# The chalice of austerity, right to the dregs

Céline Antonin, Christophe Blot and Danielle Schweisguth

This text summarizes the OFCE's April 2013 forecasts

The macroeconomic and social situation in the euro zone continues to cause concern. The year 2012 was marked by a further decline in GDP (-0.5%) and a continuing rise in the unemployment rate, which reached 11.8% in December. While this new recession is not comparable in magnitude to that of 2009, it is comparable in duration, as GDP fell for the fifth consecutive time in the last quarter of 2012. Above all, for some countries (Spain, Greece and Portugal), this prolonged recession marks the beginning of deflation that could quickly spread to other countries in the euro zone (see The onset of deflation). Finally, this performance has demonstrated the failure of the macroeconomic strategy implemented in the euro zone since 2011. The strengthening of fiscal consolidation in 2012 did not restore market confidence, and interest rates did not fall except from the point when the risk of the euro zone's collapse was mitigated by the ratification of the Treaty of stability, coordination and governance (TSCG) and the announcement of the new WTO operation allowing the ECB to intervene in the sovereign debt markets. Despite this, the fiscal dogma has not been called into question, meaning that in 2013, and if necessary in 2014, the euro zone countries will continue their forced march to reduce their budget deficits and reach the symbolic threshold of 3% as fast as possible. The incessant media refrain that France will keep its commitment is the perfect reflection of this strategy, and of its absurdity (see France: holding the required course). So until the chalice has been drunk to the dregs, the euro zone countries seem condemned to a strategy that results in recession, unemployment, social despair and the risk of political turmoil. This represents a greater threat to the sustainability of the euro zone than the lack of fiscal credibility of one or another Member State. In 2013 and 2014, the fiscal stimulus in the euro zone will again be negative (-1.1% and -0.6%, respectively), bringing the cumulative tightening to 4.7 GDP points since 2011. As and to the extent that countries reduce their budget deficits to less than 3%, they can slow the pace of consolidation (Table). While in the next two years Germany, which has already balanced the public books, will cease its consolidation efforts, France will have to stay the course in the hope of reaching 3% in 2014. For Spain, Portugal and Greece, the effort will be less than that what has already been done, but it will continue to be a significant burden on activity and employment, especially as the recessive impact of past measures continue to be felt.

In this context, the continuation of a recession is inevitable. GDP will fall by 0.4% in 2013. Unemployment is expected to break new records. A return to growth is not expected until 2014, but even then, in the absence of any relaxation of the fiscal dogma, hopes may again be disappointed since the anticipated growth of 0.9% will be insufficient to trigger any significant decline in unemployment. In addition, the return to growth will come too late to be able to erase the exorbitant social costs of this strategy, while alternatives to it are discussed inadequately and belatedly.

Table. Public balance and fiscal impulse in the euro zone countries

In GDP points

| | Public deficit | | | Fiscal impulse | |
|---|---|---|---|---|---|
| | 2012 | 2013 (p) | 2014 (p) | 2013 (p) | 2014 (p) |
| Germany | 0,2 | -0,4 | -0,1 | 0,1 | 0,0 |
| Austria | -3,0 | -2,5 | -1,8 | -0,6 | -0,3 |
| Belgium | -3,0 | -2,8 | -1,9 | -0,5 | -1,0 |
| Spain | -10,2 | -6,5 | -5,8 | -2,0 | -1,1 |
| Finland | -1,6 | -1,5 | -0,9 | -0,8 | -0,7 |
| France | -4,8 | -3,9 | -3,0 | -1,8 | -1,4 |
| Greece | -6,6 | -5,4 | -4,5 | -3,8 | -2,0 |
| Ireland | -8,2 | -8,4 | -6,6 | -1,9 | -1,8 |
| Italy | -3,0 | -3,9 | -3,4 | -1,4 | -0,7 |
| Netherlands | -4,1 | -3,4 | -3,0 | -1,7 | -0,7 |
| Portugal | -5,0 | -4,4 | -3,0 | -2,1 | -1,9 |
| Euro zone 11* | -3,2 | -2,6 | -1,8 | -1,1 | -0,6 |

* Excluding Cyprus, Luxembourg, Malta, Slovakia and Estonia.

*Sources* : Eurostat, European Commission, OFCE calculations and forecast March 2013.

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# France: the rise in cyclical unemployment continues

By Bruno Ducoudré

The Great Recession, which began in 2008, has resulted in a continuous and inexorable rise in unemployment in France, by 3.1 percentage points between the low point reached in the first quarter of 2008 (7.1% in mainland France) and the peak in the fourth quarter of 2012. The unemployment rate is now close to the record levels reached in the late 1990s. This rise can be broken down into a change in the rate of cyclical unemployment due to the lack of economic growth, and a change in the rate of structural unemployment. The latter gives information on the extent of the output gap, which is crucial for measuring the structural deficit. Consequently, any choice about the fiscal policy to be adopted to re-balance the public finances needs an analysis of the nature of the additional unemployment generated by the crisis. In other words, has the crisis mainly resulted in cyclical unemployment or structural unemployment?

A study of the Non-Accelerating Inflation Rate of Unemployment (NAIRU)[1] offers one way of analysing whether the unemployment is structural or cyclical. Based on an estimate of the wage-price spiral, we propose in the OFCE's 2013-2014 forecasts for the French economy taking a look at the level of the equilibrium rate of unemployment (ERU) using a recursive estimate of the NAIRU since 1995 in order to identify the share of cyclical unemployment.

**Table. Estimates of the equilibrium rate of unemployment**

In %

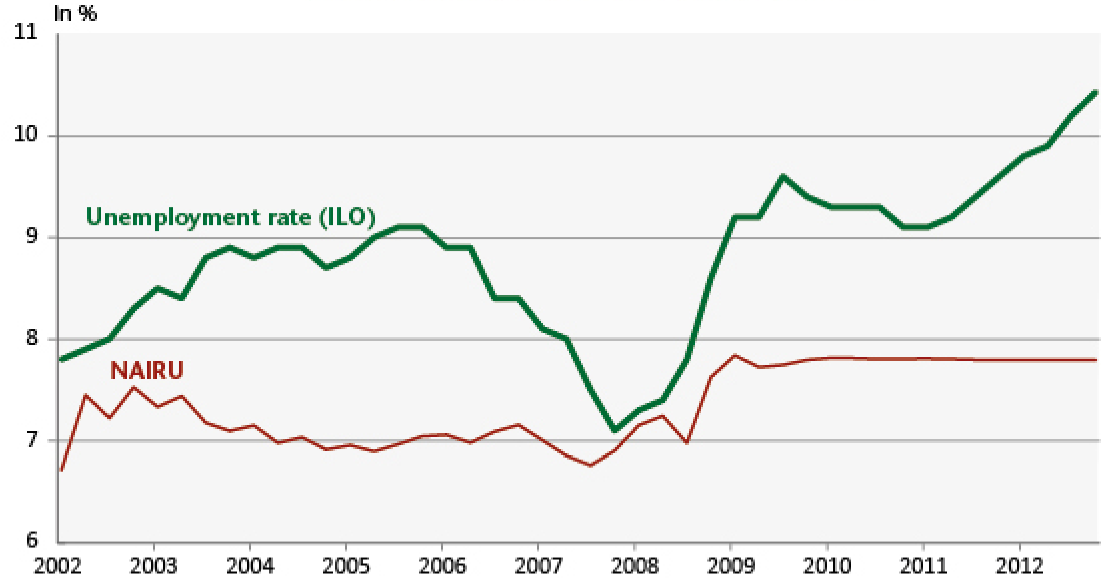
| Période | 2000-2012 | 2000-2007 | 2008-2012 |
|---|---|---|---|
| NAIRU | 7,2 | 6,8 | 7,7 |

*Note* : Hypotheses on exogenous factors: values observed on average over the periods 2000-2007 and 2008-2012. The productivity trend equals 1.1.
*Source* : OFCE calculations.

