

When the OECD persists in its mistakes...

By [Henri Sterdyniak](#)

The OECD has published an economic policy note, [“Choosing fiscal consolidation compatible with growth and equity” \[1\]](#)). There are two reasons why we find this note interesting. The OECD considers it important, as it is promoting it insistently; its chief economist has, for instance, come to present it to France’s Commissariat à la Stratégie et à la Prospective [Commission for Strategy and Forecasts]. The subject is compelling: can we really have a fiscal austerity policy that drives growth and reduces inequality? Recent experience suggests otherwise. The euro zone has been experiencing zero growth since it embarked on a path of austerity. An [in-depth study by the IMF \[2\]](#) argued that, “fiscal consolidations have had redistributive effects and increased inequality, by reducing the share of wages and by increasing long-term unemployment”. So is there some miracle austerity policy that avoids these two problems?

1) What goals for fiscal policy?

According to the authors of the OECD study, the goal of fiscal policy should be to bring the public debt down by 2060 to a “prudent” level, defined for simplicity’s sake, we are told, as 60% of GDP. All the OECD countries must work towards this objective and immediately make the necessary adjustments.

But a target of 60% is totally arbitrary. Why not 50% or 80%? Furthermore, this goal is set in terms of gross debt (as defined by the OECD) and not debt under Maastricht. But the difference is far from meaningless (at end 2012, for France, 110% of GDP instead of 91%).

The OECD makes no effort to understand why a large majority of

the organization's members (20 out of 31, including all the large countries) have a public debt that is well over 60% of GDP (Table 1). Do we really think that all these countries are poorly managed? This high level of public debt is associated with very low interest rates, which in real terms are well below the growth potential. In 2012, for example, the United States took on debt, on average, of 1.8%, Japan 0.8%, Germany 1.5%, and France 2.5%. This level of debt cannot be considered to generate imbalances or be held responsible for excessively high interest rates that could undermine investment. On the contrary, the existing debt seems necessary for the macroeconomic equilibrium.

We can offer three non-exclusive explanations for the increase in public debts. Assume that, following the financialization of the economy, firms are demanding higher rates of profit, but at the same time they are investing less in the developed countries, preferring to distribute dividends or invest in emerging markets. Suppose that globalization is increasing income inequality [\[3\]](#) in favour of the rich, who save more, at the expense of the working classes who consume virtually all of their income. Suppose that, in many countries, aging populations are increasing their savings rate. In all three cases a demand deficit arises, which must be compensated by private or public debt. Yet since the crisis of 2007-2008 private agents have been deleveraging. It was therefore necessary to increase the public debt to prop up demand, as interest rates were already at the lowest possible level. In other words, it is not really possible to reduce public debt without tackling the reason why it's growing, namely the deformation of the sharing of value in favour of capital, the increase in income inequality and unbridled financialization.

Table 1. State of the public finances in 2012 (% of GDP)

	Gross public debt	Structural primary balance	Output gap*	Loss in potential GDP due to the crisis	Effort required**
Austria	85	1.1	-1.6	-3.0	0.2
Belgium	104	0.3	-0.8	-4.5	1.6
Canada	85	-2.5	-0.4	-6.1	2.7
Finland	63	-1.8	-1.4	-9.7	3.8
France	110	-1.3	-2.4	-3.6	4.7
Germany	89	1.4	0.1	-1.6	0.0
Greece	166	3.2	-11.7	-17.6	8.2
Ireland	123	-1.8	-7.9	-9.6	5.8
Iceland	132	2.6	-4.2	-9.0	3.6
Italy	140	4.4	-4.5	-6.8	0.7
Japan	219	-8.1	-0.8	-3.1	18.3
Netherlands	83	-1.4	-1.5	-7.6	2.8
Portugal	139	-0.6	-6.7	-10.4	7.5
Spain	91	-1.8	-7.7	-9.1	5.3
United Kingdom	104	-5.1	-2.1	-10.4	9.2
United States	106	-5.4	-3.0	-5.7	7.7
Euro zone	104	0.6	-2.0	-4.9	2.6
OECD	109	-3.2	-2.3	-4.6	6.0

* According to the OECD; ** short-term effort required to eventually stabilize the debt at 60% of GDP.

According to the OECD, gross public debt on the order of 100% of GDP, as at present, poses problems in terms of fragile public finances and a risk of financial instability. The economy could in fact be caught in a trap: households (given income inequality, aging or their justified mistrust of the financial markets) implicitly want to hold 100% of GDP in public debt (the only risk-free financial asset), interest rates are already near zero, and the financial markets are wary of a country whose debt exceeds 60% of GDP. We cannot escape this trap by reducing public deficits, as this reduces economic activity without lowering interest rates; what is needed is to reduce private savings and carry out a Japanese-style financial policy: the central bank guarantees the public debt, this debt is held by households, and the rate of compensation is low and controlled.

We only regret that the OECD has not made a serious analysis of the cause of the swelling public deficits.

2) Reduce the structural primary deficits

The OECD recommends that all countries embark on extensive programmes to reduce their structural primary deficits. To do this, we must first assess these structural primary deficits. However, the OECD estimates are based on a very specific hypothesis, namely that most of the production lost due to the crisis can never be made up. That is to say, for the OECD as a whole, 4.6 points of potential GDP have been lost forever out of the 6.9 point gap in 2012 between GDP and the pre-crisis trend. Also, the OECD believes that the structural primary balance of many countries was negative in 2012 whereas it would have been positive if the loss of production could have been made up. For France, the OECD estimates the structural primary balance at -1.3% of GDP, while the balance would be 0.5% if the loss due to the crisis could be made up. Only the United States and Japan would retain a structural primary deficit under the “catch-up hypothesis”.

