

Give Recovery a Chance

By iAGS team, under the direction of [Xavier Timbeau](#)

The ongoing recovery of the Euro Area (EA) economy is too slow to achieve a prompt return to full employment. Despite apparent improvement in the labour market, the crisis is still developing under the covers, with the risk of leaving long-lasting “scars”, or a “scarification” of the social fabric in the EA. Moreover, the EA is lagging behind other developed economies and regardless of a relatively better performance in terms of public debt and current account, the current low rate of private investment is preparing a future of reduced potential growth and damaged competitiveness. So far, the Juncker Plan has not achieved the promised boost to investment. The internal rebalancing of the EA may fuel deflationary pressure if it is not dealt with through faster wage growth in surplus countries. Failure to use fiscal space where it is available will continue to weigh down on internal demand. Monetary policy may not succeed in the future in avoiding a sharp appreciation of the Euro against our trade partners’ currencies. Such an appreciation of the real effective exchange rate of the Euro would lock the EA in a prolonged period of stagnation and low inflation, if not deflation.

A window of opportunity has been opened by monetary policy since 2012. Active demand management aimed at reducing the EA current account combined with internal rebalancing of the EA is needed to avoid a worrying “new normal”. Financial fragmentation has to be limited and compensated by a reduction of sovereign spreads inside the euro area. Active policies against growing inequalities should complement this approach. Public investment and the use of all policy levers to foster a transition toward a zero carbon economy are ways to stimulate demand and respect the golden rules of public finance stability.

For further information, see [iAGS 2016 report](#)

A standard contract for France: a potluck approach?

By Jacques Barthélémy and Gilbert Cette

The debate over a single standard contract [*contrat unique*] generally arises in relation to the duality of the labour market, with on the one hand employees who are highly protected, such as civil servants and permanent employees (“CDI” contracts), and on the other hand workers shifting between periods of unemployment and poorly protected precarious jobs (fixed-term “CDD” and temporary contracts). This contrast reflects gross inequalities, and has important social and economic consequences.

To deal with this dual labour market, proposals are often made for a “single contract” that would reduce the differences in status and rights between precarious and permanent contracts. But the concept of a “single contract” is often poorly defined. If we closely examine the major differences that exist in the content of the various proposals, it even begins to look like a potluck approach!

The three stated objectives of the proposal for a single contract are: (1) to reduce inequalities in status arising from the coexistence of so-called “precarious” contracts (fixed-term and temporary contracts) and permanent contracts;

(2) to reduce the complexity and the costly uncertainties surrounding the legal treatment of redundancies; and (3) to partially internalize the social costs of redundancies. [In an article in the Revue de l'OFCE](#), we show that a single contract cannot really meet these objectives, which would be better served by other means, and that it would give rise to major legal risks.

For more information, see: [J. Barthélémy and G. Cette, 2015, « Le contrat unique: une auberge espagnole », Revue de l'OFCE no.146](#).

Should we be worried about the slowdown in China?

By [Eric Heyer](#)

China's growth is slowing. This does not really come as a surprise: the slowdown was announced by the Chinese authorities; it can be seen in the national accounts; and it was predicted in all the medium-term scenarios of the major international organizations. It corresponds to a new phase in China's economic and social development, towards growth that the authorities want to be more "qualitative, inclusive and innovative".

However, many analysts and experts believe that the Chinese economy has slowed down more than [is reflected in the country's national accounts](#). According to a survey conducted in 2015 by Bank of America Merrill Lynch, 75% of investors are convinced that the real growth rate of the Chinese economy was

less than 6% in the second quarter of 2015 on an annualized basis. For some, the overestimation of growth is due to an underestimation of inflation, particularly in the service sector. For others, China's GDP growth rate needs to be correlated with the rate for electricity generation and be in line with freight by road, rail, sea or air. However, all these values have experienced a significant decline since the start of 2014, and the stable relationship between GDP and these elements tends to indicate lower annual growth for the Chinese economy, of [around 2% in early 2015 according to Artus](#), which is more in line with the observed fall in imports. This steeper slowdown would have a violent impact on the global economy, endangering the shoots of recovery in the developed economies.

[In a recent article](#), we estimated the link between Chinese GDP and different economic variables not taken from the national accounts, using an error correction model (ECM) to evaluate the slowdown, before giving an evaluation of its impact on the GDP of the major developed countries.

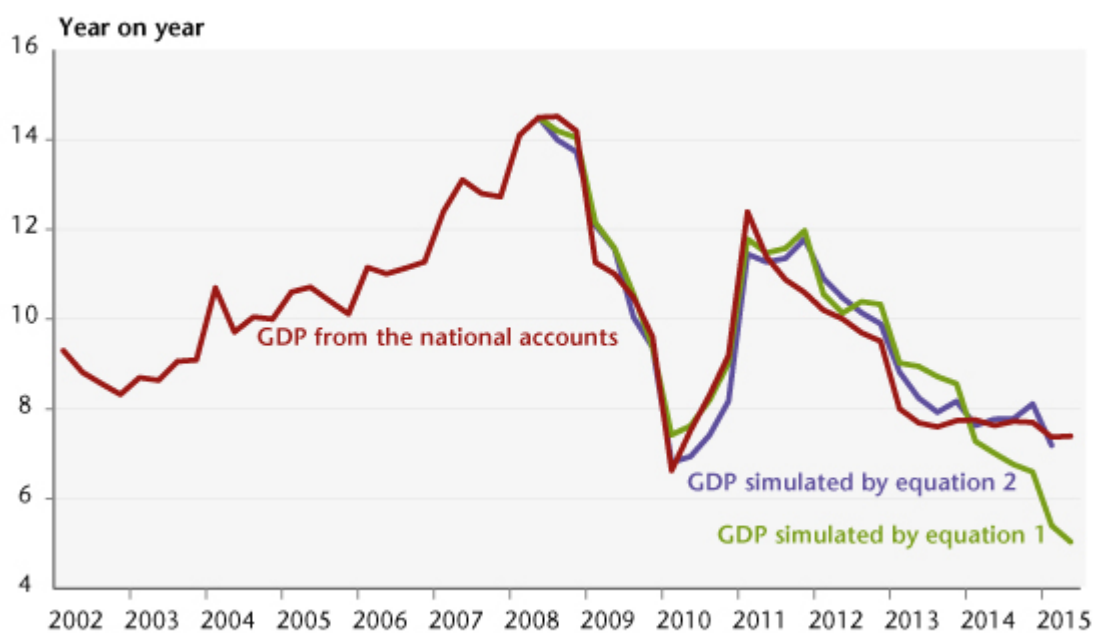
Just how much is the Chinese economy slowing down?

Drawing on the Li Keqiang index, we estimated China's GDP from variables for freight and the production of electricity and cement. While our results confirm that the Chinese economy has been slowing down since 2011, from a yoy rate of 12% to less than 8% in early 2013, the stabilization of the growth rate observed since then in the national accounts is not re-traced in this simulation, which indicates instead a continued slowdown in Chinese growth (Figure 1, equation 1).

However, this modelling of GDP does not take into account the major transformation of the Chinese economic model towards a new growth model, which began three years ago and which involves high indebtedness of domestic agents and an orientation towards more services. An enhanced analysis of variables that also draw on the labour market situation

(wages, jobs) confirms the slowdown in the Chinese economy as traced by the national accounts, reflecting the difficulty of the transition between the two growth models, and not the beginnings of a slide into recession (Figure 1, equation 2). On the other hand, the country's "industrial" part should continue to decelerate, thwarting any significant rebound in Chinese imports.

Figure. Simulated and observed growth rate of China's GDP



Sources: National accounts, OFCE calculations.

What impact will the slowdown have on the developed countries?

Three channels for the transmission of the slowdown of the Chinese economy to the developed countries can be identified:

- 1. Direct and indirect effects via the trade channel:** Given China's weight in world trade, the sharp slowdown in its output, particularly in industry, is significantly reducing the country's imports (through intermediate consumption and household consumption) and is consequently cutting demand for the rest of the world's goods. To this direct effect can be added an indirect effect due to the slowdown in partner countries affected by the reduced demand;

2. **Effects via the financial channel:** The Chinese slowdown may hit direct investment in the developed countries; conversely, the withdrawal of capital from China might be an occasion for reallocating it to other developed countries;
3. **Effects via the channel of raw materials prices:** As China buys more than half of all metals traded in the world and accounts for two-thirds of the increase in global oil consumption, the slowdown of its economy is hurting the prices of raw materials, especially oil, thereby causing a transfer of income from the countries producing commodities to the countries consuming them.

