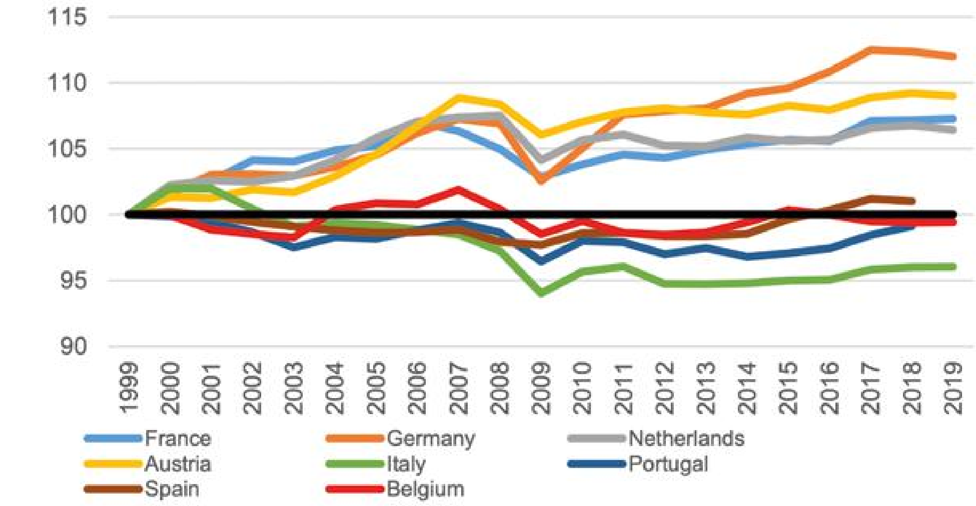
As shown in Chart 21, global factor productivity growth in the euro area has diverged since the start of the EMU. That has translated into diverging growth paths. The Covid crisis has worsened this problem, because some of the economies that have been growing the slowest over the past ten years, are also the ones that were hit the hardest by the pandemic-related crisis.

K. Knot, Governor of the De Nederlandsche Bank (DNB) stated that this issue is concerning[7], "because it threatens the coherence of the Economic and Monetary Union [...]. Resilience is about balance [...]. If you put more pressure on one leg than the other, you are bound to get some serious health problems at some point. That is not what the patient needs [...]. What the patient needs is some care to wean it from its dependance on debt and to bring back balance in economic growth".

CHART 21.

Multifactor Productivity Growth, 1999 = 100

Source: OECD



6. According to the OECD, the indicator reflects the "overall efficiency with which labour and capital inputs are used together in the production process. Changes in Multifactor Productivity Growth reflect the effects of changes in management practices, brand names, organizational change, general knowledge, network effects, spillovers from production factors, adjustment costs, economies of scale, the effects of imperfect competition and measurement errors."

7. K. Knot, "Rebuilding resilience: meeting the challenges beyond covid", Eurofi Forum, 11 September 2021.

4.2 The most indebted EU Members have experienced the highest unemployment rate in the EU 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 labour market problem. The three countries are among those with the highest share of long-term and young unemployment rate. As of October 2021, Spain had the second highest share of 15-24 years old unemployed people (30.3%) in Europe, behind Greece (33.2%) and followed by Italy (28.2%). 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 (18.6% of youth unemployment rate, against 16.9% for the euro area).

Such high levels in public expenditure thus reveal the lack of domestic structural reforms.

