

# Does central bank optimism move financial markets?

By [Paul Hubert](#) and Fabien Labondance

“Animal spirits”, also called “errors of optimism and pessimism” or “sentiments”, contribute to macroeconomic fluctuations, as has been pointed out by Pigou (1927) and Keynes (1936) and more recently by Angeletos and La’O (2013) [\[1\]](#). Quantifying these kinds of unobservable concepts is crucial for understanding how economic agents form their expectations and arrive at decisions that in turn influence the economy. In a recent [working paper](#), “Central Bank Sentiment and Policy Expectations”, we examine this issue by analysing central bank communications and assessing their impact on expectations about interest rate markets.

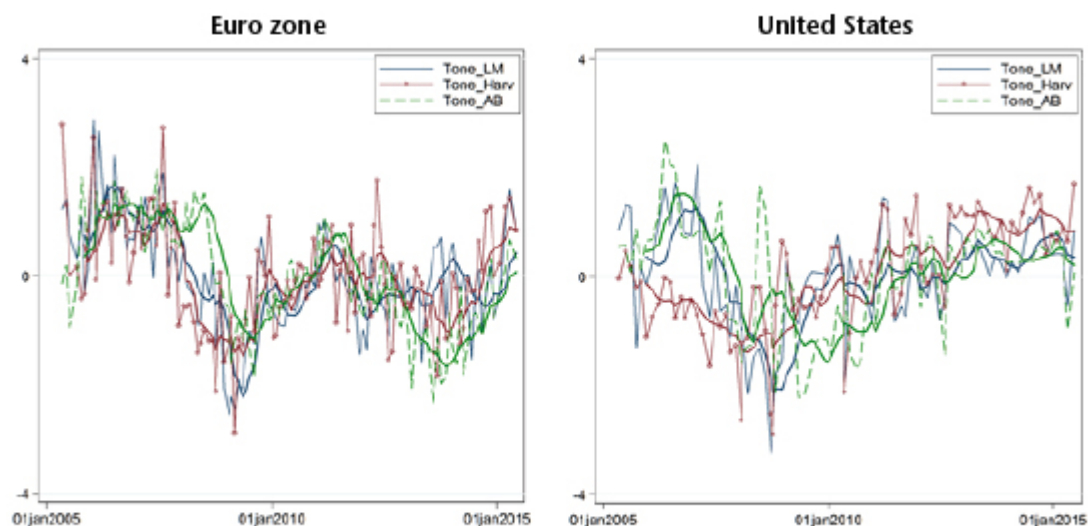
Our study aims to quantify the “sentiment” conveyed by central bank communications using the monetary policy statements of the European Central Bank (ECB) and the US Federal Reserve (Fed). We then test whether the optimism or pessimism transmitted in these statements affects the term structure of short-term interest rate expectations.

The main challenge is measuring a concept like the “sentiment” of a central bank, which is not very tangible. We first quantified the tone used by the ECB and the Fed in their monetary policy statements by using a computational linguistics approach based on three dictionaries of “positive” and “negative” words [\[2\]](#). Note that the goal here is not to measure the orientation of the discourse (whether, for example, expansionary or restrictive) but rather to quantify the use of words with a positive or negative tone in order to measure the overall tonality of the speech, regardless of its ultimate message. Sentiment is thus conceived as a component that is independent of economic fundamentals and the monetary

policy decisions actually taken [3]. In other words, we look at whether the use of certain words rather than others, regardless of the message communicated, affects the financial markets.

Figure 1 shows changes in the tone of central bank statements, calculated on the basis of the three dictionaries, for the ECB and the Fed from 2005 to 2015. The tone is correlated with the economic cycle: the speech is more optimistic (positive tone) during periods of growth and more pessimistic (negative tone) during periods of recession. Using this measure of tonality, we can see the 2008-2009 recession in the euro zone and the US, as well as the sovereign debt crisis in the euro zone in 2012-2013. The tone adopted by central bankers seems therefore to be the product of a combination of the central banks' assessment of the current and future state of the economy and of the sentiment that they are conveying.

**Figure 1. Tone of central banker statements**



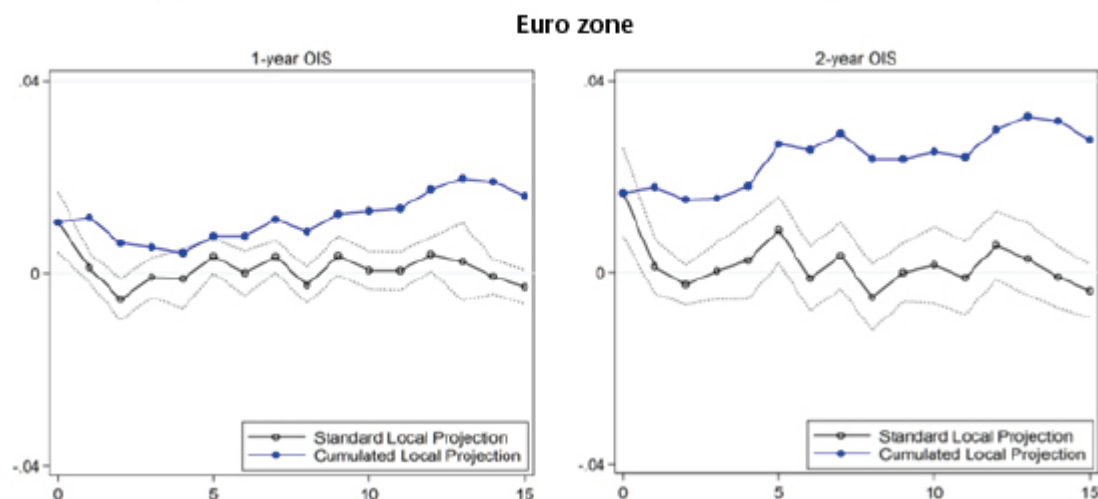
Source: The changes in tone were calculated using three dictionaries: Apel and Blix Grimaldi (2012 – AB); Loughran and McDonald (2011 – LM); and General Inquirer's Harvard IV-4 Psychosocial (Harv). The tone variables were normalized. The bold lines indicate the moving averages of the latest six statements on monetary policy.

After isolating the “sentiment” component of the variables quantifying the tone, we measured the impact of this sentiment on changes in short-term interest rate expectations, as measured by interest rate swaps (OIS – Overnight Indexed Swaps) for maturities ranging from 1 month to 10 years. Since

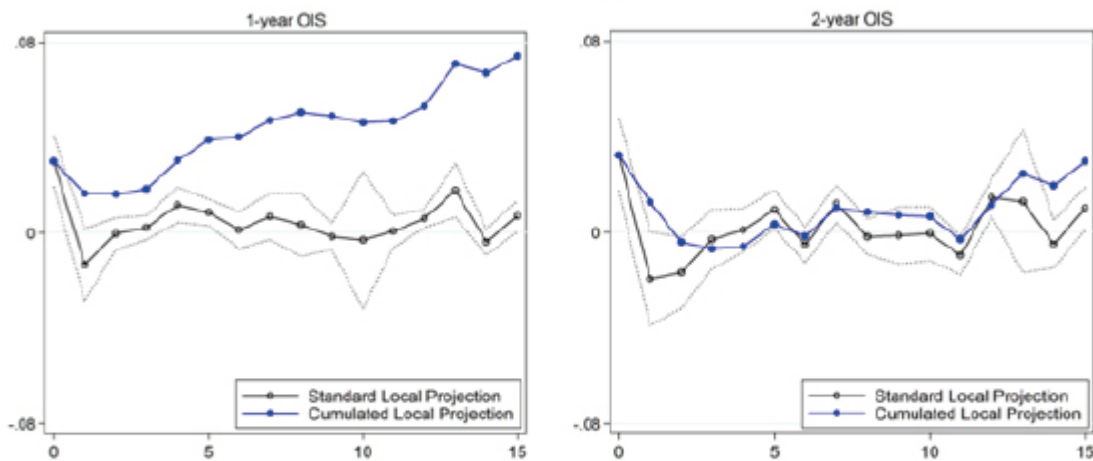
this sentiment is communicated on the day of the monetary policy decision, we also checked that we are not measuring the effect of the decision itself.

Our results show that a discourse with a positive (i.e. optimistic) sentiment has a positive effect on interest rate expectations for maturities ranging from 3 months to 10 years in the euro zone and on maturities from 1 to 3 months and from 1 to 3 years in the United States. The peak effect is for maturities of around 1 to 2 years both in the euro zone and the United States. We also show that this effect is persistent and tends to grow over time (see Figure 2). We also find that the impact of the sentiment depends on the precision of the signal, its size and its sign (the effect of pessimism is stronger than that of optimism, for example), as well as on the level of inflation and growth.

**Figure 2. Effect of sentiment on interest rate expectations**



## United States



Note: Response function to a positive sentiment shock over 15 days using the methodology of Jorda (2005). The figure shows the estimated points, the 90% confidence interval and the cumulative effect.

Source: Jorda, Oscar (2005). "Estimation and Inference of Impulse Responses by Local Projections", *American Economic Review*, 95(1), 161-182.

These results show that market reactions are not due solely to the substance of the message but also to the way that it is expressed by the central bankers. Central bankers' sentiments influence the formation of interest rate expectations and seem to set the future prospects for rate policy. In a context where observers attentively scrutinize the slightest detail that might reveal the date when the Fed will once again raise rates, this study opens new avenues for research and suggests that it might be useful to test whether the sentiment conveyed in the last speech by Janet Yellen might be a good indicator.

