The imperative of sustainability economic, social, environmental

OFCE[1], ECLM[2], IMK[3], AKW[4]

It was during the climax of the so-called Eurozone sovereign debt crisis that we engaged into the independent Annual Growth Survey – the project was first discussed at the end of the year 2011 and the first report was published in November 2011. Our aim, in collaboration with the S&D group at the European Parliament, has been to challenge and question the European Commission contribution to the European Semester, and to push it toward a more realistic macroeconomic policy, that is to say less focused on the short term reduction of public debt and more aware of the social consequences of the crisis and the austerity bias. For 7 years, we argued against a brutal austerity failing to deliver public debt control, we warned against the catastrophic risk of deflation. We also alerted on the social consequences of the deadly combination of economic crisis, increased labor market flexibility and austerity on inequalities, especially at the lower part of the income distribution. We cannot claim to have changed alone the policies of the Union, but we acknowledge some influence, although insufficient and too late to prevent the scars let by the crisis.

Today, there is a need to take this initiative a major step forward. The adoption of the UNSDGs calls for a new approach to economic governance and to economic growth. The measurement of economic performance needs to evolve into the measurement of well-being on all three accounts of sustainable development – economic, social and environmental. A broad range of policies have to be mobilized coherently to this effect, which must move fiscal policy from a dominant to an enabling and supportive role. Moreover, those policies need to be anchored on a consistent and inclusive long-term strategy, and should be monitored closely to check that they deliver sustainability.

So far, the EU has not properly embraced this agenda, and the still prevailing European Semester process is an inadequate process to lead the EU towards achieving the UNSDGs. In the same way as the iAGS challenged the dominant orthodoxy in the macroeconomic field, the iASES 2019 – independent Annual Sustainable Economy Survey, the new name of the iAGS – is our contribution to support a strategy towards sustainability and show the way.

The iASES 2019 scrutinizes the general outlook of the EU economy. The coming slowdown largely results from the gradual attenuation of the post-Great Recession recovery momentum and the convergence of growth rates towards a lower potential growth path. The slowdown of growth coincides with a revival of political turmoil – *Brexit*, Italy's public finances, the trade war and turbulences in some emerging countries. The upturn will come to an end at some point, and the euro area is not yet prepared for that, as imbalances persist and the institutional framework remains incomplete[5]. The euro area has moved into a large trade surplus, which may not be sustainable. Nominal convergence remains an important issue that should be addressed by political willingness to coordinate wage development more actively, beginning with surplus countries. Moreover, the incomplete adoption of a Banking Union may be insufficient to ensure banking stability in case of adverse shocks. The ECB could have to come to the rescue with extended unconventional policies, complemented with automatic stabilisation measures working across borders within EMU.

The social situation has slightly improved in the EU since the worse of the crisis and, on average, the unemployment rates across European countries are back at their pre-crisis levels.

However, differences across countries and sections of the population are still huge. Policy makers need to be aware of possible trade-offs and synergies between economic, social and environmental goals in general and the Sustainable Development Goals (SDGs) in particular[6]. In line with the SDGs and intended goals of the European Pillar of Social rights iASES aims at promoting policies – expanding social investments, pro-active industrial policies, reducing working time, increasing collective bargaining to limit primary formation of inequalities – that address these goals and overcome the direct and indirect negative consequences of unemployment.

Climate change is arguably the most serious challenge that we collectively face. Computing carbon budgets can be useful to warn policy-makers about the effort to be delivered in order to put society on the road to environmental sustainability. The iASES evaluates the "climate debt" which is the amount of money that will have to be invested or paid by countries for them not to exceed their carbon budget, leading to three key policy insights. There are few years left for major European countries before exhausting their carbon budget under the +2°C target. Consequently, the carbon debt should be considered as one of the major issues of the decades to come since in the baseline scenario it represents about 50% of the EU GDP to stay below +2°C[7]. Framing the climate question in the words of debt is deliberate as the concept of excessive deficit applies today totally to the procrastination we demonstrate there.

