

# What is a Left economics? (Or, why economists disagree)

By [Guillaume Allègre](#)

What is a Left economics? In an opinion column published in the newspaper *Libération* on 9 June 2015 ("[la concurrence peut servir la gauche](#)" ["Competition can serve the Left"]), Jean Tirole and Etienne Wasmer reply that to be progressive means "sharing a set of values and distributional objectives". But, as Brigitte Dormont, Marc Fleurbaey and Alain Trannoy meaningfully remark ("[Non, le marché n'est pas l'ennemi de la gauche](#)" ["No, the market is not the enemy of the Left"]) in *Libération* on 11 June 2015, reducing progressive politics to the redistribution of income leaves something out. A Left economic policy must also be concerned about social cohesion, participation in social life, the equalization of power, and we could also add the goals of defence of the environment and, more generally, leaving a fair legacy to future generations. Paradoxically, if the Left must not *a priori* reject market solutions (including the establishment of a carbon market), the de-commodification of human relations is also part of core left-wing values. The authors of these two columns insist that it is the ends that count, not the means: the market and competition can serve progressive objectives. This is not a new idea. The merchants of the 18<sup>th</sup> century had already understood that holding a private monopoly could allow them to amass great fortunes. Tirole and Wasmer draw on more recent debates, including on the issues of taxis, housing, the minimum wage, the regulation of the labour market, and university tuition fees. Their conclusion, a bit self-serving, is, first, that more independent evaluations are needed, and second, that our elected representatives and senior officials need to be trained in economics.

Does the Left define itself by values? To accept this proposal, we would need to be able to distinguish clearly between facts and values. Economics would be concerned with facts broadly speaking and would delegate the issue of values to politics. Disagreements about facts would be exaggerated. Political differences between the Left and the Right would be only a matter of where to put the cursor on values or preferences, which would be independent of the facts. According to this viewpoint, the instruments need to be designed by trained technicians, while the politicians just select the parameters. The Left and the Right would then be defined by parameters, with progressives more concerned about reducing inequality and conservatives more concerned about the size of the pie. In this scheme, disagreements among economists would be focused on values. Paradoxically, the examples used by Tirole and Wasmer are the subject of important controversies that involve more than just values: economists are very divided over the [liberalization of the taxi business](#), the [level of the minimum wage](#), and the possible [introduction of university enrolment fees](#). There are important disagreements, even among progressive economists.

Why the disagreement? There are fewer and fewer disputes over the facts, strictly speaking. The system of statistics has made considerable progress. However, pockets of resistance remain. For example, on taxis, it is difficult to know who holds the licenses and the prices at which they were acquired, even though these are very important issues. If the vast majority of licenses are held by people who received them for free, then increasing the supply via private cars with drivers ("VTC") poses no real problem of fairness. On the other hand, if most licenses were acquired on the secondary market at exorbitant prices (up to 240,000 euros in Paris), then the question of compensation arises. Buying 17,000 licenses at 200,000 euros apiece would cost the State 3.5 billion euros just for the licenses in Paris. This problem cannot be dismissed with a simple, "of course these are often expensive"

(see "Taxis vs chauffeur-driven private cars: victory of the anti-innovation lobby?").

While the facts are in little dispute, the disagreement often comes down to what matters. Should we put the emphasis on a lack of equal outcomes or a lack of equal opportunity? Should we count real estate gains when examining inequalities in capital? Should we be concerned about relative poverty or absolute poverty? Should we worry about inequality between households or between individuals? All this reflects that disagreements are not just a matter of where you put the cursor, but the prioritization of goals that are sometimes complementary and sometimes contradictory. The very way the system of statistics is constructed is not to produce pure facts but instead results from a logic that dictates that what you measure is the representation of a norm. But this norm is in fact reductive (it excludes others), so much so that the measure has meaning only from when we agree on the norm's value: the measure is never neutral vis-à-vis values.

This vision of an economic science that can distinguish facts from values is too reductive – it is often difficult to distinguish between the two. For example, depending on whether we measure the impact of tax policy on individuals or on households, the policy may be characterised as redistributive or as anti-redistributive. Often there is no easy solution to this problem, because it is difficult for the statistician to know how incomes are actually being shared within households. The current solution for measuring living standards and poverty is to assume that resources are fully shared within the household, regardless of the source of the income (labour income from one or another member, social welfare, taxation, etc.). Yet numerous studies show that for many households this assumption is false: empirical studies show that spending depends on who provides the resources, with women spending a larger portion of their income on the children.