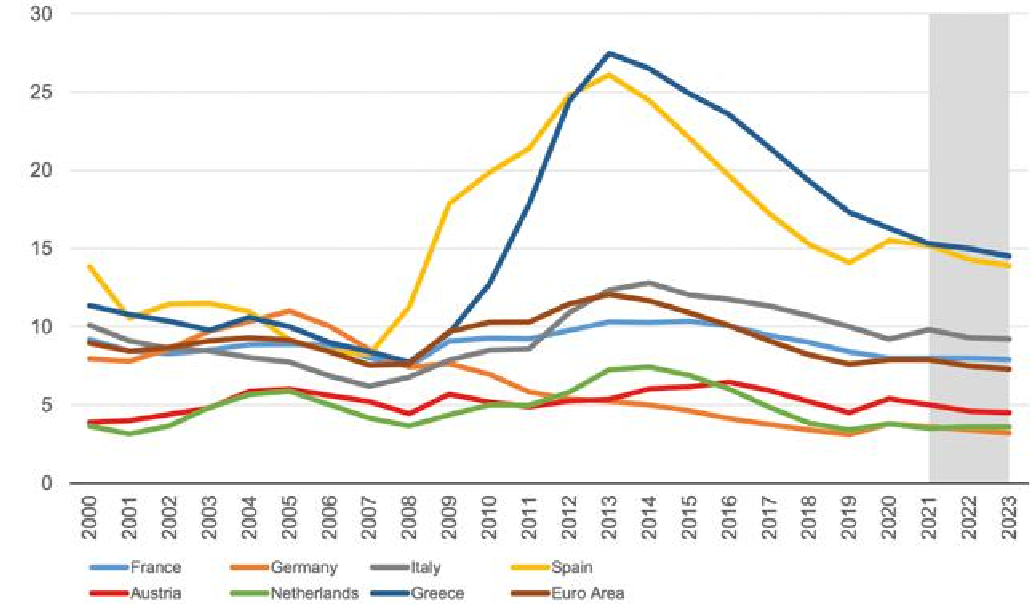
In 2019, 57% of the Italian unemployed people were in a situation of long-term unemployment[8]. France and Spain follow, with 38.8% and 37.1% respectively.

Another indicator to assesses the labour market dynamic in the EU is the employment rate: the share of the employed labour workforce in total population. Between 2005 and 2020, the number of employed people aged 15-64 in the EU increased from 180.2 million to 191.5 million in 2020 (+11.3 million). However, as mentioned by Eurostat[9], "one of the most relevant findings is that this increase is entirely caused by the increase in employed people aged 55-64, whose number went up from 19.7 million to 35.7 million over the last 15 years (+16.0 million). Looking at employed people aged 15-24, their number decreased from 18.0 million to 14.5 million (-3.5 million) in the same way as for people aged 25-54 whose number went down from 142.5 million in 2005 to 141.3 million in 2020 (-1.2 million)."

CHART 22.

Unemployment Rate, as % of active population

Source: AMECO November 2021 Forecast

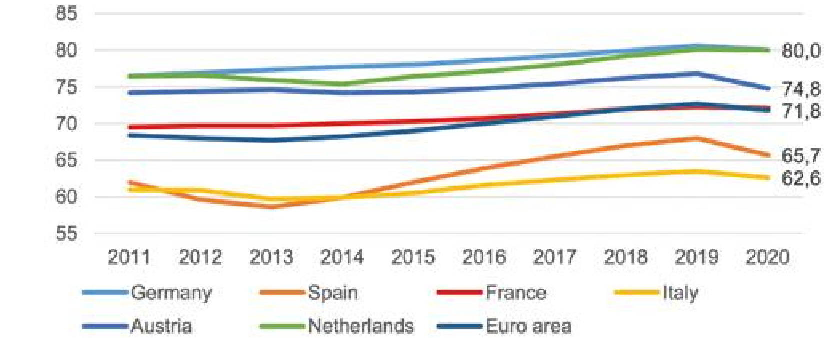


When looking at Member States individually, two groups stand out: countries with a share of people employed exceeding 70% of the population, as the Netherlands, Germany and Austria notably, and countries whose number is hovering below 65%, including Italy and Spain (*see Chart 23*). Two reasons for that difference lie in the employability of the population, measured by the level of skills, and the degree of flexibility of the labour market. Too rigid, the latter favours labour costs to be higher than labour productivity, reflected by the skills-level of the population, and so discourages firms to hire.

CHART 23.

