

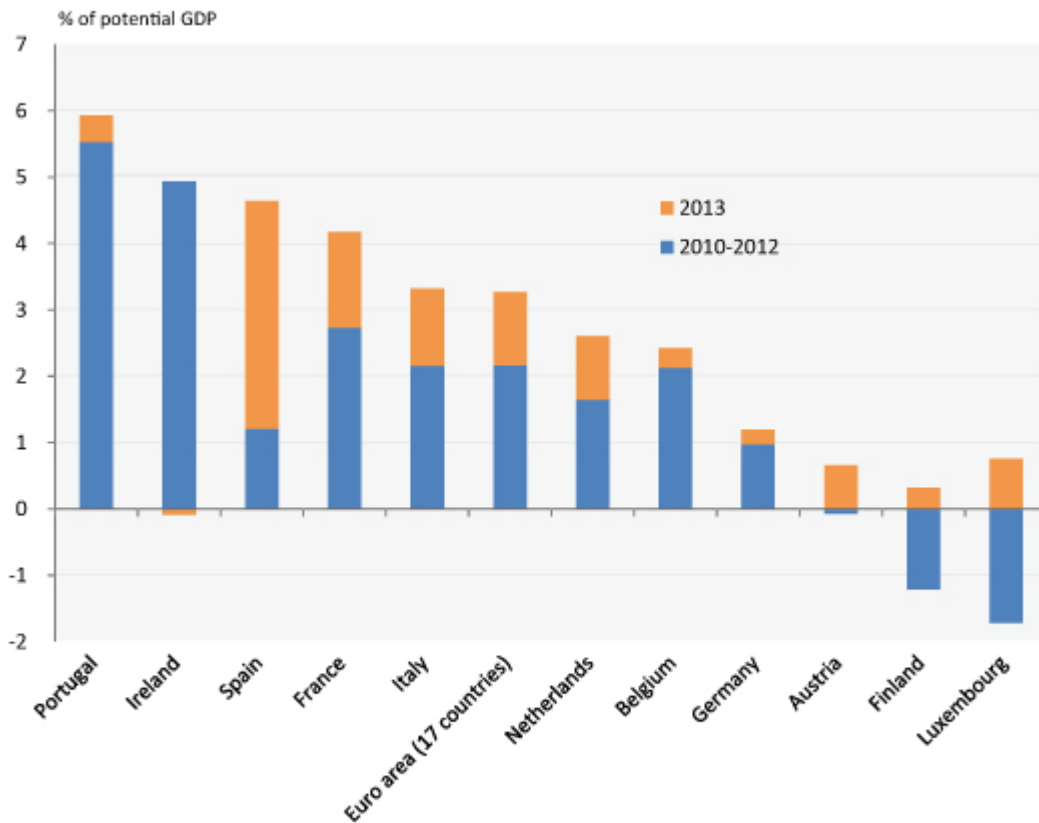
# Why France is right to abandon the 3% public déficit target by 2013

By [Mathieu Plane](#)

Given the statements by the Minister of Economy and Finance, the government seems to have reached a decision to abandon the goal of a deficit of 3% of GDP by 2013. In addition to the change of tack in the policy announced up to now, which was to bring the deficit down to 3% by 2013 “whatever the cost”, we can legitimately conclude that France is right to abandon this goal, and we offer several arguments for this. While in this post we do not review [the economic consequences of the fiscal policy being undertaken in France and the euro zone](#), which has been dictated by nominal targets for the deficit that do not take into account the way it breaks down structurally / cyclically and that have a dangerously pro-cyclical character, we nevertheless present several arguments that the European Commission may find of value:

1 – According to the latest figures from the European Commission on 22 February 2013<sup>[1]</sup>, of the euro zone countries making the greatest fiscal adjustment in 2013 from a structural viewpoint, France, with 1.4 GDP points, comes behind only Spain (3.4) and Greece (2.6). For the 2010-2013 period, the reduction in France’s structural deficit represents 4.2 GDP points, which makes France the euro zone country which, alongside Spain (4.6 GDP points), has carried out the largest budget cutbacks of the major countries in the zone, ahead of Italy (3.3 GDP points), the Netherlands (2.6) and of course Germany (1.2) (Figure 1).

Figure 1. Change in the structural deficit of the euro zone countries\*



\* For reasons of scale, we have not put Greece in the figure. Over the 2010-2013 period, Greece's structural fiscal adjustment came to 16.9 GDP points, including 2.6 in 2013.

Sources: European Commission, OFCE calculations.

2 – In 2007, before the crisis, according to the European Commission France had a structural public deficit of -4.4 GDP points, compared with an average of -2.1 for the euro zone and -0.9 for Germany. In 2013, this came to -1.9 GDP points in France, -1.3 for the euro zone, and +0.4 for Germany, which represents an improvement of the structural deficit of 2.5 GDP points for France since the start of the crisis, *i.e.* three times the average for the euro zone and twice that for Germany (Table 1). Leaving aside public investment, France's structural public deficit in 2013 was positive and higher than the euro zone average (1.2 GDP point in France, versus 0.8 for the euro zone average and 1.9 for Germany). Note that France is spending 3.1 GDP points on public investment in 2013 (0.2 GDP point less than in 2007), against a euro zone average of only 2 points (0.6 point less than in 2007) and 1.5 in Germany (equivalent to 2007). However, public investment, which has a positive impact on potential growth, and which also increases

public assets, while not changing the public administration's financial situation, can reasonably be excluded from the calculation of the structural public deficit.

**Table. Public deficit and structural deficit with and without public investment**

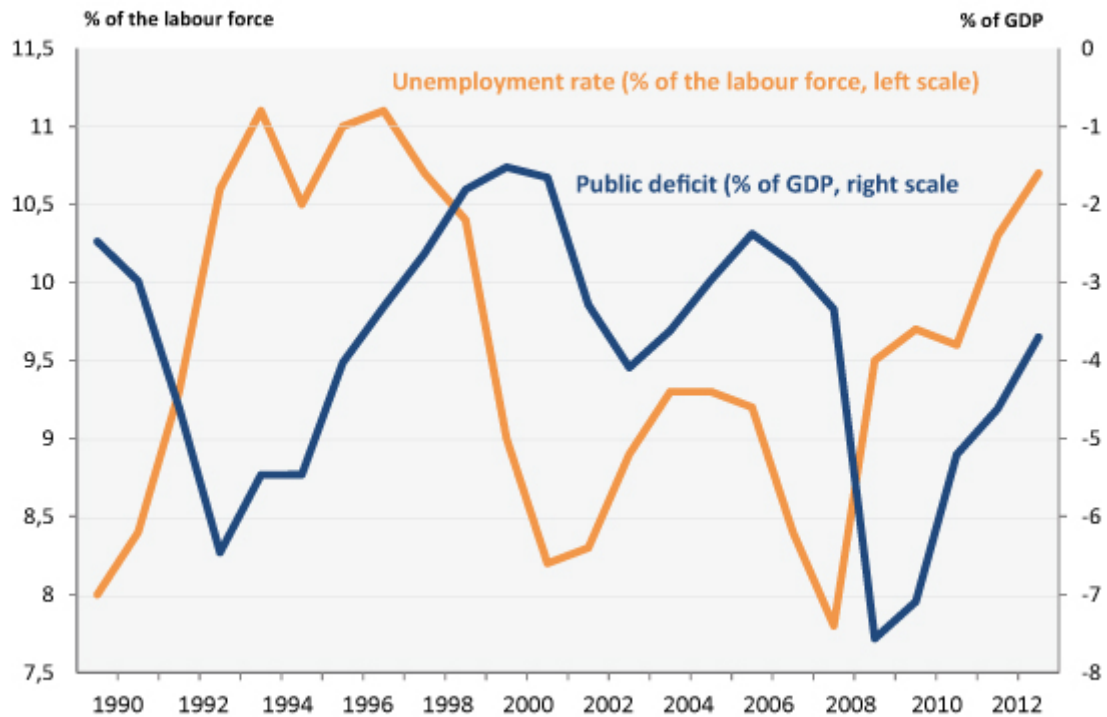
In GDP points	Public balance				Structural public balance				SPB w/o public investment			
	FRA	DEU	EZ	FRA-EZ diff.	FRA	DEU	ZE	FRA-EZ diff.	FRA	DEU	EZ	FRA-EZ diff.
<b>2007</b>	-2.8	0.2	-0.7	<b>-2.1</b>	-4.4	-0.9	-2.1	<b>-2.3</b>	-1.1	0.6	0.5	<b>-1.6</b>
<b>2013</b>	-3.7	-0.2	-2.8	<b>-0.9</b>	-1.9	0.4	-1.3	<b>-0.6</b>	1.2	1.9	0.8	<b>0.4</b>
<b>Change 2007-2013</b>	-0.9	-0.4	-2.1	<b>1.2</b>	2.5	1.3	0.8	<b>1.6</b>	2.3	1.3	0.3	<b>2.1</b>

Sources : European Commission, OFCE calculations.