Does the free character of the higher education system make it

anti-redistributive? To public opinion this is obvious: the students come from wealthier families and will receive bigger salaries than those who don't study, while everyone pays taxes, including VAT and the CSG wealth tax. This seems to be true if we think about it at time  $t$ . On the other hand, if you consider the life cycle the issue becomes more complicated: many students do not get high-paying jobs. School teachers, artists and journalists are often highly educated but make lower-than-average wages. For them, paying income tax is more advantageous than paying enrolment fees. Conversely, many people who have little education receive large salaries. Over the life cycle, having higher education paid for through income tax is redistributive (see "[Dépenses publiques d'éducation et inégalités. Une perspective de cycle de vie](#)" ["Public expenditure on education and inequality. A life cycle perspective"]).

Should we measure income at the household level or individual level? Over the life cycle or at a given point in time? These examples show that what is measured by economists usually depends on a norm. This does not however mean that the measure is completely arbitrary and ideological. In fact, social science measurement is neither entirely normative nor merely descriptive: facts and norms are intertwined.

Economists do not reason simply with raw facts. They develop and estimate behavioural models. They do this to answer the question, "What if ...?" What if we increased the minimum wage, what would be the impact on employment and wages at the bottom of the scale? You could classify the answer to such questions as facts. But unlike facts in the strict sense, they are not directly observable. They are generally estimated in models. However, the disagreements over these "facts" (the parameters estimated in the models) are very important. Worse, economists tend to greatly underestimate the lack of a consensus.

The parameters estimated by economists have meaning only within a given model. However, the disagreements between

economists are not just about the parameters estimated, but the models themselves, that is to say, about the selection of simplifying assumptions. Just as a map is a simplification of the territory it represents, economic models are a simplification of the behavioural rules that individuals follow. Choosing what to simplify is not without normative implications. The best map depends on the degree of accuracy but also on the type of trip you want to make: once again, facts and values are intertwined. Differences between policies are not simply parametric, but arise from different representations of society.

Thus, contrary to the conclusion of Tirole and Wasmer, economic evaluations cannot be simply left to objective experts. In this respect, economists resemble other social scientists more than they do physicians: in fact, agreement on what constitutes good health is easier than on what constitutes a good society. Economic evaluations must therefore be pluralist, in order to reflect as much as possible the diversity of views in a society. What separates us from implementing the reforms needed is not a pedagogical deficit on the part of the experts and politicians. Nor is it simply a problem of educating the elite. There is obviously no agreement among the experts on the reforms needed. However, the economic reforms are often too technical to submit to a referendum and too normative to be left to the "experts". To resolve this problem, consensus conferences and citizens' juries seem relevant when the subject is normative enough to care about the representativeness of the participants and technical enough that we need to seek informed opinions. In economics, these kinds of conferences could deal with the issue of the individualisation of income taxes or carbon offset taxes. In short, economists are more useful when they make the trade-offs explicit than when they seek the facade of a consensus.

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# When the OECD persists in its mistakes...

By [Henri Sterdyniak](#)

The OECD has published an economic policy note, [“Choosing fiscal consolidation compatible with growth and equity” \[1\]](#)). There are two reasons why we find this note interesting. The OECD considers it important, as it is promoting it insistently; its chief economist has, for instance, come to present it to France’s Commissariat à la Stratégie et à la Prospective [Commission for Strategy and Forecasts]. The subject is compelling: can we really have a fiscal austerity policy that drives growth and reduces inequality? Recent experience suggests otherwise. The euro zone has been experiencing zero growth since it embarked on a path of austerity. An [in-depth study by the IMF \[2\]](#) argued that, “fiscal consolidations have had redistributive effects and increased inequality, by reducing the share of wages and by increasing long-term unemployment”. So is there some miracle austerity policy that avoids these two problems?

## 1) What goals for fiscal policy?

According to the authors of the OECD study, the goal of fiscal policy should be to bring the public debt down by 2060 to a “prudent” level, defined for simplicity’s sake, we are told, as 60% of GDP. All the OECD countries must work towards this objective and immediately make the necessary adjustments.

