

# EUROFI

# Macroeconomic Scoreboard

SEPTEMBER 2022

**Jacques de Larosière and Didier Cahen  
with the support of Elias Krief**

## Inside

- Widening of the economic gap between the euro area and its main global competitors with Covid crisis and the war in Ukraine
- 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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This Eurofi Scoreboard highlights five key economic issues faced by EU Member States.

- First, the shocks triggered by the pandemic and the war in Ukraine have widened the economic gap between the euro area and its main global competitors.
- Second, the Covid-19 crisis has exacerbated existing fiscal heterogeneities across EU Member States.
- Third, EU countries with the highest level of government expenditure as percentage of GDP are those with the least competitive firms.
- Fourth, excessive level of public debt does not fuel productivity growth and employment.
- Fifth, the European economy suffers from several structural imbalances.

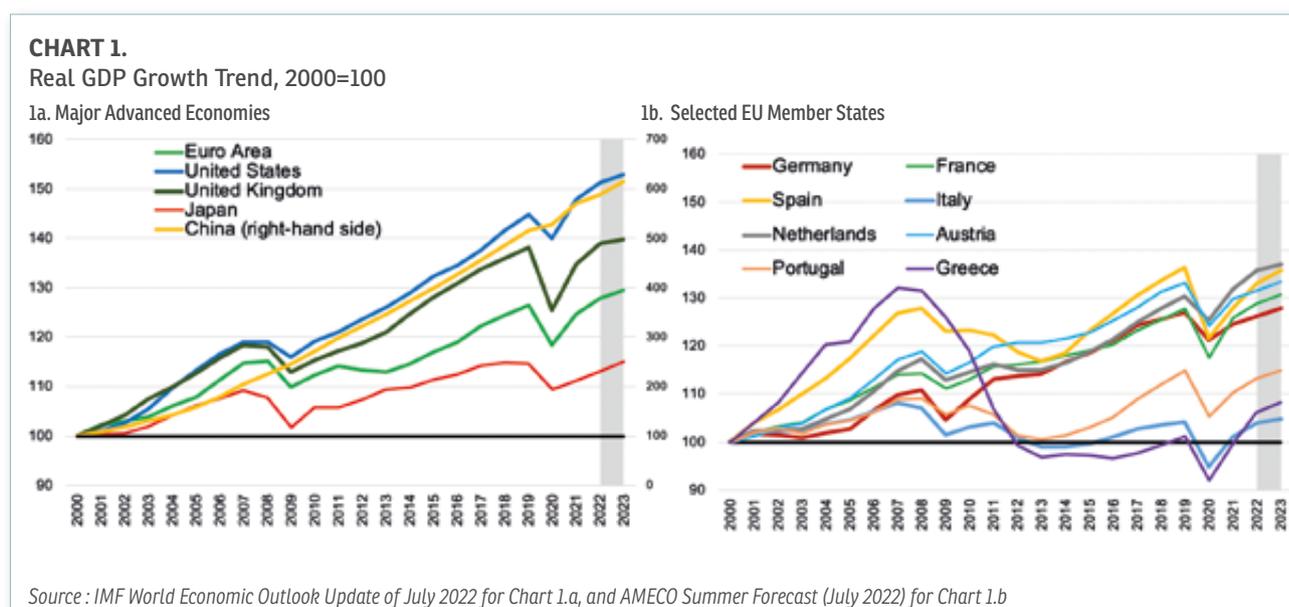
## 1. The shocks triggered by the pandemic and the war in Ukraine have widened the economic gap between the euro area and its main global competitors

The eurozone has been experiencing a structural growth shortfall relative to the United States and China since the mid-1990s due to structural problems in the euro area. The COVID-19 crisis has been more severe in Europe than in the US and China and has amplified the heterogeneity of economic performance across Member States. The economic and social impact of the war in Ukraine are also stronger in Europe given exposure through energy imports and refugee flows.

### 1.1 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 the UK) 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 (0.9%) and France (1.5%).



Real GDP growth and productivity gains in the euro area have failed to catch up with the US and China over the past two decades and productivity gaps across member countries remain significant.

Such a growth performance gap between Europe and the US can be attributed to (i) the freer and less regulated institutional environment in which firms operate in the US, (ii) lower productivity gains and investment in Europe than in the US, and (iii) the prominent role of financial markets in the financing of the US economy.

### Enterprises are freer to work and make profits in the US than in Europe:

- Less regulation and more flexible markets: Europe imposes administrative burdens on creating new firms or on growing beyond arbitrary thresholds that triggers an increase in compliance costs. This is not observed in the United States.
- Working hours are less in Europe than in the United States.
- Fiscal and social contributions are higher in Europe.

## Lower productivity gains and investment in Europe than in the US

- Low productivity gains in Europe are due to low research spending and the decline of industry (see chart 2.a).
- Underinvestment weakens potential growth in Europe (see chart 2.b).
- A significant share of euro savings resulting from external surplus (see chart 3) is lent to the rest of the world instead of being invested in the euro area countries.

**CHART 2.**

R&D Spending and Corporate Investment trend in the United States and the Eurozone

2a. Total R&D spending (as % of nominal GDP)



Sources: OECD, Eurostat, Natixis

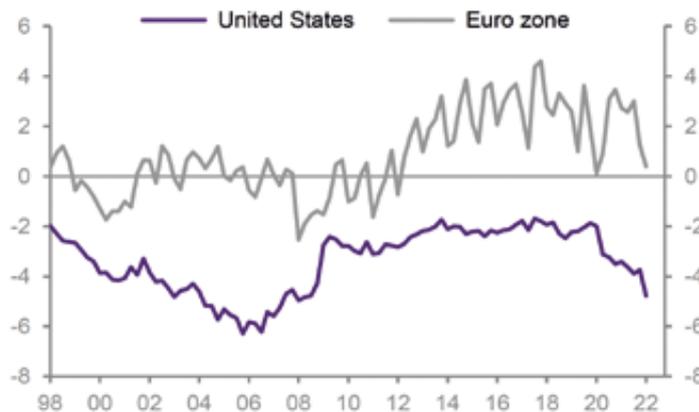
2b. Total corporate investment (as % of real GDP)



Sources: Refinitiv, BEA, Eurostat, Natixis

**CHART 3.**

Current-account balance (as % of nominal GDP)



Sources: Refinitiv, BEA, Eurostat, Natixis

This financing by Europe of the rest of the world and the United States in particular is explained not only by the absence of a single banking and financial market in Europe but also by the interest rate differential between the United States and the EU Member States: US nominal rates (10 years) have gravitated between 2012 and 2022 to levels in order of 2 to 3 points higher than German rates and above average European rates.<sup>1</sup>

## In spite of more buoyant savings in Europe, financial markets are three times more important in the US than in the EU in financing the economy.

In 2019 about 80% of total financial debt consisted of bank loans in the euro area, while it did not exceed 40% in the US.

European enterprises rely on banks for almost three quarter of their financing (¼ in the US). Therefore, in the wake of the financial crisis which has been followed by a doubling of capital requirements for banks, such a huge recapitalisation effort is bound to have a more significant impact on the European economy than on the US. Moreover, such a structure of financing by banks and the absence of an integrated capital market hinder an optimal allocation of capital for the financing of long-term investments such as transport infrastructure, sustainable energy generation or distribution.<sup>2</sup>

1. See J. (de) Larosière, "Illusion et réalité", Odile Jacob (forthcoming)

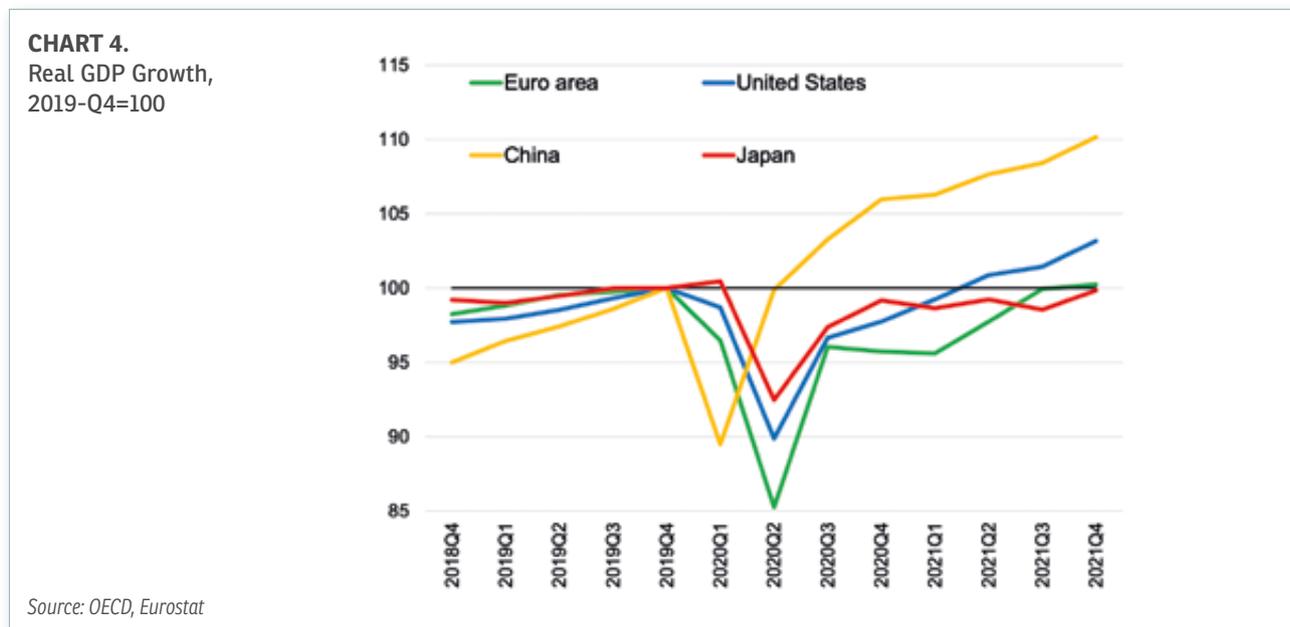
2. Capital market underdevelopment in Europe is evident when comparing company financing structures to other advanced economies. Even listed companies in Europe are substantially more bank-financed than in the United States, while the aggregate market capitalisation of listed firms is much smaller relative to GDP. In 2019, the capitalisation of the EU-27 stock market accounted for 70%, compared to 194% in US. Venture capital investments are ten times higher in the US than in Europe (as a share of GDP), and even more so in a handful of Asian countries (Singapore, China, India). European companies, especially in tech, are much more likely to be acquired by American firms than the other way around.

Equity-based financing is also a better suited solution than bank financing for high growth sectors (such as digital and high-tech) where most capital is intangible.

## 1.2 The COVID-19 crisis has been more severe in Europe than in the US, China and Japan

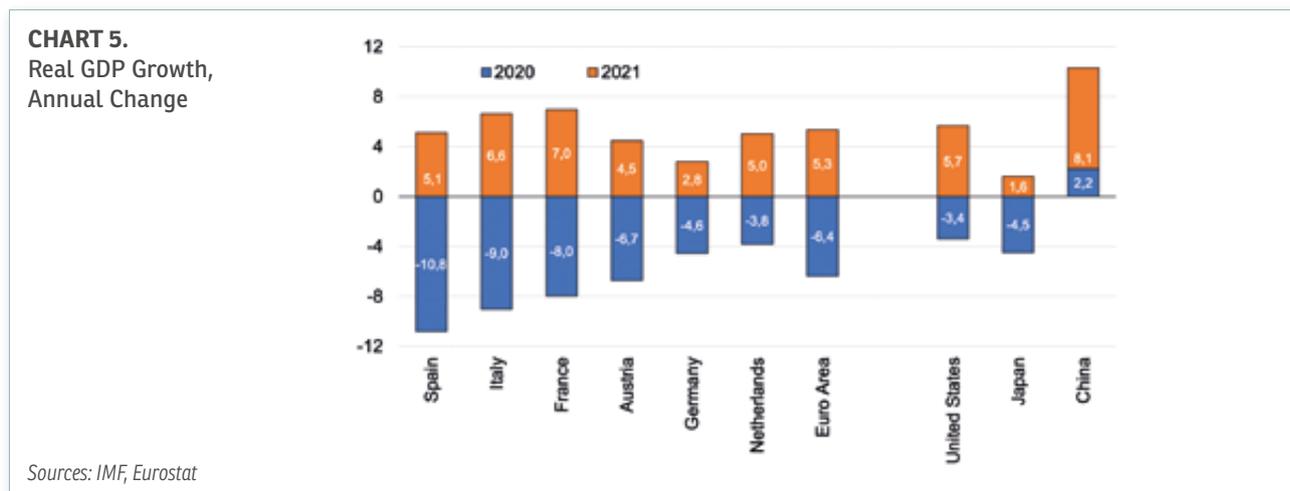
### 1.2.1 In 2020, the euro area suffered the largest GDP contraction among advanced economies

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



### 1.2.2 In 2021, Europe recovered at a slower pace than the United States and China

The rebound in growth of the eurozone in 2021 was 5.3% compared to 8.1% in China and 5.7% in the United States (see Chart 5). As of the fourth quarter of 2021, the eurozone GDP was just 0.2 percentage points above its pre-pandemic level, while it was up by 3.2 pp in the US, and 10.2 pp in China (see Chart 4).

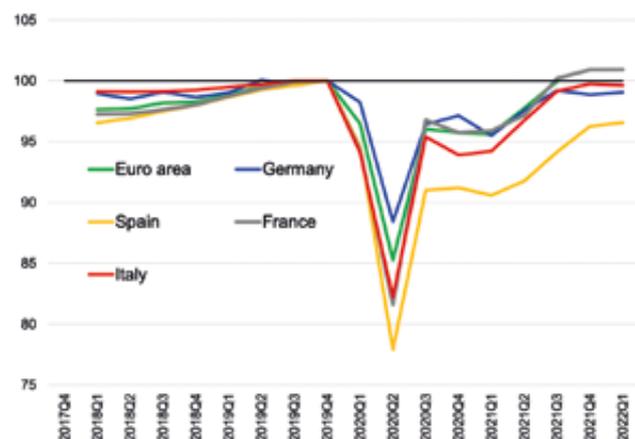


Within the euro area, the recovery is uneven across Member States. Most of them experienced a fast rebound in 2021, notably in France, the Netherlands and Belgium whose real quarterly GDP already exceeded their pre-pandemic levels as of the fourth quarter of 2021 (see Chart 6).

Thirteen euro-area Member States returned to pre-pandemic quarterly levels of output by the end of 2021. In the last quarter of 2021, the output of seven Member States, including Germany, Spain and Italy, had not reached pre-pandemic levels from the fourth quarter of 2019.

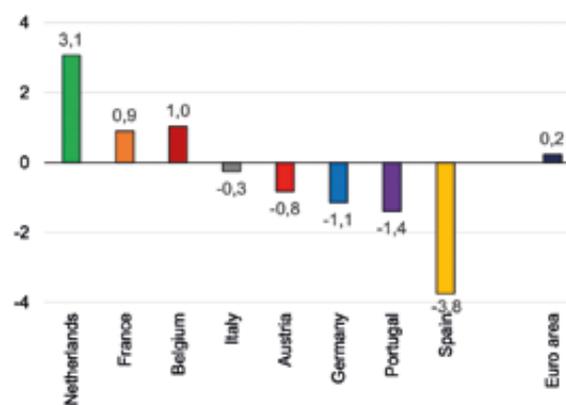
**CHART 6.****Real GDP Growth in Selected EU Member States**

6a. Real GDP Growth Trend, 2019-Q4=100

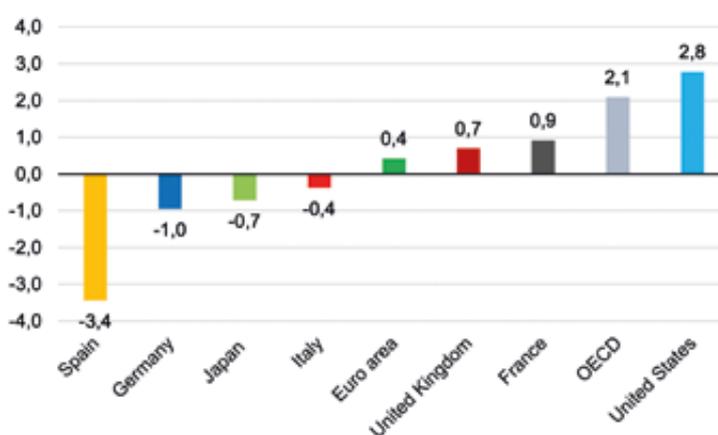


Source: Eurostat

6b. Distance with 2019-Q4 GDP as of 2021-Q4, percentage points

**1.2.3 GDP growth exceeded its pre-pandemic levels in the first quarter of 2022 in many advanced economies**

The United Kingdom exceeded its pre-pandemic (Q4 2019) level of GDP for the first time in Q1 2022, by 0.7%. In the United States, France and Canada, GDP remained higher than before the pandemic; these countries exceeded their Q4 2019 GDP levels for the first time in the second, third and fourth quarters of 2021 respectively. However, in Germany, Italy and Japan, GDP was still below pre-pandemic levels (by 1.0%, 0.4% and 0.7% respectively) in Q1 2022.