[1] Angeletos, George-Marios, and Jennifer La'O (2013), "Sentiments", *Econometrica*, 81(2), 739-780 ; Keynes, John Maynard (1936), *General Theory of Employment, Interest and Money*, London, Palgrave Macmillan; and Pigou, Arthur Cecil (1927), *Industrial Fluctuations*, London, Palgrave MacMillan.

[2] We use three different dictionaries: one by Apel and Blix-Grimaldi (2012) that focuses on the communications of the central banks; one developed by Loughran and McDonald (2011) for a financial context; and the General Inquirer's Harvard dictionary, which lists positive and negative words used in everyday life. These dictionaries list words or phrases with

positive or negative connotations. The difference between the numbers of positive and negative words indicates the tone of the text: if there are more positive than negative expressions, the tone is optimistic, and vice versa. See Apel, Mikael and Marianna Blix-Grimaldi (2012), "The information content of central bank minutes", *Riksbank Research Paper Series*, no. 92; Loughran, Tim and Bill McDonald (2011), "When is a Liability not a Liability? Textual Analysis, Dictionaries, and 10-Ks", *Journal of Finance*, 66 (1), 35-65; and <http://www.wjh.harvard.edu/~inquirer/>.

[3] Cf. Angeletos and La'0 (2013).

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# Some clarifications on economic negationism

By Pierre Cahuc and André Zylberberg

We would like to thank Xavier Ragot for permitting us to respond to his comments about our book, *Le Négationnisme économique [Economic Negationism]*. Like many critics, Xavier Ragot considered that:

- 1) "The very title of the book proceeds from great violence. This book is on a slippery slope in the intellectual debate that is heading towards a caricature of debate and verbal abuse."
- 2) The approach of our work is "scientistic" and "reductive", with "faith in knowledge drawn from natural experiments" that he doesn't believe has a "consensus in economics".
- 3) We "want to import the hierarchy of academic debate into

the public debate”.

We would like to respond to these three allegations, with which we disagree.

### 1) On economic negationism

The term “economic negationism” does not caricature the debate. We chose it because the notion of “scientific negationism” is an expression used in debates about science, and we are talking about science here. This term is in common use, for instance on the scientific blog of the newspaper *Le Monde*, “Passeurs de Sciences”, which was named the best blog in the field of science. Our work reviews the significance of the term in the introduction, and then further develops this in Chapter 7. We note that scientific negationism is a strategy based on four pillars:

- Throw doubt on and castigate “la pensée unique” [doctrinaire, dogmatic “group think”];
- Denounce moneyed and ideological interests;
- Condemn science because it can’t explain everything;
- Promote “alternative” learned societies.

This strategy aims to discredit researchers who are getting what are considered disturbing results. It affects all disciplines to one extent or another, as is shown by the works of Robert Proctor[\[1\]](#) and Naomi Oreské and Erik Conway[\[2\]](#). And this is precisely the strategy adopted both by the *Economistes Atterrés*[\[3\]](#) and in the book entitled *A quoi servent les économistes s'ils disent tous la même chose* [*What good are economists if they all say the same thing*][\[4\]](#). These texts all rely on the four pillars of scientific negationism set out above. They loudly proclaim the existence of dogmatic “group think” (pillar 1), which more or less accedes to the demands of the financial markets (pillar 2), and is thus unable to foresee financial crises (Pillar 3), resulting in the need to create alternative learned societies (and while the AFEP, the

French association of political economists, already exists, there are demands to open a new economics section in the University) (pillar 4).

This strategy does not nourish debate. It annihilates it. It is intended solely to discredit researchers, both recognized and anonymous. Jean Tirole was recently the victim of this kind of discrediting by some self-proclaimed "heterodox" economists.

## **2) With regard to a scientific and reductive approach**

Xavier Ragot says that "giving a consensus among economists the status of truth" (Cahuc, Zylberberg, p. 185) is troublesome, because it ignores the contributions of "minority" efforts. We are not erecting some consensus about truth; rather, we say very specifically (p. 185) that a consensus, when it exists, is *the best approximation* of the "truth". The use of quotation marks around the word *truth* and the qualification *best approximation* show clearly that we are not advocating some notion of scientific absolutism. Our use of the terms *consensus* and *truth* seems to us to correspond to the usual practice in the scientific process.

To bolster our position on this point, we'd like to cite our book once more, on pages 184-185: "Trusting in a community made up of thousands of researchers remains the best option for having an informed opinion about subjects that we don't really understand. It is nevertheless a form of betting, because even if science is the most reliable way to produce knowledge, it may be wrong. But to systematically call into question the results obtained by scientific specialists on a given question and prefer to rely on self-proclaimed experts is far riskier"; and on page 186: "The development of knowledge involves a collective undertaking where every researcher produces results that other researchers then test for their robustness. 'Scientific knowledge' is the photograph of this collective endeavour at a given point. This is the

most reliable picture of what we know about the state of the world. This image is not fixed, but is in fact constantly changing.”

So when no empirical study on the reduction of statutory or contractual working hours (excluding the reduction of charges) finds a positive effect on employment, there are no grounds for asserting that reducing working time can create jobs ... so long as no published studies find the opposite. Economic negationism leads to denying these results, saying that they stem from dogmatic thinking guided by either ignorance of the real world or a conspiracy. We affirm therefore that further debate is necessary, but to be constructive it must follow certain rules: the arguments must be based on contributions that have passed “peer review” to be certified as relevant. Of course, on many topics the existing studies do not make it possible to identify convergent results. When this is the case, it has to be acknowledged. There are several illustrations of this in our book.

### **3) On our recommendations for opening up debate and making it transparent**

As we have mentioned before, our objective is not to close the “intellectual debate” to public access by laypeople, but to make the debate more constructive and informative. Debates on economics, even when simply presenting the facts, are often treated as political confrontations or boxing matches between different schools of thought. We’re simply saying that to organize informative discussion (page 209), “Journalists should stop systematically calling on the same people, especially when they have no proven research activity but are nevertheless capable of expressing themselves on every subject. They should instead seek out genuine specialists. The ranking of more than 800 economists in France on the IDEAS website can help them select relevant speakers. In any case, the web pages of researchers should be consulted to ensure that their publications appear in reputable scientific



journals, a list of which is available on the same IDEAS site. If an economist hasn't published anything in the last five years in one of the 1,700 journals listed on this site, it is clear that this person has not been an active researcher for a long time, and it is best to talk to someone else to get an informed opinion. Journalists should also systematically ask for references to the articles researchers rely on for their judgments and, where applicable, request that these items be made available online to readers, listeners and viewers."

So, far from wanting to "import the hierarchy of the academic debate into the public debate", as Xavier Ragot puts it, we simply want for non-specialists to be better informed about the academic debate, so that they are able to distinguish what are matters of uncertainty (or consensus) among researchers with regard to the political options being presented.

[\[1\]](#) *Golden Holocaust: La Conspiration des industriels du tabac*, Sainte Marguerite sur Mer, Équateurs, 2014.

[\[2\]](#) *Les Marchands de doute. Ou comment une poignée de scientifiques ont masqué la vérité sur des enjeux de société tels que le tabagisme et le réchauffement climatique*, Paris, Editions le Pommier, 2012.

[\[3\]](#) *Manifeste des économistes atterrés (2010) and Nouveau manifeste des économistes atterrés (2015)*, éditions LLL.

[\[4\]](#) Editions LLL 2015.

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# “The economic negationism” of Cahuc and Zylberberg: the first-order economy

By [Xavier Ragot](#)

The book by Pierre Cahuc and André Zylberberg[1] is an injunction to take scientific truths about economics into account in the public debate, in the face of interventions that conceal private and ideological interests. The book contains interesting descriptions of the results of recent empirical work using natural experiments for the purpose of evaluating economic policies in the field of education, tax policy, the reduction of working hours, etc.

However, assertions in the book that are at the borderline of reason ultimately make it a caricature that is probably counter-productive. More than just the debate over the 35-hour working week or France’s CICE tax credit, what is at stake is the status of economic knowledge in the public debate.

## **1) Has economics become an experimental science like medicine and biology?**

The heart of the book is the claim that economic science produces knowledge to treat social ills that is on the same scientific level as medicine. I do not believe this is true. Consider this quote from the winner of the 2015 Nobel Prize in Economics, [Angus Deaton](#):

“I argue that experiments have no special ability to produce more credible knowledge than other methods, and that actual experiments are frequently subject to practical problems that undermine any claims to statistical or epistemic superiority.”  
([Deaton 2010](#))

The charge is serious; the point is not to deny the contributions of economic experiments but to understand their limitations and to recognize that there are many other approaches in economics (natural or controlled experiments constitute only a small percentage of the empirical work in economics).

What are the limits of experiments? Natural experiments serve only to measure average first-order effects without measuring secondary effects (so-called general equilibrium effects) that can significantly change the results. A well-known example: the work of the Nobel laureate Heckman (1998) in the economics of education, which showed that, at least in some cases, these general equilibrium effects significantly affect the results of experiments.

Moreover, experiments are not able to take into account the heterogeneity of the effects on populations, to accurately measure the confidence intervals, etc. I'll leave these technical discussions to the article by [Deaton](#). It should also be noted that the power to generalize from natural experiments is often weak, as these experiments are by their nature not reproducible.

