

Repeat

By [Jérôme Creel](#)

In a beautiful book for children, every two pages [Claude Ponti](#) drew two chicks, one of which says to the other: “Pete and Repeat are in a boat. Pete falls overboard. Who is left?” Then the other chick says, “Repeat”, and off we go again. At the end of the book, the second chick, its eyes bulging, screams: “Repeat!” And it never stops. It’s a bit like these analyses of economic growth and fiscal contractions where almost every month it is rediscovered that the ongoing fiscal contractions are reducing economic growth or that underestimating the real impact of fiscal policy is leading to forecast errors.

Recently, and after having authored a box in the *2013 World Economic Outlook* in October 2012, Daniel Leigh and Olivier Blanchard of the IMF published a [working document](#) that confirms that the IMF’s recent forecasting errors are due to erroneous assumptions about the multiplier effect. Because this effect was underestimated, especially at the bottom of the economic cycle, the IMF forecasters, though they are not alone (see in particular the note by [Bruno Ducoudré](#)), underestimated growth forecasts: they had not anticipated that what was required by the austerity measures and their implementation would have such a negative impact on consumer spending and business investment. The attempt to reduce state debt was taking place during a period when households and businesses were also deleveraging, meaning that it would be difficult to avoid falling into the trap of recession.

Since it must be repeated, let’s repeat! “Expansionary-fiscal-contractions and Repeat are in a boat. Expansionary-fiscal-contractions falls overboard. Who is left in the boat? Repeat!” In support of this short story, it is worth referring to a literature review conducted by [Eric Heyer](#): he shows the extent of the consensus that actually exists on the value of

the fiscal multipliers, a consensus that has emerged since 2009, *i.e.* in the midst of a recession and at the very time that recommendations for austerity measures began to emerge. A note by [Xavier Timbeau](#) shows that the analysis of current fiscal cutbacks supports an assessment that the value of the fiscal multiplier is much higher in a crisis than in normal times ... What paradoxes!

What is to be done now? Repeat, yet again, that recession may not be inevitable: as [Marion Cochard, Bruno Ducoudré and Danielle Schweisguth](#) pointed out in a supplement to the [2013 iAGS report](#), it is urgent to temper existing fiscal austerity measures in the euro zone: European growth but also actual fiscal consolidation would improve at last.

The euro zone in crisis

By [Catherine Mathieu](#) and [Henri Sterdyniak](#)

The 9th EUROFRAME Conference [1], which was held in Kiel on 8 June 2012, focused on economic policy issues in the European Union. The topic was “The euro zone in crisis: Challenges for monetary and fiscal policies”. [Issue 127 of the “Débats et Politiques” collection of the OFCE Revue](#) has published revised versions of twelve papers presented in the Conference[2], gathered in five themes: exchange rate imbalances, indicators of the debt crisis, budget rules, banking and financial issues, and strategies for resolving the crisis.

The analysis of the origins of the euro zone crisis and economic policy

recommendations to get out of the crisis have been the subject of great debate among economists, which was illustrated in the EUROFRAME Conference. In the course of these articles, the reader will see several fault-lines:

– For some, it is the irresponsible policies of the South that are the cause of the imbalances: they have allowed the development of wage and property bubbles, while the Northern countries have been implementing virtuous policies of wage austerity and structural reform. The Southern countries thus need to adopt the North's strategy and undergo a lengthy austerity cure. For others, the single currency has led to the development of twin opposing imbalances: this has led to under-valuing the economies of the North, which enabled them to offset their excessive policies on wage and social austerity with excessive external surpluses, and it has allowed the persistence of the South's external deficits; this has resulted in the need for a controlled convergence, whereby recovery in the North facilitates the absorption of the South's external imbalances.

– Some argue that each country must implement policies that combine a strong reduction in public spending – to absorb the budget deficits and reduce the public debt burden – with structural reforms (liberalization of the markets for goods and services, deregulation of the labour market) in order to offset the depressive effect on the labour market. The financial markets have to be allowed to impose the necessary discipline on the countries. Others hold that the public deficits have to be tolerated as long as necessary to support economic activity, public debt needs to be guaranteed by the European Central Bank (ECB) to ensure that domestic interest rates converge at low rates, and an EU-wide growth strategy is needed (in particular to finance the investments required for the ecological transition).

– Some even believe that we must avoid any further extension of European solidarity, as it would enable some countries to put off the reforms needed, which would lead to persistent

imbalances and thus to money creation and inflation. Others argue that errors have been made on economic policy since the inception of the euro zone, and that these have led to sharp disparities in the zone, which now need to be reduced by means of a coherent solidarity strategy. Europe is one big family and must demonstrate its solidarity and accept compromises to continue to live together.

– For some, ending the debt crisis of the euro zone countries requires the establishment of a fiscal union, which means the establishment of binding rules enshrined in the Fiscal Pact and a certain degree of fiscal federalism; the European Commission and Council should have a say on the fiscal policies of the Member States. Others think that the Member States should have a degree of autonomy to practice the fiscal policy they choose; this is a matter of both democracy and economic efficiency: the economic situations of the different countries are too diverse to invoke a uniform fiscal policy; what is needed is the open coordination of economic policy, without rigid pre-established standards on public finances, with the aim of ensuring satisfactory growth and the winding down of external imbalances.