Looking only at the first transmission channel, trade, our results are as follows: Japan and Germany are the countries most affected by the slowdown in China. The cumulative impact from 2014 to 2017 will amount to more than 2 percentage points of GDP. The impact on Japan is due to its significant exposure to Chinese trade (3% of exports to China compared with 2.4% for Germany), whereas the impact on the German economy is due more to its degree of openness (39.1% against 14.6% for Japan). Next come the United Kingdom, Italy and France, with a cumulative impact of close to 1 GDP point. Spain and the United States are least affected, with a cumulative impact of around 0.5 GDP point: the United States has a low exposure (0.7%) and a low degree of openness (8.2%). Finally, the annual peak for the impact of China's slowdown would hit in 2015, and knock 0.8 GDP point off the German economy and 0.9 GDP point off the Japanese economy.

Table. Impact of China's slowdown on the GDP of the major developed countries through the trade channel

In GDP points

	2014	2015*	2016*	2017*	Effet cumulé 2014-2017
DEU	-0.4	-0.8	-0.5	-0.4	-2.1
Direct effect	-0.3	-0.7	-0.4	-0.3	-1.7
Indirect effect	-0.1	-0.1	-0.1	-0.1	-0.3
FRA	-0.1	-0.3	-0.2	-0.2	-0.8
Direct effect	-0.1	-0.2	-0.1	-0.1	-0.5
Indirect effect	-0.1	-0.1	-0.1	-0.1	-0.3
ITA	-0.2	-0.4	-0.2	-0.2	-0.9
Direct effect	-0.1	-0.3	-0.1	-0.1	-0.6
Indirect effect	-0.1	-0.1	-0.1	-0.1	-0.3
ESP	-0.1	-0.2	-0.1	-0.1	-0.5
Direct effect	0.0	-0.1	0.0	0.0	-0.2
Indirect effect	-0.1	-0.1	-0.1	-0.1	-0.3
GBR	-0.2	-0.4	-0.2	-0.2	-1.1
Direct effect	-0.1	-0.3	-0.2	-0.2	-0.8
Indirect effect	0.0	-0.1	-0.1	0.0	-0.2
USA	-0.1	-0.2	-0.1	-0.1	-0.6
Direct effect	-0.1	-0.2	-0.1	-0.1	-0.5
Indirect effect	0.0	0.0	0.0	0.0	-0.1
JPN	-0.4	-0.9	-0.5	-0.4	-2.2
Direct effect	-0.4	-0.9	-0.5	-0.4	-2.1
Indirect effect	0.0	0.0	0.0	0.0	-0.1

* Forecasts.

Sources: National accounts, Eric Heyer's calculations.

The potential headache of measuring economies in public expenditure

By Raul Sampognaro

Since 2009, the French budget deficit has been cut by 3.3 GDP points, from 7.2 percent of GDP in 2009 to 3.9 points in 2014, even though the economic situation has been weighing heavily on the public purse. This improvement was due to the implementation of a tighter budget policy. [Between 2010 and](#)

[2013, most of the consolidation effort came from higher taxes](#), but since 2014 the effort has largely involved savings in public expenditure. In 2014, public expenditure excluding tax credits^[1] recorded its weakest growth since 1959, the year when INSEE began to publish the national accounts: in value, spending excluding tax credits increased by 0.9%, though only 0.3% in volume terms (deflated by the GDP deflator).

At first glance it may seem counter-intuitive to talk about savings on spending even though the latter has been rising constantly. This rise is, however, well below potential growth, which reflects a real long-term effort to reduce the ratio of spending to GDP. Indeed, the formula usually used to calculate the effort on spending depends on the hypothesis adopted on potential growth:

To understand why the extent of the effort on public expenditure is dependent on potential growth, one must understand the underlying concept of the sustainability of the debt. There is a consensus on the theoretical definition of the sustainability of the public debt: it is sustainable if the current stock of debt could be repaid by the anticipated future stream of the State's net revenues^[2]. While the concept is clear, its practical application is more difficult. In practice, fiscal policy is deemed sustainable when it makes it possible to stabilize the ratio of public debt to GDP at a level deemed consistent with maintaining refinancing by the market.

Thus, changes in spending that are in line with that goal should make it possible to stabilize the share of public expenditure to GDP over the long term. However, as public spending essentially responds to social needs that are independent of the economic situation (apart from certain social benefits such as unemployment insurance), stabilizing its share in GDP at any given time (which would imply it changes in line with GDP) is neither assured nor desirable. In

order to deal with this, changes in the value of public expenditure are compared to the nominal growth rate of potential GDP^[3] (which depends on the potential growth rate and the annual change in the GDP deflator).

An increase in expenditure that is above (respectively below) the potential reflects a positive (negative) impulse, because in the long run it leads to an increase (decrease) in the ratio of public spending to GDP. While the application of this concept may seem easy, potential growth is unobservable and uncertain because it is highly dependent on the assumptions made about demographic variables and future changes in productivity. In the 2016 Budget Bill (PLF), the government revised its potential growth assumptions for the years 2016 and 2017 upwards (to 1.5% instead of 1.3% as adopted at the time of the vote on the LPFP supplementary budget bill in December 2014).

This revision was justified on the basis of taking into account the structural reforms underway, in particular during the vote on the Macron Act. This was the second revision of potential since April 2014 when it was estimated at 1.6% (2014-2017 Stability Programme). The government is not the only one to repeatedly revise its assessments of potential growth. When the European Commission published its latest projections^[4], it revised its assessment of potential growth even though its previous assessment had been issued only in May^[5]. It is not easy to see what new information could change its assessment now. These recurring revisions generally complicate the economic debate^[6] and cloud discussion of the budget.

Hence using identical sets of hypotheses about the public finances, a measurement of savings on spending, and thus of the structural adjustment, would depend on the potential growth adopted (Table). Assuming a value for the growth in public spending (excluding tax credits) of +1.3% in 2016 and

in 2017, the scale of the effort on spending was evaluated at 0.7 GDP point in October 2015 (using the hypotheses in the 2016 PLF) but 0.6 point in December 2014 (2014-2019 LPFP).

Table 1. Evaluation of the effort on public expenditure based on different hypotheses for potential growth

In %

	Potential growth			Effort on spending		
	2015	2016	2017	2015	2016	2017
2016 PLF, October 2015	1,1	1,5	1,5	-0,6	-0,7	-0,5
2014-2019 LPFP, December 2014	1,1	1,3	1,3	-0,6	-0,6	-0,4
2015 PLF, October 2014	1,1	1,3	1,3	-0,6	-0,6	-0,4
2014-2017 Stability Programme, April 2014	1,5	1,6	1,6	-0,8	-0,7	-0,5
2014 PLF, September 2013	1,5	1,6	1,6	-0,8	-0,7	-0,5
2012-2017 LPFP, January 2013	1,5	1,6	1,6	-0,8	-0,7	-0,5
November 2015 forecast	1,0	1,1	1,2	-0,5	-0,4	-0,3
May 2015 forecast	1,0	1,1	—	-0,5	-0,4	—
Ageing Working Group*, May 2015	1,1	1,1	—	-0,6	-0,4	—
Ageing Working Group**, May 2015	1,6	1,6	1,6	-0,8	-0,7	-0,5

* simple average of the potential growth of 2013 and of 2020 published in *The 2015 Ageing Report*.

** average of the 2013-2060 potential growth published in *The 2015 Ageing Report*.

Sources : PLF, LPFP, European Commission forecasts, *The 2015 Ageing Report*.

While the differences identified above may seem small, they can have significant consequences on the implementation of fiscal rules, which can lead the various players to act on their assumptions in order to change the effort shown [7]. Even though this notion should guide the vision of the future trajectory of Europe's economies, the debate winds up being hijacked. Recurrent revisions in potential growth focus discussion on the more technical aspects, even though the method of estimating potential growth is uncertain by definition and there is not even a consensus among economists. Thus, the European Semester, which should set the framework for discussion and coordination between Member States in determining the economic policy that best suits the macroeconomic context, for France and for the euro zone as a whole, gets lost amidst technical discussions that are of no particular interest.