Let's take an example: Cahuc and Zylberberg use the study by Mathieu Chemin and Etienne Wasmer (2009) comparing the effects of the reduction of working time between Alsace and the whole of France to identify the impact on employment of an additional reduction of 20 minutes of working time. This work finds no impact from an additional 20-minute reduction in working time on employment. Can we conclude that the transition to 35 hours, a reduction in working time more than ten times as great, has no impact on employment? Could there be interaction effects between lowering social contributions and reducing working time? I don't think it can be said that simply reducing working time creates jobs, but it seems difficult to claim scientifically that the transition to 35 hours did not create jobs based on the studies cited (the

authors also draw on the example of Quebec, where the reduction was much greater).

The economist uses data in much more diverse ways than presented by Cahuc and Zylberberg. The book does not discuss laboratory experiments conducted in economics (see Levitt and List, 2007). Further, the relationship of economics to data is undergoing change as digital distribution creates vast access to data ("big data" in short). Econometric techniques will in all likelihood make more intense use of structural econometrics. In a recent work (Challe et al., 2016), we develop, for example, a framework for using both microeconomic and macroeconomic data to measure the impact of the great recession in the US. Finally, there has been a renewal of economic history and long-series studies. The work of Thomas Piketty is an example that has not gone unnoticed. Other work, including on financial instability (especially that by Moritz Schularik and Alan M. Taylor), also uses long time periods to enhance intelligibility. In short, the relationship of data to economics involves multiple methods that can yield conflicting results.

This is no mere detail: the scientific approach of the book is reductive. The book by Zylberberg Cahuc advances a faith in the knowledge drawn from natural experiments that I don't believe has a consensus in economics.

## **2) How to sidestep major questions**

Here is a concrete illustration of the problem with this approach. The authors render a severe verdict on France's CICE tax credit (the government's reduction of employer social charges on up to 2.5 times the minimum wage, the SMIC). The main argument is that it is well known that reducing charges in the neighbourhood of the SMIC has a much bigger impact on employment than for higher wage levels. This last point is true – but the authors are sidestepping the real issue. What is it?

The early years of the euro have seen an unprecedented divergence in labour costs and inflation between European countries. Up to the 1990s, these differences were handled over the years by devaluations / revaluations. But the single currency has made this no longer possible. The question facing economists looking at this situation is whether the euro zone can survive such misalignments (see the recent position of Stiglitz on this subject). The discussion has been focused on establishing internal devaluations in overvalued European countries and boosting wages in undervalued countries. To this end, Germany established a minimum wage, some countries cut the salaries of civil servants, while others lowered their social contributions (the CICE tax credit in France), in the knowledge that other fiscal tools are also possible (see Emmanuel Farhi, Gita Gopinath and Oleg Itskhoki, 2013). The crucial question is therefore: 1) Is an internal devaluation necessary in France, and if so how much? 2) And how could a non-recessionary internal devaluation be implemented without increasing inequality?

So there is clearly a problem if one answers these questions based on the impact of reductions of social charges near the SMIC wage level. This shows the danger of basing oneself solely on results measurable by experiments: it neglects key issues that cannot be decided by this method.

### **3) The problem of “Keynesianism”**

The authors claim that Keynesianism provides fertile soil for negationism even while stating in the book that Keynes' recipes sometimes work, but not all the time, which any economist would acknowledge. In the absence of clarification, these remarks become problematic. Indeed, recent years (following the 2008 subprime crisis) have witnessed a return of Keynesian approaches, as can be seen in recent publications. I would go so far as to say that we are living in a Keynesian moment, with great financial instability and massive macroeconomic imbalances (Ragot, 2016).

What then is Keynesianism? (It is not, of course, fiscal irresponsibility with ever greater public debt). It is the claim that price movements do not always allow markets to operate normally. Prices move slowly, wages are downwardly rigid, nominal interest rates cannot be very negative, etc. Because of all this, there are demand externalities that justify public intervention to stabilize the economy. The French debate generates concepts like “Keynesianism” and “liberalism” that have no real meaning in economic science. It is the role of the scientist to avoid false debates, not to perpetuate them.

#### **4) Should we listen only to researchers publishing in the top journals?**

The public debate differs greatly from the scientific debate in both purpose and form. Cahuc and Zylberberg want to import the hierarchy of academic debate into the public debate. This won't work.

There will always be a need for non-academic economists to discuss economic issues. The economic situation raises problems where there is no academic consensus. The business press is full of advice from bank economists, markets, institutions and trade unions, all of whom have legitimate, though non-academic, points of view. Newspapers like *Alternatives Economiques*, quoted by Cahuc and Zylberberg, present their views, as does the *Financial Times*, which has a mix of genres. Economists without formal academic credentials play a legitimate role in this debate, even if their opinions differ from those of other researchers with longer CVs.

These contradictions are concretely lived at the OFCE, whose mission is to contribute to the public debate with academic rigor. This is a very difficult exercise; it requires knowledge of the data, the legal framework, and the academic literature produced by institutions such as the Treasury, the OECD, the IMF, and the European Commission. Knowledge of the

economic literature is essential, but it is far from sufficient to make a useful contribution to the public debate.

The willingness of economists to contribute to the public debate was exemplified in the various petitions around the El Khomry law. These petitions widely debated the effect of redundancy costs on hiring and the form of the employment contract, but not the overturning of norms (a subject that to my knowledge is impossible to evaluate rigorously) – even though this is at the heart of the debate between the government and the trade unions! It is not certain that the idea of a consensus among economists will emerge strengthened by this episode.

#### **5) When a consensus exists in economics, do we have to listen to it?**

The consensus before the subprime crisis was that financialization and securitization were factors promoting economic stabilization, because of risk allocation, etc. Microeconomic studies confirmed these intuitions, because they failed to capture the real source of financial instability, which was the correlation of risks in investor portfolios. We now know that the consensus was wrong. Some economists outside the consensus, such as Roubini or Aglietta, and some economics journalists such as *The Economist*, warned of the destabilizing effects of finance, but they were outside the consensus.

Policy (and the public debate) is forced to ask: what will happen if the consensus is wrong? It has to manage all the risks – that's its responsibility. The consensus view among economists is frequently not very informative about the diversity of viewpoints and the risks involved. The public voice of economists outside the consensus is necessary and useful. For example, the Nobel Prize in Economics was awarded to Eugene Fama and Robert Schiller, who both studied financial economics. The first asserts that financial markets are efficient, and the second that financial markets generate

excessive volatility. Newspapers carry visions outside the consensus, such as *Alternatives Economiques* in France (at least it's in the title). These publications are useful to public discussion, precisely because of their openness to debate.

In science, the diversity of methods and knowledge about methodology outside the consensus enrich the debate. For the same reason, I tended to be against the creation of a new section of heterodox economists, supported by the French association of political economists (AFEP), because I see an intellectual cost to the segmentation of the world of economists. For the same reason, giving a consensus among economists the status of truth (Cahuc, Zylberberg, p. 185) is troublesome, because it ignores the contributions of the "minority" effort.

## **6) "Economic negationism: radicalization of the discourse**

The authors castigate ideological criticisms of economics that are unfamiliar with the results or even the practice of economists. The science of economics has strong political implications, and is therefore always attacked when generates disturbing results. Some criticisms lower the intellectual debate to the level of personal insults. A defence of the integrity of economists is welcome, but it requires real learning and modesty to explain what is known and what is not known.

On reading the book by Cahuc and Zylberberg, it seems that the authors take up the arms of their opponents: two camps are defined (real science and deniers), doubts are planted about the intellectual honesty of pseudo-scientists outside the consensus, we proceed by amalgamation, by mixing intellectuals (Sartre) and academic economists. The very title of the book proceeds from great violence. This book is on a slippery slope in the intellectual debate that is heading towards a caricature of debate and verbal abuse. Every economist



involved in the public debate has already been insulted by people who disagree with the results presented for purely ideological reasons. Insults need to be fought, but not by suggesting that debate can be avoided due to one's academic status.

The debate in England on Brexit showed how economists and experts were rejected because of their perceived arrogance. I'm not sure that the scientific position of the book offers a solution to these developments in the public debate. To quote Angus Deaton once again, in a recent interview he did with the newspaper *Le Monde*:

"To believe that we have all the data is singularly lacking in humility. ... There is certainly a consensus in economics, but its scope is much narrower than economists think."

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[1] Pierre Cahuc and André Zylberberg, *Le négationnisme économique et comment s'en débarrasser*, Paris, Flammarion, 2016.

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# Italy and the labour market: improvement, with caveats

By Céline Antonin

Since early 2015, the renewal of growth in Italy, the implementation of Act II of Matteo Renzi's Jobs Act, and the reduction in business charges have undeniably contributed to the improvement on the country's jobs front. Dynamic job creation, particularly with permanent (CDI) contracts, and an increase in the labour force, could give the impression that (partial) liberalization of Italy's labour market has resolved the structural weaknesses it has been facing. Nevertheless, in the first half of 2016, the creation of permanent jobs has severely dried up, and what is driving growth in employment now is an increase in fixed-term (CDD) contracts. Moreover,

stagnating labour productivity has accompanied more employment-yielding growth, particularly in the services sector. So in the absence of further action to address Italy's structural weaknesses, the upturn in the labour market may not last.