[1] [EUROFRAME](#) is a network of European economic institutes, which includes: the DIW and IFW (Germany), WIFO (Austria), ETLA (Finland), OFCE (France), ESRI (Ireland), PROMETEIA (Italy), CPB (Netherlands), CASE (Poland), NIESR (United Kingdom).

[2] Ten of which are in English and two in French.

Valuing energy savings fairly

By [Evens Salies \[1\]](#)

Following the first meeting of the *Commission mixte paritaire* (a joint commission of the two houses of the French Parliament) on the proposed legislation to “make the transition to a sound energy system”, it is important to examine the reasons that led the Senate to adopt a motion on 30 October 2012 to dismiss this bill. This rejection is based on errors of judgment that reflect the difficulty of defining a residential energy pricing that is efficient and fair in light of the government’s objectives to control energy demand. It also seems appropriate to seek clarification of whether the proportional pricing in force needs to be corrected in order to reward energy savings.

The opposition of the parliamentarians focuses on the following point: the bonus-malus system breaches the principle of equal treatment of citizens regarding access to energy.[\[2\]](#) This argument is reminiscent of the annulment by the Constitutional Council in 2009 of the carbon tax.[\[3\]](#) It is nevertheless surprising, since the principle of equal treatment is not fully respected by the current system of tariffs. In practice, each household pays two local taxes on their final consumption of electricity. However, the taxes differ from one town or department to another, for reasons that are difficult to explain. The Senators also criticized the progressivity of the bonus-malus system that is to be superposed on the current rates, treating it as a hidden tax. There seems to be little grounds for this criticism in that the social tariffs already introduce some progressivity.[\[4\]](#)

The innovative element of the bill concerns the compatibility

between the proportional pricing in force and the valuation of energy savings. Between households of similar composition who are subscribers at the same rate, there is already a reduction for the household that controls its usage. But is this reduction sufficient to compensate for the effort? In other words, should we consider that a kilowatt-hour of savings that costs an effort has the same economic value, in absolute terms, as a kilowatt-hour that is simply consumed? Everything depends on whether the savings in question is considered a gain or a loss. For households in the latter situation, the savings is seen as a cost. So the savings is not made, which is why the bonus-malus system would be effective. The others do not need an added incentive.

The bonus-malus system does not simply offer a discount (bonus) that is to be funded by the overages. [\[5\]](#) It also aims to inform individual households about their behaviour, *i.e.* whether it is virtuous or not, which is consistent with several recent observations in the literature: a household does not base its energy consumption on tiny marginal pricings, which are counted in centimes per kilowatt / hour and which people understand only imperfectly. Changes in the amount of the energy bill and announcements of price fluctuations play a greater role. Bonuses and penalties thus matter less as absolute values than as signals sent to households by their relative values on the invoice.

The superposition of the bonus-malus system on the rates in effect will of course initially simply amplify the gaps in spending between users. But the bonus that would apply on the bill of households whose behaviour benefits everyone is no less legitimate than the discounts enjoyed by households who changed suppliers once the retail energy markets were opened to competition.

Unfortunately, the rejection of the Brottes bill has ended any educational discussion about the relationship between energy efficiency and residential energy pricing. The lack of

enthusiasm for the topic in the public debate is easy to perceive from reading the recent, voluminous report of the Commission of Inquiry on the actual cost of electricity. This is not so surprising in a sector where innovation is encouraged more on the supply side. The *effacement diffus* scheme is the latest example.[\[6\]](#) But without innovation in the structure of energy tariffs too, will France be able to achieve its goal of reducing energy consumption?

[\[1\]](#) The author would like to thank Marcel Boiteux, Marc-Kévin Codognet, Jérôme Creel, Gilles Le Garrec, Marcelo Saguan and Karine Chakir. The opinions expressed in this note are the responsibility of the author alone.

[\[2\]](#) This principle is ensured by tariff equalization: the schedule of tariffs is the same regardless of the place of residence.

[\[3\]](#) On the grounds that this tax violates the equality of taxpayers with respect to the public tax burden.

[\[4\]](#) Crampes, C., Lozachmeur, J.-M., 10 Sept 2012, “Les tarifs progressifs de l’électricité, une solution inefficace”, *Le Monde*.

[\[5\]](#) In the case where the sum of the penalties is not enough to cover the bonuses, the State will finance the deficit. And even in the absence of a deficit, as the distribution of virtuous consumers is not necessarily the same from one provider to another, an equalization of the bonus-malus balances should be applied so that everyone ends up with a zero balance.

[\[6\]](#) This consists of interrupting the power to a radiator or boiler for 10 or 15 minutes.

Human capital policies and inequality in recessions' times

By [Francesco Vona](#)

Not only economic crises reduce citizens' current welfare, but might as well hinder the long-run economic potential leading to an excessive destruction of physical and human capital. This long-run effect is definitely the big risk European economies are facing in this prolonged phase of recession. Economists often take a different standpoint for investments in human capital: recessions are claimed to have a positive rather than a negative effect on skill formation because higher unemployment frees up time for schooling. What they take for granted is that the choice of staying longer in school is not constrained by the increased difficulty in affording tuition fees, living expenditures and the opportunity cost of not working, particularly for less wealthy households. If this is taken into account, the likelihood that the positive effect prevails depends on public policies as public expenditures in education are needed to offset for the reduced spending capacity of households. The austerity measures imposed to countries at greater risk of default by the European institutions make it more difficult to maintain an appropriate flow of public expenditures in education.

