2015-2017 forecasts for the French economy

By Mathieu Plane, Bruno Ducoudré, Pierre Madec, Hervé Péléraux and Raul Sampognaro

This text summarizes the **OFCE's economic forecast for the French economy for 2015-2017**

After a hesitant upturn in the first half of 2015 (with growth rates of 0.7% and 0% respectively in the first and second quarter), the French economy grew slowly in the second half year, with GDP rising by an average of 1.1% for the year as a whole. With a GDP growth rate of 0.3% in the third quarter of 2015 and 0.4% in the fourth quarter, which was equal to the pace of potential growth, the unemployment rate stabilized at 10% at year end. Household consumption (+1.7% in 2015) was boosted by the recovery in purchasing power due in particular to lower oil prices, which will prop up growth in 2015, but the situation of investment by households (-3.6%) and the public administration (-2.6%) will continue to hold back activity. In a context of sluggish growth and moderate fiscal consolidation, the government deficit will continue to fall slowly, to 3.7% of GDP in 2015.

With GDP growth in 2016 of 1.8%, the year will be marked by a recovery, in particular by rising corporate investment rates. Indeed, all the factors for a renewal of investment are coming together: first, a spectacular turnaround in margin rates since mid-2014 due to a fall in the cost of energy supplies and the impact of the CICE tax credit and France's Responsibility Pact; next, the historically low cost of capital, which has been helped by the ECB's unconventional monetary policy; and finally, an improvement in the economic outlook. These factors will lead to an acceleration of business investment in 2016, which will increase by 4% on

average over the year. Household consumption should remain strong in 2016 (+1.6%), driven by job creation in the market sector and by a slight fall in the savings rate. Fuelled by the rise in housing starts and building permits, housing investment will pick up (+3%), after shrinking for four years in a row. Foreign trade will be boosted by the impact of the euro's depreciation and the government's competitiveness policies, and will make a positive contribution to growth (+0.2 GDP point in 2016, the same as in 2015). Once the impact of the downturn in oil prices has fed through, inflation should be positive in 2016, but still low (1% on an annual average, after two years of virtual stagnation), a rate that is close to underlying inflation. The pace of quarterly GDP growth in 2016 will be between 0.5% and 0.6%: this will trigger a gradual closing of the output gap and a slow fall in the unemployment rate, which will end the year at 9.8%. The public deficit will be cut by 0.5 GDP point, due to savings in public spending, notably through the contraction of public investment (-2.6%), low growth in government spending (+0.9%), and the impact of the rise in tax revenues as the economy recovers.

Assuming that the macroeconomic environment remains favourable, the output gap is expected to continue to close in 2017. With GDP growth of 2%, the government deficit will fall further to 2.7% of GDP, passing below the 3% bar for the first time in 10 years. Under the impact of the government's employment policies and the absorption of the overstaffing by companies, the unemployment rate will continue to fall, to 9.4% of the active population by the end of 2017.

The COP 21 conference: the necessity of compromise

By Aurélien Saussay

On Tuesday, 6 October 2015, the United Nations Framework Convention on Climate Change (UNFCCC) released a preliminary version of the draft agreement that will form the basis for negotiations at the Paris Conference in December. Six years after the Copenhagen agreement, widely described as a failure, the French Secretariat is making every effort to ensure the success of COP 21 – at the cost of a certain number of compromises. Although the text's ambitiousness has been cut down, the strategy of taking "small steps" is what can make an agreement possible.

The project has renounced a binding approach, where each country's contributions were negotiated simultaneously, and replaced that with a call for voluntary contributions, where each country makes its commitments separately. This step was essential: the Kyoto Protocol, though ambitious, was never ratified by the United States, the world's principal emitter of carbon at the time – and it was the attempt to build a successor on that same model which resulted in the lack of agreement at Copenhagen.

The countries' commitments, called Intended Nationally Determined Contributions (INDC), fall into three broad categories: a reduction in emissions from the level of a given base year – generally used by the developed countries; a reduction in the intensity of emissions relative to GDP (the amount of GHGs emitted per unit of GDP produced); and finally, the relative reduction in emissions compared to a baseline scenario, called "business-as-usual", which represents the projected trajectory of emissions in the absence of specific measures.

Most emerging countries have chosen to express their targets in terms of intensity (China and India in particular) or relative to a baseline trajectory (Brazil, Mexico and Indonesia). This type of definition has the advantage of not penalizing their economic development – at the price, of course, of uncertainty about the level of the target: if economic growth exceeds the projections used, the target could be met even while the reduction in emissions achieved would be lower than expected. Moreover, part of the target is often indexed on the availability of financing and of technology transfers from developed countries – once again, a perfectly legitimate condition. Due to the contribution that having a plurality of targets makes to a fair distribution of efforts between developed, long-standing emitters and countries that have been developing recently, this represents an essential source of compromise.

With regards to the level of emissions targets set for 2030, while some are trivial – note the case of Australia, which is proposing *to increase* its emissions over 1990 levels – many involve accelerating existing efforts. To meet its commitments, Europe must reduce its emissions twice as rapidly from 2020 to 2030 as it does in the previous decade, and the United States one-and-a-half times; China will need to reduce its carbon intensity three times faster than it has in the last five years, and India two-and-a-half times faster.

As a guide, if the INDCs made public to date were fully realized, then according to the research consortium Climate Action Tracker [1], global temperatures would rise 2.7 °C above pre-industrial levels by the end of the century. This simple calculation must, however, be qualified, since the plan is for commitments to be revised every five years, and they can only be tightened. This system of iterative negotiations should make it possible to move steadily closer to the goal of 2°C that is still being upheld officially.

To be effective, it is necessary to check on whether these

commitments are actually met, which requires independent monitoring. In this respect, while guidelines have been highlighted in the current version of the draft agreement, the final negotiations will need to clarify the mechanisms actually used. In the absence of an effective verification procedure, successive revaluations of commitments could turn into a global game of liar's poker, and ultimately undermine the fight against climate change.

Moreover, the existence of relatively ambitious commitments should certainly not delay the implementation of the necessary adaptation measures, which are at present the subject of a single article in the provisional draft, with no reference to the funding that will be devoted to this. This is one of the project's main weaknesses, as the question of funding is barely mentioned – the Green Climate Fund, which was to be endowed with 100 billion dollars by 2010, has received only 10.2 billion to date.

In turning the page on Copenhagen, the draft agreement for Paris could constitute a real step forward for climate protection. It is the result of a change in method and a series of compromises which, though scaling down ambitions, are absolutely necessary to the very existence of an agreement. Demanding greater requirements for the proposal's targets could lead to the failure of the negotiations, which would be far more damaging. In its current version, the draft agreement provides a robust foundation for the future coordination of efforts against climate change.

