

# Equality at risk from simplification

By [Françoise Milewski](#) and [Hélène Périvier](#)

## Legislating to promote equality

The laws on equality in pay and in the workplace have come a long way since 1972, from the affirmation of the principle of equality to the production of a detailed numerical diagnosis that puts flesh on the bones of inequality (via the Comparative Situation Reports that have been drawn up since 1983 under the Roudy law) as well as to the duty to negotiate. The 2006 law paved the way for hitting recalcitrant companies with financial penalties, as set out in an article in the 2009 law on pensions. There were numerous attempts to limit the scope of the law up to 2012, when things were more or less clarified: companies are now obliged to produce a CSR, which reports annually on the state of inequality in well-defined areas; they must then conduct negotiations on occupational equality and equal pay and, if there is no agreement, they are required to take unilateral action. There are exhaustive controls, with agreements or plans to be filed with the government (no longer on a one-off basis as in the first formulations of the implementing decree). Companies that fail to comply with the law are put on notice to remedy this on pain of financial penalties of up to 1% of payroll.

The duty to negotiate entails collective management of the issue. Since 2012, the number of agreements signed has increased, as have formal notices and sanctions. While the content of the agreements and plans is often too general, it's a start. The framework law of 4 August 2014 on equality has complemented and strengthened these arrangements.

## Simplification: naïveté or retreat?

On the occasion of the Rebsamen bill on social dialogue, this long legislative process is suddenly being called into question under the pretext of simplification. In the bill's initial version, the requirement to produce a detailed diagnosis in a CSR is gone, having melted into the company's single database. The duty to negotiate on occupational equality also disappears, integrated into other negotiations (quality of life at work).

Given the extent of the reaction (associations, individuals, unions, researchers, etc.), the three ministries concerned issued a statement reaffirming certain principles, including that "it shall continue to be obligatory to transmit all the information that is currently found in the CSR". Amendments will be tabled to that effect. But nothing is settled. The gender indicators remain integrated into the single database, so the CSR loses its specificity. Negotiations that focus on equality are not restored, and their frequency remains unclear (annual? triennial?). Uncertainty remains.

Whatever the outcome of the parliamentary debate that is starting up on social dialogue, business has been given the signal that equality policy can be challenged, that previous requirements are ultimately not all that imperative, and that the measures taken in recent years can be relativized in the name of simplification.

If, by leaving it up to the social partners to negotiate on gender equality, this issue had emerged on its own and led to significant progress, no law on the subject would have been necessary. It was in response to inertia and persistent inequality that constraints were imposed on companies. It is because our society needs to make gender equality a fundamental principle that laws, coupled with constraints, were approved. The complexity of the social dialogue on this subject reflects the resistance of the different parties. This simplification is at best naive, and at worst a refusal to come up with public policy to promote equality.

In the field of equality, vigilance is vital. Removing the constraints means going back on the principle of equality. A desire for equality requires clear, ongoing political will: continuity and coherence in public policy is crucial.

This is the meaning of a statement by men and women researchers that was published on the *Les Echos* website on 19 May.

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## Oil: carbon for growth

By [Céline Antonin](#), [Bruno Ducoudré](#), Hervé Péléraux, Christine Rifflart, [Aurélien Saussay](#)

*This text is based on the [special study of the same name](#) [Pétrole : du carbone pour la croissance, in French] that accompanies the OFCE's 2015-2016 Forecast for the euro zone and the rest of the world.*

The 50% fall in the price of Brent between summer 2014 and January 2015 and its continuing low level over the following months is good news for oil-importing economies. In a context of weak growth, this has resulted in a transfer of wealth to the benefit of the net importing countries through the trade balance, which is stimulating growth and fuelling a recovery. Lower oil prices are boosting household purchasing power and driving a rise in consumption and investment in a context where companies' production costs are down. This has stimulated exports, with the additional demand from other oil-importing economies more than offsetting the slowdown seen in the exporting economies.

That said, the fall in oil prices is not neutral for the environment. Indeed, the fall in oil prices is making low-carbon transportation and production systems less attractive and could well hold back the much-needed energy transition and the reduction of greenhouse gas emissions (GHG).

This oil counter-shock will have a favourable impact on growth in the net oil-importing countries only if it is sustained. By 2016, the excess supply in the oil market, which has fuelled by the past development of shale oil production in the United States and OPEC's laissez-faire policy, will taper off. Unconventional oil production in the United States, whose profitability is uncertain at prices of under 60 dollars per barrel, will have to adjust to lower prices, but the tapering off expected from the second half of 2015 will not be sufficient to bring prices down to their pre-shock level. Brent crude prices could stay at about 55 dollars a barrel before beginning towards end 2015 to rise to 65 dollars a year later. Prices should therefore remain below the levels of 2013 and early 2014, and despite the expected upward trend the short-term impact on growth will remain positive.

