

# America's fiscal headache

By Christine Rifflart

Before next December 13<sup>th</sup>, the Budget Conference Committee must present the results of the discussions begun following the shutdown and debt crisis in October 2013. The objective of the negotiations is to enable Congress to approve the 2014 Budget, for which the fiscal year began on October 1 [\[1\]](#), and find an alternative to the automatic cuts in federal spending that are to take effect on 1 January 2014. An agreement does not seem out of reach. Even if sharp opposition between Republicans and Democrats remains, reason should prevail and the risk of a new budget crisis seems excluded. At worst a new Continuing Resolution [\[2\]](#) will be passed that allows institutions to continue to function and the arbitrary nature of automatic budget cuts in structural expenditure to guide government policy. At best, the negotiations will lead to reasoned cuts in expenditure, and even to increases in some revenues that will then curb the violence of the adjustment, a violence that is amplified by the ending of the exceptional measures to support income and activity that were enacted at the heart of the crisis.

There is little room for negotiation. In fiscal year 2013, the deficit for the entire public sector reached 7% of GDP (after 12.8% in fiscal year 2009), and the federal deficit came to 4.1% of GDP (after 9.8%). The federal debt currently comes to 72.7% of GDP, and is rising. Moreover, growth remains weak: 2.2% at an annual average since the 2010 recovery, with 1.8% expected in 2013, which in particular is insufficient to revitalize the job market. How then is it possible to come up with a budget policy to support growth in a context of fiscal austerity and deficit reduction while complying with the commitments previously made by Congress [\[3\]](#), in particular the Budget Control Act of 2011? Following the crisis concerning

the federal debt ceiling in July 2011, on 2 August 2011 President Obama signed the Budget Control Act of 2011, which conditioned any increase in the federal debt ceiling on a massive reduction in government spending over 10 years. In addition to the introduction of caps on discretionary spending [\[4\]](#), 1200 billion dollars in automatic cuts (sequestrations) in expenditures were planned for the period 2013 to 2021 based on a principle of parity between defense and non-defense budgets. A number of social programs (pension insurance, Medicaid, income guarantees, etc.) were exempted, while cuts to the Medicare program for the elderly were limited to 2%. In total, the cuts will apply to a little less than half of federal spending and will represent 109 billion per year in savings on the deficit, *i.e.* 0.6% of GDP.

For the 2014 fiscal year, according to the CBO the combination of these two measures (capped discretionary spending and automatic cuts in unprotected budgets) as well as the renewal of the amount of credits from 2013 to 2014 (*i.e.* a constant nominal budget) will lead to cuts in discretionary spending of 20 billion dollars that will have to be borne entirely by the Pentagon. On this basis, if the cuts are maintained, discretionary spending in the defense and non-defense budgets will have declined by 17% and 17.8%, respectively, in real terms between 2010 and 2014.

But in addition to these brutal cuts, other programs, in particular those primarily intended for low-income households, will experience a reduction in their budget in 2014 because of the expiration of the exceptional measures they previously enjoyed. Thus, the program to extend unemployment benefits created on 30 June 2008 for unemployed people who had exhausted their rights (Emergency Unemployment Compensation) ends on 1 January 2014. In the absence of other plans, this will hit 4 million people.

This is also the case of the Supplemental Nutrition Assistance Program (SNAP), which had benefited under the American

Recovery and Reinvestment Act of 2009 from additional funding that elapsed on 1 November. Yet 47.7 million beneficiaries (15% of the population) received food stamps this year. According to the CBPP, the 7% cut in the program's funds should result in a decrease of 4 million in the number of beneficiaries.

Another example: the housing benefits for the 2.1 million families who cannot find decent housing will also be affected by the termination of the budget extensions introduced in 2009 and the automatic cuts. If the budget is not renewed, from 125,000 to 185,000 of the families receiving benefits at end 2012 will no longer receive aid at end 2014.