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[1] The Consortium of the following research organizations: Climate Analytics, Ecofys, NewClimate Institute, and Potsdam Institute for Climate Impact Research.

Slowing growth: due to the supply side?

By Jérôme Creel and Xavier Ragot

The weakness of the recovery in 2014 and 2015 raises the need for a structural re-examination of the state of France's productive fabric. Indeed, an analysis of investment dynamics, the trade balance, productivity gains and business margins, and to a lesser extent companies' access to credit, indicates the existence of some disturbing trends since the early noughties. In addition, the persistence of the crisis inevitably poses the question of the unravelling of France's productive fabric since 2007 due to a combination of low growth, weak investment and numerous bankruptcies.

The contributions gathered in *Revue de l'OFCE* no.142 have a double ambition: first, to put France's businesses and economic sectors at the heart of reflection about the ins and outs of the current slowdown in growth, and second, to question the basis for theoretical analyses of future growth in light of the situation of France and Europe. Based on the various contributions, nine conclusions emerge:

1) Growth potential, a concept that aims to measure an economy's medium-term productive capacity, has fallen in France since the crisis. While the level of potential growth is high over the long term, on the order of 1.8%, it has fallen since the crisis by about 0.4 point, according to the new measurement provided by Eric Heyer and Xavier Timbeau.

2) The main point is to figure out whether this slowdown is temporary or permanent. This is important for growth forecasts but also with respect to France's European commitments, which

depend on its growth potential. One important conclusion is that a very large portion of the current slowdown is transitory and linked to France's economic policy. As Bruno Ducoudré and Mathieu Plane demonstrate, the low level of investment and employment can be explained by the macroeconomic environment and in particular by the current sluggish economy. Business behaviour does not seem to have changed during the crisis. The analysis by Ducoudré and Plane also shows that the determinants of investment differ in the short term and the long term. A 1% increase in economic activity increases investment by 1.4% after one quarter, whereas a 1% increase in the margin rate has very little impact in that same period. However, over the long term (10 years), a 1% increase in activity boosts investment by about 1%, while a 1% increase in the margin rate boosts investment by 2%. So promoting investment means supporting economic activity in the short term, while boosting margins will have an impact over the longer term.

3) France's productive fabric will take time to recover from the effects of the crisis because of three major obstacles: the weakness of investment, of course, but also the decline in the quality of investment and finally the disruption of production following on from the poor allocation of capital during the crisis, including its territorial dimension. Sarah Guillou and Lionel Nesta show that the low level of investment makes it impossible to go upmarket, which has meant less technical progress since the crisis. Jean-Luc Gaffard and Lionel Nesta then show that regional convergence has slowed since the crisis, and that economic activity has tended to decline in the most productive areas.

4) The concept of growth potential as a tool for macroeconomic management has emerged from the crisis in a profoundly weakened state. Whatever the methods used, ongoing revisions of growth potential make the idea of a system of rules-based European guidance dangerous, according to Henri Sterdyniak.

There is a need to rediscover European economic policy that is discretionary in character. In addition, fiscal policy that is more contingent on macroeconomic and financial conditions needs to be better coordinated with the climate issue, as Jérôme Creel and Eloi Laurent argue.

5) The notion of secular stagnation, that is to say, a lasting weakening of growth, has led to intense debate. Two visions of secular stagnation are discussed. The first vision, associated with Robert Gordon, insists that technological progress has been exhausted. The second flows from the analysis of Larry Summers and stresses the possibility of a permanent demand deficit. Jérôme Creel and Eloi Laurent show the limitations of the analysis of Robert Gordon for France; in particular, French demographics are more an advantage for French growth than a hindrance. Gilles Le Garrec and Vincent Touzé show the possibility of a long-term demand deficit that would hinder capital accumulation, due to the central bank's inability to make further interest rate reductions. In this kind of environment, support for demand is necessary to get out of an unfavourable equilibrium between low inflation and high unemployment, which leads to a negative perception of growth potential. Changing expectations may require large-scale policies to stimulate economic activity, along with an acceptance of high inflation over the long term.

6) The analyses presented here therefore recognize the profound difficulties with France's productive fabric and recommend better coordination of public policy. Support for demand is needed rapidly in order to restore investment, followed by an ongoing progressive policy to boost the margins of companies exposed to international competition – so, according to Jean-Luc Gaffard and Francesco Saraceno, not a competitive shock, but rather support for business that takes into account the time profile of productive investment.

7) In the longer term, part of what can be characterized as the French supply-side problem is the result of poor European

adjustments, including the discrepancy in wages between Europe's major economies. The divergence between France and Germany since the mid-1990s has been impressive. Mathilde Le Moigne and Xavier Ragot show that German wage restraint is a singularity among European countries. They offer a quantification of the impact of this wage moderation on France's foreign trade and economic activity, and conclude that German wage restraint has contributed to an increase of more than 2 points in France's unemployment rate. A supply policy could also go by the name of a policy for European re-convergence.

8) The deep-going modernization of the productive fabric will depend on spaces for cooperation, collective learning and collaboration so as to nourish the creativity made possible by new technologies. These spaces need to recognize the importance of difficult-to-value intangible assets. In economies with an ageing workforce, advances in robotics and artificial intelligence should lead to enhancing potential productivity, according to Sandrine Levasseur. Cooperation also needs to be strengthened in two areas: the company and the territory. Within companies, partnership governance should help limit short-termist financial tendencies. With respect to territory, the definition of regional innovation systems should be the focus of a modern industrial policy, according to Michel Aglietta and Xavier Ragot.

9) Guillaume Allègre concludes that it is not so much the level of production that is disturbing as the inequitable distribution of the fruits of growth, however small these may be. The emerging consensus on the negative impact of inequality on economic growth should not obscure the real debate, which does not concern just the income gap, but also what that income makes it possible to consume, i.e. equal access to goods and services of equal quality. The key question is thus the content of production, more than simply growth.

Areva, Flamanville and Fessenheim: key players in France’s nuclear turn

By Sarah Guillou

The recent law on “the energy transition to green growth”, promulgated on 17 August 2015, plans for a fall in nuclear energy’s share of electricity production from 75% to 50% by 2025. It also caps the power of the country’s nuclear plants at 63.2 GW. This limit corresponds to current capacity and implies that any new reactor start-up (Flamanville, for example) must result in the closure of a reactor with equivalent power. The decision to postpone the expected closure of the Fessenheim plant comes under this and is now part of this energy equilibrium. The conditioning of the closure of Fessenheim is provoking discontent among all those who believed in the unconditional pledge of Francois Hollande during his presidential campaign.