To measure the impact of this shock on the French economy, we have used two macroeconomic models, *e-mod.fr* and *ThreeMe*, to carry out a series of simulations. These models also allow us to assess the macroeconomic impact, the transfers in activity from one sector to another, and the environmental impact of the increased consumption of hydrocarbons. The results are presented in detail in the [special study](#). It turns out that for the French economy a 20 dollar fall in oil prices leads to additional growth of 0.2 GDP point in the first year and 0.1 point in the second, but this is accompanied by a significant environmental cost. After five years, the price fall would lead to additional GHG emissions of 2.94 MtCO<sub>2</sub>, or nearly 1% of France's total emissions in 2013. This volume for France represents nearly 4% of [Europe's goal](#) of reducing emissions by 20% from 1990 levels.

The simulations using the French *e-mod.fr* model can be extended to the major developed economies (Germany, Italy, Spain, the USA and UK) by adapting it to suit characteristics for the consumption, import and production of oil. With the exception of the United States, the oil counter-shock has a substantial positive impact that is relatively similar for all the countries, with Spain benefitting just a little more because of its higher oil intensity. Ultimately, considering the past and projected changes in oil prices (at constant exchange rates), the additional growth expected on average in the major euro zone countries would be 0.6 GDP point in 2015 and 0.1 point in 2016. In the US, the positive impact would be partially offset by the crisis that is hitting the unconventional oil production business<sup>[1]</sup>. The impact on GDP would be positive in 2015 (+0.3 point) and negative in 2016 (-0.2 point). While lower oil prices are having a positive impact on global economic growth, this is unfortunately not the case for the environment ...

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<sup>[1]</sup> See the post, [The US economy at a standstill in Q1 2015 : the impact of shale oil](#), by Aurélien Saussay, from 29 April on the OFCE site.

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## Greece on a tightrope

By [Céline Antonin](#), Raul Sampognaro, [Xavier Timbeau](#) and [Sébastien Villemot](#)

[This text summarizes the special study, "Greece on a tightrope"](#)

Since early 2015, Greece's new government has been facing intense pressure. At the very time that it is negotiating to restructure its debt, it is also facing a series of repayment deadlines. On 12 May 2015, 750 million euros was paid to the IMF by drawing on the country's international reserves, a sign that liquidity constraints are becoming more and more pressing, as is evidenced by [the letter](#) sent by Alex Tsipras to Christine Lagarde a few days before the deadline. The respite will be short: in June, the country has to make another payment to the IMF for 1.5 billion euros. These first two deadlines are only a prelude to the "wall of debt" that the government must deal with in the summer when it faces repayments of 6.5 billion euros to the ECB.

Up to now, Greece has made its payments despite its difficulties and the suspension of the bailout program negotiated with the "ex-Troika". Thus, 7.2 billion euros in remaining disbursements have been blocked since February 2015; Greece has to come to an agreement with the former Troika before June 30 if it is to benefit from this financial windfall, otherwise it will fail to meet its payment deadlines to the ECB and IMF and thus default.

Besides Greece's external repayments, the country must also meet its current expenses (civil servant salaries, retirement pensions). But the news on the fiscal front is not very encouraging (see [State Budget Execution Monthly Bulletin, March 2015](#)): for the first three months of the year, current revenue was nearly 600 million euros below projections. Only the use of its European holding funds, combined with an accounting reduction in expenditures (1.5 billion euros less than forecast) allowed the Greek government to generate a surplus of 1.7 billion euros and to meet its deadlines. So by using bookkeeping operations, the Greek government was able to transfer its debt either to public bodies or to its providers,

thus confirming the tight liquidity constraints facing the State. Preliminary data at the end of April (to be taken with caution because they are neither definitive nor consolidated for all government departments) seem nevertheless to qualify this observation. [At end April](#), tax revenues had returned to their expected level; however, the government's ability to generate cash to avoid a payment default is due to its holding down public spending through the accounting operations described above. These accounting manipulations are simply emergency measures, and it is high time, six years after the onset of the Greek crisis, to put an end to this psychodrama and finally find a lasting solution to Greece's fiscal difficulties.

Our study, ["Greece on a tightrope"](#), considers what would be the best way to resolve the Greek debt crisis over the long term and the potential consequences of a Greek exit from the euro zone. We conclude that the most reasonable scenario would be to restructure the country's debt, with a significant reduction in its present value (cutting it to 100% of Greek GDP). This is the only way to significantly reduce the likelihood of a Grexit, and is in the interest not only of Greece but also of the euro zone as a whole. Furthermore, this scenario would reduce the scale of the internal devaluation needed to stabilize Greece's external position.