[1] Reimbursable tax credits – essentially the CICE and the CIR credits – are recognized in public expenditure on the basis of the 2010 national accounts. In order to remain closely in line with economic concepts, public spending will be analyzed excluding tax credits, which will be considered as a component of taxation.

[2] This definition is accepted both by the academic literature (see for example, D’Erasmus P., Mendoza E. and Zhang J., 2015, “What is a Sustainable Public Debt?”, *NBER WP*, no 21574, September 2015, and by international organizations (see IMF, 2012, “Assessing Sustainability”).

[3] It can also be compared to an underlying trend in public expenditure which itself takes into account the changing needs to which spending responds.

[4] The European Commission expects France to grow by 1.1% in 2015, 1.4% in 2016 and 1.7% in 2017.

[5] The evaluation has changed to the second decimal.

[6] For this debate, see H. Sterdyniak, 2015, “Faut-il encore utiliser le concept de croissance potentielle?” [Should the concept of potential growth still be used?], *Revue de l’OFCE*, no. 142, October 2015.

[7] The revisions of potential growth may have an impact on the implementation of procedures. These revisions cannot give rise to penalties. At the sanctions stage, the European Commission’s hypothesis on potential growth, made at the recommendation of the Council, is used in the discussion. However, it is likely that a difference of opinion on an unobservable variable could generate friction in the process, reducing the likelihood of sanctions and making the rules less credible.

The labour market: is the unemployment rate a good indicator?

By [Bruno Ducoudré](#) and [Pierre Madec](#)

Considering the euro zone on the one hand and the United States and the United Kingdom on the other, changes in unemployment rates are a reflection of the divergences in growth highlighted in our [last fiscal year forecast](#). While between 2008 and late 2010, trends in unemployment reflected the sharp deterioration in growth and did not differ much between the euro zone, the UK and the USA, differences began to emerge from 2011. In the United Kingdom and the United States, unemployment has been falling since 2011, whereas, after a brief respite, a second phase of rising rates took place in most euro zone countries (Table 1). It was only more recently that the unemployment rate has really begun to fall in Europe (late 2013 in Spain and early 2015 in France and Italy). Overall, for the period 2011-2015 the rate rose overall (+2.7 points) in Spain. In Italy, this deterioration in the labour market even worsened (+4.5 points in this period, against +2.2 points from early 2007 to late 2010). France, though to a lesser extent, was not spared.

An analysis of the unemployment rate does not however convey the full dynamics at work in the labour market (Tables 2 and 3), in particular in terms of underemployment. Thus during the crisis most European countries reduced the effective working time [\[1\]](#) to a greater or lesser degree, through policies on partial unemployment, the reduction of overtime, or the use of working-time accounts, but also through the expansion of part-

time work (especially in Italy and Spain), including on an involuntary basis. Conversely, the favourable trend in the US labour market is partly due to a significant decline in the participation rate, which stood in the first quarter of 2015 at 62.8%, 3.3 points lower than eight years ago.

Table 1. Changes in the ILO unemployment rate

In % points

	Q1 2007 - Q4 2010	Q1 2011 - Q1 2015	Q1 2007 - Q1 2015
Germany	-2.4	-1.4	-4.2
Spain	12.1	2.7	+15.0
France	0.7	1.3	+1.9
Italy	2.2	4.5	+6.4
United Kingdom	2.4	-2.2	0.0
United States	5.0	-3.5	+1.1

Sources: National accounts, OFCE calculations.

Table 2. Changes in the labour force participation rate

In % points

	Q1 2007 - Q4 2010	Q1 2011 - Q1 2015	Q1 2007 - Q1 2015
Germany	+1.5	+0.7	+2.2
Spain	+1.3	-0.7	+0.7
France	+0.5	+1.3	+1.8
Italy	+0.1	+1.8	+1.9
United Kingdom	-0.2	+1.3	+1.1
United States	-1.9	-1.4	-3.3

Sources: National accounts, OFCE calculations.

Table 3. Changes in working time

In %

	Q1 2007 - Q4 2010	Q1 2011 - Q1 2015	Q1 2007 - Q1 2015
Germany	-2.0	-2.1	-4.1
Spain	+0.5	-3.5	-3.0
France	-0.9	-0.8	-1.7
Italy	-2.9	-2.4	-5.3
United Kingdom	-0.9	+1.4	+0.5
United States	-0.7	+0.8	+0.1

Sources: National accounts, OFCE calculations; Scope: total employment.

In order to measure the impact of these adjustments (working time and participation rate) on unemployment, it is possible, subject to a number of assumptions [2], to calculate the unemployment rate at constant employment and control for these adjustments. Except for the United States, where the participation rate has fallen sharply since 2007, all the

countries studied experienced an increase in their labour force (employed + unemployed) that was greater than in the general population; in many countries this was due to pension reforms. Mechanically, in the absence of job creation, the impact of this demographic trend is to push up the unemployment rate in the countries concerned. For instance, if the participation rate had remained at its 2007 level, the unemployment rate would be lower by 1.6 points in France and 1.1 points in Italy (Table 4). Conversely, without the significant contraction in the US labour force, the unemployment rate would have been more than 3 points higher than what was seen in 2015. Also note that since the crisis Germany has experienced a significant drop in unemployment (-4.2 points) even though its participation rate grew by 2.2 points. Assuming an unchanged participation rate, Germany's unemployment rate would be 3.1% (Figure 1).

In terms of working time, the lessons seem quite different. It thus appears that if working time had been maintained in all the countries at its pre-crisis level, the unemployment rate would have been more than 3 points higher in Germany and Italy and about 1 point higher in France and Spain, countries in which working time decreased sharply only from 2011. In the US and UK, the situation is very different: working time has changed only very little since the crisis. By controlling for working time, the unemployment rate thus changes along the lines observed in the two countries.

The tendency for working time to fall is a familiar story. Since the late 1990s, all the countries studied have greatly reduced their working hours. In Germany, between 1998 and 2008, the reduction was on average 0.6% per quarter. In France, the transition to the 35-hour week caused a similar reduction over the period. In Italy, the United Kingdom and the United States, the downward shifts in average working hours were respectively -0.3%, -0.4% and -0.3% per quarter. In total, between 1998 and 2008, working time fell by 6% in

Germany and France, 4% in Italy, 3% in the United Kingdom and the United States and 2% in Spain, which was *de facto* the only country that during the crisis intensified the decline in working time that started in the late 1990s.

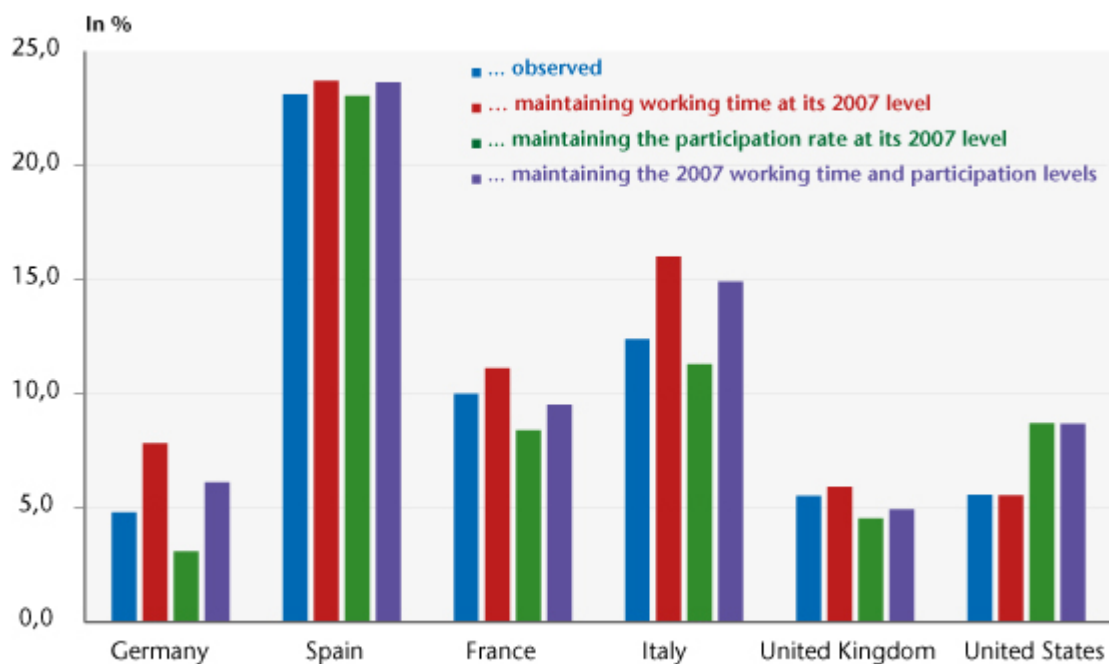
Table 4. Difference between the unemployment rate observed in the first quarter 2015 and the unemployment rate observed in case of ...

