# Holding to the required course

By Eric Heyer

This text summarizes the OFCE's 2013-2014 forecasts for the French economy.

In 2013, the French economy should see negative annual average growth, with a fall in GDP of 0.2%, before a modest recovery in 2014, with growth of 0.6 % (Table 1). This particularly mediocre performance is far from the path that an economy pulling out of a crisis should be taking.

Table 1. Summary of the forecast for 2013 and 2014

In %, annual average

| | 2010 | 2011 | 2012 | 2013* | 2014* |
|---|---|---|---|---|---|
| **Taux de croissance du PIB** | **1,6** | **1,7** | **0,0** | **-0,2** | **0,6** |
| Imports | 8,4 | 5,2 | -0,3 | 0,1 | 1,7 |
| Household consumption | 1,4 | 0,2 | -0,1 | 0,0 | 0,8 |
| Government consumption | 1,7 | 0,2 | 1,4 | 1,2 | 0,2 |
| Total investment | 1,0 | 3,5 | 0,0 | -1,9 | -0,5 |
| Exports | 9,2 | 5,5 | 2,5 | 0,9 | 2,2 |
| ***Contribution to growth*** | | | | | |
| Domestic demand excl. inventory | 1,5 | 0,9 | 0,3 | -0,1 | 0,5 |
| Change in inventory | 0,0 | 0,8 | -1,0 | -0,3 | 0,0 |
| Trade balance | 0,0 | 0,0 | 0,7 | 0,2 | 0,1 |
| **GDP growth rate, euro zone** | **2,0** | **1,1** | **-0,5** | **0,4** | **0,9** |
| ***Other indicators*** | | | | | |
| Inflation (consumption deflator) | 1,1 | 2,1 | 1,9 | 1,6 | 1,6 |
| Savings rate (% of GDI) | 15,9 | 16,2 | 16,0 | 15,6 | 15,2 |
| Unemployment rate | 9,3 | 9,2 | 9,9 | 10,7 | 11,4 |
| Public deficit (GDP points) | 7,1 | 5,2 | 4,8 | 3,9 | 3,0 |
| Public debt (GDP points) | 82,4 | 85,8 | 90,2 | 93,3 | 94,8 |
| **GDP growth rate (year-on-year)** | **1,8** | **1,1** | **-0,3** | **0,3** | **0,7** |

*Sources* : INSEE, quarterly accounts; OFCE *e-mod.fr* forecast for 2013 and 2014.

Four years after the start of the crisis, the French economy has a substantial potential for recovery: this should have led to average spontaneous growth of about 2.6% per year in 2013 and 2014, making up some of the output gap accumulated since

the onset of the crisis. But this spontaneous recovery is being hampered mainly by the introduction of fiscal savings plans in France and across Europe. To meet its commitment to cut the public deficit to 3% by 2014, the French government will have to hold to the course of fiscal consolidation it adopted in 2010, which was imposed by the European Commission in all the euro zone countries. This budget strategy should slash 2.6 percentage points off GDP growth in France in 2013 and 2.0 percentage points off GDP in 2014 (Table 2).

Table 2. The obstacles to growth in France during the years 2013 and 2014

In GDP points

| | 2013 | 2014 |
|---|---|---|
| GDP growth | -0,2 | 0,6 |
| Impact on GDP due to ... | | |
| ... oil changes | -0,2 | 0,0 |
| *Direct impact on the French economy* | *-0,1* | *0,0* |
| *Impact via addressed demand* | *0,0* | *0,0* |
| ... austerity measures | -2,6 | -2,0 |
| *Direct impact on the French economy* | *-1,8* | *-1,4* |
| *Impact via addressed demand* | *-0,8* | *-0,6* |
| ... monetary conditions | 0,0 | 0,0 |
| *Direct impact on the French economy* | *0,0* | *0,0* |
| *Impact via addressed demand* | *0,0* | *0,0* |
| ... policies on competition | 0,1 | -0,1 |
| *Direct impact on the French economy* | *0,2* | *0,0* |
| *Impact via addressed demand* | *-0,1* | *-0,1* |
| Achievement | -0,2 | 0,1 |
| Spontaneous growth rate | 2,6 | 2,6 |

*Sources* : INSEE, OFCE calculations.

By setting a pace far from its potential, the expected growth will aggravate the output gap built up since 2008, with the labour market thus continuing to worsen. The unemployment rate will rise steadily to 11.6% in late 2014.

Only a shift in European fiscal strategy could halt the rise in unemployment. This would mean limiting the negative fiscal stimulus to 0.5 percent of GDP instead of the total of 1.0 points planned in the euro zone in 2014. This reduced fiscal

effort could be repeated until the public deficit or debt reaches a defined goal. Compared to current plans, because the effort would be measured the burden of adjustment would be spread more fairly over the taxpayers in each country, avoiding the pitfall of drastic cuts in the public budgets. This new strategy would lead to a slower reduction in the public deficit (-3.4% in 2014 against -3.0% in our central scenario), but also and especially to higher economic growth (1.6% against 0.6%). This "less austerity" scenario would allow the French economy to create 119,000 jobs in 2014, *i.e.* 232,000 more than in our central forecast, and unemployment would fall instead of continuing to increase.

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# Should spending on unemployment benefits be cut?