This decision is coming in a new context for French nuclear power policy and in an international and technological situation that is leading the French state to abandon the country’s “all nuclear” approach. Areva, Flamanville and Fessenheim are key players in this shift.

Act I began with the revelation of Areva’s losses. In early 2015, the announcement of a loss of almost 5 billion euros for fiscal year 2014 relegated the company from first class status to a company in difficulty, alongside Alstom, whose energy

branch is being sold to General Electric, with completion this autumn. The Areva group had a turnover of slightly more than 8 billion euros in 2014. The group's problems are due to the simultaneous emergence of difficulties in its environment, including market and regulatory trends, technological constraints and changes in the competition (see "Areva, vaincue à la croisée des risques" [Areva: defeated at the crossroads of risk], *Note de l'OFCE*, no. 52, September 2015). With private and public governance having proved incapable of taking timely decisions to deal with these adverse developments, the moment for restructuring has come. Areva now needs 7 billion in financing for the 2015-2017 period (to cover losses and debt maturities, without including any provisions for the TVO site). The proposed agreement with EDF presented in late July concerns Areva NP.

Areva NP is already a joint venture of Areva and EDF that handles the construction of reactors and the assembly of fuel and services for the installed base; it accounts for half of Areva's sales. In late July 2015, it was duly accepted that EDF would increase its share of Areva NP's capital by injecting two billion euros, giving it between 52% and 75% of the capital, depending on the inputs of other investors, along with 400 million for the acquisition of other assets. It was also agreed that the additional costs related to the Finnish Olkiluoto OL3 reactor built by Areva would not be borne by EDF but by the State and Areva. There is still uncertainty about how to handle the risks related to the Flamanville reactor, and EDF is conditioning its commitments on lifting these risks.

Foreign capital could participate in replenishing the capital through the purchase of assets. The most likely candidates are Chinese firms, which are already partners of EDF (CNNC and CGNPC), and Mitsubishi, which has partnered with Areva (see above), alongside France's Engie (GDF Suez). The French government is prepared to bail out the company for at most 2

billion euros.

The integrated model of Areva is therefore on the rocks. Less than 15 years after its birth, Areva's industrial coherence is under question. The company has been forced to allow the entry of industry partners into its capital and into its vast range of expertise. Its activity is now concentrated on the fuel cycle (the extraction, enrichment and reprocessing of uranium), with nearly one-third of its workload ensured by its client EDF and by maintenance and decommissioning.

The refocusing strategy, market trends and the preferences incorporated in France's energy policies are mutually consistent. The nuclear market will be centred on the need to maintain plants in operating condition and on decommissioning. Just under 500 reactors are listed worldwide, so there is a vast market for maintenance and decommissioning. This is in fact the area where Areva has won contracts in recent years.

In Act II, Flamanville and Fessenheim found themselves bound by the new energy transition law, illustrating both the technological difficulties involved as well as the budgetary constraints. The completion of the construction of the Flamanville plant is meeting significant technical hurdles from the Nuclear Safety Authority. Its opening is, for the moment, subject to strong conditions. At the same time, the postponement of its opening means that the expected output of electricity production will have to do without it. The closure of the Fessenheim plant, promised for 2016, must therefore be delayed so as to avoid a transition in terms of electrical power output that will have to be filled in one way or another.

Without the capacity in the short run to replace the missing nuclear KWh by KWh from renewable energy, the replacement will have to be done using coal plants – going against the current targets for reductions in CO_2 emissions – or by importing electricity – which would hurt the trade balance and could

push up electricity prices. Given the necessity of postponing the closure of Fessenheim, the government will not fail to seize the political opportunity of the shortfall between the announcement of the plant's closure and its actual implementation.

Add to these factors the potential compensation – estimated at 5 billion euros – that EDF will request for the early closure of Fessenheim, and it is quite logical that the government is procrastinating as much as possible before deciding on the closing date.

Even today we still do not know the extent to which the State will recapitalize Areva. The government has clearly indicated that it would minimize the amount as much as possible, but for the most part it seems ready to allow foreign players in. So, concomitantly, the law on the energy transition is requiring a decrease in the share of nuclear power and the State is announcing that it can no longer finance the sector in the way it used to. More generally, the globalization of the industry, the rising cost of technology and safety requirements as well as the shift in the preferences of the average voter towards less nuclear power are all combining to redefine the State's commitment to nuclear energy.

The State is thus being politically and economically compelled to withdraw from its "all-nuclear" approach and to accept the end of everything "made in France". The final decisions that will be taken on Areva's future and on the fate of the plants in Fessenheim (which will undoubtedly close in the short term) and Flamanville (whose opening is compromised but financially necessary) will therefore mark a change in the era of nuclear policy, even if the recent energy transition law is subsequently amended by a new party in power.

Climate justice – the "Open Sesame" of the COP 21 climate conference

By Eloi Laurent

Climate negotiations cannot be limited to technical discussions between experts about the reliability of scientific data: they need to take the form of an open political dialogue that is nourished by ethical reflection involving the citizens. What should be the focus of this dialogue? With COP 21 opening in two months in Paris, it is becoming increasingly clear that the key to a possible agreement is not economic efficiency, but social justice. The "green growth" that was a goal in the past century has little mobilizing power in a world plagued by injustice. It is much more important to highlight the potential that resolute action against climate change holds for equality at the national and global level.

Three issues indicate how social justice is at the heart of the climate negotiations. The first concerns the choice of the criteria for allocating the carbon budget between countries in order to mitigate climate change (the approximately 1200 billion tons of carbon that remains to be emitted over the next three to four decade so as to limit the rise of ground temperatures to around 2 degrees by the end of the 21st century). Various indicators can be used both to estimate the carbon budget and to distribute it equitably among countries; while these indicators need to be discussed, we cannot under any circumstances ignore this issue in Paris. It is demonstrable that the application of hybrid but relatively

simple criteria on climate justice would lead to cutting global emissions almost in half over the next three decades, which would ensure meeting the goal of 2 degrees, and even targeting the increased rise in temperatures to 1.5 degrees, thereby enhancing the fairness of this common rule with respect to the most vulnerable countries and social groups.

The second issue concerns adaptation to climate change, that is to say, the exposure and sensitivity to extreme weather events and rising global temperatures that is differentiated between countries and social groups. Here too it is important to select relevant indicators of climate vulnerability to fairly allocate the available funding (which should increase to $100 billion per year by 2020). But it will be very difficult to mobilize the necessary sums without shifting the climate negotiations from the current quantitative logic to a price logic.