### **A brief review of recent labour market measures**

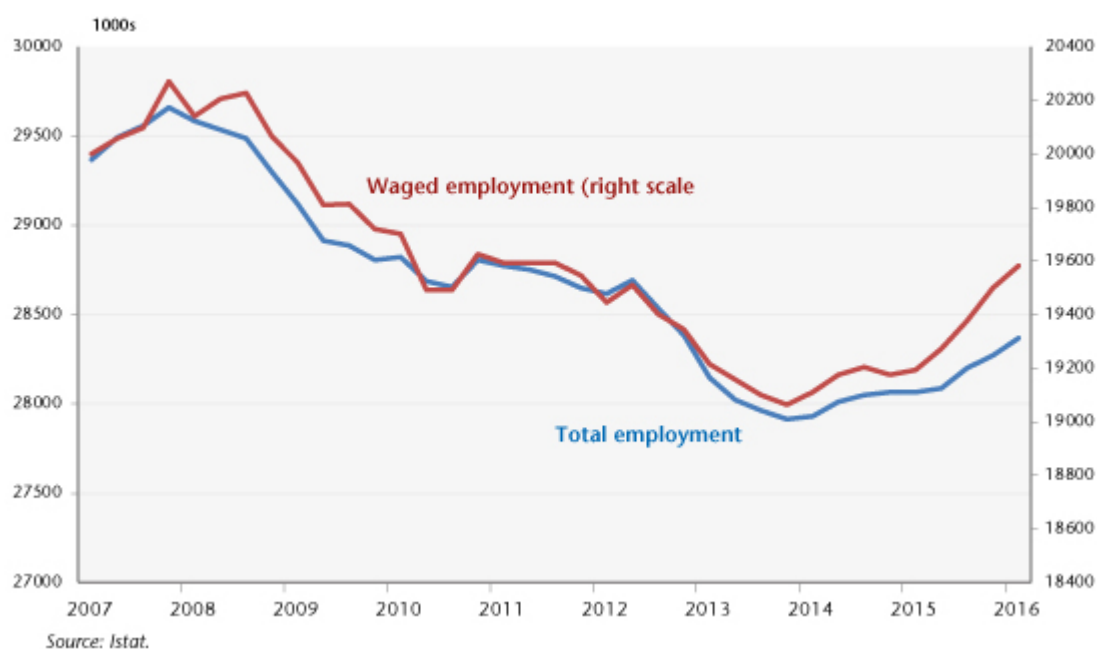
The Jobs Act is a continuation of a series of recent measures put in place since 2012 that are intended to create a more flexible labour market (see [C. Antonin, Matteo Renzi's Jobs Act: A very guarded optimism](#)). In Act I, the Jobs Act led to extending the duration of fixed-term contracts from 12 to 36 months, eliminating waiting periods and allowing more renewal periods, while limiting the proportion of fixed-term contracts within a given company. Act II introduced a new type of permanent contract, with greater protection and severance pay increases in line with seniority. It also abolished the misuse of *contratti di collaborazione*, precarious work contracts often used to disguise an employment relationship. These were to be transformed into employment contracts from 1 January 2016 (1 January 2017 for the public administration).

Furthermore, Italy has opted for cutting the taxation of labour: in 2015, the wage share of the IRAP (regional tax on productive activities) for employees on permanent contracts was removed. Above all, the 2015 Finance Act abolished social security contributions for 3 years on the new form of permanent contracts with greater protection, up to a limit of 8,060 euros per year for new hires between 1 January and 31 December 2015 who had not been on permanent contracts in the six months preceding their employment. The total cost to the budget was 1.8 billion euros. The programme was partially extended in 2016: companies taking on employees on the new permanent contracts in 2016 will be exempted from 40% of their social contributions for 2 years, and the cap on the exemption from contributions was reduced to 3,250 euros per employee.

## A sharp increase in the number of jobs created, but stagnation in the creation of permanent jobs in 2016 ...

Since the beginning of 2015, the number of jobs grew strongly in Italy (Figure 1), but still falls far short of the pre-crisis level: between the first quarter of 2015 and the first quarter of 2016, the number of jobs grew by 304,000 (+391,000 permanent jobs).

Figure 1. Waged employment and total employment



A breakdown of these figures (Table 1) reveals a major difference between 2015 and the first half of 2016: the number of new CDI jobs exploded in 2015 (+281,000 between January and December 2015), before drying up in the first half of 2016 (-18,000 from January to June 2016). In 2015, the dramatic increase in the number of CDI contracts is partly explained by the replacement of precarious jobs by permanent jobs with progressive guarantees. Thus, of the 2.0 million CDI jobs created in 2015, there were 1.4 million new CDIs and 575,000 fixed-term (CDD) contracts converted into CDIs (source: INPS). 60.8% of these new contracts benefited from the exemption from social security contributions. However, the number of new CDI contracts dropped by 33% in the first half of 2016 compared to the first half of 2015, as a result of the reduced creation of

CDIs *ex nihilo* and a sharp fall in the conversion of CDDs into CDIs (-37%). There was nevertheless a sharp increase in the number of the self-employed in 2016, after two consecutive years of decline.

**Table 1. Creation of jobs by category (flows)**

1000s of jobs

	Jan-Dec 2015	Jan-Jun 2015	Jan-Jun 2016
<b>Waged jobs</b>	316	194	61
In CDI	281	143	-18
In CDD	35	51	79
<b>Self-employed</b>	-135	-80	126
<b>Total employment</b>	181	114	187

Source : Istat, Author's calculations.

Thus, the zeal for CDIs mainly occurred in 2015, before withering in 2016. One of the reasons is the following: **the reduction in social contributions for new hires on permanent contracts had a stronger impact than the Jobs Act itself.** In fact, the reduction in social contributions applied only to contracts concluded in 2015. These were renewed for 2016, but on a much more limited scale (two years compared with three, with the cap on the exemption from payroll taxes cut by more than half), which may well explain the decline in enthusiasm. Moreover, an anticipation effect can be seen for the month of December 2015 (Table 2), with a steep increase in the number of CDIs fully exempt (they more than quadrupled compared to the average of the preceding eleven months). In the first half of 2016, there were on average 42,000 people hired per month who benefited from the two-year exemption on contributions, or 31% of total permanent CDI contracts<sup>[1]</sup>, compared with 128,000 in 2015 (taking into account December). In 2015, the exempt contracts accounted for 61% of the total.

**Table 2. New CDIs by category (exempt from charges or not)**

In monthly average

	Average Jan-Nov 2015	Dec. 2015	Average Jan-Jun 2016
New exempt CDIs (a)	78 324	248 919	32 802
Converted from CDD into exempt CDIs (b)	27 921	130 324	9 205
Total CDIs exempt (a+b)	106 245	379 243	42 008
Total CDIs created	186 495	450 186	133 532
% CDIs exempt of total CDIs	57 %	84 %	31 %

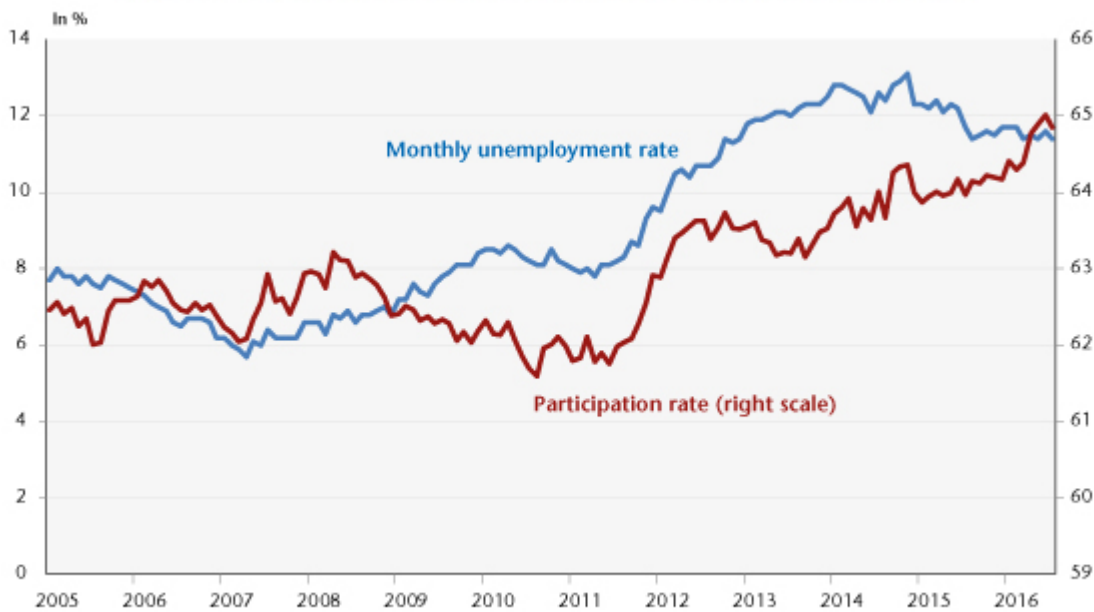
Note: The month of December was considered separately due to the sharp increase in the number of CDIs signed in that period.  
Source: INPS, author's calculations.