By Gérard Cornilleau

The Cour des comptes [Court of Auditors] has presented a report on the labour market which proposes that policy should be better "targeted". With regard to unemployment benefits in particular, it focuses on the non-sustainability of expenditure and suggests certain cost-saving measures. Some of these are familiar and affect the rules on the entertainment industry and compensation for interim employees. We will not go into this here since the subject is well known [1]. But the Cour also proposes cutting unemployment benefits, which it says are (too) generous at the top and the bottom of the pay scale. In particular, it proposes reducing the maximum benefit level and establishing a digressive system, as some unemployed

executives now receive benefits of over 6,000 euros per month. The reasoning in support of these proposals seems wrong on two counts.

In the first place, the diagnosis of the system's lack of sustainability fails to take the crisis into account: if Unedic is now facing a difficult financial situation, this is above all because of falling employment and rising unemployment. It is of course natural that a social protection system designed to support employees' income in times of crisis is running a deficit at the peak of a crisis. Seeking to rebalance Unedic's finances today by cutting benefits would abandon the system's countercyclical role. This would be unfair to the unemployed and economically absurd, as reducing revenues in a period of an economic downturn can only aggravate the situation. In such circumstances, it is also easy to understand that arguments for work incentives are of little value: it is at the top of the cycle, when the economy is approaching full employment, that it makes sense to raise the issue of back-to-work incentives. When the economy is bumping along the bottom, encouraging a more active job search may change the distribution of unemployment, but certainly not its level.

The current deficit in the unemployment insurance system simply reflects the situation of the labour market. A few calculations can help to show that the system's generosity is fully compatible with financial stability in "normal" times. To establish this, we simply measure the impact of economic growth, employment and unemployment on the system's deficit since 2009. In 2008, Unedic was running a financial surplus of nearly 5 billion euros [2]. This turned into a deficit of 1.2 billion euros in 2009 and 3 billion in 2010, before recovering somewhat in 2011 with a deficit of only 1.5 billion, which then rose to 2.7 billion in 2012. For 2013, the deficit is expected to reach 5 billion. The Table shows our estimates of the impact of the crisis on the system's revenues and

expenditures since 2009. The estimated revenue lost due to the crisis is based on the assumption of an increase in annual payroll of 3.5% per year (which breaks down into 2.9% for increases in the average wage and 0.6% for rises in employment) if the crisis had not occurred in 2008-2009. On the expenditure side, the estimated increase in benefits due to the crisis is based on the assumption of a stable level of "non-crisis" unemployment, with spending in this case being indexed on the trend in the average wage.

Table. Impact of the crisis on Unedic's accounts

In billions of euros

| | Impact of the crisis… | | Impact |
|---|---|---|---|
| | … on revenue | … on expenditure | on the balance |
| 2009 | -1,8 | +4,1 | -5,9 |
| 2010 | -2,1 | +5,1 | -7,2 |
| 2011 | -2,6 | +5,5 | -8,1 |
| 2012 | -3,1 | +6,5 | -9,6 |

*Source* : Author's calculations.

The results of this estimation clearly show that the crisis is solely responsible for the emergence of the substantial deficit run up by the unemployment insurance system. Without rising unemployment and falling employment, the system would have continued with a structural surplus, and the reform of 2009, which allowed compensation for unemployed people with shorter work references (4 months instead of 6 months), would have had only a minimal effect on its financial situation. There was no breakdown of the system, which was in fact perfectly sustainable in the long term … so long as counter-cyclical economic policies are implemented that prevent a surge in unemployment, whose sustainability is now undoubtedly more of a concern than the finances of Unedic [3].

Based on a diagnosis that is thus very questionable, the Cour des comptes has proposed reducing the generosity of unemployment benefits. Since it is difficult to put forward proposals for cutting lower benefit levels, the Cour put more emphasis on the savings that could be achieved by limiting very high benefits, which in France may exceed 6,000 euros per

month for executives on high-level salaries that are up to 4 times the maximum social security cap, which in 2013 was 12,344 euros gross per month. In reality, from a strictly accounting perspective, it is not even certain that this will have positive effects on Unedic's finances. Indeed, few people benefit from these top benefit levels, because executives are much less likely to be unemployed than are other employees. On the other hand, their higher salaries are charged at the same contribution rates, meaning that they make a net positive contribution to financing the scheme. Calculations based on the distribution of wages and of the benefits currently received by unemployed people insured by Unedic show that employees who earn more than 5,000 euros gross per month receive about 7% of unemployment benefits but provide nearly 20% of the contributions. For example, we simulated a reform that would bring French unemployment insurance into line with the German system, which is much more severely capped than the French system. The German ceiling is 5,500 euros gross per month (former Länder), against 12,344 in the French system. By retaining a cap of 5,000 euros gross per month, the maximum net benefit level in France would be around 2,800 euros. Based on this assumption, the benefits received by the unemployed in excess of the ceiling would be reduced by nearly 20%, but the savings would barely amount to more than 1% of total benefits. On the revenue side, the lower limit would result in a reduction in revenue of about 5%. The existence of a high ceiling in the French unemployment insurance system actually allows a significant vertical redistribution because of the differences in unemployment rates. Paradoxically, reducing insurance for the most privileged would lead to reducing this redistribution and undermining the system's financial stability. Based on the above assumptions, shifting to a ceiling of 5,000 euros would increase the deficit by about 1.2 billion euros (1.6 billion revenue – 400 million expenditure).