First, our estimate of the ERU takes good account of the lack of real inflationary pressures since 1995. Indeed, the actual unemployment rate is consistently higher than the ERU over this period (Figure 1). However, between 1995 and 2012 underlying inflation varies between 0 and 2%. It reaches 2% in 2002 and 2008, times when the actual unemployment rate is closer to the ERU, although this does not reflect the real inflationary pressures. In 2012, the increase in the unemployment rate led to a wider gap with the equilibrium rate of unemployment and was accompanied by a slowdown in underlying inflation, which fell below 1% by the end of the year.

Second, the NAIRU is estimated at 7.2% on average over the years 2000-2012, with an average inflation rate of 1.9% over the period. Inflation rose to an average 7.7% over the period 2008-2012 (Table 1) and to 7.8% in 2012 (Figure 1).

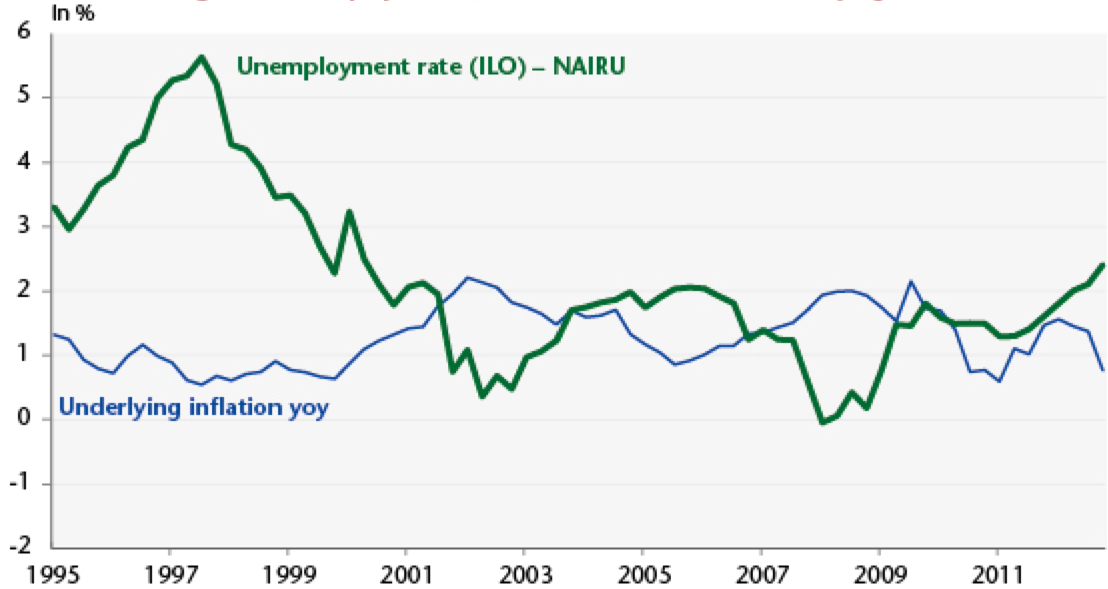
Figure 1. Unemployment rate and estimated NAIRU




*Sources* : INSEE, OFCE calculations.

Third, these estimates also indicate that the NAIRU has increased by 0.9 percentage points since the onset of the crisis. This explains at most 30% of the rise in the unemployment rate since 2008, with the remainder coming from an increase in cyclical unemployment. The cyclical component of unemployment would therefore represent 2.1 percentage points of unemployment in 2012. This change in the gap between the actual unemployment rate and the equilibrium rate of unemployment is also consistent with underlying inflation, which has been declining since 2009. Given our forecast of unemployment, this gap will increase by 1.5 percentage points, to a level of 3.6% in 2014 on an annual average.

Figure 2. Unemployment rate-NAIRU difference and underlying inflation




*Sources* : INSEE, OFCE calculations.

Estimates of the equilibrium rate of unemployment thus indicate that the gap with the actual unemployment rate has widened during the crisis. The share of cyclical unemployment has increased, with the rise in cyclical unemployment accounting for about 70% of the rise in the unemployment rate since 2008. This confirms our diagnosis of a high **output gap** for the French economy in 2012, a gap that will continue to widen in 2014 under the combined impact of fiscal austerity and a high fiscal multiplier.

*This text draws on the analysis of the economic situation and the forecast for 2013-2014, which is available [in French] on the OFCE site.*

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[1] The NAIRU is the rate of unemployment at which the inflation rate remains stable. Above it, inflation slows, which eventually makes possible an increase in employment and a reduction in unemployment. Below it, the dynamic is reversed, leading to higher inflation, a fall in employment and a return of unemployment to its equilibrium level.

# Holding to the required course

By Eric Heyer

This text summarizes the OFCE's 2013-2014 forecasts for the French economy.

In 2013, the French economy should see negative annual average growth, with a fall in GDP of 0.2%, before a modest recovery in 2014, with growth of 0.6 % (Table 1). This particularly mediocre performance is far from the path that an economy pulling out of a crisis should be taking.

Table 1. Summary of the forecast for 2013 and 2014

In %, annual average

| | 2010 | 2011 | 2012 | 2013* | 2014* |
|---|---|---|---|---|---|
| **Taux de croissance du PIB** | **1,6** | **1,7** | **0,0** | **-0,2** | **0,6** |
| Imports | 8,4 | 5,2 | -0,3 | 0,1 | 1,7 |
| Household consumption | 1,4 | 0,2 | -0,1 | 0,0 | 0,8 |
| Government consumption | 1,7 | 0,2 | 1,4 | 1,2 | 0,2 |
| Total investment | 1,0 | 3,5 | 0,0 | -1,9 | -0,5 |
| Exports | 9,2 | 5,5 | 2,5 | 0,9 | 2,2 |
| ***Contribution to growth*** | | | | | |
| Domestic demand excl. inventory | 1,5 | 0,9 | 0,3 | -0,1 | 0,5 |
| Change in inventory | 0,0 | 0,8 | -1,0 | -0,3 | 0,0 |
| Trade balance | 0,0 | 0,0 | 0,7 | 0,2 | 0,1 |
| **GDP growth rate, euro zone** | **2,0** | **1,1** | **-0,5** | **0,4** | **0,9** |
| ***Other indicators*** | | | | | |
| Inflation (consumption deflator) | 1,1 | 2,1 | 1,9 | 1,6 | 1,6 |
| Savings rate (% of GDI) | 15,9 | 16,2 | 16,0 | 15,6 | 15,2 |
| Unemployment rate | 9,3 | 9,2 | 9,9 | 10,7 | 11,4 |
| Public deficit (GDP points) | 7,1 | 5,2 | 4,8 | 3,9 | 3,0 |
| Public debt (GDP points) | 82,4 | 85,8 | 90,2 | 93,3 | 94,8 |
| **GDP growth rate (year-on-year)** | **1,8** | **1,1** | **-0,3** | **0,3** | **0,7** |

*Sources* : INSEE, quarterly accounts; OFCE *e-mod.fr* forecast for 2013 and 2014.

Four years after the start of the crisis, the French economy has a substantial potential for recovery: this should have led to average spontaneous growth of about 2.6% per year in 2013 and 2014, making up some of the output gap accumulated since the onset of the crisis. But this spontaneous recovery is being hampered mainly by the introduction of fiscal savings plans in France and across Europe. To meet its commitment to cut the public deficit to 3% by 2014, the French government will have to hold to the course of fiscal consolidation it adopted in 2010, which was imposed by the European Commission in all the euro zone countries. This budget strategy should slash 2.6 percentage points off GDP growth in France in 2013 and 2.0 percentage points off GDP in 2014 (Table 2).

**Table 2. The obstacles to growth in France during the years 2013 and 2014**

In GDP points

| | 2013 | 2014 |
|---|---|---|
| GDP growth | -0,2 | 0,6 |
| Impact on GDP due to ... | | |
| ... oil changes | -0,2 | 0,0 |
| *Direct impact on the French economy* | *-0,1* | *0,0* |
| *Impact via addressed demand* | *0,0* | *0,0* |
| ... austerity measures | -2,6 | -2,0 |
| *Direct impact on the French economy* | *-1,8* | *-1,4* |
| *Impact via addressed demand* | *-0,8* | *-0,6* |
| ... monetary conditions | 0,0 | 0,0 |
| *Direct impact on the French economy* | *0,0* | *0,0* |
| *Impact via addressed demand* | *0,0* | *0,0* |
| ... policies on competition | 0,1 | -0,1 |
| *Direct impact on the French economy* | *0,2* | *0,0* |
| *Impact via addressed demand* | *-0,1* | *-0,1* |
| Achievement | -0,2 | 0,1 |
| Spontaneous growth rate | 2,6 | 2,6 |

*Sources :* INSEE, OFCE calculations.

