

# Housing and the city: the new challenges

By Sabine Le Bayon, [Sandrine Levasseur](#) and Christine Rifflart

The residential real estate market is a market like no other. Since access to housing is a right and since inequalities in housing are increasing, the role of government is crucial to better regulate how the market functions. France has a large stock of social housing. Should it be expanded further? Should it have a regulatory role in the overall functioning of the housing market? Should our neighbours' systems of social housing, in particular the Dutch and British systems, be taken as models? On the private market, the higher prices of home purchases and rentals illustrate the lack of housing supply in the country's most attractive areas. At the individual level, the residential market is becoming less fluid: moving is difficult due to problems finding housing suited to career and family needs. It is therefore necessary to develop appropriate policies to enhance residential mobility and reduce imbalances by stimulating the supply of new housing.

Housing is also an integral part of our landscape, both urban and rural. It distinguishes our cities of today and of tomorrow. The commitments made in the framework of the Grenelle environmental consultation process demand a real revolution in land use as well as in technical standards for construction. To ensure more housing, should undeveloped land be used or should developed land be exploited more intensely? How should a housing stock that has become obsolete in terms of energy standards be renovated, and how should this be financed?

These are the challenges addressed by the contributions collected in the new book [Ville et Logement](#) in the Débats et politiques series of the *Revue de l'OFCE*, edited by

Sabine Le Bayon, Sandrine Levasseur and Christine Rifflart. With authors from a variety of disciplines (economics, sociology, political science, urban planning) and backgrounds (researchers as well as institutional players), this review aims to improve our understanding of the issues related to housing and the city.

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# What factors have put the brakes on growth since 2010?

By [Eric Heyer](#) and Hervé Péléraux

At the end of 2012, five years after the start of the crisis, France's GDP has still not returned to its earlier level (Figure 1). At the same time, the labour force in France has grown steadily and technical progress has constantly raised workers' productivity. We are therefore more numerous and more productive than 5 years ago when output was lower: the explosion in unemployment is a symptom of this mismatch. Why had the shoots of recovery seen in 2009 been choked off by mid-2010?



The main factor stifling the recovery has been the austerity measures that were enacted in France and Europe in 2010 and then intensified in 2011 and 2012 (Table 1). The impact of austerity has been all the more marked as it has been generalized throughout the euro zone. The effects of domestic cutbacks have combined with the effects of undercutting demand from other European partners. Given that 60% of France's

exports are to the European Union, any external stimulus had virtually vanished by mid-2012, less due to the slowdown in global growth, which is still almost 3%, than to the consequence of the poor performance of the euro zone, which is on the brink of recession.

It is austerity that is at the root of the lack of growth: after shaving -0.7 GDP point off growth in 2010, its effects increased in 2011 and 2012 (respectively -1.5 and -2.1 points) because of the stepped-up measures and the existence of high fiscal multipliers. Indeed, in a period of low economic activity simultaneously tightening fiscal policy in all the European countries while there is very little manoeuvring room for monetary policy (real interest rates close to zero) has led to raising the value of the multiplier. There is now a broad consensus that the short-term fiscal multipliers are high, especially as full employment is still out of reach (see [Heyer \(2012\)](#) for a review of the literature on multipliers). The theoretical debate about the value of the multiplier and the role of agents' expectations must give way to empirical observation: the multipliers are positive and greater than 1.



In addition to the fiscal drag, there is the effect of tight monetary conditions: the easing of monetary policy – seen in particular in the lower key interest rates – is far from enough to offset the negative effect on the economy of tighter borrowing conditions and the widening of the spread between private investment and risk-free public investment.

All things considered, including taking into account the impact of the resurgence in oil prices after the onset of the recession, the spontaneous growth of the French economy would have averaged 2.6% over the past three years. The realization of this potential would have led to a further reduction in excess production capacity and would ultimately have cut short the downturn in the economy that actually took place.

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# In the Netherlands, change is for now!