**CHART 7.****Real GDP (Distance with 2019-Q4 GDP as of 2022-Q1, percentage points)**

Source: OECD, Eurostat

**1.3 The economic shock triggered by the war in Ukraine will be more painful for Europe than any other advanced economy, both in terms of growth and inflation**

Beyond the immediate humanitarian impacts, the Russia's invasion of Ukraine is severely setting back the global recovery, slowing growth and accelerating inflation even further.

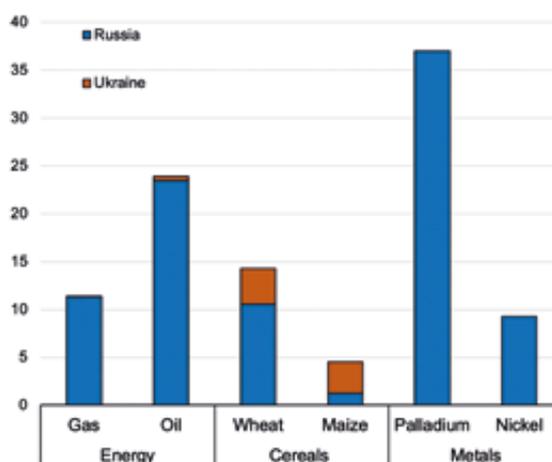
Indeed, the war in Ukraine has created a new negative supply shock for the world economy, whose impact differs across regions.

European economies are experiencing the greatest shockwaves of the conflict, particularly those that have a common border with either Russia or Ukraine. This is reflected in greater gas price rises in Europe than in other parts of the world consequential to the relative strengths of business and energy linkages with Russia prior to the conflict.

**1.3.1 A sizeable hit notably to EU growth**

Russia and Ukraine do have an important influence on the European economy. These two countries are relatively small in terms of output, but they are large producers and exporters of key food items, minerals and energy (see Chart 8). The war has already resulted in sizeable economic and financial shocks, particularly in commodity markets, with the prices of oil, gas and wheat soaring.

**CHART 8.**  
Selected commodities produced by Russia and Ukraine in 2019, % global production



Source: Bank For International Settlements (Annual Economic Report, 2022)

According to the OECD<sup>3</sup>, Russia and Ukraine together account for about 30% of global exports of wheat, 15% for corn, 20% for mineral fertilizers and natural gas, and 11% for oil. In addition, supply chains around the world are dependent on exports of metals and inert gases from Russia and Ukraine:

- Russia is a key supplier of palladium, used in catalytic converters for cars, and nickel, used in steel production and the manufacture of batteries.
- The two countries are sources of inert gases such as argon and neon, used in the production of semiconductors, and large producers of titanium sponge, used in aircraft. Both countries also have globally important reserves of uranium. The prices of many of these commodities have increased sharply since the onset of the war, even in the absence of any significant disruption of production or export volumes.

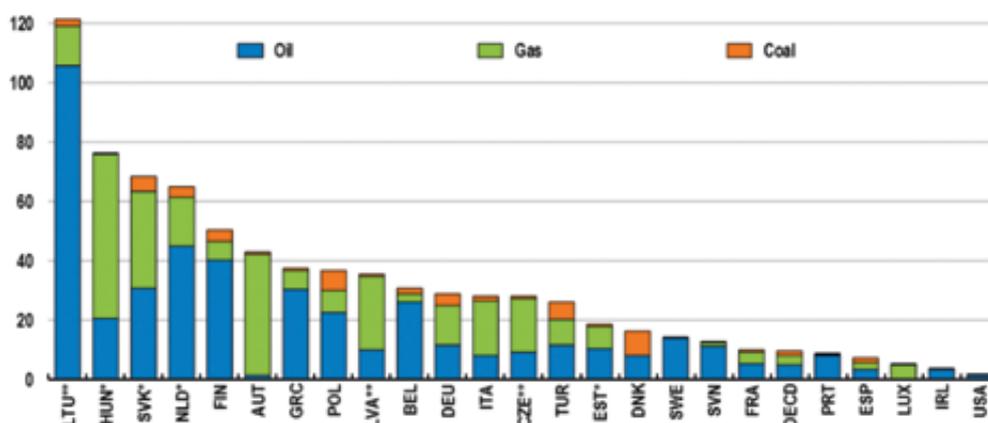
### The economic impact of the war on GDP growth will be more painful in Europe than in the United States or China

The main channels through which the war in Ukraine and sanctions on Russia affect the euro area economy are rising global energy prices and energy security.

The European Union imports more than half of its gross available energy, while the United States is almost energy independent. This means that a rise in energy prices impoverishes the EU, which has to pay income to the rest of the world for its energy.

The war has starkly highlighted that many OECD economies are heavily reliant on fossil fuel energy with a high risk of price shocks and even shortages. In 2020, Russia provided 38% of European natural gas imports, a similar proportion of coal imports (40.9%), and around a quarter of oil imports (23.9%) – see *Chart 9 below*. Gas supply is also a major source of electricity production, and an input into industrial production such as fertilisers.

**CHART 9.**  
Russian energy imports as a percentage of total energy supply, 2019



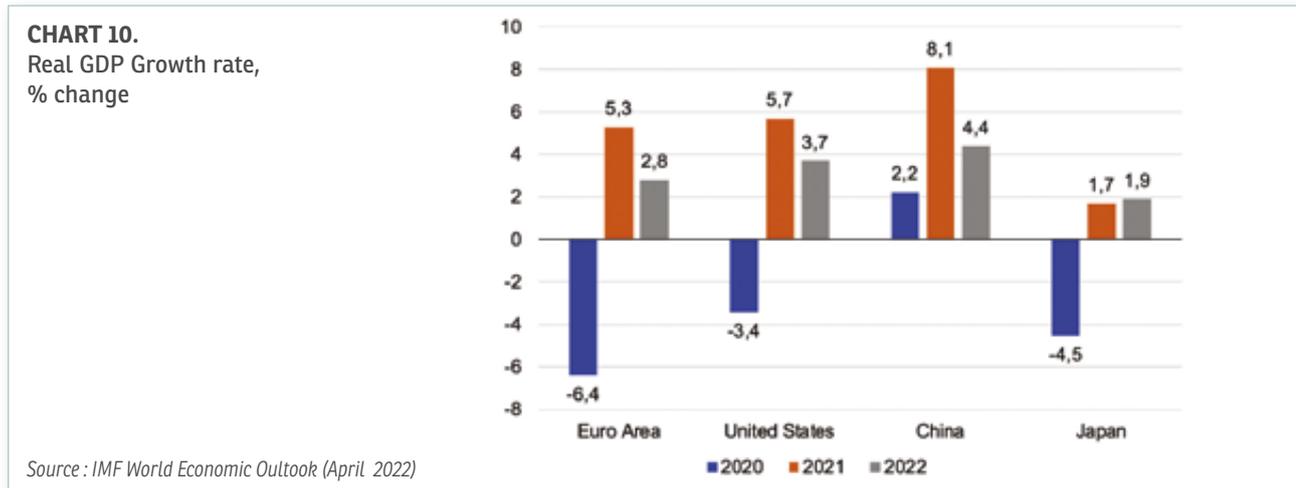
Source: IEA World Energy Balances database; and OECD calculations (extracted from the OECD Economic Outlook, Interim Report, "Economic and Social Impacts and Policy Implications of the War in Ukraine" (March 2022))

3. OECD, "The price of War", Economic Outlook, June 2022

Such a reliance to Russian energy imports renders the European Union as a whole highly vulnerable to disruptions to its energy supply. Because they are net importers, higher global prices represent a negative terms-of-trade shock for most European countries, translating into lower output.

Supply chain disruptions have also hurt some industries – with the war and sanctions further hindering production of key inputs such as nickel and palladium. Soaring metals prices could affect a wide range of industries such as aircraft space, car and chip manufacturing.

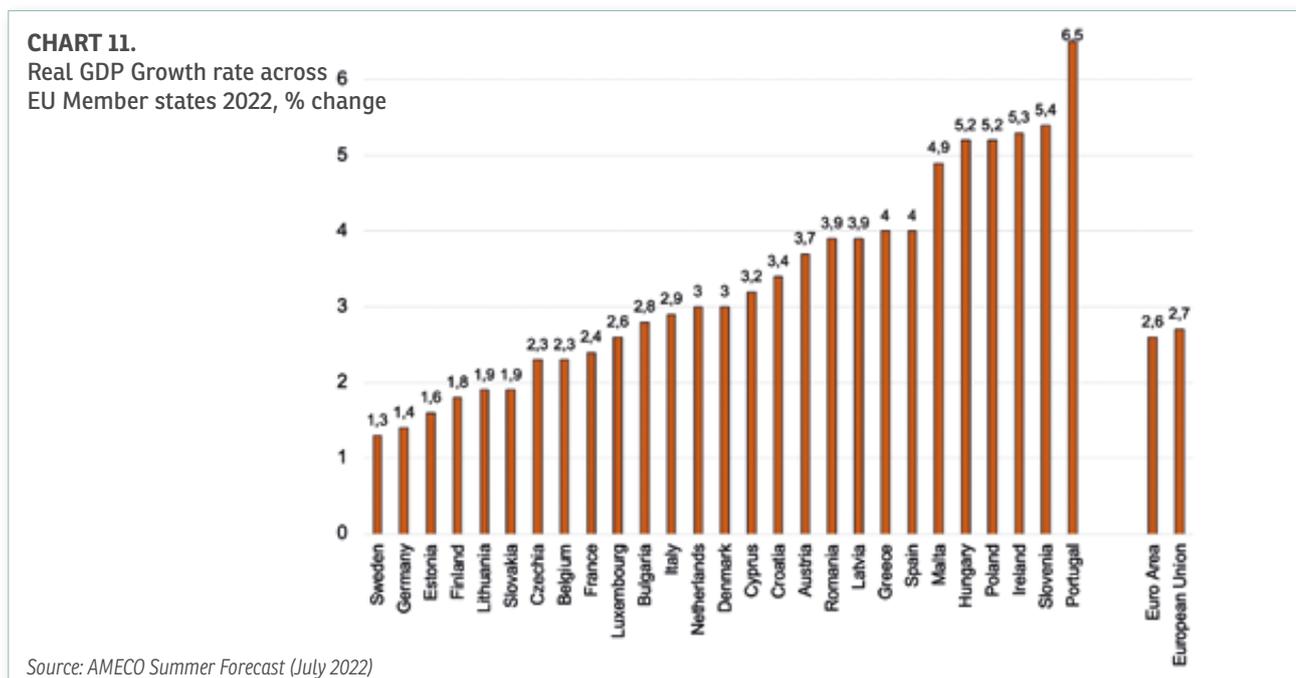
According to the IMF Forecast of April 2022, the eurozone real GDP is expected to grow by 2.8% in 2022, compared to 3.7% in the US, and 4.4% in China.



**Within the EU, Germany, Italy and some countries in Eastern Europe are particularly affected economically**

Among the main EU Member States, Germany and Italy are the hardest-hit due to relatively large manufacturing sectors and greater dependence on energy imports from Russia. For 2022, German real GDP is expected to grow by 1.4%, underperforming the eurozone (+2.7%), according to the EU Commission forecast of July 2022. Italy’s real GDP should grow by 2.9% in 2022.

Relatively less exposed to Russian commodity imports and more service-oriented, France, Spain and Portugal may be least affected by the shock in terms of output shortfall. Portugal is expected to deliver the highest growth performance in Europe, with its real GDP increasing by 6.5% in 2022. Spain (4%) would follow.



### Some countries in Eastern Europe have large direct trade and remittance links with Russia. Activities in those economies are expected to suffer the most.

Trade with Russia accounted for 6% of GDP in Latvia and Lithuania in 2021, and 1.5% in Poland and Slovakia. The three Baltic states – Estonia, Lithuania and Latvia – are among those that would suffer the most from the war in terms of output shortfall in Europe. For 2022, the Estonian real GDP may grow by 1.6% – the third lowest performance in Europe with Sweden and Germany; it should expand by 3.9% in Latvia and 1.9% in Lithuania, according to the EU Commission Forecast of July 2022.

According to the ERBD<sup>4</sup>, the disruption of trade relations with Russia will have a negative effect on Baltic countries' exports in the short term, with Russia accounting for 30% of Latvia's and 26% of Lithuania's pre-war exports outside the EU.

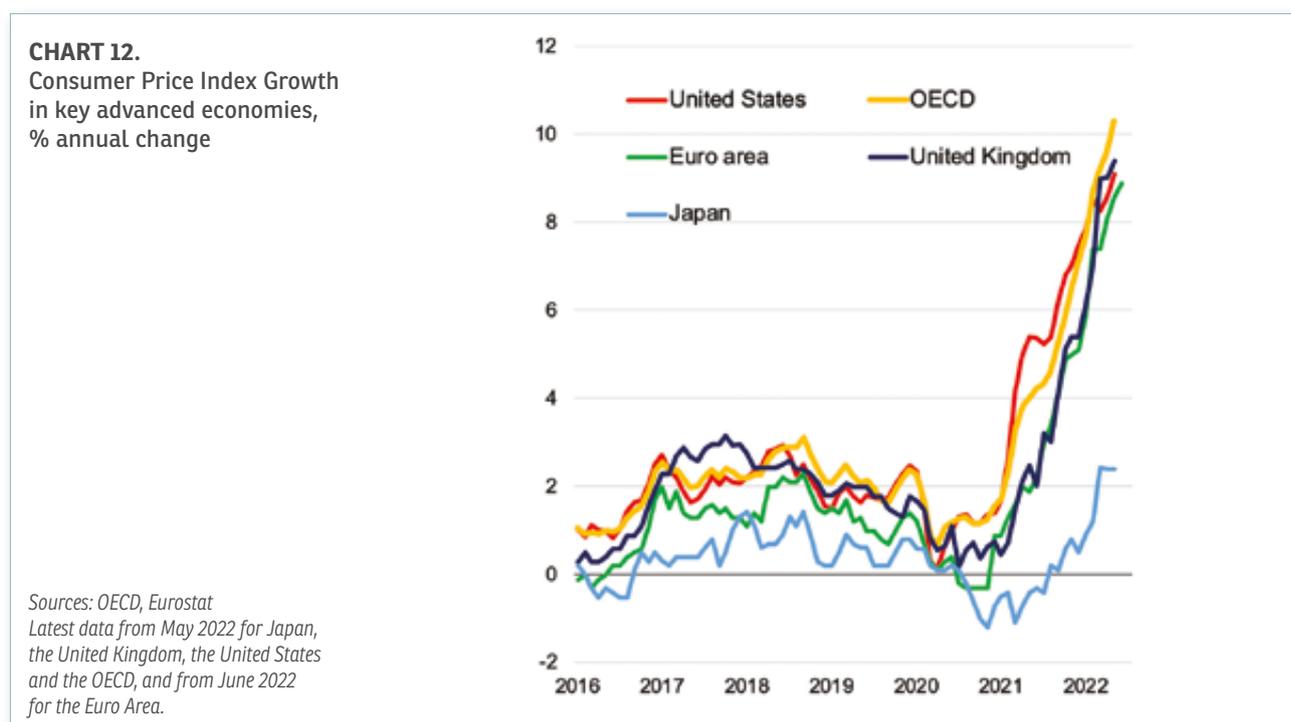
As gas constitutes on average 21% of Central Europe and Baltic States countries' energy mix, with Russia as a major gas supplier, higher energy prices are likely to weigh further notably on consumers.

The displacement of more than 6 million Ukrainian people to neighbouring countries, especially Poland, but also Romania and Hungary will also add to economic pressures in the region. By May 18, according to OECD, close to 3.4 million Ukrainians crossed into Poland, almost 930 000 in Romania, 615 000 into Hungary and 427 000 into the Slovak Republic. Germany registered about 615 000 Ukrainians, the Czech Republic 335 000, Spain 135 000 and Italy 113 000.

All EU countries provide financial support to beneficiaries of temporary protection to cover basic needs, but levels and mechanisms vary widely across countries. In the meantime, the flow of Ukrainian refugees may make a sizeable contribution to the EU labour market.

### 1.3.2 Although core inflation is much higher in the US than in Europe, inflation remains a central concern for all EU Member States

In some advanced economies, including the United States and some European countries, inflation has reached its highest level in more than 40 years. The war has amplified the impact on consumer energy prices, which have further increased since the start of the conflict.

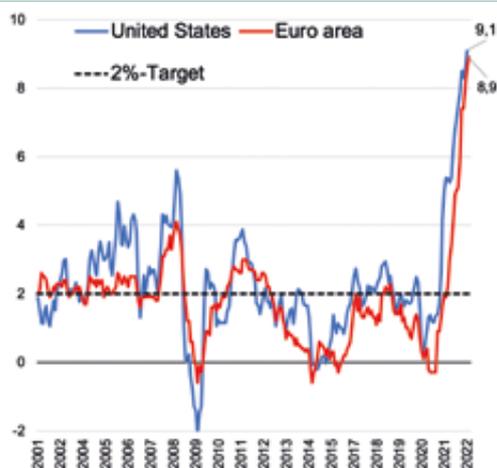


### Inflation is reaching levels not seen in decades in many countries

In June 2022, the aggregated consumer price index in the OECD rose by 10.3% compared to a year earlier, the highest level since 1988. About one-third of OECD countries recorded double-digit inflation in June 2022. In the US, inflation hits its fastest annual pace since November 1981, accelerating by 9.1% in June 2022 compared to a year ago. It reached 8.9% in the euro area in July, the highest level recorded since the creation of the monetary union in 1999. In the UK, inflation reached 9.4% in June 2022, a level not recorded since 1982. It has also significantly accelerated in Japan to 2.4% in June 2022, a level low by international standards but uncommon in a country that has battled deflation for decades.