If the Eurogroup were to refuse to restructure Greece's debt, a new assistance program would then be needed in order to deal with the current crisis of confidence and to ensure funding for the cash needs of the Greek State over the coming years. According to our calculations, this solution would require a third bailout plan of around 95 billion euros, and its success would depend on Greece being able to generate major primary budget surpluses (of around 4% to 5% of Greek GDP) over the coming decades. Historical experience shows that, due to political constraints, there is no guarantee of being able to run a surplus of this magnitude for such a long time, so this

commitment is not very credible. A new assistance program would not therefore eliminate the risk that the Greek State would face yet another financial crisis in the coming years.

In other words, the full repayment of the Greek debt is based on the fiction of running a budget surplus for several decades. Accepting a Greek exit from the euro zone would imply a significant loss of claims that the world (mainly Europe) holds both on the Greek public sector (250 billion euros) and on the private sector (also on the order of 250 billion). To this easily quantifiable loss would be added the financial, economic, political and geopolitical impact of Greece's departure from the euro zone and possibly the European Union. This might look like an easy choice, since writing off 200 billion euros in loans to the Greek State would make it possible to end this psychodrama for once and for all. But the political situation is deadlocked, and it is difficult to give up 200 billion euros without very strong counterparties and without dealing with the issue of moral hazard, in particular the possibility that this could induce other euro zone countries to demand large-scale restructurings of their own public debt.

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## **The planetary alignment has not always been favourable to the euro zone countries**

By [Eric Heyer](#) and Raul Sampognaro

In 2015, the euro zone economies will benefit from a



favourable [“planetary alignment”](#) (with the euro and oil prices down and financial constraints on the economy easing), which should trigger [a virtuous circle of growth](#). Over the previous four years (2011-2014), the “planetary alignment” that existed was in a diametrically opposite direction: the euro and oil prices were high, with financing conditions and the fiscal stance very tight.

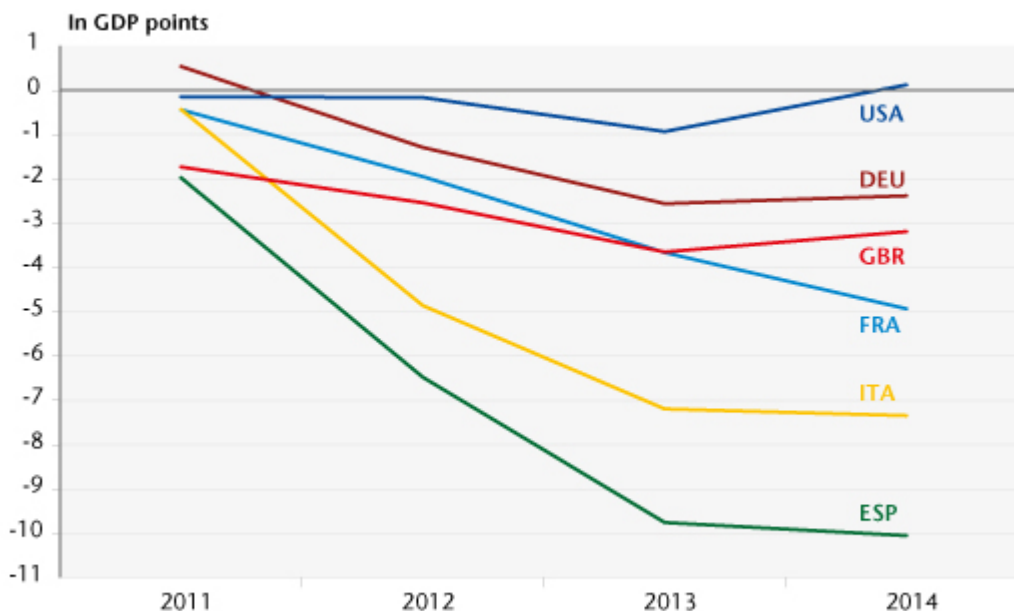
In [a recent article](#), we propose an evaluation of the impact of these four factors on the economic performance of six major developed countries since 2011 (France, Germany, Italy, Spain, the UK and USA).

It is clear from our analysis that the combination of these shocks explains a large part of the differences in growth recorded during the period 2011-2014 between the United States and the major European economies. A non-negligible part of this performance gap is explained in particular by the difference in the economic policies adopted, with a policy mix that has been much more restrictive in the euro zone than in the case of the US. In particular, a very sharp fiscal adjustment took place in the countries experiencing pressure on their sovereign debt, such as Spain and Italy. In addition, the effects of the pressure on sovereign debt were multiplied by financial fragmentation, which can be seen in the deterioration of private sector financing terms, whereas the quantitative easing measures taken by the Fed and the Bank of England helped to prop up financing conditions in these countries. It was not until Mario Draghi’s speech in July 2012 and [the announcement of the OMT programme](#) in September 2012 that the ECB’s actions were sufficient [to reduce the financial pressure](#). While exchange rate trends tended to support activity in the euro zone throughout 2011-2014, the contribution of this factor depended on the way the various countries were integrated with global trade flows [\[1\]](#) and on the scale of wage disinflation, which was particularly pronounced in Spain. Finally, the rise in oil prices held back

Europe's growth, while it had less impact in the United States, which [benefited from the exploitation of shale oil](#).

