Anti-Austerity Policies in France

John Weeks

Good-bye to TINA

In the future humans will look back in wonder that in the early years of the twenty-first century a form of madness afflicted politicians in Europe. The most obvious manifestation of this madness were the economic policies that converted an insolvency problem in Greece, a small country in southeastern Europe, into a continent wide crisis that would threaten the existence of the common currency of the European Union and the Union itself.

This madness is closely linked to the astoundingly improbable argument that the excessive expenditures of governments caused the Great Crisis of 2008, when its origin in financial speculation is obvious. More improbable still, a large proportion of the sentient population of North America and Europe endorse this fanciful indictment of the public sector.

As Abraham Lincoln pointed out, it is not possible to fool all of the people all of the time, an observation verified by the recent election in France (and Greece). In addition to his pandering to what he hoped would be the base instincts of the French electorate, Mr Sarkozy campaigned on the infamous TINA principle, There IS No Alternative to the macroeconomics of austerity. A majority of French voters would not buy it.

In almost every major media source, print, television and on-line, one of the first comments on the recent election in France was, will financial markets freak out in reaction to the election of an anti-austerity president? They have not as yet. That this question would be considered important enough to ask is a sign of the times.

It is a question that is flagrantly ideological. If by "financial markets" one means a process in which a large number of buyers and sellers of government bonds compete and through that competition determine prices and interest rates, "financial markets" do not exist. The term is an ideological obfuscation of a quite small group of very large international banks that conspire among themselves with the connivance of the rating agencies to manipulate bond prices.

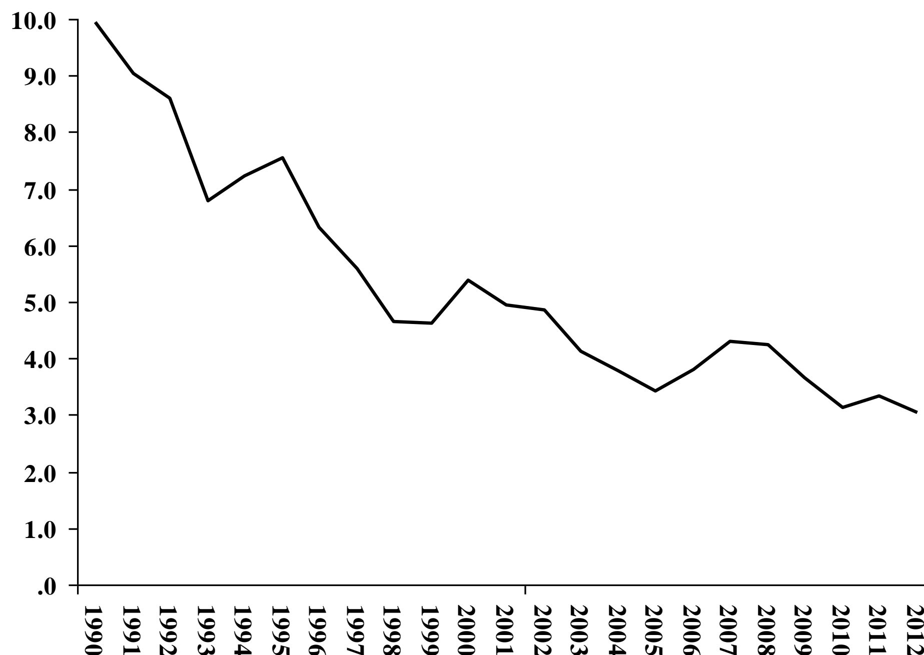
We are told that "financial markets" have granted President Hollande a "honeymoon", as if consent of the bond speculators were necessary to complete and formalize the election of a French president (or in any other country). The "honeymoon" metaphor carries the implication that the Lords of Finance await his disclaimer of the policies that induced about 52 percent of French voters to support him.

The frequently expressed TINA warning that failure to immediately reduce deficits will bring a speculative run on French bonds is nonsense. The interest rate on French public bonds has been falling for the last twenty years (see Figure 1, all statistics

from www.oecd.org). Over recent months the story is no different. The cost of borrowing for the French government today is far less than it has been in any previous year for over two decades, at about three percent.