This initial calculation does not take into account the potential impact on those whose unemployment benefits would be

greatly reduced. To clarify the order of magnitude of this effect, which is, by the way, unlikely, we simulated a situation in which the number of recipients of the highest benefits would be cut in half (*e.g.* by a reduction in the same proportion of the time they remain unemployed). Between the new ceiling and the highest level of the reference salaries, we estimated that the incentive effect increased linearly (10% fewer unemployed in the first tranche above the ceiling, then 20% fewer, etc., up to -50%). Using this hypothesis of a high impact of benefit levels on unemployment, the additional savings on benefits would be close to 1 billion euros. In this case, the reform of the ceiling would virtually balance (with an added potential cost [not significant] of 200 million euros). But we did not include the fact that the shortening of the duration of unemployment compensation for unemployed people on high benefits could increase the duration of the unemployed on lower benefits. In a situation of near full employment, it is possible to consider that the rationing of employment results from the rationing of the supply of work; in the current situation of a generalized crisis, the more realistic case involves the opposite situation of a rationing of demand for labour. Achieving budget savings by cutting high benefit levels is not credible, at least if we stick to a reform that does not change the very nature of the system.

One could of course obtain a more favourable result by reducing only the cap on benefits and not the cap on contributions. This would be very destabilizing for the system, since it would strongly encourage executives to try to pull out of a unified solidarity system that provides them with reasonable assurances today through the acceptance of a high level of vertical redistribution, while lowering the cap on benefits alone would force them to insure themselves individually while continuing to pay high mandatory fees. This type of change would inevitably call into question the basic principle of social insurance: contributions based on each person’s means in return for benefits based on need.

The general economics in the Cour's report on unemployment benefits thus seem highly questionable because, by not taking into account the effect of the crisis, it winds up proposing a pro-cyclical policy that puts additional burdens on the unemployed at a time when it is less possible than ever to make them bear the responsibility for underemployment. As for the key measure that challenges the compromise on high level benefits, it would at best be budget neutral and at worst destroy the social contract that today makes possible strong vertical redistribution within the unemployment insurance system.

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[1] Unemployment insurance has a special scheme for interim workers in the entertainment industry worth a billion euros per year. It would obviously be sensible for this expenditure to be borne by the general budget and not by Unedic.

[2] Excluding exceptional operations.

[3] On economic policy in Europe and the lack of macroeconomic sustainability, see the initial report of the Independent Annual Growth Survey project (IAGS) .

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# The tax credit to encourage competitiveness and jobs – what impact?

By Mathieu Plane

Following the submission to the Prime Minister of the Gallois Report on the pact for encouraging the competitiveness of French industry, the government decided to establish the tax credit to encourage competitiveness and jobs ("the CICE"). Based on the rising trade deficit observed over the course of the last decade, the sharp deterioration in business margins since the onset of the crisis and growing unemployment, the government intends to use the CICE to restore the competitiveness of French business and to boost employment. According to our assessment, which was drawn up using the e-mod.fr model as described in an article in the *Revue de l'OFCE* (issue 126-2012), within five years the CICE should help to create about 150,000 jobs, bringing the unemployment rate down by 0.6 point and generating additional growth of 0.1 GDP point by 2018.

The CICE, which is open to all companies that are assessed on their actual earnings and are subject to corporation tax or income tax, will amount to 6% of the total wage bill for wages below 2.5 times the minimum wage (SMIC), excluding employer contributions. It will come into force gradually, with a rate of 4% in 2013. The CICE's impact on corporate cash flow will be felt with a lag of one year from the base year, meaning that the CICE will give rise to a tax credit on corporate profits from 2014. On the other hand, some companies could benefit in 2013 from an advance on the CICE expected for 2014. The CICE should represent about 10 billion euros for the 2013 fiscal year, 15 billion in 2014 and 20 billion from 2015. As for the financing of the CICE, half will come from additional savings on public spending (10 billion), the details of which have not been spelled out, and half from tax revenue, *i.e.* an increase in the standard and intermediate VAT rate from 1 January 2014 (6.4 billion) and stronger environmental taxation.

This reform is similar in part to a fiscal devaluation and in some respects bears similarities to the mechanisms of the

"quasi-social VAT" (see Heyer, Plane, Timbeau [2012], "Economic impact of the quasi-social VAT" [in French]) that was set up by the Fillon government but eliminated with the change of the parliamentary majority as part of the second supplementary budget bill in July 2012.

According to our calculations using 2010 DADS data, the CICE would lower average labour costs by 2.6% in the market sector. The sectors where labour costs would be most affected by the measure are construction (-3.0%), industry (-2.8%) and market services (-2.4%). The ultimate sectoral impact of the measure depends both on the reduction in labour costs and on the weight of wages in value added in a given sector. Overall, the CICE would represent 1.8% of the value added of industrial enterprises, 1.9% of the value added in construction and 1.3% in market services. In total, the CICE would represent 1.4% of the value added in market sector companies. According to our calculations, the total value of the CICE would be 20 billion euros: 4.4 billion in industry, 2.2 billion in construction and 13.4 billion for market services. Industry would therefore recover 22% of the total spending, *i.e.* more than its share of value added, which is only 17%. While this measure is intended to revive French industry, this sector would nevertheless not be the primary beneficiary of the measure in absolute value, but, along with the construction sector, has the best exposure relatively speaking due to its wage structure. Furthermore, industry can benefit from knock-on effects related to reductions in the prices of inputs generated by the lowering of production costs in other sectors.