The cumulative loss in GDP was very significant in Spain (-10 points between 2011 and 2014), Italy (-7.5 points) and France (-5 points) and more moderate in the UK (-3 points) and Germany (-2.5 points). In contrast, the cumulative impact since 2011 on growth in the United States was zero, suggesting that real growth in the US was in line with spontaneous growth [\[2\]](#) (Figure 1).

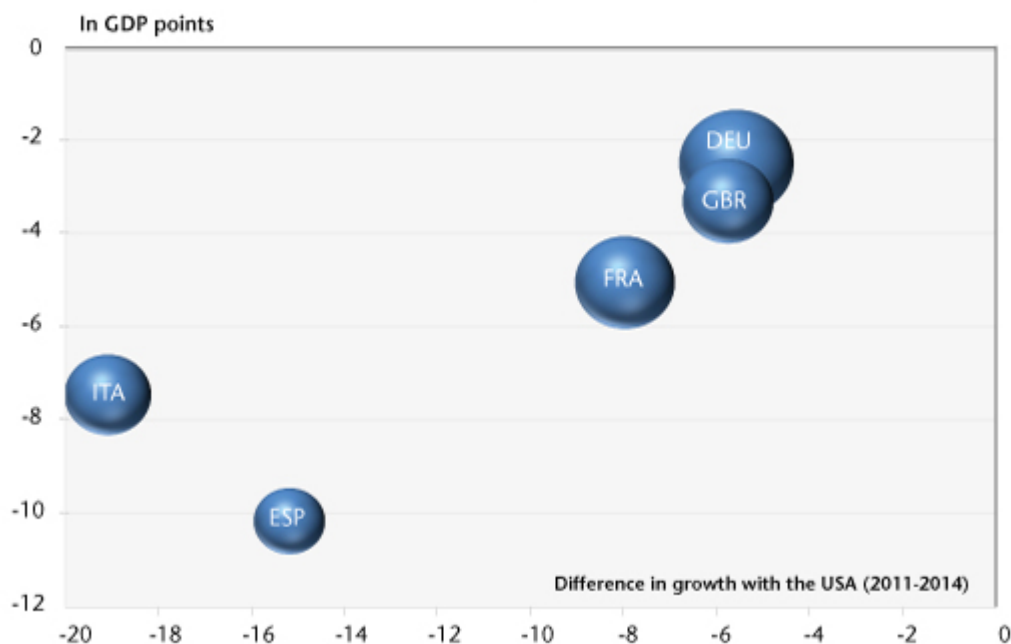
Figure 1. Cumulative impact on GDP of various shocks since 2011



Sources: National accounts, OFCE calculations.

Thus, in the absence of these shocks, Europe's spontaneous growth could have exceeded the rate of potential growth, as in the United States (Figure 2). This would have led in the euro zone countries in particular to a long-term convergence of GDP with its potential level, to a reduction in imbalances on the labour market, to the normalization of capacity utilization, and to a recovery in the public accounts.

**Figure 2. Difference in growth and the cumulative impact on GDP of various shocks for countries over the period 2011-2014**



Sources: OECD eo96 for the output gap, national accounts, OFCE calculations for the impact of the shocks.

[Go to the full version of our study.](#)

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[1] The impact of these competitiveness shocks differs across countries because of differences in the elasticity of foreign trade, but also due to variations in the countries' degree of exposure to trade and to intra / extra euro zone competition. For more on this, see [Ducoudré and Heyer \(2014\)](#).

[2] An economy's spontaneous growth results from its long-term potential growth (which depends on structural factors that determine in particular changes in the global productivity of the factors and the labour force) and the rate of closing the output gap, which was deepened in most countries by the 2008-2009 crisis and which depends on an economy's capacity to absorb the shocks that hit it.

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# The British elections: border questions (2/2)

By [Catherine Mathieu](#)

David Cameron has put the economy at the forefront of his electoral campaign, making the British economy's good performance a trump card in the Conservative programme (see "[The UK on the eve of elections ...](#)"). But, according to the polls, when May 7 comes to a close no party will be able to govern alone. While in 2010, the uncertainty was whether the Liberal Democrats would choose to ally with the Conservatives or the Labour Party, this time there is even greater uncertainty, as several parties are likely to be in a position to swing the outcome. The Liberal Democrats have lost popularity following five years of participation in government and are likely to receive less than 10% of the votes, behind the nationalist United Kingdom Independence Party (UKIP, with about 12% of voting intentions), which calls for the United Kingdom to leave the EU and won the last European elections. Faced with rising euro-scepticism, particularly in the ranks of his own Conservatives (the "Tories"), David Cameron has promised to hold a referendum on the UK's membership in the EU by the end of 2017 if he becomes Prime Minister again. As for Labour, if it is able to form a coalition government, it could ally with the Scottish National Party (SNP). But Labour has excluded this possibility in the face of attacks by David Cameron, who has raised the spectre of the fragmentation of the UK among the British electorate, which has barely recovered from its fright at the possibility of seeing Scotland become independent in the September 2014 referendum. Labour would nevertheless benefit from the support of the SNP and could form a coalition with the Liberal Democrats. The