By setting a pace far from its potential, the expected growth will aggravate the output gap built up since 2008, with the labour market thus continuing to worsen. The unemployment rate will rise steadily to 11.6% in late 2014.

Only a shift in European fiscal strategy could halt the rise in unemployment. This would mean limiting the negative fiscal stimulus to 0.5 percent of GDP instead of the total of 1.0 points planned in the euro zone in 2014. This reduced fiscal effort could be repeated until the public deficit or debt reaches a defined goal. Compared to current plans, because the effort would be measured the burden of adjustment would be spread more fairly over the taxpayers in each country, avoiding the pitfall of drastic cuts in the public budgets. This new strategy would lead to a slower reduction in the public deficit (-3.4% in 2014 against -3.0% in our central scenario), but also and especially to higher economic growth (1.6% against 0.6%). This "less austerity" scenario would allow the French economy to create 119,000 jobs in 2014, *i.e.* 232,000 more than in our central forecast, and unemployment would fall instead of continuing to increase.

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# The onset of deflation

By Xavier Timbeau

This text summarizes the April 2013 forecasts of the OFCE.

The global economic and financial crisis that began in late 2008 is now entering its fifth year. For the European Union, 2012 has been another year of recession, showing just how much the prospect of an end to the crisis, heralded so many times, has been contradicted by economic developments. Our forecasts for 2013 and 2014 can be summarized rather ominously: the developed countries will remain mired in a vicious circle of rising unemployment, protracted recession and growing doubts about the sustainability of public finances.

From 2010 to 2012, the fiscal measures already taken or announced have been unprecedented for the euro zone countries (-4.6% of GDP), the United Kingdom (-6% of GDP) and the United States (-4.7% of GDP). The fiscal adjustment in the US that has been long delayed but finally precipitated by the lack of political consensus between Democrats and Republicans will take place again in 2013 and 2014. In 2014, austerity in the euro zone will ease, although it will continue at an intense level in the countries still in deficit, which are also those with the highest fiscal multipliers.

In a context of high multipliers, the fiscal effort has a cost in terms of activity. This phrase, taken from Marco Buti, chief economist of the European Commission, sounds like both a confession and a euphemism – a confession, because the acknowledgement of the high value of the fiscal multipliers came late and was neglected too long; Olivier Blanchard and David Leigh recall that this problem led to systematic forecast errors and that these errors were much larger in countries in the worst situations undertaking the largest deficit reductions.

But the undervaluation of the multipliers also meant that the hopes accompanying deficit reduction were disappointed. The "unexpectedly" heavy impact of the austerity plans on activity has meant lower tax revenues, and thus a smaller reduction in the deficit. In attempting to meet their nominal deficit targets regardless of the cost, the States have only exacerbated the fiscal effort.

A confession like this might suggest that the error was inevitable and that the lesson has been drawn. This is not the case. First, since 2009, many voices were raised warning that the multipliers might be higher than in "normal times", that the possibility of the kind of expansive consolidation described and documented by Alberto Alesina was an illusion based on a misinterpretation of the data, and that there was a real risk of neglecting the impact of the fiscal consolidation on economic activity.

In October 2010, the IMF, under the impetus even then of Olivier Blanchard, described the risks of pursuing an overly brutal consolidation. The general awareness finally emerging in early 2013 reflected an acknowledgement of such a substantial accumulation of empirical evidence that the opposite view had become untenable. But the damage was done.

Nor was the lesson learned. According to the European Commission, the multipliers *were* high. [1] The use of the past tense reveals the new position of the European Commission: while the multiplier *were* high, they are now back to their pre-crisis value. This means that, according to the European Commission, the euro zone is again in a “normal” economic situation. The argument here is theoretical, not empirical. Normally, economic agents are “Ricardian” in the sense that Robert Barro has given this term. Agents can smooth their consumption and investment decisions and are not constrained by their income over the short-term. The multipliers would therefore be low or even zero. Fiscal consolidation (which is the name given to the unprecedented budgetary efforts made since 2010 in the euro zone) could therefore continue, this time without the hassles previously observed. This argument is undoubtedly relevant in theory, but its use in practice today is puzzling. It amounts to forgetting far too easily that we are in a situation of high unemployment, that long-term unemployment is increasing, that company balance sheets are still devastated by the loss of activity that started in 2008, and have never really recovered except in Germany, that the banks themselves are struggling to comply with accounting standards and that the IMF Managing Director, Christine Lagarde, has urged that some of them be closed. It means forgetting that the famous credit that is supposed to smooth consumption and investment has collapsed, *i.e.* amidst a rampant and powerful credit crunch. It means forgetting that in this era when the injunction to prefer the private sector over the public sector is stronger than ever, panic in the financial markets is leading savers and investment advisers to opt for investments in State sovereign bonds with yields of less than 2% at 10 years. And this is taking place despite downgrades by the credit rating agencies because these States are perceived (and "priced", to use the jargon of the trading floors) as having the lowest risk. Such are the paradoxes of a time when one voluntarily submits to taxation by accepting negative real interest rates on investments and paying dearly for default insurance.

So if the confession seems belated and not to have had much impact on the dogma for escaping the crisis, it also involves a euphemism. For what are these costs that Marco Buti refers to? The price to be paid for an unavoidable financial situation? A hard time to get through before we return to a healthy future? It is by turning away from a detailed analysis of the risks run by continuing the current economic strategy, which has finally been acknowledged as having been incorrectly calibrated, that we miss what is most important. By pursuing the short-term goal of consolidation, while the fiscal multipliers are high, the conditions that make the fiscal multipliers high in the first place are maintained or even reinforced. The period of unemployment and underutilization of capacity are thus prolonged. This prevents the reduction of private debt, the starting point of the crisis, thus perpetuating it.

The fiscal effort has been disappointing in the short term, as the consequence of a high multiplier is that the deficit is reduced less than expected, or even not at all. Public debt in turn increases, as the effect of the denominator outweighs the slower growth of the numerator (see the iAGS report for a discussion and a simple formalization). There are numerous examples, the most recent of which was France, and the most spectacular Spain. But the disappointment is not just in the short term. The persistence of zero growth and a recession changes expectations about future growth: what was analyzed a few quarters ago as a cyclical deficit is now considered structural. The disappointment also modifies the future potential. The hysteresis effects in the labour market, the reduction in R&D, the delays with infrastructure and even, as can be seen now in Southern Europe, the cutbacks in education, in the fight against poverty and in the integration of immigrants all obscure the long-term outlook.

In 2013 and 2014, the developed countries will all continue their fiscal consolidation efforts. For some, this will mean the repetition and thus the accumulation of an unprecedented effort over five consecutive years. For Spain, this amounts to a cumulative fiscal effort of more than 8 percentage points of GDP! With few exceptions, unemployment will continue to rise in the developed countries, reaching a situation where involuntary unemployment exceeds the capacity of the national unemployment insurance systems to replace the lost employment income, especially since these systems are facing budget cuts themselves. In this context, wage deflation will kick off in the countries hit hardest. Since the euro zone has fixed exchange rates, this wage deflation will inevitably be transmitted to other countries. This will constitute a new lever perpetuating the crisis. As wages decrease, it becomes impossible for economic agents to access the financial system to smooth their economic decisions. The debts that have been targeted for reduction since the onset of the crisis will appreciate in real terms. Debt deflation will become the new vector of entrapment in the crisis.