The expected effects of the CICE on growth and employment differ in the short and long term (see graphic). By giving rights in 2014 based on the 2013 fiscal year, the CICE will have positive effects in 2013, especially as the tax hikes and public spending cuts will not take effect until 2014. The result will be a positive impact on growth in 2013 (0.2%), although it will take longer to affect employment (+23,000 in

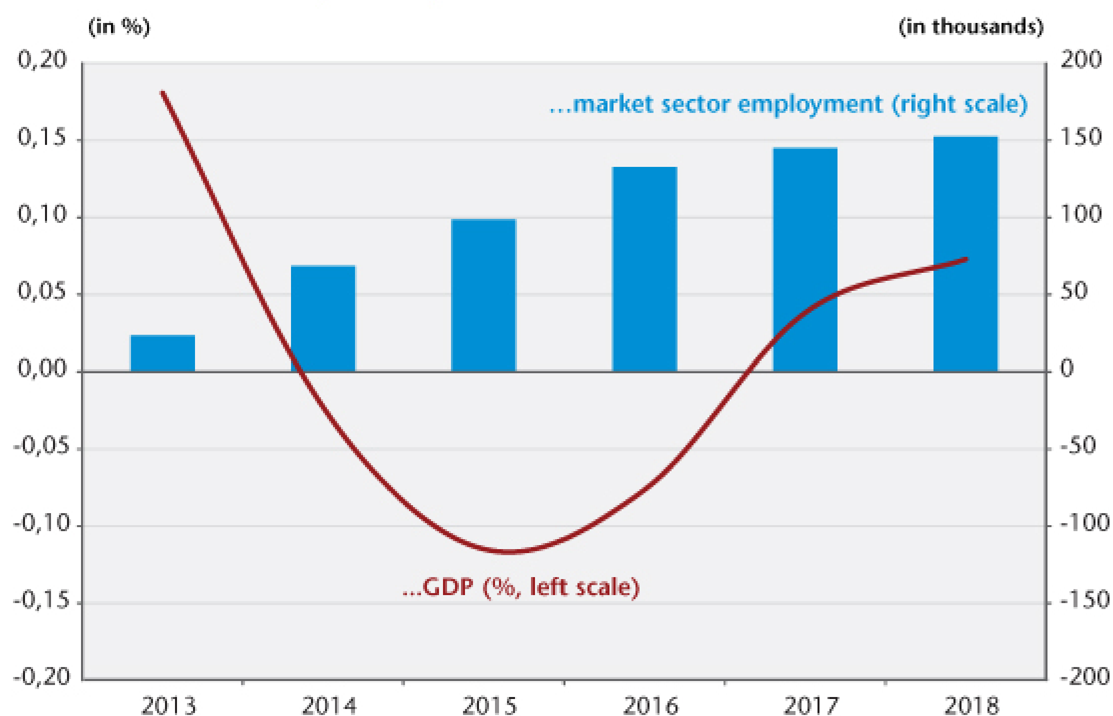
2013) due to the time it takes employment to adjust to activity and the gradual ramping-up of the measure.

On the other hand, the impact of the CICE will be slightly recessive from 2014 to 2016, as the loss in household purchasing power linked to higher taxes and the cuts in public spending (household consumption and public demand will contribute -0.2 GDP point in 2014 and then -0.4 point in 2015 and 2016) will prevail over lower prices and the recovery of business margins. Apart from the first year, the CICE's positive impact on growth related to income transfers will be slow to be seen, as gains in market share related to lower prices and to higher business margins are dependent on a medium / long-term supply-side mechanism, with demand-side impacts being felt more rapidly.

The implementation of the CICE will gradually generate gains in market share that will make a positive contribution to activity by improving the foreign trade balance (0.4 GDP point in 2015 and 2016), whether through increased exports or reduced imports. From 2017, the external balance will not contribute as much to the economy (0.3 GDP point) due to the improved purchasing power of households, resulting in slowing the reduction in imports. Despite the higher margins and the improved profitability of capital, productive investment will fall off slightly due to the substitution effect between labour and capital and the negative accelerator effect related to the fall in demand.

With the decline in the cost of labour relative to the cost of capital, the substitution of labour for capital will gradually boost employment to the detriment of investment, which will lead to job-rich GDP improvements and to lower gains in productivity. This dynamic will result in steady gains in employment despite the slight fall-off in activity between 2014 and 2016. Due to the rise in employment and the fall in unemployment, but also to possible wage compensation measures in companies arising from the greater fiscal pressure on

households, wages will regain part of their lost purchasing power based on an increase in real pay. This catch-up in purchasing power will help to generate growth, but will limit the impact on employment and productivity gains.

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# Spain: a lose-lose strategy

by Danielle Schweisguth

*At a time when the IMF has publicly recognized that it underestimated the negative impact of fiscal adjustment on Europe's economic growth, Spain is preparing to publish its public deficit figure for 2012. The initial estimate should be around 8% of GDP, but this could be revised upwards, as was the case in 2011 – while the target negotiated with the European Commission is 6.3%. With social distress at a peak, only a sustainable return to growth would allow Spain to solve*

*its budget problems through higher tax revenue. But the austerity being imposed by Europe is delaying the return of economic growth. And the level of Spain's fiscal multiplier, which by our estimates is between 1.3 and 1.8, is rendering the policy of fiscal restraint ineffective, since it is not significantly reducing the deficit and is keeping the country in recession.*

