

France's battered growth

By the Analysis and Forecasting Department

This text summarizes the 2016-2017 forecast for the French economy. [Click here to consult the full version, in French.](#)

The news on 28 October that French economic growth came to 0.2% in the third quarter of 2016 constitutes a cyclical signal that is consistent with our analysis of the state of France's economy. This figure is close to our latest forecast (+0.3% forecast for the third quarter) and in line with our growth scenario up to 2018.

After three years of sluggish growth (0.5% on average over the period 2012-14), activity picked up moderately in France in 2015 (1.2%), driven by falling oil prices, the depreciation of the euro and a lowered level of fiscal consolidation. For the first time since 2011, the French economy has begun to create jobs in the private sector (98,000 for the year as a whole), which has been encouraged by tax measures that cut labour costs. Combined with an increase in the number of employees in the public sector (+49,000) and the creation of non-salaried jobs (+56,000), the number of unemployed according to the ILO fell in 2015 (-63,000, or -0.2 percentage point of the active population). Meanwhile, boosted by additional tax cuts on industrial equipment, business investment has revived in 2015 (+3.9% yoy).

French growth has been below that of the rest of the euro zone since 2014; in addition to the fact that it did better over the period 2008-2013, this is due to two major factors: first, France made greater fiscal adjustments than its European neighbours over the period 2014-16, and second, exports did not contribute much to growth, even though the fiscal approach to supply policy aimed to restore the competitiveness of French business. It seems, however, that since 2015 French

exporters have chosen to improve their margins rather than to reduce their export prices, with no impact on their export volumes. While for a number of quarters now this behaviour has resulted in falling market share, this might still turn out to be an asset in the longer term due to strengthening the financial position of the country's exporters, especially if these margins are reinvested in non-cost competitiveness and lead to upgrading the products manufactured in France.

In 2016, despite a strong first quarter (+0.7%) driven by exceptionally strong domestic demand excluding stock (+0.9%), GDP growth will peak at 1.4% on average over the year (see table). The mid-year air pocket, which was marked by strikes, floods, terrorist attacks and the originally scheduled end of the investment tax reduction, partly explains the weak recovery in 2016. As a result of the pick-up in margin rates, the historically low cost of capital and the extension of the investment tax cut, investment should continue to grow in 2016 (+2.7% yoy). The creation of private sector jobs should be relatively dynamic (+149,000), due to support from the CICE competitiveness tax credit, the Responsibility Pact and the *prime à l'embauche* hiring bonus. In total, taking into account unwaged employees and the workforce in the public sector, 219,000 jobs will be created in 2016. The unemployment rate will fall by 0.5 point over the year, of which 0.1 point is linked to the implementation of the "training 500,000" programme, so at year end will come to 9.4% of the workforce. Meanwhile the public deficit will drop to 3.3% of GDP in 2016, after a level of 3.5% in 2015 and 4% in 2014.

In 2017, France's economy will grow at a 1.5% rate, which will be slightly above its potential rate (1.3%), as the country's fiscal policy will not hold down GDP for the first time in seven years. On the other hand, in contrast to the forecast last spring, France will have to confront two new shocks: the negative impact of Brexit on foreign trade and the terrorist attacks' influence on the number of tourists. These two shocks

will cut 0.2 percentage point off GDP growth in 2017 (following 0.1 point in 2016). The French economy will create 180,000 jobs, including 145,000 in the private sector, reducing the unemployment rate by “only” 0.1 point, due to the rebound in the labour force as people who benefit from the training programme gradually re-join the workforce. The renewed rise in oil prices and the depreciation of the euro will see inflation rising to 1.5% in 2017 (after 0.4% in 2016). Finally, the government deficit will be 2.9% of GDP in 2017, back below the 3% threshold for the first time in ten years. After stabilizing at 96.1% of GDP in 2015 and 2016, the public debt will fall slightly, down to 95.8% in 2017.

The French economy though battered by new shocks and with the wounds from the crisis far from having healed, is recovering gradually, as can be seen by the gradual improvement in economic agents’ financial position: business margins are up, household purchasing power has rebounded, the deficit is down and the public debt has stabilized.