The falling public borrowing rate in France corresponds to the experience in other eurozone countries. In Italy the public borrowing cost at the beginning of the 1990s was almost fifteen percent, three times current rates (see my article in this journal). The high interest rates in the European Union in the 1990s were conscious policy, as governments sought to maintain their exchange rates to enter the soon-to-be-created "euro". A better example of the lesson "be careful of what you want because you might get it" could not be found.

Figure 1: Long Term Interest Rate on French Public Bonds,.1990-2012



Public Finances in France

The austerity gang tells us that whatever might be the policy preferences of the new French president, he must quite quickly face the reality of the state of the country's public finances. When he does, he will have no choice but to accept the severe constraints public finances impose on policy (TINA again).

This is wrong. There are alternatives, and they are obvious and feasible. From 1990 through 2008, the public sector deficit in France averaged minus 3.4 percent of gross national product (see Figure 2). Over eighty percent of the deficit (all but -0.6 percentage points) represented interest payments resulting from the borrowing policy of the early 1990s. During the 2000s up to when the global crisis broke, the deficit averaged better than the dreaded Maastricht Criterion, at minus 2.8 percent, a full ninety percent of

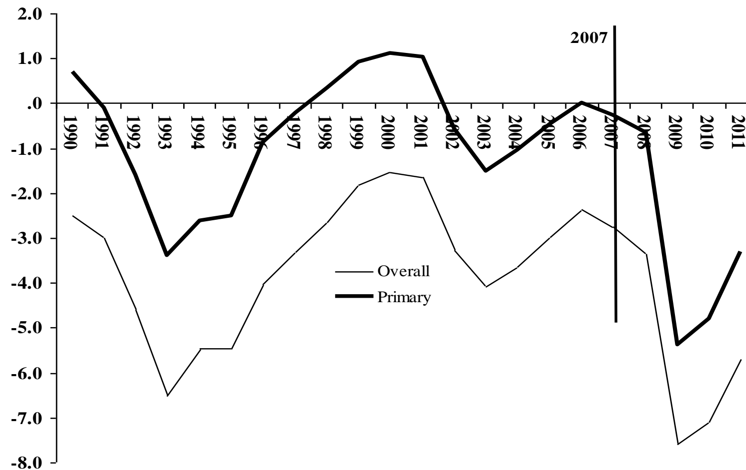
which was interest on the public debt.

As I pointed out here in an earlier article on Italy, the relevant measure for the health of public finances is the deficit minus interest payments, the *primary* deficit. This is the measure used by the International Monetary Fund in its conditionality programs. Why it is not the preferred measure of the European Commission is a mystery perhaps best explained by economic illiteracy. Similar economic illiteracy is demonstrated in the EC use of the gross public liabilities as a measure of indebtedness rather than the net liabilities. Using the appropriate measure, governments of France posted tiny deficits, averaging less than one half of one percent of GDP during 2000-08.

The full force of the global crisis hit France in 2009, when the economy declined by 2.6 percent. Output decline directly causes fiscal deficits to increase (see Figure 3). If there are any invariant economic "laws" that is one of them. The overall fiscal deficit increased from minus 3.3 percent of GDP in 2008, to minus 7.6 percent in 2009, sixty percent of which represented revenue decline. The other forty percent of the increase in the deficit came from automatically activated expenditures such as support for the unemployed.

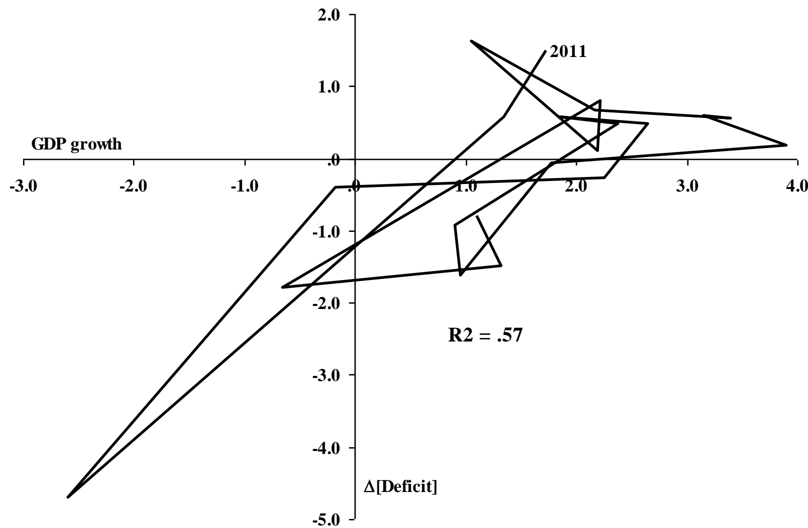
The new president of France aims to balance the budget by 2016. A growth policy will do that, because increases in output generate revenue and reduce social support spending. It was GDP growth, albeit weak, that lowered the deficit from minus 7.1 percent of GDP in 2010 to minus 5.7 in 2011 (with a *primary* deficit of minus 3.3). Grow and the deficit disappears; the deficit has no "structural" component.