According to the information currently available, a minimum agreement on the Budget Conference Committee seems to be emerging. The cuts in the defense budget could be approved [\[5\]](#), while eventual increases in public utility charges would be used to fund budget extensions for some social programs and lighten the impact of the automatic cuts. Last April, President Obama presented his Draft 2014 Budget to Congress. At that time he proposed to remove the procedures for automatic cuts, to reduce the debt in the long term through an extensive fiscal reform, and in the shorter term to defer a portion of the 2014 budget cuts to fiscal years 2015 and 2016 in order to boost growth. The agreement, which is likely to be presented to Congress by 13 December, will undoubtedly not be this ambitious. Faced with Republican (the majority in the House of Representatives) partisans of additional savings, the Democrats (the majority in the Senate) will find it difficult to defend an increase in public spending in 2014 and to adopt a fiscal policy that is less harmful to growth this year than it was in 2013.

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[1] After not having been adopted by Congress, the 2014 budget has been financed since 16 October by a Continuing Resolution (see note 2) on the basis of the 2013 budget amounts. The Resolution is retroactive from the 1st day of the 2014 fiscal year, *i.e.* 1 October 2013, until 15 January 2014.

[2] A Continuing Resolution is a temporary resolution passed by Congress that is used to extend the appropriations made the previous fiscal year to the current fiscal year, while waiting for new measures to be approved.

[3] According to the [CBPP](#), if all the deficit reduction measures adopted since 2010 in the 2011 Budget, the Budget Control Act of 2011 and the American Taxpayer Relief Act of 2012 are taken into account, the cumulative impact on the deficit would be 4000 billion over the period 2014-2023, *i.e.* the equivalent of 24% of 2013 GDP.

[4] Discretionary spending (33% of federal spending) is spending for which the budgets are voted on an annual basis, unlike mandatory spending (61%), which is based on programs covered by prior law. The spending side of the government's fiscal policy rests mainly on changes in discretionary spending, which are structural expenditure.

[5] Expenditure related to defense had already fallen by 13.1% in real terms between Q3 2010 and Q3 2013.

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# Could France have a different fiscal policy?

By [Jérôme Creel](#)

Shouldn't the economic crisis that is gripping the euro zone, including France, lead to calling into question the approach being taken by fiscal policy? In light of the unprecedented [broad consensus](#) among economists about the impact of fiscal policy on the real economy, it is clear that the austerity measures being adopted by France are a mistake. Moreover, invoking European constraints is not a good enough argument to exclude a much more gradual process of putting the public purse in order (also see the [iAGS project](#)).

There is no need to go beyond what European legislation requires, and doing so can be especially harmful if in fact the additional budgetary efforts generate less growth and, ultimately, further deterioration in the public finances due to higher social spending and lower tax revenue. What do the existing European treaties actually demand? In the case of a government deficit that exceeds 3% of GDP, the minimum effort required for fiscal adjustment consists of reducing the cyclically adjusted deficit, *i.e.* the structural deficit, by at least 0.5% of GDP per year. Furthermore, the time period for reducing the debt to 60% of GDP is 20 years. Finally, exceptional circumstances now include an "unusual event" that could justify deviating from the current standards for the deficit.

Based on these exceptional circumstances and on the rule requiring an annual improvement of at least 0.5% of GDP in the structural deficit, it can be shown that the French government has fiscal maneuvering room in 2012 and 2013, while still complying with European fiscal rules.

Table 1 lists the sequence of public deficits and of GDP growth from 2011 to 2013 according to two forecasts produced by the European Commission in the Spring and then the Autumn of 2012. According to the Spring forecast, the French structural deficit was supposed to decrease by 1.2% of GDP between 2011 and 2013, on average slightly above what is required by the Commission. In fact, the improvement from 2011 to 2012 exceeded 0.5% of GDP, while it fell below that from 2012 to 2013.