3 – In 2013, the public deficit, even at 3.7% of GDP according to the European Commission, is once again at a level close to that of 2008, similar to that of 2005, and below that of 2004 and of the entire 1992-1996 period. The public deficit figure expected for 2013 corresponds to the average over the past thirty years, and thus no longer seems so exceptional, which is easing the pressure that France could experience on the financial markets. In contrast, according to the European Commission the unemployment rate in France in 2013 will reach 10.7% of the workforce, which is very close to its historic peak in 1997 (Figure 2). With an unemployment rate in 2013 that is 1.3 percentage points higher than the average over the last thirty years, an exceptional situation now characterizes the labour market more than it does the government deficit. While new austerity measures would help to reduce the deficit, however painfully, due to the [high value of the fiscal multiplier in the short term](#) they will lead on the other hand to going well beyond our historic unemployment peak. Indeed, as we showed in our [latest forecast in October 2012](#), if France really tries to meet its budget commitment for 2013 “whatever the cost”, this will require a new fiscal tightening of over 20 billion euros, in addition to the [36 billion euros already](#)

[planned](#). This would lead to a recession, with GDP down -1.2% and 360,000 job losses (instead of expected growth of 0% and the loss of about 160,000 jobs), with the unemployment rate reaching 11.7% of the labour force by late 2013.

Figure 2. Public deficit and unemployment rate



Source: European Commission.

To restore its public accounts since 2010, France has undertaken a historic fiscal effort, well beyond the average of its European partners, which has cost it in terms of growth and employment. Adding another layer of austerity in 2013 to the already historic build-up of austerity would lead us this year straight into a recession and an unprecedented worsening in the labour market. If there is a choice, are a few tenths of a point in the public deficit worth such a sacrifice? Nothing is less certain. It is thus essential to put off the goal of reducing the deficit to 3% of GDP to at least 2014.

---

[1] We have a different evaluation of the level of the structural deficit. For example, for 2013 we evaluate the improvement in France's structural public deficit at 1.8 GDP points, but in order not to prejudice the analysis we are using the figures provided by the Commission.

---

# The taxation of family benefits – is this the right debate?

By [Hélène Périvier](#) and François de Singly

*Debate on the taxation of the family allowance has begun once again. Faced with a deficit in the government's family accounts of about 2.5 billion euros in 2012, the idea of taxing the allowance has resurfaced as a way to refill coffers that have emptied, in particular as a result of the economic crisis. The debate often pits an accounting logic that aims to make up the deficits quickly against the logic of a conservative family policy. This post offers a broader perspective that goes beyond this binary approach to the issue.*

**From family accounts that were balanced...**

In the current period, dealing with the budget involves squaring a circle: less tax revenue and greater social

spending because of the economic crisis. The temptation is to solve this equation by reducing social spending to make up for declining revenues. It is in this context that the proposal to subject the family allowance to income tax has resurfaced.

During economic crises, the automatic stabilizer role played by social welfare, including family policy, is fundamental. It limits the effects of the crisis on the living standards of those who are most at risk, and therefore also helps to contain the rise in inequality. By supporting household income, it prevents a collapse of economic activity. During the kind of economic downturn we are experiencing today, cutting social spending is not desirable and can be [counter-productive macroeconomically](#).

However, it is not absurd to try to balance the budget for family expenditure over the medium and long term, as this ensures that public action to support families will be sustainable. The deficit in the family accounts comes to 2.5 billion euros. But this is mainly because of the crisis and the consequent reduction in revenues, and is thus cyclical. Mechanically, with legislation unchanged, the family accounts should balance again within a few years if economic growth returns (these assumptions are based on [an annual growth rate of 2% from 2014](#)). Although a debt would still exist due to the accumulation of deficits in 2012 and the following years [1], this could be gradually eliminated using the surpluses generated after the return to equilibrium. But the outlook changes if there is no return to growth or if recovery takes longer than expected, in which case questions about the family budget allocation could be raised with regard to its redistribution or its level. The CNAF pays more than 12 billion euros for the family allowance [2], regardless of the parents' income. Families with two children receive 127 euros per month for the two children and 163 euros for each additional child. These family benefits are not taxed. Taxing them would reduce the amount of post-tax benefits paid to

families, progressively in line with income. This would generate additional tax revenue of approximately 800 million euros. It might seem fairer if families with higher incomes bore more of the burden of budget cutbacks than families on lower incomes. But this issue is more complex than it appears.

The taxation of family benefits might seem to be a way to make up for the loss in the progressivity of the tax system that has occurred over the years, which is mainly due to lower marginal rates in the income tax system, and thereby make things more equitable. But this answer is only a race to the bottom socially, a headlong rush by our welfare state that would lead to reducing its scope of action.

Taxing the family allowance reduces the level of transfers from households without children to families with children, *i.e.* it violates the principle of horizontal equity. Of course, it also helps in particular to increase the level of transfers from the best-off families with children to those less well-off. But to strengthen the overall degree of vertical redistribution (that is to say, to increase the level of transfers from the richest households to the poorest), the tax system has to be made more progressive, which is what was done with the latest fiscal adjustments ([introduction of a 45% tax bracket in particular](#)). In this context, the universality of family allowances could then be maintained, which has the advantage of consolidating the support of high-income households for the principle of the welfare state: they pay more taxes, but they receive the same amount of family benefits when they have children.

The taxation of the family allowance is not simply an adjustment in family policy, it also affects its values — and in particular the principle of horizontal equity. While it may be necessary to rethink the objectives of family policy, which are now outdated in many respects, as we show in the next section, the current period is probably not the best for conducting this debate, because the urgency of the situation

and the desire to find more room for fiscal manoeuvring would lead to the adoption of a short-term vision, whereas family policy is intrinsically long-term policy.

### **..to a balanced family policy**

Nevertheless, this debate on the relevance of taxing the family allowance should not lead to policy paralysis. The principles of current family policy were established based on the way society was viewed over 70 years ago. Although adjustments have been made, the principles remain. Yesterday's objectives do not reflect tomorrow's challenges. It is thus essential to renegotiate the foundations of family policy. How should the welfare state's family activities be reoriented? What compass should be followed? This is the question we need to answer.

One of the goals of contemporary family policy is to prop up the birth-rate. State support increases with the birth order of the child, for example, by granting an additional one-half personal allowance on taxation per child, starting from the third child. When considering how to redeploy spending on family policy, removing the one-half personal allowance should be a top priority for proposals to rebalance the accounts. Similarly, the family allowance is paid only from the second child. France is one of the only countries in Europe not to grant an allowance from the first child. But the dynamic fertility rate found in France is not the result of pro-childbirth family policies like this; instead, it has more to do with the support given for working women with children: kindergarten, extracurricular childcare, care in early childhood, as well as support for mothers in the workforce (rather than stigmatizing this, as is the case in Germany). Family policy needs to be reoriented towards an objective that respects the rights of every child regardless of their birth order. It should focus on the social citizenship of the individual (that is to say, a more individually-based method of acquiring social rights) from birth to death (while taking



into account longer life spans).

A renovated family policy would reflect the principle of equality between children and equality between women and men, including in particular an overhaul of early childhood support, a massive increase in childcare and changes in the system of parental leave. The cost of dealing with early childhood support would be about [an additional 5 billion euros per year](#). Furthermore, the latest publication of the OECD, [Education at a Glance 2012](#), shows that in France children's academic success is strongly correlated with the level of the parents' education. Finally, the [level of child poverty is disturbing](#). These are all major challenges we must meet.

The rise of partnerships outside marriage but also of divorces (and separations more generally) and family recompositions are a sign of greater individual freedom with regard to life choices. This constitutes a progressive step in the way our society functions. But separations are often accompanied by a decline in living standards and often are not financially possible for individuals on low incomes. In addition, the economic consequences when the couple breaks down hit women harder than men. [\[3\] Single-parent families](#), most often mothers with the children in their care, are more exposed to poverty than other households. A family policy that is more in line with these new living arrangements, and which would accompany changes in the family structure over the life cycle, needs to be considered.