By [Christophe Blot](#)

While France has just reaffirmed that it will meet its commitment to reduce its budget deficit to below 3% by 2014 (see [Eric Heyer](#)), the Netherlands has announced that it is abandoning this goal on the grounds that additional austerity measures could jeopardize growth. The country plunged into recession in 2012 (-1%), and GDP will fall again in 2013 (see [the analysis of the CPB](#), the Netherlands Bureau for Economic Policy Analysis). In these circumstances, the social situation has deteriorated rapidly, with a 2 percentage point rise in unemployment in five quarters. In the first quarter of 2013, 7.8% of the workforce was out of work. Beyond the implications for the Netherlands itself, could this rejection of austerity (finally) signal a shift in Europe's strategy of fiscal consolidation?

Up to now, the coalition government elected in September 2012 and led by the Liberal Mark Rutte had followed the general strategy of consolidation, with expectations of rapidly bringing the deficit below 3%. However, the austerity measures already being implemented together with an adjustment in the housing market and the general decline in activity throughout the euro zone led the Netherlands into a new recession in 2012 and put off the prospects of meeting the budget target in 2013. In view of the European Commission's projections for growth and for the budget deficit in 2013, it does however

seem that the Dutch government would have been able to achieve a deficit of 3% in 2014, but like France, at the cost of taking additional measures.

The budget deficit is expected by the Commission to come to 3.6% in 2013. The CPB expects an even slightly lower deficit (3.3%), using growth forecasts similar to those of the Commission. In these conditions, the fiscal effort required to reach the 3% target in 2014 would amount to between 3.5 and 7 billion euros. In comparison, for France this would require the approval of additional austerity measures for 2014 amounting to 1.4 GDP points, *i.e.* just under 30 billion euros (see [France: holding to the required course](#)).

However, under pressure from the social partners, the Dutch government ultimately abandoned the plan announced on March 1 that provided for savings of 4.3 billion euros, which mainly consisted of a wage freeze in the public sector, a freeze in the income tax scale and the stabilization of public spending in real terms. Putting austerity on hold like this should give a small boost to the economy without calling into question fiscal sustainability, as the improved prospects for growth should reduce the cyclical component of the budget deficit.

While the 3% target will of course not be met, it is not at all clear that the markets will make much out of this infringement of the rules. In fact, the difference in interest rates vis-à-vis the German rate has stabilized since it was announced that the plan had been abandoned, whereas the difference had tended to increase in the previous weeks (see figure).



While this decision should not upset the economic and financial stability of the Netherlands or the euro zone, it does nevertheless send a strong anti-austerity signal from a country that had hitherto favored fiscal consolidation. It is

therefore one more voice that is challenging the effectiveness of this strategy and emphasizing the economic and social risks associated with it ([see here](#) for an overview of the case against austerity and the 2013 [iAGS report](#) for more specific points concerning an alternative strategy for Europe). It is also a decision that should give France inspiration. Credibility is not necessarily gained by sacrificing one objective (growth and employment) for another (the budget deficit). It is still necessary to await the response of the European Commission in that the Netherlands, like most countries in the euro zone, is subject to an excessive deficit procedure. If the decision of the Netherlands is not challenged, then this will represent a significant shift in European macroeconomic strategy.

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## France's Stability Programme: the missing line

By [Eric Heyer](#)

On April 17, the government presented its Stability Programme for 2013-2017 for the French economy. For the next two years (2013-2014), the government has relied on the projections of the European Commission in forecasting growth of 0.1% in 2013 and 1.2% in 2014. Our purpose here is not to revisit these forecasts, though they do seem overly optimistic, but rather to discuss the analysis and outlook for France for the period 2015-2017 that is explicit and sometimes implicit in this document.