Assume that long-term rates remain below the growth rate of the economy and that it is not necessary to reduce the public debt ratios. Then a structural primary balance at equilibrium would be sufficient to stabilize the public debt. Only two countries would need to make fiscal efforts: Japan (for 6.7 GDP points) and the US (for 2 points). The other countries would primarily be concerned with re-establishing a satisfactory level of production.

However, the OECD assumes that the countries will suffer forever from the shock induced by the crisis, that it is imperative to reduce the debts to 60% of GDP, that long-term rates will be higher (by about 2 points) than the economy's growth rate in the very near future, and that public health spending will continue to rise. This leads it to conclude that most countries should immediately engage in a highly restrictive policy, representing 4.7 GDP points for France, 7.7 points for the United States, 9.2 points for the United Kingdom, etc.

The problem is that the OECD study assumes that these restrictive policies will not have any impact on the level of economic activity, or at least that the impact will be temporary, so that it can be neglected in a structural study of the long term. This is based on a notion that, though widespread, is wrong: that the economy has a long-term equilibrium that would not be affected by short or medium-term shocks. But this makes no sense. Real economies can go off in a different direction and experience periods of prolonged and cumulative depression. Is it possible to imagine a long-term Greek economy that is unaffected by the country's current situation? The shock induced by the strategy advocated by the OECD would mean a lengthy period of stagnation in Europe , Japan and the United States; the depressive effect would not be offset by lower interest rates, which have already hit bottom; a fiscal cutback of 6% of the OECD's GDP would result in a fall in GDP of 7.2% [\[4\]](#); and the decrease in activity would be so great that debt ratios would rise in the short term (see the explanatory box below). To believe that the economy would eventually return to its long-term trajectory is just wishful thinking. The OECD provides no assessment of the impact of such a policy produced with a macroeconomic model.

We can only wonder that the OECD continues to advocate austerity policies that were shown in the years 2012-2013 to have adverse effects on growth and a negligible impact on the level of public debt, instead of advocating a policy stimulus that, while its content is of course debatable, would be more promising for the Western economies.

3) Choosing the right instruments

The bulk of the OECD study, however, is devoted to researching the policy instruments that would be most effective for achieving fiscal consolidation.

Based on previous work, the OECD assigns to each instrument an impact on growth, equity and the trade balance (Table 2). The

organization has happily discovered that in some cases public expenditure can be helpful for growth as well as equity: such is the case of spending on education, health, family benefits and public investment. These should therefore be protected to the fullest. However, the OECD does not go so far as to imagine that they could be strengthened in some countries where they are particularly low today. In other cases, the OECD remains faithful to its free market doctrine: for example, it considers that spending on pensions is detrimental to long-term growth (since reducing it would encourage seniors to remain in employment, thereby increasing output) and is not favourable to equity. One could argue the opposite: that reducing public spending on pensions would hit the poorest workers, who would then live in poverty during their retirement; the better-off would save in the financial markets, which would strengthen these and thus fuel financial instability. Similarly, for the OECD unemployment and disability benefits hurt employment, and thus growth. Moreover, subsidies would be detrimental to long-term growth, as they undermine the competitive balance, and thus efficiency, but the OECD puts all subsidies in the same bag: the research tax credit, the PPE employment bonus, and the common agricultural policy, whereas a more detailed analysis is needed. Moreover, orthodox economic theory itself recognizes the legitimacy of public action when the market fails. The OECD has a negative view of social contributions, whereas it is legitimate for public PAYG systems to be funded in this way. The organization believes that income tax hurts long-term growth by discouraging people from working: but this is not what we find in Scandinavia.

Finally, the ranking produced (Table 2) is only partly satisfactory. The OECD warns against lowering certain public spending (health, education, investment, family) and occasionally advocates higher taxes on capital, corporation tax and income tax, and environmental taxes. But at the same time it advocates cutting back on pensions and unemployment

insurance and reducing subsidies.

The OECD seeks to take into account the heterogeneity of national preferences. But it does so in a curious way. It considers that countries where income inequality is high (the United States and United Kingdom) should be more concerned with equity, but that the opposite holds for egalitarian countries (Sweden, Netherlands). But the opposite position could easily be supported. Countries that have highly egalitarian systems want to keep them and continue to take account of equity in any reforms they undertake.

Ultimately, suppose that, like France, all the countries had set up an efficient system for the control of their public finances (the [RGPP](#) then the [MAP](#)). At equilibrium, all expenses and revenues have the same marginal utility. If there is a need to save money, this should involve a reduction in costs and an increase in revenue in the same proportions. Dispensing with this strategy would require a detailed analysis of the utility of the spending and the cost of the revenue, an analysis that the OECD is incapable of providing. The fact that the OECD considers that spending on disability is generally detrimental to growth does not give it the right to advocate a strong reduction in disability spending in Finland, without taking into account the specific features of the Finnish system

Table 2. Short-term (ST) and long-term (LT) impact of fiscal consolidation instruments on growth, equity and the trade balance, according to the OECD

	Growth		Equity		Trade balance	Ranking*
	ST	LT	ST	LT		
Spending (down)						
Education	--	--	-	--	+	17
Health	--	-	-	-	++	15
Other spending	--	+	-		+	9
Pensions		++			++	2
Disability	-	+	--	-	++	11
Unemployment	-	+	-		++	4
Family	-	-	--	--	+	16
Subsidies	-	++	+	+	+	1
Investment	--	--			++	13
Revenue (up)						
Income tax	-	--	+	+	+	5
Social contributions	-	--	-	-		14
Corporation tax	-	--	+	+	++	6
Ecological tax	-	+	-		+	7
Consumer tax	-	-	-		+	12
Property tax	-				+	8
Other property tax	-		++	+	+	3
Sale of goods	-	+	-	-	+	10

* The higher the figure, the less the instrument should be used in fiscal consolidation.