It is necessary to redefine the content and contours of our future family policy, but the desire to balance the family accounts cannot be the sole engine driving this process. We must stop thinking about this kind of change in a narrow way, as we need to reform the very foundations of the system based on new needs and on the principles of justice and solidarity that underpin our social welfare state.

---

[1] In 2011, the debt in the family accounts was transferred to the Caisse d'amortissement de la dette sociale (CADES), ([Organic Law 2010-1380 – in French](#)).

[2] Which represents about 15% of the total amount of benefits paid out of the family accounts.

[3] Jeandidier Bruno and Cécile Bourreau-Dubois, 2005, “Les conséquences microéconomiques de la disunion”, In Joël M.-E. and Wittwer J., *Economie du vieillissement. Age et protection sociale*, Ed. L'Harmattan,, Vol. 2, pp. 335-351.

---

# Should family benefits be cut? Should they be taxed?

By [Henri Sterdyniak](#)

The government has set a target of balancing the public accounts by 2017, which would require cutting public spending by about 60 billion euros. The Prime Minister, Jean-Marc Ayrault, has given Bernard Fragonard, President of the Haut Conseil à la Famille, France's advisory body on the family, a deadline of end March to propose ways to restructure family policy so as to balance the budget for the family accounts by 2016. Aid to families thus has to be cut, by 2.5 billion euros (6.25% of family benefits), *i.e.* the equivalent of the 2012 deficit for the CNAF, the French national family allowances fund. Is this justified from an economic perspective and a social perspective?

The CNAF accounts have been hit by the recession, as the amount of social security contributions and CSG tax that it receives has gone down. Based on an estimate that total payroll is 5% below its normal level, the loss of revenue for the CNAF can be estimated at 2.5 billion euros. The CNAF deficit as a whole is thus cyclical. Arguing that the way to cut the deficit is by reducing benefits undermines the stabilizing role of public finances. Consider a fall in private demand of 1% of GDP; assuming a multiplier equal to 1, GDP also shrinks by 1%; the deficit in the public finances will then increase by 0.5%. If you want to avoid this deficit, then government spending would need to be cut by 0.5% of GDP, which would then reduce GDP, and consequently tax revenue, thereby requiring further reductions. *Ex post*, public spending would fall by 1% and GDP by 2%. Fiscal policy would then be playing a destabilizing role. The CNAF therefore needs to be managed based on looking at its structural dimension, which was in fact balanced in 2012. On the economic front, in a situation of a deep depression, when consumption and activity are stagnant, nothing can justify undermining the purchasing power of families [\[i\]](#).

Moreover, successive governments have gradually made the CNAF responsible for both pension benefits for stay-at-home parents (4.4 billion euros in 2012) and increases in family pensions (4.5 billion in 2012). Thus, of the CNAF's 54 billion euros in funds, nearly 9 billion is being diverted into the pension scheme and does not directly benefit children.



This diversion has been possible because family benefits have risen only slightly in the past, as they are generally indexed to prices, not wages. Worse, in some years, benefits have not even risen at the same pace as inflation. Finally, from 1984 to 2012, the monthly basis for calculating the family allowance (the BMAF) lost 5.7% in absolute purchasing power

(column 1 of the table), but 25% in purchasing power relative to median household income (column 2). Should we perpetuate and even widen this growing gap?

Young people under age 20 represent 25% of the population. Using the INSEE's equivalence scale, 12.5% of household income should be provided by the family benefits that go to families with children in order to ensure that they have the same standard of living as people without children. Yet the totality of family benefits represents only 4.2% of household income [\[ii\]](#).

The RSA income support is significantly lower than the pension minimum under the pretext of encouraging RSA beneficiaries to work, but this is hurting the living standards of children, who usually live with people in the workforce, not with pensioners. The creation of the RSA *activité* [the income supplement for the working poor] could have provided significant additional resources for many families of low-wage workers, but it is poorly designed: many potential beneficiaries don't even apply for it. Moreover, it does not benefit the unemployed (and thus their children). In 2010, the poverty rate of children (at the 60% threshold) was 19.8%, compared with 14.1% for the population as a whole. At the 50% threshold, it was 11.1%, against 7.8% for the general population. This means that 2.7 million children are below the 60% poverty line, with 1.5 million even below the 50% line.

A family with three children has a lower standard of living than a childless couple earning the same wages: by 16% at the level of two times the minimum wage, and by 30% at the level of five times the minimum wage. Family allowances have become very low for the middle classes; the family quotient simply takes into account the reduction in living standards caused by the presence of children, but it does not provide specific assistance to families. Aid to children is not excessive at any level of income. In 2010, the average standard of living was 10% lower for children than for the average population.

The opposite should be the case, since children need a decent standard of living to develop their full potential, and parents who raise their children play a fundamental social role, in addition to their role in the workforce.

Should the family allowance be taxed? This would mean ignoring that the amount is already very low compared to the cost of children. Median income per consumption unit was around 1 660 euros in 2012; the average cost of a child, who represents 0.3 consumption unit, is thus about 500 euros. Yet the allowance amounts to 64 euros per child for a family with two children and 97 euros per child for a family with three children. The allowance would thus have to be at least multiplied by 5 before taxing it became a legitimate question.

Making progress toward the goals on French family policy proclaimed in the Social Security Financing Act (LFSS) [\[iii\]](#) – reducing disparities in living standards due to family structure, lifting all children out of poverty, increasing the number of places in childcare – would require devoting greater resources to family policy. This is a burden that should be borne by all taxpayers, not just by middle-class families, who are not the ones most favoured under the existing system.

Cutting the amount that the nation spends on its children by 2.5 billion euros would be a mistake in terms of both macroeconomic policy and social policy. As Charles Gide observed, “Of all the investments a country can make, it is the education of the children that is the most profitable.”

---

[\[i\]](#) For a similar argument, see Gérard Cornilleau, 2013, “Should spending on unemployment benefits be cut?”, *OFCE blog*, 6 February.

[\[ii\]](#) See Henri Sterdyniak, 2011, “Faut-il remettre en cause la politique familiale française”, *Revue de l’OFCE*, no. 116.

[\[iii\]](#) See the PLFSS, 2013, *Programme de qualité et d’efficience, Famille*.

---

# Should spending on unemployment benefits be cut?

By [Gérard Cornilleau](#)

The Cour des comptes [Court of Auditors] has presented a [report on the labour market](#) which proposes that policy should be better “targeted”. With regard to unemployment benefits in particular, it focuses on the non-sustainability of expenditure and suggests certain cost-saving measures. Some of these are familiar and affect the rules on the entertainment industry and compensation for interim employees. We will not go into this here since the subject is well known [\[1\]](#). But the Cour also proposes cutting unemployment benefits, which it says are (too) generous at the top and the bottom of the pay scale. In particular, it proposes reducing the maximum benefit level and establishing a digressive system, as some unemployed executives now receive benefits of over 6,000 euros per month. The reasoning in support of these proposals seems wrong on two counts.

In the first place, the diagnosis of the system’s lack of sustainability fails to take the crisis into account: if

Unedic is now facing a difficult financial situation, this is above all because of falling employment and rising unemployment. It is of course natural that a social protection system designed to support employees' income in times of crisis is running a deficit at the peak of a crisis. Seeking to rebalance Unedic's finances today by cutting benefits would abandon the system's countercyclical role. This would be unfair to the unemployed and economically absurd, as reducing revenues in a period of an economic downturn can only aggravate the situation. In such circumstances, it is also easy to understand that arguments for work incentives are of little value: it is at the top of the cycle, when the economy is approaching full employment, that it makes sense to raise the issue of back-to-work incentives. When the economy is bumping along the bottom, encouraging a more active job search may change the distribution of unemployment, but certainly not its level.