Table. Summary of the forecast for France

Change from the preceding period, in %

	2016				2017				2015	2016	2017	2018
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4				
GDP	0.7	-0.1	0.3	0.5	0.4	0.4	0.4	0.4	1.2	1.4	1.5	1.5
GDP / capital	0.6	-0.2	0.2	0.4	0.3	0.3	0.2	0.3	0.8	0.9	1.0	1.0
Household consumption	1.1	-0.1	0.2	0.5	0.3	0.3	0.3	0.3	1.5	1.5	1.3	1.3
Public consumption	0.4	0.4	0.2	0.2	0.2	0.2	0.3	0.3	1.4	1.5	1.0	1.2
Total GFCF, of which:	1.3	-0.2	0.4	0.6	0.7	0.4	0.4	0.4	0.9	2.7	1.9	1.4
<i>Private production</i>	2.1	-0.4	0.4	0.6	0.8	0.4	0.4	0.4	2.7	3.7	1.9	1.4
<i>Housing</i>	0.1	-0.3	0.3	0.6	0.6	0.7	0.5	0.4	-0.8	0.4	2.0	1.5
<i>Public</i>	0.1	0.7	0.4	0.5	0.5	0.5	0.4	0.4	-3.9	2.5	1.9	1.2
Exports of goods and services	-0.4	0.2	0.5	0.5	0.6	0.6	0.6	0.6	6.0	0.8	2.2	2.5
Imports of goods and services	0.2	-1.8	0.5	0.4	0.5	0.5	0.5	0.5	6.4	1.8	1.3	2.0
<i>Contributions :</i>												
Non-inventory domestic demand	0.9	0.0	0.2	0.5	0.4	0.3	0.3	0.3	1.4	1.8	1.4	1.3
Change in Inventory	-0.1	-0.8	0.1	0.0	0.0	0.0	0.0	0.0	0.1	-0.1	-0.1	0.1
Foreign trade	-0.2	0.6	0.0	0.0	0.0	0.0	0.0	0.0	-0.3	-0.3	0.2	0.1
Consumer prices (HICP), Q/Q-4	0.0	0.1	0.4	0.9	1.8	1.1	1.5	1.6	0.1	0.4	1.5	1.6
Unemployment rate	9.9	9.6	9.5	9.4	9.4	9.4	9.4	9.3	10.1	9.6	9.4	9.3
Household savings rate (% of GDI)	14.5	14.8	14.9	14.7	14.6	14.5	14.6	14.7	14.5	14.7	14.6	14.6
Margin rate of non-fin corp. (% of VA)	32.2	31.7	31.8	31.8	31.9	31.8	31.8	31.7	31.4	31.9	31.8	31.8
Public deficit (% of GDP)									-3.5	-3.3	-2.9	-2.4
Public debt (% of GDP)									95.8	96.1	95.8	95.3

Sources: INSEE, OFCE forecasts 2016-2018.

The critique of capital in the 21st century: in search of the macroeconomic foundations of inequalities

By [Guillaume Allègre](#) and [Xavier Timbeau](#)

In his book *Capital in the 21st Century*, Thomas Piketty offers a critical analysis of the dynamics of capital accumulation. The book is at the level of its very high ambitions: it addresses a crucial issue, it draws on a very substantial statistical effort that sheds new light on the dynamics of distribution, and it advances public policy proposals. Thomas Piketty combines the approach of the great classical authors (Smith, Ricardo, Marx, Walras) with impressive empirical work that was inaccessible to his illustrious predecessors.

Thomas Piketty shows the mechanisms pushing towards a convergence or divergence in the distribution of wealth and highlights how the strength of divergence is generally underestimated: if the return on capital (r) is higher than economic growth (g), which historically has almost always been the case, then it is almost inevitable that inherited wealth will dominate built-up wealth, and the concentration of capital will reach extremely high levels: "The entrepreneur inevitably tends to become a rentier, more and more dominant over those who own nothing but their labour. Once constituted, capital reproduces itself faster than output increases. The past devours the future."

The book thus seeks the basis for inequality in macroeconomics ($r > g$), whereas the usual suspects are found at the

microeconomic level. In [OFCE Working document no. 2014-06 \[in French\]](#), we argue that this macro-foundation for inequality is not convincing and that the same facts can be interpreted using a different causality, in which inequality arises from the operation of (imperfect) markets, scarcity rents and the establishment of property rights. It is not $r > g$ that turns entrepreneurs into rentiers, but the establishment of mechanisms that allow the extraction of a perpetual rent that explains the historical constancy of $r > g$.