Lib-Dems have drawn several red lines with respect to entering a coalition government: less fiscal austerity if they ally themselves with the Conservatives or more fiscal restraint if they join with Labour, except in education where the Liberal Democrats want more resources than the two major parties.

### **Economic and social programmes of the main parties: similarities, with some slight differences ...**

The Conservatives are welcoming the rebound in growth and employment, and have halved the public deficit relative to GDP in 2018/2019. They feel they have “put the house in order” and now want to “repair the roof while the sun is shining”. They say they want this to benefit everyone. They therefore want to increase spending on the health system (NHS), maintain spending on education and increase the number of places in university. They are committed to continue to raise pensions by at least 2.5% per year. They will make significant public investments in transport. They will not increase VAT, income tax, or social contributions. On the other hand, they will further reduce the cap on income assistance so as “to make work pay”.

The Conservatives want to promote apprenticeships, encourage business, regulate the right to strike, cut paperwork, and get disabled people into the workplace. They wish to control and reduce immigration from the EU (bringing it down to “tens of thousands” per year instead of “hundreds of thousands” now). The right to social benefits will be cut back (it will be necessary to have resided in the country for at least four years to qualify for tax credit and child benefit, and social housing will be reserved for British citizens). They want to provide cheap energy to households by developing energy savings and renewable energies, especially nuclear.

The Tories have set themselves the goal of bringing the public deficit into a small surplus (0.2 percent of GDP) through a combination of cutting public spending and social spending and

combatting tax evasion and avoidance (taking action on non-domiciled status – “non-doms” – and the taxation of multinational firms).

For Labour, “Britain only succeeds when working people succeed”. A national renewal is needed so that “the economy works for working people”. Labour is denouncing the increase in inequality and in precarious jobs and the fall in the purchasing power of working families.

But the Labour Party is also proclaiming their commitment to reducing the public deficit every year. Their goal is to bring the current account deficit (excluding investment) into balance by 2018-19, which would mean a public deficit of 1.4% of GDP. This goal is less ambitious than that of the Conservatives and would be met in part by higher taxes. The maximum marginal rate of income tax would rise from 45% to 50%. A tax would be introduced on “mansions” (properties worth more than 2 million pounds). Labour has pledged to maintain the most competitive corporate tax rates in the G7. This rate, which was cut to 20% in April, would nevertheless be raised by one point. The levy on banks would be increased (900 million expected). Labour also wish to reinstate a lower 10% starting rate of tax, to be financed by the abolition of the allowance for married couples. They want to eliminate the very unpopular tax on vacant rooms (the “bedroom tax”). Like the Conservatives, they would remove the tax advantages for “non-doms”.

Labour, however, want to cut government spending, except on health, education and international development. They propose an increase in NHS funding in order to reduce waiting times. They have pledged to raise the hourly minimum wage to GBP 8.00 in 2019 (from the current level of 6.50 pounds, which is set to rise to 6.70 in October 2015). They propose to regulate zero-hour contracts (at least for employees who have worked regularly for more than 12 weeks). On the other hand, they do not question a cap on income assistance. Labour also say that

they will control immigration and limit the right of immigrants to social benefits (by requiring at least two years' residence in the country). They want to implement an industrial strategy to develop a green economy. They propose reducing the role of shareholders in corporate management and creating a British Investment Bank to help finance small businesses.

The Liberal Democrats call is for a "stronger economy, fairer society". They want to make the UK a world leader in terms of future technologies. They want to increase spending on health and education. They also want to increase the availability of childcare and parental leave. Above all, they want to develop green taxation and make the transition to a low-carbon economy. They aim to balance the current budget, like Labour, but this would occur a year earlier (2017-2018). This would be achieved by limited spending cuts, but also by increasing taxes on the wealthy, on banks, on big business and pollution and by fighting tax avoidance. They too propose a mansion tax.