4. ERBD, "Regional economic prospects", The return of runaway prices, May 2022

**CHART 13.**  
Consumer Price Index Growth  
in the United States and  
the Euro Area, % annual change



Sources : BIS, Eurostat  
As of June 2022 for the United States  
and July 2022 for the Euro area

**Even prior to the war Ukraine, Inflation was already an issue for all EU Member States, especially for European Eastern countries**

Since November 2021, the headline inflation (HICP) has been greater than 2% in all Eurozone Member States and has kept rising until February 2022. However, the dynamic was very uneven across countries, with headline inflation ranging from 4.2% in France to 14% in Lithuania as of February 2022. The relatively low figure in France notably reflects the offsetting government measures in the form of freezing gas and electricity prices in place since October 2021 and late January 2022, respectively. The importance of nuclear power in its domestic energy consumption also contributed to limit the rise in energy prices, unlike other key Member States such as Germany and Italy, whose inflation rates were already exceeding 5.5% and 6.2% in February 2022.

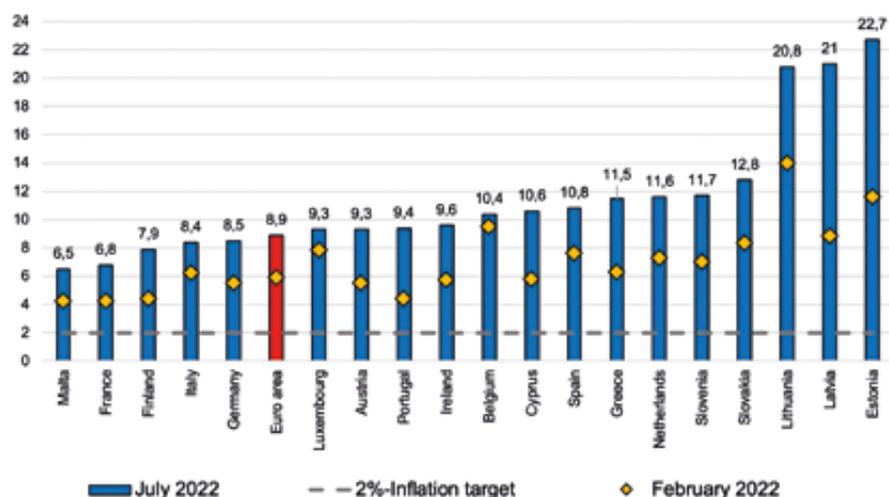
With Lithuania (14%), Estonia (11.6%) already experienced a double-digit figure in February, followed by other Eastern countries as Latvia (8.8%) and Slovakia (8.3%). EU Member States outside the euro area also suffered elevated numbers at this time, as the Czech Republic (10%), Hungary (8.4%), Bulgaria (8.4%) and Poland (8.1%) in particular.

**The war in Ukraine has triggered a major global commodity market shock, pushing inflation to higher levels in Europe**

Although already elevated before the war, energy and food prices increased further following the invasion of Ukraine by Russia. Accordingly, inflation in the euro area has jumped by 2.7 percentage points from 5.9% in February to 8.9% in July 2022. The figure has risen sharply for all members between the start of the war in Ukraine in February 2022 and July 2022. Estonia (+11.1 pp), Lithuania (+6.8 pp) and Latvia (+12.2 pp), which are among the most exposed to the war, have experienced the largest changes in the eurozone between February and May. Headline inflation also jumped significantly in Germany (+3), Portugal (+5) and the Netherlands (+4.3) in particular. It exceeded 10% in Spain (10.8%).

France experienced relatively smaller changes compared to other key EU Member states are due to the magnitude of energy-related measures taken by government to offset the rise in energy prices.

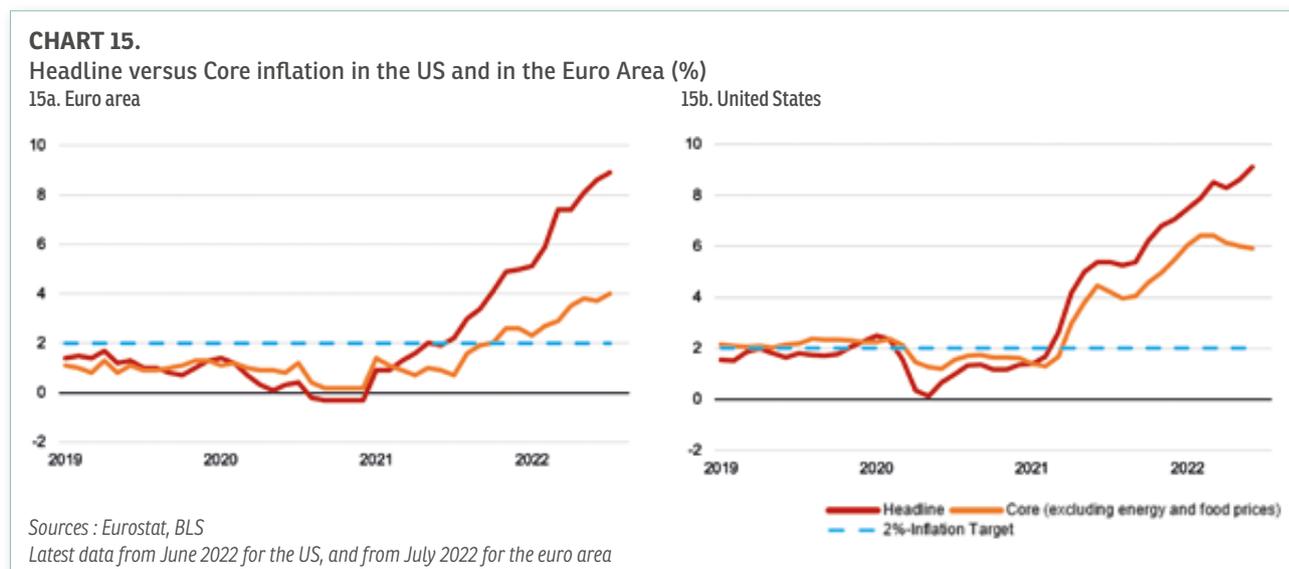
**CHART 14.**  
Headline Inflation across  
Eurozone Member States,  
annual change (%)



Source: Eurostat

## Core inflation is much higher in the US and the UK than in the eurozone

Core inflation, which excludes energy and food prices, was 3.7% in the eurozone in June 2022 (before slightly increasing to 4% in July), nearly half the US level of 5.9% (see chart 15).



Relatively higher underlying inflation in the US reflects the prevalence of domestic pressures driven by aggregate demand-supply imbalances, rebalancing of demand to goods from services and the tightness of the labour market.

In the US, demand grew rapidly in 2021, due in part to policy support. Meanwhile, a host of bottlenecks held back supply, including outbreak-induced factory closures, restrictions at ports, congested shipping lanes, container shortfalls. This has been exacerbated by the rebalancing of demand from services to goods: as in-person services were more disrupted by pandemic restrictions, spending shifted toward goods. Coinciding with supply bottlenecks, this rotation put pressure on goods prices.

Finally, labour markets have significantly tightened in some advanced economies, particularly the United States and the United Kingdom. Employer demand for workers far exceeds the number of available job seekers, as there were 11.3 million jobs openings for 6.3 million American unemployed in February 2022, according to the Labor Department. Labour supply shortfalls – particularly in contact-intensive sectors – mean that nominal wage growth has picked up rapidly. As of March 2022, the average hourly earnings increased by 5.6% compared to a year ago, twice as much as the pace recorded during the previous decade trend (+2%).

By contrast, annualised labour cost has remained sluggish in the euro area, up by 3.7% compared to a year ago, as of Q2-2022. This development occurred while unemployment fell to 6.6% in May 2022, its lowest since the creation of the euro area. So far, rising prices of imported energy and other commodities have been the main contributors to inflation in the euro area. In April 2022, energy alone, to which households dedicate 11% of their spending, accounted for two third (65%) of the headline inflation.

However, the recent acceleration of the core index in the euro area, from 2.9% in March to 3.5% in April and 4% in July 2022, indicates that inflation is spreading into a wider share of items of the consumption basket, as firms pass higher input costs into final consumer prices. Such second-round effects render inflation more entrenched in the economy, and so raise the prospect of future wage increases as a way for households to preserve their purchasing power.

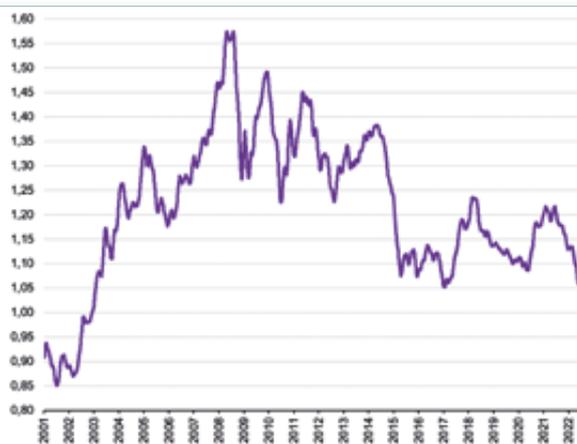
Although inflation is more driven by domestic pressures in the US and the UK (tight labour market, strong wage increases...), EU Member States are also experiencing high inflation, in particular across Eastern countries, where consumer prices have been growing at double-digit levels. By triggering a global commodity shock, the war in Ukraine has aggravated the situation, leading to much higher energy and food prices for European households. The euro currency depreciation against the US dollar is also exacerbating imported inflation in Europe.

## Inflation is likely to worsen in Europe following the euro currency depreciation against the US dollar

The euro has been depreciating against the US dollar as monetary policy diverge between the euro area and the United States. The prospect of longer than expected accommodative monetary policy in Europe coupled with rising inflation are pushing real yields into deeper negative territories and lead investors to divest European assets. Between January and end-July 2022, the euro currency has fallen by 9.5% against the USD, bringing the value to its lowest level since 2002.

The depreciation of the euro currency renders dollars-denominated commodities more expensive for European firms that are net-importers, which tends to be passed to final consumer prices and so supports imported inflation.

**CHART 16.**  
US Dollar vs  
Euro exchange rate

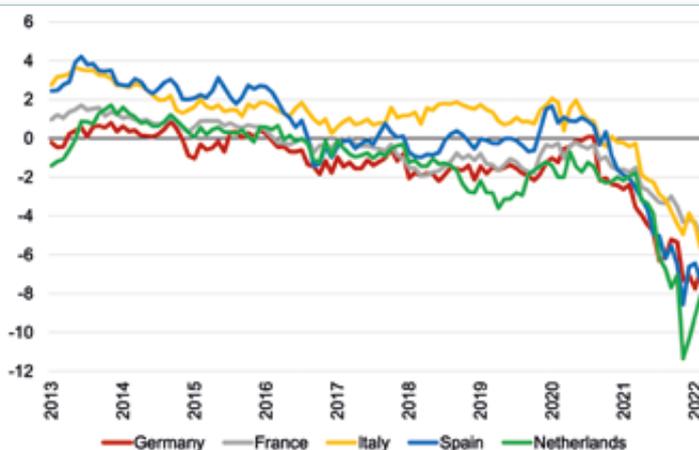


Source: Federal Reserve  
Last data from 31 July 2022

**Despite inflation persisting at high levels for over a year, monetary policy in the Eurozone has never been so accommodating: real interest rates are at record negative levels**

Chart 17 below shows that real interest rates in the euro zone have never been so negative. In fact, despite inflation exceeding 2% in the euro zone since April 2021, the central bank's key interest rates only started to rise from July 2022.

**CHART 17.**  
Real 10-Year Government Bond Yields  
of Selected Eurozone Member States,  
percentage points



Source: OECD  
As of 30 June 2022

This low real interest rate has existed for more than 20 years: it has not only favoured indebtedness, but also degraded its quality; it has contributed to the decline of productive investment due to zero or even negative returns, in favour of liquid investments, which are certainly non-interest-bearing, but risk-free. It has also contributed to the rise in asset valuation for the benefit of privileged social categories (see *Eurofi monetary scoreboard*, September 2022).

## 2. The Covid-19 crisis has exacerbated existing fiscal heterogeneities across EU Members States

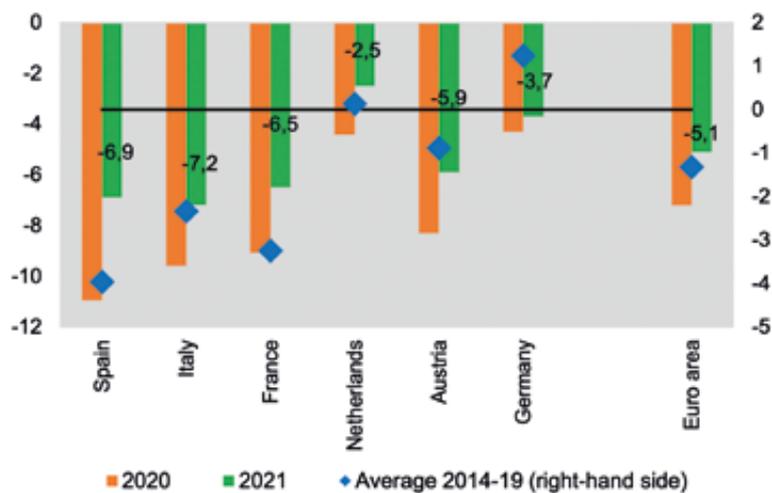
### 2.1 EU countries that have best managed their public finances after the Global Financial Crisis (2008) and the EU Sovereign crisis (2011-13) are those that have suffered the least from the Covid-19 shock

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 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 18*).

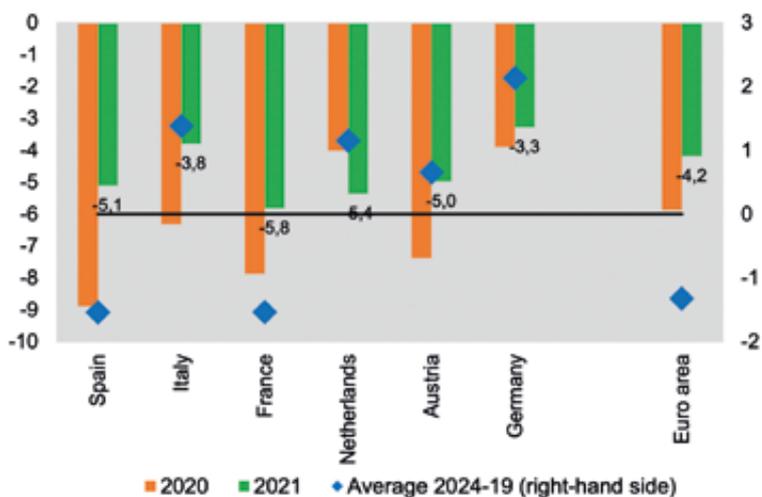
In 2021, the level of fiscal balance across EU Member States has converged towards its pre-crisis configuration: countries with healthy public finances prior to the COVID-19 crisis have registered fiscal deficits significantly lower than the eurozone average of 5.1%. This was the case of Germany and the Netherlands in particular, whose total fiscal deficit dropped to 3.7% of GDP and 2.5% respectively. By contrast, the figure remained above 5% of GDP in Spain (-6.9%), France (-6.5%) and Italy (-7.2%) in 2021.

**CHART 18.**  
General Government Budget Balance,  
% of GDP



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

**CHART 19.**  
General Government Primary  
Budget Balance, % of GDP



Source: Eurostat  
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 one jumped from 126% to 136%, and Spain's rose from 86% to 95%.

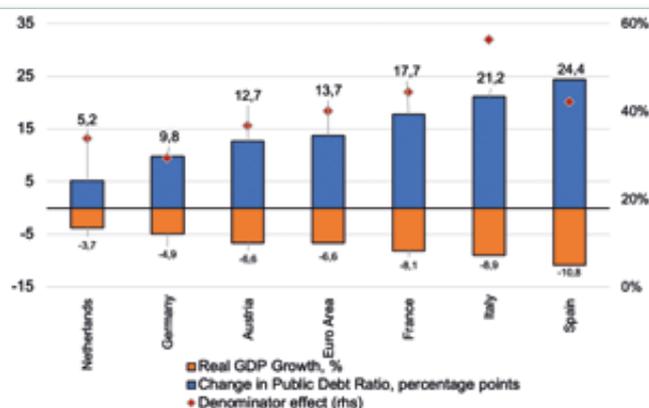
The continuous rise of public debt-to-GDP ratio in these three Member States is mainly due to the accumulation of yearly fiscal deficits. As shown in Chart 19, the average deficit of France and Spain exceeded 3% of GDP, the threshold of Maastricht fiscal rules, between 2014 and 2019. Unlike Italy, these 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 19).

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 between 2019 and 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 20).

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”, 42.3% of the rise of the Spanish public debt ratio was related to the fall of GDP that year. The figure reached 56.4% in Italy – the highest level in the eurozone – and 44.5% in France. It accounted for 33.9% in the Netherlands, 29.5% in Germany and 36.4% in Austria.

