# Oye! News from Europe

## *The Unmitigated Failure of European "Austerity"*

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Michael D. Tanner of the CATO Institute recently published an article entitled "Europe's Failed Austerity" discussing the recent election results in Europe as they relate to the public's backlash against austerity programs. He notes that many American advocates of "bigger is better government" use the apparent failure of European austerity measures as an example of why Washington must make a sharp U-turn, reversing its very modest attempts at fiscal balance. This seems to be of particular importance to these advocates because they draw the conclusion that Europe's very modest recent economic growth is directly related to cuts in government spending. This recent GDP data release from Eurostat would appear to bear up that argument:

Flash estimate for the first quarter of 2012

**Euro area and EU27 GDP stable**

0.0% and +0.1% respectively compared with the first quarter of 2011

GDP remained stable in both the **euro area**[1] (EA17) and the **EU27**[2] during the first quarter of 2012, compared with the previous quarter, according to flash estimates published by **Eurostat, the statistical office of the European Union**. In the fourth quarter of 2011, growth rates were -0.3% in both zones.

Compared with the same quarter of the previous year, seasonally adjusted GDP remained stable in the **euro area** and increased by 0.1% in the **EU27** in the first quarter of 2012, after +0.7% and +0.8% respectively in the previous quarter.

During the first quarter of 2012, GDP in the **United States** increased by 0.5% compared with the previous quarter (after +0.7% in the fourth quarter of 2011).

Compared with the same quarter of the previous year, GDP rose by 2.1% in the **United States** (after +1.6% in the previous quarter).

**Growth rates of GDP in volume**
(based on seasonally adjusted* data)

| | Percentage change compared with the previous quarter | | | | Percentage change compared with the same quarter of the previous year | | | |
|---|---|---|---|---|---|---|---|---|
| | 2011 | | | 2012 | 2011 | | | 2012 |
| | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | Q1 |
| EA17 | 0.1 | 0.1 | -0.3 | **0.0** | 1.6 | 1.3 | 0.7 | **0.0** |
| EU27 | 0.2 | 0.3 | -0.3 | **0.0** | 1.6 | 1.4 | 0.8 | **0.1** |
| *Member States* | | | | | | | | |
| Belgium | 0.3 | 0.0 | -0.1 | **0.3** | 2.2 | 1.6 | 1.2 | **0.6** |
| Bulgaria | 0.3 | 0.1 | 0.1 | **0.0** | 2.1 | 1.4 | 0.9 | **0.5** |
| Czech Republic | 0.3 | -0.1 | -0.1 | **-1.0** | 2.1 | 1.3 | 0.6 | **-1.0** |
| Denmark | 0.4 | -0.1 | -0.1 | : | 1.4 | 0.0 | 0.5 | : |
| Germany | 0.3 | 0.6 | -0.2 | **0.5** | 2.9 | 2.7 | 2.0 | **1.2** |
| Estonia | 1.8 | 0.9 | -0.2 | **0.3** | 8.2 | 8.0 | 5.1 | **4.0** |
| Ireland | 1.1 | -1.1 | -0.2 | : | 1.8 | 0.1 | 1.0 | : |
| Greece** | : | : | : | : | -7.3 | -5.0 | -7.5 | **-6.2** |
| Spain | 0.2 | 0.0 | -0.3 | **-0.3** | 0.8 | 0.8 | 0.3 | **-0.4** |
| France | 0.0 | 0.3 | 0.1 | **0.0** | 1.7 | 1.5 | 1.2 | **0.3** |
| Italy | 0.3 | -0.2 | -0.7 | **-0.8** | 1.0 | 0.4 | -0.4 | **-1.3** |
| Cyprus | 0.0 | -0.8 | -0.3 | **-0.3** | 1.4 | -0.2 | -0.8 | **-1.4** |
| Latvia | 1.9 | 1.4 | 1.0 | **1.1** | 5.2 | 6.6 | 5.7 | **5.6** |
| Lithuania | 1.5 | 1.2 | 0.8 | **0.0** | 6.5 | 6.7 | 5.2 | **4.3** |
| Luxembourg | -0.5 | 1.0 | 0.2 | : | 0.7 | 1.9 | 0.8 | : |
| Hungary | 0.0 | -0.1 | 0.0 | **-1.3** | 1.9 | 1.4 | 1.2 | **-1.5** |
| Malta | 0.4 | 0.1 | -0.6 | : | 3.0 | 2.5 | 0.0 | : |
| Netherlands*** | 0.1 | -0.4 | -0.7 | **-0.2** | 1.6 | 1.1 | -0.1 | **-1.3** |
| Austria**** | 0.5 | 0.0 | 0.0 | **0.2** | 4.1 | 2.6 | 1.4 | **0.7** |
| Poland | 1.2 | 1.0 | 1.1 | : | 4.5 | 4.2 | 4.4 | : |
| Portugal | -0.2 | -0.6 | -1.3 | **-0.1** | -1.1 | -2.0 | -2.9 | **-2.2** |
| Romania | 0.2 | 1.1 | -0.2 | **-0.1** | 1.4 | 3.4 | 2.2 | **0.8** |
| Slovenia | -0.1 | -0.4 | -0.7 | : | 0.8 | -0.2 | -1.5 | : |
| Slovakia | 0.8 | 0.7 | 0.8 | **0.8** | 3.4 | 3.2 | 3.3 | **3.2** |
| Finland | 0.2 | 1.1 | 0.3 | **1.3** | 1.8 | 3.3 | 1.6 | **2.9** |
| Sweden | 1.1 | 0.9 | -1.1 | : | 4.8 | 4.4 | 1.2 | : |
| United Kingdom | -0.1 | 0.6 | -0.3 | **-0.2** | 0.4 | 0.3 | 0.5 | **0.0** |
| *EFTA countries* | | | | | | | | |
| Iceland | -4.4 | 4.4 | 1.9 | : | 1.3 | 4.0 | 2.8 | : |
| Norway | 0.5 | 1.1 | 0.5 | : | 0.7 | 3.9 | 1.8 | : |
| Switzerland | 0.4 | 0.3 | 0.1 | : | 2.1 | 1.7 | 1.2 | : |
| *Main economic partners* | | | | | | | | |
| United States | 0.3 | 0.5 | 0.7 | **0.5** | 1.6 | 1.5 | 1.6 | **2.1** |
| Japan | -0.3 | 1.7 | -0.2 | : | -1.7 | -0.5 | -0.6 | : |