### **... and a number of unknowns**

The Institute for Fiscal Studies (IFS) has published two notes: "Post-election austerity: Parties' plans compared", *IFS Briefing Note BN 170*, 22 April, and "Taxes and benefits: The parties' plans", *IFS Briefing notes BN 172*, 28 April. In these notes the IFS attempts to estimate the proposed measures, but underlines the lack of detail in the different programmes. The Conservatives are planning more spending cuts, while Labour and the Liberal Democrats are planning a less rapid reduction in deficits and consequently in public debt. Under the Tories, the public deficit would fall from 5% of GDP in 2014-15 to 0.6% in 2017-18, to 1.1% for the Liberal Democrats, to 2% for Labour, and to 2.5% for the SNP. The public debt would decline from 80% of GDP in 2014-15 to 72% in 2019-20 under the Conservative plan, compared with 75% for the Liberal Democrats, 77% for Labour and 78% for the SNP. The three parties have announced that they will pursue the goal of

deficit reduction but without specifically detailing how they would do this. The Conservatives, for instance, would not increase taxes; they would have to make an 18% cut in spending on non-protected sectors, that is to say, defence, transportation, social assistance and justice. They do not spell out how they would make large savings on social welfare spending while excluding pensions and the NHS. At the end of April, the Liberal Democrats injected into the debate the idea that the Conservatives would consider reducing family allowances, which David Cameron has denied he will do, but suspicion remains just a few days before the election. All the parties have committed not to increase the main VAT rate, income tax or health insurance contributions, but all of them are also counting on a great deal of revenue from the fight against tax avoidance.

### **Scotland-Europe: two key issues in the elections**

Two issues make this vote unique and have given rise to a very specific political configuration. First, the Scottish National Party (SNP) is continuing to call for Scotland's independence, despite the outcome of the referendum in September 2014 (55% no). As a centre-left party that is currently in power in Edinburgh, it could win 55 of the 59 Scottish seats, at the expense of the Labour party, and thus be in a pivotal position for securing a future majority. It is calling for a new referendum on Scottish independence, but also for an end to austerity policies on public and social welfare spending.

UKIP is calling for the UK to leave the EU. David Cameron has promised to hold a referendum on this before the end of 2017 if the Conservatives prevail. In any case, Cameron is opposing any extension of Europe's economic or political powers; Europe must above all be a single market that needs for free market policies to be maximized; he rejects any European regulations on financial services as well as any solidarity between countries, any increase in the EU budget, and any increase in the British contribution ("I am not paying that bill"). He



wants the UK to have the possibility of limiting the social rights of EU immigrants, which would be the main point in any Conservative negotiations over keeping the United Kingdom in the EU. David Cameron will not come out for keeping the UK in the EU until these demands are taken into account. Labour has denounced the UK's loss of influence in Europe caused by its isolationism, but it is also demanding less Europe: the UK should remain free to set its own immigration policy and social policy. According to Gordon Brown, leaving the EU would transform the UK into a "new North Korea", without allies and without influence. Labour would hold a referendum if Europe wanted to impose unacceptable measures on the UK. The Liberal Democrats are very attached to Europe. They want to defend business in Europe, along with the Transatlantic Trade and Investment Partnership (TTIP), eliminate unnecessary institutions such as the European Economic and Social Council and the sessions of the EU Parliament in Strasbourg. They want to maintain freedom of movement in Europe but reduce immigrants' rights to benefits. They will vote no on a referendum for leaving the EU. Currently, 35% of the British people would vote for leaving the EU and 57% against (but 38% want to stay while reducing the EU's powers). The large corporations and even more so the City want to remain in a big market. As was the case during the Scottish referendum, some corporations (e.g. HSBC[\[1\]](#)) are threatening to move their headquarters if the UK leaves the EU. The richest and best-educated part of the population also wants to stay in the EU.

The UK's economic and political development is thus now subject to three uncertainties: the risk that there will be no clear majority in Westminster; the return of the Scottish debate; and the debate on leaving the European Union.

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[\[1\]](#) But HSBC is also challenging the increase in taxes on banks as well as the regulations inspired by the Vickers report, which would require ring-fencing the activities of the commercial banks.

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# **The United Kingdom on the eve of elections: The economy, David Cameron's trump card (1/2)**

By [Catherine Mathieu](#)

In the countdown to the general elections on 7 May 2015, there is so much suspense that the bookmakers are putting the Conservative Party as winners and Ed Miliband, the Labour leader, as the next Prime Minister! Not only are the Labour Party and the Conservative Party running neck-and-neck in the polls, but with voting intentions fluctuating between 30 and 35% for many months now, neither party seems poised to secure a sufficient majority to govern alone. David Cameron, current PM and leader of the Tories, has placed the British economy at the heart of the election campaign. And the figures do seem rather flattering for the outgoing government with regard to growth, employment, unemployment, public deficit reduction, etc., though there are some less visible weaknesses in the UK economy.

## A flattering macroeconomic result

With growth of 2.8% in 2014, the UK topped the charts for growth among the G7 countries (just ahead of Canada at 2.5% and the United States at 2.4%). The British economy has been on the road to recovery for two years, as growth picked up from 0.4% yoy in the fourth quarter of 2012 to 3% in the fourth quarter of 2014. This recovery stands in contrast to the situation of the large euro zone economies, where there was a weak recovery in Germany (respectively, 1.5% after 0.4%) and weak growth in France (only 0.4%, against 0.3% in 2012), with Italy still in recession (-0.5% after -2.3%).