**... but stagnation in the number of jobless due to the growth in the workforce ...**

Despite the dynamic jobs market, unemployment has stagnated in Italy since mid-2015 at a level of 11.6% (Figure 2). This paradox is explained by the increase in the active population: between July 2015 and July 2016, the workforce expanded by 307,000 people. Several phenomena are behind this:

1. The pension reform, which has led to seniors staying in their jobs;
2. A “flexion” or bending effect: with the return of growth and the improvement in the labour market, discouraged workers have begun looking for jobs again;
3. Immigration: positive net migration has had an impact on the labour market. The share of foreigners in Italy’s labour force rose from 10.7% to 11.1% between first quarter 2014 and first quarter 2016.

Figure 2. Unemployment rate and participation rate, 2005-June 2016



Source: Istat.

In conclusion, although it is not reflected in the unemployment figures, there has been an undeniable improvement in Italy's labour market, with a great deal of job creation and marked growth in the workforce. This improvement is attributable not just to the Jobs Act, but to three combined factors: 1) the return of growth since 2015, driven by the ultra-accommodative policy of the European Central Bank, less fiscal austerity and falling oil prices; 2) the reduction in labour taxes introduced in 2015 and extended in part in 2016; and 3) the implementation of the Jobs Act. In the light of Table 2, it can also be assumed that the reduction of business social charges had a stronger impact than the Jobs Act per se.

After the upturn in 2015, the figures for the first half of 2016 call for caution. The drying up of the creation of permanent jobs in 2016 shows that the Renzi reform did not resolve the underlying problem, namely the structural weaknesses of Italy's labour market, in particular labour productivity. To restore growth and employment, Italy really needs to address the issue of structural reform, including the poor level of innovation, research and development, the low level of competitiveness and the undercapitalization of its SMEs.

[1] including the conversion of CDD contracts into CDIs.

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# François Hollande's five years in office: Stagnation or recovery?

By OFCE

The five-year term of French President Francois Hollande has been marked by serious economic difficulties, but also by some signs of improvement in the last year of his mandate. Overall, France experienced low growth from 2012 to 2014, mainly due to the fiscal consolidation policy, with moderate growth after that (see: [OFCE, Policy Brief, no2, September 5<sup>th</sup>, 2016](#)).

The scale of the fiscal shock at the start of Hollande's mandate, when the government underestimated the negative impact on growth, proved to be incompatible with a fall in unemployment during the first half of the mandate.

The effort to improve France's public finances involved a major fiscal adjustment, even though the target of a 3% public deficit was put off till the end of Hollande's term in office. According to the calculations of the European Commission, France's structural balance (i.e. the balance adjusted for cyclical effects) will have improved by 2.5 points over the 2012-2016 period. This effort did not however prevent the public debt from reaching a historic peak and from diverging significantly from the level in Germany.



Fiscal consolidation in France and in Europe had a marked negative impact, amounting to 0.8 point per year on average between 2012 and 2017. The simultaneity of the austerity policies enacted in Europe amplified their recessionary impact by depressing domestic demand, but also external demand.

The economic policy of the governments led by Ayrault and Valls was initially marked by a significant period of rising taxation, on both companies and households, followed by a shift towards a supply policy in 2014. This policy, embodied in the Responsibility Pact and the CICE tax credit, is bearing fruit late in Hollande's term, as business margins improve, although household purchasing power and short-term growth have been hurt.

After a period marked by a significant downturn in business margins, they picked up over the first four years of the five-year term by the equivalent of 1 point in added value thanks to tax measures, and one additional point due to lower oil prices. The profit margin in industry even reached a level comparable to the historical records of the early 2000s.

Based on our forecasts for the five-year mandate as a whole, ILO-measured unemployment will have increased by about 100,000 people, despite the creation of 720,000 jobs, due to the lack of growth, combined with an increase in the labour force.

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# Europe is dead – Long live Europe!

By [Maxime Parodi](#) and [Xavier Timbeau](#)

The British people's vote for Brexit merely reinforces the

political logic that has become an imperative. On the one hand, people want to be consulted, while on the other, Europe is summoned to change. François Hollande believes that, “the vote of the United Kingdom is putting Europe to the test”; Alain Juppé holds that, “we must write a new page, a new chapter, in the history of Europe”; the leaders of France’s National Front, but not they alone, are calling for a referendum on France’s membership in the EU and in the euro. Throughout Europe, debate along these same lines is underway.

A few days ago, we wrote on the [Terranova Foundation site](#): “The referendum on the UK’s membership in the European Union will lead to a shock that is more political than economic. It will be difficult to contain demands for similar consultations. Meeting these demands by ‘more Europe’ will only heighten the distance between the peoples and European construction. To think that referendums could on the other hand legitimize the status quo would also be a mistake. We propose responding to the democratic need not by a ‘all or nothing’ approach but by a process of democratic ownership that helps to legitimize European integration and to imagine future possibilities.”

This method of democratic ownership of Europe and the euro has to be taught. Referendums “for or against” won’t cut it. The federal leap now acts as a foil for probably a large majority of Europeans. But a public domain does nevertheless exist in Europe. Articulating what today are the sites of democracy, the EU Member States, with the need, for some subjects, of a supranational legitimacy is the alternative to the invention of the European citizen. But it is the method that counts. And all the levers of participatory democracy, of broad national and transnational debates, including through citizen juries, must be mobilized to take stock of the current state of Europe and propose reforms that will render it more democratic. **This could lead to concrete advances such as a parliament of the euro zone or an extension of the European Parliament’s powers.**

It is also the way to reverse the trend towards the breakdown of Europe.

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# Brexit: What are the lessons for Europe?

By [Catherine Mathieu](#) and [Henri Sterdyniak](#)

The British vote to leave the European Union is aggravating the political crisis in Europe and in many European countries. Leaving the EU has become a possible alternative for the peoples of Europe, which may encourage parties advocating national sovereignty. The United Kingdom's departure automatically increases the weight of the Franco-German couple, which could destabilize Europe. If Scotland leaves the UK to join the EU, independence movements in other regions (Catalonia, Corsica, etc.) could seek a similar outcome. But the fragility of Europe also stems from the failure of the strategy of "fiscal discipline / structural reforms".

The departure of the United Kingdom, a fierce advocate of economic liberalism and opponent of any increase in the European budget and in the powers of Europe's institutions, as well as of a social Europe, could change the dynamics of the debate in Europe, but some East European countries, the Netherlands and Germany have always had the same position as the UK. The departure will not, by itself, cause a shift in European policy. On the other hand, the liberalization of services and the financial sector, which the UK has been pushing for, could be slowed. The British Commissioner, Jonathan Hill, head of financial services and capital markets,

should be promptly replaced. This will raise the sensitive issue of British EU officials, who in any case can no longer occupy positions of responsibility.

This will also open up a period of economic and financial uncertainty. The reaction of the financial markets, which do not like uncertainty and are in any case volatile, should not be accorded an excessive importance. The pound sterling has of course rapidly depreciated by 10% against the euro, but it was probably overvalued, as evidenced by the British current account deficit of around 6.5% of GDP in 2015.

According to Article 50 of the European Constitution, any country that decides to leave the EU should negotiate a withdrawal agreement, which sets the exit date<sup>[1]</sup>. Otherwise, after two years the country is automatically outside the Union. The negotiations will be delicate, and must of necessity deal with all the issues. During this period, the UK will remain in the EU. European countries will have to choose between two attitudes. An understanding attitude would be to sign a free trade agreement quickly, with the goal of maintaining trade and financial relations with the UK as a privileged partner of Europe. This would minimize the economic consequences of Brexit for both the EU and the UK. However, it seems difficult to see how the UK could simultaneously enjoy both complete freedom for its own economic organization and full access to Europe's markets. The UK should not enjoy more favourable conditions than those of the current members of the European Free Trade Association (EFTA – Norway, Iceland and Liechtenstein) and Switzerland; like them, it should undoubtedly integrate the single market legislation (in particular the free movement of persons) and contribute to the EU budget. The issue of standards, such as the European passport for financial institutions (this is now granted to the EFTA countries, but not to Switzerland), etc., would be posed very quickly. The UK may have to choose whether to comply with European standards on which it will not have a say

or to be subject to regulatory barriers. The negotiations will of course be open-ended. The UK could argue for a Europe that is more open to countries outside the EU. But how much weight will it have once it's out?

A tough attitude intended to punish London so as to set an example and deter future candidates from leaving would instead require the UK to renegotiate all trade treaties from scratch (i.e. from WTO rules) so as to encourage multinational companies to relocate their factories and headquarters to mainland Europe and close British banks' access to the European market in order to push them to repatriate euro zone banking and financial activity to Paris or Frankfurt. But it would be difficult for Europe, a supporter of the free movement of goods, services, people and business, to start erecting barriers against the UK. The euro zone has a current account surplus of 130 billion euros with the UK: does it want to call this into question? European companies that export to the UK would oppose this. Industrial cooperation agreements (Airbus, arms, energy, etc.) could only be challenged with difficulty. A priori it would seem unlikely that London would erect tariff barriers against European products, unless in retaliation. Conversely, London could play the card of setting up tax and regulatory havens, particularly in financial matters. It could not, however, avoid international constraints (agreements such as at COP21, on the fight against tax avoidance, on the international exchange of tax and banking information, etc.). The risk would be to start a costly game of mutual reprisals (one that it would be difficult for Europe, divided between countries with different interests, to lead).

Upon leaving the European Union, the United Kingdom, a net contributor to the EU, would a priori save about 9 billion euros per year, or 0.35% of its GDP. However, the EFTA countries and Switzerland contribute to the EU budget as part of the single market. Again, everything depends on the

negotiations. It would seem that the savings for the UK will be only about 4.5 billion euros, which the other Member countries will have to make up (at a cost of around 0.5 billion euros for France).