Outside of the former Iron Curtain countries of Slovakia, Estonia, Latvia and Lithuania plus Finland, the United States' Q1 2012 GDP modest growth rate of 2.1 percent looks stellar when compared to most of the rest of Europe where the average economic growth rate is a barely perceptible (and easily correctable in a downward direction) 0.1 percent for all 27 nations. Apparently, these big government advocates would suggest that it is Europe's cut and slash ways that have triggered a near-continentwide recession; this logic would suggest that America should continue along its "stimulate by spending more than it brings in" philosophy to keep the Union out of recession.

On average, Europe's government spending contributes more than half of GDP. Government spending appears to still be at roughly the same level despite so-called austerity. Rather than cutting spending, nations have elected to raise taxes, a measure that according to some economists is likely to have the exact opposite impact on debt than anticipated. Here is a breakdown of the austerity measures for both France and the United Kingdom:

1.) France has raised taxes by imposing a 3 percent surtax on incomes above €500,000 accompanied by a one perentage point increase in the top marginal tax rate, raising it from 40 to 41 percent. France also increased corporate taxes by 5 percent on businesses with more than €250 million in revenue and closed some corporate tax loopholes. This was topped off with an increase in VAT from 19.6 percent to 21.2 percent. All of this was implemented to keep the budget deficit for 2012 to 4.5 percent of GDP which is still above the 3 percent European Union target. By the end of February 2012, the budget deficit had narrowed by 13.5 percent on a year-over-year basis, however, year-over-year spending was up from €57 billion to €63.56 billion. Fortunately, revenues were up 13.5 percent to €43.2 billion. Despite France's best-laid plans, the budget deficit hit 5.2 percent of GDP.

2.) The coalition government in the United Kingdom has hiked personal income taxes for those earning more than £150,000 to 50 percent. According to Mr. Tanner, that move actually managed to decrease income tax revenues by £509 million. Oops! While the U.K. government did trim payrolls and programs, British government spending consumes more than 49 percent of GDP and has risen by £59.2 billion from 2009 to 2011. Again, oops!

This seems to be the pattern throughout the Eurozone. Raise taxes on the wealthy and promise that you'll cut spending at some distant and poorly defined point in the future. In addition, governments in the Eurozone have decided that raising the level of the Value Added Tax "licence to print money" is the best option to achieve a semblance of fiscal responsibility. As shown on this chart, here's how many Member States and other jurisdictions are adopting this practice:

**European VAT increases in 2012 and beyond**

You can review all current European VAT rates here.