At a time when the IMF has publicly recognized that it underestimated the negative impact of fiscal adjustment on Europe's economic growth – the famous fiscal multiplier – Spain is preparing to publish its public deficit for 2012. The initial estimate should be around 8% of GDP, but this could be revised upwards as was the case in 2011. If we exclude the financial support for the banking sector, which is not taken into account in the excessive deficit procedure, the deficit then falls to 7% of GDP. This figure is still higher than the official target of 6.3% that was the subject of bitter negotiations with the European Commission. Recall that until September 2011, the initial target deficit for 2012 was 4.4% of GDP. It was only after the unpleasant surprise of the publication of the 8.5% deficit for 2011 (which was later revised to 9.4%) – which was well above the official 2011 target of 6% of GDP – that the newly elected government of Mariano Rajoy asked the European Commission for an initial relaxation of conditions. The target deficit was then set by Brussels at 5.3% of GDP for 2012. In July 2012, pressure on Spain's sovereign rate – which approached 7% – then led the government to negotiate with the Commission to put off the 3% target to 2014 and to set a deficit target of 6.3% of GDP in 2012.

Tableau. Growth, fiscal impulse and the public deficit in Spain

| | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 |
|---|---|---|---|---|---|---|
| GDP growth (%) | 3,5 | 0,9 | -3,7 | -0,3 | 0,4 | -1,4 |
| Fiscal impulse (% of GDP) | 0,6 | 1,0 | 1,3 | -2,2 | -0,9 | -3,3 |
| Public deficit* (% of GDP) | 1,9 | -4,5 | -11,2 | -9,7 | -9,4 | -8,0 |

* The public deficit includes the financial support given to the banking sector.
*Sources* : Ministerio de Hacienda y Administraciones Publicas, OFCE forecast for 2012.

But the strategy of trying to reduce the deficit by 2.6 GDP points while in a cyclical downturn proved to be ineffective and even counter-productive. Furthermore, the result has not been worth the effort involved, even though the European authorities have praised it repeatedly. A succession of three consecutive years of austerity plans of historic proportions (2010, 2011 and 2012) has led to only a very small improvement in the budget balance (Table). The deficit was reduced by 3.2 percentage points in three years, while two years of crisis were enough to expand it by 13.3 points (from 2007 to 2009). The fiscal impulse was -2.2 percentage points of GDP in 2010, -0.9 point in 2011 and -3.3 points in 2012, or a total of 6.4 GDP points of fiscal effort (68 billion euros). Yet the crisis has precipitated the collapse of the real estate market and greatly weakened the banking system. Since then, the country has plunged into a deep recession: GDP has fallen by 5.7% since the first quarter of 2008, which puts it 12% below its potential level (assuming potential growth of 1.5% per year), with 26% of the workforce currently unemployed, in particular 56% of the young people.

The deterioration of Spain’s economic situation has hit tax revenue very hard. Between 2007 and 2011, the country’s tax revenues have fallen further than in any other country in the euro zone. Revenue declined from 38% of GDP in 2007 to 32.4% in 2011, despite a hike in VAT (2 points in 2010 and 3 points in 2012) and an increase in income tax rates and property taxes in 2011. The successive tax increases only slightly alleviated the depressive effect of the collapse of the tax

base. VAT revenues recorded a sharp drop of 41% in nominal terms between 2007 and 2012, as did the tax on income and wealth (45%). In comparison, the decrease in tax revenue in the euro zone was much more modest: from 41.2% of GDP in 2007 to 40.8% in 2011. Finally, rising unemployment has undermined the accounts of the social security system, which will experience a deficit of 1 percentage point of GDP in 2012 for the first time in its history.

To compensate for the fall in tax revenue, the Spanish government had to take drastic measures to restrict spending to try to meet its commitments, including a 5% reduction in the salaries of civil servants and the elimination of their Christmas bonus; a hiring freeze in the public sector and increasing the work week from 35 to 37.5 hours (without extra pay); raising the retirement age from 65 to 67, along with a pension freeze (2010); a reduction of unemployment benefits for those who are unemployed more than seven months; and lowering severance pay from 45 days per year worked to 33 days (20 if the company is in the red). Even though household income has stagnated or declined, Spanish families have experienced a significant increase in the cost of living: a 5-point increase in VAT, higher electricity rates (28% in two years), higher taxes on tobacco and lower reimbursement rates for medicines (retirees pay 10% of the price and the employed 40% to 60%, depending on their income).

The social situation in Spain is very worrying. Poverty has increased (from 23% of the population in 2007 to 27% in 2011, according to Eurostat); households failing to pay their bills are being evicted from their homes; long-term unemployment has exploded (9% of the labour force); unemployed youth are a lost generation, and the best educated are emigrating. The VAT increase in September has forced households to tighten their budgets: spending on food declined in September and October 2012, respectively, by 2.3% and 1.8% yoy. Moreover, the Spanish health system is suffering from budget cuts (10% in

2012), which led to the closure of night-time emergency services in dozens of municipalities and to longer waiting lists for surgery (from 50,000 people in 2009 to 80,000 in 2012), with an average waiting time of nearly five months.

Social distress is thus at a peak. The movement of the *indignados* led millions of Spaniards to take to the streets in 2012, in protests that were often violently suppressed by riot police. The region of Catalonia, the richest in Spain but also the most indebted, is threatening to secede, to the consternation of the Spanish government. On 24 January, the Catalan government passed a motion on the region's sovereignty, the first step in a process of self-determination that could lead to a referendum in 2014.