But a target of 60% is totally arbitrary. Why not 50% or 80%? Furthermore, this goal is set in terms of gross debt (as defined by the OECD) and not debt under Maastricht. But the difference is far from meaningless (at end 2012, for France,

110% of GDP instead of 91%).

The OECD makes no effort to understand why a large majority of the organization's members (20 out of 31, including all the large countries) have a public debt that is well over 60% of GDP (Table 1). Do we really think that all these countries are poorly managed? This high level of public debt is associated with very low interest rates, which in real terms are well below the growth potential. In 2012, for example, the United States took on debt, on average, of 1.8%, Japan 0.8%, Germany 1.5%, and France 2.5%. This level of debt cannot be considered to generate imbalances or be held responsible for excessively high interest rates that could undermine investment. On the contrary, the existing debt seems necessary for the macroeconomic equilibrium.

We can offer three non-exclusive explanations for the increase in public debts. Assume that, following the financialization of the economy, firms are demanding higher rates of profit, but at the same time they are investing less in the developed countries, preferring to distribute dividends or invest in emerging markets. Suppose that globalization is increasing income inequality [\[3\]](#) in favour of the rich, who save more, at the expense of the working classes who consume virtually all of their income. Suppose that, in many countries, aging populations are increasing their savings rate. In all three cases a demand deficit arises, which must be compensated by private or public debt. Yet since the crisis of 2007-2008 private agents have been deleveraging. It was therefore necessary to increase the public debt to prop up demand, as interest rates were already at the lowest possible level. In other words, it is not really possible to reduce public debt without tackling the reason why it's growing, namely the deformation of the sharing of value in favour of capital, the increase in income inequality and unbridled financialization.

**Table 1. State of the public finances in 2012 (% of GDP)**

	Gross public debt	Structural primary balance	Output gap*	Loss in potential GDP due to the crisis	Effort required**
Austria	85	1.1	-1.6	-3.0	0.2
Belgium	104	0.3	-0.8	-4.5	1.6
Canada	85	-2.5	-0.4	-6.1	2.7
Finland	63	-1.8	-1.4	-9.7	3.8
France	110	-1.3	-2.4	-3.6	4.7
Germany	89	1.4	0.1	-1.6	0.0
Greece	166	3.2	-11.7	-17.6	8.2
Ireland	123	-1.8	-7.9	-9.6	5.8
Iceland	132	2.6	-4.2	-9.0	3.6
Italy	140	4.4	-4.5	-6.8	0.7
Japan	219	-8.1	-0.8	-3.1	18.3
Netherlands	83	-1.4	-1.5	-7.6	2.8
Portugal	139	-0.6	-6.7	-10.4	7.5
Spain	91	-1.8	-7.7	-9.1	5.3
United Kingdom	104	-5.1	-2.1	-10.4	9.2
United States	106	-5.4	-3.0	-5.7	7.7
Euro zone	104	0.6	-2.0	-4.9	2.6
OECD	109	-3.2	-2.3	-4.6	6.0

\* According to the OECD; \*\* short-term effort required to eventually stabilize the debt at 60% of GDP.

According to the OECD, gross public debt on the order of 100% of GDP, as at present, poses problems in terms of fragile public finances and a risk of financial instability. The economy could in fact be caught in a trap: households (given income inequality, aging or their justified mistrust of the financial markets) implicitly want to hold 100% of GDP in public debt (the only risk-free financial asset), interest rates are already near zero, and the financial markets are wary of a country whose debt exceeds 60% of GDP. We cannot escape this trap by reducing public deficits, as this reduces economic activity without lowering interest rates; what is needed is to reduce private savings and carry out a Japanese-style financial policy: the central bank guarantees the public debt, this debt is held by households, and the rate of compensation is low and controlled.

We only regret that the OECD has not made a serious analysis of the cause of the swelling public deficits.