All things considered, the recommendations for France (Table 3) are of little use, whether this is a matter of greatly reducing the level of pensions and unemployment benefits (under the pretext that France is more generous than the average of the OECD countries!) or of reducing subsidies (but why?) or of reducing public consumption (because France needs an army, given its specific role in the world).

Table 3. Fiscal adjustments recommended for France by the OECD (% of GDP)

	Short term	Long term
Pensions	-0.6	-2.2
Subsidies	-0.7	-0.7
Unemployment benefits	-0.7	-0.4
Ecological tax	+0.7	
Corporation tax	+0.5	
Other public consumption	-1.2	-1.1
Total adjustment	4.7	4.7

Overall, the OECD does not provide any simulation of the impact of the recommended measures on growth or equity. It is

of course possible to do worse, but this still winds up in a project that would lead to a sharp decline in growth in the short to medium term and a decrease in spending on social welfare. Even though it claims to take account of the trade balance, it does not argue that countries running a surplus should pursue a stimulus policy in order to offset the depressive impact of the restrictive policies of countries running a deficit.

But the OECD also holds that there are of course miracle structural reforms that would improve the public deficit without any cost to growth or equity, such as reducing public spending without affecting the level of household services by means of efficiency gains in education, health, etc.

What a pity that the OECD is lacking in ambition, and that it does not present a really consistent programme for all the member countries with an objective of growth and full employment (to reduce the unemployment caused by the financial crisis) and of reducing trade imbalances, especially a programme with social objectives (reducing inequality, universal health insurance, and a satisfactory level of social welfare)!

Box: Austerity policy and the public debt

Consider an area where GDP is 100, the public debt is 100, the tax burden is 0.5 and the multiplier is 1.5. Reducing public spending by 1 lowers GDP by 1.5 and public revenue by 0.75; the public balance improves by only 0.25. The debt / GDP ratio rises from 100% to $99.75 / 98.5 = 101.25\%$. It takes 6 years for it to fall below 100%.

[1] Boris Cournède, Antoine Goujard, Alvario Pina and Alain de Serres, *OECD Economic Policy Papers*, July 2013. A more detailed version can be found in: Boris Cournède, Antoine Goujard and Alvario Pina, “How to achieve growth-and-equity fiscal consolidation ?”, *OECD Economics Department Working Paper*, 2013.

[2] Laurence Ball, Davide Furceri, Daniel Leigh, and Prakash Loungani, “The Distributional Effects of Fiscal Consolidation”, IMF WP/13/151, June 2013.

[3] See: OECD, 2012, *Toujours plus d'inégalité* [More and more inequality], March.

[4] Using the multiplier of 1.2 from the OECD Note, 2009, “The Effectiveness and the Scope of Fiscal Stimulus”, March.

The strange forecasts of the European Commission for 2014

By [Mathieu Plane](#)

The figures for French growth for 2014 published by the European Commission (EC) in its last report in May 2013 appear to reflect a relative consensus. Indeed, [the Commission expects GDP to grow by 1.1% in 2014](#), which is relatively close to the forecasts by [the OECD \(1.3%\)](#) and [the IMF \(0.9%\)](#) (Table 1). However, these forecasts of broadly similar growth hide

some substantial differences. First, in defining future fiscal policy, the Commission, unlike the other institutions, considers only the measures already approved. While the Commission's growth forecasts for 2013 included the measures enacted by the Finance Act for 2013 (and therefore the austerity measures), the forecasts for 2014 do not include any forthcoming fiscal measure, even though according to [the stability programme submitted to Brussels in April 2013](#) the government plans austerity measures amounting to 20 billion euros in 2014 (a fiscal impulse of -1 GDP point). The exercise carried out by the Commission for 2014 is thus closer to an economic framework than an actual forecast, as it fails to include the most likely fiscal policy for the year. As a result, the French government has no reason to rely on the Commission's growth forecast for 2014 as it makes radically different assumptions about fiscal policy. But beyond this difference, there is also a problem with the overall coherence of the economic framework set out by the Commission for 2014. It is indeed difficult to understand how for 2014 the Commission can forecast an increase in the unemployment rate with a significantly worsened output gap and a positive fiscal impulse.