Only a lasting return to growth would enable Spain to solve its budget problems through higher tax revenue. But the tightening of financing conditions on Spain's sovereign debt since the summer of 2012 has forced the government to strengthen its austerity policy, which is delaying the return to economic growth. Furthermore, the European Commission has agreed to provide financial assistance to Spain only if it renounces its sovereignty in budget matters, at least partially, which the government of Mariano Rajoy is still reluctant to accept. The initiative of the European Commission on the exclusion of capital expenditures from calculations of the public deficit for countries close to a balanced budget, the details of which will be published in the spring, is a step in the right direction (El Pais). But this rule would apply only to the seven countries where the fiscal deficit is below 3% of GDP (Germany, Luxembourg, Sweden, Finland, Estonia, Bulgaria and Malta), which leaves out the countries facing the most difficult economic situations. Greater awareness of the social dramas that underlie these poor economic performances should lead to greater respect for the fundamental rights of Europe's citizens. Moreover, in the 2013 iAGS report the OFCE showed that a restrained austerity policy

(budget restrictions limited to 0.5 percent of GDP each year) is more effective from the viewpoint of both growth and deficit reduction in countries like Spain where the fiscal multipliers are very high (between 1.3 and 1.8, according to our estimates).

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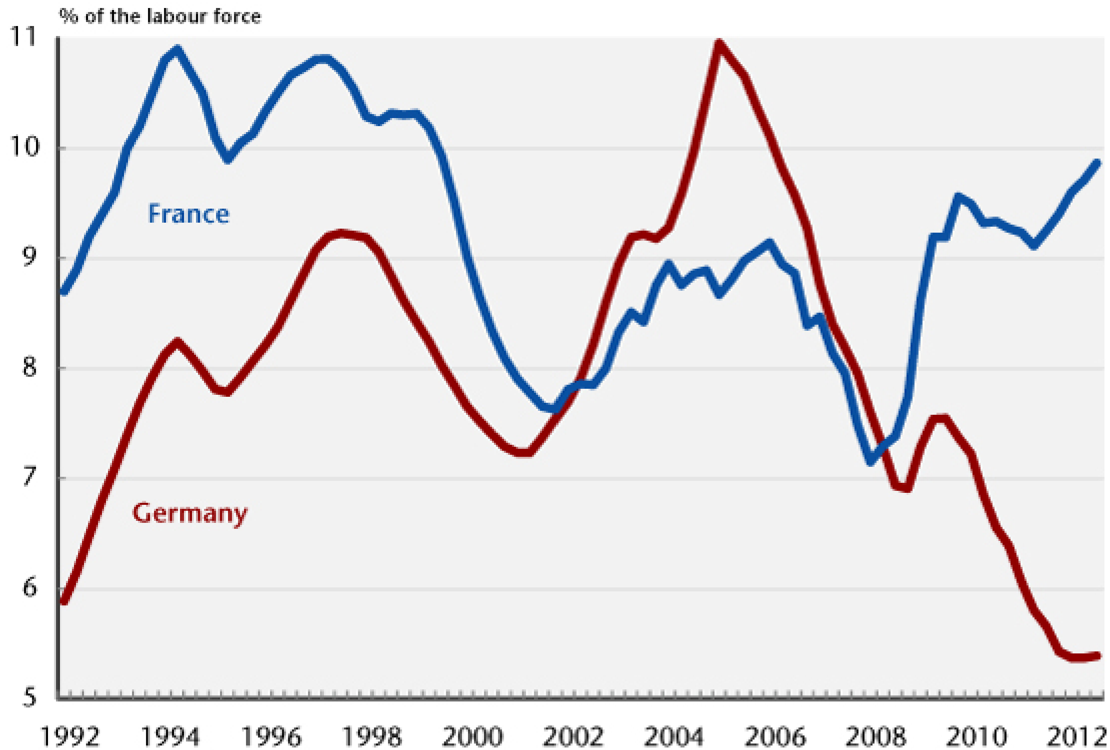
# Higher unemployment in France, greater poverty in Germany