What about the Autumn 2012 forecast? The expected improvement in France's structural deficit was now expected to be 1.1% of GDP between 2011 and 2012 and then 1.4% of GDP between 2012 and 2013, taking into account [the government's commitment to reduce public spending and raise taxes](#). These projected improvements in the structural deficit are two and three times greater than what European fiscal rules require, which is a lot! For the year 2013, this amounts to almost 20 billion euros that need not be levied on French households and businesses. Abandoning this levy does not mean abandoning fiscal austerity, but rather *spreading it out over time*.

Furthermore, the European Commission now expects a slowdown in the French economy in 2013. Unless one argues that the French government is responsible for this slowdown – and while this might indeed be the case in light of the austerity budget the government is imposing on the French economy, it is far from clear that the European Commission would want to employ such an argument, given its role in championing austerity! – this deterioration in the country's growth prospects could fall within the category of an "unusual event," thus giving France an opening to invoke exceptional circumstances in order to *stagger and extend* its fiscal adjustment efforts.

Instead of awaiting the miraculous effects of structural reform – a potentially lengthy and uncertain process – all that is really needed is to apply the regulations in force,

without imposing an overly restrictive reading of what they contain, so as to limit the reduction in growth being caused by austerity and avoid a new period of rising unemployment. According to the conclusions of the [iAGS report](#), staggering the fiscal austerity measures in France would lead to adding 0.7 GDP point to growth every year from 2013 to 2017.

The “unusual event” constituted by yet another year of very low growth in 2013 for France also opens the possibility of suspending the austerity policies, at least temporarily. Once again according to the findings of the iAGS report, the French government should put off till 2016 its policy of consolidating the public finances. The gain in terms of growth would be 0.9 percentage point per year between 2013 and 2017. Provided that this policy is actually conducted carefully and not postponed indefinitely, it would enable France to reduce its public debt to GDP ratio in compliance with existing EU treaties.

#### Forecast for the French economy

		2011	2012	2013
Public deficit (% of GDP)	Spring 2012	5.2	4.5	4.2
	Autumn 2012	5,2	4.5	3.5
Structural deficit (% of GDP)	Spring 2012	4.1	3.2	2.9
	Autumn 2012	4.5	3.4	2.0
PIB (%)	Spring 2012	1.7	0.5	1.3
	Autumn 2012	1.7	0.2	0.4

Source: European Commission forecasts.

# 2013: what impact will the (national) fiscal measures have on growth?

By [Mathieu Plane](#)

*This text supplements the [October 2012 forecasts for the French economy](#)*

After having detailed the multiplier effects expected for the different fiscal policy instruments, the average domestic fiscal multiplier associated with the austerity measures being implemented in France in 2013 will be 0.9. This policy will cut GDP by 1.7% in one year alone. After a cumulative fiscal effort of 66 billion euros in 2011 and 2012, the structural saving expected for 2013 represents about 36 billion euros (1.8 GDP points) if we include both the measures in the 2013 budget bill (*Projet de loi de finances – PLF*) and the various measures adopted previously (Table). The fiscal shock resulting from the PLF for 2013 comes to 28 billion euros, of which 20 billion is solely on tax and social security contributions (*prélèvements obligatoires – PO*). Of the remaining 8 billion, an increase of nearly 5 billion euros in tax and social security contributions is from the second supplementary budget (*Loi de finances rectificative – LFR*) for the summer of 2012, the rest being mainly due to the first LFR for 2012 and to the hike in contributions resulting from the revision of the pension reform in summer 2012.

In total, the fiscal effort in 2013 can be broken down between tax and social contributions of about 28 billion euros (1.4 GDP points) and structural savings on primary public expenditure of 8 billion (0.4 GDP point). The burden of higher taxes and social contributions breaks down to nearly 16 billion euros for households and more than 12 billion for



business. This breakdown does not take into account the competitiveness measures announced on 6 November by the Prime Minister. The tax credits for competitiveness and employment (CICE) will not have any fiscal impact in 2013, with the exception of the possible establishment in 2013 of an advance on their future tax credits for some companies short of cash.