According to the document provided to Brussels, the government

is committed to maintaining its fiscal consolidation strategy throughout the five-year period. The structural effort will lessen over the years, representing only 0.2 percent of GDP in 2017, *i.e.* nine times less than the effort required of citizens and business in 2013. Under this assumption, the government expects a return to 2% annual growth during the period 2015-2017. The deficit will continue to shrink, reaching 0.7 percent of GDP in 2017. This effort would even lead for the first time in over 30 years to a structural fiscal surplus in 2016, rising to 0.5 percent of GDP in 2017. For its part, public debt would peak in 2014 (at 94.3 GDP points) then begin to decline from 2015 to a level of 88.2 GDP points by the end of the five-year period, which is lower than the level when the Socialists came to power (Table 1). It should be noted, however, that in this official document nothing is said about the changes in unemployment that the government expects will result from its policies by the end of the five-year period. This is the reason for our introduction of a missing line in Table 1.



Based on assumptions similar to those of the government for fiscal policy as well as for the potential for growth, and starting from the same short-term situation, we have attempted to verify the analysis provided by the government and to supplement it by integrating the changes in unemployment related to its Programme.

Table 2 summarizes this work: it indicates that growth would accelerate gradually over the period 2015 to 2017, to over 2% in 2017. Growth over the period would average 1.8%, a rate close to but slightly lower than the 2% expected in the Stability Programme [\[1\]](#).

At end 2017, the deficit would be close to the government target, without however reaching it (1 GDP point instead of 0.7 GDP point). The public debt would also fall to a level

comparable to that in 2012.

In this scenario, which is similar to that of the government, the trend in unemployment will not reverse until 2016; by the end of the five-year period, the unemployment rate is expected to be 10.4% of the working population, *i.e.* a level higher than that prevailing at the time François Hollande assumed office.



The scenario proposed by the government in the Stability Programme seems optimistic in the short term and misses the goal in the medium term. On this last point, it seems surprising to want to stick to a policy of austerity after the economy has seen the public finances balanced in structural terms and while the unemployment rate is rising above its historical peak.

A more balanced approach could be considered: assume that from 2014 the euro zone adopts a “reasonable” austerity plan aimed at both restoring the structural balance of the public finances and reducing the unemployment rate. This alternative strategy would involve rolling back the planned fiscal stimulus in all the euro zone countries and limiting it to 0.5 GDP point [2]. This would constitute a fiscal effort that could be sustained over time and allow France, for example, to eliminate its structural deficit by 2017. Compared to the current plans, this would provide a greater margin for maneuver that would spread the burden of the adjustment more fairly.



Table 3 summarizes the results of simulating this new strategy. Less austerity leads to more growth in all the countries. However, our simulation also takes into account the impact of economic activity in one country on other countries



via international trade. In 2017, in the “less austerity” scenario, the public finances would be in the same state as in the baseline scenario, with the additional growth offsetting the reduced effort. However, in this scenario, unemployment would decline in 2014, and by 2017 would have fallen to a level comparable to the 2012 level.

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[1] The difference in growth can arise either because of not taking into account the impact of foreign trade due to the austerity plans being implemented in other partner countries, or because the fiscal multiplier used in the Stability Programme is lower than in our simulation, where it is around 1. Indeed, we believe that in a period of low economic activity, adopting policies of fiscal restraint that are applied simultaneously in all the European countries and when there is little maneuvering room for monetary policy (real interest rates are close to zero) leads to pushing up the value of the multiplier. There is also now [a broad consensus on the fact that the short-term multipliers are high](#), especially given that full employment is still out of reach (see [Heyer \(2012\)](#) for a review of the literature on multipliers).

[2] This strategy has already been simulated in previous OFCE work, such as that by [Heyer and Timbeau in May 2012](#), by [Heyer, Plane and Timbeau in July 2012](#) and by the [iAGS report in November 2012](#).