So far, however, the standard view of a positive effect of recessions on skill formation is in line with data (Oecd, *Education at Glance 2012*). In the majority of European

countries, including the most financially exposed ones, both enrollment rates at all levels of education and public expenditures in education as a proportion of public expenditures are held unchanged (or increased) one year after the crisis. Unfortunately, updated data until 2012 are not available to evaluate long-term country responses[1]. However, a reversal of this trend is likely to occur in next years if further budget cuts are carried out in indebted states. Signals in this direction have already emerged in budget cuts just implemented in Italy and Spain, two of the countries already with a relatively low level of subsidies for less advantaged students compared to the EU average (Usher and Cervanen, 2005). Poor households are likely to bear the costs of these cuts the most as they heavily rely on public support to overcome stringent liquidity constraints. Equity considerations in access to education are of paramount importance as students from good family backgrounds have a significantly higher probability to acquire higher degrees and to enter elite institutions in virtually all European countries (see Raitano and Vona, 2010). Even leaving aside equity considerations, it would be exceedingly difficult in this context to pursue the target of the Lisbon agenda, 'making Europe the most competitive knowledge-based economy in the world', without interventions aimed at improving the quality of European educational systems from which long-run growth crucially depends.

To make hands meet and reconcile equity with improving quality, market-based solutions have been proposed. The main goal is to drain fresh, mainly private, resources into slack educational systems and, at the same time, to increase competition as a discipline device for improving quality. *The Economist*, for instance, recently supported a voucher system that would enable students to choose between public and private institutions[2]. For university education, another proposal under consideration in many countries (see Ichino and Terlizzese 2012, for Italy) and already adopted in many others

(see Dearden *et al.* 2008) is to combine higher tuition fees, that would reduce the burden on the public budget, and a system of contingent student loans to be repaid depending on future incomes. It is claimed that such a system would increase fairness. While educational systems in Europe certainly need substantial interventions to increase quality, it is not warranted that these reforms would go in the right direction.

On the voucher system, it should be observed that the existing quality of private schools in EU countries is not higher than the one of public schools. Considering PISA (Program for International Student Assessment) test scores as a standardized measure of quality, We estimate the impact of private schools on average test at the school level controlling for confounding factors at the school and the country level (family background, country-level policies, class size, school location, see for details Raitano and Vona, 2010). From this analysis, it emerges clearly that public schools outperform private ones in reading, science and math scores. Therefore, a simple reallocation of resources towards the private sector would lead to a decrease in overall quality. Put it differently, the private sector is not ready to take the lead for reforming the educational system in EU countries, hence creating a larger market for private schools might even be inefficient. It is also questionable whether a voucher system would really succeed in increasing the students' choices in presence of limited slots for best schools and priority given to those residents in the school neighborhood.

On the income-contingent scheme, it certainly improves loan-based schemes that tend to select out students with both low propensity to risk and self-esteem, such as typically those from marginal ethnic groups or poor family background. Indeed, conditioning loan repayments to future income reduces the uncertainty of human capital investments and so should

work particularly well for disadvantaged students. However, the perception of the risks involved might not be reduced enough to induce people to invest, particularly when the loan taken is relatively large (as it would be for the increase in the fees) and when other lifelong loans such as mortgages are expected to be undertaken in the future. In addition, since disadvantaged students make the choice of starting university in an unfavorable position in terms of existing skills and competencies, their expectations on future earnings might be so low to not justify the risk, though partial, of paying for university education. Even if these problems of income-contingent schemes can be somehow corrected, for instance in the UK they are complemented by a grant for disadvantaged students (Dearden *et al.*, 2008), they can hardly favour an effective equalization of educational opportunities.

These critiques do not imply that human capital policies and the European educational system are well designed and dynamic enough. Particularly for university education, increasing competition for scarce resources and decentralization in decision-making can help in creating highly innovative institutions, but not to increase equal access for all. In particular for the issue of equality of opportunity, it is well known that it is better achieved intervening early in the educational stream (Cunha and Heckman 2007, Heckman and Bas 2010). According to this view, policies imposing the share of less well-off students in elite universities, as it has been recently proposed for France and experimented in Brazil, seem to perform poorly both for equity and efficiency.

In times of crisis, an alternative way to make the European system more dynamic, to prevent an excessive destruction of human capital and to increase equality of opportunity is (obviously as it might be) to target the issue at the European level. However, 'inclusive' interventions to enhance the competences of less rich pupils are not at zero cost, but typically require large scale public investments in the

crucial phase of pre-primary education and, later one, targeted interventions in marginal schools of poor neighborhoods. A large scale public intervention can be done launching EU bonds conditioned to certain strategic goal such as the finance kindergarten for all European kids or targeted interventions in marginal schools. Incidentally, these 'conditioned bonds' would probably appear far more acceptable for skeptic citizens of Nordic countries. EU resources for these goals can also be drained by gradually phasing out the expensive Community Agricultural Policy, which absorbs more than 1/3 of the EU budget, and by devoting a fraction of structural funds for targeted interventions in marginal primary and secondary schools. Clearly, targeted EU policies for skill formation, especially of the less well-off, would also have a positive effect on growth by increasing the share of students with good basic skills and so the effectiveness of lifelong training policies, which crucially depends on the level of basic skills.