In %

	... maintaining working time at its 2007 level	...maintaining the participation rate at its 2007 level	...maintaining the 2007 participation rate and working time levels
Germany	+3.1	-1.7	+1.4
Spain	+1.0	-0.1	+0.9
France	+1.2	-1.6	-0.4
Italy	+3.6	-1.1	+1.5
United Kingdom	0.0	-1.0	-1.0
United States	0.0	+3.1	+3.1

Sources : National accounts, OFCE calculations.

Figure 1. Unemployment rate in first quarter 2015 in the case of ...



Sources : National accounts, OFCE calculations; Scope: total employment.

[1] Working time is understood here as the total number of hours worked by employees and the self-employed (i.e. total employment).

[2] It is assumed that, at constant use, a one-point increase in the participation rate leads to an increase in the unemployment rate. Employment and working time are not considered here in full-time equivalents. Finally, neither the “halo of unemployment” nor any possible “bending effects” are taken into account.

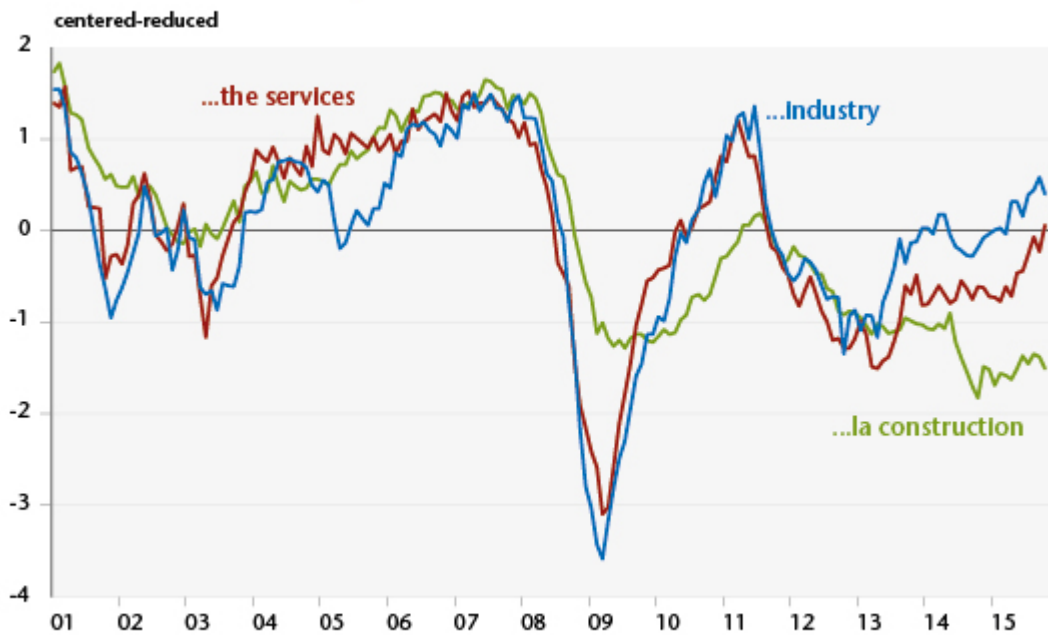
The French economy on the road to recovery

by Hervé Péléraux

The publication of the INSEE’s business surveys on October 22 confirms the French economy’s positive situation in the second half of 2015, suggesting that the negative performance in the second quarter of 2015 (0%) will turn out to have been merely “an air pocket” after the strong growth seen in the first quarter (+0.7%). The business climate in industry has exceeded its long-term average for the seventh month in a row, and the service sector has been recovering rapidly since May 2015 and has climbed back to its average, the highest level in four years (Figure 1). The business climate in the construction sector nevertheless is still suffering from the crisis that hit it, but its downward trend halted at the end of 2014; despite monthly hiccups, the sector has begun a slow recovery

that could signal the end of its woes in the coming quarters.

Figure 1. Business climate in ...



Source : INSEE.

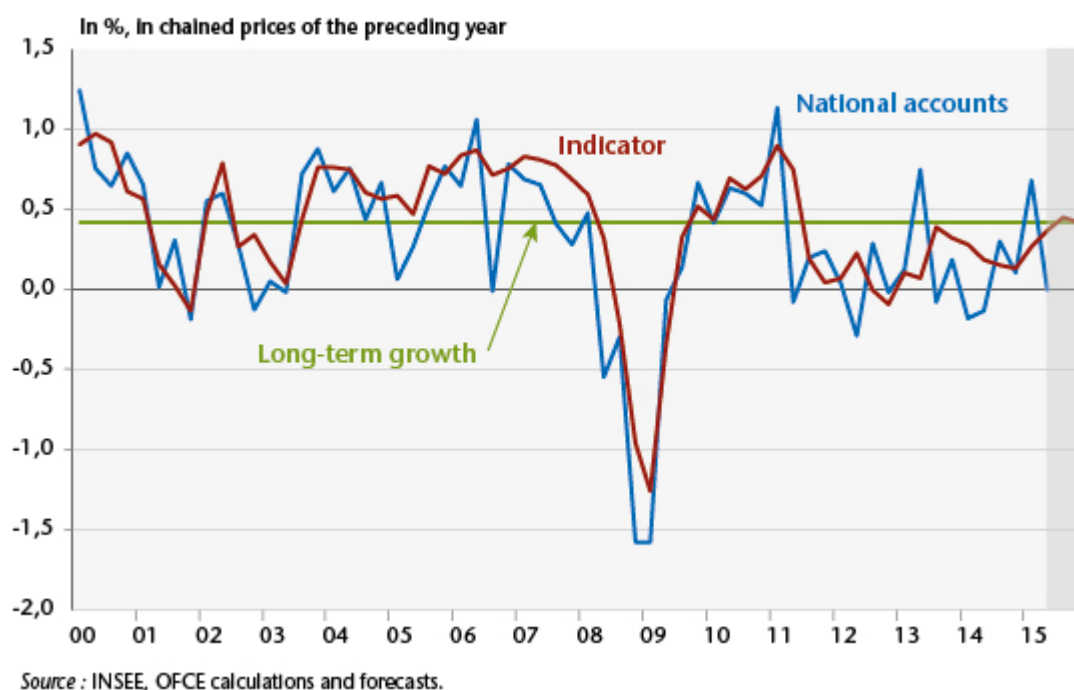
The confidence indicators, which provide qualitative information summarizing the balance of opinion on the various questions posed about business activity, consumer confidence and the situation in commerce, can be converted into quantitative information by means of an econometric equation linking these to the quarterly GDP growth rate[1]. Doing this makes it possible to use these purely qualitative data to estimate the GDP growth rate in the past and near future (two quarters), given that the publication of the surveys precede that for GDP. Among the sectoral indicators available, only the business climate in industry, services and construction provide econometrically useful information to trace the trajectory of the GDP growth rate. The other series are not significant, in particular the indexes for consumer confidence and for confidence in the retail and wholesale trade.

The leading index, which has a significantly more smoothed profile than GDP growth rates, cannot fully capture the volatility of activity and therefore should not strictly speaking be considered a predictor of growth (Figure 2). On

the other hand, from a more qualitative viewpoint, it manages to delineate quite correctly the phases during which growth is above or below average (or the long-term) determined by the estimate. From this perspective, the indicator can be seen as marking a turning point in the economic cycle. Since the second quarter 2011, the indicator has not depicted any crossing of the long-term growth rate, despite the false signs of recovery raised by the quarterly GDP figures for Q2 2013 and Q1 2015.

Based on the survey data available up to October, the growth foreseen by the indicator is 0.4% in the third and fourth quarter of 2015, exactly equal to long-term growth [2]. While a signal of recovery is not yet clearly given by the indicator, it should be noted that the information on the fourth quarter, which is limited to the October surveys, is quite partial. The confidence climates, which are extrapolated to the end of the year, are based on conservative assumptions and are likely to be upgraded if the surveys continue to improve from now to December.