This different interpretation of the same phenomena has consequences for public policy. The *ex post* taxation of capital, where necessary, can only be a second-level choice: first the constraints of scarcity have to be removed and the definition of property rights and the rights of owners and non-owners must be defined. Are landlords going to be free to charge any rent they like? Can they limit other construction around their property? How much protection is labour law going to give workers? To what extent can they influence managerial decisions within the company? In our opinion it is the answers to these questions that determine the relationship between economic growth and the return on capital, as well as capital's weight in the economy. The point is to prevent owners of capital from exploiting a favourable balance of power. In this respect, while its shape has changed, capital in the twenty-first century is much like it was in the late nineteenth century. Dealing with it will require more than a tax on capital.

For more information, see: "La critique du capital au XXI^e siècle : à la recherche des fondements macroéconomiques des inégalités", [Document de travail de l'OFCE, n°2014-06](#).

A recession is not inevitable

By Marion Cochard, Bruno Ducoudré and Danielle Schweisguth

The cold blast from the autumn forecasts continues with the publication of the European Central Bank's latest forecasts. Revising its growth outlook for the euro zone downwards (to -0.3% for 2013, against the forecast of 0.9% in September), the ECB in turn is now pointing to the reinforced austerity measures and the growing impact of uncertainty in the financial markets. It is clear that the intensity of the fiscal consolidation is paralyzing growth in the euro zone through the interplay of the fiscal multipliers, while not managing to restore confidence. In this note we show that the recessionary spiral that the euro zone is getting sucked into is not an inevitability.

In the first edition of the [2013 iAGS report](#), which was produced in partnership with the German IMK institute and the Danish ECLM institute, the OFCE offers an alternative strategy to the current fiscal consolidation policy. This alternative would make it possible to restore growth in the medium term while still meeting the European budget commitments. As Jérôme Creel showed in his latest post, ["Could France have a different fiscal policy?"](#), there is room for budgetary manoeuvring in a way that is consistent with the current treaty framework.

Under the aegis of the European Commission, the European countries have pledged to continue their austerity programmes from 2013 to 2015 on a relatively large scale, especially if we take into account the efforts already made. Apart from Germany, where the cumulative fiscal impulse will be virtually nil, most European countries are planning to reduce their primary structural deficit by more than 2 GDP points between 2012 and 2015 (from -1.4 points for Finland to -7.5 points for Greece, cf. the table).

Table. Cumulative fiscal impulses in the euro zone

In GDP points

	Germany	France	Italy	Spain	Netherlands	Belgium	Greece	Portugal	Ireland	Austria	Finland
2010-2012	0,1	-4,1	-4,7	-7,0	-2,3	-1,5	-18,3	-9,1	-8,3	-1,1	-3,3
2013-2015	-0,3	-2,9	-2,1	-4,2	-2,9	-2,2	-7,5	-2,6	-5,7	-1,8	-1,4

Source : Eurostat data, iAGS simulations.