With these policies for increasing equality of opportunity in place, the effect of reforms aimed at increasing competition among universities using a combination of loans, higher tuition fees and premia depending on academic records can not only be fairer, but also remarkably more effective by enlarging the pool of potential candidates for good universities and enhancing the lifelong learning potential of EU citizens.

Further readings:

Raitano, M. and Vona, F., 2010. Peer Heterogeneity, Parental Background and Tracking: Evidence from PISA 2006. *Documents de travail de l'OFCE* 23-2010.

Dearden, L., Fitzsimons, E., Goodman, A., Kaplan, G., 2008. [Higher Education Funding Reforms in England: The Distributional Effects and the Shifting Balance of Costs.](#) *Economic Journal* vol. 118(526).

Cunha, F., and Heckman, J., 2007. [The Technology of Skill Formation](#). *American Economic Review* 97(2).

Heckman, J., and Bas, J., 2009. Policies to Create and Destroy Human Capital in Europe. *IZA Discussion Papers* 4680, Institute for the Study of Labor.

Usher, P., and Cervanen, A., 2005. *Global higher education rankings: Affordability and accessibility in comparative perspective*. Washington, Toronto: Educational Policy Institute.

[1] Eurostat has data updated to 2010, see <http://appsso.eurostat.ec.europa.eu/nui/setupModifyTableLayout.do>. As it is evident looking at the percentage of public expenditures in education as a percentage of GDP, only in Italy one can observe a timid -0.1% decline between 2007 and 2010.

[2] <http://www.economist.com/node/21564556>

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

By Bruno Ducoudré

Following on the heels of the IMF and the European Commission

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

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

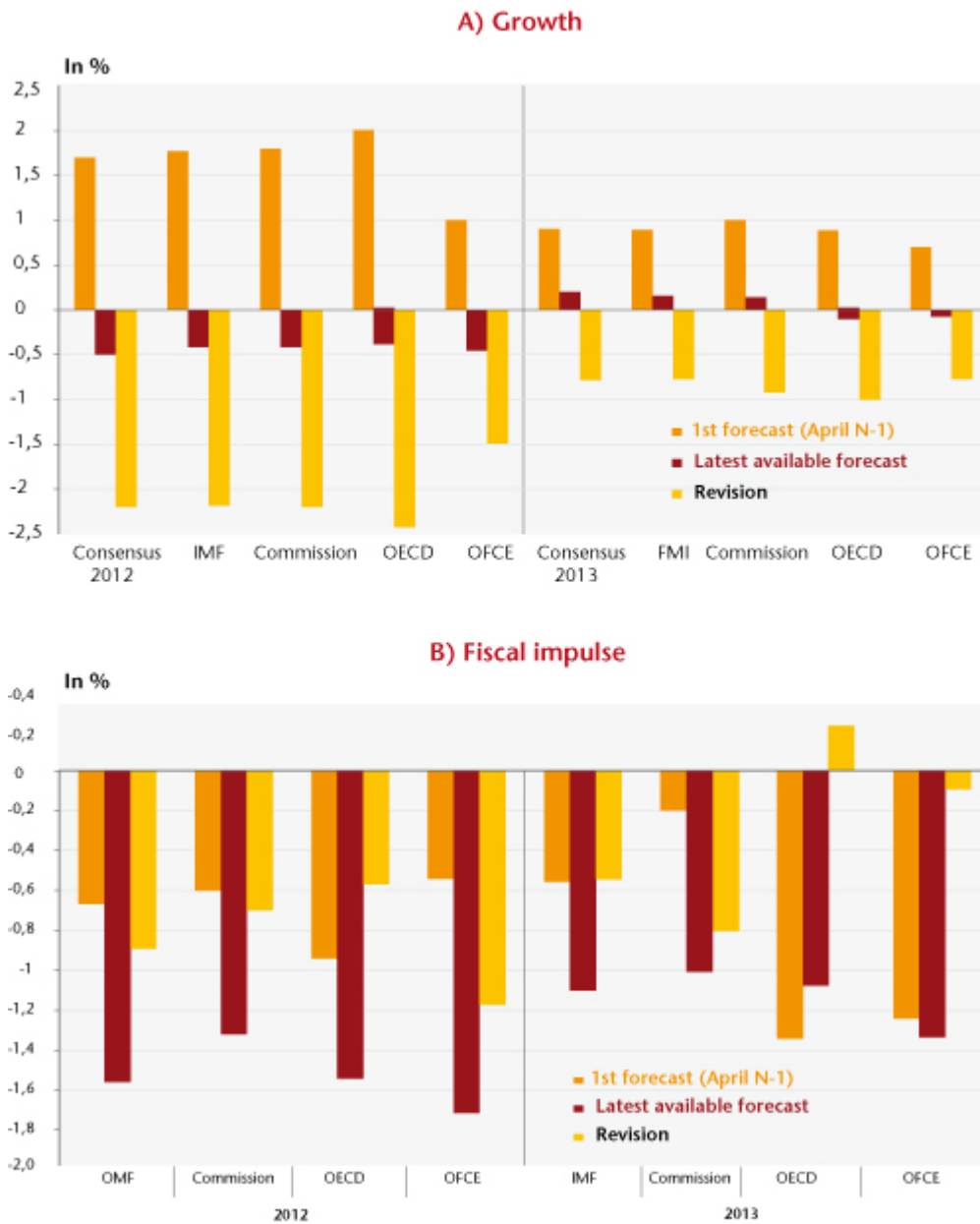
- – What are the main factors leading to the revision of the growth forecasts? Given the scale of the austerity measures being enacted in the euro zone, we can expect that the revised forecast of the fiscal impulses is a major determinant of the revisions to the growth forecasts. These revisions are, for example, the main factor explaining the [OFCE's revisions to its growth forecasts for France in 2012](#).
- – Is this change in discourse concretely reflected in an upward revision of the multipliers used in the forecasting exercises? These institutions do not generally specify the size of the multipliers used in their forecasting. An analysis of the revisions to the forecasts for the euro zone in 2012 and 2013 can, however, tell us the extent to which the multipliers have been revised upwards.