There is, in this situation, a particularly specious argument to justify this conduct: that there was no alternative, *i.e.* that history was written before 2008 and that the errors in economic policy committed before the crisis made it inevitable, and above all that any other choice, such as postponing the consolidation of the public finances to a time when the fiscal multipliers were lower, was simply not possible. Market pressures and the need to restore lost credibility before 2008 made prompt action essential. If the actions carried out had not been carried out just as they were, then the worst would have happened. The euro would have collapsed, and defaults on public and private debt would have plunged the euro zone into a depression like that of the 1930s, or even worse. The great efforts undertaken made it possible to avert a disaster, and the result of these measures is, at the end of the day, quite encouraging. Such is the story.

But this argument ignores the risks being run today. Deflation, the prolongation of mass unemployment, the collapse of the welfare states, the discrediting of their policies, the undermining of consent to taxation, all carry the seeds of threats whose consequences can only be glimpsed today. Above all, this dismisses the alternative for the euro zone of exercising its sovereignty and demonstrating its solidarity. This argument is based on the idea that for the States fiscal discipline is to be exercised through the markets. It obscures the fact that the public debt and currency are inseparable. An alternative does exist; it requires that the public debt in the euro zone be pooled; it requires a leap towards a transfer of sovereignty; and it requires completing the European project.

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[1] "With fiscal multipliers higher than in normal times, the consolidation efforts have been costly in terms of output and employment", Marco Buti and Karl Pichelmann, ECFIN *Economic Brief Issue* 19, Feb. 2013, *European prosperity reloaded: an optimistic glance at EMU@20*.

# An hommage to Alain Desrosières, statistician, sociologist, historian and philosopher of statistics

By Françoise Milewski and Henri Sterdyniak

Alain Desrosières has passed away, at the age of 72. An administrator at the INSEE, he had been editor of the journal *Économie et statistique,* then head of the Department of social studies, before working on the comparative analysis of Europe’s statistical systems.

He was the troubled conscience of official statistics in France.

Alain’s many books and articles traced the birth and growth of statistics. His articles discuss their scientific and social foundations. They highlight the links between statistical standards and the production of statistics, between the history of economic policy and statistical methods and categories, in the face of the trend to “naturalize” them. “The ways of thinking society, managing it and quantifying it are inseparable”, he declared. Statistics cannot be separated from its use, and it evolves with changes in public policy. And so, for instance, he raised questions about “the quality of quantity”.

Alain passionately lived and studied the contradictions of statistics, a tool for knowledge and a tool for governing. Are statistics in the service of democracy, helping society to better understand itself, or of the State, helping it to better achieve its goals? And this State, which organizes and finances the statistical system, itself has two faces: the welfare state, an instrument of resistance to market forces, as well as a State in the service of a social formation shaped by capitalism.

Statistics measures and classifies. But is it a neutral scientific discipline, or does it express the vision that society has of itself at a given point, especially since it must rely on administrative sources that are themselves not neutral? Should it base itself on people’s everyday experience, or, on the contrary, challenge this in the name of science?

Can we account for different societies using the same categories? Alain has devoted great attention to the statistical harmonization that the European Union implies, with its risk of negating differences between societies.

He questioned the policy on indicators implemented by the Open Method of Coordination (OMC) and France’s organic law on budget bills (LOLF). Policies define indicators that statisticians are supposed to measure, and then set targets for these indicators. But this practice is dangerous, as these indicators become the focus of the analysis even as the policies aim to improve the indicators, which tends to cause them to lose their significance.

Below we reproduce some snippets from his articles, as an invitation to read them in their entirety. The myth of the data that is indisputable because impartial, the unconditional respect in the face of indicators that, because quantified are thus indisputable, regardless of the methods, standards and conventions underpinning their calculation – all these are a constant threat for the social sciences, particularly economics. And for society.

Alain Desrosières took part in numerous meetings of statisticians in order to give his colleagues food for thought about their practices and their methods (see in particular the conference of 30 March 2011: "Official statistics as a unique public good", Workshop 3). He developed fertile links between statistical practice and sociologists, in particular Pierre Bourdieu and Bruno Latour.

He showed the influence of nomenclatures on the constitution of statistical information and, through that, on the structuring of society (*Les Catégories socioprofessionnelles*, co-authored by Laurent Thévenot, La Découverte, Repères collection, 1988).

Alain leaves us a number of major works: *La politique des grands nombres, histoire de la raison statistique* (Editions La Découverte, Paris, 1993) and *L'argument statistique*, in two volumes: I: *Pour une sociologie historique de la quantification*, and II: *Gouverner par les nombres* (Les Presses des Mines ParisTech, Sciences sociales collection, Paris, 2008).

He leaves us his most recent work: "Est-il bon, est-il méchant ? Le rôle du nombre dans le gouvernement de la cité néolibérale" (*Nouvelles perspectives en sciences sociales*, volume 7, no. 2, May 2012).

Alain set an example as a modest but demanding intellectual who sought to put his professional experience and scientific efforts in the service of democracy.

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A few short excerpts from his writings:

"How can the contradiction be resolved between the ethos of the statisticians and taking feedback into account, even when it seems to them just an annoying obstacle to their mission, which they conceive of as 'providing unbiased reflections of reality'? It is not possible to isolate a moment of measurement that is independent of its uses, in particular the conventions that are the first step in quantification. The training of statisticians needs to be decompartmentalized and supplemented with the study of history, political science, the sociology of statistics, econometrics, probability, accounting and management. This program, inspired by the achievements of *Sciences Studies* (Pestre, 2006), could facilitate the inclusion of quantitative tools in social debates, without winding up in either *a priori* rejection or unconditional, naïve respect for 'facts that are indisputable because quantified'."

*Est-il bon, est-il méchant ? Le rôle du nombre dans la cité néolibérale. C*onclusion of a presentation to the seminar *L'Informazione Prima Dell'Informazione. Conoscenza E Scelte Pubbliche*, Milan Bicocca, 27 May 2010, *Nouvelles perspectives en sciences sociales*, volume 7, no. 2, May 2012.

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"Quantification has become a sign of objectivity, rigor and impartiality that is mobilized in a variety of situations, from political debate to scientific demonstration, and including business indicators and the measurement of public opinion. However, quantification, in its various statistical formats, is not content merely to provide a reflection of the world, but also creates new ways of thinking, representing, expressing and acting on it, through the power of its models and its procedures, its broad dissemination and its use in argumentation. This book shows how 'statistical argument' is historically constructed, and what the cognitive and social effects of quantification systems are today."

*Pour une sociologie historique de la quantification*, Volume 1 of *L'argument statistique* (Les Presses des Mines Paris-tech, Sciences socials collection, Paris, 2008), back cover.

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“Governments of men use and abuse the ‘argument of statistics’. With the emergence of a neo-liberal state, public policy is increasingly relying on quantitative indicators that provide evaluations of the performance of different policy actions. The various ‘winners’ are broadcast widely (often under the Anglo-American rubric of ‘benchmarking’), ranking high schools, universities, even nations. This rite of quantification, far from providing a neutral image of phenomena, transforms and performs them. This book offers specific case studies, surveys of family budgets, planning commissions, local statistics and national accounts, analyzing the production of official statistics and their use by the public authorities. And it will be seen how statistics has imposed itself as both an evidentiary tool in the empirical sciences and a tool of government, in accordance with the intuition that Foucault had already presented in the 1970s under the name of ‘governmentality’.”

*Gouverner par les nombres*, Volume 2 of *L’argument statistique* (Les Presses des Mines Paris-tech, Sciences socials collection, Paris, 2008), back cover.

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“Major crises are of course times when statistics are mobilized intensively to express the gravity of the situation. But they are also times of great debate, during which the role of the state in the regulation and control of the economy is completely rethought. To each of these crises corresponds the emergence of new ways of quantifying the social world. New models of action imply new variables and new systems of observation.

Economic and political history from the 1880s to the present day has offered at least three (if not four) examples of such configurations, combining ways of thinking society, ways of acting on it, and statistics adapted to the times. The crisis of the 1880s prompted the great statistics on labour and employment. The crisis of 1929 was the source of Keynesian macroeconomic policies and national accounts. The crisis of the 1970s was thought about in the neoliberal categories of microeconomics, and led to state reforms focusing in particular on performance indicators. Finally, the two crises of the 2000s, ecological and then financial, will perhaps give rise to radically new ways of thinking and quantifying public action. A review of the way that a few somewhat older crises were experienced, and their impact on the use of official statistics, may be useful for thinking about the magnitude of the changes that may result from these two recent crises."