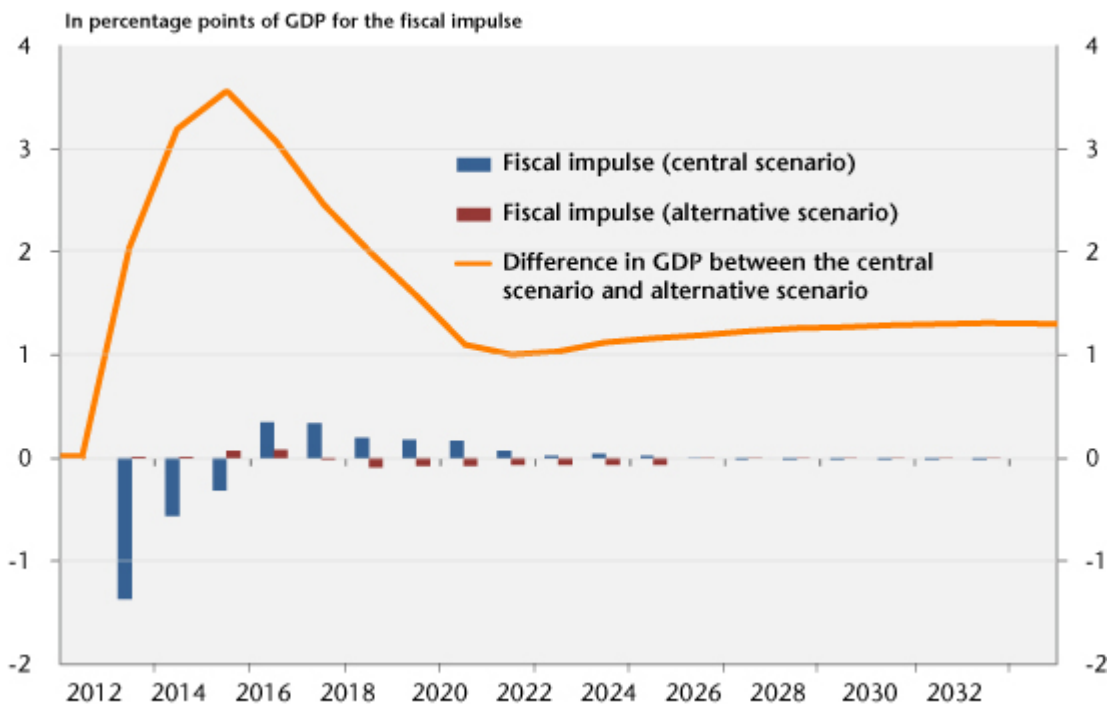
These adjustments are being undertaken in a very poor economic climate, which has been marked by austerity budgets from 2010 to 2012: growth in the euro zone will be -0.4% in 2012 and -0.3% in 2013. However, according to a series of recent theoretical and empirical studies[1], the fiscal multipliers turn upwards as the economic cycle heads downwards. In this context, the speed and magnitude of the fiscal adjustment is especially costly in terms of growth, and thus counter-productive in terms of the fiscal consolidation.[2] Encouraging a return to growth by easing the austerity would enable the economies of the euro zone to pull out of their recessionary spiral, which is marked by a steep rise in unemployment.

In order to develop this alternative strategy, we used the iAGS model to carry out simulations for the euro zone countries over a period of 20 years. These were conducted in two steps:

1. In our central scenario, we integrated the planned budget cuts announced by the various countries up to 2015. Starting from 2016, we calculated the fiscal impulses needed to achieve the 60% debt threshold by 2032, while limiting the size of these impulses to +/-0.5 GDP points per year. As shown in Figure 1 (central scenario), the structural adjustment carried out between 2010 and 2015 is significant enough in most countries to allow a relaxation of economic policy starting in 2016, while meeting the debt criterion by 2032.
2. For each country, we then decided on an alternative

budget strategy by staggering the reduction of the structural deficit over time. This strategy consists in starting in 2013 with the implementation of fiscal impulses of a more limited amount in absolute value than those announced by the current governments (maximum +/-0.5 GDP points per year), and doing this until the adjustment is sufficient to achieve the debt target of 60% of GDP by 2032. This strategy leads to more measured fiscal adjustment for the euro zone countries in difficulty and to slightly positive fiscal impulses in countries whose debt trajectory is in better shape (Germany, Finland, and Italy). For the zone as a whole, the fiscal impulse is almost zero in 2013 and 2014, with the bulk of the adjustment spread from 2017 to 2024.

Figure 1. Fiscal impulses and difference in GDP between the central and alternative scenarios