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

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

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

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



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

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

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

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

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

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

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

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

[multipliers.](#)

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

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

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

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

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

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

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

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

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

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

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

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

The ban on naked CDS takes effect

By Anne-Laure Delatte

The [small CDS market](#) serves as an instrument for coordinating speculation against European states. To stop the speculation, the European Union recently adopted a new regulation that came into force on 1 November. Unfortunately, this new law, though pioneering and ambitious, suffers from flaws that render it ineffective. This provides an example of how the interests of a single economic sector can capture policy.

Quick primer on finance: how to speculate against a State

Two methods have won their spurs: short sales in the bond market and naked sales on the CDS market. Let's take two examples. If you think that Spain will not be able to meet its commitment to reduce its deficit in 2013, you could make money by betting against it the next time it issues bonds. To do this, you need to find an investor on the market who is prepared to buy Spanish bonds when they are next issued. You sell your customer bonds at that point while wagering that the price will be lower than what they think. You do not buy the titles at that time, as you can buy them at the time of delivery. You win if your expectations were correct: if the price of Spanish bonds declined due to the deterioration in the country's economic situation, then you will buy them for less than the purchase price that you agreed to. You are engaging in short selling.

There is another way of operating that the new European law also tries to counter. You make your bets on the market for credit default swaps (CDS), that is, the market for insurance against a Spanish default. It is smaller, it is concentrated, and it is easier to affect than the bond market. There's no

need for Spain to declare bankruptcy to pocket your winnings! Buy Spanish CDS (on state or Santander bonds) today and sell them when the risk has increased: you resell the protection for more ... One detail: do not actually burden yourself with Spanish bonds. They are useless since it is on the resale of the CDS that you make your profit. Your intention was never to insure the bonds... The CDS are tradable goods whose price evolves according to supply and demand. And this is precisely the advantage of a small liquid market: you can move the market with lesser amounts...

The Directive that took effect on 1 November 2012 banned these two strategies: short selling sovereign bonds and naked trading in sovereign CDS. If you now want to bet on the CDS market, you are required to hold in your portfolio the securities that the CDS protects, or at least very similar ones.

At last, a courageous law! A ban on naked CDS, which was considered in the United States and then abandoned in 2009, is a pioneering act by Europe! It's no longer possible to speculate against Europe's states...

Except that:

The ban does not apply to "market makers". Who are they? To be sure that a market works, certain operators are committed to always buy or sell a security to anyone who so wishes (they simply determine the price of the transaction). This ensures market liquidity. For example, Morgan Stanley is a very active market maker on the entire CDS market; the bank provides continuous prices for all market transactions. "So these market makers are useful. Can you imagine if we even included these operators in the ban on naked CDS? There would be no more liquidity!" This is the essence of the argument used by the major banks to negotiate their exemptions and the specific argument used to justify the exemption of these market makers from the ban on naked sovereign CDS sales in Europe. The

market makers won: they can continue to trade CDS without holding the underlying bonds.

But wasn't the point made [in the previous post](#) that this market is in fact highly concentrated? That 87.2% of transactions were carried out by the 15 largest banks in the world ... all of which are market makers? In other words, the new rule will be applied to everyone ... except the main players on the market. It seems that the big French banks are currently in discussion with the [European financial markets authority](#) (ESMA) over the exact definition of a market maker to ensure that they too are exempt.

Of course. But the hedge funds too? They aren't market makers, they're clients. So the Directive must apply to them!

Except that:

Only the sovereign CDS market is concerned. It is still possible to hold CDS on a bank issue without holding the title. So it will be easy to circumvent the ban on betting against a State by betting against one of its banks (Santander in the example above). One shudders when contemplating the fragility of Spain's banks...

In conclusion, the idea for such a law was commendable. But the devil is still and always in the detail. The financial sector has defended its interests during the drafting of the law. It is urgent to develop the means to counterbalance this during negotiations. The Finance Watch association has been created specifically with this objective: to be present and make the voice of civil society heard during the preparation of financial reforms. The only problem is, it's David against Goliath...

Could France have a different fiscal policy?