Employment Rate of the 20-64, as share of total population

Source: Eurostat



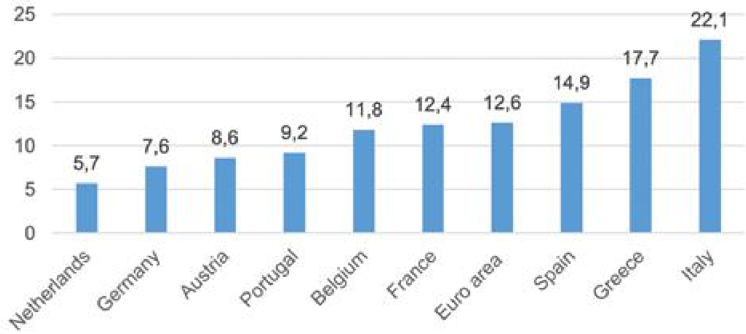
8. People staying unemployed for at least twelve consecutive months (OECD definition).
9. See https://ec.europa.eu/eurostat/statistics-explained/index.php?title=Employment_-_annual_statistics#employment_down_compared_to_2019

The significant share of youth unemployment rate in some EU countries reveals the existing difficulties in joining the labour market. Such failures favour the proliferation of Youth 'NEET' (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 24.

Young People Neither Employed, in Education or Training in 2019, as % of 15-29 population

Source: Eurostat



4.3 The combination of low employment rate and low productivity growth leads to higher output gaps

The combination of low employment rate and low productivity growth — as the result of a lack of productive investments and the persistence of structural rigidities — translates into higher output gaps. The output gap indicator reflects the difference between the GDP level effectively achieved and its potential, which is the level of gross domestic product if production factors were fully used.

Between 2014 and 2019, countries with low employment rate, as Italy and Spain especially, have never registered any positive output gap. With a slightly higher employment rate, France is in better place, although it remains markedly below the level of the Netherlands, Austria and Germany. The three latter countries have all experienced a positive output gap during the two years predating the Covid-19 crisis (*see Chart 25 and Table 3*).

CHART 25.

Average Output Gap between 2014 and 2019, as percent of potential GDP

Source: OECD

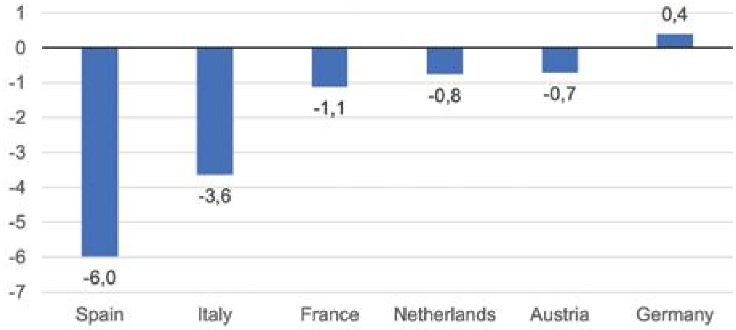


TABLE 3.

Output Gap in Selected EU Member States, % of potential GDP

Source: OECD

	2014	2015	2016	2017	2018	2019	Average 2014-2019
Spain	-11,7	-8,9	-6,7	-4,5	-2,8	-1,3	-6,0
Italy	-5,9	-5,2	-4,0	-2,6	-2,1	-2,0	-3,6
France	-2,0	-2,0	-2,1	-0,8	-0,2	0,4	-1,1
Netherlands	-2,3	-1,8	-1,4	0,0	0,5	0,5	-0,8
Austria	-2,0	-2,0	-1,2	-0,2	0,7	0,5	-0,7
Germany	0,1	-0,3	0,1	1,4	0,9	0,3	0,4

5. THE EUROPEAN ECONOMY SUFFERS FROM SEVERAL STRUCTURAL IMBALANCES

Beyond the increasing fiscal and productivity growth rates and labour market characteristics heterogeneities across the Monetary Union (*see part 2*), the Monetary Union is suffering from two additional structural vulnerabilities: a growing heterogeneity in productive specialisation and current account imbalances. The euro has contributed to strengthen the EU countries with a strong economy and to weaken the others. Indeed, the elimination of currency risks is enabling those countries to fully exploit — and even over-exploit — their comparative advantages. This exploitation of comparative advantages leads economies' productive specialisations and sector structures divergeance (*see Charts 26 and 27*). The result is divergent living standards between euro area countries (*see Chart 31*).