**CHART 20.**  
Real GDP Growth,  
Change in Public Debt Ratio  
and Denominator Effect in 2020



Source: Eurostat

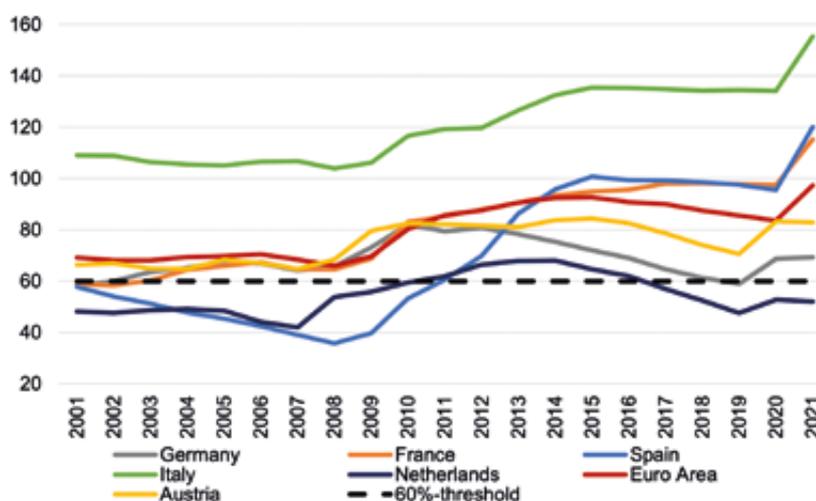
### 2.3 Countries whose public finances deteriorated the most in 2020 still registered high fiscal deficits in 2021

Although it declined markedly compared to 2020, fiscal deficits remained elevated in 2021 in some Southern Member States. Among the major EU Member States, Italy delivered the highest negative balance, with 7.2% of GDP, from 9.2% in 2020 (see chart 19). France and Spain delivered a fiscal deficit of respectively 6.5% of GDP and 6.9% in 2021, from 9% and 10.9% in 2020.

The figure was less elevated among major Northern Member States. In Germany, fiscal deficit dropped to 3.7% of GDP, from 4.3% in 2020. It returned below 3% of GDP in the Netherlands (-2.5% of GDP), from 4.2% a year earlier.

In 2021, the public debt-to-GDP ratio stabilised at elevated levels in some of these EU Member States. Thanks to strong GDP growth performance (see Part I), the ratio fell marginally in France from 114.6% of GDP in 2020 to 112.9% in 2021 (see Chart 21). It also dropped by 1.6 pp in Spain (from 120% to 118.5%) and by 4.6 pp in Italy (from 155.3% to 150.8%). Still, these figures remained nearly twice as high as in Germany (69.3% of GDP) and the Netherlands (52.1% of GDP) in 2021.

**CHART 21.**  
Evolution of Gross Public Debt to GDP  
ratio in Major EU Member states, %



Source: Eurostat

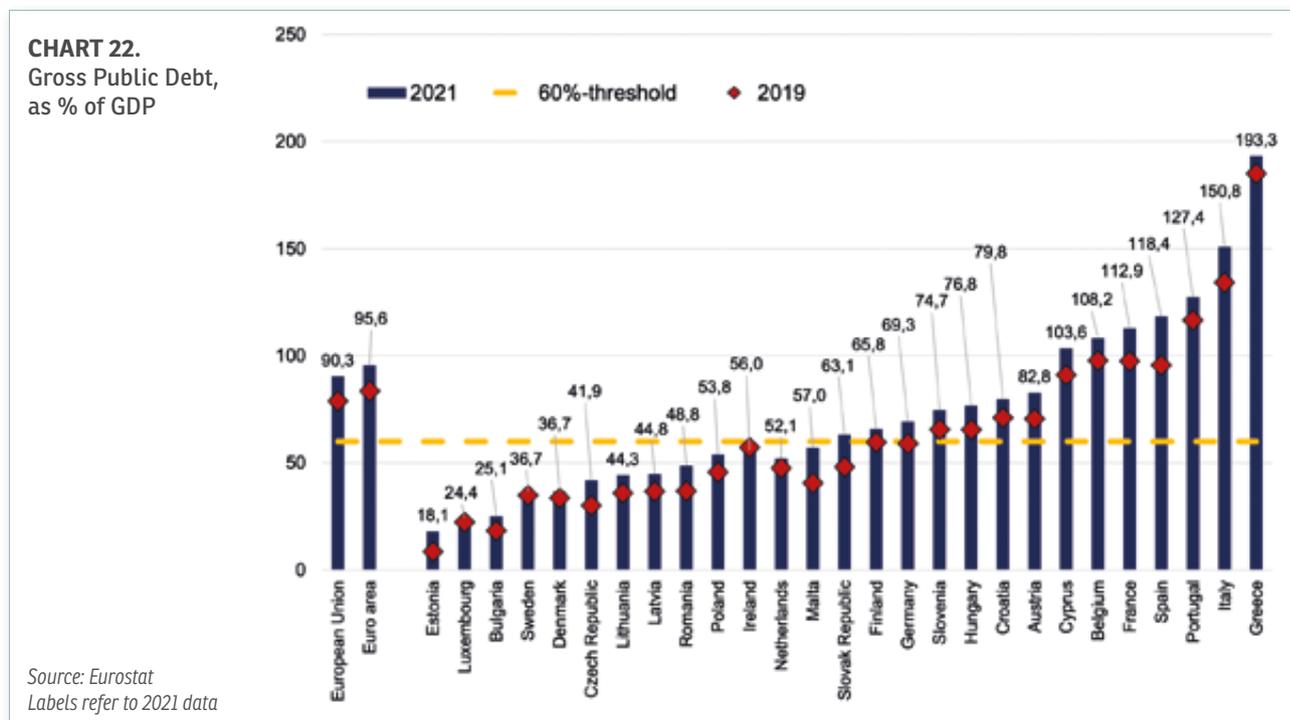
### 2.4 In 2021, the fiscal heterogeneity worsened across EU members in terms of public debt-to-GDP

In 2021, the level of public debt ranged from 18.1% of GDP in Estonia to 193.3% in Greece. Within this range, three groups of countries can be distinguished in the European Union (see Chart 22).

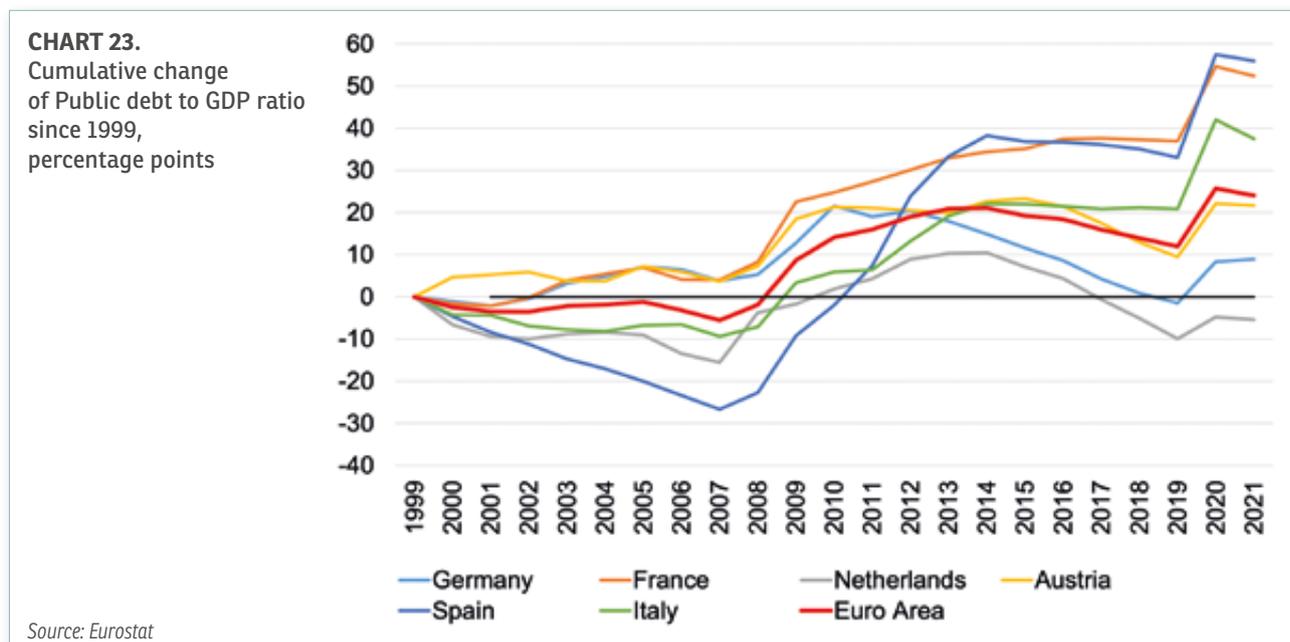
A first group contains seven Member States whose debt remained above 100% of GDP at the end of 2021. This ratio reached 193.3% in Greece, 150.8%, in Italy and over 110% in Portugal (127.4%), Spain (120.6%), France (112.9%), Belgium (108.2%) and Cyprus (103.6%).

On the other hand, seventeen EU countries kept their ratio of public debt below 75% of GDP in 2021. Among them, Germany and the Netherlands saw their public debt hovering at 69.3% and 52.1% of GDP in 2021, respectively. With the Netherlands, twelve other countries had a public-debt-to-GDP ratio below the Maastricht threshold of 60% in 2021: Malta (57%), Ireland (56%), Poland (53.8%), Romania (48.8%), Latvia (44.8%), Lithuania (44.3%), the Czech Republic (41.9%), Denmark (36.7%), Sweden (36.7%), Bulgaria (25.1%), Luxembourg (24.4%) and Estonia (18.1%).

Three other countries, i.e. Austria, Croatia, Hungary, registered a level of public debt ranging from 75% of GDP to 83% in 2021.



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 23, the public debt-to-GDP ratio has prudently increased by 8.9 pp in Germany, 21.7 pp in Austria and even dropped in the Netherlands by 5.4 pp over the past two decades until 2021. In the meantime, the level has risen by 37.5 pp in Italy, 55.9 pp in France and 52.4 pp in Spain.



## 2.5 For 2022 and 2023, fiscal deficits are projected to remain above 3% of GDP in France, Italy and Spain

For 2022, seventeen Member States are projected to experience a deficit greater than 3% of GDP, up from fifteen countries in 2021, according to the EU Commission Forecast of May 2022. It is projected to exceed 4% of GDP in 2022, in Italy (-5.5%), France (-4.6%) and Spain (-4.9%) – see Table 1 below.

By contrast, fiscal deficits in Germany (-2.5%) and the Netherlands (-2.7%) should remain below 3% of GDP.

For 2023, fiscal deficits should decline slightly but still remain above 3% of GDP in France (-3.2%) and exceed 4% of GDP in Italy (-4.3%) and Spain (-4.4%).

Accordingly, public debt is expected to remain at high levels in some European countries. In 2023, the public debt-to-GDP ratio is expected to remain well above 100% of GDP in Italy (146.8%), Spain (113.7%) and France (109.1%), while it is expected to converge towards 60% of GDP in Germany (64.5%), and to approach 50% of GDP in the Netherlands (50.9%).

**TABLE 1.**  
General Government Budget Balance  
and Gross Public Debt's Forecasts  
for 2022 and 2023, % of GDP

	Budget Balance			Gross Public Debt		
	2021	2022	2023	2021	2022	2023
France	-6,5	-4,6	-3,2	112,9	111,2	109,1
Germany	-3,7	-2,5	-1	69,3	66,4	64,5
Italy	-7,2	-5,5	-4,3	150,8	147,9	146,8
Spain	-6,9	-4,9	-4,4	118,4	115,1	113,7
Netherlands	-2,5	-2,7	-2,1	52,1	51,4	50,9
Austria	-5,9	-3,1	-1,5	82,8	80	77,5
Portugal	-2,8	-1,9	-1	127,4	119,9	115,3

Source: EU Commission Spring Forecast (May 2022)

It is important to understand that as public debt ratios worsen, the problem of debt sustainability becomes more acute.

Historically, a negative “ $r-g$ ” ratio (where  $r \equiv$  interest rate,  $g \equiv$  economic growth rate) does not eliminate sustainability problems. Indeed, the growth rate and the interest rate are not independent of the level of indebtedness. The higher the level of indebtedness, the higher the market interest rate and the more fragile the economy. Hence the extreme caution that must be attached to the question of risks to debt sustainability in Europe. It must be understood that money creation and the purchase of public securities will not always be able to solve this problem. The Maastricht Treaty contains limits on the monetary financing of the Treasury, and opinions on this issue are far from unified.

Since the pandemic hit in 2020, the general escape clause of the Stability and Growth Pact has been applied and the Commission motivated the Member States to pursue an expansionary fiscal policy. Reacting to the economic consequences of the Russian invasion of Ukraine, the European Commission postponed the renewed enforcement of its fiscal rules by a year, to 2024.

However, the problem of excessive public deficits and indebtedness of some EU Member States constitutes the central explanation for the financial fragmentation within the eurozone. Without an effectively implemented European fiscal framework, it is not possible to resolve this issue and thus to reduce the growing heterogeneity in terms of budget and debt between the virtuous states (Germany, the Netherlands, Austria, Portugal, etc.) and the others (Italy, France, Spain, etc.).

As we have observed, these fundamental matters have been with us for nearly 20 years and were not created by the war in Ukraine or the Covid crisis. The war in Ukraine exacerbates these problems but is not the cause.

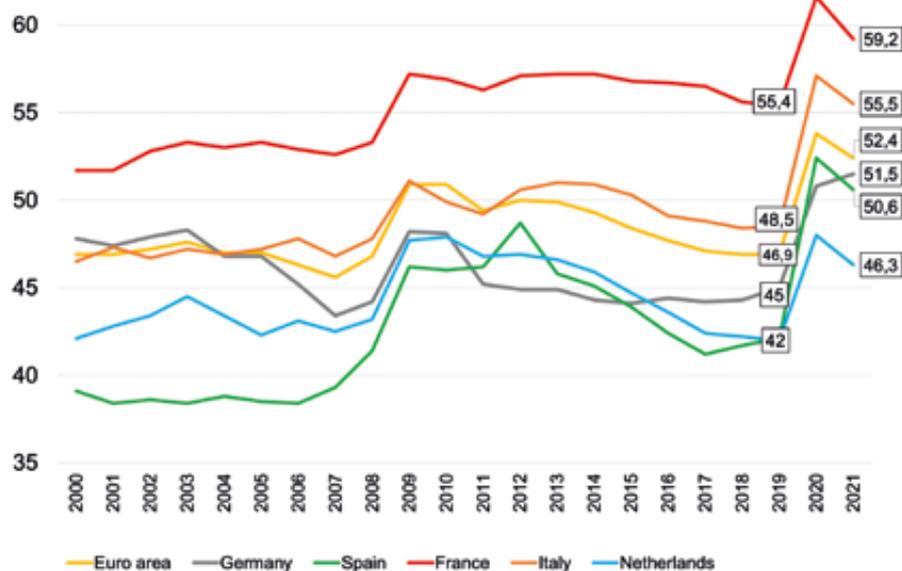
By renewing the suspension of European budgetary rules once again in May 2022, policy makers believe they will have an easier time later. In reality, postponing solves nothing, exacerbates tensions within the market (due to the lack of reference points) and only complicates the resolution of problems that are likely to become even more acute.

## 3. EU countries with the highest level of government expenditure as percentage of GDP are those with the least competitive firms

### 3.1 With 59.2% of its GDP in 2021, France holds the record high in terms of level of public spending in the EU

France already had the highest level of public spending in Europe before the COVID crisis, with 55.6% of GDP in 2019. With Finland (53.2%) and Belgium (51.8%) were the only countries in the Union whose public expenditures-to-GDP ratio exceeded 50% of GDP in 2019. By contrast, the level of public spending in Germany, the Netherlands, Spain and 17 other EU members remained below the European Union average of 47% of GDP in 2019 (see Chart 27).

**CHART 24.**  
Total Public Expenditure,  
as % of GDP

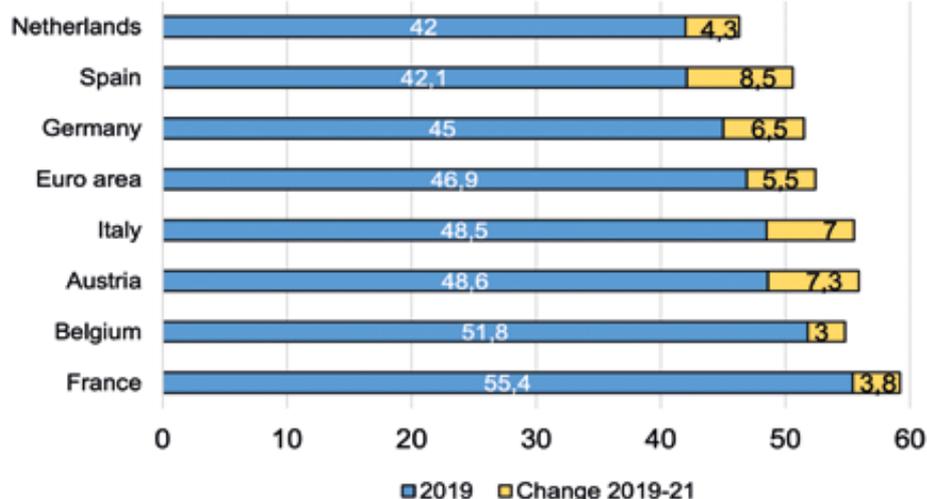


Source: Eurostat

Following the COVID-19 crisis, public spending increased by 3.8 pp in France from 2019 to 2021, compared with 5.5 pp in the euro zone (see Chart 25). France is among countries whose increase in spending as a percentage of GDP was the lowest: it was 6.5 percentage points in Germany, 7 pp in Italy, 7.3 pp in Austria, 8.3 pp in Spain and 4.3 pp in the Netherlands. Among the large countries, only Belgium shows a lower increase (2.9 pp).