Finally, combatting inequality seems to be the most effective way to involve citizens in the climate dialogue. The fight against climate change must be understood not as a social threat or an opportunity for profit-making but as a lever for achieving equality: a chance to reduce disparities in human development between countries and within countries.

The case of China shows how constraints on cutting CO2 emissions can turn into a tool for reducing inequality: the limitation on coal consumption simultaneously reduces the country's greenhouse gas emissions and the damage caused to the Chinese population's health by fine particles, which are distributed very unevenly around the territory and therefore within the population. The same applies to the much desired regulation of automobile traffic in France's urban areas, which represents both a gain for health and a reduction in emissions related to mobility. This dual climate-health dividend (reducing emissions to contain global warming has an indirect effect, i.e. improving health) must therefore be at the heart of the Paris negotiations. The fight against climate

change offers a chance to reduce the inequalities that will be so devastating: by cross-checking the "social" map and the "climate" map, we can anticipate that the impact of heat waves will be felt strongest in regions where both climatic exposure and the share of elderly people living alone are at high levels. The climate risk is a socio-ecological risk. Inequality associated with this risk is environmental inequality [article in French]. The goal of COP 21 should not be to "save the planet" or even less to "save growth" but rather to "save our health" by protecting the most vulnerable from the worst of the climate crisis.

Financialisation and financial crisis: vulnerability and traumatic shock

By Jérôme Creel, Paul Hubert, Fabien Labondance

Since the mini-crash that took place in the Shanghai stock market in August, financial instability has resurfaced in the markets and the media and, once again, the link with financialisation has been evoked. The Chinese crisis resulted from a combination of real estate and stock market bubbles that were fed by the abundant savings of a middle class in search of high-yield investments. It feels like we've gone back almost ten years when what is considered the excessive financialisation of the US economy – with abundant savings from the emerging countries enabling the build-up of

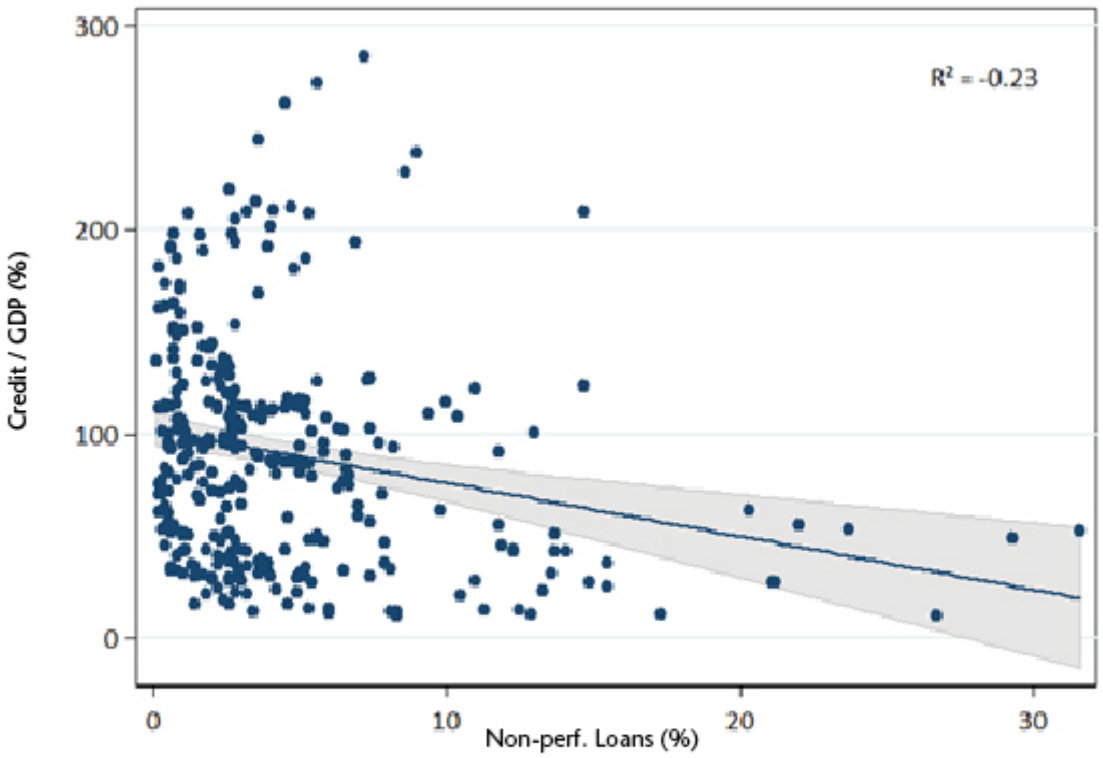
widespread US consumer debt – is treated as the cause of the financial instability and crisis that was triggered in the summer of 2007.

Is there really a link between, on the one side, increasing indebtedness and the great variety of financial investments, and on the other, volatile stock prices and a deterioration in the quality of bank loans? And if there is, what is the direction of the dynamics: from financialisation to financial instability, from financial instability to financialisation, or both at once? A rise in indebtedness could well lead to increasingly risky lending to agents who wind not being able to repay them, which would then lead to a financial crisis: this is one possible case. The occurrence of a crisis would change the behaviour of households and firms, causing them to reduce debt: this is the second case, in which financial instability reduces the financialisation of the economy. Depending on which is the case, the public policies needed differ. In the first, we need to monitor the degree of the economy's financialisation and target, for example, a maximum ratio of bank credit to GDP in order to prevent the rise and bursting of speculative bubbles. In the second case, there are two possibilities: to treat the causes, and thus to monitor the quality of loans to households and business so as to ensure the proper allocation of capital in the economy; or to treat the consequences by supporting productive investment to annihilate any rationing of credit.

In the course of the debate on the links between financialisation and financial instability, and on the consequences to be drawn in terms of public policy, the European situation is interesting for two reasons: the European Union has set up a system for monitoring external imbalances, including financial ones, from 2011, and a banking union since 2014. In a recent working paper, we look at this debate for several groups of countries in the European Union over the period 1998-2012.

At first glance, the relationship between these two concepts is not easy to demonstrate, as can be seen in the graph below. It shows a scatter plot that for each year and for each European country gives the levels of financialisation (approximated here by the share of credits / GDP) and of financial instability (approximated here by non-performing loans). The correlation between these variables is -0.23.

Figure. Financialisation and financial instability



Note: Non-performing loans, or bad debt, expressed as a percentage of total loans granted by banks.
Credit/GDP: total amount of bank credit expressed as a percentage of GDP.