"Crises économiques et statistiques, de 1880 à 2010", *ParisTech Review*, 30 August 2010.

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# 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:

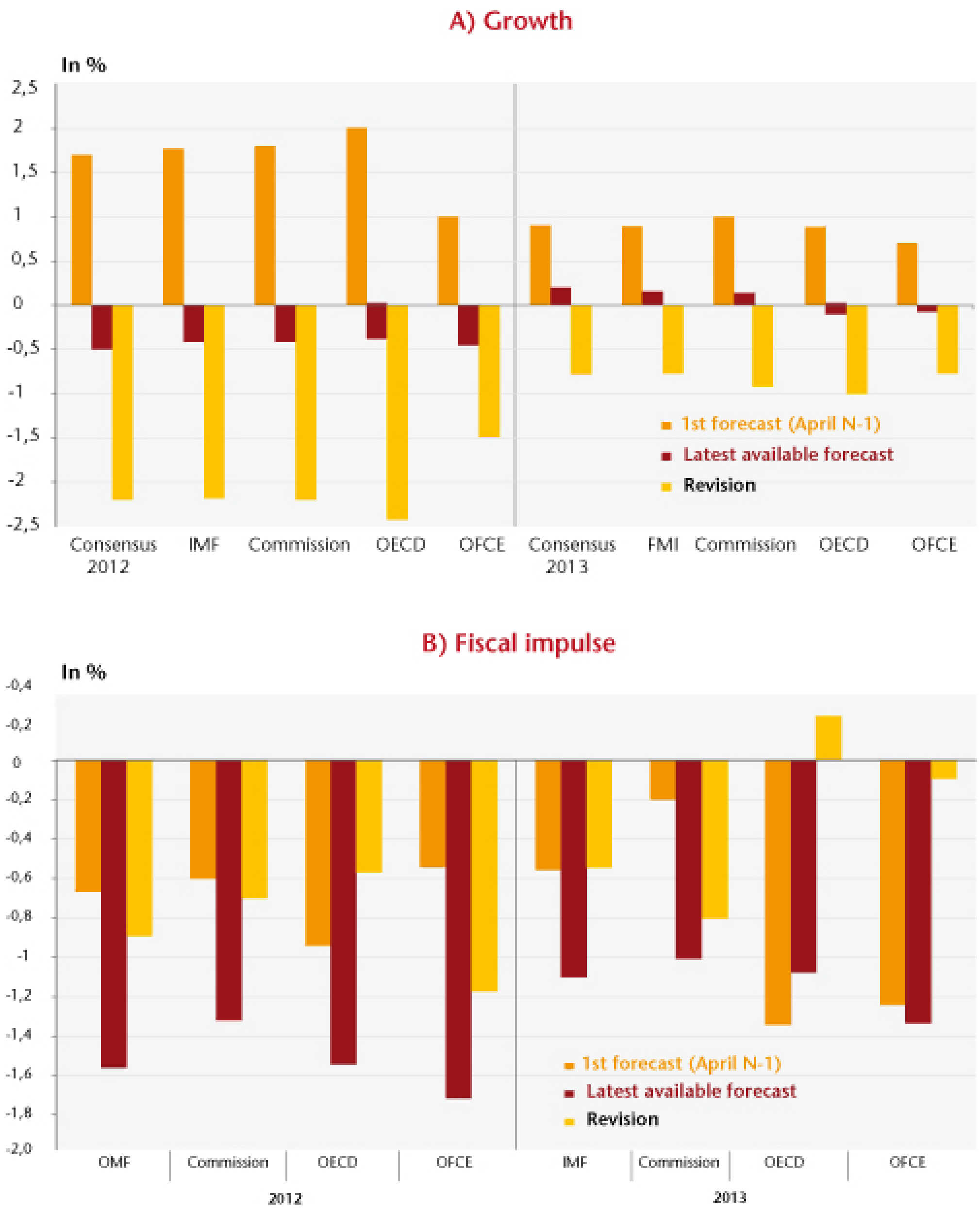
- – What are the main factors leading to the revision of the growth forecasts? Given the scale of the austerity measures being enacted in the euro zone, we can expect that the revised forecast of the fiscal impulses is a major determinant of the revisions to the growth forecasts. These revisions are,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

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

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 | | $\Delta\tilde{g}$ | $\Delta k.IB$ | $k.\Delta IB$ | $\Delta\tilde{\varepsilon}$ | $k_0$ | $k_1$ |
|---|---|---|---|---|---|---|---|
| 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** | | $\Delta\tilde{g}$ | $\Delta k.IB$ | $k.\Delta IB$ | $\Delta\tilde{\varepsilon}$ | $k_0$ | $k_1$ |
| 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** | | $\Delta\tilde{g}$ | $\Delta k.IB$ | $k.\Delta IB$ | $\Delta\tilde{\varepsilon}$ | $k_0$ | $k_1$ |
| 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** | | $\Delta\tilde{g}$ | $\Delta k.IB$ | $k.\Delta IB$ | $\Delta\tilde{\varepsilon}$ | $k_0$ | $k_1$ |
| 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."

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# 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.

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# What is the value of the fiscal multipliers today?

By Xavier Timbeau

We inherited higher public deficits and greatly increased public debts from the crisis (Table 1). Reducing these will require a major fiscal effort. But a programme that is too brutal and too fast will depress activity and prolong the crisis, not only compromising the fiscal consolidation effort but also locking the economies into a recessionary spiral. The value of the fiscal multiplier (the link between fiscal policy and economic activity) both in the short term and in the long term is thus a critical parameter for stabilizing the public finances and returning to full employment.

**Public deficit and public debt 2007-2012**

| *In GDP points* | Public deficit | | Net public debt minus financial assets | |
|---|---|---|---|---|
| | 2012 | Change 2012-2007 | 2012 | Change 2012-2007 |
| **DEU** | -0.9 | -1.1 | 52 | 9 |
| **FRA** | -4.5 | -1.7 | 66 | 31 |
| **ITA** | -1.7 | -0.1 | 96 | 9 |
| **ESP** | -5.4 | -7.3 | 54 | 37 |
| **NLD** | -4.3 | -4.4 | 43 | 15 |
| **BEL** | -2.8 | -2.7 | 82 | 9 |
| **PRT** | -4.6 | -1.4 | 81 | 32 |
| **IRL** | -8.4 | -8.5 | 82 | 82 |
| **GRC** | -7.4 | -0.6 | 134 | 52 |
| **AUT** | -2.9 | -1.9 | 48 | 17 |
| **Euro area (EA11)** | -3.0 | -2.3 | 63 | 20 |
| **GBR** | -7.7 | -4.9 | 74 | 46 |
| **USA** | -8.3 | -5.3 | 85 | 37 |
| **JPN** | -9.9 | -7.8 | 134 | 54 |

*Source : OECD, Economic outlook* 91.

When the multiplier (in the short term) is greater than approximately 2 (actually 1/*a*, *a* being the sensitivity of the public deficit to the economic cycle and valued at about 0.5 in the developed countries), then fiscal cutbacks produce such a decrease in activity that the short-term deficit increases with the cuts. When the multiplier is greater than approximately 0.7 (in fact, 1/(*a*+*d*), *d* being the ratio of debt to GDP), then fiscal restraint increases ratio of debt to GDP in the short term. In the longer term, things get complicated, and only a detailed modelling can help to understand in what circumstances today fiscal restraint would lead to a sustained reduction in the debt-to-GDP ratio. The value of the multiplier in the medium term is of course crucial (it is usually assumed to be null, or zero, but in the case of cost-effective public investment, this assumption does not hold), but hysteresis effects as well as changes in expectations about inflation or about sovereign interest rates (and therefore the critical gap, *i.e.* the gap between 10-year sovereign bond rates and the economy's nominal potential growth rate) interact with changes in the debt and in GDP.

