How Austerity Has Crippled the European Economy – In Numbers

by Thomas Fazi on 31 March 2016 @battleforeurope

Europe's post-crisis response – consisting of a combination of fiscal austerity, neoliberal structural reforms and expansionary monetary policies – has unambiguously failed. In early 2016 – eight years after the outbreak of the financial crisis – the eurozone's overall real GDP was still below the pre-crisis peak (March 2008). The Greek economy was 27.6 per cent smaller. Spain's was 4.5 per cent smaller. Portugal's was 6.5 per cent smaller. Even those countries with above-average eurozone growth were not performing very well: Germany, for example, was only 5.5 per cent larger than it was in March 2008, while France was only 2.7 per cent larger. Meanwhile, most of the world has returned to, or surpasses, pre-crisis GDP levels.

Overall, the euro area has experienced a stagnant – below 2 per cent – annualised growth rate since the beginning of 2012 (following a brief post-crisis recovery), averaging 1.6 per cent in early 2016. A very slight acceleration is expected in 2017. Over the same period (2012-16), various countries – such as Greece, Italy and Portugal – have experienced near-zero or even negative growth rates. The ECB's policies – quantitative easing, negative interest rates, etc. – have not provided much of a stimulus, and cannot be expected to do so in the future. What this means is that the 'euro crisis', in purely macroeconomic terms, has been far worse than the Great Depression of the 1930s, when it took European countries on average four to five years to return to pre-crisis GDP levels.

In early 2016, industrial production in the euro area was down more than 10 per cent compared to pre-crisis levels (the EU28 fared only slightly better). Further, investment (gross fixed capital formation) remained below 2007 levels in 21 of 28 countries. The Commission argues for a 'coordinated boost to investment', but the proposed investment plan remains a weak and unconvincing response to the depth of the problem.

'Deflation' and deflation

From the beginning of 2013, the euro area's inflation rate has been well below the ECB's 2 per cent inflation target – and in February 2016 turned negative again (for the first time since 2009). In other words, the eurozone has experienced continuous 'deflation' – understood as performance below the policy level set by the ECB – for at least three years (and arguably for longer, depending on the methodology used). Over the same period, most periphery countries have experienced outright deflation (i.e., negative inflation rates). The ECB's asset-buying program – totaling more than 700 billion euros throughout 2015 and early 2016 (equal to roughly 7 per cent of the eurozone's GDP) – has failed to avert these deflationary tendencies (this is not surprising, considering that the European economy seems to have fallen into a so-called 'liquidity trap').

Various studies, mostly based on the latest research into the so-called ‘fiscal multiplier’, have attributed the euro area’s below-average post-crisis economic performance (compared to the rest of the world) to the policies of fiscal consolidation of recent years. One such study concluded that fiscal consolidation in the eurozone over the 2011-13 period reduced GDP by 7.7 per cent. Another study concluded that, had the peripheral economies of the EMU implemented fiscal austerity only half as severe over the 2010-13 period, Greek GDP would be nearly 14 per cent higher, Spain’s GDP would be nearly 10 per cent higher, whilst Portugal’s and Ireland’s economies would have shrunk by 5.5 per cent and 3.5 per cent less respectively. The study also concludes that across the five PIIGS, the number of unemployed would be 1.2m lower if fiscal austerity had been less severe. The European Commission’s rhetoric and the accompanying policy measures suggest no awareness of either the depth of the problems or the extent of policy change required to tackle them. There has been a verbal recognition that past policies have failed and that a big change is needed if GDP and employment growth are to be restored and maintained, but this has led only to half-hearted and uncoordinated responses.

Fiscal fumbling

The key obstacle remains continued adherence to the eurozone’s fiscal rules. The overall fiscal stance has moved from restrictive to neutral, meaning that while state budgets are no longer used to depress economic activity across the EU as a whole, they are not employed to stimulate expansion either. Moreover, the slight relaxation comes with warnings of the need for accelerated structural reforms – vaguely defined but including measures that have cut wages and hence consumer demand – and ‘growth-friendly fiscal consolidation’. In practice that means continuing a degree of austerity.