5.1 Growing heterogeneity in productive specialisation

As it is common in a currency area, Member States of the eurozone have divergent productive specialisations with consequences on relative productivity and potential growth rates. The elimination of foreign exchange risks normally encourages productive specialisation within the Monetary Union because it mainly benefits net exporting countries.

Moreover, the position of the best performing and most productive countries tends to improve further as a result of the monetary union itself. Indeed, the economies of the best performing countries benefit from the fact that the external value of the euro represents an average for the entire economic area and appears undervalued in relation to their economic performance, resulting in an additional competitive advantage. For example, it is estimated that Germany's exchange rate is 20% undervalued, in terms of a real effective exchange rate towards the euro area. Its correction would imply, arithmetically, a 2% annual inflation rate in Germany and a 0% inflation in the other countries for a decade — which would be unrealistic and probably misconceived.

In such a context, since the creation of the euro, the northern countries of the Monetary Union (Germany and the Netherlands in particular) have been able to maintain a competitive industry, while the southern countries (Greece, France and Spain in particular) have progressively experienced deindustrialisation. The former (EU Northern countries) have gained market share in world trade, while those of the South have lost market share. Charts 26 and 27 highlight the divergence of industry and tourism across EU Member States.

CHART 26.

Share of Manufacturing in Total Added Value

Source: OECD

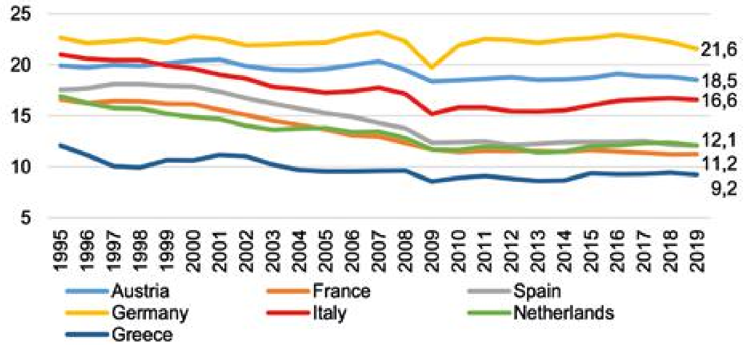
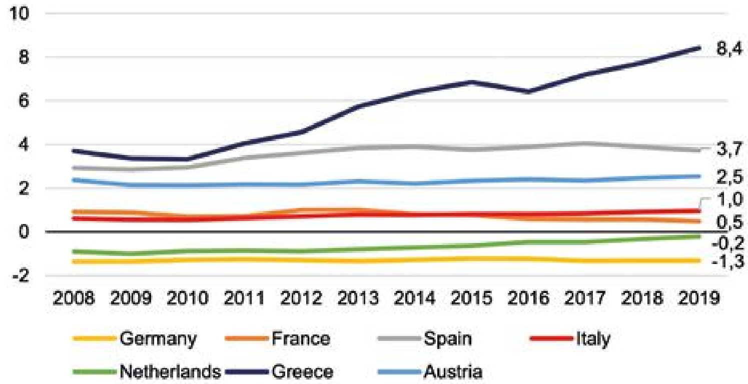


CHART 27.