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# 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
<b>Euro zone 11*</b>	<b>-3,2</b>	<b>-2,6</b>	<b>-1,8</b>	<b>-1,1</b>	<b>-0,6</b>

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

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

# 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)<sup>[1]</sup> 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 %

Périod	2000-2012	2000-2007	2008-2012
NAIRU	7,2	6,8	7,7

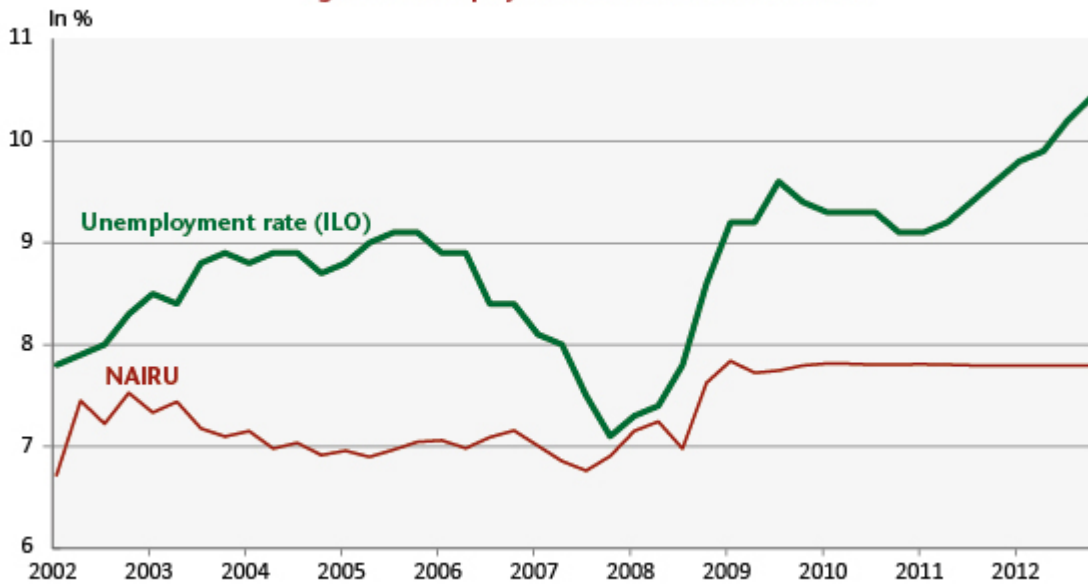
Note : Hypotheses on exogenous factors: values observed on average over the periods 2000-2007 and 2008-2012. The productivity trend equals 1.1.

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).

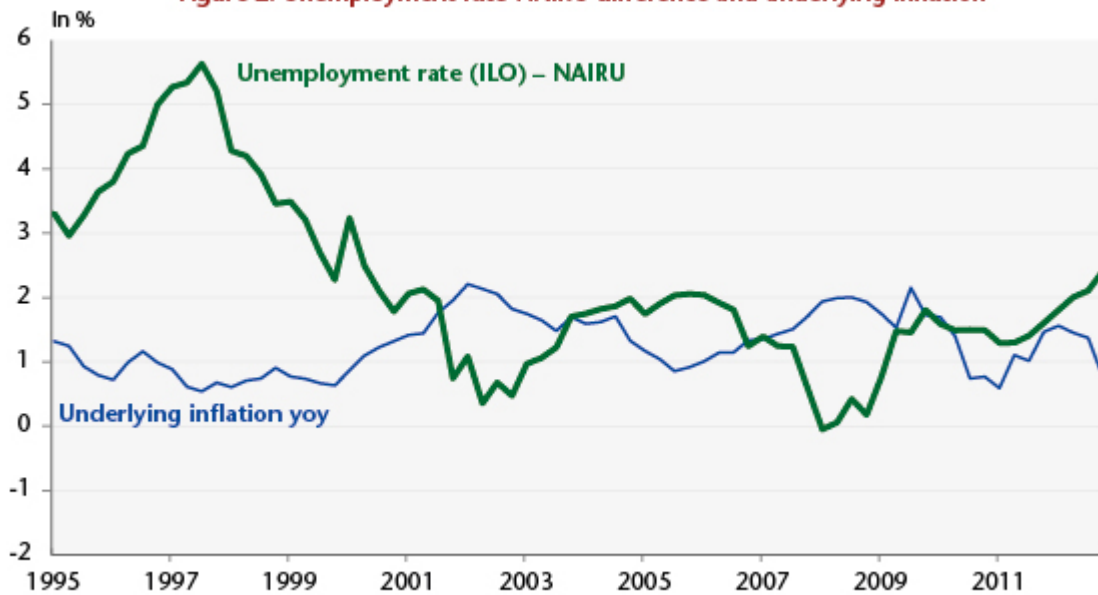
Figure 1. Unemployment rate and estimated NAIRU



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.