The current deficit in the unemployment insurance system simply reflects the situation of the labour market. A few calculations can help to show that the system's generosity is fully compatible with financial stability in "normal" times. To establish this, we simply measure the impact of economic growth, employment and unemployment on the system's deficit since 2009. In 2008, Unedic was running a financial surplus of nearly 5 billion euros [2]. This turned into a deficit of 1.2 billion euros in 2009 and 3 billion in 2010, before recovering somewhat in 2011 with a deficit of only 1.5 billion, which then rose to 2.7 billion in 2012. For 2013, the deficit is expected to reach 5 billion. The Table shows our estimates of the impact of the crisis on the system's revenues and expenditures since 2009. The estimated revenue lost due to the crisis is based on the assumption of an increase in annual payroll of 3.5% per year (which breaks down into 2.9% for increases in the average wage and 0.6% for rises in employment) if the crisis had not occurred in 2008-2009. On the expenditure side, the estimated increase in benefits due

to the crisis is based on the assumption of a stable level of “non-crisis” unemployment, with spending in this case being indexed on the trend in the average wage.

**Table. Impact of the crisis on Unedic’s accounts**

In billions of euros

	Impact of the crisis...		Impact on the balance
	... on revenue	... on expenditure	
2009	-1,8	+4,1	-5,9
2010	-2,1	+5,1	-7,2
2011	-2,6	+5,5	-8,1
2012	-3,1	+6,5	-9,6

Source : Author’s calculations.

The results of this estimation clearly show that the crisis is solely responsible for the emergence of the substantial deficit run up by the unemployment insurance system. Without rising unemployment and falling employment, the system would have continued with a structural surplus, and the reform of 2009, which allowed compensation for unemployed people with shorter work references (4 months instead of 6 months), would have had only a minimal effect on its financial situation. There was no breakdown of the system, which was in fact perfectly sustainable in the long term ... so long as counter-cyclical economic policies are implemented that prevent a surge in unemployment, whose sustainability is now undoubtedly more of a concern than the finances of Unedic [\[3\]](#).

Based on a diagnosis that is thus very questionable, the Cour des comptes has proposed reducing the generosity of unemployment benefits. Since it is difficult to put forward proposals for cutting lower benefit levels, the Cour put more emphasis on the savings that could be achieved by limiting very high benefits, which in France may exceed 6,000 euros per month for executives on high-level salaries that are up to 4 times the maximum social security cap, which in 2013 was 12,344 euros gross per month. In reality, from a strictly accounting perspective, it is not even certain that this will have positive effects on Unedic’s finances. Indeed, few people benefit from these top benefit levels, because executives are



much less likely to be unemployed than are other employees. On the other hand, their higher salaries are charged at the same contribution rates, meaning that they make a net positive contribution to financing the scheme. Calculations based on the distribution of wages and of the benefits currently received by unemployed people insured by Unedic show that employees who earn more than 5,000 euros gross per month receive about 7% of unemployment benefits but provide nearly 20% of the contributions. For example, we simulated a reform that would bring French unemployment insurance into line with the German system, which is much more severely capped than the French system. The German ceiling is 5,500 euros gross per month (former Länder), against 12,344 in the French system. By retaining a cap of 5,000 euros gross per month, the maximum net benefit level in France would be around 2,800 euros. Based on this assumption, the benefits received by the unemployed in excess of the ceiling would be reduced by nearly 20%, but the savings would barely amount to more than 1% of total benefits. On the revenue side, the lower limit would result in a reduction in revenue of about 5%. The existence of a high ceiling in the French unemployment insurance system actually allows a significant vertical redistribution because of the differences in unemployment rates. Paradoxically, reducing insurance for the most privileged would lead to reducing this redistribution and undermining the system's financial stability. Based on the above assumptions, shifting to a ceiling of 5,000 euros would increase the deficit by about 1.2 billion euros (1.6 billion revenue – 400 million expenditure).

This initial calculation does not take into account the potential impact on those whose unemployment benefits would be greatly reduced. To clarify the order of magnitude of this effect, which is, by the way, unlikely, we simulated a situation in which the number of recipients of the highest benefits would be cut in half (e.g. by a reduction in the same proportion of the time they remain unemployed). Between the new ceiling and the highest level of the reference salaries,

we estimated that the incentive effect increased linearly (10% fewer unemployed in the first tranche above the ceiling, then 20% fewer, etc., up to -50%). Using this hypothesis of a high impact of benefit levels on unemployment, the additional savings on benefits would be close to 1 billion euros. In this case, the reform of the ceiling would virtually balance (with an added potential cost [not significant] of 200 million euros). But we did not include the fact that the shortening of the duration of unemployment compensation for unemployed people on high benefits could increase the duration of the unemployed on lower benefits. In a situation of near full employment, it is possible to consider that the rationing of employment results from the rationing of the supply of work; in the current situation of a generalized crisis, the more realistic case involves the opposite situation of a rationing of demand for labour. Achieving budget savings by cutting high benefit levels is not credible, at least if we stick to a reform that does not change the very nature of the system.

One could of course obtain a more favourable result by reducing only the cap on benefits and not the cap on contributions. This would be very destabilizing for the system, since it would strongly encourage executives to try to pull out of a unified solidarity system that provides them with reasonable assurances today through the acceptance of a high level of vertical redistribution, while lowering the cap on benefits alone would force them to insure themselves individually while continuing to pay high mandatory fees. This type of change would inevitably call into question the basic principle of social insurance: contributions based on each person's means in return for benefits based on need.

The general economics in the Cour's report on unemployment benefits thus seem highly questionable because, by not taking into account the effect of the crisis, it winds up proposing a pro-cyclical policy that puts additional burdens on the unemployed at a time when it is less possible than ever to

make them bear the responsibility for underemployment. As for the key measure that challenges the compromise on high level benefits, it would at best be budget neutral and at worst destroy the social contract that today makes possible strong vertical redistribution within the unemployment insurance system.

---

[1] Unemployment insurance has a special scheme for interim workers in the entertainment industry worth a billion euros per year. It would obviously be sensible for this expenditure to be borne by the general budget and not by Unedic.

[2] Excluding exceptional operations.

[3] On economic policy in Europe and the lack of macroeconomic sustainability, see the initial [report of the Independent Annual Growth Survey project \(IAGS\)](#).

---

## **The tax credit to encourage competitiveness and jobs – what impact?**

By [Mathieu Plane](#)

Following the submission to the Prime Minister of the [Gallois Report on the pact for encouraging the competitiveness of French industry](#), the government decided to establish the tax credit to encourage competitiveness and jobs (“the CICE”). Based on the rising trade deficit observed over the course of

the last decade, the sharp deterioration in business margins since the onset of the crisis and growing unemployment, the government intends to use the CICE to restore the competitiveness of French business and to boost employment. According to our assessment, which was drawn up using the e-mod.fr model as described in an article in the [Revue de l'OFCE \(issue 126-2012\)](#), within five years the CICE should help to create about 150,000 jobs, bringing the unemployment rate down by 0.6 point and generating additional growth of 0.1 GDP point by 2018.

The CICE, which is open to all companies that are assessed on their actual earnings and are subject to corporation tax or income tax, will amount to 6% of the total wage bill for wages below 2.5 times the minimum wage (SMIC), excluding employer contributions. It will come into force gradually, with a rate of 4% in 2013. The CICE's impact on corporate cash flow will be felt with a lag of one year from the base year, meaning that the CICE will give rise to a tax credit on corporate profits from 2014. On the other hand, some companies could benefit in 2013 from an advance on the CICE expected for 2014. The CICE should represent about 10 billion euros for the 2013 fiscal year, 15 billion in 2014 and 20 billion from 2015. As for the financing of the CICE, half will come from additional savings on public spending (10 billion), the details of which have not been spelled out, and half from tax revenue, *i.e.* an increase in the standard and intermediate VAT rate from 1 January 2014 (6.4 billion) and stronger environmental taxation.

This reform is similar in part to a fiscal devaluation and in some respects bears similarities to the mechanisms of the "quasi-social VAT" ([see Heyer, Plane, Timbeau \[2012\], "Economic impact of the quasi-social VAT" \[in French\]](#)) that was set up by the Fillon government but eliminated with the change of the parliamentary majority as part of the second supplementary budget bill in July 2012.

According to our calculations using 2010 DADS data, the CICE would lower average labour costs by 2.6% in the market sector. The sectors where labour costs would be most affected by the measure are construction (-3.0%), industry (-2.8%) and market services (-2.4%). The ultimate sectoral impact of the measure depends both on the reduction in labour costs and on the weight of wages in value added in a given sector. Overall, the CICE would represent 1.8% of the value added of industrial enterprises, 1.9% of the value added in construction and 1.3% in market services. In total, the CICE would represent 1.4% of the value added in market sector companies. According to our calculations, the total value of the CICE would be 20 billion euros: 4.4 billion in industry, 2.2 billion in construction and 13.4 billion for market services. Industry would therefore recover 22% of the total spending, *i.e.* more than its share of value added, which is only 17%. While this measure is intended to revive French industry, this sector would nevertheless not be the primary beneficiary of the measure in absolute value, but, along with the construction sector, has the best exposure relatively speaking due to its wage structure. Furthermore, industry can benefit from knock-on effects related to reductions in the prices of inputs generated by the lowering of production costs in other sectors.