Overall, all the institutions share the idea that the output gap in France is currently very wide, lying somewhere between -3.4 percent of GDP (for the EC) and -4.3 percent (for the OECD) in 2013 (Table 1). Everyone thus believes that current GDP is very far from its long-term trajectory, and this deficit in activity should therefore lead, in the absence of an external shock or a constraint on fiscal and monetary policy, to a spontaneous catch-up in growth in the coming years. This should result in a growth rate that is higher than the potential, regardless of the latter's value. So logically, if there is a neutral or positive fiscal stimulus, GDP growth should therefore be much greater than the trend potential. For the IMF, the negative fiscal impulse (-0.2 percent of GDP) is more than offset by the spontaneous catch-up of the economy,

resulting in a slight closing of the output gap (0.2) in 2014. For the OECD, the strongly negative fiscal impulse (-0.7 percent of GDP) does not allow closure of the output gap, which continues to widen (-0.3), but less than the negative impact of the impulse due to the spontaneous process of catching up. In both these cases (OECD and IMF), the restrictive fiscal policy holds back growth but leads to an improvement in the public accounts in 2014 (0.5 percent of GDP for the OECD and 0.3 for the IMF).



As for the Commission, its budget forecasts include a positive fiscal impulse for France in 2014 (+0.4 GDP point). As we saw above, the Commission takes into account only the fiscal measures already approved that affect 2014. However, for 2014, if no new fiscal measures are taken, the tax burden should spontaneously decrease due to the fall between 2013 and 2014 in the yield of certain tax measures or the partial financing of other measures (such as the CICE Tax credit for competitiveness and jobs). This could of course result in a positive fiscal impulse in 2014. But despite this impact, which is similar to a stimulus policy (on a small scale), the closure of the output gap (0.1 percent of GDP) is less than the fiscal impulse. This suggests implicitly that fiscal policy has no effect on activity and especially that there is no spontaneous catch-up possible for the French economy despite the very large output gap. But it is not clear why this is the case. Suddenly, the government balance deteriorates in 2014 (-0.3 percent of GDP) and the unemployment rate rises by 0.3 percentage points (which may seem paradoxical with an output gap that doesn't worsen). The French economy is thus losing on all fronts according to the major macroeconomic indicators.

In view of the potential growth, the output gaps and the fiscal impulses adopted by the Commission (the OECD and the

IMF), and based on incorporating relatively standard assumptions ([a short-term fiscal multiplier equal to 1](#) and spontaneous closure of the output gap in 5 years), one would have expected the Commission to go for growth in France in 2014 of 2.1% (1.7% for the OECD and 1.2% for the IMF), and thus a steep reduction in unemployment.

Paradoxically, we do not find this same logic in the Commission's forecasts for Germany and the euro zone as a whole (Table 2). In the case of Germany, despite a slight deterioration in the output gap in 2013 (-1 GDP point), which would normally point to some spontaneous catch-up by the German economy in 2014, and an almost neutral fiscal impulse (0.1 GDP point), Germany's growth in 2014 is expected to be 1.8%, thus permitting the output gap to close by 0.5 GDP point, resulting in a fall in the unemployment rate and a reduction in Germany's public deficit in 2014.

In the case of the euro zone, we find the same scenario: a marginally positive fiscal impulse (0.2 percent of GDP) and a rapid reduction in the output gap (0.7 percent of GDP), which translates both into an improvement in the public accounts despite the positive fiscal impulse and a fall in the unemployment rate (even if we would have expected a greater reduction in the latter in light of the improvement in the output gap).

Given the potential growth, the output gaps and the fiscal impulses adopted for each country by the Commission, the forecast for 2014 could have been for growth of 2.1% in France, 1.6% in Germany and 1.3% for the euro zone.



Finally, why would France, despite a greater output gap than Germany and the euro zone and a stronger positive fiscal impulse, experience an increase in its unemployment rate in 2014 while the rate falls in the other countries? Should we

interpret this as reflecting that it is a problem or even impossible for the Commission to include in a forecast that a policy without fiscal consolidation could lead to growth and reduce unemployment spontaneously in France?

Revising the multipliers and revising the forecasts – From talk to action?

By Bruno Ducoudré

Following on the heels of the IMF and the European Commission (EC), the OECD has also recently made a downward revision in its forecast for GDP growth in the euro zone in 2012 (-0.4%, against -0.1% in April 2012) and in 2013 (0.1%, against 0.9% in April 2012). In its latest forecasting exercise, the OECD says it now shares with the other international institutions (the IMF [i] and EC [ii]) the idea that the multipliers are currently high in the euro zone [iii]: the simultaneous implementation of fiscal austerity throughout the euro zone while the economy is already in trouble, combined with a European Central Bank that has very little leeway to cut its key interest rate further, is increasing the impact of the ongoing fiscal consolidation on economic activity.

The revision of the positioning of the three institutions poses two questions:

- – What are the main factors leading to the revision of

the growth forecasts? Given the scale of the austerity measures being enacted in the euro zone, we can expect that the revised forecast of the fiscal impulses is a major determinant of the revisions to the growth forecasts. These revisions are, for example, the main factor explaining the [OFCE's revisions to its growth forecasts for France in 2012](#).