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# 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*
<b>Taux de croissance du PIB</b>	<b>1,6</b>	<b>1,7</b>	<b>0,0</b>	<b>-0,2</b>	<b>0,6</b>
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
<b>Contribution to growth</b>					
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
<b>GDP growth rate, euro zone</b>	<b>2,0</b>	<b>1,1</b>	<b>-0,5</b>	<b>0,4</b>	<b>0,9</b>
<b>Other indicators</b>					
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
<b>GDP growth rate (year-on-year)</b>	<b>1,8</b>	<b>1,1</b>	<b>-0,3</b>	<b>0,3</b>	<b>0,7</b>

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

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# Family benefits: family business?

By [Hélène Périvier](#)

[Bertrand Fragonard has submitted his report to the Prime Minister](#); it aims, first, to enhance the redistributive nature of family policy and, second, to rebalance the accounts of the family branch, which have recently been running a deficit, by 2016. A realignment of family benefits towards low-income families is proposed as the first objective. As for the second, the two options proposed are adjusting benefits based on means, or taxing them. How can 2 billion euros be found in today's lean times?

***With the cow already thin, is it really the time to put it on a diet?***

The cutbacks in spending on family policy are part of a broader economic austerity policy aimed at rebalancing the public accounts. The government deficit is of course a serious issue, which cannot simply be swept under the rug. It is bound up with the durability and sustainability of our welfare state, and as concerns the topic being discussed here more specifically, with the future of family policy. But the magnitude and timing of the fight against deficits are central to its effectiveness. The OFCE's forecasting work shows that the massive reductions in public spending being made by France will undercut growth. The lack of growth will in turn slow deficit reduction, which will thus not live up to expectations. Ultimately, you can't have your cake and eat it too, in particular if the economy isn't producing the ingredients.



If we continue down this path of trimming family policy, then how should we proceed? Who should bear the cost? Should we cut spending or increase revenues?

### ***Staying the course?***

A number of principles guide public action. They constitute a compass that helps to stay the course that we have set and to develop the tools needed to do this. With regard to family policy, the first principle concerns horizontal equity: this requires that a household should not see its standard of living fall with the arrival of a child. In other words, based on this principle, all households finance support that benefits only households with dependent children. This constitutes redistribution from households without children to those with children, whether the household is rich or poor. This sharing of the cost of children is justified by the idea that a healthy birth rate benefits everyone. Family allowances are emblematic of this principle.

The second principle concerns vertical equity: every household should participate in the financing of family policy in a progressive manner based on its income, and low-income households with dependent children should receive special assistance, such as the family income supplement [*le complément familial*], a means-tested assistance for families with three or more children.

Nothing of course prevents us from changing tack by changing the relationship between these two principles. Indeed, family policy does need to be reformed: it should take into account the changes undergone by French society in recent decades (which policy now does only partially): increased numbers of women in the workforce, the rise in divorce and unmarried partnerships (today most children are born to couples who are neither married nor civil partners), new family configurations, concern for the equality of children with respect to collective care and socialization, territorial

inequalities, etc. ([Périvier and de Singly, 2013](#)). These considerations on family policy need to be integrated into an overall vision of the tax-benefit system for families –otherwise public policy risks becoming incoherent. The mission statement behind the Fragonard report highlights above all rebalancing the family branch accounts by 2016, “with a significant shift from 2014”.