Balance of Payments in Travel, % of GDP

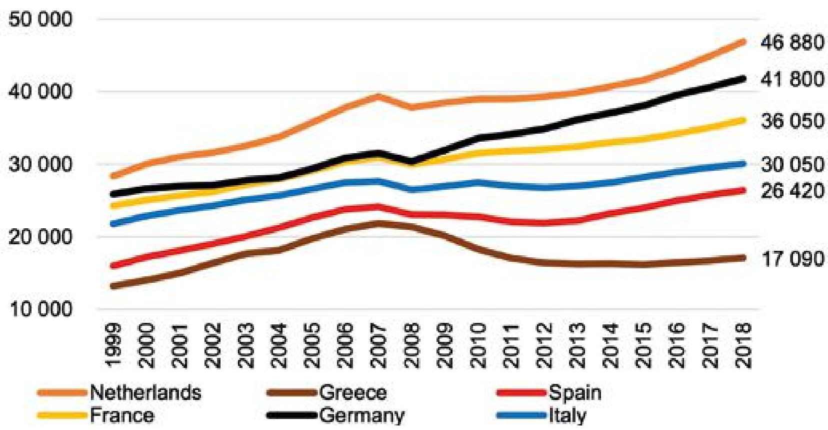
Source: Eurostat



This process also leads to a divergence of per capita levels between eurozone countries. Hence, the Netherlands per capita GDP (current Local Currency Unit) was in 2019 almost three times greater than the Greek one, with EUR 46 880 per year against EUR 17 090 for the latter (*see Chart 28*). In 1999 it was only twice more (€26 530 for the Netherlands and €13 000 for Greece).

CHART 28.

GDP per Capita, current euros

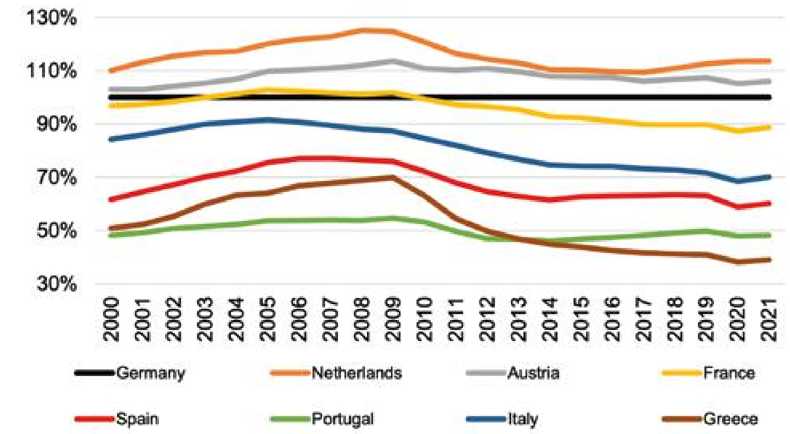


Another illustration of the growing economic heterogeneity across EU Member States is the gap between per capita GDP of a given country and the German one (*see Chart 29*). Over the past two decades, from 2000, two groups of countries stand out: those having systematically exceeded the level of German GDP per capita, as the Netherlands and Austria, and those that have constantly remained below, as Italy, Spain, Portugal or Greece. Once close to the first group, since the 2008 Great Financial Crisis, French GDP per capita has gradually fallen behind towards the low-income countries.

CHART 29.

GDP per Capita, as % of German GDP per capita

Source: IMF



5.2 The existence in the euro area of countries with large current account surpluses and countries with persistent current account deficits make the consistency of EU policies much more problematic

Charts 30 and 31 underline how significant discrepancies are, between Member States.

Current account surpluses in Germany and the Netherlands averaged 7.71% and 9% respectively, over the 2013-2019 period, while French deficit reached 0.6%.

For 2021 and 2022, the EU Commission forecasts a current account surplus:
• in Germany of 6.7% of GDP in 2021 and 6.8% in 2022 (after 7.1% in 2020);
• in Netherlands of 8.4% of GDP in 2021 and 9% in 2022 (after 7% in 2021).

In 2021 and 2022, the EU Commission forecasts a current account deficit in France of 2.4% of GDP in 2021 and 2.2% in 2022 (after 1.9% in 2020).

TABLE 4.