At the end of 2014, Britain's GDP was 5% above its pre-crisis level (*i.e.* first quarter 2008), due to a strong recovery in services, which was particularly spectacular in business services (where value added (VA) was 20% above its pre-crisis level, representing 12% of VA), with a good performance in the fields of health care (VA 20% above the level of early 2008; 7% of VA) and in real estate (VA 17% above the pre-crisis level; 11% of added value).

According to the initial estimates released on April 28 by the Office of National Statistics (ONS), GDP nevertheless increased by only 0.3% in the first quarter of 2015, instead of 0.6% as in the previous quarters. While this initial estimate is likely to be revised (upwards or downwards, only half of the data on the quarter is known for this first estimate), this slowdown in growth just a few days before the elections comes at a bad time for the outgoing government...

*A strong decline in the unemployment rate ...*

Another highlight of the macro-economic record as the elections approach: the unemployment rate has been falling steadily since late 2011, and was only 5.6% (ILO definition) in February 2015, against 8.4% in late 2011. This rate is one of the lowest in the EU, better than in France (10.6%) and

Italy (12.6%), though still behind Germany (only 4.8%). While the unemployment rate has not yet reached its pre-crisis level (5.2%), it is now close. The number of jobs has increased by 1.5 million in the UK since 2011, and David Cameron unhesitatingly boasts of the UK's success as "the jobs factory of Europe", creating more jobs on its own than the rest of Europe combined! [\[1\]](#)

Behind this strong increase in employment, however, there are many grey areas.... First, the nature of the jobs created: 1/3 of the jobs created during this recovery are individual entrepreneurs, who now represent 15% of total employment. In times of crisis, a rise in the number of the self-employed generally reflects hidden unemployment, although according to a recent study by the Bank of England[\[2\]](#) this increase is part of a trend. The issue of the growth in what are called "zero hour" contracts, which are contracts for jobs with no guaranteed number of hours, has also burst into the discussion. Until 2013, this type of contract was not subject to statistical monitoring, but according to surveys recently released by the ONS, 697,000 households were affected by this type of contract (representing 2.3% of employment) in the fourth quarter of 2014, against 586,000 (1.9% of employment) a year earlier, *i.e.* an increase of 111,000 persons, while total employment increased by 600,000 over the period: zero-hours contracts therefore concern only a relatively small portion of the jobs created.

One corollary of the job creation that has taken place since 2011 is low gains in productivity. The British economy began to create jobs from the beginning of the recovery, while productivity fell sharply during the crisis. Companies have kept more employees on the payroll than they usually do in times of crisis, but in return wage increases have been curtailed. UK productivity today remains well below its pre-crisis level. Will the British economy keep a growth model based on low productivity and low wages for a long time to

come? It is too early to tell, but this is a subject lying in the background of the election campaign.

### *Very low inflation*

Inflation, as measured by the harmonized index of consumer prices (HICP), fell in February 2015 to only 0% yoy against 1.9% at the end of 2012. This slowdown was due to lower energy prices, but since the end of 2012, also to a slowing in core inflation: from 1.9% at end 2012 to 1.2% in February 2015. The question of inflationary risks has been debated within the UK Monetary Policy Committee for many months now: growth and low unemployment are potentially harbingers of short-term inflationary pressure, if one accepts that the economy is once again approaching full employment. In fact, the continuous decline in inflation since 2012, coming amid low wage increases, a more expensive pound and falling energy prices, has put off the prospect of an acceleration in short-term inflation. For the moment, the members of the Bank of England's Monetary Policy Committee are voting unanimously for the status quo.

Long-term interest rates on government debt remain at low levels, which was one of the goals hammered at by the Conservatives during the 2010 electoral campaign. In fact, UK rates are moving in much the same way as US rates, in line with similar growth prospects.

Despite this relatively good record, the British economy is still fragile.

### **The vulnerabilities of the British economy over the medium term**

#### *Household debt continues to be high*

Household debt had reached record levels before the 2007 crisis, and at that time represented 160% of household annual income. Since then, households have begun to deleverage, with

indebtedness falling to 136% at end 2014, which is still well above the 100% level of the 1990s. This deleveraging is lessening households' vulnerability to a further economic slowdown or to a fall in the price of assets (especially property), but this also has the effect of reining in private domestic demand, while the household savings rate remains low (about 6%) and growth in nominal and real wages moderate. The rebalancing of domestic demand should continue, especially in terms of business investment.