The expected effects of the CICE on growth and employment differ in the short and long term (see graphic). By giving rights in 2014 based on the 2013 fiscal year, the CICE will have positive effects in 2013, especially as the tax hikes and public spending cuts will not take effect until 2014. The result will be a positive impact on growth in 2013 (0.2%), although it will take longer to affect employment (+23,000 in 2013) due to the time it takes employment to adjust to activity and the gradual ramping-up of the measure.

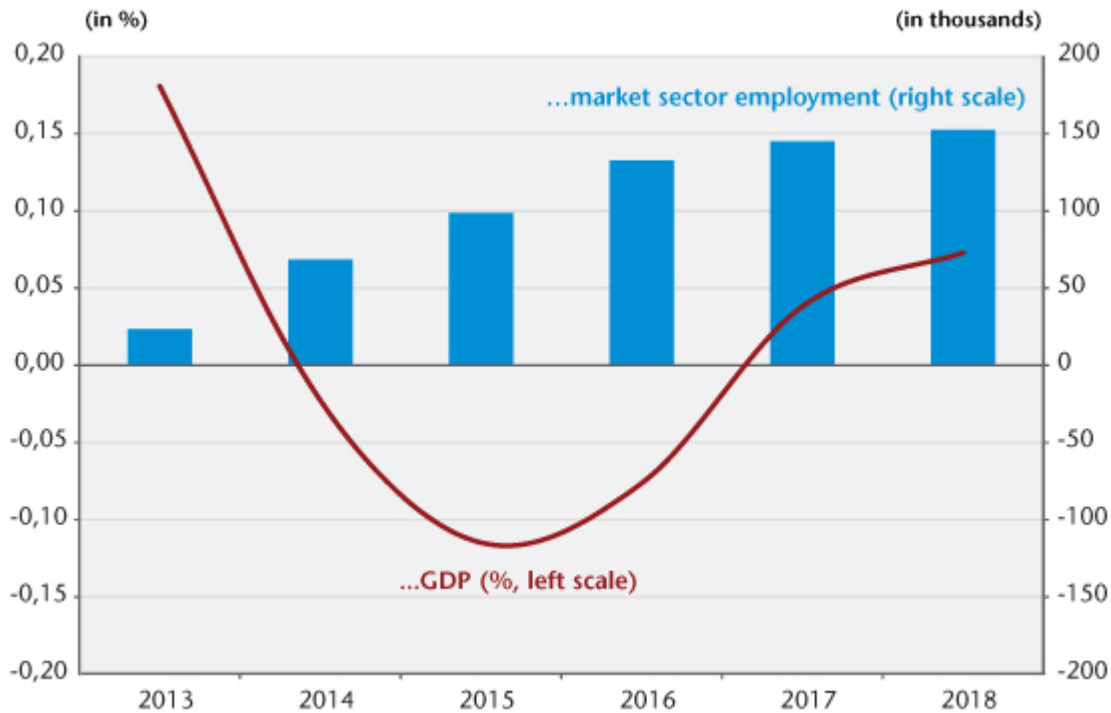
On the other hand, the impact of the CICE will be slightly recessive from 2014 to 2016, as the loss in household purchasing power linked to higher taxes and the cuts in public

spending (household consumption and public demand will contribute -0.2 GDP point in 2014 and then -0.4 point in 2015 and 2016) will prevail over lower prices and the recovery of business margins. Apart from the first year, the CICE's positive impact on growth related to income transfers will be slow to be seen, as gains in market share related to lower prices and to higher business margins are dependent on a medium / long-term supply-side mechanism, with demand-side impacts being felt more rapidly.

The implementation of the CICE will gradually generate gains in market share that will make a positive contribution to activity by improving the foreign trade balance (0.4 GDP point in 2015 and 2016), whether through increased exports or reduced imports. From 2017, the external balance will not contribute as much to the economy (0.3 GDP point) due to the improved purchasing power of households, resulting in slowing the reduction in imports. Despite the higher margins and the improved profitability of capital, productive investment will fall off slightly due to the substitution effect between labour and capital and the negative accelerator effect related to the fall in demand.

With the decline in the cost of labour relative to the cost of capital, the substitution of labour for capital will gradually boost employment to the detriment of investment, which will lead to job-rich GDP improvements and to lower gains in productivity. This dynamic will result in steady gains in employment despite the slight fall-off in activity between 2014 and 2016. Due to the rise in employment and the fall in unemployment, but also to possible wage compensation measures in companies arising from the greater fiscal pressure on households, wages will regain part of their lost purchasing power based on an increase in real pay. This catch-up in purchasing power will help to generate growth, but will limit the impact on employment and productivity gains.

Graphic. Impact of the CICE tax credit on...



Source : e-mod.fr, OFCE calculations.

# 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.

---

## **2013: what impact will the (national) fiscal measures have on growth?**

By [Mathieu Plane](#)

*This text supplements the [October 2012 forecasts for the French economy](#)*

After having detailed the multiplier effects expected for the different fiscal policy instruments, the average domestic fiscal multiplier associated with the austerity measures being

implemented in France in 2013 will be 0.9. This policy will cut GDP by 1.7% in one year alone. After a cumulative fiscal effort of 66 billion euros in 2011 and 2012, the structural saving expected for 2013 represents about 36 billion euros (1.8 GDP points) if we include both the measures in the 2013 budget bill (*Projet de loi de finances – PLF*) and the various measures adopted previously (Table). The fiscal shock resulting from the PLF for 2013 comes to 28 billion euros, of which 20 billion is solely on tax and social security contributions (*prélèvements obligatoires – PO*). Of the remaining 8 billion, an increase of nearly 5 billion euros in tax and social security contributions is from the second supplementary budget (*Loi de finances rectificative – LFR*) for the summer of 2012, the rest being mainly due to the first LFR for 2012 and to the hike in contributions resulting from the revision of the pension reform in summer 2012.

In total, the fiscal effort in 2013 can be broken down between tax and social contributions of about 28 billion euros (1.4 GDP points) and structural savings on primary public expenditure of 8 billion (0.4 GDP point). The burden of higher taxes and social contributions breaks down to nearly 16 billion euros for households and more than 12 billion for business. This breakdown does not take into account the competitiveness measures announced on 6 November by the Prime Minister. The tax credits for competitiveness and employment (CICE) will not have any fiscal impact in 2013, with the exception of the possible establishment in 2013 of an advance on their future tax credits for some companies short of cash.

Based on the variants in the fiscal multiplier, made with e-mod.fr according to the economy's position in the cycle, for the main taxes and social security contributions as well as for the key components of public expenditure [1] and based on the different evaluations we were able to carry out, particularly in the context of [the assessment of the Five-year economic programme](#), we applied a specific fiscal multiplier to

each measure for 2013 (Table). The short-term multipliers take into account only the direct effects of the measures on domestic activity, regardless of the fiscal policies of our trading partners, which amplify the impact of national policy. It is also assumed that monetary policy remains unchanged. The long-term multiplier values differ from the short-term ones, being generally lower unless a long-term negative output gap is maintained.

Of the 16 billion euro increase in tax and social security contributions on households in 2013, the discretionary increase in personal income tax (IR) will be 6.4 billion, including 3.2 billion from the 2013 Budget Act (*Loi de finances*) – against 4 billion in the PLF, as the proposal to tax capital gains on securities at the income tax scale will be largely amended, and the yield from the measure could decrease by about 0.8 billion, with the shortfall being able to be offset by the extension of the exceptional 5% contribution from the IS tax on large corporations), and with the rest coming from the supplemental LFR for 2012 (including 1.7 billion solely from the de-indexation of the personal income tax schedule). While the increase in personal income tax from the 2013 PLF is targeted at high earners, the amount this will contribute (3.2 billion) represents only 11% of the increase in tax and social security contributions (20% if we limit ourselves to households) in 2013, and less than 9% of the total fiscal effort. According to our calculations, the average fiscal multiplier associated with the different measures that increase personal income tax will be 0.7 in 2013.

