Monday, October 21, 2024

tomorrowsaffairs.com

Tomorrow's Affairs

Analysis of today
Assessment of tomorrow

By: Daniel Lacalle

The euro area is in stagnation despite retroactive GDP upgrades

It is difficult to understand how citizens demand more economic power for governments when fiscal policy fails abjectly, as we have seen in Europe.

We need to put the current euro area stagnation in context. Economic weakness is coming after the European Commission decided to ignore all fiscal limits and allowed government spending to run free throughout the EU and the euro area. It is also happening in the middle of an enormous stimulus plan, the 723-billion-euro Next Generation EU Fund.

You cannot make this up. The euro area remains in stagnation despite massively upgrading the last four years' GDP retroactively and implementing a record stimulus plan.

In this case, statistical revisions serve as a justification for increased debt and taxes. When the denominator increases retroactively, it leads to a decrease in the tax wedge to GDP and debt to GDP ratios, thereby offering governments a fictitious solution. More "fiscal space" is found. Taxpayers pay.

The 2019 base euro area GDP was 11.89 trillion. It was retroactively revised to 12.12 trillion euros. The 2023 GDP figure rose from 14.2 to 14.5 trillion euros.

The retroactive revisions to GDP in the euro area are significant. Spain increased the past GDP by 4.2 points compared with the 2019 base. Italy gained 2.6 points, Germany gained 1.92 points, France gained 0.6 points, Belgium gained 1.03 points, and Portugal gained 0.74 points.

The fabricated diagnosis

Many may raise doubts about these retrospective adjustments to statistical data, which should be accurate and seldom alter by more than 0.5 percentage points.

However, this is not the primary issue. The problem is that governments use this bloated GDP figure to find more space to hike taxes and issue more debt, ultimately harming economic development and productivity.

What is the problem?

In 2014, the European Union underwent a significant transformation. The extreme left repeated the false diagnosis of the previous crisis, which EU officials bought into.

The EU's "austerity" policies were purportedly the problem, despite the fact that government spending in most economies ranged from 35 to 56% of GDP.

Since 2014, the major euro area economies have seen nothing but tax hikes and elevated government spending

Therefore, the solution to future crises would be to allow governments to spend without constraint in order to prevent a crisis. However, that diagnosis was completely fabricated. The pillar that holds the EU together and remains unaffected in crises is government spending.

Since 2014, the major euro area economies have seen nothing but tax hikes and elevated government spending, topped with a chain of stimulus packages that have undoubtedly failed.

We must remember that the current stagnation in the euro area is a result of billions of Next Generation EU funds, years of negative nominal rates, and an ECB balance sheet that remains above 43% of GDP, nearly 70% larger than the Federal Reserve's.

Massive government intervention

The euro area was already experiencing stagnation in the fourth quarter of 2019, prior to the COVID-19 pandemic, which allowed governments to mask their failures with the excuse of the pandemic.

The issues facing the euro area have never stemmed from a lack of government spending or limited stimuli, but rather from the exact opposite. Massive government intervention has caused the euro area to stagnate.

Every time that the euro area enters another episode of stagnation, officials blame it on the lack of public investment. However, France demonstrates why this approach is a failure.

France started the year with an unsustainable estimate of a 4.4% deficit to GDP. Less than a year later, the deficit grew to a predicted 6.1%.

> France, a country with the highest taxes in the OECD, is overspending. How do they plan to solve it?

How did France go from an already massive 4.4% public deficit to 6.1%? France, a country with the highest taxes in the OECD, is overspending. How do they plan to solve it? By raising taxes even higher.

The case of Spain is insulting. The country has benefited from a record level of tourism, billions of Next Generation EU funds, and a rising population, but the government does not see any other way to reduce the deficit than to increase taxes.

The citizens of the euro area have become poorer

Now, governments are expecting that ECB rate cuts will revive the stagnant euro area. However, if governments continue to increase taxes and maintain unsustainable spending plans, the next debt crisis will come inevitably.

The sole purpose of ECB rate cuts is to lower the cost of borrowing for governments.

If governments continue to increase taxes and maintain unsustainable spending plans, the next debt crisis will come inevitably - Daniel Lacalle

With a four-year accumulated inflation rate of 20% and core inflation exceeding the target, the citizens of the euro area have become poorer, and inflationist policies remain.

Now, euro area citizens are told that they need to pay even higher taxes. None of this will fix the growth, productivity, and competitive problems of the euro area.

Unless governments start shrinking their budgets, cutting taxes, and eliminating excessive regulation and administrative burdens, all we will see is the eurozone ending as a museum.