### *Business investment is catching up*

Business investment was structurally weak in the 2000s in the UK. But the recovery has been underway for 5 years, and the rate of investment volume is now close to its level of the early 2000s. The recovery of investment is obviously good news for the UK's productive capacity. But there is still an external deficit, a sign that the UK is struggling to regain competitiveness, at least with regard to the trade in goods. The stabilization of the trade deficit at around 7 GDP points in 2014, however, was due to the goods deficit being partially offset by a growing surplus in services (5 GDP points at end 2014), a sign that the UK economy still has a high level of specialization in services. Nevertheless, taking into account the balance in income<sup>[3]</sup>, the current account deficit came to 5.5 GDP points, which is high.

### *The deceptive appearance of the public finances*

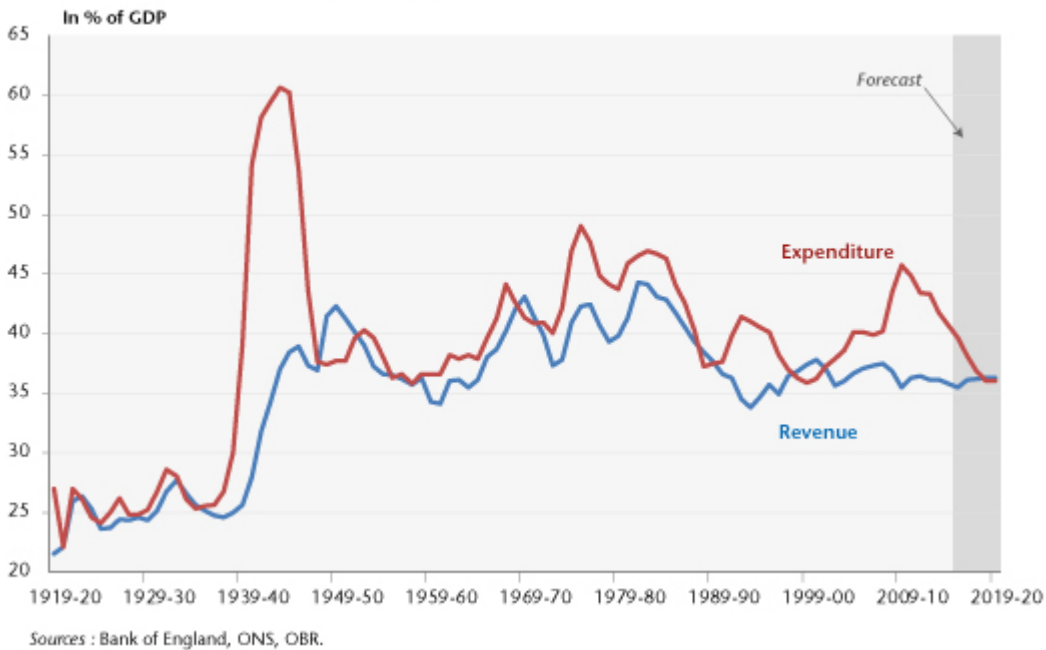
In 2010, the Tory campaign blamed the previous government for letting the deficits mount during the crisis. Their electoral programme included a large-scale fiscal austerity plan, which corresponded to the archetypical IMF plans: 80% spending cuts and 20% revenue increases over a 5-year horizon. In fact, as soon as they came to power, the government increased the VAT rate, which in 2010-2011 interrupted the recovery; it cut spending, while preserving the public health system (NHS) that the British hold so dear, as well as public pensions, which

are low in the UK, but which the government decided to peg to inflation or wages (using whichever is the higher of the two variations, with a guaranteed minimum of 2.5%).

Five years later, David Cameron is highlighting the “success” of his government, which has cut the public deficit in half, from a level of 10% in 2010 to 5.2% in 2014. But with respect to the government’s initial ambitions, this is in fact only a partial success: its first budget in June 2010 set out a public deficit of only 2.2% of GDP in 2014. The originally planned decrease in public expenditure relative to GDP was in fact realized, but revenue rose much less than expected (due in part to sluggish household income).

While the austerity programme was generally weaker than what had been announced, in the March 2015 budget the government set out sharp cuts in public spending by 2019, which would bring it down from the current level of 40% of GDP to only 36% of GDP, one of the lowest levels of public spending since World War 2 (graphic). This reduction in public spending would be sufficient in itself to balance the public deficit, without any significant tax hikes: this would represent large-scale budget cuts, whose components are not specified and which it is hard to imagine would not sooner or later affect spending on health care and pensions, which the government has so carefully avoided doing up to now...

### Public spending and revenue over the long term



[1] “We are the jobs factory of Europe; we’re creating more jobs here than the rest of Europe put together” (Speech on 19 January 2015).

[2] “Self-employment: what can we learn from recent developments?”, *Quarterly Bulletin*, 2015Q1.

[3] But the deficit of the balance of direct investment income (2 percentage points of GDP) is probably inflated by the relatively good performance of foreign companies operating in the UK in comparison to British companies operating abroad.