Given the uncertainty of the negotiations (and of exchange rate trends), all assessments of Brexit's impact on other EU countries can only be very tentative. Moreover, this will necessarily have only a second-order impact on the EU countries: if tariff or non-tariff barriers reduce French exports of cars to the UK and of British cars to France, French manufacturers can supply their national markets while facing less competition and can also turn to third countries. It is nevertheless useful to have an order of magnitude: in 2015, exports from France (from the EU) to the UK represented 1.45% of GDP (respectively 2.2%); exports from the UK to the EU represented 7.1% of British GDP. A priori, an equivalent impact on UK / EU trade will have 3.2 times less impact on the EU than on the UK.

According to the OECD [\[2\]](#), the fall in EU GDP will come to 0.8% by 2023 (against 2.5% for the UK), whereas remaining in the EU, participating in the deepening of the single market and signing free trade agreements with the rest of the world would lead to a rise in GDP for all EU countries. But how credible is this last assertion, given the euro zone's current poor performance and the cost for the economic and social cohesion of European countries of opening the borders? But if Europe is functioning poorly, then leaving should improve market prospects. The UK's foreign trade would suffer a contraction, which would hurt its long-term productivity, but despite its openness the British economy's productivity is already weak. The OECD does not raise the question of principle: should a country give up its political sovereignty to benefit from the potential positive effects of trade liberalization?

According to the Bertelsmann Foundation [\[3\]](#), the reduction in EU GDP (excluding the UK) in 2030 would range from 0.10% in

the case of a soft exit (the UK having a status similar to that of Norway) to 0.36% in the worst case (the UK having to renegotiate all its trade treaties); France would be little affected (-0.06% to -0.27%), but Ireland, Belgium and Luxembourg more so. The study multiplied these figures by five to incorporate medium-term dynamics, with the reduction in foreign trade expected to have adverse effects on productivity.

Euler-Hermes also reported very weak figures for the EU countries: a fall of 0.4% in GDP with a free trade agreement and of 0.6% without an agreement. The impact would be greater for the Netherlands, Ireland and Belgium.

### **Europe needs to rebound, with or without the United Kingdom...**

Europe must learn the lessons from the British crisis, which follows on the debt crisis of the southern European countries, the Greek crisis, and austerity, as well as from the migrant crisis. It will not be easy. There is a need to rethink both the content of EU policies and their institutional framework. Is the EU up to the challenge?

The imbalances between EU Member countries grew from 1999 to 2007. Since 2010, the euro zone has not been able to develop a coordinated strategy enabling it to restore a satisfactory level of employment and reduce the imbalances between Member states. The economic performance of many euro zone countries has been poor, and downright catastrophic in southern Europe. The strategy implemented in the euro zone since 1999, and strengthened since 2010 – “fiscal discipline / structural reforms” – has hardly produced satisfactory results socially or economically. On the contrary, it gives people the feeling of being dispossessed of any democratic power. This is especially true for countries that benefited from assistance from the Troika (Greece, Portugal, Ireland) or the European Central Bank (Italy, Spain). The Juncker plan that was intended to boost investment in Europe marked a turning point

in 2015, but it remains timid and poorly taken up: it was not accompanied by a review of macroeconomic and structural policy. There are important disagreements in Europe both between nations and between political and social forces. In the current situation, Europe needs a strong economic strategy, but it has not been possible to agree on one collectively in today's Europe.

There are two fundamental reasons for this morass. The first concerns all the developed countries. Globalization is creating a deeper and deeper divide between those who benefit from it and those who lose<sup>[4]</sup>. Inequalities in income and status are widening. Stable, well-paid jobs are disappearing. The working classes are the direct victims of competition from low-wage countries (Asian countries and former Soviet bloc countries). They are being asked to accept cuts in wages, social benefits, and employment rights. In this situation, the elite and the ruling classes can be open-spirited, globalist and pro-European, while the people are protectionist and nationalist. This same phenomenon underlies the rise of France's National Front, Germany's AfD, UKIP, and in the US the Republican Donald Trump.

Europe is currently operated according to a liberal, technocratic federalism, which seeks to impose on people policies and reforms that they are refusing, sometimes for reasons that are legitimate, sometimes questionable, and sometimes contradictory. The fact is that Europe in its current state is undermining solidarity and national cohesion and preventing countries from choosing a specific strategy. The return to national sovereignty is a general temptation.

Furthermore, Europe is not a country. There are significant differences in interests, situations, institutions and ideologies between peoples, which render progress difficult. Because of the differences in national situations, many arrangements (the single monetary policy, the free movement of



capital and people) pose problems. Rules that had no real economic foundation were introduced in the Stability Pact and the Budgetary Treaty: these did not come into question after the financial crisis. In many countries, the ruling classes, political leaders and senior civil servants have chosen to minimize these problems, so as not to upset European construction. Crucial issues concerning the harmonization of taxes, social welfare, wages and regulations have been deliberately forgotten. How can convergence towards a social Europe and a fiscal Europe be achieved between countries whose peoples are attached to structurally different systems? Given the difficulties of monetary Europe, who would wish for a budgetary Europe, which would take Europe further from democracy?

In the UK-EU Agreement of 19 February, the UK has recalled the principles of subsidiarity. It is understandable that countries concerned about national sovereignty are annoyed (if not more) by the EU's relentless intrusions into areas that fall under national jurisdiction, where European intervention does not bring added value. It is also understandable that these countries refuse to constantly justify their economic policies and their economic, social or legal rules to Brussels when these have no impact on the other Member states. The UK noted that the issues of justice, security and individual liberties are still subject to national competence. Europe needs to take this feeling of exasperation into account. After the British departure, it needs to decide between two strategies: to strengthen Europe at the risk of further fuelling people's sense of being powerless, or to scale down the ambition of European construction.

The departure of the United Kingdom, the de facto distancing of some Central European countries (Poland, Hungary) and the reticence of Denmark and Sweden could lead to an explicit switch to a two-tiered EU. Many national or European intellectuals and politicians think that this crisis could

provide just such an opportunity. Europe would be explicitly divided into three groupings. The first would bring together the countries of the euro zone, which would all agree to new transfers of sovereignty and to build a stronger budgetary, fiscal, social and political union. A second grouping would bring together the European countries that do not wish to participate in such a union. The last grouping would include countries linked to Europe through a free trade agreement (currently Norway, Iceland, Liechtenstein and Switzerland, and later the UK and other countries).

Such a project would, however, pose many problems. Europe's institutions would have to be split between euro zone institutions operating on a federal basis (which need to be made more democratic) and EU institutions continuing to operate in the Union manner of the Member states. Many countries currently outside the euro zone are opposed to this kind of change, which they feel would marginalize them as "second-class" members. The functioning of Europe would become even more complicated if there were both a European Parliament and a euro zone Parliament, euro zone commissioners, euro zone and EU financial transfers, and so on. This is already the case for instance with the European Banking Agency and the European Central Bank. Many questions would have to be decided two or three times (once in the euro zone, again at the EU level, and again for the free trade area).

Depending on the issue, the Member country could choose its grouping, and things would quickly head towards an à la carte union. This is hardly compatible with the democratization of Europe, as soon there would be a Parliament for every question.

The members of the third grouping would then be in an even more difficult situation, with the obligation to comply with regulations over which they had no power. Should our partner countries be placed in the dilemma of either accepting heavy losses of sovereignty (in political and social matters) or

being denied the benefits of free trade?

There is clearly no agreement between the peoples of Europe, even within the euro zone, on moving towards a federal Europe, with all the convergences that this would imply. In the recent period, the five Council Presidents and the Commission proposed new steps towards European federalism: creating a European Budget Committee, establishing independent Competitiveness Councils, conditioning the granting of Structural Funds on respect for budgetary discipline and the implementation of structural reforms, establishing a European Treasury and a euro zone minister of finance, moving towards a financial union, and partially unifying the unemployment insurance systems. These developments would reinforce the technocratic bodies to the detriment of democratically elected governments. It would be unpleasant if these were implemented, as is already partially the case, without the people being consulted.

Furthermore, no one knows how to proceed with convergence on tax and social matters. Upwards or downwards? Some proposals call for a political union in which decisions are taken democratically by a euro zone government and parliament. But can anyone imagine a federal authority, even a democratic one, that is able to take into account national specificities in a Europe composed of heterogeneous countries? What about decisions concerning the French pension system taken by a European Parliament? Or a finance minister for the zone imposing spending cuts on Member countries (as the Troika did in Greece)? Or automatic standards on public deficits? In our opinion, given the current disparity in Europe, economic policies must be coordinated between countries, not decided by a central authority.

Europe needs to reflect on its future. Using the current crisis to move forward towards an "ever closer union" without more thought would be dangerous. Europe must live with a contradiction: the national sovereignties that peoples are

attached to have to be respected as much as possible, while Europe must implement a strong and consistent macroeconomic and social strategy. Europe has no meaning in itself, but only in so far as it implements the project of defending a specific model of society, developing it to integrate the ecological transition, eradicating mass unemployment, and solving the imbalances within Europe in a concerted and united manner. But there is no agreement within Europe on the strategy needed to achieve these goals. Europe, which has been unable to generally lead the Member countries out of recession or to implement a coherent strategy to deal with globalization, has become unpopular. Only after a successful change of policies will it regain the support of the peoples and be able to make institutional progress.