## 2) Reduce the structural primary deficits

The OECD recommends that all countries embark on extensive programmes to reduce their structural primary deficits. To do this, we must first assess these structural primary deficits. However, the OECD estimates are based on a very specific hypothesis, namely that most of the production lost due to the crisis can never be made up. That is to say, for the OECD as a whole, 4.6 points of potential GDP have been lost forever out of the 6.9 point gap in 2012 between GDP and the pre-crisis trend. Also, the OECD believes that the structural primary balance of many countries was negative in 2012 whereas it would have been positive if the loss of production could have been made up. For France, the OECD estimates the structural primary balance at -1.3% of GDP, while the balance would be 0.5% if the loss due to the crisis could be made up. Only the United States and Japan would retain a structural primary deficit under the “catch-up hypothesis”.

Assume that long-term rates remain below the growth rate of the economy and that it is not necessary to reduce the public debt ratios. Then a structural primary balance at equilibrium would be sufficient to stabilize the public debt. Only two countries would need to make fiscal efforts: Japan (for 6.7 GDP points) and the US (for 2 points). The other countries would primarily be concerned with re-establishing a satisfactory level of production.

However, the OECD assumes that the countries will suffer forever from the shock induced by the crisis, that it is imperative to reduce the debts to 60% of GDP, that long-term rates will be higher (by about 2 points) than the economy's growth rate in the very near future, and that public health spending will continue to rise. This leads it to conclude that most countries should immediately engage in a highly restrictive policy, representing 4.7 GDP points for France, 7.7 points for the United States, 9.2 points for the United Kingdom, etc.

The problem is that the OECD study assumes that these restrictive policies will not have any impact on the level of economic activity, or at least that the impact will be temporary, so that it can be neglected in a structural study of the long term. This is based on a notion that, though widespread, is wrong: that the economy has a long-term equilibrium that would not be affected by short or medium-term shocks. But this makes no sense. Real economies can go off in a different direction and experience periods of prolonged and cumulative depression. Is it possible to imagine a long-term Greek economy that is unaffected by the country's current situation? The shock induced by the strategy advocated by the OECD would mean a lengthy period of stagnation in Europe , Japan and the United States; the depressive effect would not be offset by lower interest rates, which have already hit bottom; a fiscal cutback of 6% of the OECD's GDP would result in a fall in GDP of 7.2% [\[4\]](#); and the decrease in activity would be so great that debt ratios would rise in the short term (see the explanatory box below). To believe that the economy would eventually return to its long-term trajectory is just wishful thinking. The OECD provides no assessment of the impact of such a policy produced with a macroeconomic model.

We can only wonder that the OECD continues to advocate austerity policies that were shown in the years 2012-2013 to have adverse effects on growth and a negligible impact on the level of public debt, instead of advocating a policy stimulus that, while its content is of course debatable, would be more promising for the Western economies.

### **3) Choosing the right instruments**

The bulk of the OECD study, however, is devoted to researching the policy instruments that would be most effective for achieving fiscal consolidation.

Based on previous work, the OECD assigns to each instrument an impact on growth, equity and the trade balance (Table 2). The

organization has happily discovered that in some cases public expenditure can be helpful for growth as well as equity: such is the case of spending on education, health, family benefits and public investment. These should therefore be protected to the fullest. However, the OECD does not go so far as to imagine that they could be strengthened in some countries where they are particularly low today. In other cases, the OECD remains faithful to its free market doctrine: for example, it considers that spending on pensions is detrimental to long-term growth (since reducing it would encourage seniors to remain in employment, thereby increasing output) and is not favourable to equity. One could argue the opposite: that reducing public spending on pensions would hit the poorest workers, who would then live in poverty during their retirement; the better-off would save in the financial markets, which would strengthen these and thus fuel financial instability. Similarly, for the OECD unemployment and disability benefits hurt employment, and thus growth. Moreover, subsidies would be detrimental to long-term growth, as they undermine the competitive balance, and thus efficiency, but the OECD puts all subsidies in the same bag: the research tax credit, the PPE employment bonus, and the common agricultural policy, whereas a more detailed analysis is needed. Moreover, orthodox economic theory itself recognizes the legitimacy of public action when the market fails. The OECD has a negative view of social contributions, whereas it is legitimate for public PAYG systems to be funded in this way. The organization believes that income tax hurts long-term growth by discouraging people from working: but this is not what we find in Scandinavia.

Finally, the ranking produced (Table 2) is only partly satisfactory. The OECD warns against lowering certain public spending (health, education, investment, family) and occasionally advocates higher taxes on capital, corporation tax and income tax, and environmental taxes. But at the same time it advocates cutting back on pensions and unemployment

insurance and reducing subsidies.