Source : Creel et al. (2015) based on GFDD databases.

We test the two typical cases discussed above. We call the first case the vulnerability effect. As financialisation develops, it engenders a sort of euphoria that leads to granting loans that are increasingly risky, which fosters financial instability. This hypothesis derives from the work of Minsky (1995) [1]. We simultaneously test the potentially negative relationship between financial instability and financialisation, which we call the trauma effect. The very occurrence of financial instability as well as its impact

encourages economic agents to take less risk and to shed debt. Our estimates show that the link between financial instability and financialisation is not uni-directional. Contrary to what is suggested by the simple correlation coefficient, the sign of the relationship is not the same when looking at the effect of one variable on the other, and vice versa. Both the vulnerability and the trauma effect have been at work in the European countries. A macro-prudential policy intended to monitor the policy on granting bank loans, in terms of their volume and quality, therefore does indeed seem necessary in Europe.

We also tested the possibility that these effects are non-linear, that is to say, that they depend on reference values. The vulnerability hypothesis depends both on the level of financialisation (the higher it is, the stronger the relationship) and on time. This last point shows us that the positive relationship between financialisation and financial instability shows up at the moment of crisis for countries that are already heavily financialised. Finally, in the countries on the EU periphery [2], long-term interest rates and inflation rates greatly influence the financial instability variable. Consequently, it seems that for these countries there is a need for strong coordination between banking supervision and macroeconomic surveillance.

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[1] Minsky H. P. (1995), “Sources of Financial Fragility: Financial Factors in the Economics of Capitalism”, paper prepared for the conference, *Coping with Financial Fragility: A Global Perspective*, 7-9 September 1994, Maastricht, available at Hyman P. Minsky Archive. Paper 69.

[2] This group consists of Spain, Ireland, Italy, Greece, Portugal and the countries from the Eastern enlargements in 2004 and 2007. The establishment of this group is explained in the working paper.

The upward drift in senior unemployment continued in August

Analysis and Forecasting Department (France team)

The figures for the month of August 2015 published by France's Pôle Emploi job centre show a significant increase in the number of people registered as Category A (+20,000), i.e. an additional 156,000 job seekers over one year, following two months of relative stability. While this figure is undoubtedly disappointing, the uncertainty surrounding monthly fluctuations in enrolment at the job centre should not be forgotten. Despite the downturn in the numbers registered in categories B and C in the last month (-11,600), the number of job seekers who have carried out an active job search has risen by nearly 332,000 since August 2014.

This figure nuances the publication of the unemployment rate as defined by the International Labour Office (ILO), which gives a less negative image of the French labour market. This statistic points to a slight fall in the unemployment rate in the first six months (-0.1 point), largely due to shrinkage of the labor force (-0.2 point).

Beyond the total figure, the data published for August confirms the divergences observed between different age groups. While up to September 2010 the number of people aged 50 or over registered in Category A at the job centre was lower than for the under 25 age group, there are now 330,000

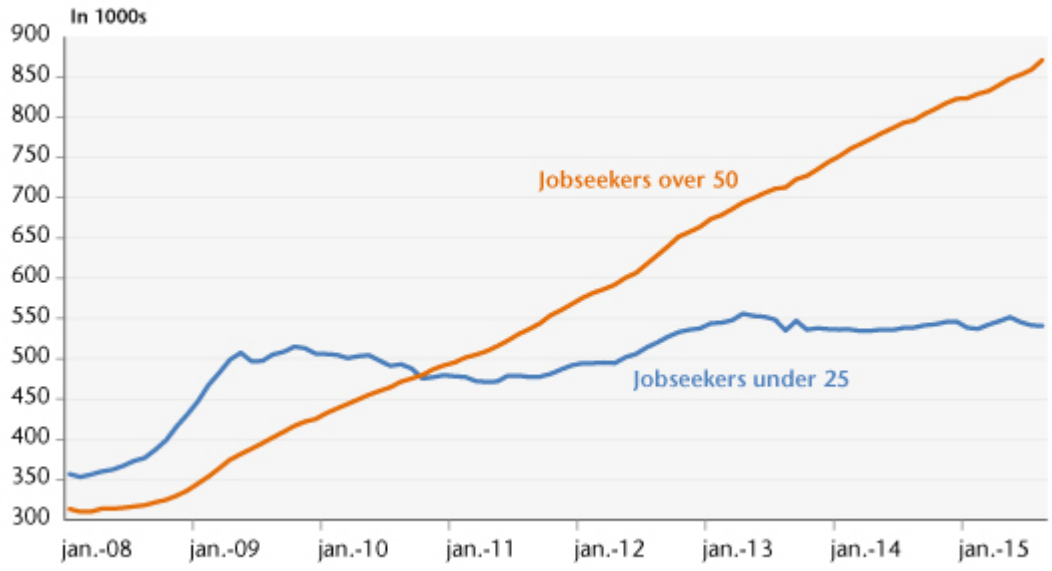
more unemployed seniors than unemployed youth (graph). The increase in this gap since 2010 is due to several factors. The implementation of a series of pension reforms (2003, 2010), coupled with the elimination of exemptions for seniors on job-seeking, has led to a longer duration of employment and a later statutory retirement age. In a context of weak growth, the rise in the rate of senior employment has been insufficient to absorb the growth in the workforce for that age group, resulting in a higher unemployment rate for the over 50s.

The weaker increase in the number of unemployed youth is the result of two main factors. First, the employment policies implemented since 2013 have targeted youth in particular, including the *emplois d'avenir* programme. Second, the weak job creation in the market sector has mainly taken the form of temporary jobs (CDD fixed-term and temporary contracts), an area in which young people are heavily represented (34.2% of young people in employment are on CDD contracts or temping, versus 8.4% for other age groups).

Finally, while seniors are unemployed less often than young people (4.6% of those aged 50-64 against 8.6% for 15-24-year-olds), they are more exposed to long-term unemployment. 62% of the seniors registered at Pole Emploi have been jobless for more than a year, against 21% of young people.

All this indicates that only a macroeconomic policy aimed at increasing the overall level of employment is capable of simultaneously dealing with unemployment among both young people and seniors. Otherwise, in a situation where employment is lacking overall, policies that are aimed at certain categories, even if effective for that specific target, may lead to adverse effects on other categories.

Figure. Jobseekers in Category A according to age



Source: Pôle Emploi.