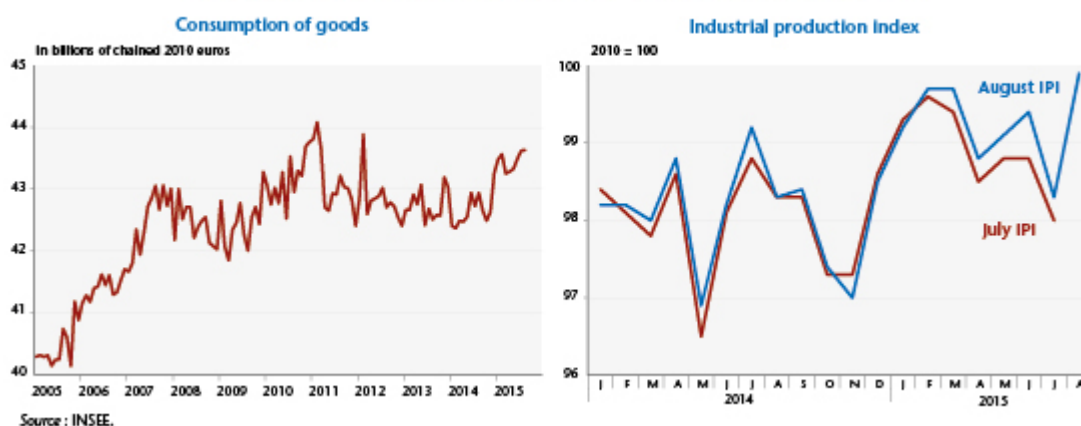
Figure 2. GDP growth rate observed and estimated by the indicator



The quantitative information available at this time for the

third quarter of 2015 also gives cause for optimism, after the disappointment of the second quarter. Under the impact of the disinflation brought on by lower energy prices, which enabled a sharp rebound in purchasing power, household consumption of goods recovered sharply at the beginning of the year (Figure 3). The rise was interrupted in the second quarter, due to poor sales in March, which pulled down the figures, but consumption has resumed its upward trajectory continually since then. The carry-over in August for the third quarter was clearly positive (+0.6%), which suggests that the consumption of goods will again contribute positively to GDP growth for the quarter.

Figure 3. Household consumption of goods and Industrial production index



The projection of a return to growth in the third quarter is also confirmed by trends in the industrial production index (IPI), which rose sharply in August (+1.6% for the total IPI, and +2.2% for the manufacturing index itself). This rebound followed a drop in production after the peak in February-March 2015 [3], which contributed to the poor performance of GDP in the second quarter (Figure 3), and nourished the idea that the second quarter was not an “air pocket” but the continuation of a long phase of stagnation for a France that was unable to take advantage of the favourable winds blowing from outside [4]. The carry-over in industrial production in August now stands at 0.3%, while it was -0.7% in the old series available in July.

The recent trends in the monthly indicators augur a renewal of growth in the third quarter of 2015. The extrapolation of GDP growth using the leading indicator, supplemented by the already available quantitative data, also points to a 0.4% increase in activity in the third quarter, which, if it is realized, would then put the economy on a firm track to finally initiate a recovery.

[1] For greater detail, see: « [France : retour sur désinvestissement, Perspectives 2015-2017 pour l'économie française](#) » [[The 2015-2017 forecast for the French economy](#)], pp. 34-37.

[2] The long-term growth considered here is not the potential growth estimated by its structural determinants using a production function, but the average GDP growth rate as reflected in the estimate of the indicator.

[3] It should be noted that the statistical revisions can change the perception of the economy's dynamics in the very short term. The IPI series published on 9 October 2015 by the INSEE has revised the level of the index significantly upwards compared to the previous publication. The IPI is still on a downward trend between February and July 2015, but the trajectory described is less negative, and the quarterly average of the index in the second quarter of 2015 is affected: according to the old series, it stood at -0.7%, compared with -0.4% according to the revised series.

[4] See Heyer E. and R. Sampognaro, 2015, « [L'impact des chocs économiques sur la croissance des pays développés depuis 2011](#) », [The impact of economic shocks on the growth of the developed countries since 2011], *Revue de l'OFCE*, no. 138, June 2015.

The labour market on the road to recovery

By [Bruno Ducoudré](#)

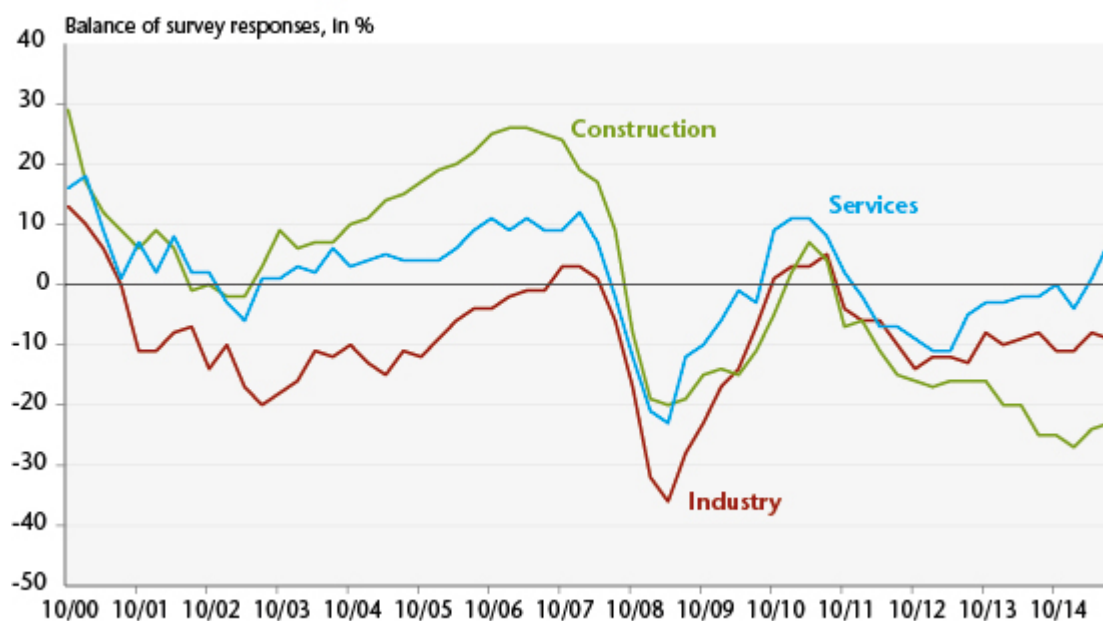
A look at the figures just published by France's Pôle Emploi job centre for the month of September 2015 shows that the number of job seekers who were registered and inactive (category A) has declined significantly (-23,800), following an increase in August (+20,000). While this is encouraging news, the decrease has to be compared with the increases seen in categories B and C (+25,600). So while employment has indeed picked up, this has not resulted in the numbers of people exiting unemployment as measured by the job centre, *i.e.* it has not put a stop to the continuing rise in the number of long-term unemployed (+10.4% in one year). Nevertheless, these trends do support the conclusions drawn from current analysis which indicate that [a recovery has indeed begun](#).

After seeing 76,000 jobs created in France in 2014 due to growth in non-commercial jobs, the first half of 2015 was marked by an increase in the workforce in the commercial sector (+26,000), which resulted in an acceleration of job creation in the economy overall (+45,000) over the first half of the year. The recently released statistics on employment confirm the accelerating trend in the third quarter of 2015: hence, over a year, declarations on job hires of over one month recorded by ACOSS rose by 3.7%, following 0.7% in the previous quarter. Business surveys also point to an increase in hiring intentions in the third quarter; these have turned positive in the service sector since the year started, which is also when the low point seen in construction was probably

reached (see Figure 1).

Our analysis of the labour market up to 2017, which was spelled out in the latest OFCE forecasts of October 2015, indicates that the commercial sector will continue to generate jobs up to the end of 2015 (+0.1% in the third and fourth quarters). The pace of job creation will nevertheless remain too low to foresee a fall in the unemployment rate by year end, particularly in light of our forecast for the GDP growth rate (0.3% in Q3 2015 and 0.4% in Q4) and the existence of overstaffing in companies, which we estimate at 100,000 in Q2 2015. The unemployment rate should remain stable at 10% until year end. With GDP growth of 1.8% in 2016, job creation will pick up markedly in the commercial sector once the overstaffing has been absorbed by companies, allowing the unemployment rate to fall starting in the second quarter of 2016. This decline will continue until the end of 2017.