### ***Don't lose your bearings!***

While staying the course on family policy, some leeway is possible. To draw on the contributions of all households, the taxation of the couple could be reviewed. Under the current system, married couples or civil partners have two tax shares; this leads to tax reductions that increase in line with the difference in the income of the two partners (the extreme case being that of Mr. Breadwinner and Mrs. Housewife, the arrangement that this type of taxation was designed to encourage). This is what is called the conjugal quotient [\[1\]](#). This “benefit” is not capped [\[2\]](#), unlike the benefit related to the presence of a child (the famous family quotient, whose ceiling was recently reduced to 2000 euros). Capping the conjugal quotient would not call into question the principle of horizontal equity, as many childless couples benefit from it, couples who, for the most part, had dependent children in the past and have benefited from a generous family policy. Doing this would spread the effort to rebalance the family branch accounts over a wide range of households, including those who do not have or no longer have dependent children [\[3\]](#). The complete elimination of the conjugal quotient (*i.e.* the individualisation of taxes) would provide additional tax revenue of 5.5 billion euros ([HCF, 2011](#)). This tax “benefit” could initially simply be capped: the yield would be greater or smaller, depending on the ceiling adopted [\[4\]](#). The distribution of the gain for couples related to the marital quotient is concentrated among the highest income deciles ([Architecture des aides aux familles, HCF, 2011](#)). Another

possible tax revenue concerns the extra half-share granted for having raised a child alone for at least 5 years. Now capped at 897 euros, this benefit could be eliminated, as it does not meet any of the principles set out above and it is doomed to disappear.

These steps would increase tax revenue and help fund family policy. These options would unquestionably increase the tax burden on households. If we add to the effort requested the constraint to not increase taxation, then the 2 billion euros would have to be found through cuts in spending on family benefits. The room for manoeuvring becomes almost razor thin. Out of concern for vertical fairness, these cuts must be borne by the best-off families with children. But this vertical redistribution is conceived within the limited framework of families with children. Yet vertical equity generally consists of a redistribution from better-off households to poorer households. What is therefore being applied here would be a principle of vertical equity that could be described as "restricted vertical equity".

### ***There is no free lunch...***

The family allowance is clearly in the firing line in this narrow framework for family policy that excludes from its scope the taxation of couples in particular. It represents 15% of the family benefits paid, or 12 billion euros. There are two main options: the amount could be adjusted in line with the level of household resources, or the benefits could be taxed. But which? Both options have advantages and disadvantages.

Subjecting the family allowance to conditions would help to target wealthy families while not affecting the others. This targeting would enhance the redistributive character of the system, which would definitely be an advantage. But this requires setting income thresholds above which the amount of benefits received decreases. So families in similar situations

would receive different levels of benefits depending on whether their incomes were just below or just above the threshold. This would undermine the universal commitment to the welfare state. Furthermore, the thresholds could lead to a contraction in the labour supply of women in couples: the “classic” trade-off would be, “if I work more, we will lose benefits” – it is still the activity of women, and always the activity of women, that suffers. To limit these negative effects, the thresholds could be smoothed and variable income ceilings introduced based on the activity of the two partners by raising those applying to couples where both work. What would gradually emerge is a huge white elephant, a Rube Goldberg machine that generates higher management costs with extra work for the CAF service. In addition, the system would be less transparent, because it is more complex, leading to overpayments, fraud, and even more annoying, a lack of take-up (those eligible for a benefit don’t apply). Finally, selective benefits are the breeding ground for debate around a culture of dependency, with the suspicion that “the reason these people don’t work is in order to get benefits”. Note that this risk disappears if the thresholds are set at a high level.

Taxing the family allowance would get around these problems: it is simple, with no extra management costs, as the amount of benefits received would just be added to taxable income. So the progressiveness of the income tax system would apply. More affluent families with children would pay more than those on lower incomes. But targeting would be less accurate than before: many families with children would be affected, and households that were previously not taxable may become so (even if this involved small amounts). Finally, the tax burden would increase, which is politically costly.