The OECD seeks to take into account the heterogeneity of national preferences. But it does so in a curious way. It considers that countries where income inequality is high (the United States and United Kingdom) should be more concerned with equity, but that the opposite holds for egalitarian countries (Sweden, Netherlands). But the opposite position could easily be supported. Countries that have highly egalitarian systems want to keep them and continue to take account of equity in any reforms they undertake.

Ultimately, suppose that, like France, all the countries had set up an efficient system for the control of their public finances (the [RGPP](#) then the [MAP](#)). At equilibrium, all expenses and revenues have the same marginal utility. If there is a need to save money, this should involve a reduction in costs and an increase in revenue in the same proportions. Dispensing with this strategy would require a detailed analysis of the utility of the spending and the cost of the revenue, an analysis that the OECD is incapable of providing. The fact that the OECD considers that spending on disability is generally detrimental to growth does not give it the right to advocate a strong reduction in disability spending in Finland, without taking into account the specific features of the Finnish system

**Table 2. Short-term (ST) and long-term (LT) impact of fiscal consolidation instruments on growth, equity and the trade balance, according to the OECD**

	Growth		Equity		Trade balance	Ranking*
	ST	LT	ST	LT		
<b>Spending (down)</b>						
Education	--	--	-	--	+	17
Health	--	-	-	-	++	15
Other spending	--	+	-		+	9
Pensions		++			++	2
Disability	-	+	--	-	++	11
Unemployment	-	+	-		++	4
Family	-	-	--	--	+	16
Subsidies	-	++	+	+	+	1
Investment	--	--			++	13
<b>Revenue (up)</b>						
Income tax	-	--	+	+	+	5
Social contributions	-	--	-	-		14
Corporation tax	-	--	+	+	++	6
Ecological tax	-	+	-		+	7
Consumer tax	-	-	-		+	12
Property tax	-				+	8
Other property tax	-		++	+	+	3
Sale of goods	-	+	-	-	+	10

\* The higher the figure, the less the instrument should be used in fiscal consolidation.

All things considered, the recommendations for France (Table 3) are of little use, whether this is a matter of greatly reducing the level of pensions and unemployment benefits (under the pretext that France is more generous than the average of the OECD countries!) or of reducing subsidies (but why?) or of reducing public consumption (because France needs an army, given its specific role in the world).

**Table 3. Fiscal adjustments recommended for France by the OECD (% of GDP)**

	Short term	Long term
Pensions	-0.6	-2.2
Subsidies	-0.7	-0.7
Unemployment benefits	-0.7	-0.4
Ecological tax	+0.7	
Corporation tax	+0.5	
Other public consumption	-1.2	-1.1
<b>Total adjustment</b>	<b>4.7</b>	<b>4.7</b>

Overall, the OECD does not provide any simulation of the impact of the recommended measures on growth or equity. It is

of course possible to do worse, but this still winds up in a project that would lead to a sharp decline in growth in the short to medium term and a decrease in spending on social welfare. Even though it claims to take account of the trade balance, it does not argue that countries running a surplus should pursue a stimulus policy in order to offset the depressive impact of the restrictive policies of countries running a deficit.

But the OECD also holds that there are of course miracle structural reforms that would improve the public deficit without any cost to growth or equity, such as reducing public spending without affecting the level of household services by means of efficiency gains in education, health, etc.

What a pity that the OECD is lacking in ambition, and that it does not present a really consistent programme for all the member countries with an objective of growth and full employment (to reduce the unemployment caused by the financial crisis) and of reducing trade imbalances, especially a programme with social objectives (reducing inequality, universal health insurance, and a satisfactory level of social welfare)!

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### **Box: Austerity policy and the public debt**

Consider an area where GDP is 100, the public debt is 100, the tax burden is 0.5 and the multiplier is 1.5. Reducing public spending by 1 lowers GDP by 1.5 and public revenue by 0.75; the public balance improves by only 0.25. The debt / GDP ratio rises from 100% to  $99.75 / 98.5 = 101.25\%$ . It takes 6 years for it to fall below 100%.