Figure 1. Forecast of labour force trends



Sources: INSEE, business surveys.

The last three years of weak growth have hurt employment in the commercial sector (-73,000 jobs between the start of 2012 and the end of 2014, cf. the Table). The strength of employment in the non-commercial sector, supported by the ramp-up of subsidized contracts (the “jobs for the future”

programme and non-commercial job integration contracts) helped to offset the loss of commercial sector jobs, with total employment rising by 164,000 over the same period, which slowed the increase in the ILO unemployment rate: this figure for mainland France rose from 9% of the labour force in late 2011 to 10.1% at end 2014, i.e. a 1.1 point increase.

Tableau. Employment and unemployment

Annual change in 1000s, at last quarter						
Year on year	2012	2013	2014	2015*	2016*	2017*
Observed labour force	265	46	203	62	134	139
Total employment	31	57	76	103	193	242
- Commercial sector	0	-38	-35	73	238	245
Employed	-63	-58	-43	60	209	216
Unemployed	63	20	8	14	28	29
- Non commercial sector	31	95	111	29	-45	-3
Subsidized jobs	5	60	21	17	-54	-4
Non-subsidized jobs	26	35	90	12	10	1
Unemployment	234	-11	127	-41	-58	-103
Unemployment rate at Q4 (%)	9,7	9,7	10,1	10,0	9,8	9,4
GDP growth rate (%)	0,3	0,8	0,2	1,1	1,8	2,0

* OFCE forecast

Sources : INSEE and Ministry of Labour, OFCE forecasts, e-mod.fr 2015-2017, October 2015.

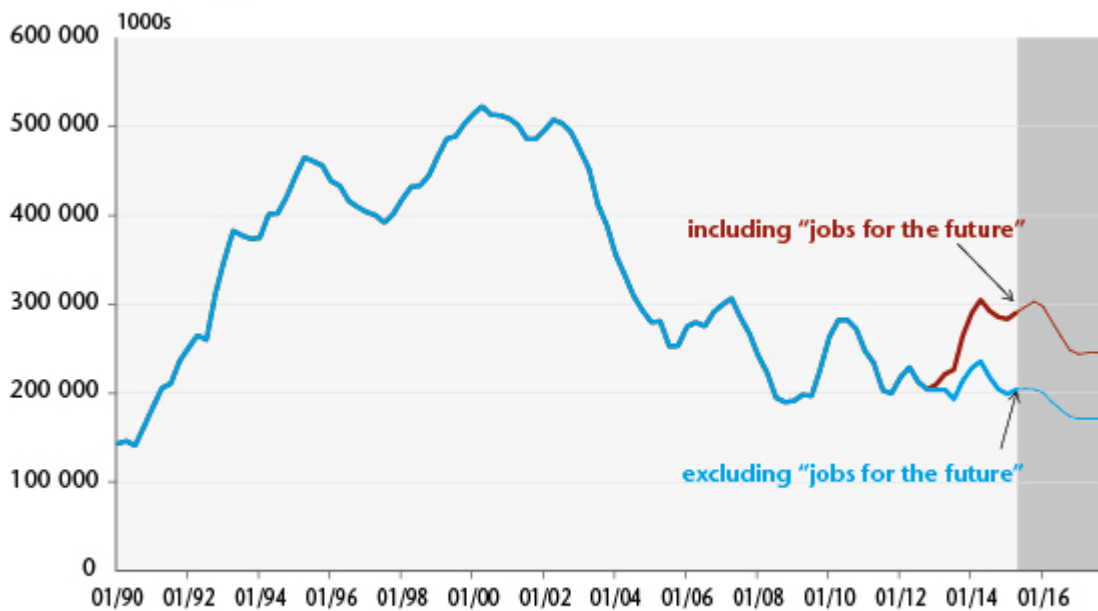
2015 is a year of transition, with a resumption of job creation in the commercial sector (+73,000 expected for the year as a whole) but less dynamic job creation in the non-commercial sector. For the full year, job creation will be boosted by the acceleration of growth (an annual average of +1.1% expected in 2015 but 1.4% yoy) and the implementation of policies to cut labour costs (CICE tax credit and the Responsibility Pact). The cumulative impact of the CICE and the Responsibility Pact, after taking into account the effect of financing, will create or save 42,000 jobs in 2015. However, job creation will be hampered by the presence of overstaffing^[1]: as economic activity picks up pace, companies typically absorb underutilized labour before increasing the volume of employment.

As for the non-commercial sector, employment policy is continuing to support the labour market in 2015 through the increase in subsidized job contracts. This increase has

nevertheless been slower than in previous years, with the number of “jobs for the future” contracts peaking in 2015 (Figure 2). Ultimately, total employment will increase by 103,000 in 2015, with the unemployment rate remaining stable at 10% till year end.

For 2016 and 2017, the acceleration of growth (at respectively 1.8% and 2%) combined with the ongoing implementation of policies to cut labour costs and the closing of the productivity cycle in the course of 2016 will lead to accelerating job creation in the commercial sector. This will increase, year on year, to 238,000 in 2016 and 245,000 in 2017 for the commercial sector alone, a rate comparable to what was seen between mid-2010 and mid-2011 (234,000 jobs created). However, in 2016, the number of subsidized contracts in the non-commercial sector set out in the 2016 Finance Bill will be down from previous years (200,000 CUI-CAE jobs and 25,000 “jobs for the future” in 2016, compared with 270,000 and 65,000 respectively for 2015). For 2017, we are assuming stability in the stock of subsidized non-commercial job contracts (see Figure 2). Overall, the long-term return of job creation by business will trigger a decline in the unemployment rate starting in the second quarter of 2016. Although sluggish, this fall should be sustainable, with the unemployment rate down to 9.8% of the labour force at end 2016 and 9.4% by end 2017.

Figure 2. Subsidized contracts in the non-commercial sector



Note :The fall in CUI-CAE contracts seen in the second half of 2014 comes from the switch from CAE job Integration contracts to CDD fixed-term contracts.

Scope: Mainland France.

Sources : DARES, OFCE forecasts *emod.fr* 2015-2017, October 2015.

[1] The presence of overstaffing in businesses derives from the gap between labour productivity and its long-term trend, called the productivity cycle. This reflects the time employment takes to adjust to economic activity. See Ducoudré and Plane, 2015, « [Les demandes de facteurs de production en France](#) » [The demand for production factors in France], *Revue de l'OFCE*, no.142.

An ever so fragile recovery

By the Department of Analysis and Forecasting, under the direction of [Eric Heyer](#) and [Xavier Timbeau](#)

This text summarizes the OFCE's [economic forecast for 2015-2017](#) for the euro zone and the rest of the world.

The figures for euro zone growth in the first half of 2015 have confirmed the upswing glimpsed at the end of 2014. While the zone's return to growth might once have been taken to indicate the end of the global economic and financial crisis that struck in 2008, the turbulence hitting the emerging countries, particularly over the summer in China, is a reminder that the crisis ultimately seems to be continuing. China's economic weight and its role in world trade are now so substantial that, even in the case of a soft landing, the impact on growth in the developed countries would be significant. We nevertheless anticipate that the scenario for a recovery need not be called into question, and that euro zone growth will be broadly supported by favourable factors (lower oil prices and ECB monetary support) and by some weakening of unfavourable factors (easing of fiscal policies). But the fact remains that the situation in the developing world will add new uncertainty to an already fragile recovery.

Between 2012 and 2014, the euro zone economies stagnated at the very time that the United States turned in average GDP growth of 2%. The recovery that got underway after the sharp contraction in 2008-2009 was quickly cut short in the euro zone by the sovereign debt crisis, which led almost immediately to the uncontrolled tightening of financial conditions and the reinforcement of the fiscal consolidation being implemented in the Member States, as they searched for market credibility.

The euro zone then plunged into a new recession. In 2015,

these economic policy shocks are no longer weighing on demand. The ECB helped to reduce sovereign debt risk premiums by announcing the Outright Monetary Transaction programme (OMT) in September 2012 and then by implementing quantitative easing so as to improve financial conditions and promote a fall in the euro. In terms of fiscal policy, while in some countries the consolidation phase is far from over, the measures being taken are smaller in scale and frequency. Furthermore, growth will also be helped by the fall in oil prices, which should last, and the resulting gains in household purchasing power should in turn fuel private consumption. These factors thus reflect an environment that is much more favourable and propitious for growth.