By Eric Heyer

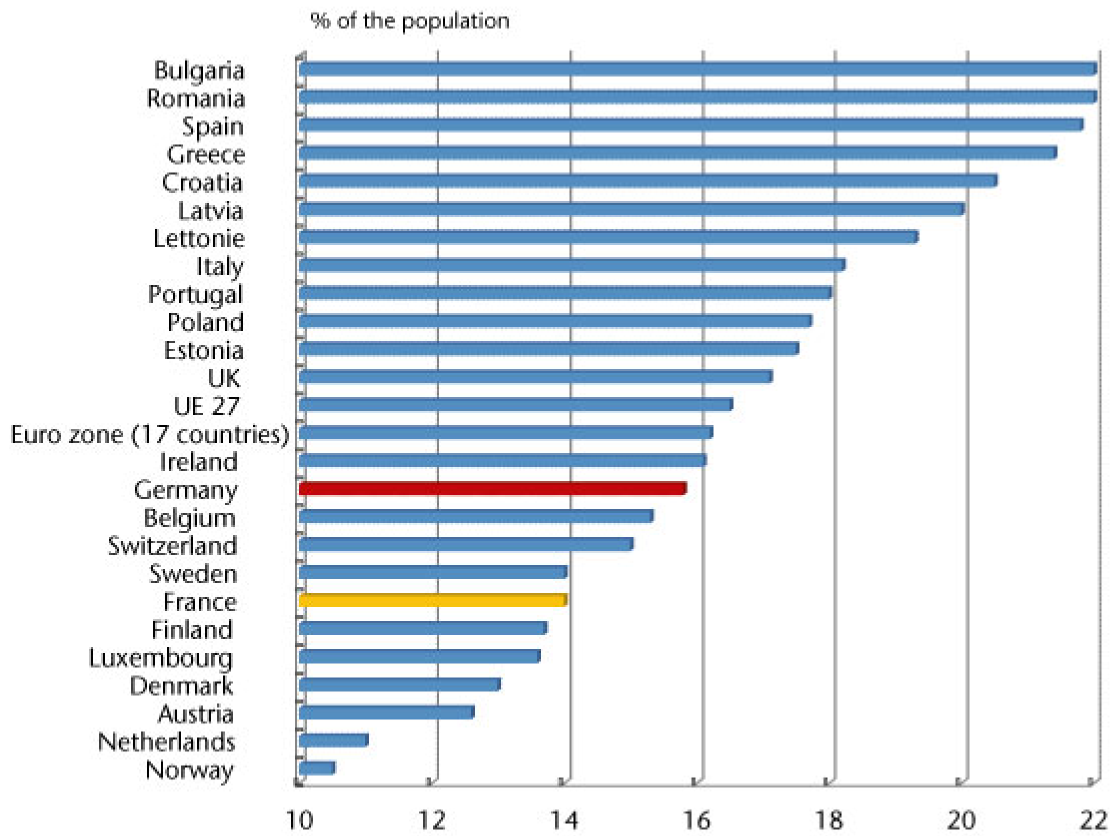
Will France be the new Greece, as *The Economist* has argued? Should French reforms be accelerated and be modelled on those implemented in Germany ten years ago? For German public opinion, for its authorities and for a large number of economic experts, the answer is obvious. Not only does Germany have a lower deficit, but unlike its French neighbour it has also managed to significantly reduce its unemployment rate. Starting from a similar level in the early 2000s (close to 7.7% at end 2001), the unemployment rate now stands at 5.4% of the labour force in Germany, 4.5 percentage points below the level in France (Figure 1).




The purpose of this note is not to revisit the reasons for this difference, which have already been the subject of posts on this blog (see in particular the impact of demography, by G. Cornilleau, of the reduction in working hours, by E. Heyer and M. Plane, and of the rise in male-female inequalities, by H. Périvier). The point rather is simply to note that the reduction of unemployment in Germany has been accompanied by a steep rise in poverty.

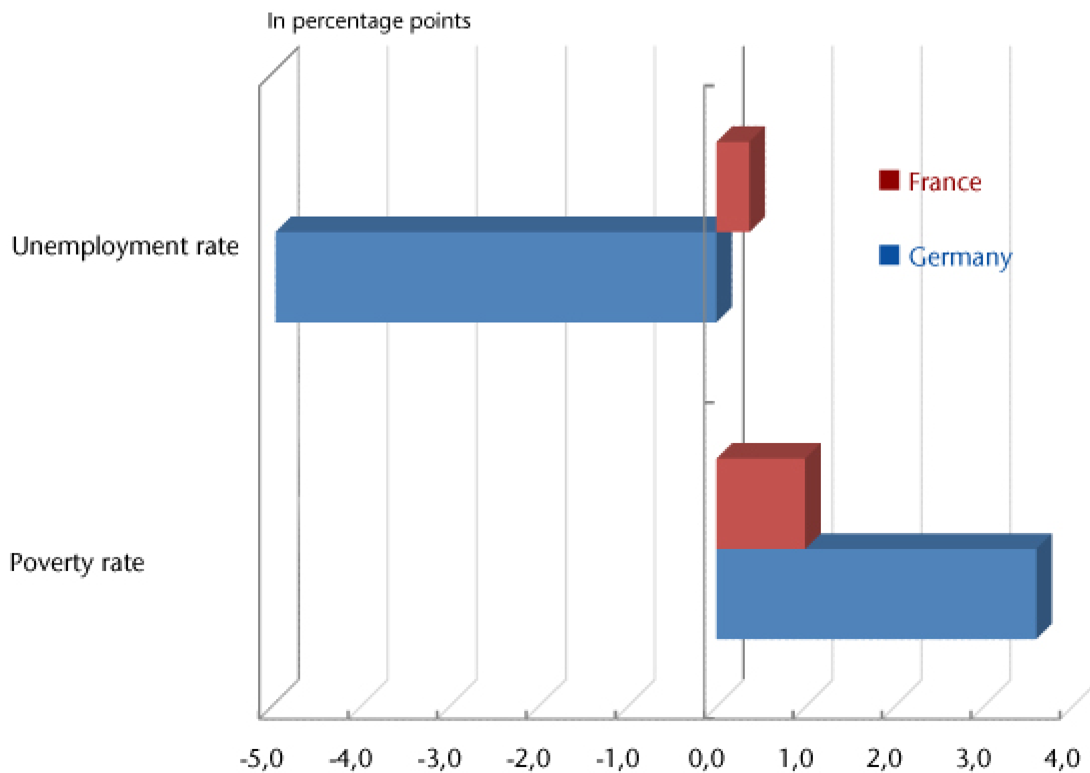
According to Eurostat, over the past six years the poverty rate (measured at the threshold of 60% of median income) has risen by 3.6 percentage points in Germany, four times more than the rise observed in France (0.9 point). In 2011, despite the sharp drop in unemployment and the large differential with France, the poverty rate in Germany was 1.8 points higher than the level observed in France, *i.e.* a difference of over 11% (Figures 2 & 3).

Graphique 2 : Poverty rate (60 % of median income) in 2011




*Source* : Eurostat.