In early 2016, the euro area’s unemployment rate stood at 10.5 per cent (17m people), while the youth unemployment rate was 21.5 per cent (3m) – up from 7 and 15 per cent respectively in 2008. The figures for the EU28 were respectively 10.6 per cent (22m) and 20 per cent (4.5m). Among the member states, the highest unemployment and youth unemployment rates were recorded in Greece (24.6 and 49.5 per cent) and Spain (21.4 and 47.5 per cent). This has been accompanied by a rise in the rates of long-term unemployment, implying that a large number of unemployed face increasing difficulty in finding a job, while the danger of their sliding into poverty and material deprivation correspondingly increases. This is complemented by a lack of public sector opportunities. On the contrary: cuts in public spending are accelerating this trend.

Moreover, poverty (including in-work poverty) and at-risk-of-poverty rates have increased significantly in all European countries since 2008, reflecting an overall decline in terms of social justice. In early 2016, nearly one-quarter of EU citizens (24.6 per cent) are regarded as being at-risk-of-poverty or social exclusion – an extremely high and worrisome value. Measured against today’s total EU population, this corresponds to approximately 122m. The gap between northern European and southern European countries remains enormous. In Greece, 36 percent of the total population is at-risk-of-poverty or social exclusion. In Spain, this figure was above 29 percent. For children and youths, these shares were even higher. In Portugal, the poverty rate within the total population is 27.5 percent. By contrast, Sweden, Denmark, Finland and the Netherlands stand at the top of the overall index. Various studies have concluded that the increase in poverty, at-risk-of-poverty and social exclusion rates is a direct result of the policies of fiscal austerity and internal devaluation pursued in recent years. Research has also shown that austerity has increased inequality by fattening the tail of the income distribution, implying a redistribution from workers to asset owners (i.e., from the bottom majority of the distribution to the top minority).

Debt still rising…

Austerity fails most spectacularly, even on its own narrow terms, when the effect on debt is considered. In early 2016, the euro area's debt-to-GDP level stood at a record-high 93 per cent, compared with a pre-austerity level of 79.3 per cent at the end of 2009. As a result, interest payments tend to absorb a high and sometimes increasing share of GDP despite the extremely low-level of interest rates. In the event of future interest rate increases this will mean a further futile austerity drive.

Private debt is still very high in several member states as well, partly because the ongoing crisis has hampered the private sector's 'deleveraging' process. This is has resulted in the growth of non-performing loans (NPLs) across the continent. NPLs are particularly elevated in some southern countries, such as Italy, Greece, Portugal and Cyprus. And they are generally concentrated in the corporate sector, most notably among small and medium-sized enterprises (SMEs). This is reflected in the fact that, despite the cost of borrowing falling quite substantially since 2008, total loans to households and non-financial institutions remain stagnant. This has worrying implications not only for the financial stability of the euro area but also for the prospects of economic recovery, given that 'higher NPLs tend to reduce the credit-to-GDP ratio and GDP growth, while increasing unemployment', a study has found. This is also attributable to the austerity policies, which have exacerbated the recession in a number of countries, further deteriorating the balance sheets of families and corporates and, in turn, those of banks. These developments further underline the fact that, under the current circumstances, monetary policy alone is unlikely to bring about recovery and that what is needed instead is a coordinated fiscal expansion in the EU, with an emphasis on public investment.

As for intra-EMU current account imbalances, arguably one of the leading causes of the crisis, the rebalancing has been significant but the adjustment has been shouldered entirely by deficit countries (through decreased imports, not increased exports). That is, deficit countries have sharply reduced their current account deficits, but surplus countries have not reduced their current account surpluses, with Europe's overall adjustment essentially premised on demand emanating from outside Europe. The result has been that the EMU as a whole, which had an overall balanced external position in 2007, in early 2016 registered a record-high – and growing – current account surplus of 3.7 per cent of GDP. The net result has been a deflationary bias for the euro area (and particularly for periphery countries), as well as for the world economy. As global demand experiences a dramatic slowdown, an export-led solution to the crisis appears more unlikely than ever.