By [Jérôme Creel](#)

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

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

Based on these exceptional circumstances and on the rule requiring an annual improvement of at least 0.5% of GDP in the structural deficit, it can be shown that the French government

has fiscal maneuvering room in 2012 and 2013, while still complying with European fiscal rules.

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

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

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

Instead of awaiting the miraculous effects of structural reform – a potentially lengthy and uncertain process – all that is really needed is to apply the regulations in force, without imposing an overly restrictive reading of what they contain, so as to limit the reduction in growth being caused by austerity and avoid a new period of rising unemployment. According to the conclusions of the [iAGS report](#), staggering the fiscal austerity measures in France would lead to adding 0.7 GDP point to growth every year from 2013 to 2017.

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

Forecast for the French economy

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

Source: European Commission forecasts.

Is nationalization a trap or a tool of industrial policy?

By [Jean-Luc Gaffard](#)

The closure of the Florange blast furnaces in the Moselle region by ArcelorMittal and the French government's hunt for a buyer led it to temporarily consider nationalizing the site, that is, not only the production of crude steel, but also the cold forming line. The threat of nationalization was clearly wielded with a view to forcing the hand of the Mittal group so that it would sell the operations to another firm. If a nationalisation like this had been carried out, it would have been a penalty-nationalization, *i.e.* a sanction of behaviour by the Mittal group deemed contrary to the public interest. Apart from this unusual feature, it would have also raised issues about competition.

The project around the Mittal site is reminiscent in some ways of the nationalization of Renault in 1945. It would be hard to argue, however, that any reproaches would be along the same lines. There would clearly be no question of the nationalized site being made a showcase for a social policy designed to spur the country's growth. The goal was less ambitious. It involved neither more nor less than a transfer of ownership from one private group to another. This would, of course, have been a first in the use of the weapon of nationalization. Any comparison with the French government's support for Alstom in 2004 doesn't hold: in this latter case, the point was to save a company that might go bankrupt as a result of risky acquisitions, and not simply to replace it with another company. Moreover, the problem was confined to the company in question, with no global or even sectoral implications.

Comparisons with the support of the Obama administration for the automotive industry in 2009 are also out of place, as that involved saving a company that was being forced into bankruptcy in an industry generally considered strategic.

The reality in the case of Florange was and remains that no potential buyer thought they would be able to keep the blast furnaces operating in an environment marked by falling demand for steel, in particular in the wake of the crisis in the automobile industry. That is why, whatever happened, the buyer would demand to keep the rolling mill too. This requirement would be in its best interest: the blast furnaces could not be taken over except on the condition that they could supply the activity immediately downstream on the same site. If this condition had been met, it would undoubtedly have posed a problem for the Mittal group, as it currently provides the steel for the mill in Florange from its Dunkirk site, so the new situation would have caused it difficulties, including in terms of jobs. In other words, a temporary nationalization with a view to a transfer of ownership would interfere with competition between private entities. It is far from clear that this was in line with the general interest.

The occasionally argued thesis that Mittal's strategy was the act of managers who were merely obeying the shareholders and who were advocates of an economy without factories or machines does not really hold water in light of the nature of the firm's activity and the degree of integration of the different production sites. One could, however, make the hypothesis that Mittal's strategy involving the closure of the blast furnaces in Florange amounted to a plan to ration supply that was designed to prevent a collapse of steel prices and boost already low margins. This hypothesis might be credible if the demand for steel depended primarily on its price, whereas it is obvious that the decline observed is the result of the global crisis and particularly the slump in sales in the automotive and construction industries. In other words, a fall

in steel prices today would not lead to higher demand and ensure the continued operation of all the blast furnaces. It is much more plausible to assume that, in the current macroeconomic environment, the transfer of ownership that was considered would simply have resulted in changing market shares rather than increasing the market's size.

In fact, there could only be real doubt about both the legitimacy and the capacity of the public authorities to arrange the most appropriate configuration for the market, or even the breakdown of the jobs to be saved or destroyed. Furthermore, if a decision to nationalize had indeed been taken in a situation like this, any determination of fair compensation would have proven difficult and prone to litigation.

In short, the nationalization under consideration could hardly have been an effective tool of industrial policy. It is not for the public authorities to arbitrate between private interests to determine who owns what, including when certain sites are to be closed. This type of arbitration is the responsibility of the competition authorities. Industrial policy, in turn, should interfere as little as possible with the division of market shares between the various competitors. At most it could ensure the survival of companies whose activity is considered strategic and who are going through a difficult period due to the global situation or to industrial choices that have proved erroneous or simply more expensive than expected.

In this situation, it is not surprising that the government did not follow up with the nationalization project and instead supported the compromise of simply requiring that Mittal undertakes to make investments to modernize the site and to maintain the blast furnaces in running order with a view to equipping them with highly efficient technology in terms of carbon dioxide emissions, leading to a gain in competitiveness, as part of the European Ultra-Low Carbon

Dioxide Steelmaking project ([Ulcoss](#)).

The nationalization under consideration was indeed a trap in every sense of the word. The political and media battle about the fate of the Florange site revealed, in fact, an error in the government's analysis. The difficulties being experienced by the French steel industry result from a lack of demand, which is in turn the result of a policy choice of generalized austerity. Trying to resolve this macroeconomic problem with a microeconomic solution was, at a minimum, risky and shows the inconsistency of the short-term and medium-term decisions being taken on economic policy.