Starting from a much higher level of spending than the other countries in 2019, France nevertheless remained at the top of the eurozone and the European Union, with public spending equal to 59.2% of GDP in 2021. This is nearly seven points above the eurozone average of 52.4% of GDP, and 7.7 pp above the German's level of 51.5% of GDP. With Germany, public expenditures exceeded 50% of GDP in Italy (55.5%) and Spain (50.9%), while it remained relatively low in the Netherlands (46.3%).

**CHART 25.**  
Total Public Expenditure  
before and after the  
COVID-19 crisis, as % of GDP



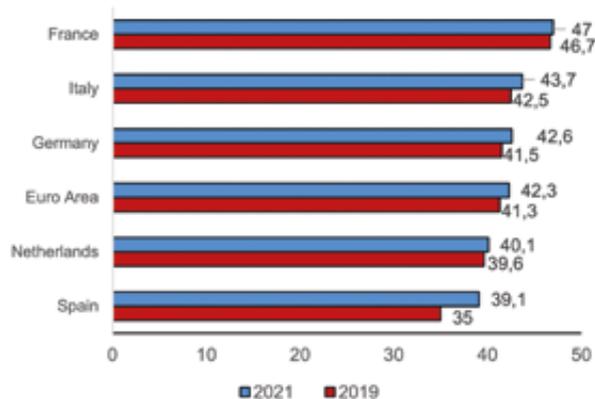
Source: Eurostat

### 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 with Denmark in the European Union. Its current tax burden – or amount of tax collected on firms and households<sup>5</sup> – accounted for 46.7% of GDP in 2019. That was nearly six percentage points above the euro area average of 41.3% (see Chart 26).

5. 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 26.**  
Current tax burden in 2019 and 2021,  
% of GDP



Source: Eurostat

In 2021, the level of current tax burden rose by 0.3 pp in France, less than the euro area average (+1 pp), Germany (+1.1 pp), Italy (+1.2 pp) and Spain (+4.1 pp). However, the level of taxation remained the second highest in France, reaching 47% of GDP in 2021, just below Denmark (47.8%). This is more than 5 pp above the euro area average of 42.3% of GDP, Germany (42.6%), the Netherlands (40.1%) and Spain (39.1%), according to Eurostat.

Too 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 2), France has been suffering of a permanent deficit of its trade balance and more broadly of its current account balance since 2007 (see Chart 27). 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 2.**  
Breakdown of tax revenue by country  
and by detailed tax categories in 2019,  
% of GDP

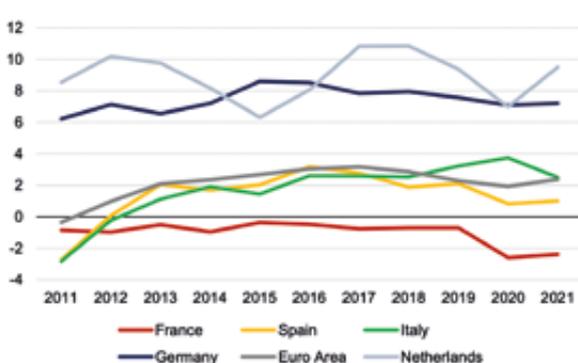
	Taxes on production and imports	Current taxes on income, wealth etc	Capital taxes	Net social contributions	Total
France	17,0	13,1	0,6	16,8	47,6
Italy	14,6	14,4	0,1	13,5	42,6
Germany	10,9	13,3	0,2	17,3	41,7
Netherlands	12,5	13,2	0,2	14,0	39,8
Spain	11,7	10,4	0,4	12,9	35,4
Euro Area	13,3	13,0	0,3	15,1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

Source: Eurostat

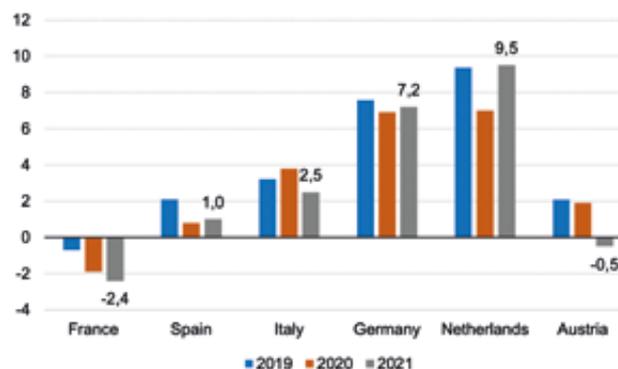
By contrast, countries with a level of taxation below the euro area average present the most competitive firms of the area. With tax revenue on production and imports accounting for 10.9% of GDP in 2019 (see Table 2), Germany delivered the second highest current account surplus, behind the Netherlands; that is also characterised by a relatively low level of tax burden (12.5% of GDP).

**CHART 27.**  
Current Account Balance in main EU Member States, % of GDP

27a. Over the past decade



27b. Recent trend



Source: AMECO

**TABLE 3.**

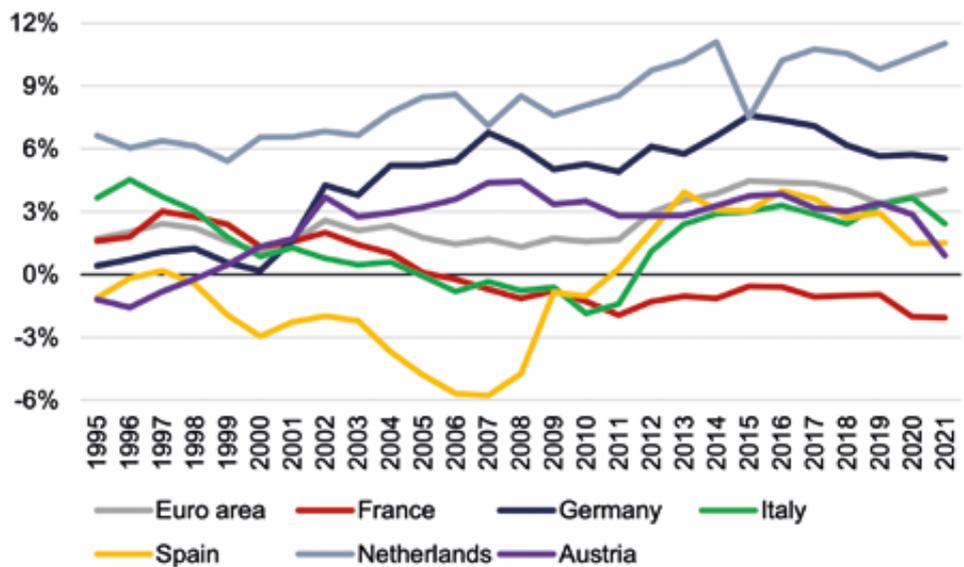
Current Account Balance in main EU Member States, % of GDP and EUR bn

	2019		2020		2021	
	EUR bn	% of GDP	EUR bn	% of GDP	EUR bn	% of GDP
France	-17,1	-0,7	-59,2	-1,9	-59,9	-2,4
Spain	26,2	2,1	9,3	0,8	11,5	1,0
Italy	57,8	3,2	62,1	3,8	44,8	2,5
Germany	262,9	7,6	238,3	6,9	257,7	7,2
Netherlands	76,2	9,4	55,8	7,0	81,4	9,5
Austria	8,3	2,1	7,2	1,9	-2,1	-0,5
<b>Euro Area</b>	<b>273,9</b>	<b>2,3</b>	<b>219,1</b>	<b>2,6</b>	<b>291,6</b>	<b>3,2</b>

Source: AMECO

**CHART 28.**

Net Exports of Goods and Services, % of GDP



Source: AMECO

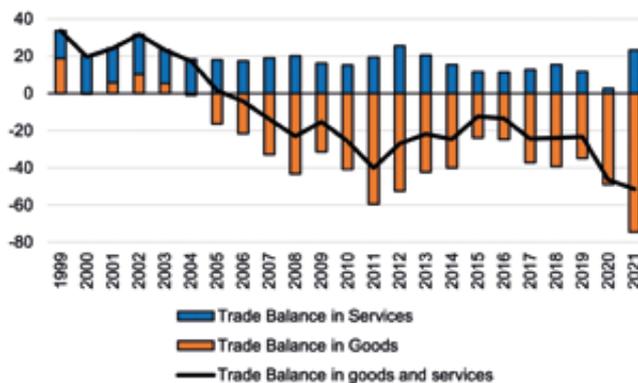
France’s current account deficit of EUR 59 bn in 2021 was mainly due to the negative trade balance of goods, which amounted to EUR 74.5 bn, a record-high figure. This deficit was partly offset by the surplus in the services balance (+ EUR 23.1bn in 2021) – rising thanks to the recovery of global tourism after the pandemic – resulting in a trade deficit of EUR 53 bn in 2021.

In the same year, Germany recorded a trade surplus of EUR 197.5 bn, of which EUR 183.5 bn came from trade in goods (see Chart 29 below). The German trade balance in goods has always been in surplus over the past two decades, while it has gradually fallen to negative territory in France since 2004. Such performance reflects the process of deindustrialisation and the expansion of the less export-driven service sector, starting in the late 1980s (see Part 4).

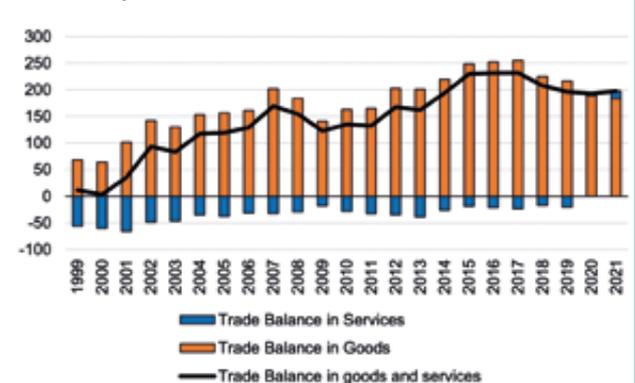
**CHART 29.**

Trade Balance in France and Germany, EUR bn

29.a : France



29.b : Germany



Source: AMECO

### 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 4). 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 4.**  
Major Functions of Public Expenditures of Selected EU Member States, % of GDP (2019)

	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

Source: Eurostat

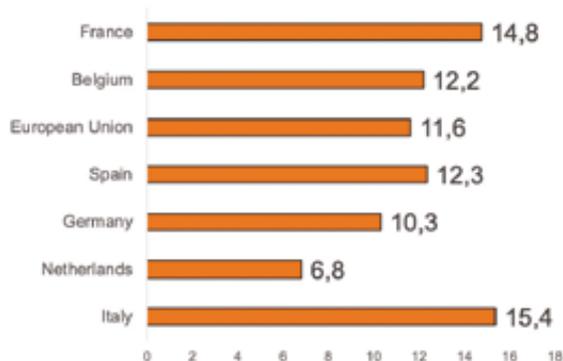
Considering the determinants of social protection, public pensions account for the highest proportion. At 11.6% of GDP in the EU in 2019, its level is mainly linked to the average effective labour market exit age (see chart 30). Excluding Italy and in most EU countries, the earlier working-age people retire, the higher is the total cost of pensions. 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 for the country:

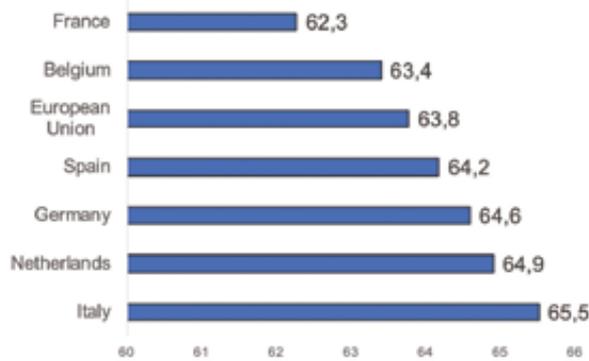
- **The generosity of the system.** The replacement rate – or percentage of an individual’s annual employment income that is replaced by retirement income when they retire – was 20 pp higher than the EU average in 2019 (66.9% in Italy against 46.2% in the EU).
- **The persistent low level of employment 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 demographic 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 old-age dependency ratio; that is the number of dependents aged over 65, compared with the total population. At 58.5% in 2019, the ratio is projected to reach 70% by 2030.

**CHART 30.**  
Public Pensions Spending and Labour Market exit age in selected EU Member States

30a. Gross Public Pensions, as % of GDP in 2019



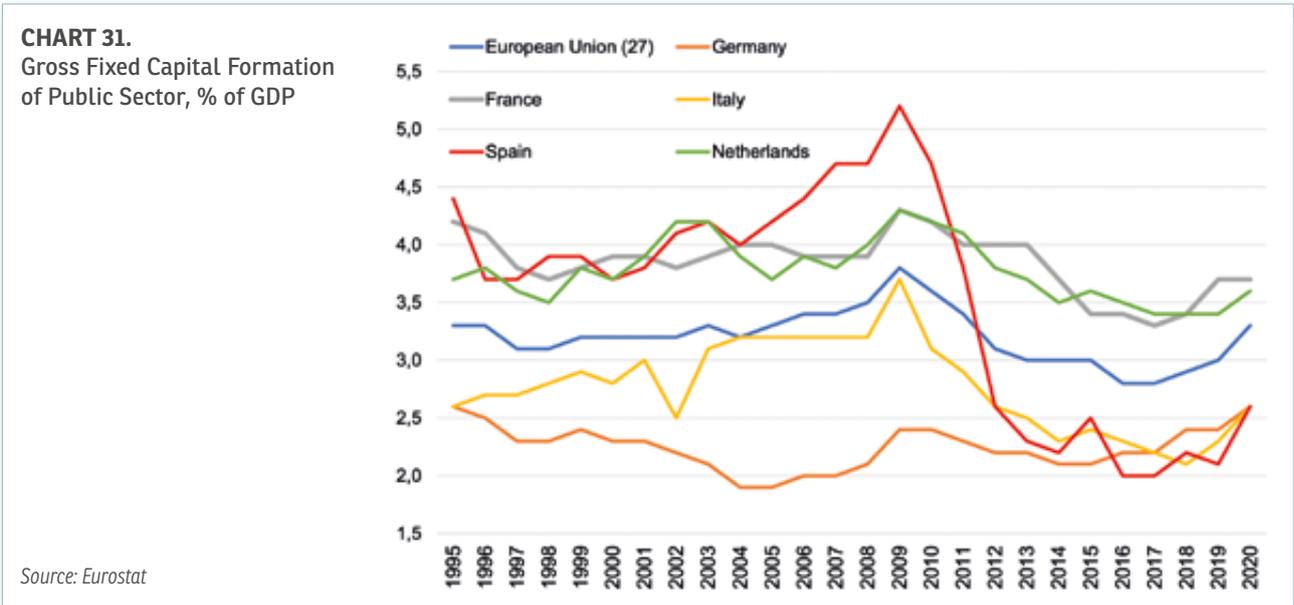
30.b : Average effective labour market exit age, 2019



Source: Eurostat

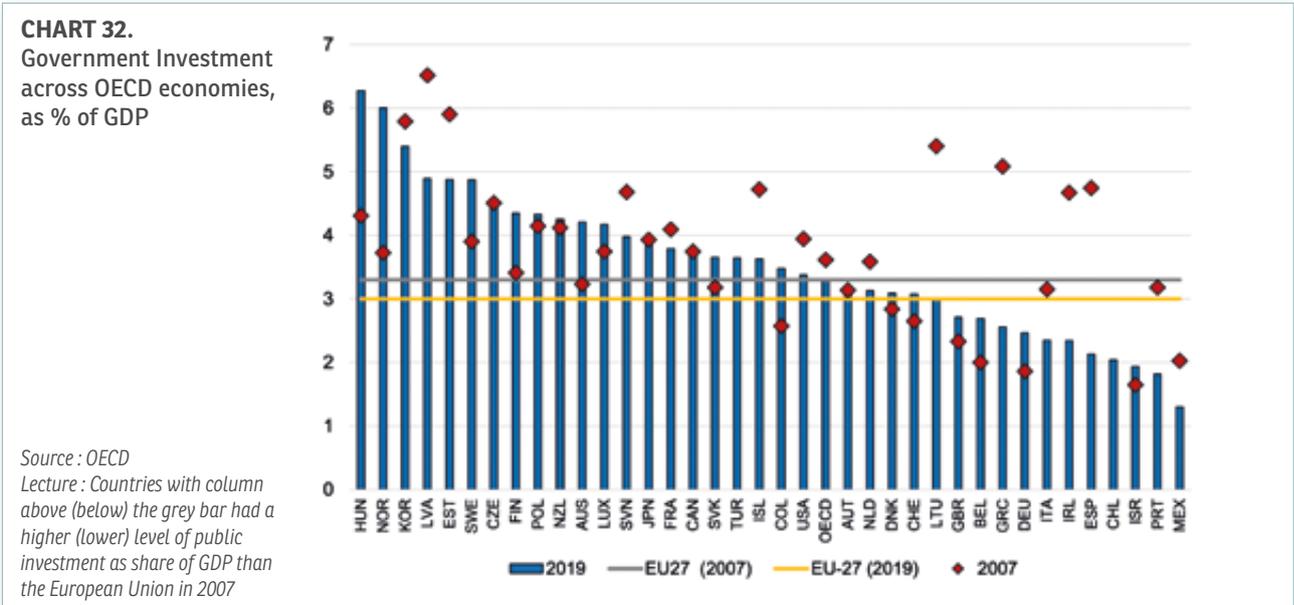
**3.4 Such levels of public expenditures have been reached at the expense of productive investment, hence weakly contributing to gross capital formation<sup>6</sup>**

As share of GDP, public investment has never exceeded 4% in the European Union since 1996, (the first available year recorded by Eurostat). 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 31).