Figure 2: Public Sector Balances in France, 1990-2011 (percent of GDP)



Note: The primary deficit is the overall deficit minus interest on the public debt.

Figure 3: Change in the overall Public Sector Balance
and the Rate of Economic Growth in France, 1990-2011



Note: The vertical axis measures the year-to-year change in the public sector balance (not the deficit itself), and on the horizontal axis is the year-to-year growth rate of GDP. The chart is easily interpreted: an increase in the growth rate reduces the deficit. To be specific, the chart suggests that an increase in the growth rate of one percentage point reduces the deficit by 0.75 percentage points.

Fiscal Expansion is Sound Policy

The combination proposed by Francoise Hollande of increased taxation and a greater increase in expenditure is not only a viable alternative for France, it is rational economic policy. The part of the expansionary policy that would be funded through borrowing is certain to be at interest rates far below those during 1993-95, when the overall deficit averaged almost six percent of GDP and the public sector borrowed at over seven percent.

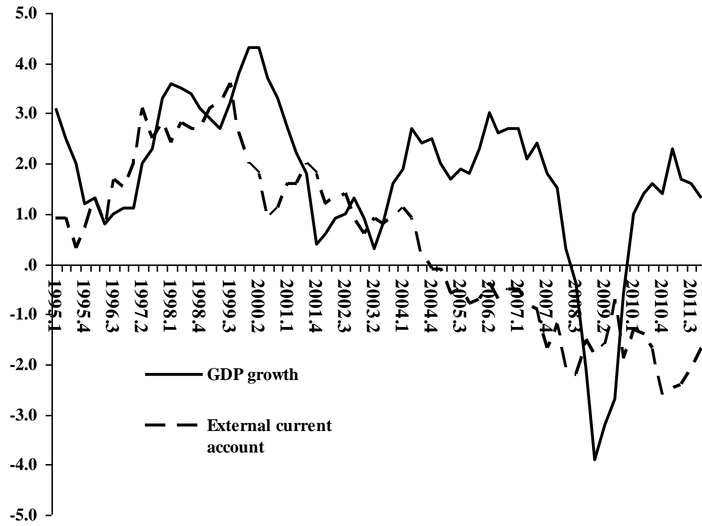
The new economic program devotes a substantial part of the rise in expenditure to public investment, designed to increase capacity and lower production costs in France through improved infrastructure. This is sound macroeconomic policy: a stimulus whose short term effect is to bring the economy close to full employment, and whose medium term effect is to increase productive capacity. The first realizes the economy's potential and the second increases that potential.

A constrain on expansionary fiscal policy might be caused by fears of its impact on the French balance of payments. If the government induces an expansion, might this draw imports that would create an unsustainable trade deficit and external account? This has not been the experience of France over the last decade and a half (see Figure 4). If we use the common measure of external sustainability, the current account of the balance of payments, this had tended to improve with growth and deteriorate with output decline.

The conditions of the French economy provide no reason why an expansionary macro policy would be other than rational and effective. Vague references to the alleged failure "Keynesian" policies of Mitterrand government in the early 1980s are no more

than warmed over ideology. That a rational macro policy would be questioned demonstrates the power of a dysfunctional sect of economics closely akin to alchemy, "alconomics", as it were. Stimulate the French economy, put people to work and invest in the future. Radical stuff, or so the speculators think.

Figure 4: GDP Growth and the External Current Account in France, 1995-2011 (quarterly)



Note: The current account is the trade and services balance plus net short term flows such as individual remittances, profit transfers.