Until recently, most economists believed that the value of the multiplier depends on the composition of the fiscal stimulus (taxes, expenditure and the nature of taxes and expenditure), the size of the economy and its openness (the more open the economy, the lower its multiplier) and the existence of anticipations of a fiscal shock (an anticipated shock would have little effect, in the long term, it would have none, with only an unexpected shock having a temporary effect)[1]. Recent literature (since 2009) has taken an interest in the value of the fiscal multiplier in the short term in times of crisis . Two main conclusions emerge:

1. The multiplier is higher in "times of crisis" (in the short term or as long as the crisis lasts). In "times of crisis" means high unemployment or a very wide output gap. Another symptom may be a situation where safe long-term interest rates are very low (*i.e.* negative in real terms), suggesting a flight to safety (radical uncertainty) or a liquidity trap (expectations of deflation). Two theoretical interpretations are consistent with these manifestations of the crisis. One, price expectations are moving toward deflation, or radical uncertainty makes it impossible to form an expectation, which is consistent with very low safe interest rates and leads to the paralysis of monetary policy. Or second, more economic agents (households, firms) are subject to short-term liquidity constraints, perpetuating the recessionary spiral and preventing monetary policy from functioning. In one case as in the other, the fiscal multipliers are higher than in normal times because the expansionary fiscal policy (resp. restrictive) forces the economic agents to take on debt (resp. shed debt) collectively instead of individually. In "times of crisis" the multiplier is in play including when it is anticipated and its effect persists until a

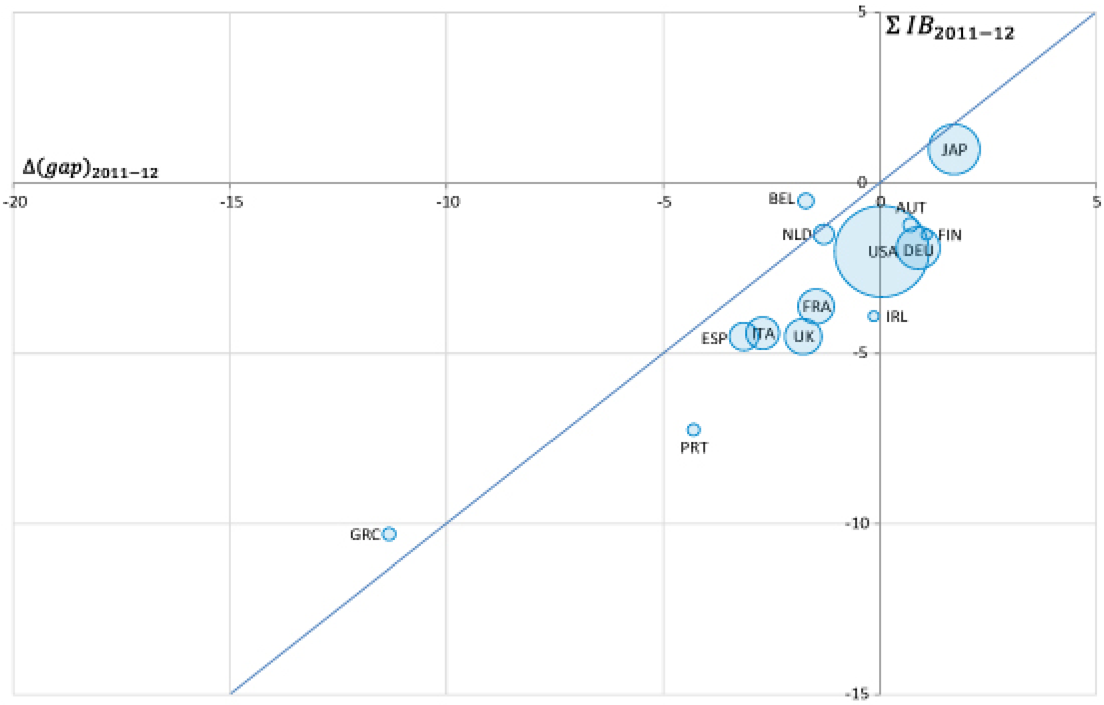
return to full employment.

2. The multiplier is higher for expenditures than it is for compulsory levies. The argument in normal times is that higher compulsory levies acts as a disincentive and spending cuts as an incentive on the supply of labour. In a small open economy, when monetary policy also induces a real depreciation of the currency, fiscal restraint can increase activity, a result that has long allowed supporters of fiscal discipline to promise all kinds of wonders. But in times of crisis, in addition to the fact that the multipliers are higher, the logic applicable in normal circumstances is reversed. The use of taxes as disincentives for the labour supply or spending cuts as incentives does not work in an economy dominated by involuntary unemployment or overcapacity. It is in fact the expectations of a recession or of deflation that act as disincentives, which is another factor indicating high multipliers.

Econometric estimates (based on past experience of “times of crisis”) lead to retaining a fiscal multiplier of around 1.5 (for an average mix of spending and compulsory levies).

Taking together 2011 and 2012, years in which a very strong fiscal impulse was carried out, confirms this econometric evaluation. By comparing on the one hand changes in the output gap from end 2010 to 2012 (on the abscissa) and on the other hand the cumulative fiscal impulse for 2011 and 2012, we obtain the short-term impact of the fiscal consolidation. Figure 1 depicts this relationship, showing a close link between fiscal restraint and economic slowdown.

Graphe 1 : Change in the output gap and the impulse 2011-2012




*Source: OECD, Economic Outlook 91*, June 2012. The year 2012 is a projection (OFCE forecast October 2012).
The area of the bubbles is proportional to real GDP in 2011 ($ PPP).

For most countries, the “apparent” multiplier is less than 1 (the lines connecting each of the bubbles are below the bisector, the “apparent” multiplier is the inverse of the slope of these lines). Figure 2 refines the evaluation. The changes in the output gap are in effect corrected for the “autonomous” dynamic of the closing of the output gap (if there had been no impulse, there would have been a closing of the output gap, which is estimated as taking place at the same rate as in the past) and for the impact of each country’s budget cutbacks on the others through the channel of foreign trade. The bubbles in orange therefore replace the blue bubbles, integrating these two opposing effects, which are evaluated here while seeking to minimize the value of the multipliers. In particular, because the output gaps have never been so extensive, it is possible that the gaps are closing faster than what has been observed in the last 30 or 40 years, which would justify a more dynamic counterfactual and therefore higher fiscal multipliers.

Austria and Germany are exceptions. As these two countries enjoy a more favourable economic situation (lower unemployment, better business conditions), it is not surprising that the multiplier is lower there. Despite this, the “corrected apparent” multiplier is negative. This follows either from the paradoxical effects of the incentives, or more likely from the fact that monetary policy is more effective and that these two countries have escaped the liquidity trap. But the correction provided here does not take into account any stimulus from monetary policy.

In the United States, the “2011-2012 corrected apparent” multiplier comes to 1. This “corrected apparent” multiplier is very high in Greece (~ 2), Spain (~ 1.3) and Portugal (~ 1.2), which is consistent with the hierarchy set out in point 1. This also suggests that if the economic situation deteriorates further, the value of the multipliers may increase, exacerbating the vicious circle of austerity.

For the euro zone as a whole, the “corrected apparent” multiplier results from the aggregation of “small open economies”. It is thus higher than the multiplier in each country, because it relates the impact of the fiscal policy in each country to the whole zone and no longer just to the country concerned. The aggregate multiplier for the euro zone also depends on the composition of the austerity package, but especially to the place where the measures are being implemented. However, the biggest fiscal impulses are being executed where the multipliers are highest or in the countries in the deepest crisis. The result is that the aggregate multiplier for the euro zone is 1.3, significantly higher than that derived from the US experience.

A comparison of the fiscal plans for 2011 and 2012 with the economic cycle in those years yields a high estimate for the fiscal multipliers. This confirms the dependence of the multiplier on the cycle and constitutes a serious argument against the austerity approach, which is to be continued in 2013. Everything indicates that we are in a situation where [austerity is leading to disaster](#).

Graphe 2 : Changes in the output gap and the impulse 2011-2012


*Source: OECD, Economic Outlook 91*, June 2012. The year 2012 is a projection (OFCE forecast October 2012).
The area of the bubbles is proportional to real GDP in 2011 ($ PPP).