After reaching 3.4% of GDP in 2007 – its highest non-crisis-period level – the level of public investment in the EU gradually declined to 2.8% of GDP in 2017 (see Chart 31). It then rose slightly to 3% in 2019, a level similar to the OECD average in the same year (see Chart 32), but lower than in the United States (3.4% of GDP), Canada (3.8%), Japan (3.9%), Australia (4.2%) and South Korea (5.4%).

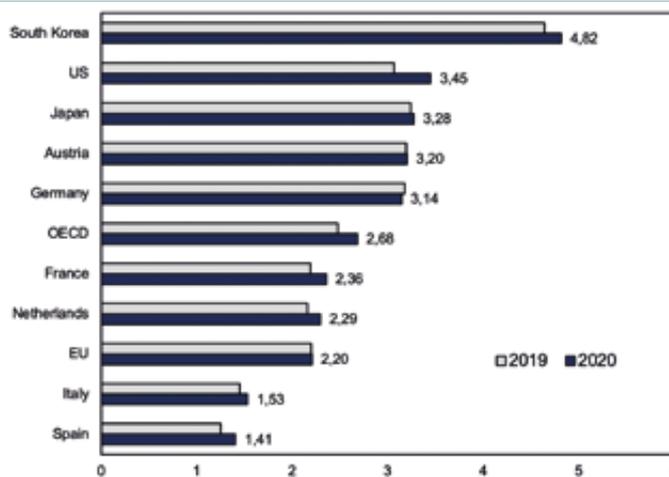
Such a period of under-investment at the EU level was notably attributable to Germany, where gross capital formation from the public sector never exceeded 2.6% of GDP since 1995 (see Chart 31). Spanish and Italian governments also contributed to this decline, both investing less than 2.5% between 2012 and 2018.



Research and Development (R&D) – a measure of qualitative investment – 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 33).

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

**CHART 33.**  
Gross domestic spending on R&D,  
% of GDP)



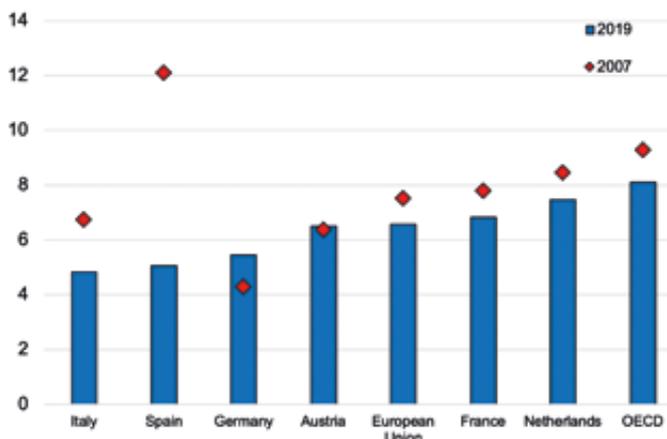
Source : OECD

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

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 34). 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 32).

Chart 34 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.

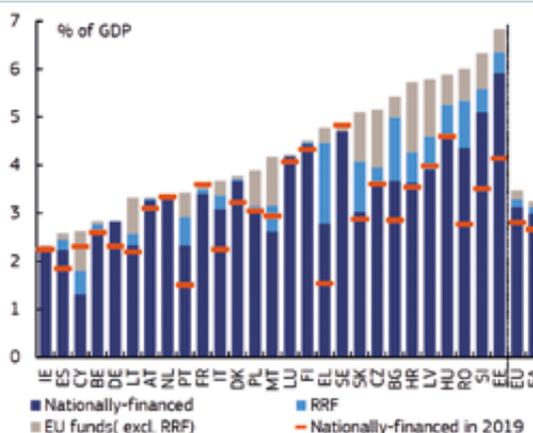
**CHART 34.**  
Share of Public Investment  
in Total Government Expenditure, %



Source: OECD

According to the EU Commission, the EU aggregated public investment-to-GDP ratio is projected to increase from 3% of GDP in 2019 to 3.5% in 2023, as almost all Member States are expected to spend more on public investment than they did before the pandemic. Around a quarter of that increase is related to investment financed by the EU, especially through the Recovery and Resilience Facility (see Chart 35).

**CHART 35.**  
Public Investment in the EU, 2019 and 2023



Source: AMECO Spring Forecast, May 2022

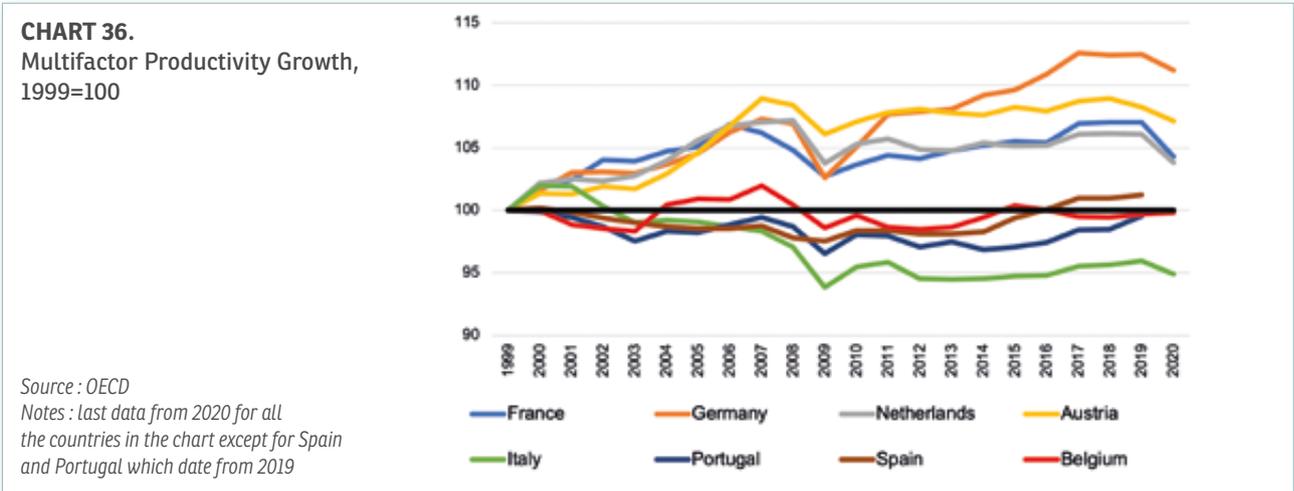
# 4. Excessive level of public debt does not fuel productivity growth and employment

## 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<sup>7</sup>. 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 36).

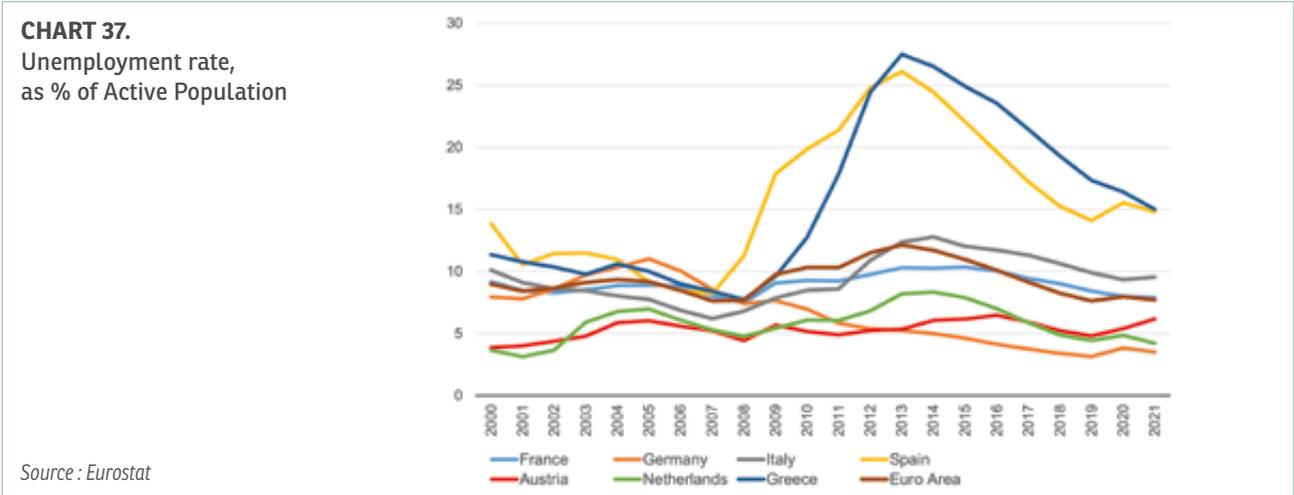
As shown in Chart 36, global factor productivity growth in the euro area has diverged since the start of the EMU. That has translated into diverging growth paths. The Covid crisis has worsened this problem because some of the economies that have been growing the slowest over the past ten years, are also 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<sup>8</sup>, “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 dependence on debt and to bring back balance in economic growth”.



## 4.2 The most indebted EU Members have experienced the highest unemployment rates in the EU since 2007, as Spain (14.8% in 2021), Italy (9.5%) and France (7.8%)

Although French unemployment rate declined slowly below 8% until 2021, massive unemployment reveals a key structural labour market problem.



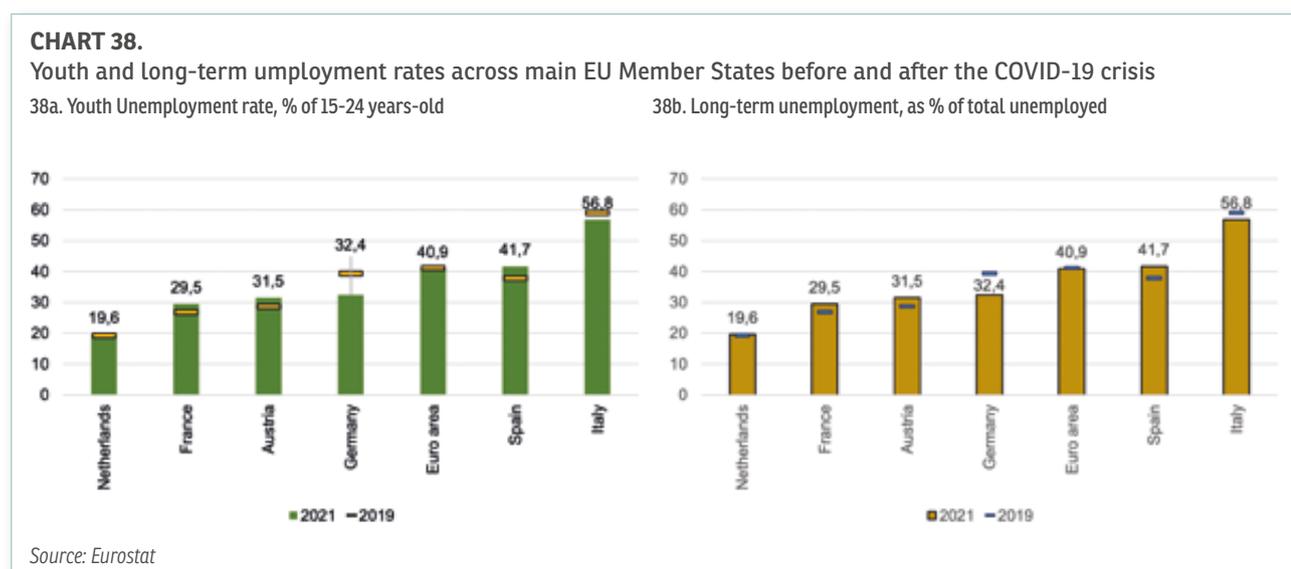
7. According to the OECD, the indicator reflects the “overall efficiency with which labour and capital inputs are used together in the production process. Changes in Multifactor Productivity Growth reflect the effects of changes in management practices, brand names, organisational change, general knowledge,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

8. K. Knot, “Rebuilding resilience: meeting the challenges beyond covid”, Eurofi Forum, 11 September 2021

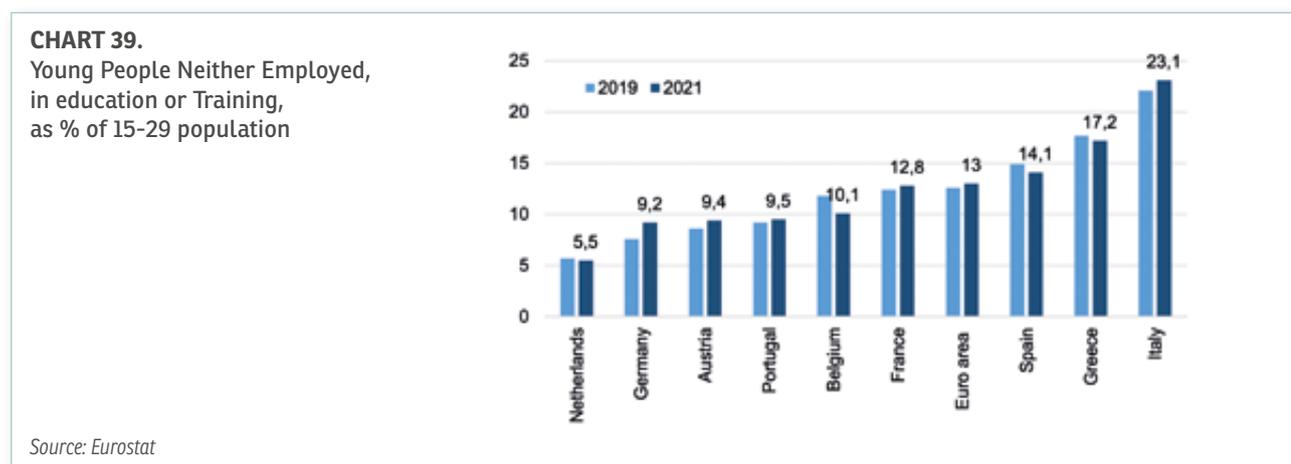
More generally, Spain, Italy and France are among those with the highest share of long-term and young unemployment rate. For the full year of 2021, Spain had the highest share of 15-24 years old unemployed people (34.8%) in Europe, even surpassing the level of Greece (35.5%) and followed by Italy (29.7%). 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 (18.9% of youth unemployment rate, against 16.8% for the euro area).

Such high levels in public expenditure highlights the ineffectiveness of education and formation policies, as well as the lack of domestic structural reforms.

In 2021, 56.8% of the Italian unemployed people were in a situation of long-term unemployment<sup>9</sup>. France and Spain follow, with 29.5% and 41.7% respectively.



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 2 million young people aged between 15 and 29 are in this situation, the highest share among European Union countries.

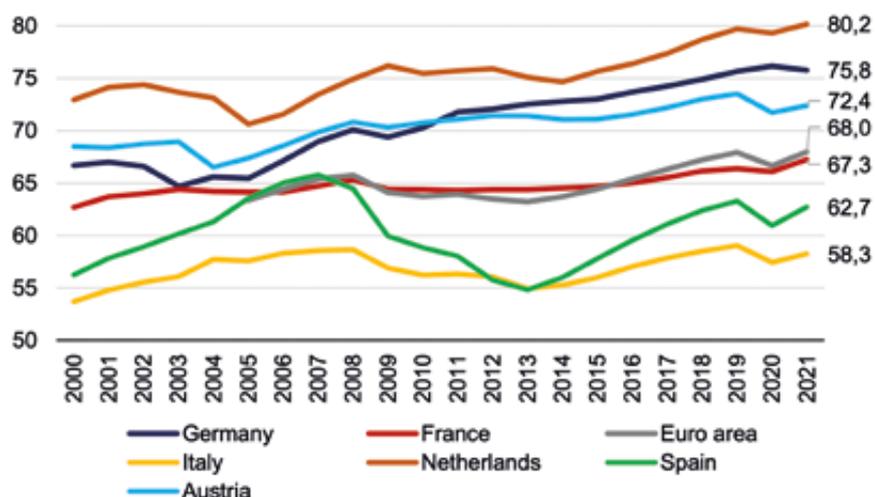


### 4.3 The employment rate in France, Spain and Italy is close to 10 percentage points lower than in Germany and the Netherlands

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 40).

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

**CHART 40.**  
Employment rate  
of the 15-64, as share of total  
active population



Source: OECD

In 2021, 67.3% of the people aged 15-64 were employed in France, compared to 75.8% in Germany, according to the OECD.