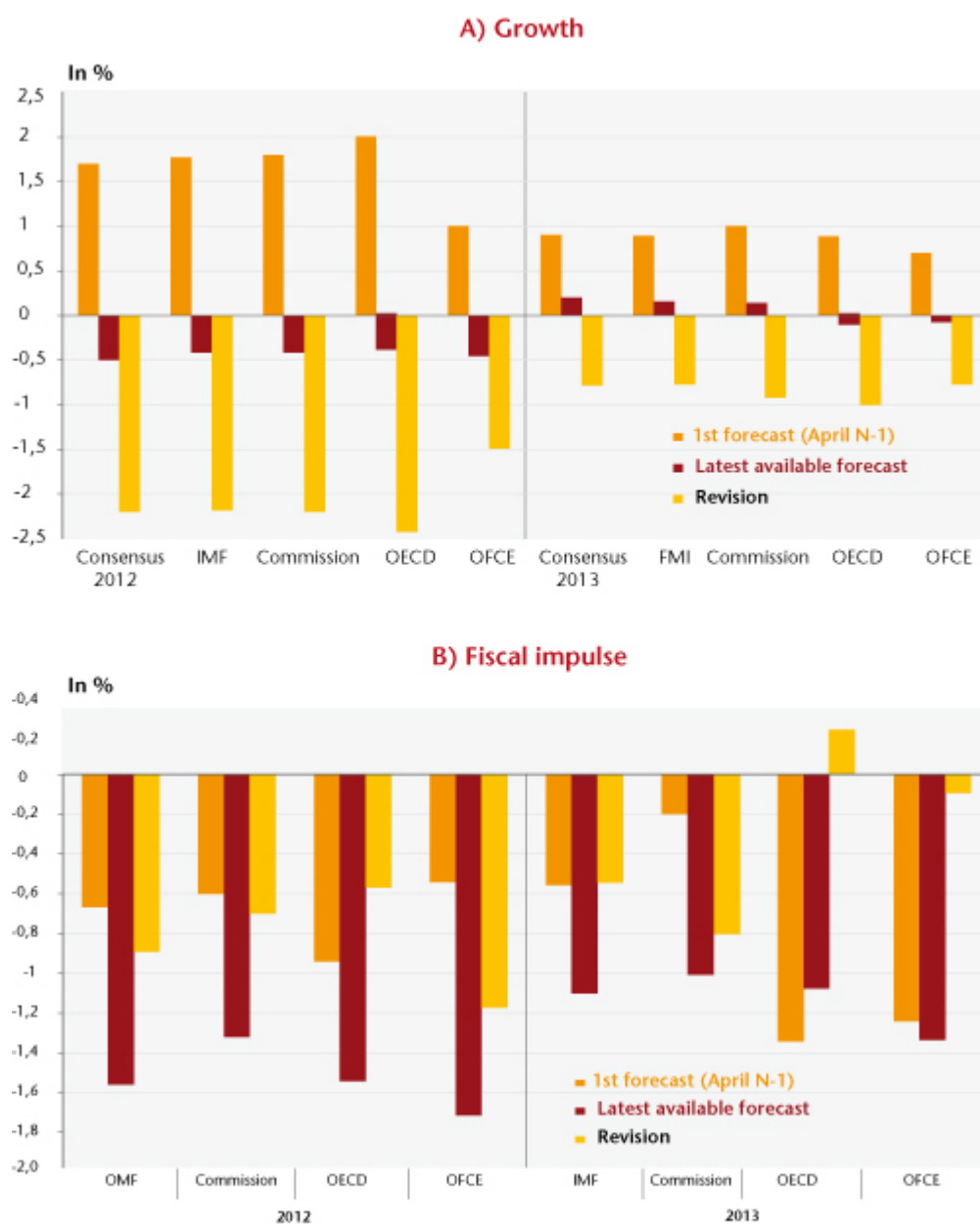
- – Is this change in discourse concretely reflected in an upward revision of the multipliers used in the forecasting exercises? These institutions do not generally specify the size of the multipliers used in their forecasting. An analysis of the revisions to the forecasts for the euro zone in 2012 and 2013 can, however, tell us the extent to which the multipliers have been revised upwards.

The following graph shows that between the forecast made in April of year N-1 for the euro zone and the latest available forecast for year N, the three institutions have revised their forecast sharply downward, by -2.3 points on average in 2012 and -0.9 point on average in 2013.

At the same time, the fiscal impulses have also been revised, from -0.6 GDP point for the OECD to -0.8 GDP point for the IMF for 2012, and by 0.8 point for the Commission to +0.2 point for the OECD in 2013, which explains some of the revisions in growth for these two years.

Comparatively speaking, for 2012 the OFCE is the institute that revised its growth forecast the least, but which changed its forecast for the fiscal impulse the most (-1.7 GDP points forecast in October 2012, against the forecast of -0.5 GDP point in April 2011, a revision of -1.2 points). In contrast, for 2013 the revision in the growth forecast is similar for all the institutions, but the revisions of the impulses are very different. These differences may thus arise in part from the revision of the multipliers.

Figure. Forecasts of growth and of the fiscal impulse for the euro zone*



* For each of the two years, the first forecast is for April N-1. The latest forecast is the one for October / November 2012 (IMF, OFCE, OECD, European Commission) or September 2012 (Consensus Forecast).
 The fiscal impulse is defined as the opposite of the change in the primary balance corrected for any cyclical variation.
 Sources: Consensus Forecast, IMF, European Commission, OECD, OFCE calculations and forecast October 2012.

The revisions of the growth forecasts \check{g} can be broken down into several terms:

- – A revision in the fiscal impulse IB , denoted ΔIB ;
- – A revision in the multiplier k , denoted Δk , k_0 being the initial multiplier and k_1 the revised multiplier;
- – A revision of the spontaneous growth in the euro zone

(excluding the impact of fiscal policy), of fiscal impulses outside the euro zone, etc.: Δe

$$\Delta \tilde{g} = \Delta \tilde{e} + \Delta(k.IB) = \Delta \tilde{e} + \Delta k.IB + k.\Delta IB$$

The revision of the OFCE forecast by -1.5 points for 2012 that took place between April 2011 and October 2012 breaks down as follows: -1.3 points from the revision of the fiscal impulses, and -0.3 point from the upward revision of the multiplier (table). The sum of the effects of the other sources of revision adds 0.1 percentage point growth in 2012 compared with the forecast made in April 2011. In contrast, the revision for 2013 is due mainly to the increase in the size of the multiplier.