However, it is clear that this scenario depends on some volatile elements, such as the fall in oil prices and the weaker euro. The Chinese slowdown adds another element of risk to the scenario, which is based on the assumption that China will make a smooth transition from an export-oriented growth model to one driven by domestic demand. We expect the euro zone to grow at a rate of 1.5% in 2015 and 1.8% in 2016 and 2017. The main short-term risks to this scenario are negative. If oil prices go up and the euro doesn't stay down, and if the slowdown in the emerging countries turns into an economic and financial crisis, then growth worldwide and in the euro zone will be significantly lower. This risk is particularly critical given the very high level of unemployment still plaguing the zone (11% in August 2015). Nevertheless, given the pace of anticipated growth, we expect the unemployment rate to fall in 2016-2017 by around 0.6 percentage point per year. At this pace, it will take almost seven years to bring the rate back to its pre-crisis level. So while the prospects for recovery from the 2008 crisis are uncertain, the social crisis undoubtedly has a long time to run.

Investing in the zero carbon economy in order to escape secular stagnation

By [Xavier Timbeau](#)

What the downward revisions of various forecasts ([IMF](#), [OECD](#), [OFCE](#)) presented in early autumn 2015 tell us about the euro zone is not very comforting. A recovery is underway, but it is both sluggish and fragile (see: "[A very fragile recovery](#)"). The unemployment rate in the euro zone is still very high (almost 11% of the labour force in the second quarter), and a sluggish recovery means such a slow fall (0.6 point per year) that it will take more than seven years to return to the 2007 level. Meanwhile, the European Central Bank's unconventional monetary policy is having difficulty re-anchoring inflation expectations. The announcement of quantitative easing in early 2015 pushed up the 5-year/5-year forward inflation rate [\[1\]](#), but since July 2015 the soufflé has collapsed once again and medium-term expectations are 0.8% per year, below the ECB target (2% per year). Underlying inflation has settled in at a low level ([0.9% per year](#)), and there is a high risk that the euro zone will be frozen in a state of low inflation or deflation, strangely resembling what Japan has experienced from the mid-1990s to today. Low inflation is not good news because it is triggered by high unemployment and slowly rising nominal wages. The result is real wages growing more slowly than productivity. Little or no inflation means both real interest rates that remain high, which increases the burden of debt and paralyzes investment, but also an unconventional monetary policy that undermines the ability to measure risks and which gradually loses its

credibility for maintaining price stability, i.e. to keep inflation within declared targets. At the [Jackson Hole Symposium](#) in August 2014, Mario Draghi announced that, in the face of persistent unemployment, monetary policy cannot do everything. Structural reforms are necessary (what else could a central banker say?). But a demand policy is also needed. Not having one means [running the risk of secular stagnation](#), as was formulated by Hansen in the late 1930s and recently brought up to date by Larry Summers.

Europe does not, however, lack investment opportunities. The [COP21 commitments](#), though timid, assume a reduction in CO₂ emissions (equivalent) per capita from 9 tons to 6 tons within 15 years, and investment will need to pick up pace in a big way if the change in global temperature is not to exceed 2°C. This means aiming to put an end to the use of petroleum and coal (or the large-scale development of carbon capture and storage) within 35 years. Achieving this will require investment on a massive scale, which is estimated in the [European Commission's Energy Road Map](#) at over 260 billion euros (nearly 2% of GDP) per year by 2050. The social profitability of such investments is substantial (since it helps to avoid climate catastrophe and makes it possible to meet the EU's commitments to the world's other countries), but – and this is the problem posed by our sluggish recovery – their private profitability is low, and uncertainty about future demand together with poor coordination could give pause to the “animal spirits” of our entrepreneurs. Secular stagnation results from the very low profitability of investments, particularly after taking into account the real rates anticipated and the risk of a more serious depression. To avoid this trap, the social returns on investment in a zero carbon economy need to become evident to all, and in particular they need to coincide with private returns. There are numerous tools that can do this. We can use carbon pricing and markets for trading in emission rights; we can use a carbon tax; we can develop certificates for new investments

(assuming we know how to ensure that they reduce CO2 emissions compared to an opposing counterfactual) or impose standards (if these are followed!). The difficulties of the transition and the acceptance of a relatively painful change in prices can be eased by compensatory measures (which have a budgetary cost, [see Chapter 4 of the IAGS 2015 report](#), but are part of the stimulation package). It might also be desirable to draw on monetary policy to amplify the stimulus (see [this proposal by Michel Aglietta and Etienne Spain](#)). The implementation of artillery like this to reduce emissions and boost the European economy is not straightforward and would require wrenching the institutional framework. But that's the price to pay in order to avoid sinking into a long period of stagnation which, with the inequalities and impoverishment that it would generate, would certainly break up the European project.

This text was published on *Alterecoplus* on 22 October 2015.

Lower taxation on business but higher on households

By [Mathieu Plane](#) and Raul Sampognaro

Following the delivery of the Gallois Report in November 2012, the government decided at the beginning of Francois Hollande's five-year term to give priority to reducing the tax burden on business. But since 2015, the President of the Republic seems to have entered a new phase of his term by pursuing the objective of reducing the tax burden on households. This was seen in the elimination of the lowest income tax bracket and the development of a new allowance mechanism that mitigates tax progressivity at the lower levels of income tax. But more

broadly, what can be said about the evolution of the compulsory tax burden on households and businesses in 2015 and 2016, as well as over the longer term?

Based on data provided by the INSEE, we have broken down trends in the tax burden since 2001, distinguishing between levies on companies and those on households (Figure). While this is purely an accounting analysis and is not based on the final fiscal impact, it nonetheless gives a view of the breakdown of the tax burden [\[1\]](#). In particular, this exercise seeks to identify the tax burden by the nature of the direct payer, assuming constant wages and prices (excluding tax). This accounting breakdown does not therefore take into account macroeconomic feedback and does not address the distributional and intergenerational impacts [\[2\]](#) of taxation.

For the period from 2001 to 2014, the data is known and recorded. They are *ex post* and incorporate both the effects of the discretionary measures passed but also the impact of fiscal gains and shortfalls that are sensitive to the business cycle. However, for 2015 and 2016, the changes in the tax burden for households and businesses are *ex ante*, that is to say, they are based solely on the discretionary measures that have an impact in 2015 and 2016 and calculated in the Social, Economic and Financial Report of the 2016 Finance Bill for 2016 [[Rapport économique social et financier du Projet de loi de finances pour 2016](#)]. They therefore do not, for both years, include [potential effects related to variations in tax elasticities that could modify the apparent tax burden rates](#). Furthermore, under the new accounting standards of the European System of Accounts (ESA) tax credits, such as the CICE, are considered here as reductions in the tax burden, and not as a public expenditure. Furthermore, the CICE tax credit is recognized at the tax burden level in terms of actual payments and not on an accrual basis.

Several major points emerge from this analysis of the recent period. First, tax rates rose sharply in the period 2010-2013,

representing an increase of 3.7 percentage points of GDP, [with 2.4 points borne by consumers and 1.3 by business](#). Over this period, fiscal austerity was relatively balanced between households and business, with the two experiencing a tax increase that was more or less proportional to their respective weights in the tax burden [\[3\]](#).

However, from 2014 a decoupling arose between the trends in the tax burdens for households and for business, which is continuing in 2015 and 2016. Indeed, in 2014, due to the impact of the CICE tax credit (6.4 billion euros, or 0.3 percent of GDP), the tax burden on business began to decline (by 0.2 GDP point), while the burden on households continued to rise (by 0.4 GDP point), mainly because of the hike in VAT (5.4 billion), the increase in environmental taxes (0.3 billion with the introduction of the carbon tax) and the increase in the contribution to the public electricity service (CSPE) (1.1 billion), together with the increase in social contributions for households (2.4 billion), mainly due to the rise in contribution rates to the general and complementary social security scheme and the gradual alignment of rates for civil servant with those for private-sector employees.