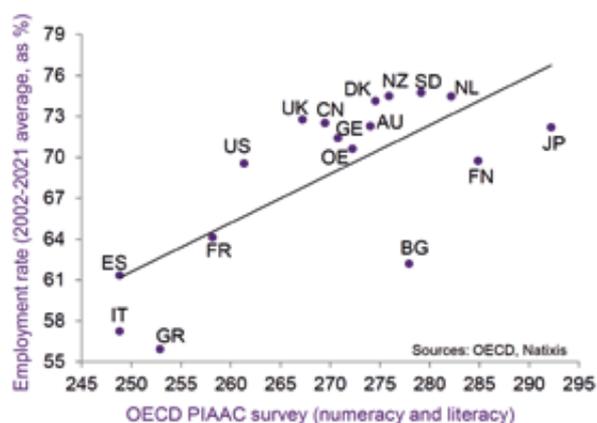
One reason for the employment gap between France and Germany is due to the fact that the employment rate of the 60-64 is 35% in France, compared with 62% in Germany in 2021. As the effective retirement age is lower in France (see section 3.3), workers leave the labour market earlier than in Germany.

In addition to the nature of the pension system, the reasons behind the remaining gap between France and German's employment rates stem from (i) the lack of appropriate skills in the workforce, and (ii) the burden of taxes on companies, which force them to make trade-offs as offshoring their activities, at the expense of domestic employment and investment.

According to P. Artus, the skills of the labour force explain 53% of the gap between the employment rate of OECD countries, while the weight of corporate contributions and production taxes explains 35%.

As highlighted by P. Artus<sup>10</sup>, the employment rate is the weakest in countries where labour skills are low (see Chart 41).

**CHART 41.**  
Employment rate and OECD PIAAC survey



Source: OECD

Yet France stands in the bottom quarter of the OECD countries in terms of adult skills and ranks in the last place when it comes to young people's skills in science. France also has, after Sweden, the highest production tax burden in Europe (17% of GDP versus 13.3% in the euro area in 2019, see Part 3). This overall weakness in skills and this heavy tax burden largely explain the low employment rate in France.

Persistent low employment rate is closely linked to public finances and inequalities. Because fewer people are employed and thus paid and less firms produce domestically, public revenues – a source from which the government can draw to finance long-term public investments – is reduced. As tax revenues are linked to potential production, which in turn is linked to the employment rate, increasing the employment rate would therefore increase tax revenues and so create fiscal space.

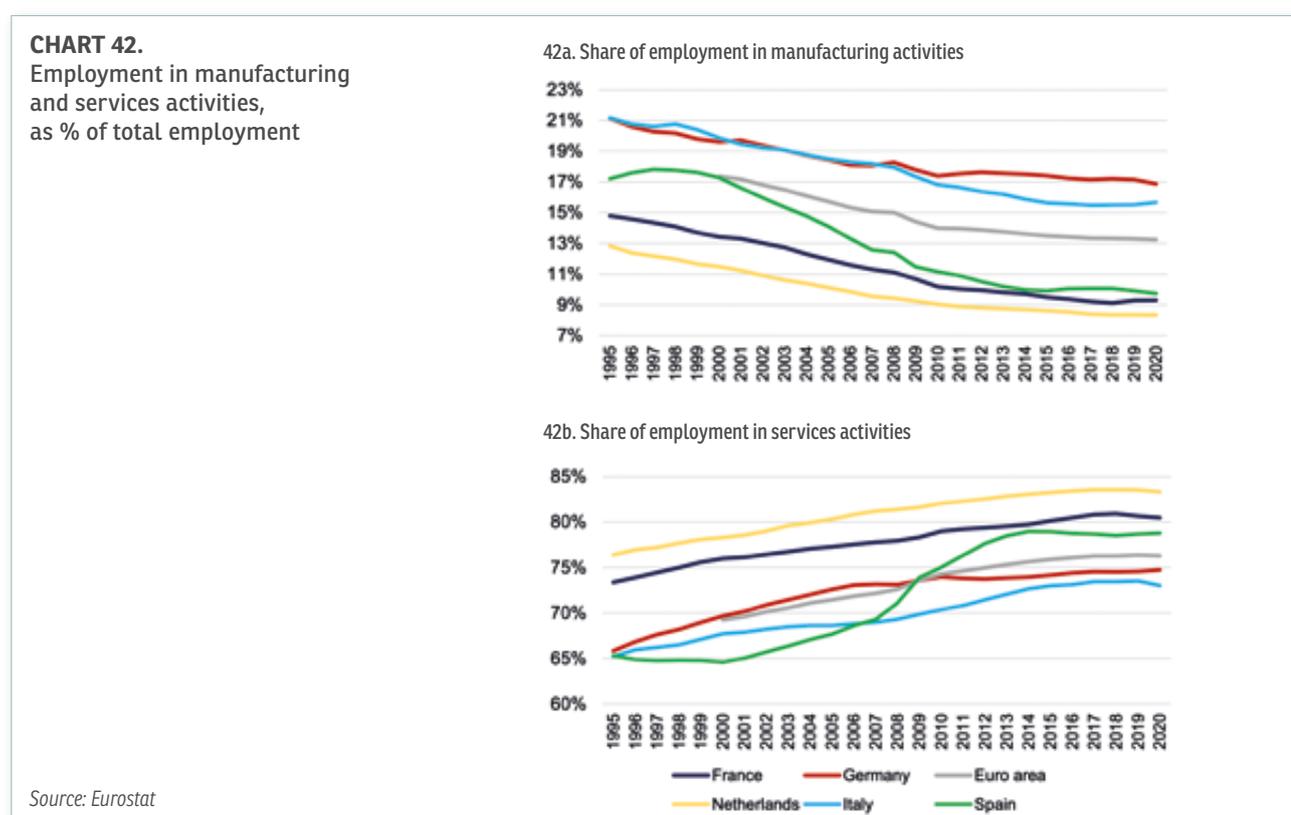
10. P. Artus, "France: is public spending the answer?", Flash Economics, Natixis (09 May 2022)

There is a negative correlation between income inequalities (before redistribution) and employment rate. The relation is even more pronounced for countries in the path of deindustrialisation, where the quality and the remuneration of the employment has deteriorated. Indeed, workers are suffering a decline of living standards since productivity per capita, and so wages are relatively higher in the manufacturing sector than in the rest of the economy (*see next section*).

#### 4.4 “Bad jobs” are more prevalent in deindustrialising economies and are concentrated in low-skilled and precarious activities

Although employment rates have increased over the past decade, the quality of employment has deteriorated over the same period in some EU Member States. This deterioration is due in particular to the sectoral shift of these economies in favour of services and at the expense of manufacturing activities.

Since the 1980s, manufacturing employment in France, for example, has declined by more than 30%, while jobs in services increased by 55%. This pushed employment in the service sector to account for 80.5% of total employment in 2019, far above the euro area level of 76.4%<sup>11</sup> (*see Chart 42 below*). Reversely, the share of employment in manufacturing dropped significantly in France, from 18.5% in 1985 to 9.3% in 2019, below the euro area of 13.2%. Among other major EU Member States, the tertiarisation has been particularly pronounced in Spain and the Netherlands, where respectively 78.8% and 83.4% of the workforce was employed in the service sector in 2019, from 65.4% and 76.4% in 1995.



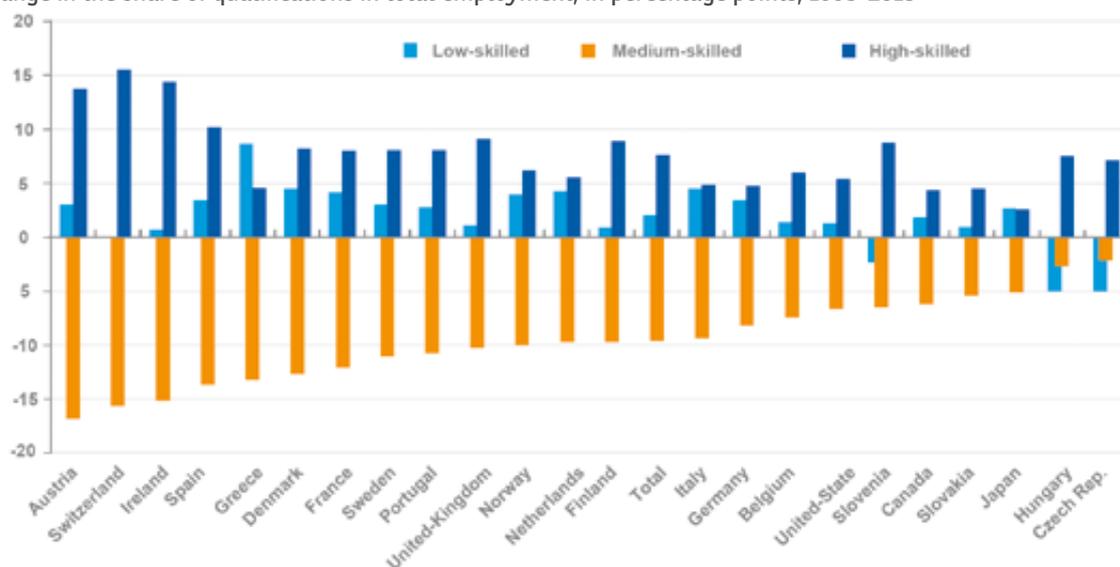
The bulk of job creation in the service sector is concentrated between well-qualified jobs (finance, information and technology, complex business services, etc.) and low-skilled or unskilled jobs (hotel, catering, distribution, transport, leisure, personal services). This labour market polarisation has led to the fall in the share of medium-skilled workers (*see Chart 43 below*) – formerly prominent in manufacturing-based activities – and the rise in the number of low-skilled, or “bad jobs”. The latter are poorly remunerated and characterised by a high degree of precariousness and hardship.

The proportion of temporary employment is highest in countries where employment is mainly concentrated in the service sector, such as Spain or the Netherlands. France, which gradually became a service-based economy over the past three decades, saw the share of temporary employment rise more than fivefold, from 3.3% of dependent employment in 1983 to 16.3% in 2019 (*see Chart 44*). Although this phenomenon has been widespread across advanced economies through the development of automation notably, it has been even more pronounced in countries in the process of deindustrialisation, according to the OECD<sup>12</sup>.

11. “Three jobs out of four in services”, Eurostat ([https://ec.europa.eu/eurostat/cache/digpub/european\\_economy/bloc-3a.html?lang=en#:~:text=In%202020%2C%20employment%20in%20services,from%209%20%25%20to%205%20%25](https://ec.europa.eu/eurostat/cache/digpub/european_economy/bloc-3a.html?lang=en#:~:text=In%202020%2C%20employment%20in%20services,from%209%20%25%20to%205%20%25))

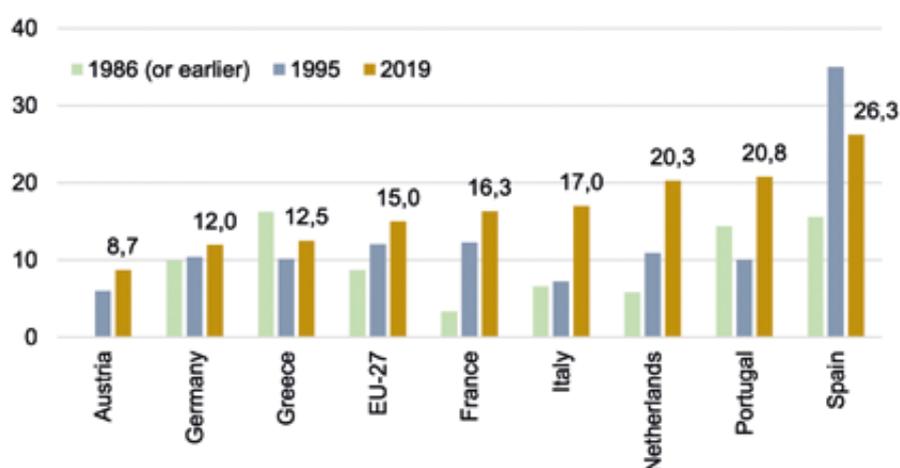
12. “Perspectives de l’emploi : l’avenir du travail”, OECD (2019) [https://www.oecd-ilibrary.org/sites/b7e9e205-fr/1/2/2/index.html?itemId=/content/publication/b7e9e205-fr&\\_csp\\_=2a079d50bcd66cc314da33d3c16ff87&itemIGO=oeed&itemContentType=book#figure-d1e4389](https://www.oecd-ilibrary.org/sites/b7e9e205-fr/1/2/2/index.html?itemId=/content/publication/b7e9e205-fr&_csp_=2a079d50bcd66cc314da33d3c16ff87&itemIGO=oeed&itemContentType=book#figure-d1e4389)

**CHART 43.**  
Change in the share of qualifications in total employment, in percentage points, 1995-2015



Source: OECD (2017), OECD Employment Outlook 2017, based on European, U.S., Canadian, Japanese, and Swiss Employment Surveys  
 Note: High-skill occupations include jobs classified under the ISCO major groups 1, 2, and 3. That is, legislators, senior officials, and managers (Group 1), professionals (Group 2), and technicians and associate professionals (Group 3). Medium-skilled occupations include jobs classified under the ISCO major groups 4, 7 and 8. That is, clerks (Group 4), craft and related trades workers (Group 7), plant and machine operators and assemblers (Group 8). The low-skilled occupations include jobs classified under the ISCO major group 5 and 9. That is, service workers and shop and market sales workers (Group 5), elementary occupations (Group 9).

**CHART 44.**  
Temporary employment, as % of total dependent employment



Source: OECD  
 Notes: Temporary employment includes wage and salary workers whose job has a pre-determined termination date, according to the OECD. This indicator is broken down by age group and it is measured as percentage of dependent employees (i.e. wage and salary workers); data labelled "1986 or earlier" date from 1983 for France, Italy, the Netherlands, Greece, the EU-27; It dates from 1984 for Germany, and from 1986 for Spain and Portugal; The first available data for Austria dates from 1995.

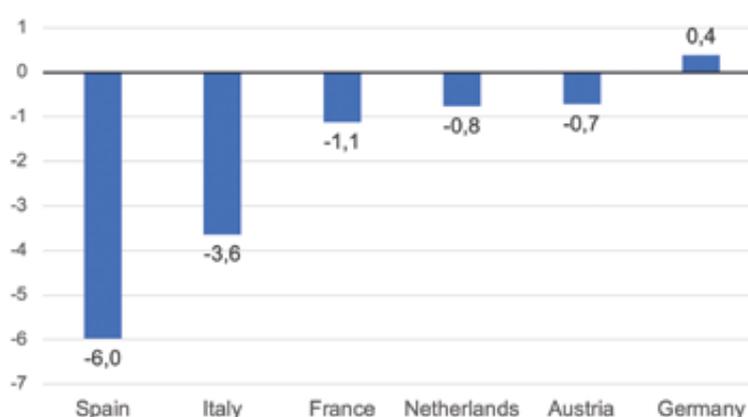
#### 4.5 The combination of low employment rate and low productivity growth leads to higher output gaps

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 rates, 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 45 and Table 5).

**CHART 45.**

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



Source: OECD

**TABLE 5.**

Output gap in selected EU Member States, % of potential GDP

	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

Source: OECD

## 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 some EU countries' economies and to weaken 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 divergence (see Charts 46 and 47). The result is divergent living standards between euro area countries (see Charts 48 and 49).

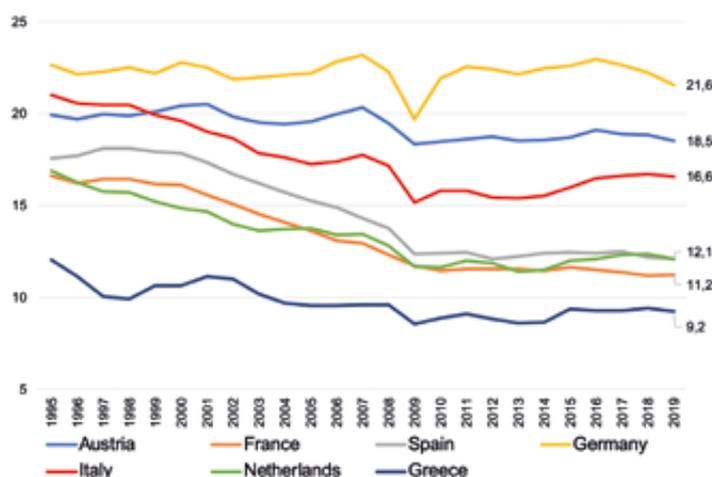
### 5.1 Growing heterogeneity in productive specialisation.

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 both further improve as a result of the Monetary Union. 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.

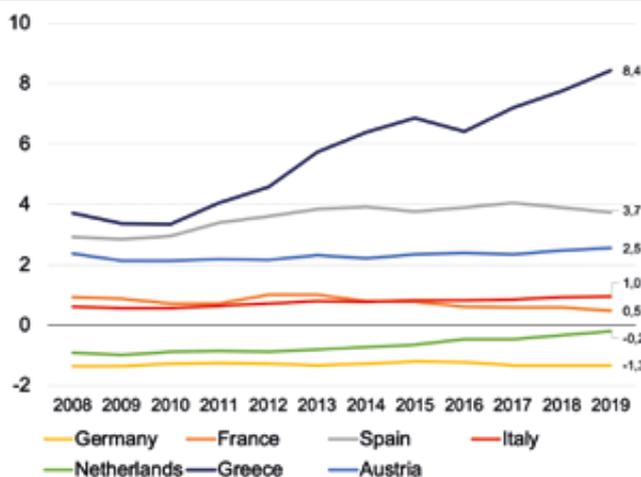
In such a context, since the creation of the euro, the northern countries of the Monetary Union (Germany and the Netherlands in particular) have been able to maintain a competitive industry, while the southern countries (Greece, France and Spain in particular) have progressively experienced deindustrialisation. EU Northern countries have gained market share in world trade, while those of the South have lost market share. Charts 46 and 47 highlight the divergence of industry and tourism across EU Member States.