As for the international institutions, these elements (size of the multiplier, spontaneous growth, etc.) are not all known to us, except for the fiscal impulses. There are a number of polar cases that can be used to infer an interval for the multipliers used in the forecasting. In addition, if it is mainly revisions of the fiscal impulse and revisions of the size of the multiplier that are the source of the revision of the growth forecasts, as a first approximation it can be assumed that $\Delta e = 0$. We can then calculate the implied multiplier for the case that the entirety of the revision is attributed to the revision of the fiscal impulses, and for the case that the revision is divided between the revision of the multiplier and the revision of the impulse.

Attributing the entirety of the revisions of the forecasts for 2012 to the revision of the impulses would imply very high initial multipliers, on the order of 2.5 for the IMF to 4.3 for the OECD (Table), which is not consistent with the IMF analysis ([which evaluates the current multiplier at between 0.9 and 1.7](#)). On the other hand, the order of magnitude of the inferred multipliers for the IMF (1.4) and the Commission (1.1) for the year 2013 seems closer to the current consensus, if we look at the [current literature on the size of the](#)

[multipliers.](#)

The hypothesis could also be made that in the recent past the Commission, the OECD and the IMF based themselves on multipliers derived from DSGE models, which are generally low, on the order of 0.5 [1]. Adopting this value for the first forecasting exercise (April 2011 for the year 2012 and April 2012 for 2013), we can calculate an implicit multiplier such that the entirety of the revisions breaks down between the revision of the impulse and the revision of the multiplier. This multiplier would then be between 2.8 (OECD) and 3.6 (EC) for the year 2012, and between 1.3 (OECD and IMF) and 2.8 (EC) for 2013.

Table. Breakdown of the revisions in the growth forecasts for the euro zone

Revision of the OFCE forecasts							
		$\Delta \hat{g}$	$\Delta k \cdot IB$	$k \cdot \Delta IB$	$\Delta \hat{e}$	k_0	k_1
2012		-1.5	-0.3	-1.3	0.1	1.1	1.6
2013		-0.8	-0.7	-0.1	0.0	1.1	1.6
The entire revision is attributed to the revision of the impulse							
		$\Delta \hat{g}$	$\Delta k \cdot IB$	$k \cdot \Delta IB$	$\Delta \hat{e}$	k_0	k_1
IMF	2012	-2.2	0.0	-2.2	0.0	2.5	2.5
	2013	-0.7	0.0	-0.8	0.0	1.4	1.4
Commission	2012	-2.2	0.0	-2.2	0.0	3.1	3.1
	2013	-0.9	0.0	-0.9	0.0	1.1	1.1
OECD	2012	-2.4	0.0	-2.4	0.0	4.3	4.3
	2013	-1.0	0.0	-1.0	0.0	-4	-4
The entire revision is attributed to the revision of the multiplier							
		$\Delta \hat{g}$	$\Delta k \cdot IB$	$k \cdot \Delta IB$	$\Delta \hat{e}$	k_0	k_1
IMF	2012	-2.2	-1.7	-0.4	0.0	0.5	3.1
	2013	-0.7	-0.4	-0.3	0.0	0.5	1.3
Commission	2012	-2.2	-1.9	-0.4	0.0	0.5	3.6
	2013	-0.9	-0.5	-0.4	0.0	0.5	2.8
OECD	2012	-2.4	-2.2	-0.3	0.0	0.5	2.8
	2013	-1.0	-1.1	0.1	0.0	0.5	1.3
The final multiplier is valued at 1.3							
		$\Delta \hat{g}$	$\Delta k \cdot IB$	$k \cdot \Delta IB$	$\Delta \hat{e}$	k_0	k_1
IMF	2012	-2.2	-0.5	-0.4	-1.2	0.5	1.3
	2013	-0.7	-0.4	-0.3	0.0	0.5	1.3
Commission	2012	-2.2	-0.5	-0.4	-1.4	0.5	1.3
	2013	-0.9	-0.2	-0.4	-0.3	0.5	1.3
OECD	2012	-2.4	-0.8	-0.3	-1.4	0.5	1.3
	2013	-1.0	-1.1	0.1	0.0	0.5	1.3

Sources : IMF, European Commission, OECD, OFCE 2012 calculations and forecasts.

The revisions of the forecast for 2012 are not primarily drawn from a joint revision of the fiscal impulses and the size of the multipliers. A significant proportion of the revisions for

growth also comes from a downward revision for spontaneous growth. Suppose now that the final multiplier is worth 1.3 (the average across the range estimated by the IMF); the revision of the spontaneous growth in the euro zone then accounts for more than 50% of the revision in the forecast for the euro zone in 2012, which reflects the optimistic bias common to the Commission, the OECD and the IMF. In comparison, the revision of spontaneous growth accounts for less than 10% of the revision in the OFCE forecast for 2012.

On the other hand, the size of the multipliers inferred from the revisions of the forecasts for 2013 appears to accord with the range calculated by the IMF – on the order of 1.1 for the Commission, 1.3 for the OECD and 1.3 to 1.4 for the IMF. The revisions of the growth forecasts for 2013 can therefore be explained mainly by the revision of the fiscal impulses planned and the increase in the multipliers used. In this sense, the controversy over the size of the multipliers is indeed reflected in an increase in the size of the multipliers used in the forecasting of the major international institutions.