The increase in taxes and social contributions from households will come mainly from the increase in payroll taxes and social security contributions (8.7 billion euros) set out in the Social Security budget act (PLF) for 2013 (2.9 billion) and the measures in the supplemental LFR for 2013 (5.3 billion, which includes changes to the tax exemption on overtime, a

limitation on tax breaks and employee savings, a higher CSG wealth tax on income from capital, etc.) and pension reform, with an increase in the contribution rate (0.5 billion). The average fiscal multiplier related to these measures is 0.9. Finally, the reform of inheritance tax will raise a further 1.1 billion in tax and social contributions. On the other hand, the revenue from the ISF wealth tax will be 1.3 billion lower than in 2012. Indeed, the yield from the one-off wealth tax contribution set up under the supplemental LFR for 2012 will be greater than from the one set up under the new reform in 2013. The fiscal multiplier for these two measures is 0.3.

In total, according to our calculations, the increase in levies on households in 2013 will on average have a multiplier of 0.8 and will amputate growth by 0.6 GDP point.

For business, the measures adopted mainly involve an increase in the corporate income tax as provided in the budget bill (PLF) for 2013 (8 billion euros, of which 4 billion is related to the reform of the deductibility of financial expenses). The average multiplier for the increase in the corporate income tax (IS) is estimated at 0.7 in 2013. 2.3 billion euros will come from a rise in social security contributions and payroll taxes with a fiscal multiplier of unity. Finally, other measures such as the sectoral measures on the taxation of insurance or the exceptional contribution of the oil industry will increase the tax burden on business by 1.9 billion in 2013, with an average fiscal multiplier estimated at 0.5.

In our assessment, the increase in taxes and social contributions from companies will on average have a multiplier of 0.8 and will reduce GDP by 0.5 GDP point in 2013.

In addition, the short-term fiscal multiplier associated with public expenditure in a low phase of the cycle is, in our model, 1.3, so it is higher than that associated with tax and social contributions. This result is consistent with the most recent empirical literature (for details, see the box, "[Fiscal](#)

[multipliers: size matters!](#)” The estimated loss of activity resulting from tightening up on public expenditure will come to 0.5 GDP point in 2013.

In total, the average domestic fiscal multiplier associated with the austerity policy being implemented in France in 2013 will be 0.9, and this policy will reduce GDP by 1.7%. This result is in the lower range of the [latest work of the IMF](#); using recent data on 28 countries, it has estimated the actual multipliers at between 0.9 and 1.7 since the beginning of the Great Recession.

## Main measures affecting the structural public deficit in 2013

	Measures (in bn)	Fiscal multiplier estimated in the short term	Impact on GDP (%)
<b>Households</b>	<b>15.7</b>	<b>0.8</b>	<b>-0.6</b>
<b>Income tax</b>	<b>6.4</b>	<b>0.7</b>	<b>-0.2</b>
PLF 2013 (taxation of capital income at IR tax rate, new brackets, etc.)*	3.2	0.6	-0.1
LFR II 2012 (reversal of tax exemption of overtime)	0.5	0.4	0.0
LFR I 2012 (de-indexation of IR brackets, suppression tax breaks and Scellier scheme, etc.)	2.7	0.8	-0.1
<b>ISF wealth tax</b>	<b>-1.3</b>	<b>0.3</b>	<b>0.0</b>
PPLF 2013 (reform of ISF wealth tax)	1.0	0.3	0.0
LFR II 2012 (repercussions from one-off 2012 contribution)	-2.3	0.3	0.0
<b>Inheritance tax</b>	<b>1.1</b>	<b>0.3</b>	<b>0.0</b>
LFR II 2012 (reversal of breaks on inheritance tax)	1.1	0.3	0.0
<b>Social contributions and payroll tax</b>	<b>8.7</b>	<b>0.9</b>	<b>-0.4</b>
Social security PLF 2013 (reform of self-employed payroll tax, higher tax on beer and tobacco, etc.)	2.9	1.0	-0.1
LFR II 2012 (reversal of overtime exemption, limitation of tax breaks and employee savings, higher CSG wealth tax, capital income, etc.)	5.3	0.8	-0.2
Pension reform (higher contributions)	0.5	1.0	0.0
<b>Other</b>	<b>0.8</b>	<b>0.6</b>	<b>0.0</b>
PLF 2013 (higher tax on vacant housing, tougher "automobile malus", etc.)	0.9	0.6	0.0
LFR II 2012 (lower VAT on books)	-0.1	1.0	0.0
<b>Business**</b>	<b>12.2</b>	<b>0.8</b>	<b>-0.5</b>
<b>Corporate income tax</b>	<b>8</b>	<b>0.7</b>	<b>-0.3</b>
PLF 2013 (limits on financial expenses deductibility, reform of the "cinquième acompte", etc.)	8	0.7	-0.3
<b>Payroll tax and social contributions</b>	<b>2.3</b>	<b>1.0</b>	<b>-0.1</b>
Social security PLF 2013 (higher CNRACL contribution rate, reform on wage tax, etc.)	1.8	1.0	-0.1
Pension reform	0.5	1.0	0.0
<b>Other</b>	<b>1.9</b>	<b>0.5</b>	<b>-0.1</b>
PLF 2013 (sectoral measures on taxation of business insurance) (sectoral measures on taxation of business insurance)	1.3	0.8	-0.1
LFR II 2012 (one-off contribution of oil industry, taxation of financial transactions, etc.)	0.6	0.2	0.0
<b>Total Business and Household Taxes and Contributions</b>	<b>27.9</b>	<b>0.8</b>	<b>-1.1</b>
<b>Structural saving on primary public expenditure</b>	<b>8.0</b>	<b>1.3</b>	<b>-0.5</b>
<b>Total fiscal impulse</b>	<b>35.9</b>	<b>0.9</b>	<b>-1.7</b>

\* This amount incorporates the downward revision of the yield initially foreseen in the PLF 2013 of the measure taxing capital gains at the personal income tax rate, which is to be offset by the extension of the exceptional 5% corporate income tax contribution for large corporations.

\*\* This breakdown does not measure the final fiscal impact that is to be borne by households if the increase in business taxes is passed on in prices.

Sources : PLF 2013, Social security PLF 2013, LFR I and II 2012, OFCE calculations.

[1] For more on this, see Creel, Heyer, Plane, 2011, "Petit précis de politique budgétaire par tous les temps", *Revue de l'OFCE*, no. 116, January 2011.

---

# What is the value of the fiscal multipliers today?

By [Xavier Timbeau](#)

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

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



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

Source : OECD, *Economic outlook 91*.

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

growth rate) interact with changes in the debt and in GDP.

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

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

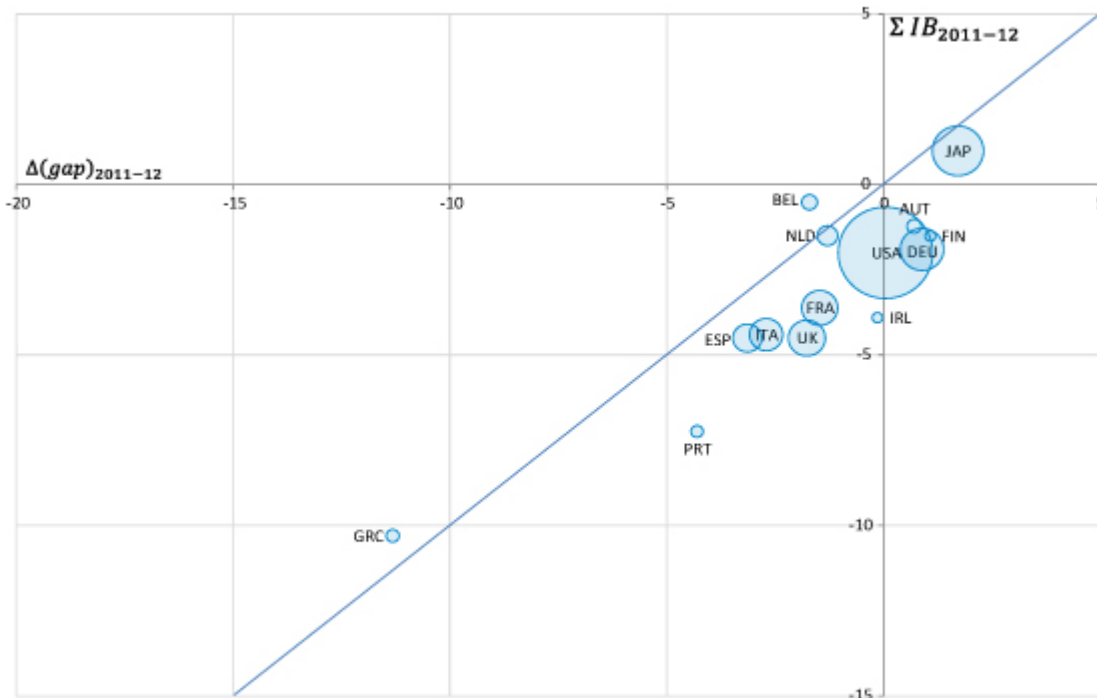
return to full employment.