By construction, in both cases families that have only one child would not be affected because, under a family policy designed to promote high birth-rates, they do not receive family benefits. And in both cases families without dependent

children are not required to contribute.

***Don't throw the baby out with the bath water ...***

Adjusting the family allowance for income is the track that seems to be preferred by the Fragonard report. The opinion of the High Council for the family (HCF) indicates that this approach has been rejected by the majority of that body's members. Overall, the measures proposed in the report are to reduce the spending on families with dependent children within the limited scope of family policy, namely benefits. The danger looming is that the guidelines proposed lead to paralysis by freezing the different oppositions and exacerbating the conservative visions for family policy. Some will justly view this as a systematic attack on family policy, since the overall budget is cut. Nevertheless, an overhaul of family assistance is needed, but it cannot involve a reduction in spending in this area as the need is so great, especially to ensure progress with regard both to gender equality and equality between children. Any reform must be based on the principles of justice and on an approach to the welfare state that needs to be reviewed and renegotiated. Even though the budget constraints are serious, we cannot reduce the amount allocated to family policy, but nor should we retreat from the in-depth reform that is needed.

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[\[1\]](#) Note that mechanisms such as a tax break or incentive to promote employment tend to favour people who are cohabiting over married couples. The interactions between the multiple tax provisions complicate comparisons of the tax treatment of people with different marital statuses.

[\[2\]](#) It is, implicitly, but for extremely high levels of income, reaching the upper end of the income tax brackets with or without the marital quotient (this implicit cap limits the

advantage to 12,500 euros).

[3] On condition that these additional tax revenues are paid to the family branch.

[4] For a ceiling of 2,590 euros, the extra tax revenue from capping the conjugal quotient would be about 1.4 billion euros (HCF, 2013).

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## **In memoriam. Raymond Boudon**

By Michel Forsé

Raymond Boudon, Professor Emeritus at the University of Paris Sorbonne, died at the age of 79 on Wednesday, 10 April 2013. It is difficult to summarize so much fruitful work. He was of course the leader of the school of thought known as methodological individualism, which holds that the collective is always the result of rational individual actions. He devoted much of his effort to setting out the foundations for this and attached great importance to the thought of Max Weber. At the beginning of his career, his personal contacts with the American Paul Lazarsfeld led him to develop a formalized and rigorous approach to social facts, in contrast to the structuralism which was so much in vogue at the time and which he disliked. For Boudon, as the title of one of his latest books (2011) suggests, sociology was a science in the strict sense of the term. In a similar vein, he also tried to show in numerous articles and books all the havoc that ideological and cultural relativism could inflict.

A very prolific author, arguably making him one of the major

sociologists of the twentieth century, he was also an editor. At the PUF publishing house he was until recently head of the "Sociologies" collection, which featured both translations of classic works and publications by young authors. For many years he also directed *Année Sociologique*, the journal founded by Emile Durkheim.

As a member of the Académie des Sciences Morales et Politiques, he played an active role promoting research projects. He was also a member of many prestigious foreign academies, such as the British Academy and the American Academy of Arts and Sciences.

Raymond Boudon graduated from the prestigious Ecole Normale Supérieure with a degree in philosophy and taught throughout his career – many of his works are marked by a strong pedagogical approach. He wanted to make the great authors known, often in a new light, and to bring to life key concepts of sociology, for example, through the *Dictionnaire critique de la sociologie* and *Traité de sociologie*, which he directed. He was of course also a researcher, in the field of methods and theories as well as in empirical analysis. At the CNRS, he founded and for many years headed up the Study Group on Sociological Methods and Analysis.

Exacting in his scientific approach to social facts, unperturbed by not following the latest fashion, and with an impressive *oeuvre* translated into many languages, Raymond Boudon was, nevertheless, very simple and approachable, as all those who knew him can attest. Beyond the scholar whose work will remain, first and foremost we have lost a militant humanist.