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[1] Boris Cournède, Antoine Goujard, Alvario Pina and Alain de Serres, *OECD Economic Policy Papers*, July 2013. A more detailed version can be found in: Boris Cournède, Antoine Goujard and Alvario Pina, “How to achieve growth-and-equity fiscal consolidation ?”, *OECD Economics Department Working Paper*, 2013.

[2] Laurence Ball, Davide Furceri, Daniel Leigh, and Prakash Loungani, “The Distributional Effects of Fiscal Consolidation”, IMF WP/13/151, June 2013.

[3] See: OECD, 2012, *Toujours plus d'inégalité* [More and more inequality], March.

[4] Using the multiplier of 1.2 from the OECD Note, 2009, “The Effectiveness and the Scope of Fiscal Stimulus”, March.

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# **Plea for a growth pact: the sound and fury hiding a persistent disagreement**

By [Jean-Luc Gaffard](#) and [Francesco Saraceno](#)

The emphasis on the need to complement fiscal restraint by measures to boost growth, which is rising in part due to the electoral debate in France, is good news, not least because it represents a belated recognition that austerity is imposing an

excessively high price on the countries of southern Europe.

Nevertheless, there is nothing new about invoking growth, and this may remain without consequence. In 1997, as a result of a French government intervention, the Stability Pact became the Stability and Growth Pact, but this had no significant impact on the nature of strategy, which remained fully oriented towards the implementation of strict monetary and fiscal rules and a constant search for more flexible markets.

Last week, [Mario Draghi](#), along with [Manuel Barroso and Mario Monti](#), were worried not only about the recession taking place in Spain, Portugal, the Netherlands and Great Britain but also about the need to respond formally to a request that may come from a new French government. They too are arguing for a negotiated Growth Pact, while taking care to note that it must consist of a common commitment to carry out structural reforms wherever they have not yet been made. This position echoes the February [letter](#) of the eleven Prime Ministers to the European authorities. In other words, nothing is to change in the doctrine that determines the choice of Europe's economic policy: growth can be achieved only through structural reform, in particular of the labour markets.

There are two grounds for criticizing this position. [It is far from sure](#) that structural reform is effective, unless, that is, it is wielded in a non-cooperative spirit to improve the competitiveness of the country that undertakes the reform at the expense of its trading partners, as Germany was able to do with the Hartz reforms. Secondly, widespread reform, including where this is justified in terms of long-term growth, would initially have a recessionary impact on demand [\[1\]](#), and hence on activity. Reform cannot therefore deal with what is actually the immediate top-priority requirement, namely stemming the spreading recession.

The real challenge facing Europeans is to reconcile the short term and the long term. The solution proposed so far, general



fiscal austerity aimed at [restoring the confidence of private actors](#), which would be complemented by structural reforms intended to increase the potential growth rate, just doesn't work. This can be seen by developments in Greece, as well as in Portugal and Ireland, which are model students of Europe's bailout plans, and also in Britain, Italy and Spain. The fiscal multipliers remain firmly Keynesian (see [Christina Romer](#), and [Creel, Heyer and Plane](#)), and any "non-Keynesian" effects on expectations are limited or nonexistent.

Growth can neither be decreed nor established instantly, unlike the deflationary austerity spiral in which more and more European countries are currently trapped.

Growth is likely to materialize only if fiscal consolidation is neither immediate nor drastic – in fact, only if the consolidation required of countries in difficulty is spread over time (beyond the year 2013, which in any case will be impossible to achieve) and if the countries that are able to carry out a more expansionary fiscal policy actually do this in such a way that at the European level the overall impact is neutral or, even better, expansionary. This strategy would not necessarily be punished by the markets, which have shown recently that they are sensitive to the requirement for growth. Otherwise, steps should be taken by the ECB to deal with the constraints imposed by the markets. This short-term support must be accompanied by substantial medium-term investment made through European industrial programs financed by the issuance of Eurobonds – which would mean, finally, a European budget on a scale large enough to handle the tasks facing the Union. This method of coordinating short- and medium-term choices would be an important step towards the establishment of the kind of federal structure that alone will allow the resolution of the "European question".

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[1] R.M. Solow, Introduction to Solow, R.M. Ed. (2004), *Structural Reforms and Macroeconomic Policy*, London: Macmillan).