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

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

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

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



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

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

Austria and Germany are exceptions. As these two countries

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

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

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

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

[austerity is leading to disaster.](#)

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



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

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

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

---

## **A review of the recent literature on fiscal multipliers: size matters!**

By [Eric Heyer](#)

Are the short-term fiscal multipliers being underestimated? Is there any justification for the belief that fiscal restraint can be used to drastically reduce deficits without undermining business prospects or even while improving the medium-term situation? This is the question that the IMF tries to answer in its latest [report on the world economic outlook](#). The Fund devotes a box to the underestimation of fiscal multipliers during the 2008 crisis. While until 2009 the IMF had estimated that in the developed countries they averaged about 0.5, it now calculates that they have ranged from 0.9 to 1.7 since the Great Recession.

This reassessment of the value of the multiplier, which [X. Timbeau discusses in an interesting reading](#) on the basis of a

“corrected apparent” multiplier, builds on the numerous studies carried out by IMF researchers on the issue and especially that of [Batini, Callegari and Melina \(2012\)](#). In this article, the authors draw three lessons about the size of the fiscal multipliers in the euro zone, the U.S. and Japan:

1. The first is that gradual and smooth fiscal consolidation is preferable to a strategy of reducing public imbalances too rapidly and abruptly.
2. The second lesson is that the economic impact of fiscal consolidation will be more violent when the economy is in recession: depending on the countries surveyed, the difference is at least 0.5 and may be more than 2. This observation was also made in another study by the IMF ([Corsetti, Meier and Müller \(2012\)](#)) and is explained by the fact that in “times of crisis” more and more economic agents (households, firms) are subject to very short-term liquidity constraints, thus maintaining the recessionary spiral and preventing monetary policy from functioning.
3. Finally, the multipliers associated with public expenditure are much higher than those observed for taxes: in a recessionary situation, at 1 year they range from 1.6 to 2.6 in the case of a shock to public spending but between 0.2 and 0.4 in the case of a shock on taxes. For the euro zone, for example, the multiplier at 1 year was 2.6 if government spending was used as an instrument of fiscal consolidation and 0.4 if the instrument was taxation.

As the economic crisis continues, the IMF researchers are not the only ones raising questions about the merits of the fiscal consolidation strategy. In an NBER working paper in 2012, two researchers from Berkeley, [Alan J. Auerbach and Yuriy Gorodnichenko](#), corroborate the idea that the multipliers are higher in recessions than in periods of expansion. [In a second study](#), published in the *American Economic Journal*, these same



authors argue that the impact of a shock on public expenditure would be 4 times greater when implemented during an economic downturn (2.5) than in an upturn (0.6). This result has been confirmed for the US data by three researchers from the University of Washington in St. Louis ([Fazzari et al. \(2011\)](#)) and by two economists at the University of Munich ([Mittnik and Semmler \(2012\)](#)). This asymmetry was also found for the data on Germany in a study by a Cambridge University academic and a Deutsche Bundesbank researcher, [Baum and Koester \(2011\)](#).

In other work, a researcher at Stanford, [Hall \(2009\)](#), affirms that the size of the multiplier doubles and is around 1.7 when the real interest rate is close to zero, which is characteristic of an economy in a downturn, as is the case today in many developed countries. This view is shared by a number of other researchers, including two at Berkeley and Harvard, [DeLong and Summers \(2012\)](#), two from the Fed, [Erceg and Lindé \(2012\)](#), those of the [OECD \(2009\)](#), those of the [European Commission \(2012\)](#) and in some recent theoretical work ([Christiano, Eichenbaum and Rebelo \(2011\)](#), [Woodford \(2010\)](#)). When nominal interest rates are blocked by the zero lower bound, anticipated real interest rates rise. Monetary policy can no longer offset budgetary restrictions and can even become restrictive, especially when price expectations are anchored on deflation.

As already noted by J. Creel on this blog ([\*\*insert link to the post of 22.02.12\*\*](#)) with respect to the instrument to be used, *i.e.* public spending or taxation, other IMF economists together with colleagues from the European Central Bank (ECB) the US Federal Reserve (FED), the Bank of Canada, the European Commission (EC) and the Organization for Economic Cooperation and Development (OECD) compared their assessments in an article published in January 2012 in the *American Economic Journal: Macroeconomics* ([Coenen G. et al. \(2012\)](#)). According to these 17 economists, on the basis of eight different macroeconometric models (mainly DSGE models) for the United

States, and four models for the euro zone, the size of many multipliers is large, particularly for public expenditure and targeted transfers. The multiplier effects exceed unity if the strategy focuses on public consumption or transfers targeted to specific agents and are larger than 1.5 for public investment. For the other instruments, the effects are still positive but range from 0.2 for corporation tax to 0.7 for consumer taxes. This finding is also shared by the [European Commission \(2012\)](#), which indicates that the fiscal multiplier is larger if the fiscal consolidation is based on public expenditure, and in particular on public investment. These results confirm those published three years ago by the [OECD \(2009\)](#) as well as those of economists from the Bank of Spain for the euro zone ([Burriel et al \(2010\)](#)) and from the Deutsche Bundesbank using data for Germany ([Baum and Koester \(2011\)](#)). Without invalidating this result, a study by [Fazzari et al \(2011\)](#) nevertheless introduced a nuance: according to their work, the multiplier associated with public spending is much higher than that observed for taxes but only when the economy is at the bottom of the cycle. This result would be reversed in a more favourable situation of growth.

Furthermore, in their assessment of the US economy, researchers at the London School of Economics (LSE) and the University of Maryland, [Ilzetzki, Mendoza and Vegh \(2009\)](#), highlight a high value for the fiscal multiplier for public investment (1.7), *i.e.* higher than that found for public consumption. This is similar to the results of other IMF researchers ([Freedman, Kumhof, Laxton and Lee \(2009\)](#)).

In the recent literature, only the work of Alesina, a Harvard economist, seems to contradict this last point: after examining 107 fiscal consolidation plans, conducted in 21 OECD countries over the period 1970-2007, Alesina and his co-authors ([Ardagna in 2009](#) and [Favero et Giavazzi in 2012](#)) conclude first that the multipliers can be negative and second that fiscal consolidations based on expenditure are associated

with minor, short-lived recessions, while consolidations based on taxation are associated with deeper, more protracted recessions. In addition to the emphasis on the particular experiences of fiscal restraint (Scandinavian countries, Canada), which are not found when including all experiences with fiscal restriction (or expansion), the empirical work of Alesina *et al.* suffers from an endogeneity problem in the measurement of fiscal restraint.

The notion of a narrative record of fiscal impulse helps to avoid this endogeneity. For example, in the case of a real estate bubble (and more generally in cases of large capital gains), the additional tax revenues from the real estate transactions results in a reduction in the structural deficit, as these revenues are not cyclically based (the elasticity of revenues to GDP becomes much higher than 1). So these are associated with an expansionary phase (in conjunction with the housing bubble) and a reduction in the structural deficit, which artificially strengthens the argument that reducing the public deficit may lead to an increase in activity, whereas the causality is actually the reverse.

With the exception of the work of Alesina, a broad consensus emerges from the recent theoretical and empirical work in the existing economic literature: a policy of fiscal consolidation is preferable in periods of an upturn in activity, but is ineffective and even pernicious when the economy is at a standstill; if such a policy is to be enacted in a downturn, then tax increases would be less harmful to the activity than cuts in public spending ... all recommendations contained in [Creel, Heyer and Plane \(2011\)](#).