Current Account Balance, % of GDP

Sources: OECD Economic Outlook (December 2021); AMECO November 2021 Forecast

					AMECO		OECD	
	2007	Average 2014-19	2019	2020	2021	2022	2021	2022
France	-0,1	-0,6	-0,3	-1,9	-2,4	-2,2	-1,0	-2,0
Italy	-1,4	2,2	3,2	3,5	3,5	2,7	3,1	3,0
Spain	-9,4	2,3	2,1	0,7	0,3	0,8	0,6	1,0
Austria	3,8	2,0	2,8	2,5	-0,1	-0,2	-0,2	0,1
Netherlands	6,9	9,0	9,4	7,0	8,4	9,0	8,5	8,9
Germany	6,9	7,7	7,4	6,9	6,7	6,8	6,8	6,1
Euro Area	0,0	2,7	2,4	2,2	3,0	3,0	n.a	n.a
European Union	0,0	3,1	2,9	2,8	3,1	3,2	n.a	n.a

In principle, imbalances in a Union are not in themselves a source of concern. But, as it is the case today, these figures are of a durable and structural nature.

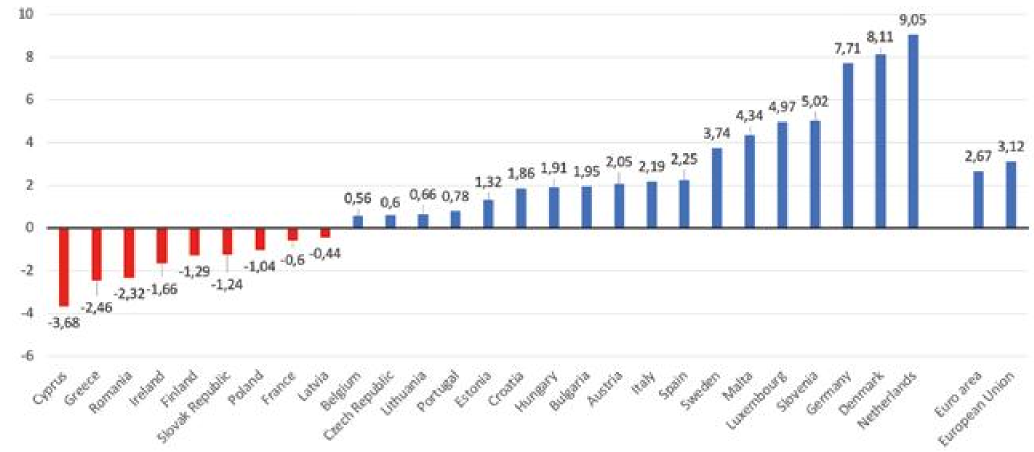
If the eurozone were the equivalent of a nation, such discrepancies in current accounts could be acceptable

Indeed, since there would be only one balance of payments for the entire zone, as in the US for example, rebalancing adjustments would take place automatically through the mobility of capital and labour.

CHART 30.

Average Current Account Balance between 2014 and 2019, % of GDP

Source: AMECO



Subregions with high current deficits (and therefore overvalued "currencies") would be winning because they could "import" cheap goods from surplus generating subregions, the latter contributing through this implicit subsidy to the adjustment of the deficit zone.

But in fact, the EMU is composed of national balance of payments and national budgets

Macro-economic imbalances relative to the "highest performing economy" are not a matter to be corrected by the Union. They are issues exclusively dependent on economic policies of the nations.

Since countries cannot adjust their exchange rates to their competitive positions, it is up to the domestic competitive position to adjust to the exchange rate. Devaluations can only be internal and lead to a reduction of domestic demands and revenues.

The problem raised by these imbalances

Of course, the objective is not unifying all the balance of payments within Europe. Some countries have to catch up from very low standards of living and this necessarily incurs some deficits of balance of payment. However, the dynamics should not compound this heterogeneity but reduce it.