[1] Directed by Xavier Timbeau with Guillaume Allègre, Christophe Blot, Jérôme Creel, Magali Dauvin, Bruno Ducoudré, Adeline Gueret, Lorenzo Kaaks, Paul Malliet, Hélène Périvier, Raul Sampognaro, Aurélien Saussay, Xavier Timbeau.

[2] Jon Nielsen, Andreas Gorud Christiansen.

[3] Peter Hohlfeld, Andrew Watt.

[4] Michael Ertl, Georg Feigl, Pia Kranawetter, Markus Marterbauer, Sepp Zuckerstätter.

[5] See « Some Challenges Ahead for the EU », *OFCE Policy Brief*, n°49, February 5,2019.

[6] See « Social Sustainability: From SDGs to Policies », *OFCE Policy Brief*, n° 50, February 5, 2019.

[7] See "An explorative evaluation of climate debt", *OFCE Policy Brief*, n° 45, December 11, 2018.

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:

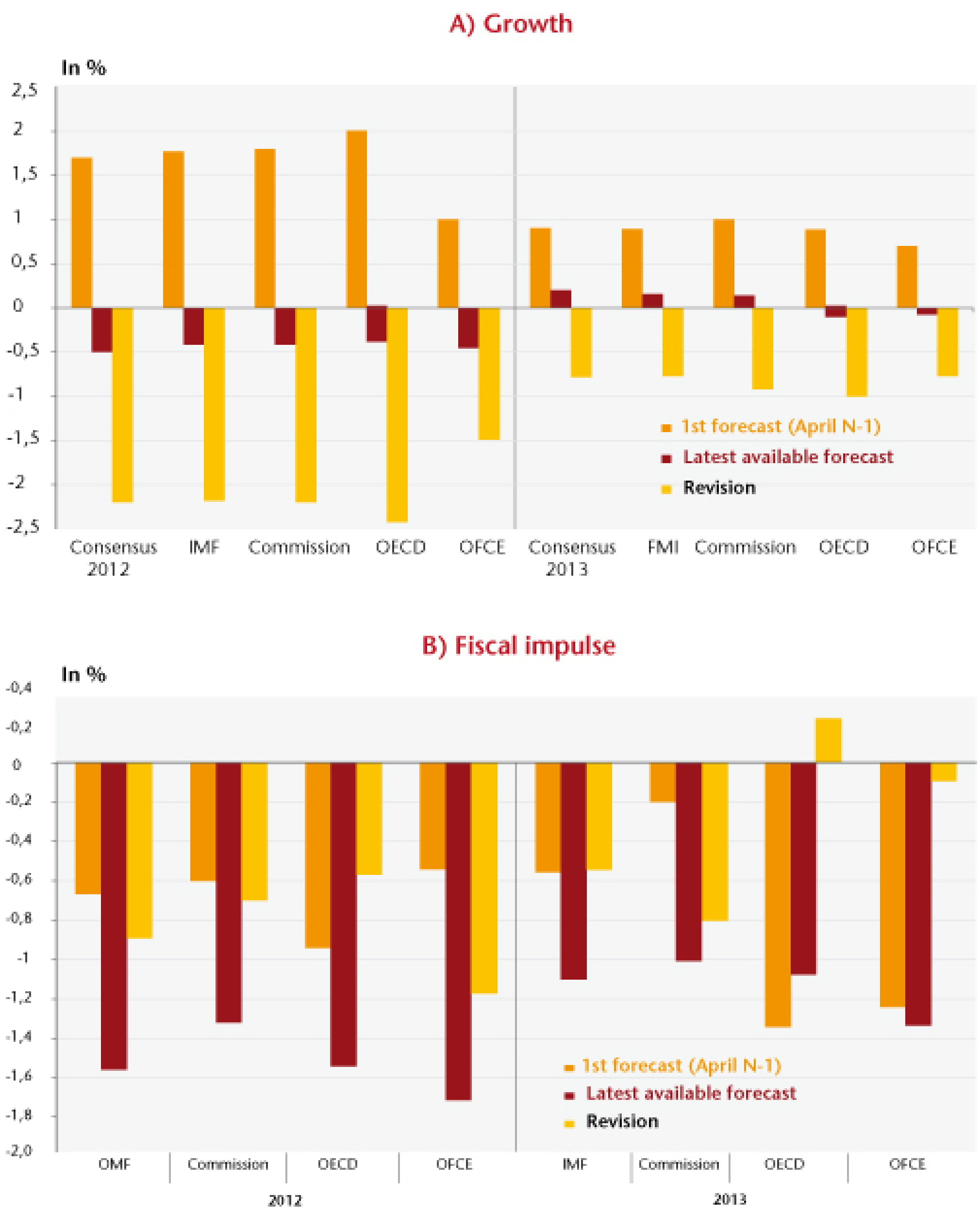
- – What are the main factors leading to the revision of the growth forecasts? Given the scale of the austerity measures being enacted in the euro zone, we can expect that the revised forecast of the fiscal impulses is a major determinant of the revisions to the growth forecasts. These revisions are, 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 *ğ* 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*