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[1] There has been an intense debate about the theoretical and especially the empirical validity of these assertions (see Creel, Heyer and Plane 2011 and Creel, Ducoudré, Mathieu and Sterdyniak 2005). Recent empirical work undertaken for example by the IMF has contradicted the analyses made in the early 2000s, which concluded that anti-Keynesian effects dominate Keynesian effects. Thus, at least with regard to the short term, before the crisis and in “normal times”, the diagnosis today is that the fiscal multipliers are positive. The endogeneity of measurements of a fiscal impulse by simply varying the structural deficit interfered with the empirical analysis. The use of a narrative record of fiscal impulses addresses this issue and significantly alters estimates of the multipliers. In most macroeconomic models (including dynamic stochastic general equilibrium – DGSE – models), the fiscal

multipliers are also positive in the short term (on the order of 0.5 for a pure fiscal shock “in normal times”). In the long run, the empirical analysis does not tell us much, as the noise drowns out any possibility of measurement. The long term therefore reflects mainly an *a priori* theory that remains largely dominated by the idea that fiscal policy can have no long-term effect. However, in the case of public investment or of possible hysteresis, the assumption of a non-null effect in the long run seems more realistic.

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# The euro zone: confidence won’t be enough

By Céline Antonin, Christophe Blot and Danielle Schweisguth

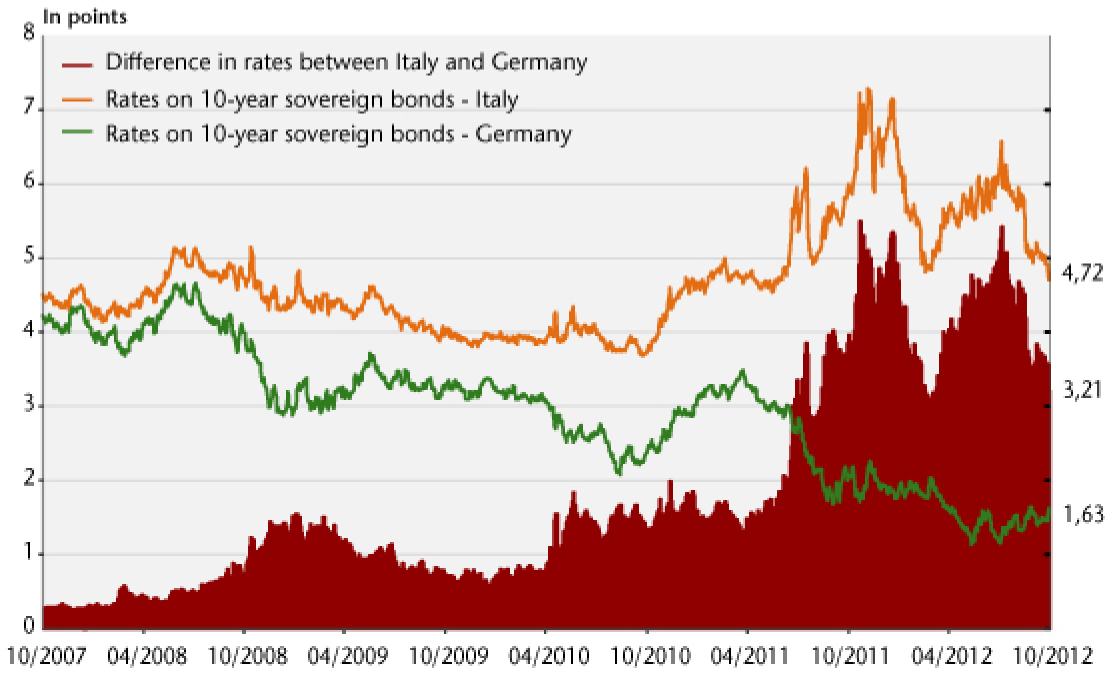
*This text summarizes the OFCE’s October 2012 forecasts for the economy of the euro zone.*

After more than two years of crisis in the euro zone, this time the meeting of the European Council, held on 18 and 19 October, had nothing of the atmosphere of yet another last-chance summit. Even though discussions on the future banking union [1] were a source of tension between France and Germany, there was no sword of Damocles hanging over the heads of the European heads of state. However, it would be premature to assume that the crisis is coming to an end. It is sufficient to recall that the GDP of the euro zone has still not regained its pre-crisis level, and in fact declined again by 0.2% in the second quarter of 2012. This decline is forecast to continue, as we expect GDP to fall by 0.5% in 2012 and by 0.1% in 2013. Consequently, the unemployment rate in the euro zone, which has already surpassed its previous historical record from April 1997, will rise further, reaching 12.1% by end 2013. What then are the reasons for the lull? Can the euro zone quickly resume its growth and hope to finally put an end to the social crisis?

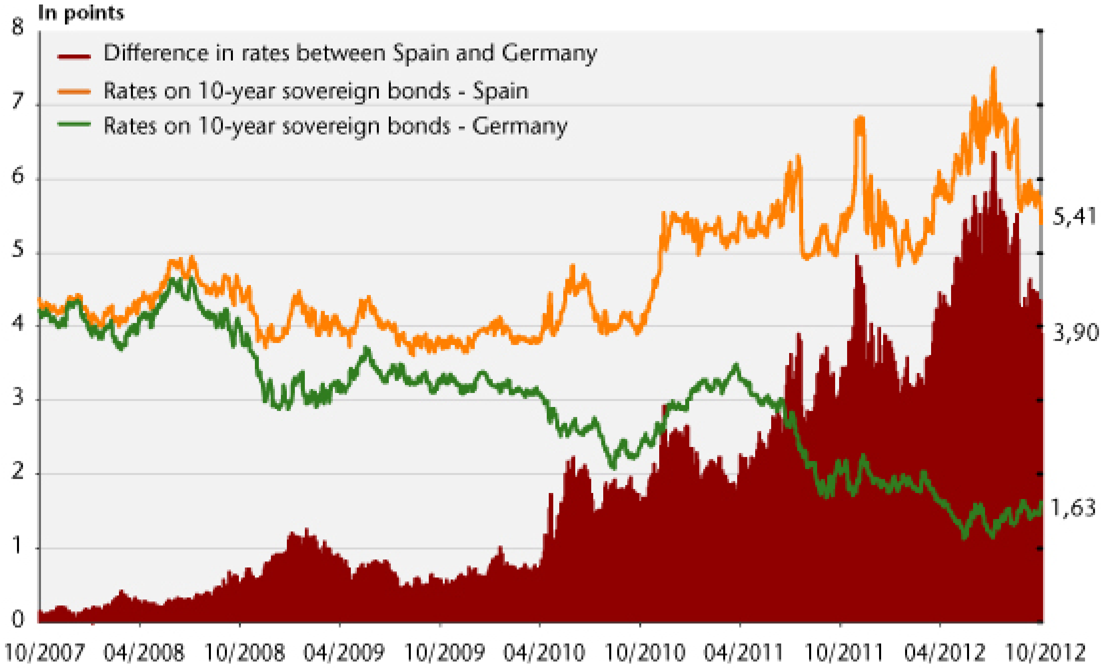
Since the end of 2011, Europe has adopted a new treaty (the Treaty on stability, coordination and governance, the TSCG) which is being ratified in the 25 signatory countries. The new law is specifically intended to strengthen both budgetary discipline – through the adoption of national golden rules – and solidarity through the creation of the European Stability Mechanism (ESM), in so far as the use of the ESM is conditional on ratification of the TSCG. On 6 September, the ECB unveiled the basic points of its new conditional purchase of sovereign debt (see here), which is aimed at reducing the interest rates of countries subject to the ESM. Thus, the risk premium, as measured by the difference between the Italian and Spanish sovereign interest rates and the German rate, after peaking on 24 July 2012, decreased respectively by 2.2 and 2.5 points (Figures 1 and 2). This is of course still far from normal, but this lull is nevertheless welcome and it shows that the spectre of a breakup of the euro zone has receded.