[1] See, for example, European Commission (2012): “Report on public finances in EMU”, *European Economy* no. 2012/4. More precisely, the multiplier from the QUEST model of the European Commission is equivalent to 1 the first year for a permanent shock to public investment or civil servant pay, 0.5 for other public expenditure, and less than 0.4 for taxes and transfers.

[i] See, for example, page 41 of the [World Economic Outlook of the IMF](#) from October 2012: “The main finding ... is that the multipliers used in generating growth forecasts have been systematically too low since the start of the Great Recession, by 0.4 to 1.2, depending on the forecast source and the

specifics of the estimation approach. Informal evidence suggests that the multipliers implicitly used to generate these forecasts are about 0.5. So actual multipliers may be higher, in the range of 0.9 to 1.7.”

[\[iii\]](#) See, for example, page 115 of the European Commission’s [Report on Public finances in EMU](#): “In addition, there is a growing understanding that fiscal multipliers are non-linear and become larger in crisis periods because of the increase in aggregate uncertainty about aggregate demand and credit conditions, which therefore cannot be insured by any economic agent, of the presence of slack in the economy, of the larger share of consumers that are liquidity constrained, and of the more accommodative stance of monetary policy. Recent empirical works on US, Italy, Germany and France confirm this finding. It is thus reasonable to assume that in the present juncture, with most of the developed economies undergoing consolidations, and in the presence of tensions in the financial markets and high uncertainty, the multipliers for composition-balanced permanent consolidations are higher than normal.”

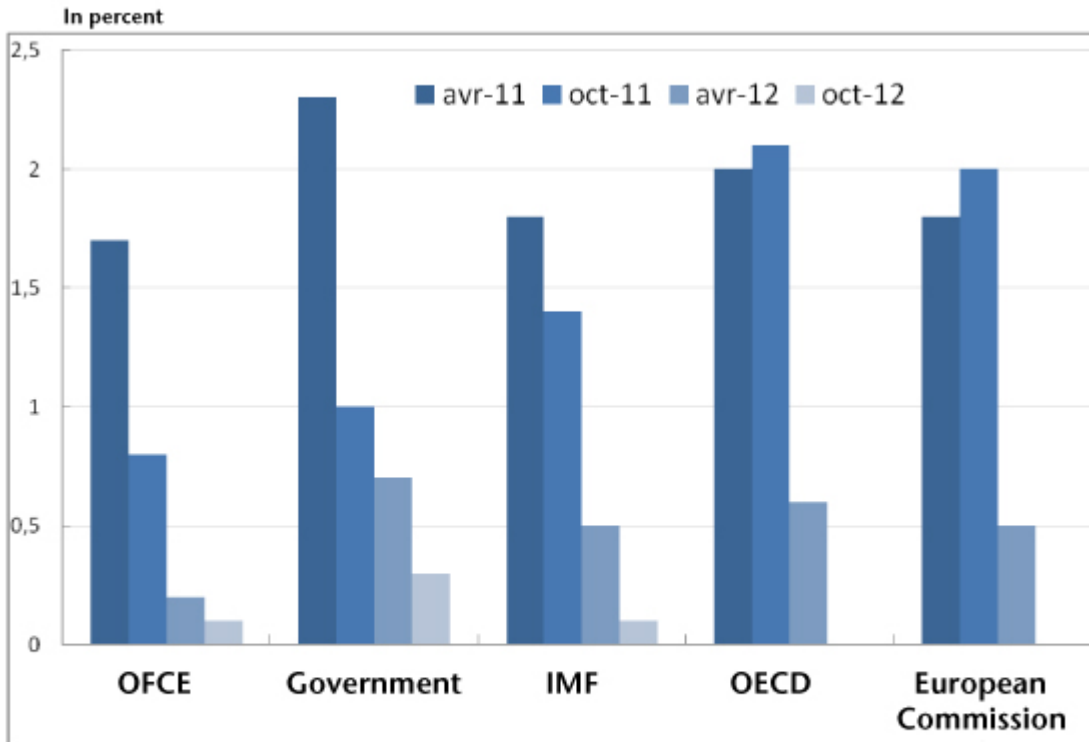
[\[iii\]](#) See, for example, page 20 of the [OECD Economic Outlook](#) from November 2012: “The size of the drag reflects the spillovers that arise from simultaneous consolidation in many countries, especially in the euro area, increasing standard fiscal multipliers by around a third according to model simulations, and the limited scope for monetary policy to react, possibly increasing the multipliers by an additional one-third.”

Why has French growth been revised downwards?

By Bruno Ducoudré and [Eric Heyer](#)

In its [October 2012 forecasts](#), the OFCE has revised its growth forecast for 2012 and 2013. The major international institutions, the OECD, the IMF and the European Commission, also regularly review their growth forecasts to incorporate newly available information. An analysis of these revised forecasts is particularly interesting in that it shows that these institutions use low fiscal multipliers in developing their forecasts. In other words, the recessionary impact of fiscal policy has been underestimated by the OECD, the IMF and the European Commission, leading to substantial revisions of their growth forecasts, as is evidenced by the dramatic shifts by the [IMF](#) and the [European Commission](#) in the size of the multipliers.