The redistributive effects of the ECB's QE programme

By Christophe Blot, Jérôme Creel, Paul Hubert, Fabien Labondance and Xavier Ragot

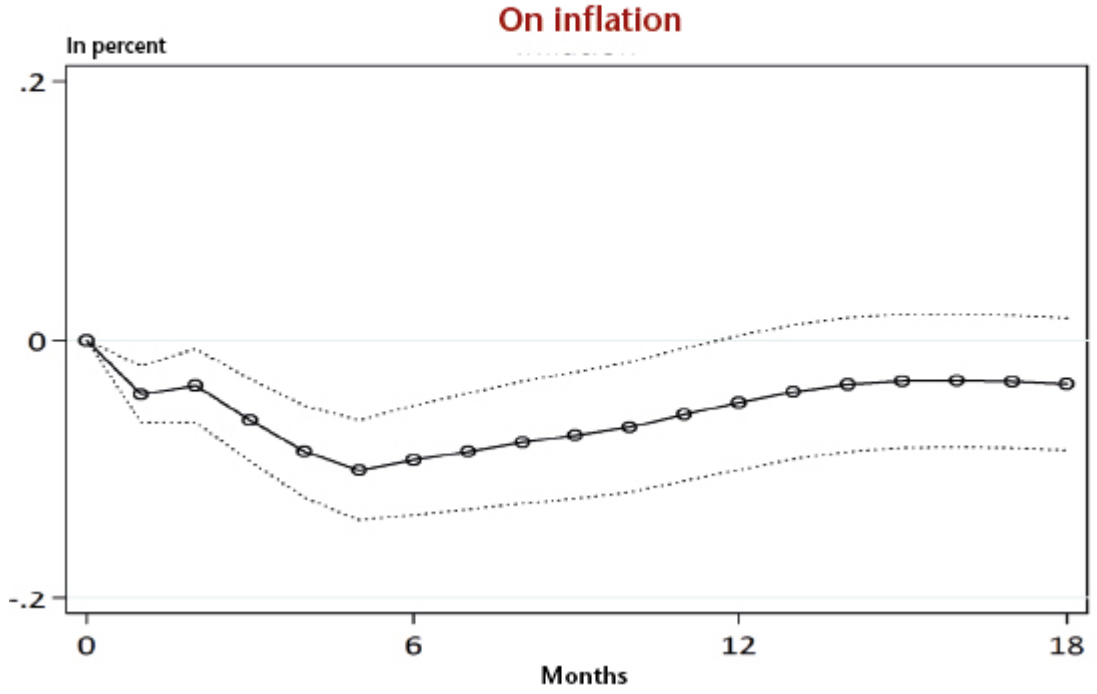
Rising inequality in income and wealth has become a key issue in discussions of economic policy, and the topic has inserted itself into evaluations of the impact of monetary policy in the US and Japan, the precursors of today's massive quantitative easing programmes (QE). The question is thus posed as to whether the ECB's QE policy has had or will have redistributive effects.

In a paper prepared for the European Parliament, Blot et al. (2015) point out that the empirical literature gives rise to two contradictory conclusions. In the US, the Fed's base rate

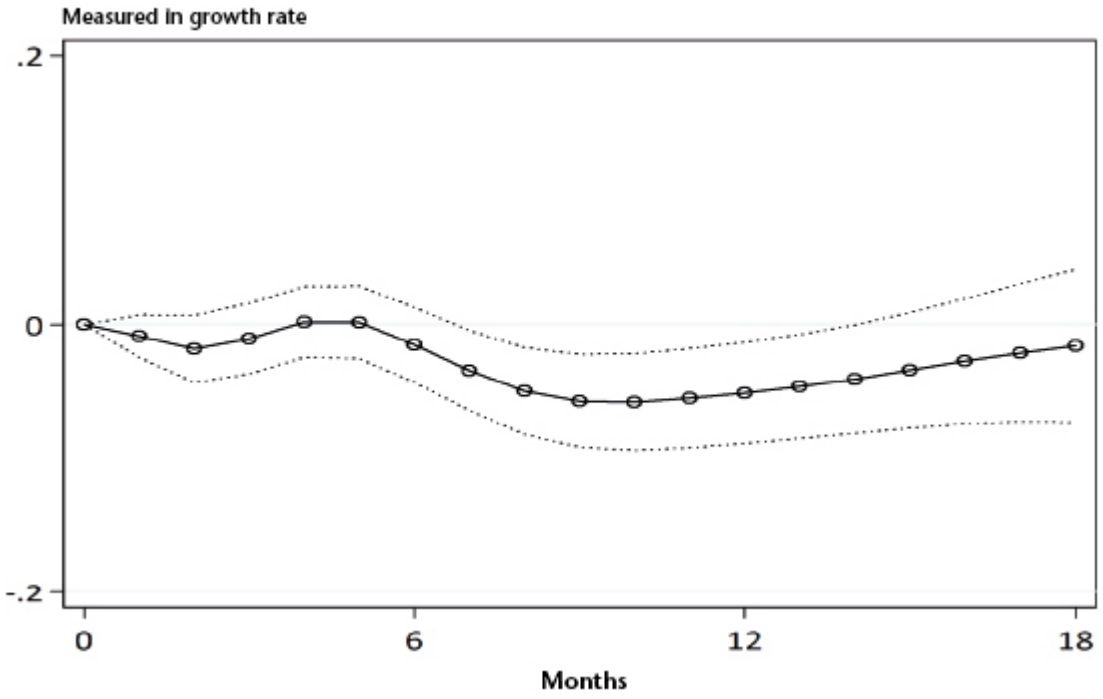
cuts tend to reduce inequality. Conversely, in Japan an expansionary QE type policy tends to increase inequality. So what's the situation in Europe?

Based on macroeconomic data aggregated for the euro zone as a whole, Blot et al. (2015) show that while European monetary policy, conventional and unconventional, have indeed had an impact on the unemployment rate, the number of hours worked and the rate of inflation (see graphs), this was limited. This result suggests that the ECB's expansionary monetary policy has tended to reduce inequality, but not by much. So when the ECB finally decides to wind up its expansionary policy, we can expect a slight increase in inequalities to follow. Because of this effect, though small, Blot et al. (2015) suggest that the ECB should be held accountable not just for price stability or economic growth, but also for the impact of its policies in terms of inequality and the mechanisms needed to take this into account.

