



Question of the Week: Has the European Fiscal Crisis Ended?

Daniel J. Mitchell January 13, 2013

I've frequently commented on Europe's fiscal mess and argued that excessive government spending is responsible for both the sovereign debt crisis and the economic stagnation that plagues the continent.

But it does seem that things have calmed down, so the readers who have submitted questions about whether the fiscal crisis has ended obviously are paying attention.

I have two responses.

My first answer is very mature and thoughtful: HAHHAHAHAHAHAHAHA, are you ;@(\$&^#'% kidding me?

My second answer is a bit more guarded and circumspect: No. To be more specific, the immediate crisis may have slightly abated, but I have no confidence that the long-run problem has been solved.

But let me start with some good news. Most of the hard-hit European nations have finally begun the cut spending. And when I say cut spending, I mean they actually spent less in 2011 than they did in 2010 (unlike the fake version of spending cuts that you find in the U.S. and U.K., where spending simply grows at a slower pace).

We don't have data for 2012, but I wouldn't be surprised if many of the PIIGS nations also cut spending last year as well.

Now for some bad news. Unlike the Baltic nations, the PIIGS dragged their feet and didn't reduce the burden of government spending until they had no choice.

Moreover, they all imposed crippling tax hikes. Indeed, the tax increases in Greece were so severe that even the International Monetary Fund warned that the country might be past the Laffer Curve revenue-maximizing point.

So while long-overdue reductions in spending meant less money was being diverted from the economy's productive sector, higher tax rates have discouraged entrepreneurs and investors from creating jobs and wealth.

So what's the net effect?

From an optimistic perspective, the fiscal situation should stabilize if governments keep spending under control. Some additional spending cuts would be very desirable since government spending consumes 45 percent-50 percent of GDP in these nations, which is at least double the growth-maximizing level.

"I'm going back in my bottle if you don't cut spending!"

But even if these nations merely abide by Mitchell's Golden Rule and restrain spending so that it grows slower than the private sector, that would be progress.

The reason I'm not optimistic, though, is that I don't sense any commitment to smaller government. I fear governments will let the spending genie out of the bottle at the first opportunity. And we're talking about a scary genie, not Barbara Eden.

And to make matters worse, Europe faces a demographic nightmare. These charts, reproduced from a Bank for International Settlements study, show that even the supposedly responsible nations in Europe face a tsunami of spending and debt over the next 25-plus years.

So you can understand why I don't express a lot of optimism about European economic policy in this interview with Canadian TV.

The ostensible topic was European-wide financial regulation, but that topic is really a proxy for the fact that some nations want to bail out their financial sectors. But they're in such lousy fiscal shape that they can't borrow the money that would be needed to prop up their dodgy banks.

So I pointed out that European-wide regulation wasn't the right answer. It wouldn't make banks safer (since it would be based upon the deeply flawed Basel regulations), but could become a vehicle for nations such as Germany to further subsidize countries such as Spain.

But I hope I got across my main point, which is that these nations are burdened with too much government and their problems won't be solved with more handouts, regulation, or bureaucracy.

In other words, there's no substitute for genuine spending cuts implemented by the nation states of Europe.

P.S. Just in case you're under the impression that only cranky libertarians think government is too big in Europe, I invite you to peruse this research from the European Central Bank, World Bank, and National Bank of Finland.

P.P.S. To close with some European-themed humor, we have three videos: 1) A romantic comedy involving Mr. Greece and Ms. Germany, 2) Hitler learning about the European downgrade, and 3) A Greek perspective on Germany.

P.P.P.S. Heck, I can't resist sharing this cartoon, this Dave Barry mockery, and the non-PC map of Europe as well.