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

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 Δe = 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							
		$\Delta\tilde{g}$	$\Delta k.IB$	$k.\Delta IB$	$\Delta\tilde{e}$	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							
		$\Delta\tilde{g}$	$\Delta k.IB$	$k.\Delta IB$	$\Delta\tilde{e}$	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							
		$\Delta\tilde{g}$	$\Delta k.IB$	$k.\Delta IB$	$\Delta\tilde{e}$	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							
		$\Delta\tilde{g}$	$\Delta k.IB$	$k.\Delta IB$	$\Delta\tilde{e}$	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.

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[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.

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[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."

[ii] 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."

iAGS, independent Annual Growth Survey 2013

by OFCE (Paris), ECLM (Copenhagen) and IMK (Düsseldorf)

The independent Annual Growth Survey (iAGS) brings together a group of internationally competitive economists from three European economic institutes to provide an independent alternative to the Annual Growth Survey (AGS) published by the European Commission. iAGS 2013 focuses on the Eurozone economic outlook and on the sustainability of public finances until 2032. This first report advocates delaying and spreading fiscal consolidation in due respect of current EU fiscal rules.

Four years after the start of the Great Recession, the euro area remains in crisis. GDP and GDP per head are below their pre-crisis level. The unemployment rate has reached a historical record level of 11.6 % of the labour force in September 2012, the most dramatic reflection of the long lasting social despair that the Great Recession produced. The sustainability of public debt is a major concern for national governments, the European Commission and financial markets, but successive and large consolidation programmes have proven unsuccessful in tackling this issue. Up to now, asserting that austerity was the only possible strategy to get out of this dead end has been the cornerstone of policymakers' message to European citizens. But this assertion is based on a fallacious diagnosis according to which the crisis stems from the fiscal profligacy of members states. For the Euro area as a whole, fiscal policy is not the origin of the problem. Higher deficits and debts were a necessary reaction by governments facing the worst recession since WWII. The fiscal response was successful in two respects: it stopped the recession process and dampened the financial crisis. As a consequence, it led to a sharp rise in the public debt of all Euro area countries.

During normal times, sustainability of public debt is a long-term issue whereas unemployment and growth are short-term ones. Yet, fearing an alleged imminent surge in interest rates and constrained by the Stability and Growth Pact, though transition towards more normal times had not been completed, member states and the European Commission reversed priorities. This choice partly reflects well-known pitfalls in the institutional framework of EMU. But it is equally reflecting a dogmatic view in which fiscal policy is incapable of demand management and the scope of public administrations has to be fettered and limited. This ideology has led member states to implement massive fiscal austerity during bad times.

As it is clear now, this strategy is deeply flawed. Eurozone countries and especially Southern European countries have undertaken ill-designed and precipitous consolidation. The austerity measures have reached a dimension that was never observed in the history of fiscal policy. The cumulative change in the fiscal stance for Greece from 2010 to 2012 amounts to 18 points of GDP. For Portugal, Spain and Italy, it has reached respectively 7.5, 6.5 and 4.8 points of GDP. The consolidation has rapidly become synchronized leading to negative spillovers over the whole euro area, amplifying its first-round effects. The reduction in economic growth in turn makes sustainability of public debt ever less likely. Thus austerity has been clearly self-defeating as the path of reduction of public deficits has been by far disappointing regarding the initial targets defined by member states and the Commission.