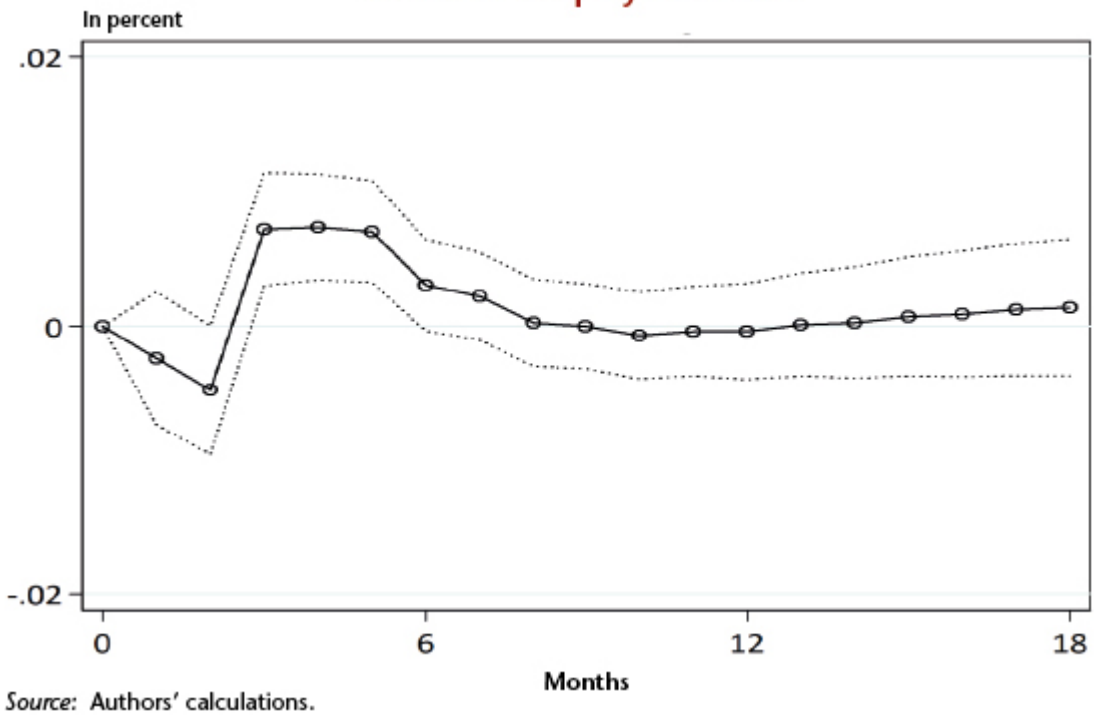
Figures. The impact of a restrictive monetary policy shock (0.2 percentage point hike in the implicit interest rate) in the euro zone...



On hours worked



On the unemployment rate



Source: Authors' calculations.

Wage moderation in Germany – at the origin of France's economic difficulties

By *Xavier Ragot, President of the OFCE, CNRS-PSE, together with Mathilde Le Moigne, ENS*

If the future of the euro zone does indeed depend on political cooperation between France and Germany, then economic divergences between the two countries should be a cause for concern. These divergences need to be analysed, with particular attention to three specific areas: the unemployment rate, the trade balance and the public debt. Germany's unemployment rate is falling steadily; in June it was under the 5% mark, which represents almost full employment, whereas the French rate is over 10%. Germany's low unemployment rate does not however reflect strong consumption by German households, but rather the country's export capacity. While France continues to run a negative trade balance (importing more than it exports), Germany is now the world's leading exporter, ahead of China, with a trade surplus that will run close to 8% in 2015. As for the public deficit, it will be around 3.8% in France in 2015, while Germany is now generating a surplus. This has impressive consequences for the way the public debt is changing in the two countries. In 2010 they were similar, at around 80% of GDP, but in 2014 Germany's public debt fell below 75%, and is continuing to decline, while France's debt has continued to grow, and has now hit 97%. This kind of gap is unprecedented in recent times, and is fraught with mounting tension over the conduct of monetary policy.

This triple divergence is inevitably leading to differences in the political response, with respect to the population's ability to take in migrants and to the understanding of

countries facing economic difficulties, such as Greece, but also with respect to the ability to cope with future economic crises. Economic divergence will become political divergence. The point is not to idealize the German situation, which is characterized by a large number of workers who have failed to benefit from the fruits of growth, as is shown in a recent study by France Stratégie, as well as by a rapid decline in population. This should not stop us from taking a hard look at the economic gap arising between the two countries.

What are the reasons for Germany's commercial success?

Many factors have been advanced to explain the divergence between the two neighbours: for some, it's a matter of the German strategy – outsourcing value chains, aggressive wage moderation, fostering competition between companies – and for others, French weaknesses: poor geographical and / or sectoral specialization, insufficient public support for exporters, and a lack of competition in certain sectors. Our recent study emphasizes the delayed impact of German wage moderation and suggests that this could explain almost half of the Franco-German divergence. To understand the mechanisms involved, it is necessary to distinguish between the sectors exposed to international competition and the sectors that are sheltered. The exposed sectors include industry, but also agriculture, including animal husbandry, which is currently in the news, and some services that can be traded. The sheltered sector includes transportation, real estate, retailing and a large part of personal services.

While unit labour costs in France have risen regularly and at similar levels in the two above-mentioned sectors, they have remained extraordinarily stable in Germany for nearly ten years. This wage moderation is the result of both poor management of German reunification, which tipped the balance of power during wage negotiations in favour of employers, and, to a much less extent, the introduction of the Hartz reforms in 2003-2005, which aimed to create low-paid work in the less

competitive sectors (particularly the sheltered sector). The cost of German reunification is estimated at 900 billion euros, in terms of transfers from former West Germany, or slightly less than three times the Greek debt. Faced with this kind of challenge, the wage moderation initiated in 1993 represented a strategy for re-convergence between the two parts of Germany. In 2012, German nominal wages were 20% lower than French wages in the exposed (tradable) sector and 30% lower in the sheltered sector, compared to the 1993 levels. A look at French and German margin levels shows that in the exposed sector, French exporters have made significant efforts by reducing their margins in order to maintain their price competitiveness. In the sheltered sector, French margins are on average 6% higher than German margins. The bulk of France's loss of price competitiveness is therefore a loss of cost competitiveness.

How much have these differences contributed to unemployment and the trade balance in the two countries? Our quantitative analysis shows that if German wage restraint had not taken place between 1993 and 2012, today's 8% gap in the trade balances would instead be 4.7% (2.2% of this being due solely to German wage moderation in the sheltered sector). Thus, Germany's wage moderation policy explains almost 40% of the difference in trade performance between the two countries. We also found that this wage moderation accounts for more than 2 points of France's unemployment.

The non-price competitiveness gap

This leaves nearly 60% of the difference in the trade balances still needing to be explained. Our study suggests that this difference is due to the quality of the goods produced, so-called non-price competitiveness. Between 1993 and 2012, the German quality-price ratio increased by around 19% compared with that of France, which has therefore more than offset the rise in German export prices relative to French prices. There is clearly a "quality" effect in this non-price

competitiveness: Germany produces “high end”, more innovative goods than France does in the same sectors. It is also possible to see an impact due to the outsourcing of some German production (nearly 52% of production volume in 2012) to countries where costs are lower: Germany today is a centre for design and assembly, which saves money on its intermediary costs, enabling it to invest more in brand strategies and efforts to move upscale.