In 2015, the tax burden on business will fall by 9.7 billion euros (0.5 GDP point) with the implementation of the CICE tax credit (6 billion), the first Responsibility Pact measures (5.9 billion related to the first tranche of reductions in employer social security contributions, an allowance on the C3S tax base and a "*suramortissement*", an additional tax reduction, on investment), while other measures, such as those related to pension reform, are increasing corporate taxation (1.7 billion in total). Conversely, the tax burden on households should increase in 2015 by 4.5 billion (0.2 GDP point), despite the elimination of the lowest income tax bracket (-2.8 billion) and the reduction in self-employed contributions (-1 billion). The hike in the ecological tax (carbon tax and TICPE energy tax) and the CSPE together with

the non-renewal in 2015 of the exceptional income tax reductions of 2014 represent an increase in taxation on households of, respectively, 3.7 and 1.3 billion. Other measures, such as those affecting the rates of contributions to general, supplemental and civil servant pension schemes (1.2 billion), along with local taxation (1.2 billion), including the modification of the DMT0 tax ceiling and measures affecting tourist and parking taxes, are also raising taxes on households.

Table. Measures affecting household and corporate tax burdens - 2015 and 2016

In billion euros

	2015	2016
HOUSEHOLDS		
Income tax cut for low-income households	-2,8	-2,0
Ecology taxes + TICPE + CSPE	3,7	2,7
Change in VAT	0,5	-0,2
Local taxes	1,3	1,1
Elimination of PPE working tax credit		2,0
Old-age and CSA community autonomy tax	0,5	0,8
Other changes to social security contributions	0,8	0,1
Other measures	1,9	0,2
Reduction in self-employed contributions (Responsibility Pact)	-1,0	
Fight against tax fraud and avoidance	-0,4	-0,6
Total of measures affecting household tax burden	4,5	4,1
Total excluding fight against tax fraud and avoidance	4,9	4,7
BUSINESS		
CICE tax credit	-6,0	-0,3
C3S allowance (Responsibility Pact)	-1,0	-1,0
Elimination of exceptional IS corporate income tax (Responsibility Pact)		-2,3
Tax reduction on investments	-4,5	-3,5
Other measures affecting social security contributions	-0,4	-0,2
Other social contributions measures	1,1	1,0
Other measures	0,9	0,9
Fight against tax fraud and avoidance	0,2	-0,5
Total of measures affecting corporate tax burden	-9,7	-5,9
Total excluding fight against tax fraud and avoidance	-9,9	-5,4

Sources: PLF (Finance Act) 2016; OFCE calculations.

In 2016, the tax burden on business will fall by 5.9 billion (0.3 GDP point), mainly due to the second phase of the Responsibility Pact. Reductions in employer social security contributions on wages lying between 1.6 and 3.5 times the SMIC minimum wage (3.1 billion), the elimination of the corporate income tax (IS) surcharge (2.3 billion), the second

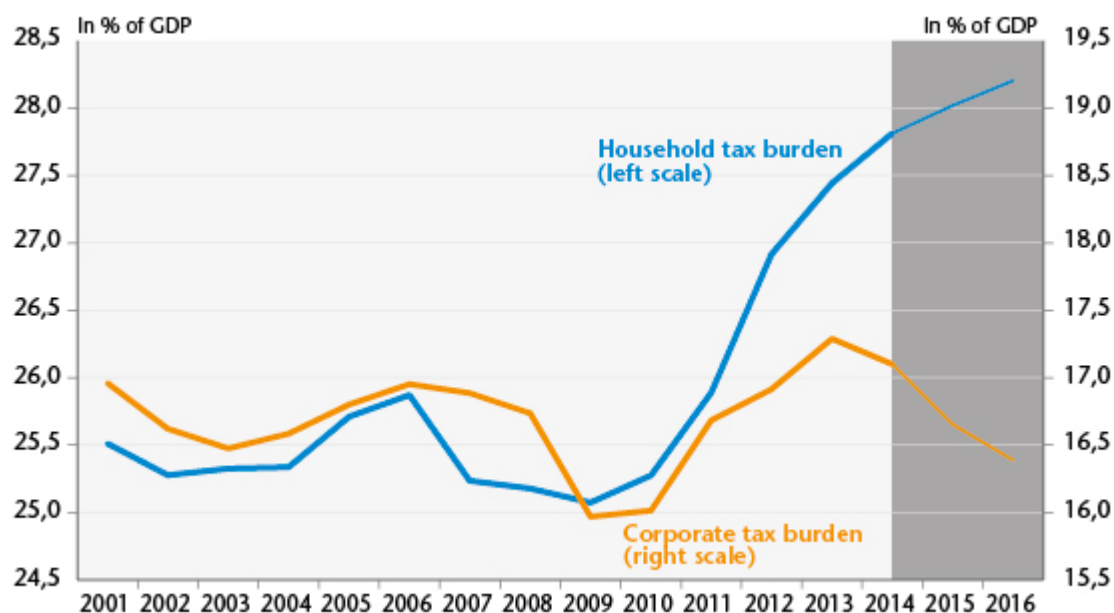
allowance on the C3S tax base (1 billion), the implementation of the CICE tax credit (0.3 billion) and the additional tax reduction on investment (0.2 billion) have been only partially offset by tax increases on business, mainly with the hike on pension contribution rates (0.6 billion). However, as in previous years, the tax burden on households will increase in 2016 by 4.1 billion (0.2 GDP point), despite a further reduction in income tax (2 billion). The main measures increasing household taxation are similar to those in 2015, including environmental taxation, with the hike in the carbon tax (1.7 billion) and the CSPE tax (1.1 billion), measures on financing pensions (0.8 billion), and the expected increase in local taxation (1.1 billion). Note that the elimination of the PPE working tax credit in 2016 will mechanically lead to an increase in the household tax burden of 2 billion^[4], but this will be offset by an equivalent amount for the new Prime d'activité working tax credit.

Ultimately, over the period 2010-2016, the household tax burden will increase by 66 billion euros (3.1 GDP points) and the burden on business by 8 billion (0.4 GDP point). The household tax burden will reach a historic high in 2016, at 28.2% of GDP. Conversely, the corporate tax burden in 2016 will amount to 16.4% of GDP, less than before the 2008 crisis. And in 2017, the last phase of the Responsibility Pact (with the complete elimination of the C3S tax and the reduction of IS corporate tax rates) and the expected CICE-related reimbursements should lead to cutting corporate taxation by about 10 billion euros, bringing the corporate tax burden down to the lowest point since the early 2000s.

The need to finance measures both to enhance corporate competitiveness and to reduce the structural deficit is placing the entire burden of the fiscal adjustment on households. Thus, the reduction in income tax in 2015 and 2016 will not offset the rise in other tax measures, most of which were approved in Finance Acts prior to 2015, and seems low in

relation to the tax shock that has hit households since 2010. However, how these recent tax changes affect growth and the consequent impact on inequality will depend on the way business makes use of the new resources generated by the massive decline in its tax burden since 2014. These funds could lead to a rise in wages, employment, investment or lower prices or to higher dividends and a reduction in debt. Depending on the way business allocates these, the impact to be expected on the standard of living in France and on inequality will not of course be the same. An evaluation of the impact of these changes on the tax burden will surely lead to future studies and debate.

Figure: Changes in the tax burden on households and business



Sources : Insee, PLF (Finance Act) 2016; OFCE calculations.

[1] The tax burden on households includes direct taxes (CSG, CRDS, IRPP, housing tax, etc.), indirect taxes (VAT, TICPE, CSPE, excise taxes, etc.), tax on capital (ISF, DMTG, property tax, DMT0, etc.), and salaried and self-employed social security contributions. The corporate tax burden includes the various taxes on production (value-added tax and corporate

property tax (ex-TP), property tax, C3S tax, etc.), taxes on wages and labour, corporate income tax and employer social security contributions.

[2] For example, employer social contributions for pensions are analyzed here as a tax burden on business and not as deferred wages for households or a transfer of income from assets to retirees.

[3] In 2013, 61% of the tax burden was on households and 39% on business. However, over the 2010-2013 period, tax increases were borne 64% by households and 36% by business, which was more or less their respective weights in taxation.

[4] The PPE credit will be replaced by the Prime d'activité working tax credit, in an equivalent amount, which also encompasses the RSA activité tax credit; for accounting purposes the PPE is considered as a public expenditure. However, this new measure should not change household income macroeconomically, but only the nature of the transfer. Thus, excluding the elimination of the PPE, the tax burden on households would increase by 2.1 billion in 2016.