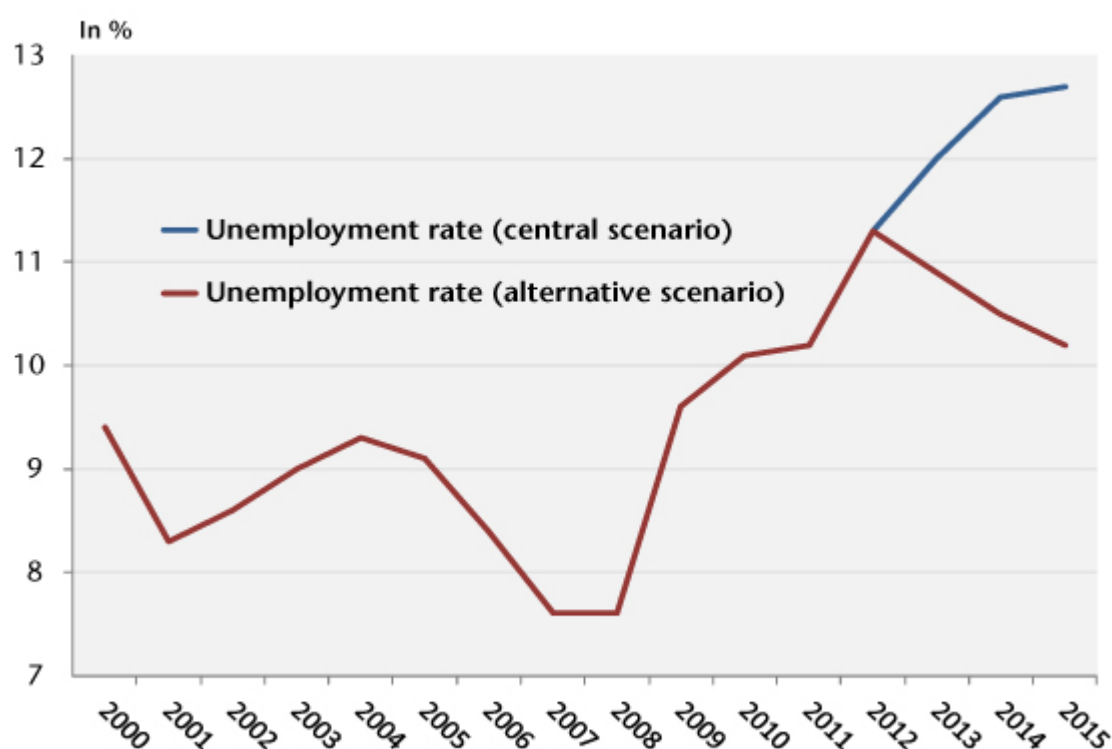
Source : iAGS, authors' calculation.

Figure 1 shows the difference in the level of GDP between the two scenarios. Limiting the size of the fiscal impulses helps to achieve a higher level of GDP and is

compatible with a debt target of 60% of GDP by 2032 (alternative scenario). The effectiveness of the fiscal consolidation is enhanced when it is being conducted in an environment that is less unfavourable to the economy. This strategy achieves the same debt target with a cumulative fiscal adjustment that is 50 billion euros less than in the central scenario.

According to our calculations, the alternative scenario would restore a 2% growth rate in the euro zone in 2013, compared with -0.3% if the planned fiscal policies are carried out. The revival of activity would boost the labour market and help to turn around the unemployment rate in 2013, with a decline to 10.2% in 2015, compared with 12.8% if the austerity policies are continued, representing 3 million fewer unemployed people in 2015.

Graphique 2. Unemployment rate in the euro zone - Central and alternative scenarios



Source: Eurostat data, iAGS simulation.

[\[1\] A review of the recent literature on fiscal multipliers: size matters!](#)

[\[2\] What is the value of the fiscal multipliers today?](#)

Does inequality hurt economic performance?

By [Francesco Saraceno](#)

Economic theory has long neglected the effects of income distribution on the performance of the economy. Students were taught right from Introduction to Economics 101 that the subject of efficiency had to be separated from considerations of equity. The idea is that the size of the cake had to be expanded to the maximum before it is shared. It was implicit in this dichotomy that economists should address the issue of efficiency and leave the question of distribution (or redistribution) to the politicians. In this framework, the economist's role is simply to ensure that choices about the channels for redistribution through taxation and public spending do not affect growth by interfering with the incentives of economic agents. Echoes of this view can be found both in the debate about the taxation of very large incomes envisaged by the French Government as well as in authors like [Raghuram Rajan](#) who justify inequality with references to technical progress and international trade, a view refuted by [Paul Krugman](#).

Since the work of Simon Kuznets in the 1950s, some economists have of course questioned whether excessive inequality might not inhibit economic growth, in particular by blocking the

accumulation of human capital. But this has long been a minority view among economists. Indeed, the dramatic increase in inequality documented among others by [Atkinson, Piketty and Saez](#) as well as by institutions such as the [OECD](#) and the [IMF](#) failed to give rise to a deep-going reflection about the relationship between inequality and economic performance.

It was the crisis that revived this concern. Growing inequality [is now suspected](#) of being a source of increasing household debt and speculative bubbles, leading to the accumulation of internal and external imbalances that have set off the current crisis. This is the argument developed by authors like [Joseph Stiglitz](#) and [James Galbraith](#).

Today the dichotomy between efficiency and distribution is no longer tenable. Inequality is becoming an essential theme in economic analysis, for both the short and long terms. To stimulate discussion on this topic, the OFCE and the SKEMA Business School are holding a workshop on "[Inequality and Economic Performance](#)" in Paris on 16 and 17 October 2012.