Based on the variants in the fiscal multiplier, made with e-mod.fr according to the economy's position in the cycle, for the main taxes and social security contributions as well as for the key components of public expenditure [\[1\]](#) and based on the different evaluations we were able to carry out, particularly in the context of [the assessment of the Five-year economic programme](#), we applied a specific fiscal multiplier to each measure for 2013 (Table). The short-term multipliers take into account only the direct effects of the measures on domestic activity, regardless of the fiscal policies of our trading partners, which amplify the impact of national policy. It is also assumed that monetary policy remains unchanged. The long-term multiplier values differ from the short-term ones, being generally lower unless a long-term negative output gap is maintained.

Of the 16 billion euro increase in tax and social security contributions on households in 2013, the discretionary increase in personal income tax (IR) will be 6.4 billion, including 3.2 billion from the 2013 Budget Act (*Loi de finances*) – against 4 billion in the PLF, as the proposal to tax capital gains on securities at the income tax scale will be largely amended, and the yield from the measure could decrease by about 0.8 billion, with the shortfall being able to be offset by the extension of the exceptional 5% contribution from the IS tax on large corporations), and with the rest coming from the supplemental LFR for 2012 (including 1.7 billion solely from the de-indexation of the personal income tax schedule). While the increase in personal income tax from the 2013 PLF is targeted at high earners, the amount

this will contribute (3.2 billion) represents only 11% of the increase in tax and social security contributions (20% if we limit ourselves to households) in 2013, and less than 9% of the total fiscal effort. According to our calculations, the average fiscal multiplier associated with the different measures that increase personal income tax will be 0.7 in 2013.

The increase in taxes and social contributions from households will come mainly from the increase in payroll taxes and social security contributions (8.7 billion euros) set out in the Social Security budget act (PLF) for 2013 (2.9 billion) and the measures in the supplemental LFR for 2013 (5.3 billion, which includes changes to the tax exemption on overtime, a limitation on tax breaks and employee savings, a higher CSG wealth tax on income from capital, etc.) and pension reform, with an increase in the contribution rate (0.5 billion). The average fiscal multiplier related to these measures is 0.9. Finally, the reform of inheritance tax will raise a further 1.1 billion in tax and social contributions. On the other hand, the revenue from the ISF wealth tax will be 1.3 billion lower than in 2012. Indeed, the yield from the one-off wealth tax contribution set up under the supplemental LFR for 2012 will be greater than from the one set up under the new reform in 2013. The fiscal multiplier for these two measures is 0.3.

In total, according to our calculations, the increase in levies on households in 2013 will on average have a multiplier of 0.8 and will amputate growth by 0.6 GDP point.

For business, the measures adopted mainly involve an increase in the corporate income tax as provided in the budget bill (PLF) for 2013 (8 billion euros, of which 4 billion is related to the reform of the deductibility of financial expenses). The average multiplier for the increase in the corporate income tax (IS) is estimated at 0.7 in 2013. 2.3 billion euros will come from a rise in social security contributions and payroll taxes with a fiscal multiplier of unity. Finally, other

measures such as the sectoral measures on the taxation of insurance or the exceptional contribution of the oil industry will increase the tax burden on business by 1.9 billion in 2013, with an average fiscal multiplier estimated at 0.5.

In our assessment, the increase in taxes and social contributions from companies will on average have a multiplier of 0.8 and will reduce GDP by 0.5 GDP point in 2013.

In addition, the short-term fiscal multiplier associated with public expenditure in a low phase of the cycle is, in our model, 1.3, so it is higher than that associated with tax and social contributions. This result is consistent with the most recent empirical literature (for details, see the box, "[Fiscal multipliers: size matters!](#)") The estimated loss of activity resulting from tightening up on public expenditure will come to 0.5 GDP point in 2013.

In total, the average domestic fiscal multiplier associated with the austerity policy being implemented in France in 2013 will be 0.9, and this policy will reduce GDP by 1.7%. This result is in the lower range of the [latest work of the IMF](#); using recent data on 28 countries, it has estimated the actual multipliers at between 0.9 and 1.7 since the beginning of the Great Recession.

