

Fiscal policy honoured

By [Jérôme Creel](#)

“The size of many multipliers is large, particularly for spending and targeted transfers.” Who today would dare to write such a thing?

The answer is: 17 economists from the European Central Bank, the US Federal Reserve, the Bank of Canada, the European Commission, the International Monetary Fund, and the Organization for Economic Cooperation and Development, in an article published in January 2012 in the [American Economic Journal: Macroeconomics](#).

They continue in the abstract: “Fiscal policy is most effective if it has moderate persistence and if monetary policy is accommodative. Permanently higher spending or deficits imply significantly lower initial multipliers.”

What are the values of these multiplier effects, and what about the significant reduction in such effects if fiscal policy is expansionary over the long term? According to these 17 economists, based on eight different macroeconomic models for the US and four different models for the euro zone, the conclusion is clear: a fiscal stimulus that is in effect for 2 years, accompanied by an accommodative monetary policy (the interest rate is kept low by the central bank) produces multiplier effects that are well above one both in the United States and in the euro zone (between 1.12 and 1.59) if the stimulus plan targets public consumption, public investment or targeted transfers. For other instruments available to government, such as VAT, the effects are smaller, on the order of 0.6, but still decidedly positive.

What if the stimulus is continued? The multiplier effects of a permanent increase in public consumption dwindle, of course, but they remain positive in the euro zone, regardless of the

model used and regardless of the assumption made about the monetary policy pursued. Rare cases of negative multiplier effects are reported for the United States, but these depend on the model used or on assumptions about monetary policy.

Finally, a comment and a question raised by this recent article.

The comment: the choice of an optimal fiscal policy in the euro zone is well worth a few moments of reflection, reading and analysis of current work, rather than a truncated and distorted vision of fiscal policy that is judged without fair consideration as harmful to economic activity.

The question: an expansionary fiscal policy has ... expansionary effects on gross domestic product; must we really deprive ourselves of an instrument that is, after all, effective?

Austerity is not enough

By André Grjebine and [Francesco Saraceno](#)

It is certainly possible to question whether the role acquired by the rating agencies in the international economy is legitimate. But if in the end their message must be taken into account, then this should be done based on what they are really saying and not on the economic orthodoxy attributed to them, sometimes wrongly. This orthodoxy is so prevalent that many commentators are continuing to talk about the decision by Standard & Poor's (S&P) to downgrade the rating of France and other European countries as if this could be attributed to an

insufficiently strong austerity policy.

In reality, the rating agency [justifies](#) the downgrade that it has decided with arguments opposed to this orthodoxy. For instance, the agency criticises the agreement between European leaders that emerged from the EU summit on 9 December 2011 and the statements that followed it, making the reproach that the agreement takes into account only one aspect of the crisis, as if it "... stems primarily from fiscal profligacy at the periphery of the euro zone. In our view, however, the financial problems facing the euro zone are as much a consequence of rising external imbalances and divergences in competitiveness between the EMU's core and the so-called 'periphery'. As such, we believe that a reform process based on a pillar of fiscal austerity alone risks becoming self-defeating, as domestic demand falls in line with consumers' rising concerns about job security and disposable incomes, eroding national tax revenues."

Based on this, S&P believes that the main risk facing the European states could come from a deterioration in the fiscal positions of certain among them "in the wake of a more recessionary macroeconomic environment." As a result, S&P does not exclude a further deterioration in the coming year of the rating of euro zone countries.

So if the European countries do indeed take into account the explanations of the rating agency, they should implement economic policies that are capable of both supporting growth and thereby facilitating the repayment of public debts while at the same time rebalancing the current account balances between the euro zone countries. This dual objective could be achieved only by a stimulus in the countries running a surplus, primarily Germany.

Unsustainable debt

The budget adjustments being imposed on the countries of the

periphery should also be spread over a period that is long enough for its recessionary effects to be minimised. Such a strategy would accord with the principle that in a group as heterogeneous as the euro zone, the national policies of member countries must be synchronised but certainly not convergent, as is being proposed in some quarters. Such a policy would boost the growth of the zone as a whole, it would make debt sustainable and it would reduce the current account surpluses of some countries and the deficits of others. The least we can say is that the German government is far from this approach.

Didn't Angela Merkel respond to the S&P statement by calling once again for strengthening fiscal discipline in the countries that were downgraded, that is to say, adopting an analysis opposed to that of the rating agency? Given its argumentation, one begins to wonder whether the agency wouldn't have been better advised to downgrade the country that wants to impose austerity throughout the euro zone rather than wrongly to give it a feeling of being a paragon of virtue by making it one of the few to retain its AAA rating.