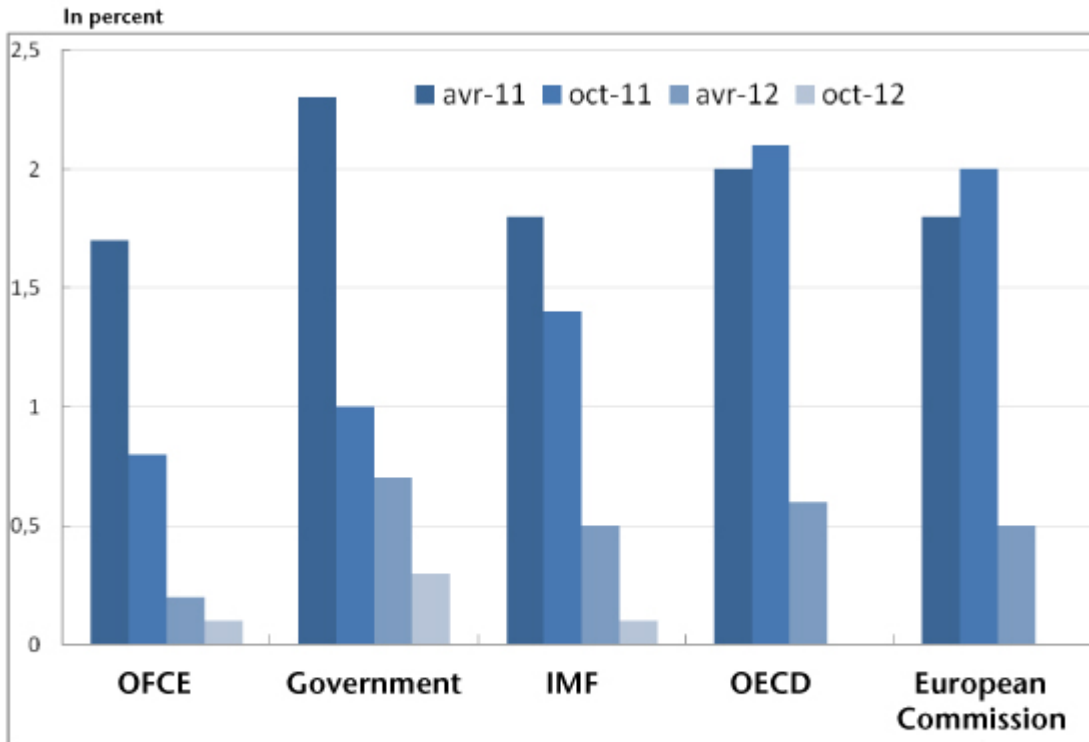
---

# Why has French growth been revised downwards?

By Bruno Ducoudré and [Eric Heyer](#)

In its [October 2012 forecasts](#), the OFCE has revised its growth forecast for 2012 and 2013. The major international institutions, the OECD, the IMF and the European Commission, also regularly review their growth forecasts to incorporate newly available information. An analysis of these revised forecasts is particularly interesting in that it shows that these institutions use low fiscal multipliers in developing their forecasts. In other words, the recessionary impact of fiscal policy has been underestimated by the OECD, the IMF and the European Commission, leading to substantial revisions of their growth forecasts, as is evidenced by the dramatic shifts by the [IMF](#) and the [European Commission](#) in the size of the multipliers.

Graphique 1. Révisions of growth in French GDP for 2012



Note : Growth in 2012 is reviewed four times each year by each institution. The first revision took place in April 2011, the second in October 2011, the third in April 2012 and the final one in October 2012. The OECD has not yet published its latest revisions.

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

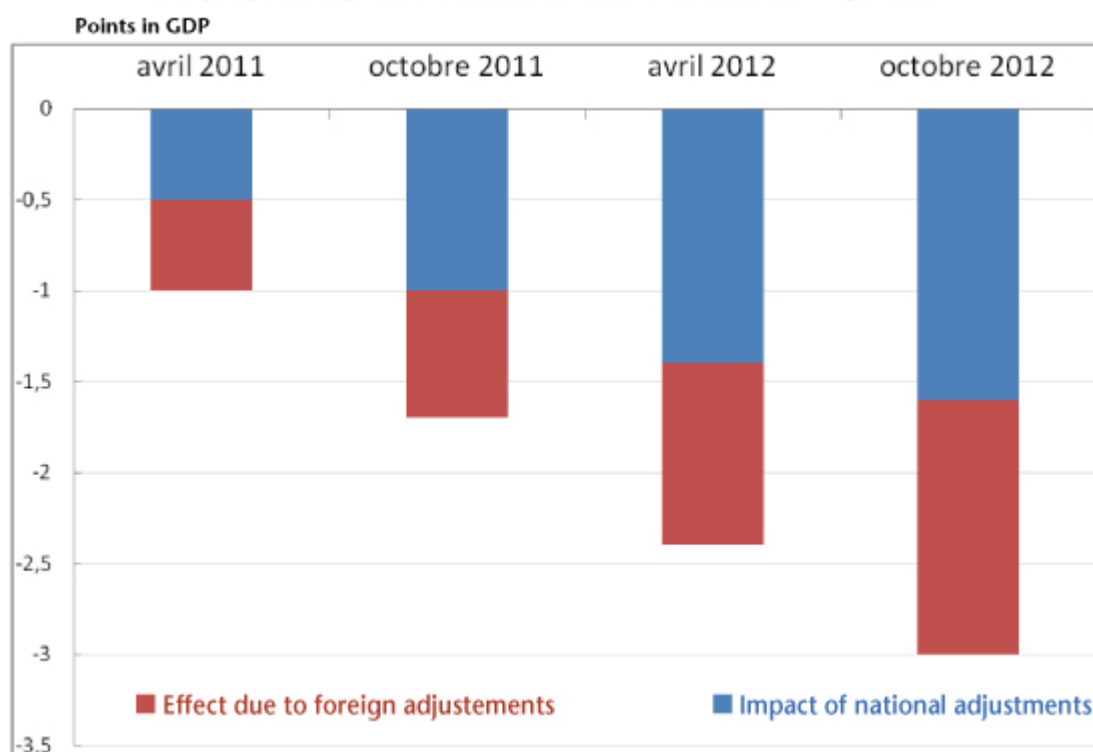
Figure 1 shows that between the forecast made in April 2011 and the latest available forecast, the government, like all the other institutions, revised its growth forecast for France sharply downwards.

The austerity policies have also been strengthened at the same time, particularly in the euro zone. The European countries undertook their stability program in order to return to balanced public finances within three years. In contrast to the years before the crisis, the implementation of these commitments is now considered a necessary or even sufficient condition for pulling out of the crisis. Moreover, in a context of financial uncertainty, being the only State not to meet its commitment to fiscal consolidation would be punished immediately by the markets (higher sovereign rates, a downgraded rating, a fine from the European Commission, implicit contagion of sovereign defaults). But in trying to reduce their deficits abruptly and synchronously, Europe's governments are inducing new slowdowns in activity.

A vicious circle has been created: with each downward revision in their forecasts for 2012 growth, Europe's governments implement new austerity measures to meet their deficit commitments. This has happened in France, but especially in Italy, which has virtually tripled its fiscal effort, and in Spain, which is now engaged in the greatest austerity effort of any major European country.

According to our estimates for the French economy (that is to say, using a multiplier of 1), the series of fiscal savings plans adopted at the national level have led to revising growth downwards by -1.1 points between April 2011 and October 2012 (from an impact of -0.5 GDP point to -1.6 points). Since these same policies are in force in our trading partners, this has led to revising growth for this same period by 0.9 point due to foreign trade (from -0.5 GDP point to -1.4 point) (Figure 2).

Graphique 2. Impact of the latest fiscal adjustments on 2012 growth



Source : OFCE October 2012 calculations and forecasts.

For the year 2012, the OFCE's revisions for the French economy can be explained in full simply by the escalation in the fiscal savings measures announced over the last 12 months,

*i.e.* the national plans and those applied by our partner countries (Table 1).

**Tableau 1. Determinants of the revisions to the OFCE forecast for France for 2012**

	April 2011	October 2012	Revision
GDP growth	1,7	0,1	-1,6
(a) - Austerity measures (in GDP pt)	-0,6	-1,60	-1,0
(b) – Value of the fiscal multiplier	0,95	0,95	0,0
Impact of austerity plans in France (a + b)	-0,5	-1,6	-1,1
Impact of the austerity measures of France's partners	-0,5	-1,4	-0,9
Other adjustment factors			0,4

Source : OFCE calculations.

Leaving aside this escalation of austerity, our diagnosis of the French economy has changed very little over the last 18 months: without it, we would have even revised our growth forecast slightly upwards (0.4%).