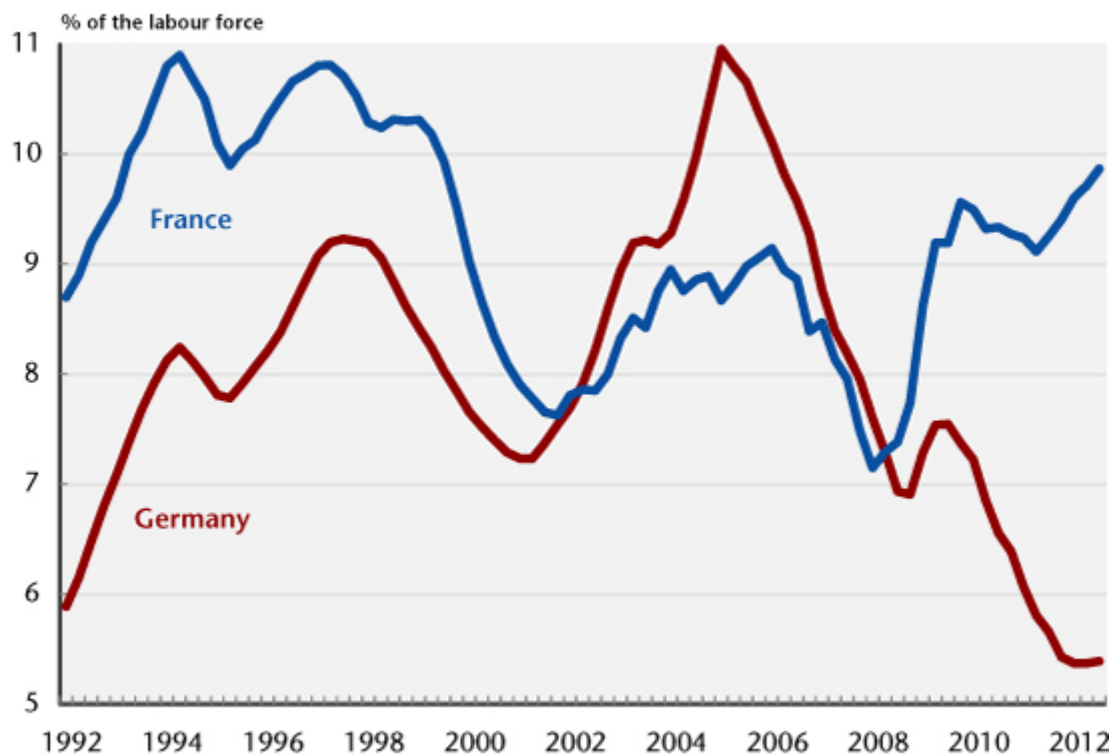
Higher unemployment in France, greater poverty in Germany

By [Eric Heyer](#)

Will France be the new Greece, as *The Economist* has argued? Should French reforms be accelerated and be modelled on those implemented in Germany ten years ago? For German public opinion, for its authorities and for a large number of economic experts, the answer is obvious. Not only does Germany have a lower deficit, but unlike its French neighbour it has also managed to significantly reduce its unemployment rate. Starting from a similar level in the early 2000s (close to 7.7% at end 2001), the unemployment rate now stands at 5.4% of

the labour force in Germany, 4.5 percentage points below the level in France (Figure 1).

Figure 1 : Changes in unemployment in Germany and France over the last 20 years



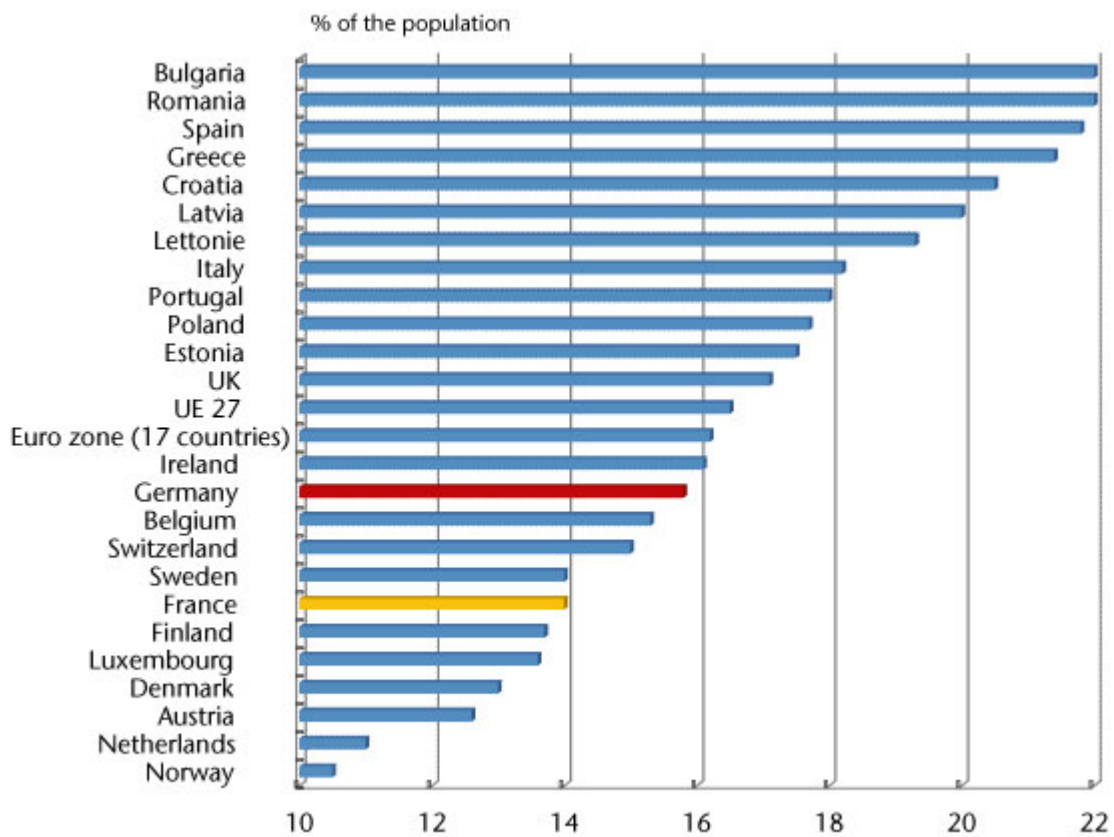
Source : ILO.