**CHART 46.**  
Share of manufacturing  
in total value added



Source: OECD

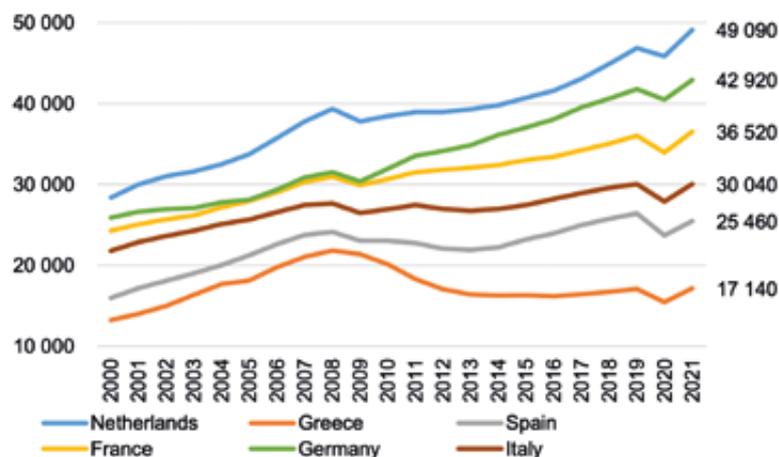
**CHART 47.**  
Balance of payments  
in travel, % of GDP



Source: Eurostat

This process also leads to a divergence of per capita GDP levels between eurozone countries. Hence, the Netherlands per capita GDP (current Local Currency Unit) was in 2021 almost three times greater than the Greek one, with EUR 49 090 per capita against EUR 17 140 for the latter (see Chart 48). In 2000 it was only twice more (EUR 28 380 for the Netherlands and EUR 13 230 for Greece).

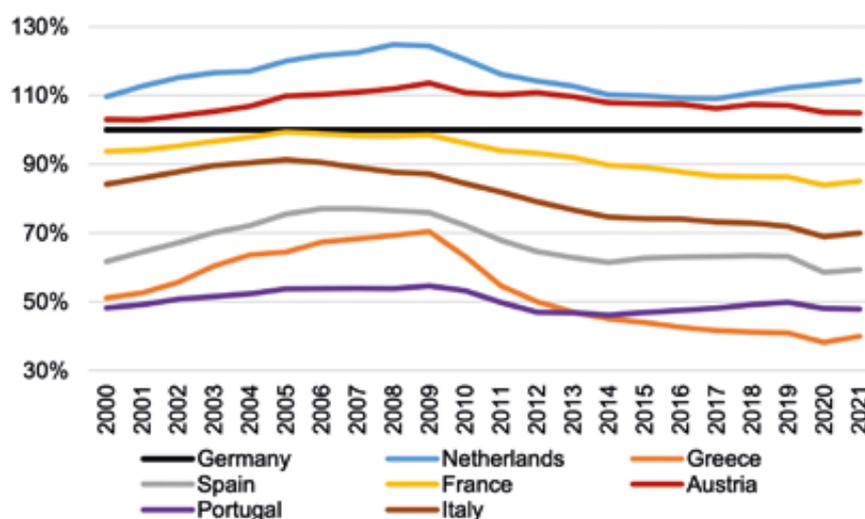
**CHART 48.**  
Per Capita GDP, current euros



Source: Eurostat

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 49). Over the past two decades two groups of countries stand out: those having systematically exceeded the level of German GDP per capita, as the Netherlands and Austria have, and those that have constantly remained below, such as Italy, Spain, Portugal or Greece. Once close to the first group, since the 2008 Great Financial Crisis, the French per capita GDP has gradually fallen behind, towards the EU low-income countries.

**CHART 49.**  
Per Capita GDP, as % of German  
Per Capita GDP



Source: Eurostat

## 5.2 The existence in the euro area of countries with large current account surpluses and countries with persistent current account deficits threatens the coherence, and eventually the existence, of the Economic and Monetary Union (EMU)

Table 6 and Chart 50 underline the existence of significant discrepancies between Member States.

Current account surpluses in Germany and the Netherlands averaged 7.7% and 9% respectively, over the 2014-2019 period, while French deficit reached 0.6% (see Chart 56).

For 2022 and 2023, the EU Commission forecasts a current account surplus:

- in Germany of 6.1% of GDP in 2022 and 6.5% in 2023 (after 7.2% in 2021)
- in the Netherlands of 8.7% of GDP in 2022 and in 2023 (after 9.5% in 2021)

In 2022 and 2023, the EU Commission forecasts<sup>13</sup> a current account deficit in France of 3% of GDP in 2022 and 2% in 2023 (after 2.4% in 2021).

However, the current account balance of the Eurozone is expected to be weaker than estimated in 2022, due to the deterioration of the trade balance in particular. According to Rexecode<sup>14</sup>, the euro area recorded a monthly trade deficit of EUR 17.6 bn in March 2022, and EUR 31.9 bn in April. This surge in imports value comes from the dependence with Russia (+83%) because of higher energy prices and with China. Also, the persistence of supply-chain disruptions and the slowdown in the Chinese economy are also penalising export industries such as the automobile industry in Germany, resulting in a decline in exports. In the first four months of 2022, imports value had increased by 37% in the euro area compared to the same period in 2019, while exports had fallen by 16%.

**TABLE 6.**  
Current Account Balance, % of GDP

	2007	Average 2014-19	2019	2020	2021	AMECO Forecasts	
						2022	2023
France	-0,1	-0,6	-0,7	-1,9	-2,4	-3,0	-2,0
Spain	-9,4	2,2	2,1	0,8	1,0	1,8	2,1
Italy	-1,4	2,2	3,2	3,8	2,5	1,2	1,6
Germany	6,9	7,7	7,6	6,9	7,2	6,1	6,5
Netherlands	6,9	9,0	9,4	7,0	9,5	8,7	8,7
Austria	3,8	1,9	2,1	1,9	-0,5	-1,1	-0,8
Euro Area	0,0	2,6	2,3	2,6	3,2	2,4	2,9
European Union	0,0	3,1	2,9	2,4	3,2	2,8	2,7

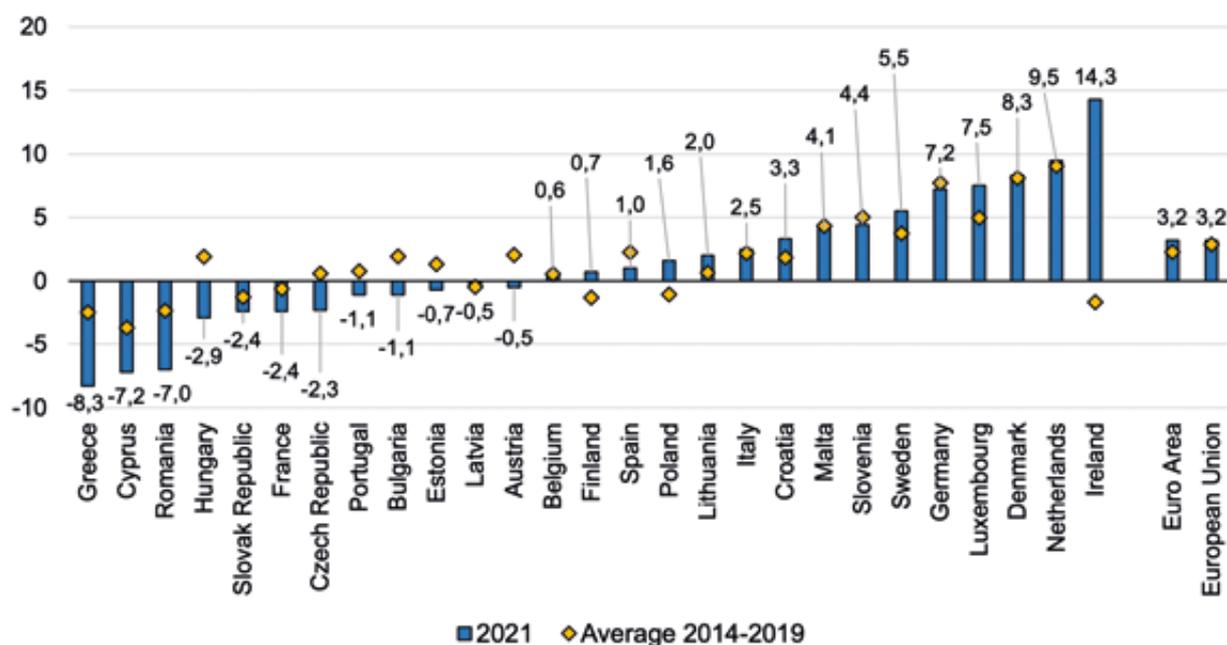
Source: AMECO, Spring Forecast (May 2022)

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.

13. EU Commission Spring Forecast (May 2022)

14. "un bond des importations européennes depuis la Chine", Lettre de Rexecode (3 June 2022)

**CHART 50.**  
Current account balance across EU Member States, % of GDP



Source : AMECO  
Labels refer to 2021 data

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

Indeed, since there would only be 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.

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 balances 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 national economic policies.

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**

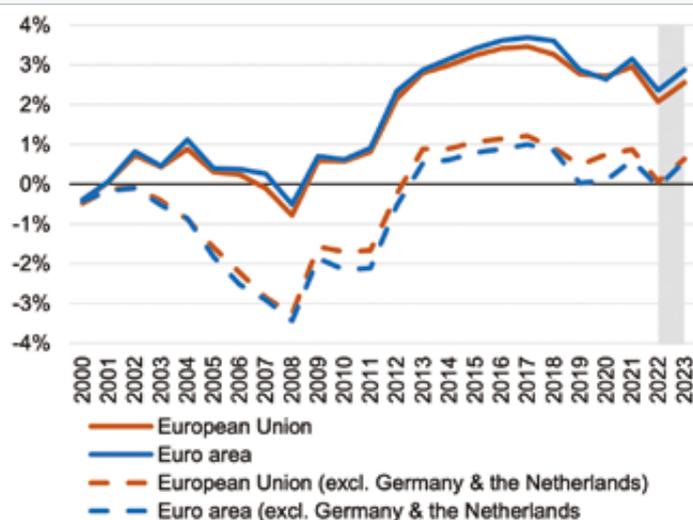
Of course, the objective is not unifying all balances of payments within the EU. Some countries have to catch up from very low standards of living and this necessarily incurs some deficits of balance of payment. However, the dynamics should not compound this heterogeneity but reduce it.

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 (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 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 48 and 49).

Consequently, the euro area exhibits a savings surplus of EUR 273.9 bn (or 2.3% of GDP in 2019), which is no longer being lent to other euro area countries but lent to the rest of the world excluding the euro area.

**CHART 51.**  
Current Account Balance,  
% of Nominal GDP

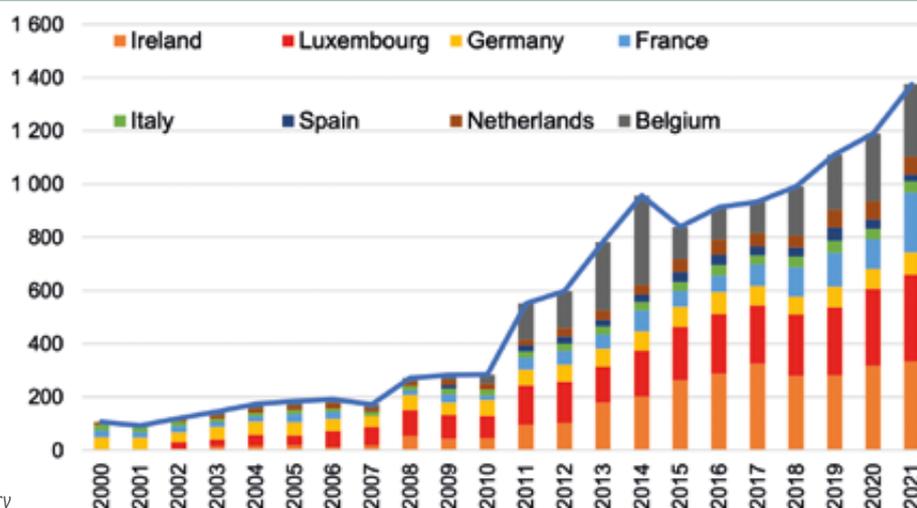


Source : AMECO, Spring Forecast (May 2022)

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 2021, the volume of US federal debt held by eurozone residents was multiplied by more than ten, increasing from USD 106.3 bn to USD 1 375.3 bn. Within the area, all countries that registered a positive current account balance are lending to the United States (see Chart 59) and therefore finance the US external and fiscal deficits. These include Germany (USD 83.4 bn in 2021), the Netherlands (USD 68.1 bn), Luxembourg (USD 325.6 bn), Spain (USD 24.9 bn), Belgium (USD 271.7 bn) and Italy (USD 42.4 bn). Although achieving an average current account deficit, France and Ireland also hold a significant amount of US federal debt, lending respectively USD 224.9 bn and USD 334.3 bn to the US Treasury in 2021.

**CHART 52.**  
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).

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## Conclusion

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A monetary union does not by itself create economic convergence.

This Scoreboard underlines that the eurozone is a currency area comprising heterogeneous countries with a low level of federalism (their productivity levels, productive specialisation, level of fiscal deficits and indebtedness, and level of labour force skills being different).

As we have observed, many Member States have relaxed their macroeconomic discipline over the last twenty years and those who played the card of fiscal vigilance turned out to be the winners. The Covid-19 crisis has exacerbated these existing heterogeneities across EU Member States. In this context, it is important that the implementation of Next Generation EU is a success<sup>15</sup>.

But as long as it is not sufficiently understood, notably in highly indebted countries, that excessive debt is a source of under-competitiveness, the economic situation in these countries will continue to deteriorate and it will be all the more difficult to progress in Europe towards more public or private risk sharing.

It is also an illusion to try to solve the structural problems of our economies by prolonged increases in public or private debt or by using money creation. Yet this is what has been too often tried by pursuing lax fiscal, monetary and political policies that inevitably pose systemic risks to financial stability and therefore to future growth. It is not because budget deficits are monetised that they disappear. In addition, central banks 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. The only way of promoting robust growth in the EU is to implement ambitious structural reforms in all Member States.

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 North to South. Europe benefits from a large pool of savings which could contribute to finance long term investments and notably those related to the green and digital transition, provided that such savings are not taxed but remunerated. However, these savings exit the EU and finance the rest of the world (in particular the United States). 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 the eurozone countries and the insufficient number of investment projects. These limited cross-border capital flows in the euro area reflect as the lack of a genuine Banking Union and integrated financial markets as well as persistent doubts of some investors in Northern Europe about the solvency of states and companies in other countries.

If the divergence of interest rates between the two sides of the Atlantic continues to increase in favour of the United States, the problem of transfer savings to higher interest rate areas could have very negative consequences for Europe.

The result of a too slow monetary normalisation in the euro area, in a context of persistent and very high inflation – HICP inflation is above 2% in the euro zone since April 2021 and increased to 8.6% in June 2022 compared to 8.1% in May and 7.4% in April 2022 – would be an acceleration of inflation and low growth (productive investment would continue to fall as we have seen over the past 20 years in periods of very low interest rates).

Consequently, the eurozone has to embark on the right course: fighting inflation, which requires vision and courage, 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 can only be envisaged if sufficient discipline starts reversing the trend of ever-growing economic heterogeneities across Member States.

Ultimately, the paradox of the euro is that a single currency and national economic policies coexist without a strong cement of coordination. Ultra-accommodating and asymmetric monetary policy have been used to overcome the contradictions of this paradox, but the price of this permanent rescue is costly. It is essential to ensure convergence of fiscal and structural policies. An intelligent revision of the Stability and Growth Pact should help to resolve these contradictions and thus make the euro sustainable.

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15. 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

To be viable, the eurozone needs:

- **To combat very high and persistent inflation without further delay by gradually returning to positive real interest rates.** As the 2022 annual economic BIS report reminds us, the most pressing monetary policy task is to restore low and stable inflation and to sustainably rebuild monetary buffers. Higher rates will also reduce central banks remittances to the governments. The reappearance of spreads should not dominate the decision-making process.  
It is usual in times of high inflation to increase nominal and real interest rates to avoid further increases in demand. The recommendation is therefore to raise interest rates and gradually move to positive real interest rates. This would only not be the case if the economy were in a deep economic crisis with rising unemployment or a risk of deflation, which is not the current situation (nor the one that has prevailed since the beginning of the second quarter of 2021, when inflation returned strongly). As long as interest rates remain negative or zero, the nominal increases implemented can only generate very weak recessionary effects.
- **National budgets under control in all parts of the Union.** No responsible state cannot be expected financing current public deficits generated by other eurozone members of the Union that do not follow the rules of the Union. The future – and notably the solution to market fragmentation – 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. Postponing discussions on the revision of the Pact delays the solution, exacerbates tensions within the market (due to the lack of benchmarks) and only complicates the resolution of problems that are likely to become even more acute.
- **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. Ultimately, the fate of euro will depend on the political will to achieve genuine cooperation within the euro area.





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