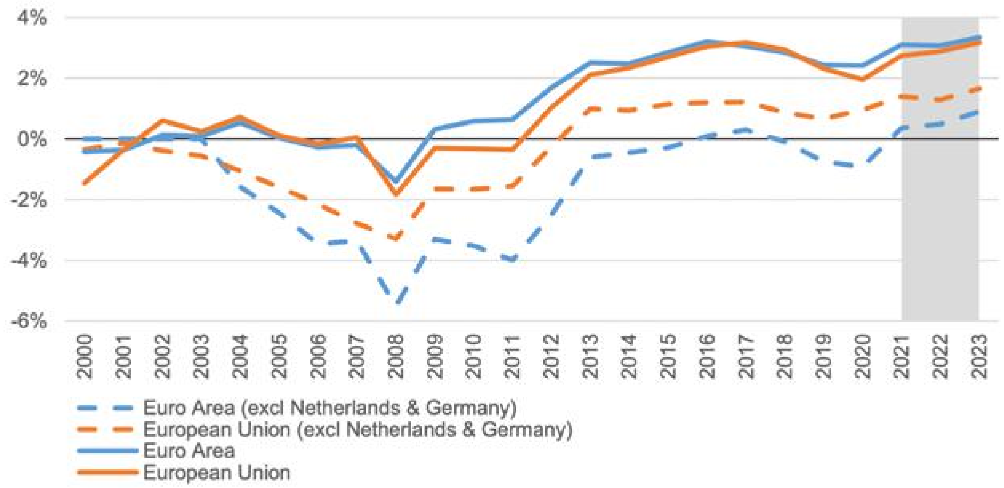
Since the EU sovereign debt crisis (2011-2012), Member States with excess savings (Germany and the Netherlands in particular) no longer finance investment projects in lower per-capita-capital countries (Spain, Italy, Portugal, Greece). This is notably due to the interest rate differential between the US and Europe (the risk is better remunerated in the US than in Europe), the limited financial flows between eurozone countries and the insufficient number of investment projects. These limited cross-border capital flows in the euro area reflect the persistent doubts of investors in Northern Europe about the solvency of states and companies in other countries, as well as the lack of a genuine Banking Union and integrated financial market.

The fact that Germany's and the Netherlands' external surpluses are no longer lent to the other Member States reduces the capacity of peripheral countries to invest as well as their potential growth and contribute to increase the per capita income heterogeneity in the euro area *(see Charts 28 and 29*).
Consequently, the euro area exhibits a savings surplus of more than €277 billion (or 2.4% of GDP in 2019), which is no longer being lent to the other euro area countries but lent to the rest of the world excluding the euro area.

CHART 31.

Current Account Balance, % of nominal GDP

Source: AMECO



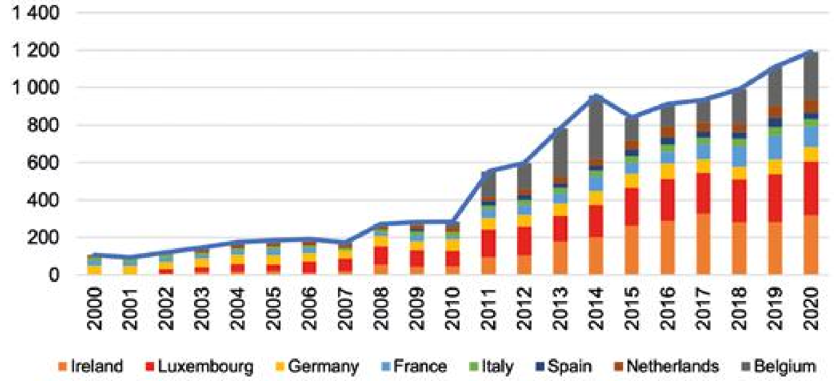
The eurozone's external surplus has largely been used to buy bonds in the rest of the world, in particular for US Treasuries.

Between 2000 and 2020, the volume of US federal debt held by eurozone residents was multiplied by more than ten, increasing from USD 106.3 bn to USD 1190.1 bn. Within the area, all countries that registered a positive current account balance are lending to the United States (*see Chart 32*) and therefore finance the US external and fiscal deficits. These include Germany ($75.4 bn in 2020), the Netherlands ($69.7 bn), Luxembourg ($287.7 bn), Spain ($35.3 bn), Belgium ($253.5 bn) and Italy ($39.1 bn). Although achieving an average current account deficit, France and Ireland also hold a significant amount of US federal debt, lending respectively $111.3 bn and $318.1 bn to the US Treasury in 2020.