Graphique 1. Révisions of growth in French GDP for 2012



Note : Growth in 2012 is reviewed four times each year by each institution. The first revision took place in April 2011, the second in October 2011, the third in April 2012 and the final one in October 2012. The OECD has not yet published its latest revisions.

Sources : IMF, European Commission, OECD, OFCE October 2012 calculations and forecasts.

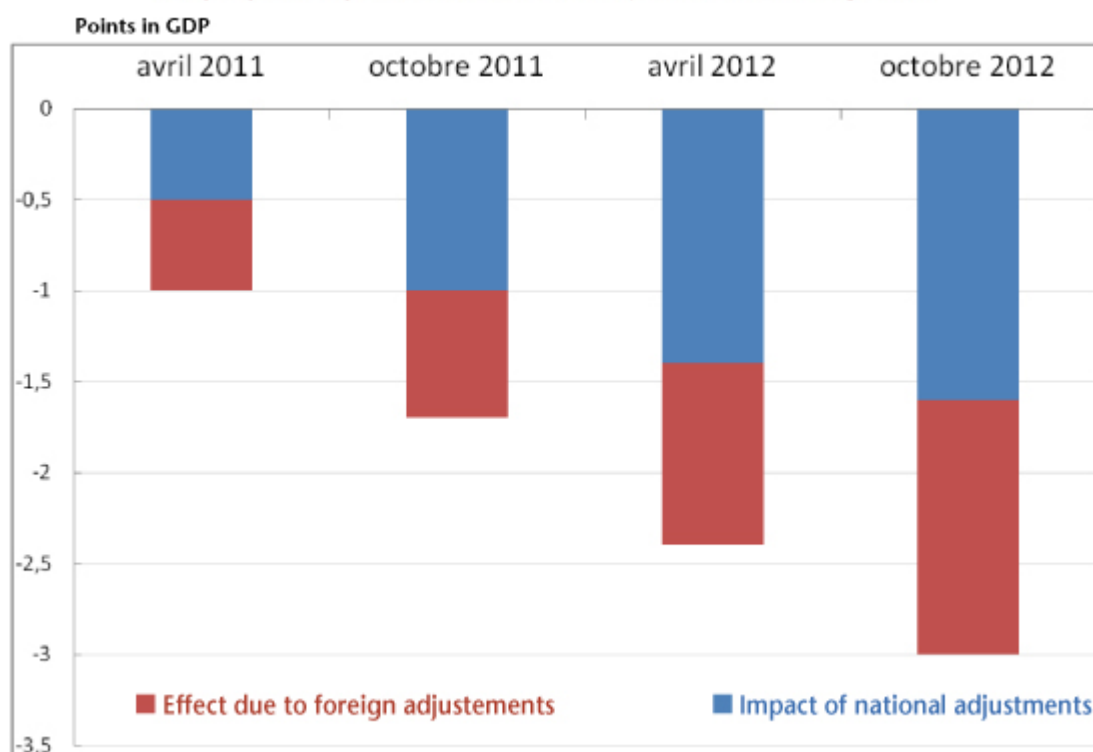
Figure 1 shows that between the forecast made in April 2011 and the latest available forecast, the government, like all the other institutions, revised its growth forecast for France sharply downwards.

The austerity policies have also been strengthened at the same time, particularly in the euro zone. The European countries undertook their stability program in order to return to balanced public finances within three years. In contrast to the years before the crisis, the implementation of these commitments is now considered a necessary or even sufficient condition for pulling out of the crisis. Moreover, in a context of financial uncertainty, being the only State not to meet its commitment to fiscal consolidation would be punished immediately by the markets (higher sovereign rates, a downgraded rating, a fine from the European Commission, implicit contagion of sovereign defaults). But in trying to reduce their deficits abruptly and synchronously, Europe's governments are inducing new slowdowns in activity.

A vicious circle has been created: with each downward revision in their forecasts for 2012 growth, Europe's governments implement new austerity measures to meet their deficit commitments. This has happened in France, but especially in Italy, which has virtually tripled its fiscal effort, and in Spain, which is now engaged in the greatest austerity effort of any major European country.

According to our estimates for the French economy (that is to say, using a multiplier of 1), the series of fiscal savings plans adopted at the national level have led to revising growth downwards by -1.1 points between April 2011 and October 2012 (from an impact of -0.5 GDP point to -1.6 points). Since these same policies are in force in our trading partners, this has led to revising growth for this same period by 0.9 point due to foreign trade (from -0.5 GDP point to -1.4 point) (Figure 2).

Graphique 2. Impact of the latest fiscal adjustments on 2012 growth



Source : OFCE October 2012 calculations and forecasts.

For the year 2012, the OFCE's revisions for the French economy can be explained in full simply by the escalation in the fiscal savings measures announced over the last 12 months,

i.e. the national plans and those applied by our partner countries (Table 1).

Tableau 1. Determinants of the revisions to the OFCE forecast for France for 2012

	April 2011	October 2012	Revision
GDP growth	1,7	0,1	-1,6
(a) - Austerity measures (in GDP pt)	-0,6	-1,60	-1,0
(b) – Value of the fiscal multiplier	0,95	0,95	0,0
Impact of austerity plans in France (a + b)	-0,5	-1,6	-1,1
Impact of the austerity measures of France's partners	-0,5	-1,4	-0,9
Other adjustment factors			0,4

Source : OFCE calculations.

Leaving aside this escalation of austerity, our diagnosis of the French economy has changed very little over the last 18 months: without it, we would have even revised our growth forecast slightly upwards (0.4%).