Since spring 2011 unemployment within the EU-27 and the Euro zone has begun to increase rapidly and in the past year alone unemployment has increased by 2 million people. Youth unemployment has also increased dramatically during the crisis. In the second quarter of 2012 9.2 million young people in the age of 15-29 years were unemployed, which corresponds to 17.7 percent of the 15-29 years old in the workforce and accounts for 36.7 percent of all unemployed in the EU-27. Youth unemployment has increased more dramatically than the overall unemployment rate within the EU. The same tendencies are seen for the low skilled workers. From past experience it is well known that once unemployment has risen to a high level it has a tendency to remain high the years after. This is known as persistence. Along with the rise in unemployment the first symptoms that unemployment will remain high in the coming years are already visible. In the second quarter of 2012 almost 11 million people in EU had been unemployed for a year or longer. Within the last year long term unemployment has increased with 1.4 million people in the EU-27 and with 1.2 million people within the Euro area.

As a result of long term unemployment the effective size of the workforce is diminished which in the end can lead to a higher structural level in unemployment. This will make more difficult to generate growth and healthy public finances within the EU in the medium term. Besides the effect of long term unemployment on potential growth and public finances one should also add that long term unemployment may cause increased poverty because sooner than expected unemployment benefits will stop. Thus long term unemployment may also become a deep social issue for the European society. Given our forecast for unemployment in EU and the Euro area, we estimate that long term unemployment can reach 12 million in EU and 9 million in the Euro area at the end of 2013.

What is striking is that consequences of ill-designed consolidation could and should have been expected. Instead, they have been largely underestimated. Growing theoretical and empirical evidence according to which the size of multipliers is magnified in a fragile situation has been overlooked. Concretely, whereas in normal times, that is when the output gap is close to zero, a reduction of one point of GDP of the structural deficit reduces activity by a range of 0.5 to 1% (this is the fiscal multiplier), this effect exceeds 1.5% in bad times and may even reach 2% when the economic climate is strongly deteriorated. All the features (recession, monetary policy at the zero bound, no offsetting devaluation, austerity amongst key trading partners) known to generate higher-than-normal multipliers were in place in the euro area.

The recovery that had been observed from the end of 2009 was brought to a halt. The Euro area entered a new recession in the third quarter of 2011 and the situation is not expected to improve: GDP is forecast to decrease by 0.4 % in 2012 and again by 0.3 % in 2013. Italy, Spain, Portugal and Greece seem to sink in an endless depression. The unemployment soared to a record level in the Eurozone and especially in Spain, Greece, Portugal and Ireland. Confidence of households, non financial companies and financial markets has collapsed again. Interest rates have not receded and governments of Southern countries still face unsustainable risk premium on their interest rate, despite some policy initiatives, while Germany, Austria or France benefit from historically low interest rates.

Rather than focus on public deficits the underlying cause of the crisis needs to be addressed. The euro area suffered primarily from a balance of payments crisis due to the build-up of current account imbalances between its members. When the financial flows needed to finance these imbalances dried up the crisis took hold in the form of a liquidity crisis. Attempts should have been made to adjust nominal wages and prices in a balanced way, with minimal harm to demand, output and employment. Instead salvation was sought in across-the-board austerity, forcing down demand, wages and prices by driving up unemployment.

Even if some fiscal consolidation was almost certainly a necessary part of a rebalancing strategy to curb past excesses in some countries, it was vital that those countries with large surpluses, especially Germany, took symmetrical action to stimulate demand and ensure faster growth of nominal wages and prices. Instead the adjustment burden was thrust on the deficit countries. Some progress has been made in addressing competitive imbalances, but the cost has been huge. Failure to ensure a balanced response from surplus countries is also increasing the overall trade surplus of the euro area. This is unlikely to be a sustainable solution as it shifts the adjustment on to non-euro countries and will provoke counteractions.