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# Must balancing the public finances be the main goal of economic policy

By [Henri Sterdyniak](#)

The financial crisis of 2007-2012 caused a sharp rise in public deficits and debt as States had to intervene to save the financial system and support economic activity, and especially as they experienced a steep drop in tax revenues due to falling GDP. In early 2012, at a time when they are far from having recovered from the effects of the crisis (which cost them an average of 8 GDP points compared to the pre-crisis trend), they face a difficult choice: should they continue to support activity, or do whatever it takes to reduce public deficits and debt?

[An in-depth note expands on nine analytical points:](#)

- The growth of debt and deficits is not peculiar to France; it occurred in all the developed countries.
- France's public bodies are certainly indebted, but they also

have physical assets. Overall the net wealth of government represented 26.7% of GDP in late 2010, or 8000 euros per capita. Moreover, when all the national wealth is taken into account (physical assets less foreign debt), then every French newborn has an average worth at birth of 202 000 euros (national wealth divided by the number of inhabitants).

– In 2010, the net debt burden came to 2.3% of GDP, reflecting an average interest rate on the debt of 3.0%, which is well below the nominal potential growth rate. At this level, the real cost of the debt, that is, the primary surplus needed to stabilize the debt, is zero or even slightly negative.

– The true “golden rule” of public finances stipulates that it is legitimate to finance public investment by public borrowing. The structural deficit must thus be equal to the net public investment. For France, this rule permits a deficit of around 2.4% of GDP. There is no reason to set a standard for balancing the public finances. The State is not a household. It is immortal, and can thus run a permanent debt: the State does not have to repay its debt, but only to guarantee that it will always service it.

– The public deficit is detrimental to future generations whenever it becomes destabilizing due to an excessive increase in public spending or an excessive decrease in taxation, at which point it causes a rise in inflation and interest rates and undermines investment and growth. This is not the situation of the current deficit, which is aimed at making adjustments to provide the necessary support for economic activity in a situation of low interest rates, due to the high level of household savings and the refusal of business to invest more.

– For some, the 8 GDP points lost during the crisis have been lost forever; we must resign ourselves to persistently high unemployment, as it is structural in nature. Since the goal must be to balance the structural public balance, France needs

to make an additional major effort of around 4 percentage points of GDP of its deficit. For us, a sustainable deficit is about 2.4 GDP points. The structural deficit in 2011 is already below that figure. It is growth that should make it possible to reduce the current deficit. No additional fiscal effort is needed.

– On 9 December 2011, the euro zone countries agreed on a new fiscal pact: the Treaty on Stability, Coordination and Governance of the European Monetary Union. This Pact will place strong constraints on future fiscal policy. The structural deficit of each member country must be less than 0.5% of GDP. An automatic correction mechanism is to be triggered if this threshold is exceeded. This constraint and the overall mechanism must be integrated in a binding and permanent manner into the fiscal procedures of each country. Countries whose debt exceeds 60% of GDP will have to reduce their debt ratio by at least one-twentieth of the excess every year.

This project is economically dangerous. It imposes medium-term objectives (a balanced budget, a debt rolled back to below 60% of GDP) that are arbitrary and are not *a priori* compatible with the necessities of an economic equilibrium. Likewise, it imposes a fiscal policy that is incompatible with the necessities of short-term economic management. It prohibits any discretionary fiscal policy. It deprives governments of any fiscal policy instrument.

– As the rise in public debts and deficits in the developed countries came in response to mounting global imbalances, we cannot reduce the debts and deficits without addressing the causes of these imbalances. Otherwise, the simultaneous implementation of restrictive fiscal policies in the OECD countries as a whole will lead to stagnating production, falling tax revenues and deteriorating debt ratios, without managing to reassure the financial markets.

– A more balanced global economy would require that the countries in surplus base their growth on domestic demand and that their capital assumes the risks associated with direct investment. In the Anglo-American world, higher growth in wage and social income and a reduction in income inequalities would undercut the need for swelling financial bubbles, household debt and public debt. The euro zone needs to find the 8 GDP points lost to the crisis. Instead of focussing on government balances, the European authorities should come up with a strategy to end the crisis, based on a recovery in demand, and in particular on investment to prepare for the ecological transition. This strategy must include keeping interest rates low and public deficits at the levels needed to support activity.