CHART 32.

Outstanding Treasuries Held (USD bn)

Source: US Department of the Treasury



Developing cross-border financial flows within the euro area is essential. The true objective of a currency area is that savings should flow to finance the most productive investments throughout the currency area. Indeed, in a monetary union, the elimination of currency risk allows savings from the countries that have a high level of per capita capital (Germany, the Netherlands, France) to finance investment in the countries with lower per capita capital and higher marginal productivity of capital (for example Spain, Italy, Portugal). Income convergence therefore normally stems from the transfer of savings from high per-capita-income countries to low per-capita-income countries. But, as mentioned above, these transfers disappeared in the 2008-2010 period.

The phenomenon is there to stay. Indeed, we need to take into account a structural feature, which is the increasing specialisation, industry wise, of surplus countries. Success breeds success. Helped by the implicit devaluation stemming from the favourable cost evolution, exports of surplus countries become more profitable. It would be illusory to believe that the structural advantages of German exports could be transmitted to and copied by southern or eastern European countries which have a different industrial story and cannot become little Ruhr (while the Ruhr can become and is becoming stronger).

*   *

*

A monetary union does not by itself create economic convergence. The eurozone is a currency area comprising heterogeneous countries (their productivity levels, their productive specialisation, the level of fiscal deficits and indebtedness, the level of labour force skills are different) with a low level of federalism. In this perspective, the agreement on the *Next Generation EU* fund, is a remarkable advance.

The Covid-19 crisis has exacerbated these existing heterogeneities across EU Member States. The euro area is a monetary union that is becoming not sustainable without additional elements of solidarity. This is why the implementation of *Next Generation EU* must be a success[10].

Europe's savings should not finance the rest of the world rather than lower per-capita European countries.
Monetary policy can erase spread differentials but cannot address structural issues and notably the lack of confidence and the persistence of structural discrepancies, which explains the limited capital flows from the North to the South.

Consequently, the eurozone has to embark on the right course: more fiscal responsibility and more supply reforms geared to increase productivity, as well as steps to complete the Banking Union and implement the Capital Market Union. But this move to integration can only be envisaged if sufficient discipline were — in a tangible manner — to start reversing the trend of ever-growing burdens.

10. The Recovery and Resilience Facility is the biggest programme of the recovery plan with a maximum of EUR 672.5 billion of loans and grants for Member States to finance reforms and investments. The aim of the Recovery and Resilience Facility is to mitigate the economic and social impact of the coronavirus pandemic and make European economies and societies more sustainable, resilient, and better prepared for the challenges and opportunities of the green and digital transitions.

Thinking that money creation can solve the problems arising from excessive debt is an illusion. It is not because budget deficits are monetised that they disappear. In addition, the central bank will not always be able to buy everything, and the quality of a state's signature is an essential element of confidence that shall be preserved at all costs for the country's future. It is economic growth that eventually solves indebtedness issues.

To be viable, the eurozone needs:

- **National budgets under control in all parts of the Union.** No responsible state should ever accept financing current public deficits generated by other eurozone members of the Union that do not follow the rules of the Union. The future depends on a consolidation of present weak fiscal positions (primary surpluses) and a shift towards quality of expenditure and investment. We do not need more redistributive expenses. We must rein them in and allow adequate space for public investment. The revision of the stability and Growth Pact is of paramount importance in this respect.
- **Domestic structural measures towards increasing growth potential should be encouraged and monitored.** Reducing output gaps cannot be ensured just by subsidies to the labour markets. This requires more substantially to increase the productivity of the system, which necessitates more competition and long-term investment. Making the European recovery plan a success is therefore essential and should contribute to boost potential growth.
- **An active banking and integrated capital market in Europe.**

In sum, members of the Monetary Union must act together to make it work, and not behave as passive individual bystanders hoping that things will turn out fine.

Completed on 2 February, 2022

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