There is a pressing need for a public debate on such vital issues. Policymakers have largely ignored dissenting voices, even as they have grown louder. The decisions on the present macroeconomic strategy for the Euro area should not be seized exclusively by the European Commission at this very moment, for the new EU fiscal framework leaves Euro area countries some leeway. Firstly, countries may invoke exceptional circumstances as they face "*an unusual event outside the control of the (MS) which has a major impact on the financial position of the general government or periods of severe economic downturn as set out in the revised SGP (…)".* Secondly, the path of consolidation may be eased for countries with excessive deficits, since it is stated that "*in its recommendation, the Council shall request that the MS achieves annual budgetary targets which, on the basis of the forecast underpinning the recommendation, are consistent with a minimum annual improvement of at least 0.5 % of GDP as a benchmark, in its cyclically adjusted balance net of one-off and temporary measures, in order to ensure the correction of the excessive deficit within the deadline set in the recommendation*". This is of course a minimum, but it would also be seen as a sufficient condition to bring back the deficit to Gdp ratio towards 3 % and the debt ratio towards 60 %.

A four-fold alternative strategy is thus necessary:

First, delaying and spreading the fiscal consolidation in due respect of current EU fiscal rules. Instead of austerity measures of nearly 100 billion euros for the whole euro area, a more balanced fiscal consolidation of 0.5 point of GDP, in accordance with treaties and fiscal compact, would give for the sole 2013 year a concrete margin for manoeuvre of more than 60 billion euros. This amount would substantially contrast with the vows of the June and October 2012 European Councils to devote (still unbudgeted) 120 billion euros until 2020 within the Employment and Growth Pact. By delaying and capping the path of consolidation, the average growth for the Eurozone between 2013 and 2017 may be improved by 0.7 point per year.

Second, it involves that the ECB fully acts as a lender of last resort for the Euro area countries in order to relieve MS from the panic pressure stemming from financial markets. For panic to cease, EU must have a credible plan made clear to its creditors.

Third, significantly increasing lending by the European Investment Bank as well as other measures (notably the use of structural funds and project bonds), so as to meaningfully advance the European Union growth agenda. Vows reported above have to be transformed into concrete investments.

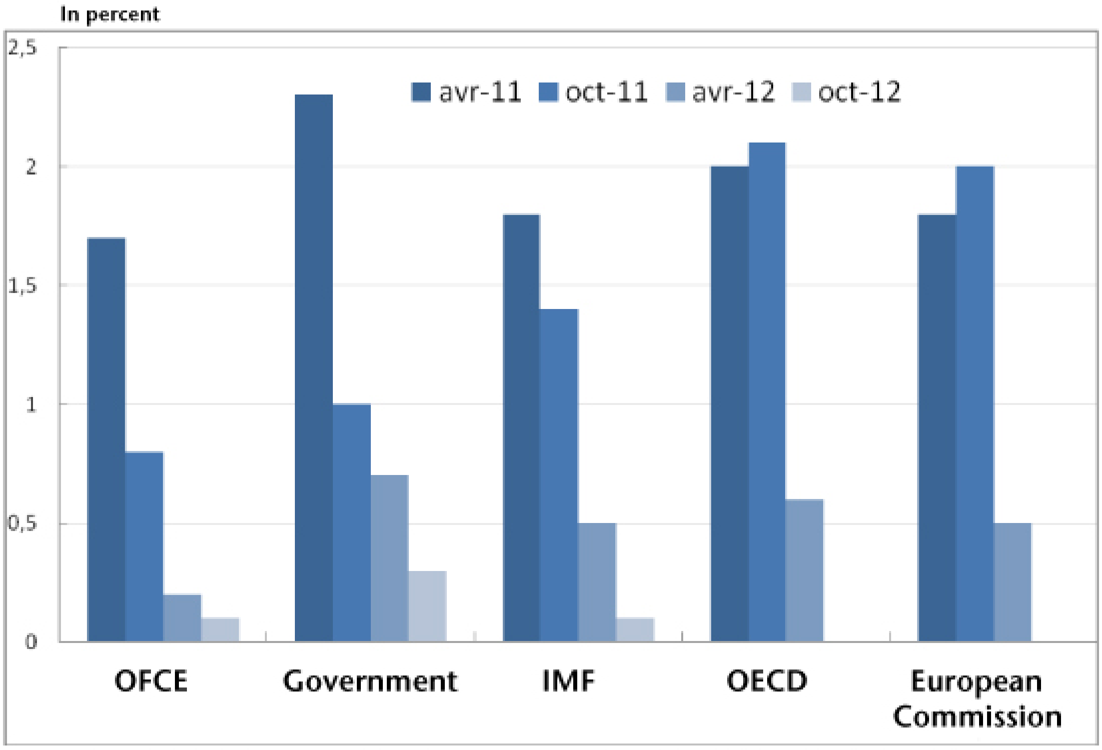
Fourth, a close coordination of economic policies should aim at reducing current accounts imbalances. The adjustment should not only rely on deficit countries. Germany and the Netherlands should also take measures to reduce their surpluses.