[\[1\]](#) See in particular the report of the French Senate by Albéric de Montgolfier: *Les conséquences économiques et budgétaires d'une éventuelle sortie du Royaume-Uni de l'Union Européenne* [The economic and budgetary consequences of a future withdrawal of the United Kingdom from the European Union], June 2016.

[\[2\]](#) OECD, 2016, *The Economic Consequences of Brexit: A Taxing Decision*, April. Note that to treat leaving the euro as a tax increase does not make economic sense and represents a communication that is unworthy of the OECD.

[\[3\]](#) *Brexit – potential economic consequences if the UK exits the EU*, Policy Brief, 2015/05.

[\[4\]](#) See, for example, Joseph E. Stiglitz, 2014, “Le prix de l'inégalité”, *Les Liens qui libèrent*, Paris.

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# The effects of the oil counter-shock: The best is yet to come!

By [Eric Heyer](#) and [Paul Hubert](#)

After falling sharply over the past two years, oil prices have been rising once again since the start of the year. While a barrel came in at around 110 dollars in early 2014 and 31 dollars in early 2016, it is now close to 50 dollars.

Will this rise in oil prices put a question mark over the gradual recovery that seems to have begun in France in 2016?

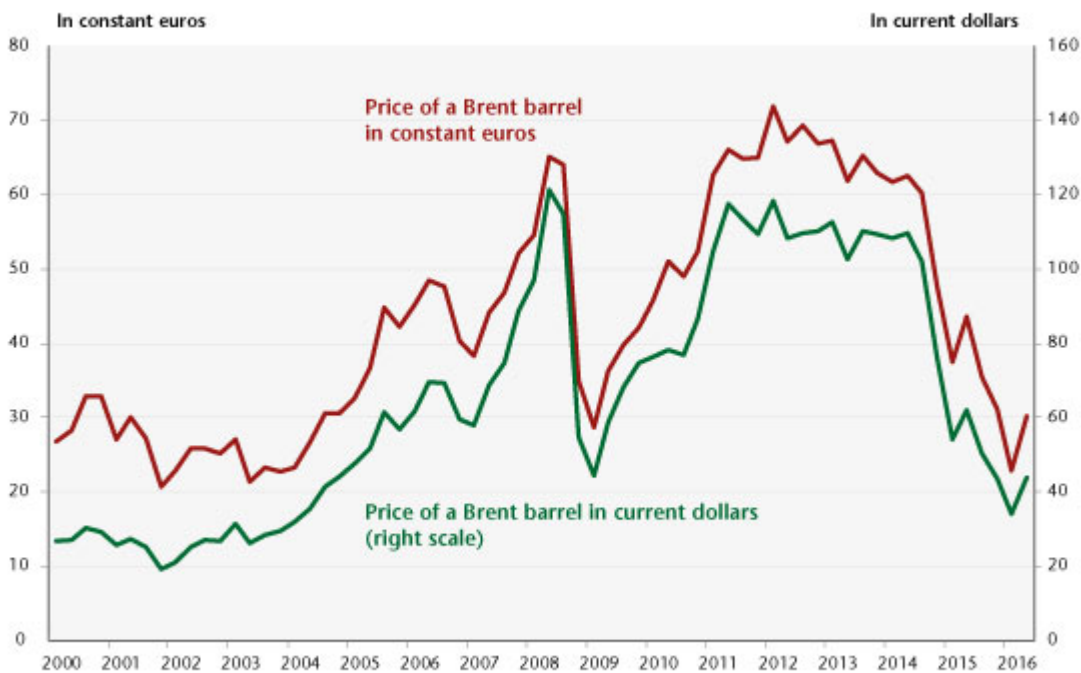
In [a recent study](#), we attempted to answer three questions about the impact of oil prices on French growth: will a change in oil prices have an immediate effect, or is there a time lag between the change and the impact on GDP? Are the effects of rises and falls in oil prices asymmetrical? And do these effects depend on the business cycle? The main results of our study can be summarized as follows:

1. There is a time lag in the impact of oil price variations on French GDP. Over the period 1985-2015 the lag was on average about 4 quarters;
1. The impact, whether downward or upward, is significant only for variations in oil prices greater than 1 standard deviation;
2. The asymmetric effect is extremely small: the elasticity of growth to oil prices is the same whether the price rises or falls. Only the speed at which the impact is transmitted differs (3 quarters in the case of a rise, but 4 in the case of a fall);
3. Finally, the impact of oil price changes on economic activity depends on the phase in the business cycle: the

elasticity does not differ significantly from zero in situations of a “crisis” or a “boom”. However, the elasticity is much greater in absolute terms when the economy is growing slowly (an economic slump).

Let us now apply these results to the situation since 2012. Between the first quarter of 2012 and first quarter of 2016, the price of a barrel of Brent crude plummeted from 118 dollars to 34 dollars, a fall of 84 dollars in four years. If we factor in the euro/dollar exchange rate and changes in consumer prices in France, the fall amounts to a 49 euro reduction over the period (Figure 1).

**Figure 1. Changes in the price of a barrel of Brent crude**

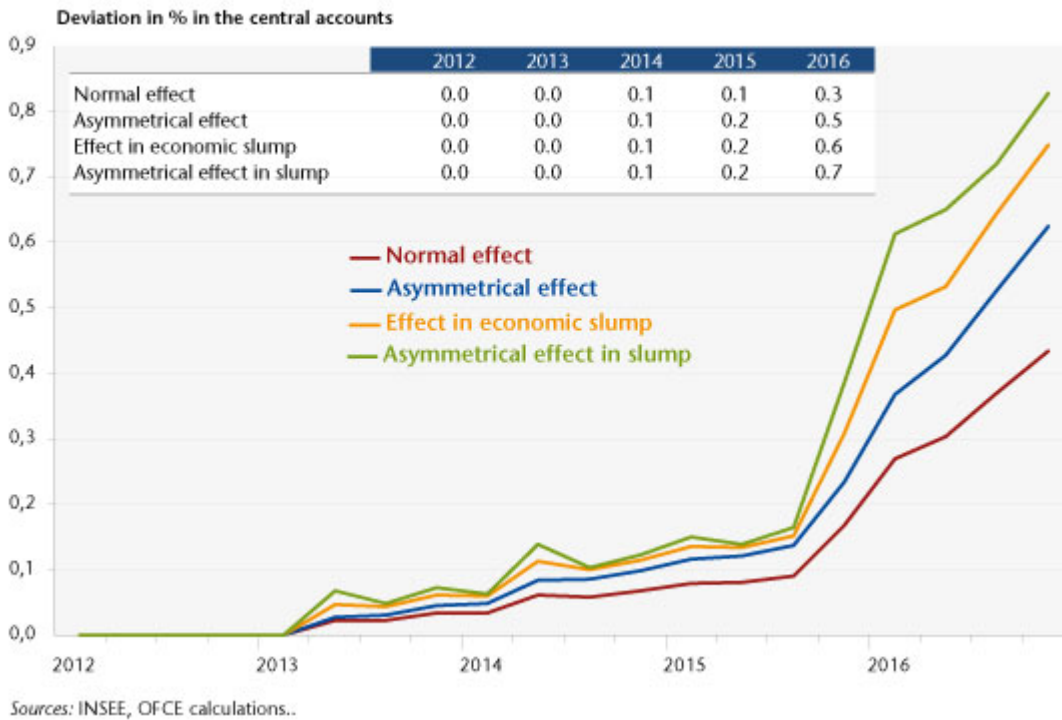


Sources: INSEE, OFCE calculations..

We evaluated the impact of a decline like this on France’s quarterly GDP, taking into account the above-mentioned time lag, asymmetry and phase of the business cycle.

Factoring all this in indicates that the oil counter shock ultimately did not show up much in 2015. As illustrated in Figure 2, the impact should make itself felt from the first quarter of 2016, regardless of the hypotheses adopted. The positive effect of the oil counter-shock is yet to come!

Figure 2. Impact on GDP of the fall in oil prices since 2012



# Is the decline of industry due to the growth of services?

By [Sarah Guillou](#)

On [Friday, April 8 2016](#), the *Observatoire Français des Conjonctures Economiques (OFCE)* began a series of quarterly seminars on the analysis of France's productive network. The purpose is to bring together researchers and discussion of the situation, the diversity and the heterogeneity of the companies making up France's production system. This discussion is now being fed by the increasing use of business data. We hope in this way to enrich the analysis of the strong and weak points in the country's production fabric, with a

*view to guiding the development of public policies aimed at strengthening it.* [\[1\]](#)

The first seminar took up the role of services in deindustrialization as measured by the decline of industrial employment as a share of total employment. Since 2000, the manufacturing industry in France has lost more than a quarter of its work force, i.e. more than 900,000 jobs. A recent note by the INSEE ([Insee Première, No 1592](#)) points out that manufacturing's weight in the economy has been halved from 1970 to today. Even though deindustrialization has aroused greater attention in France than elsewhere, probably because of the country's interventionist tradition and the challenges facing its labour market, it is taking place in all the developed economies. This raises questions about underlying structural trends common to all these countries.

However, the decline in industrial employment is being accompanied by net job creation in services. It also appears that the growth of services is being driven in part by changes in industrial production methods. Products are incorporating an increasingly large component of services, and companies are expanding their portfolio of service products. The fragmentation of production processes – fuelled by the opportunities provided by globalization – is isolating low value-added manufacturing units from high value-added services units.