“Buy French”: From the slogan to the reality

By [Jean-Luc Gaffard](#), [Sarah Guillou](#), [Lionel Nesta](#)

The current election campaign is lending weight to simplistic proposals like the slogan “buy French”, which evokes the need

for France to re-industrialize. And to accomplish this, what could be simpler than to convince the population to buy native products designated with a special label? This is also more politically correct than advocating a straightforward return to protectionism. Employment is expected to benefit, along with the balance of trade. But if we look more closely, not only is it difficult to identify the geographical origin of products, but even if that were possible, any preference that these products might enjoy could well wind up in job losses. This solution for dealing with the need for re-industrialization ultimately reflects a refusal to get to the bottom of the problem.

Can we really define what it means to “buy French”? Does it mean buying the products of French companies? What about buying products made in France by foreign companies instead of buying products made abroad by French companies? These simple questions show that it is not so easy to pin down what is “Made in France”. One major difficulty is that the final goods produced in a country usually incorporate intermediate goods manufactured abroad. It may even happen that the components of a final product are manufactured by a competitor in another country. The iPhone is emblematic of this [fragmentation](#). Should we refrain from purchasing intermediate goods from low-wage countries even though this makes it possible to produce final goods at a lower cost and boost exports by being more competitive on price? Those who think so should no longer be touting German industry as an example, since everyone knows about the growing share of imported inputs in the production of the final goods Germany exports (OECD, *Measuring Globalisation: OECD Economic Globalisation Indicators 2010*, p. 212).

Imagine, nevertheless, domestic consumers who are able to identify products with a high labour content and are ready to make sacrifices out of a spirit of economic patriotism. Don't the polls tell us that over two-thirds of consumers would be

willing to pay more for French goods? While there are doubts about whether they would actually do this, it would be risky to ignore the opportunity cost of such a choice. Buying more expensive products simply because they are French reduces purchasing power. Other goods and services would not be purchased or would be bought for less abroad. The balance sheet for employment is far from certain.

Should this exercise in economic patriotism actually materialize, it would be a way that consumers form attachments to certain types of products, in this case based on their place of manufacture, which would in turn reduce the intensity of competition. This could lead the companies concerned to cut back on their efforts to become more competitive on price and other factors. Why, indeed, should they shell out for expensive and risky investments when have a guaranteed customer base? It's a safe bet that they will not do this much, if at all. The national economy would then be locked in a low technology trap, doomed to slower growth, obviously with damaging consequences for employment in the medium and long term. This would also deprive the economy of the means to innovate and improve the competitiveness of its products.

Finally, it is likely that the willingness to buy French products would benefit products that replace goods made elsewhere in Europe rather than goods made in developing countries, either because the latter are no longer manufactured at all in France or because the price differences with French products would still be prohibitive. Ultimately it would not be possible to avoid further shifts in production to low-wage countries, with the consequent job losses. Furthermore, from a European perspective the non-cooperative character of this kind of measure could lead our European partners to adopt reciprocal measures, which would be detrimental to exports and employment.

The slogan "buy French" masks a refusal to see that the downturn is a global phenomenon which calls for a

comprehensive response at the European level, and a refusal to consider a proactive industrial policy that takes into account the realities of supply as well as demand.

This is not just a matter of looking the other way. France is undergoing a deindustrialization process that threatens its capacity for growth. But who can deny that this phenomenon has accelerated with the crisis and that this acceleration is set to increase [as the general austerity measures and restrictions on bank credit further undermine domestic and European demand](#) for consumer durables? Unless we are willing to accept that an entire segment of industry in France and elsewhere in Europe is destroyed, with no hope of ever returning, and with as a consequence still greater disparities between countries and sharper conflicts of interest, it is clearly urgent to support this kind of demand.

Is this kind of support “the solution”? Of course not: propping up demand will not be enough, as an industrial policy aimed at strengthening the supply side is also needed. The point is not to protect domestic production nor to promote the conquest of foreign markets through competition on taxation or social charges, but to stimulate investments designed to produce new goods and services, which is the only way to create stable jobs. Rather than try to rely on dubious slogans, the goal should be [to consolidate production that has the advantage of being high quality in terms of design, safety and reliability,](#) and which corresponds to what French and European consumers genuinely want.