Could this new wave of optimism be a precursor to an upturn in the economy of the euro zone? The answer to this question is, unfortunately, negative. The fiscal policies of countries in the zone are still highly restrictive, a situation that has even intensified in 2012, pushing Italy and Spain back into recession and deepening the recession that was already hitting Portugal and Greece. For the euro zone as a whole, the fiscal stimulus will come to 1.7 percent of GDP in 2012 (table). The series of votes on national budgets confirms this strategy of a forced reduction of budget deficits for 2013, with the overall fiscal consolidation for the euro zone as a whole coming to 1.3%. There will be significant differences between the countries, since in Germany the fiscal stimulus will barely be negative (-0.2 point) while in Spain, Italy and Greece it will be more than -2 GDP points. However, the recessionary impact of this synchronized fiscal consolidation will be even greater given that the euro zone countries are still at the bottom of the economic cycle. In these conditions, the targets for budget deficit reduction will not be met, which will inevitably raise the question of the appropriateness of further budget cuts. More and more Member States thus risk being caught in a vicious circle where low growth calls for further fiscal adjustments that in turn deepen the economic and social crisis. It is essential that any decision about improving the governance of the European Union or the transmission of monetary policy restores confidence and creates the conditions for a return to growth. But this will be insufficient to escape the recession and should not obscure the impact of the fiscal strategy.

Graphique 1. Long-term sovereign interest rates in Italy and the Italy-Germany *Spread*



Graphique 2. Long-term sovereign interest rates in Spain and the Spain-Germany *Spread*




*Source* : Datastream.

Tableau. Fiscal stimulus in the euro zone countries

In GDP points

| | 2009 | 2010 | 2011 | 2012 | 2013 |
|---|---|---|---|---|---|
| Germany | 0,7 | 1,5 | -0,9 | -0,5 | -0,2 |
| Autria | 0,4 | 0,6 | -1,6 | -0,1 | -0,9 |
| Belgium | 1,9 | -0,3 | -0,1 | -1,1 | -0,8 |
| Spain | 3,8 | -2,5 | -1,1 | -3,4 | -2,4 |
| Finland | 0,4 | 1,5 | -1,6 | -0,4 | -1,3 |
| France | 2,3 | -0,5 | -2,9 | -1,6 | -1,8 |
| Greece | 3,2 | -8,0 | -5,3 | -5,0 | -3,9 |
| Ireland | 2,2 | -4,4 | -1,5 | -2,4 | -1,8 |
| Italy | 0,8 | -0,4 | -1,2 | -3,2 | -2,1 |
| Netherlands | 4,0 | -1,1 | -0,2 | -1,0 | -1,2 |
| Portugal | 5,0 | -0,7 | -3,7 | -3,7 | -1,8 |
| Euro zone 11* | 1,8 | -0,3 | -1,3 | -1,7 | -1,3 |

* Excluding Cyprus, Luxembourg, Malta, Slovakia, Slovenia and Estonia.
*Note* : The fiscal stimulus is measured by the opposite of the variation in the cyclically adjusted primary balance, that is, excluding interest charges and exceptional revenue: it approximates the discretionary budget policy.
*Sources* : OFCE calculations and forecasts, October 2012.

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[1] See here for an analysis of the importance of the proposed banking union and the questions it raises.

# France: will the war of the 3% take place?

By Eric Heyer

*This text summarizes the OFCE's October 2012 forecasts for the French economy.*

The French economy is expected to see average annual growth of 0.1% in 2012 and 0.0% in 2013. This performance is particularly poor and far from the path that an economy recovering from a crisis would normally experience.

Four years after the onset of the crisis, the French economy has real potential for a rebound: this should lead to spontaneous average growth of about 3.0% per year in 2012 and 2013, making up some of the output gap built up since the start of the crisis. But this spontaneous recovery is being hampered, mainly by the establishment of budgetary savings plans in France and throughout Europe. The fiscal consolidation strategy imposed by the European Commission is likely to slice nearly 6 percentage points off GDP in France during 2012 and 2013.

Table 1. The brakes on growth in France

En points of GDP

| Rythm | ... quaterly | | ... annually | |
|---|---|---|---|---|
| | 2012 | 2013 | 2012 | 2013 |
| Spontaneous recovery | 0,8 | 0,8 | 2,1 | 3,1 |
| *Budget impact* | *-0,4* | *-0,4* | *-1,6* | *-1,7* |
| *Oil shock* | *-0,05* | *0,0* | *-0,2* | *0,0* |
| *External environment* | *-0,4* | *-0,3* | *-1,4* | *-1,2* |
| *Achievement* | | | *-1,0* | *-0,2* |
| Growth forecasts | -0,04 | 0,04 | 0,1 | 0,0 |

Sources : INSEE, OFCE calculations.

By setting a pace that is far from its potential, the expected growth will increase the output gap accumulated since 2008 and will lead to a further deterioration on the labour market. The unemployment rate will rise steadily and hit 11% by late 2013.

Moreover, the reduction of the budget deficit expected by the Government due to the implementation of its consolidation strategy – the target for the general government deficit is 3% of GDP in 2013 – will be partially undermined by the shortfall in tax revenue due to weak growth. The general government deficit will come to 3.5% in 2013.

Under these conditions, should the government do whatever it can to fulfil its commitment to a 3% deficit in 2013?

In a context of financial uncertainty, being the only State not to keep its promise of fiscal consolidation is a risk, *i.e.* of being punished immediately by an increase in the financial terms on the repayment of its debt. This risk is real, but limited. The current situation is that of a "liquidity trap" and abundant savings. The result is a "flight to quality" phenomenon on the part of investors seeking safe investments. But among these are both German and French government bonds. Under these conditions, reducing the government deficit by 1 GDP point instead of 1.5 point would have very little impact on French bond rates.

However, maintaining a target of a 3% deficit in 2013 could have a dramatic impact on economic activity and employment in France. We simulated a scenario in which the French government maintains its budgetary commitment regardless of the costs and the economic situation. If this were to occur, it would require the adoption of a new programme of budget cuts in the coming months in the amount of 22 billion euros.

This strategy would cut economic activity in the country by 1.2% in 2013. It would lead to a further increase in the unemployment rate, which would reach 11.7% at year end, nearly 12%. As for employment, this obstinacy would intensify job losses, costing nearly 200,000 jobs in total.

A darker scenario is also possible: according to our forecasts, and taking into account the draft budget bills known and approved, no major European country would meet its deficit reduction commitments in 2013. By underestimating the difficulty of reaching inaccessible targets, there is a high risk of seeing the euro zone countries locked into a spiral where the nervousness of the financial markets would become the engine driving ever greater austerity. To illustrate this risk, we simulated a scenario in which the major euro zone countries (Germany, France, Italy and Spain) implement new austerity measures to meet their deficit targets in 2013. Adopting such a strategy would result in a strong negative shock to economic activity in these countries. For the French economy, it would lead to additional austerity that either at the national level or coming from its euro zone partner countries would cause a severe recession in 2013. French GDP would fall by more than 4.0%, resulting in a further increase in the unemployment rate, which would approach 14%.

## Table 2. Illustrative scenarios of risks to French growth

In %

| | 2011 | 2012* | 2013* |
|---|---|---|---|
| **Central scenario** | | | |
| GDP | 1,4 | **0,1** | **0,0** |
| Gov't deficit *(in GDP points)* | -7,1 | **-4,4** | **-3,5** |
| Unemployment rate | 9,4 | **10,2** | **11,0** |
| Market employment | 104 | **-95** | **-166** |
| **Scenario where France alone meets its budget commitments** | | | |
| GDP | | | **-1,2** |
| Gov't deficit (in GDP points) | | | **-3,0** |
| Unemployment rate | | | **11,7** |
| Market employment *(in 1000s)* | | | |
| Change | | | **-361** |
| Deviation from central scenario | | | **-195** |
| **Scénario where euro zone countries meet their budget commitments** | | | |
| GDP | | | **-4,6** |
| Gov't deficit *(in GDP points)* | | | **-3,0** |
| Unemployment rate | | | **18,8** |
| Market employment *(in 1000s)* | | | |
| Change | | | **-910** |
| Déviation from central scenario | | | **-744** |

* OFCE forecast October 2012

*Sources :* INSEE ; OFCE calculations *e-mod.fr.*