These changes in production methods need to be analysed to understand the extent of this phenomenon. It seems that the changes occurring within industry are just as much factors driving the decline of industry as the rise of services in employment. In other words, there is a question of how much deindustrialization finds a mirror image in the growth of services, or even its explanation.

Three contributions helped to provide some answers to the following questions: which manufacturers are producing



services and with what impact on their performance? What is the role of services in the development of global value chains? Are flows of international services replacing flows of goods? Three main lessons emerge.

## **1 – “Servitization” and the decline in manufacturing jobs are clearly correlated**

Manufactured products are incorporating an increasingly significant amount of services. This can be seen both by the growing share of companies that produce services ([Crozet and Millet, 2015](#)) and export them ([Castor et al., 2016](#)) and by the rising content of services in exports (Miroudot, 2016)[\[2\]](#).

The growth in companies’ value-added “services” may well push all their jobs into the service sector, including what are strictly speaking manufacturing jobs, if the added value of the services becomes dominant. Today an average of 40% of manufacturing employment corresponds to service activities. Furthermore, the fragmentation of production processes is intensifying, as is the distribution around the world of outsourced activities based on the comparative advantages of different locations. If the company maintains an anchor in the home country, it usually keeps only the higher value-added jobs there, in line with the cost of the related work and qualifications, meaning jobs often characterized as services.

Note that these changes in production methods clearly reflect a decrease in manufacturing functions in a product’s added value, which translates into a decline of manufacturing in the sources of the wealth of nations. But it is important not to underestimate the impact of the fragmentation of production units. Thus, jobs in services, formerly attributed to manufacturing, are being reclassified as service jobs even though the underlying production task has not changed, and this is happening regardless of outsourcing abroad.

However, this reclassification is all the more likely as

“servitization” accelerates and becomes a must for companies to remain competitive.

## **2 – The servitization of manufacturing is a competitive factor**

Servitization, which is associated with qualitative improvements in products and more generally the creation of value in manufacturing, is a factor in competitiveness.

As is shown by Crozet and Millet (2015), the production of services by manufacturing enterprises is a factor that enhances their performance. There are actually many French manufacturing companies that produce services, with 70% producing these for third parties (2007 data). The decision to produce services represents an important turning point, and clearly boosts performance. The authors’ estimates thus show that taking this decision raises profitability, employment, total sales and sales of goods. Even though there are sectoral variations, the impact on performance is positive, whatever the industrial sector in question.

At the aggregate level, the share of imported services in the export of goods is also growing. In France’s exports, the share of services ranges from 30% to 50%, depending on the sector. The fragmentation of production processes is leading to outsourcing certain service functions and to the provision of imported services. This dynamic goes hand in hand with the integration of economies in international trade, with the benefit of globalization opportunities and ultimately with the competitiveness of economies (see [De Backer and Miroudot, 2013](#)).

## **3 – The direct and indirect export of services will continue to make a positive contribution to the trade balance**

The developments described above directly affect the trade in services. It is indeed increasingly services that are the subject of trade in intermediate products, with the latter being estimated at nearly 80% of world trade. Digitalization,

along with differentiation through services, is leading to the fragmentation of production with the inclusion of more and more services.

Trade in services in France has not experienced a decline since the crisis of 2007. Even though the trade balance in services has shrunk slightly since 2012, it has remained positive since the start of the 21st century, and the export of services has been rising faster than for goods. As the world's third largest exporter of services – especially because of tourism – France will see service exports increase as a share of its trade balance. Admittedly, for the moment, the volume of exported services has not offset the negative balance for goods, but the development of intra-firm trade in services and of intermediary services will eventually reverse their respective shares.

Trade in services is even more concentrated than trade in goods. It is mainly carried out by French or foreign multinational corporations, which account for more than 90% of this trade. While just over half of trade takes place with the European Union (EU), this component is running a deficit, while non-EU trade is running a surplus. It is interesting to note that the balance is positive for companies that are part of a French group, but negative for companies belonging to a foreign group (Castor *et al.*, 2016).

## **In conclusion**

It seems that the dichotomy between industry and services is becoming increasingly inappropriate to describe the dynamics of employment and the productive specialization of economies. An approach in terms of productive functions that breaks down the job properly based on whether it involves manufacturing activities strictly speaking or other activities, such as transportation and logistics, administrative support or R&D services, would allow a better understanding of a country's skills and comparative advantages.

More generally, the growth of services and their increasing role in production and exports is giving them an increasingly central role in economic growth. Getting better statistics on the production and export of services and improving the methods of assessing productivity in services are prerequisites for a better understanding of the role of services in growth and of the levers to be activated to achieve this.

[1] A scientific committee responsible for the organization of the OFCE seminar on the Analysis of the Production System is composed of V. Aussilloux (France Stratégie), C. Cahn (Banque de France), V. Charlet (La Fabrique de l'Industrie), M. Crozet (Univ. Paris I, CEPII), S. Guillou (OFCE), E. Kremp (INSEE), F. Magnien (DGE), F. Mayneris (Univ. Louvain), L. Nesta (OFCE), X. Ragot (OFCE), R. Sampognaro (OFCE), and V. Touzé (OFCE).

[2] Miroudot, S. (forthcoming), "Global Value Chains and Trade in Value-Added: An Initial Assessment of the Impact on Jobs and Productivity", *OECD Trade Policy Papers*, no. 190, OECD Publishing.

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# Small recovery after a big crisis

By the Analysis and Forecasting Department

[This text summarizes the 2016-2017 outlook for the global](#)

[economy and the euro zone. Click here to consult the complete version \[in French\].](#)

Global growth is once again passing through a zone of turbulence. While growth will take place, it is nevertheless being revised downwards for 2016 and 2017 to 2.9% and 3.1%, respectively. The slowdown is first of all hitting the emerging countries, with the decline in Chinese growth continuing and even worsening (6.1% anticipated for 2017, down from 7.6% on average in 2012-2014). The slowdown in Chinese demand is hitting world trade and fuelling lower oil prices, which in turn is exacerbating the difficulties facing oil and commodity producers. Finally, the prospect for the normalization of US monetary policy is resulting in a reflux of capital. The dollar is appreciating even as the currencies of the emerging countries of Asia and Latin America are depreciating. While the industrialized countries are also suffering from the Chinese slowdown through the demand channel, growth is resilient there thanks to falling oil prices. The support provided by monetary policy is being cut back in the US, but is strengthening in the euro zone, keeping the euro at a low level. Countries are no longer systematically adopting austerity policies. In these conditions, growth will slow in the US, from 2.4% in 2015 to 1.9% in 2016 and then 1.6% in 2017. The recovery will pick up pace slightly in the euro zone, driven mainly by the dynamism of Germany and Spain and the improved outlook in France and Italy. For the euro zone as a whole, growth should come to 1.8% in 2016 and 1.7% in 2017. This will push down the unemployment rate, although by year-end 2017 it will still be 2 points above its pre-crisis level (9.3%, against 7.3% at year-end 2007).

While the United States seems to have avoided the risk of deflation, the euro zone is still under threat. Inflation is close to zero, and the very low level of expectations for long-term inflation reflects the ECB's difficulty in regaining

control of inflation. Persistent unemployment indicates some continuing shortcomings in managing demand in the euro zone, which has in fact been based entirely on monetary policy. While the ECB's actions are a necessary condition for accelerating growth, they are not sufficient, and must be supplemented by more active fiscal policy.

At the level of the euro zone as a whole, overall fiscal policy is neutral (expansionary in Germany and Italy in 2016 but restrictive in France and even more so in Greece), whereas it needs to be more expansionary in order to bring unemployment down more rapidly and help to avert deflationary risks. Furthermore, the continuing moderate growth is leading to the accumulation of current account surpluses in the euro zone (3.2% in 2015). While imbalances within the euro zone have been corrected to some extent, this mainly took place through adjustments by countries in deficit prior to the crisis. Consequently, the surplus in the euro zone's current account will eventually pose risks to the level of the euro, which could appreciate once the monetary stimulus ends, thereby slowing growth.

**Table. Outlook for world growth**

Annual growth rate (%)

	Weight in the total(1)	GDP in volume		
		2015	2016	2017
DEU	3,7	1,4	1,9	1,6
FRA	2,6	1,2	1,6	1,6
ITA	2,3	0,6	1,2	1,0
ESP	1,6	3,2	3,3	2,4
EUZ	13,4	1,5	1,8	1,7
GBR	2,4	2,3	2,1	1,7
NPM(2)	2,4	3,8	3,1	3,2
UE 28	18,6	1,9	2,0	1,8
USA	17,2	2,4	1,9	1,7
JPN	4,8	0,5	0,7	0,4
Developed countries	44,5	1,9	1,7	1,6
RUS	3,6	-3,7	-1,0	1,0
CHN	14,9	6,9	6,3	6,1
Other Asian countries	16,6	5,2	5,2	5,4
Latin America	8,8	-0,4	-0,9	1,5
World	100	2,9	2,9	3,1

(1) Weight according to GDP and PPP estimated by the IMF for 2008.

(2) Poland, Hungary, Czech Republic, Romania, Bulgaria and Croatia.

Sources: IMF, OECD, national sources, OFCE calculations and forecast, April 2016.