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 fthe final on in October 2012. The OECD has not yet published its latest revisions.

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

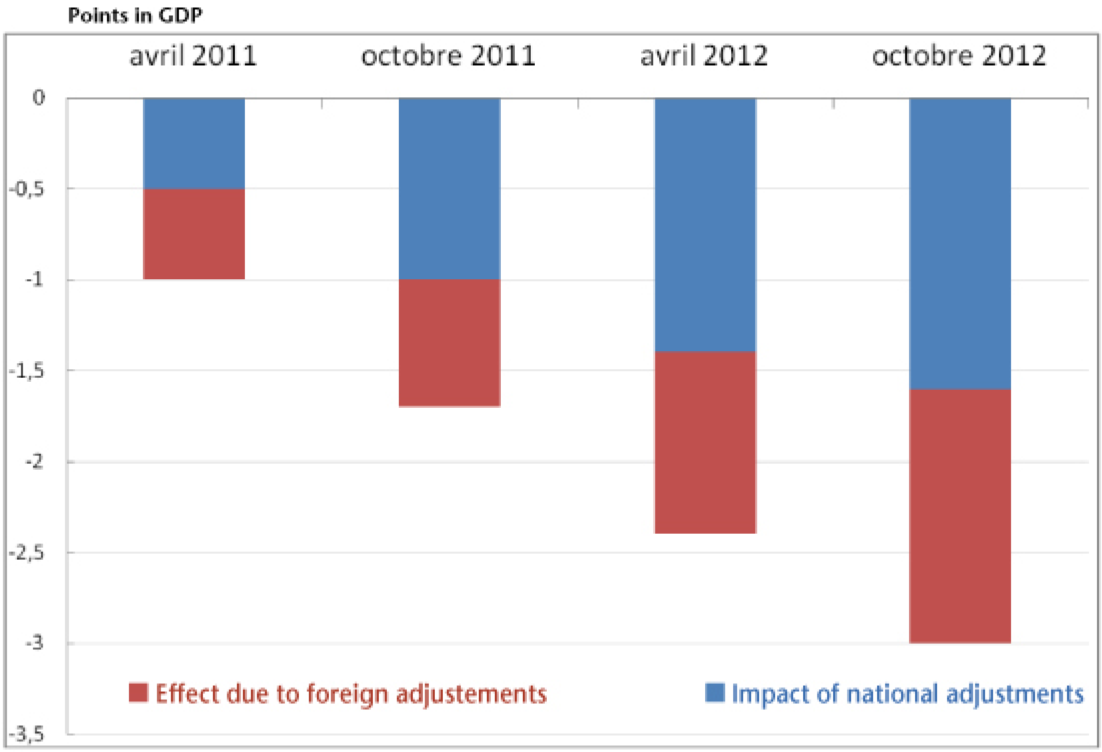
Figure 1 shows that between the forecast made in April 2011 and the latest available forecast, the government, like all the other institutions, revised its growth forecast for France sharply downwards.

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%).