## Main measures affecting the structural public deficit in 2013

	Measures (in bn)	Fiscal multiplier estimated in the short term	Impact on GDP (%)
<b>Households</b>	<b>15.7</b>	<b>0.8</b>	<b>-0.6</b>
<b>Income tax</b>	<b>6.4</b>	<b>0.7</b>	<b>-0.2</b>
PLF 2013 (taxation of capital income at IR tax rate, new brackets, etc.)*	3.2	0.6	-0.1
LFR II 2012 (reversal of tax exemption of overtime)	0.5	0.4	0.0
LFR I 2012 (de-indexation of IR brackets, suppression tax breaks and Scellier scheme, etc.)	2.7	0.8	-0.1
<b>ISF wealth tax</b>	<b>-1.3</b>	<b>0.3</b>	<b>0.0</b>
PPLF 2013 (reform of ISF wealth tax)	1.0	0.3	0.0
LFR II 2012 (repercussions from one-off 2012 contribution)	-2.3	0.3	0.0
<b>Inheritance tax</b>	<b>1.1</b>	<b>0.3</b>	<b>0.0</b>
LFR II 2012 (reversal of breaks on inheritance tax)	1.1	0.3	0.0
<b>Social contributions and payroll tax</b>	<b>8.7</b>	<b>0.9</b>	<b>-0.4</b>
Social security PLF 2013 (reform of self-employed payroll tax, higher tax on beer and tobacco, etc.)	2.9	1.0	-0.1
LFR II 2012 (reversal of overtime exemption, limitation of tax breaks and employee savings, higher CSG wealth tax, capital income, etc.)	5.3	0.8	-0.2
Pension reform (higher contributions)	0.5	1.0	0.0
<b>Other</b>	<b>0.8</b>	<b>0.6</b>	<b>0.0</b>
PLF 2013 (higher tax on vacant housing, tougher "automobile malus", etc.)	0.9	0.6	0.0
LFR II 2012 (lower VAT on books)	-0.1	1.0	0.0
<b>Business**</b>	<b>12.2</b>	<b>0.8</b>	<b>-0.5</b>
<b>Corporate income tax</b>	<b>8</b>	<b>0.7</b>	<b>-0.3</b>
PLF 2013 (limits on financial expenses deductibility, reform of the "cinquième acompte", etc.)	8	0.7	-0.3
<b>Payroll tax and social contributions</b>	<b>2.3</b>	<b>1.0</b>	<b>-0.1</b>
Social security PLF 2013 (higher CNRACL contribution rate, reform on wage tax, etc.)	1.8	1.0	-0.1
Pension reform	0.5	1.0	0.0
<b>Other</b>	<b>1.9</b>	<b>0.5</b>	<b>-0.1</b>
PLF 2013 (sectoral measures on taxation of business insurance) (sectoral measures on taxation of business insurance)	1.3	0.8	-0.1
LFR II 2012 (one-off contribution of oil industry, taxation of financial transactions, etc.)	0.6	0.2	0.0
<b>Total Business and Household Taxes and Contributions</b>	<b>27.9</b>	<b>0.8</b>	<b>-1.1</b>
<b>Structural saving on primary public expenditure</b>	<b>8.0</b>	<b>1.3</b>	<b>-0.5</b>
<b>Total fiscal impulse</b>	<b>35.9</b>	<b>0.9</b>	<b>-1.7</b>

\* This amount incorporates the downward revision of the yield initially foreseen in the PLF 2013 of the measure taxing capital gains at the personal income tax rate, which is to be offset by the extension of the exceptional 5% corporate income tax contribution for large corporations.

\*\* This breakdown does not measure the final fiscal impact that is to be borne by households if the increase in business taxes is passed on in prices.

Sources : PLF 2013, Social security PLF 2013, LFR I and II 2012, OFCE calculations.

[1] For more on this, see Creel, Heyer, Plane, 2011, "Petit précis de politique budgétaire par tous les temps", *Revue de l'OFCE*, no. 116, January 2011.