The purpose of this note is not to revisit the reasons for this difference, which have already been the subject of posts on this blog (see in particular the impact of demography, by [G. Cornilleau](#), of the reduction in working hours, by [E. Heyer and M. Plane](#), and of the rise in male-female inequalities, by [H. Périvier](#)). The point rather is simply to note that the reduction of unemployment in Germany has been accompanied by a steep rise in poverty.

According to Eurostat, over the past six years the poverty rate (measured at the threshold of 60% of median income) has risen by 3.6 percentage points in Germany, four times more than the rise observed in France (0.9 point). In 2011, despite the sharp drop in unemployment and the large differential with France, the poverty rate in Germany was 1.8 points higher than

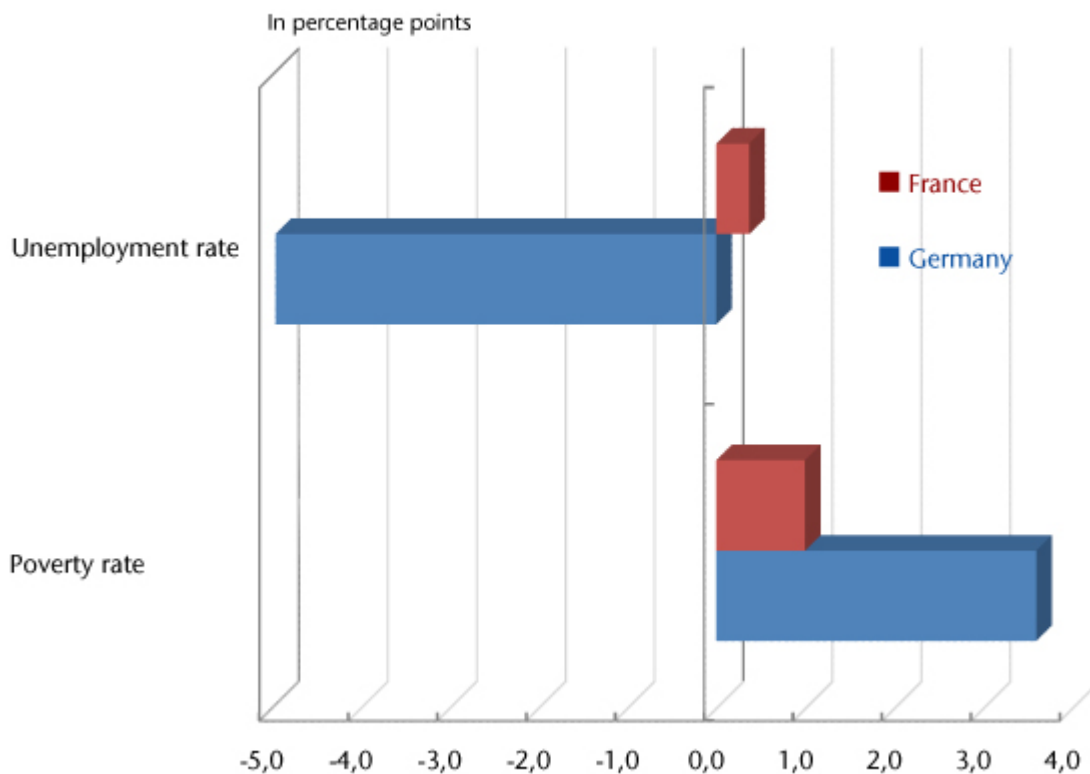
the level observed in France, *i.e.* a difference of over 11% (Figures 2 & 3).

Graphique 2 : Poverty rate (60 % of median income) in 2011



Source : Eurostat.

Figure 3 : Changes in the unemployment rate and poverty rate (60 % of median income) in France and in Germany (2005-2011)



Source : Eurostat.

There is, therefore, a hidden side to the reforms implemented in Germany over the past ten years, which have led to lower unemployment but greater poverty.

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.