Is Europe spending too much?

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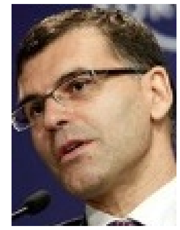
Yes, it is, according to **Simeon Djankov**. *He notes that public expenditures had risen to dangerously high levels in some Southern and Western European countries even prior to the eurozone crisis and argues that the European Central Bank's loose monetary policy since 2012 has provided public sectors with little incentive to modernise. This, in turn, may be helping to fuel Eurosceptic rhetoric.*



The eurozone crisis, the rise of nationalist parties across Europe and the Brexit vote have all pointed to significant vulnerabilities in the European social model. Europe is home to only 8 per cent of the world's population, yet it produces 50 per cent of global social payments (public pensions, healthcare benefits, maternity leave and associated benefits, public education and access to subsidized public transport). These social benefits come at a large cost, typically covered by high taxation and chronic budget deficits. Dissatisfaction with these costs has risen among taxpayers, especially when social benefits are lavished on immigrants. Nationalist movements in Nordic and Central European countries, and most recently in the United Kingdom have gathered support aimed at curtailing such expenditure.

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Is Europe spending too much? The answer is yes. Public expenditures had risen to dangerously high levels in some Southern and Western European countries even prior to the eurozone crisis. As an average share of EU GDP, they reached 50.3 per cent in 2009. By 2015, they had declined to 47.4 per cent of GDP. In contrast, they were 35 per cent in the United States and 34 per cent in Switzerland in 2015.

In 2015, public expenditures in various EU countries ranged from 35 to 58 per cent of GDP. The highest public expenditures as a share of GDP were to be found in Finland (58 per cent), France (57 per cent), Denmark (56 per cent), Greece (55 per cent), and Belgium (54 per cent). At the other end, Ireland, Lithuania, and Romania had public expenditures of 35 per cent of GDP. The United Kingdom was in the middle of the European Union membership on public expenditures, with 43 per cent of GDP.

Higher public expenditures tend to lead to large budget deficits and rising public debts. In 2015, the average EU public debt was 88 per cent of GDP, far above the Maastricht ceiling of 60 per cent of GDP imposed on all European Union members. This is one of the consistent criticisms levied at the EU by nationalist parties and movements like the Leave campaign in the United Kingdom: that European leaders do not follow their own rules.

There was a temporary respite from increased spending in 2009-2012. The fiscal tightening after the eurozone crisis went along with pursuing structural reforms to improve public finances across Europe. In this period, two-thirds of European Union members have managed at least one significant reform in the pension, healthcare or public education sectors.

Since 2012 however, the increasingly loose monetary policy of the European Central Bank (ECB) has slowed down progress towards more balanced public spending. The ECB has committed to buy each month from €60bn to €80bn of EU bonds to increase liquidity in Europe. It also expanded the range of assets it would buy to include high-quality corporate bonds. This loose monetary policy has allowed European governments to borrow at very low or no cost, reducing their incentive to modernise the social sectors. In some cases, for example Italy, previously-initiated reforms were aborted.

In the meantime the ECB has aggressively cut interest rates to spur consumption and investment, moving into negative territory in 2014 and charging banks 0.4 percent to hold their cash overnight since March 2016. Sweden and Denmark have also adopted negative rates, weakening their currencies in the process. The main result of negative interest rates is clear: governments are more willing to incur additional debt and spend money. Denmark is an example, with the budget deficit projected to reach 2.5 percent of GDP in 2016, after the government managed to reach a surplus two years earlier.

There are some differences in the reach of loose monetary policy across Europe, especially among Eurozone and non-Eurozone countries. These differences are exploited in a new project by the Financial Markets Group at the London School of Economics and the insurer Swiss Re, which are conducting comparative analysis on the effects of loose monetary policy on structural reforms. Among the main questions are the systemic risk implications of a low interest rate environment; which types of structural reforms are abandoned during a period of easy money; and how can European countries come out of a period of loose monetary policy.

Answering these questions helps not only forecast public expenditures in Europe, but also project economic growth, which has faltered since the Eurozone crisis. If higher growth materializes, optimizing spending may be easier to achieve.

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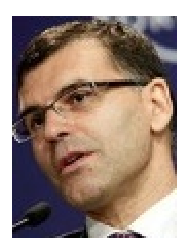
About the author

Simeon Djankov – *LSE Financial Markets Group*
Simeon Djankov is former deputy Prime Minister and Finance Minister of Bulgaria. He is now Executive Director of LSE's Financial Markets Group.



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