**Belgium**: withdrew VAT on legal and digital TV services from 1 January 2012

**Croatia**: raised VAT from 23% to 25% from 1 March 2012

**Curaçao** - VAT raised from 5% to 6% January 2012

**Cyprus**: VAT increased 2% to 17% from March 2012

**Czech Republic:** increased the reduced VAT rate from 10% to 14% and has proposed increasing the standard VAT rate from 20% to 21%

**Finland**: 1% VAT rise to 24% in 2013

**France**: increased VAT on books and ebooks to 7%; but 1.6% French VAT rise to 21.2% may be withdrawn

**Hungary**: raised the standard VAT rate from 25% to 27% from January 2012

**Ireland**: increased the main VAT rate from 21% to 23% in January 2012

**Italy**: VAT rate rise from 21% to 23% October 2012

**Latvia**: to reduce VAT rate from 22% to 21% in July 2012

**Luxembourg**: cut the VAT levied on ebooks and newspapers from 15% to 3% from January 2012

**Maderia (Portugal):** increase VAT from 16% to 24% from April 2012.

**Netherlands**: proposes raising VAT rate 2% to 21%

**Norway** - cuts VAT on food increased from 14% to 15%

**Poland**: proposed VAT rise to 24%

**Portugal**; raised VAT on restaurants to 23% from the start of 2012

Spain: potential VAT rise to up to 20% in 2013

Never let it be said that there's an original thinker among our leadership.

How lucrative is the VAT machine? Looking at the case of Germany, government's receipts from VAT totalled 36.6 percent of all revenue compared to only 21.4 percent from income taxes on wages. To simplify things, the more Germans spend, the more the government makes. In my opinion, this certainly is not a sustainable situation particularly if a continent-wide or global recession takes hold.

While the topic of a Value Added Tax (VAT) has been on the back burner since it reappeared in early April 2010 after a comment by Paul Volcker, the imposition of a consumption tax is not likely off the table over the long-term, particularly since the U.S. is the only OECD nation without a national sales tax. With four deficits in a row in excess of $1 trillion, Washington desperately needs a "money machine" since apparently, it has not seriously crossed the minds of those in Congress to cut spending. With a debt of $15.7 trillion, Washington will be looking for any source of revenue that it can get its hands on. It's going to be a case of "monkey see, monkey do" for cash-starved Washington.

To put this tax into perspective, here is a chart showing current VAT rates across Europe:

| Member States | Code | Super Reduced Rate | Reduced Rate | Standard Rate | Parking Rate |
|---|---|---|---|---|---|
| Belgium | BE | - | 6 / 12 | 21 | 12 |
| Bulgaria | BG | | 9 | 20 | - |
| Czech Republic | CZ | - | 14 | 20 | - |
| Denmark | DK | - | - | 25 | - |
| Germany | DE | - | 7 | 19 | - |
| Estonia | EE | - | 9 | 20 | - |
| Greece | EL | - | 6,5 / 13 | 23 | - |
| Spain | ES | 4 | 8 | 18 | - |
| France | FR | 2,1 | 5,5 / 7 | 19,6 | - |
| Ireland | IE | 4,8 | 9 / 13,5 | 23 | 13,5 |
| Italy | IT | 4 | 10 | 21 | - |
| Cyprus | CY | - | 5 / 8 | 15 | - |
| Latvia | LV | - | 12 | 22 | - |
| Lithuania | LT | - | 5 / 9 | 21 | - |
| Luxembourg | LU | 3 | 6 / 12 | 15 | 12 |
| Hungary | HU | - | 5 / 18 | 27 | - |
| Malta | MT | - | 5 / 7 | 18 | - |
| Netherlands | NL | - | 6 | 19 | - |
| Austria | AT | - | 10 | 20 | 12 |
| Poland | PL | | 5 / 8 | 23 | - |
| Portugal | PT | - | 6 / 13 | 23 | 13 |
| Romania | RO | | 5 / 9 | 24 | - |
| Slovenia | SI | - | 8,5 | 20 | - |
| Slovakia | SK | - | 10 | 20 | - |
| Finland | FI | - | 9 / 13 | 23 | - |
| Sweden | SE | - | 6 / 12 | 25 | - |
| United Kingdom | UK | - | 5 | 20 | - |

Washington will be hard-pressed not to engage the services of this particular cash cow and what better time to do it than when a President is in his second term with no need to try for re-election. From personal experience, living in a jurisdiction that is about to implement a similar tax, governments will do whatever they can to assure voters that these regressive forms of tax are anything but regressive and that you will actually be financially better off under the new regime.

I summary, looking back at Europe, we see governments grabbing for cash using creative tax measures at the same time as they are making very modest attempts at spending restraint. Could these very unpopular moves be why voters in France and Greece couldn't wait to turf their governments in recent elections? Perhaps the electorate in other European nations will follow suit as they tire of watching their governments grossly mismanage their fiscal responsibilities.

Moving to the western shores of the Atlantic Ocean, perhaps Americans will adopt the same modus operandi in November 2012. Maybe we're all just a wee bit tired of the same old nonsense from those that we elect to "lead" us.