This effect is nevertheless probably endogenous, that is to say, it flows in part from Germany’s advantage in cost competitiveness. Low labour costs have enabled German exporters to maintain their margins in the face of external competition. The funds generated have led to investments which French companies have probably had to forego in order to maintain their price-competitiveness, thus losing the opportunity to catch up with German products in terms of non-price competitiveness over the longer term.

A positive way out and up

The root cause of the gap in economic performance between Germany and France lies in the nominal divergence observed between the two countries since the early 1990s. One way to reduce these differences would be to promote convergence in wages in Europe and in its labour markets more generally. Germany would need to allow wage inflation that was higher than in the periphery countries, thereby dealing with the increase in social inequalities in Germany, while France must not fall into the trap of competitive deflation, which would destroy its domestic demand, while keeping wage movements under control. In this respect, the report of the five Presidents presented by the European Commission on 22 June 2015 proposes the establishment of national competitiveness authorities, which hopefully would allow greater cooperation on social welfare and employment.

The difference in wages between France and Germany has

profound implications in terms of economic thought. The increased trade integration that followed the introduction of the euro led not to a convergence but to a divergence in labour markets. It is then up to each State to once again bring about convergence of the economies while supporting economic activity. This State intervention in the economy is more complex than the simple Keynesian framework for the management of aggregate demand, and now involves the convergence of labour markets. Heretofore, Europe's response has been systematic cuts in labour costs, while what is really needed is to increase wages in surplus countries, such as Germany, for example by using the minimum wage as a tool. All this, it is true, is economics. The politics begins when we realize that only long-term cooperation can bring about a convergence in national interests.

Unemployment: a fall by temping

by Analysis and Forecasting Department (France team)

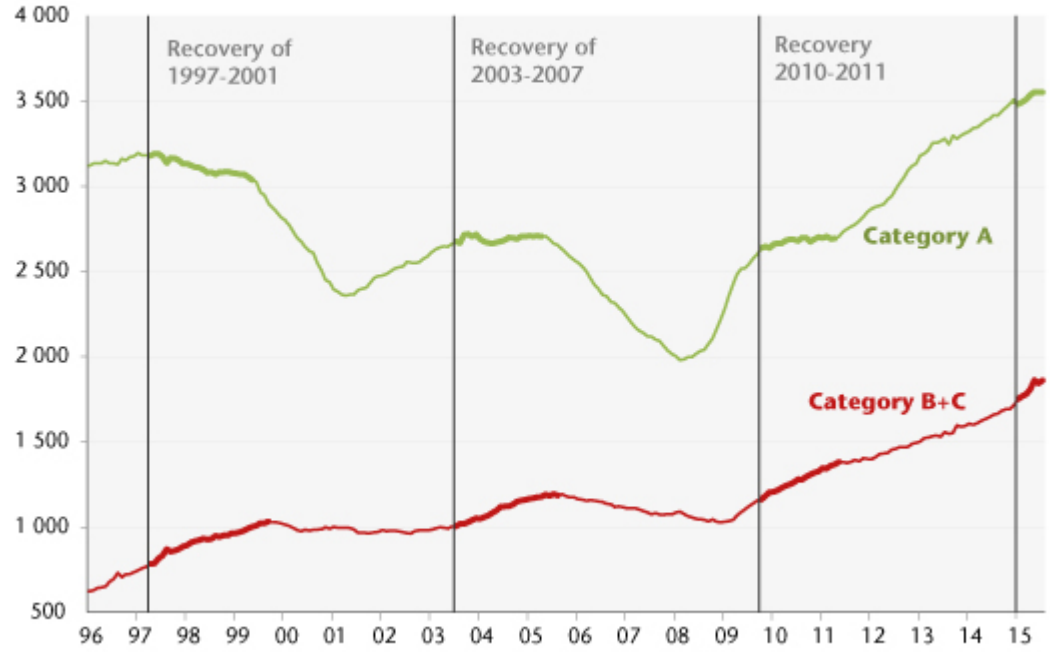
The unemployment figures for the month of July 2015 indicate a slight fall (-1900) in the number of people registering in category A. There is still too much uncertainty about monthly changes in enrolment at France's Pôle Emploi job centre to conclude that there has been a lasting improvement in the state of the labour market. However, the increase observed since January 2015 (+50,900 registered in category A) is smaller in scale than the figures recorded for this same period during the past three years (+128,500 on average for

the first seven months of the previous three years). It is comparable to the situation in 2010-2011 (+44,300 on average in the first seven months of both years), which were years of renewed growth.

Seen in the context of the first buds of recovery, this trend in unemployment is not surprising. First, the pick-up in GDP growth observed in the first six months (+0.7% according to preliminary accounts published by the INSEE) is expected to gain pace in the coming quarters. For now, this recovery has meant a rise in salaried employment of +26,600 in the competitive sector during the first six months of 2015. This has been sufficient to limit the increase in unemployment, without however reversing it, as labour force numbers have increased by about 75,000 during the half year.

Furthermore, the increase in registrations in categories B and C [1] has been more marked than for category A (+145,600 since the year's start). This is due partly to some switching by the jobless in category A into these other categories, which reflects an increase in precarious employment that is consistent with the increase in temporary jobs in the first half year (+11,600): historically, an improvement in the labour market starts with an increase in precarious jobs (fixed term, temporary). This is also coinciding with an increase in job offers collected by Pôle Emploi, as well as with exits from the job centre due to a return to work, a figure that reflects a return to levels comparable to those observed in 2010-2011.

Figure. Enrolment in the Pôle Emploi job centre by category



Source : Pôle Emploi.

Finally, the trends differ by age group: the number of people under age 25 registered in category A is 4,600 lower than its level at year-end 2014. In fact, the young, who are over-represented in so-called temporary jobs (34.2% of young people in work are on fixed-term CDD contracts or are temping, compared with 8.4% of those in other age groups), benefit from the creation of this type of job, and from the increase in subsidized jobs that are targeted specifically at their age group. Conversely, the enrolment in category A of people aged 50 and over is rising steadily (+36,100 since the year started). 62% of those aged 50 and older have been enrolled in the job centre for over a year, versus an average of 39% for other age groups.

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[1] These categories group people who have worked on reduced hours during the month, but are still registered at Pôle emploi.