**Figure 3 : Changes in the unemployment rate and poverty rate (60 % of median income) in France and in Germany (2005-2011)**




*Source* : Eurostat.

There is, therefore, a hidden side to the reforms implemented in Germany over the past ten years, which have led to lower unemployment but greater poverty.

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# France: will the war of the 3% take place?

By Eric Heyer

*This text summarizes the OFCE's October 2012 forecasts for the French economy.*

The French economy is expected to see average annual growth of 0.1% in 2012 and 0.0% in 2013. This performance is particularly poor and far from the path that an economy recovering from a crisis would normally experience.

Four years after the onset of the crisis, the French economy has real potential for a rebound: this should lead to spontaneous average growth of about 3.0% per year in 2012 and 2013, making up some of the output gap built up since the start of the crisis. But this spontaneous recovery is being hampered, mainly by the establishment of budgetary savings plans in France and throughout Europe. The fiscal consolidation strategy imposed by the European Commission is likely to slice nearly 6 percentage points off GDP in France during 2012 and 2013.

Table 1. The brakes on growth in France

En points of GDP

| Rythm | ... quaterly | | ... annually | |
|---|---|---|---|---|
| | 2012 | 2013 | 2012 | 2013 |
| Spontaneous recovery | 0,8 | 0,8 | 2,1 | 3,1 |
| *Budget impact* | *-0,4* | *-0,4* | *-1,6* | *-1,7* |
| *Oil shock* | *-0,05* | *0,0* | *-0,2* | *0,0* |
| *External environment* | *-0,4* | *-0,3* | *-1,4* | *-1,2* |
| *Achievement* | | | *-1,0* | *-0,2* |
| Growth forecasts | -0,04 | 0,04 | 0,1 | 0,0 |

Sources : INSEE, OFCE calculations.

By setting a pace that is far from its potential, the expected growth will increase the output gap accumulated since 2008 and will lead to a further deterioration on the labour market. The unemployment rate will rise steadily and hit 11% by late 2013.

Moreover, the reduction of the budget deficit expected by the Government due to the implementation of its consolidation strategy – the target for the general government deficit is 3% of GDP in 2013 – will be partially undermined by the shortfall in tax revenue due to weak growth. The general government deficit will come to 3.5% in 2013.

Under these conditions, should the government do whatever it can to fulfil its commitment to a 3% deficit in 2013?

In a context of financial uncertainty, being the only State not to keep its promise of fiscal consolidation is a risk, *i.e.* of being punished immediately by an increase in the financial terms on the repayment of its debt. This risk is real, but limited. The current situation is that of a “liquidity trap” and abundant savings. The result is a “flight to quality” phenomenon on the part of investors seeking safe investments. But among these are both German and French government bonds. Under these conditions, reducing the government deficit by 1 GDP point instead of 1.5 point would have very little impact on French bond rates.

However, maintaining a target of a 3% deficit in 2013 could

have a dramatic impact on economic activity and employment in France. We simulated a scenario in which the French government maintains its budgetary commitment regardless of the costs and the economic situation. If this were to occur, it would require the adoption of a new programme of budget cuts in the coming months in the amount of 22 billion euros.

This strategy would cut economic activity in the country by 1.2% in 2013. It would lead to a further increase in the unemployment rate, which would reach 11.7% at year end, nearly 12%. As for employment, this obstinacy would intensify job losses, costing nearly 200,000 jobs in total.

A darker scenario is also possible: according to our forecasts, and taking into account the draft budget bills known and approved, no major European country would meet its deficit reduction commitments in 2013. By underestimating the difficulty of reaching inaccessible targets, there is a high risk of seeing the euro zone countries locked into a spiral where the nervousness of the financial markets would become the engine driving ever greater austerity. To illustrate this risk, we simulated a scenario in which the major euro zone countries (Germany, France, Italy and Spain) implement new austerity measures to meet their deficit targets in 2013. Adopting such a strategy would result in a strong negative shock to economic activity in these countries. For the French economy, it would lead to additional austerity that either at the national level or coming from its euro zone partner countries would cause a severe recession in 2013. French GDP would fall by more than 4.0%, resulting in a further increase in the unemployment rate, which would approach 14%.

## Table 2. Illustrative scenarios of risks to French growth

In %

| | 2011 | 2012* | 2013* |
|---|---|---|---|
| **Central scenario** | | | |
| GDP | 1,4 | 0,1 | 0,0 |
| Gov't deficit (*in GDP points*) | -7,1 | -4,4 | -3,5 |
| Unemployment rate | 9,4 | 10,2 | 11,0 |
| Market employment | 104 | -95 | -166 |
| **Scenario where France alone meets its budget commitments** | | | |
| GDP | | | -1,2 |
| Gov't deficit (in GDP points) | | | -3,0 |
| Unemployment rate | | | 11,7 |
| Market employment *(in 1000s)* | | | |
| Change | | | -361 |
| Deviation from central scenario | | | -195 |
| **Scénario where euro zone countries meet their budget commitments** | | | |
| GDP | | | -4,6 |
| Gov't deficit *(in GDP points)* | | | -3,0 |
| Unemployment rate | | | 18,8 |
| Market employment *(in 1000s)* | | | |
| Change | | | -910 |
| Déviation from central scenario | | | -744 |

* OFCE forecast October 2012
*Sources* : INSEE ; OFCE calculations *e-mod.fr.*

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# France-Germany: The big demographic gap

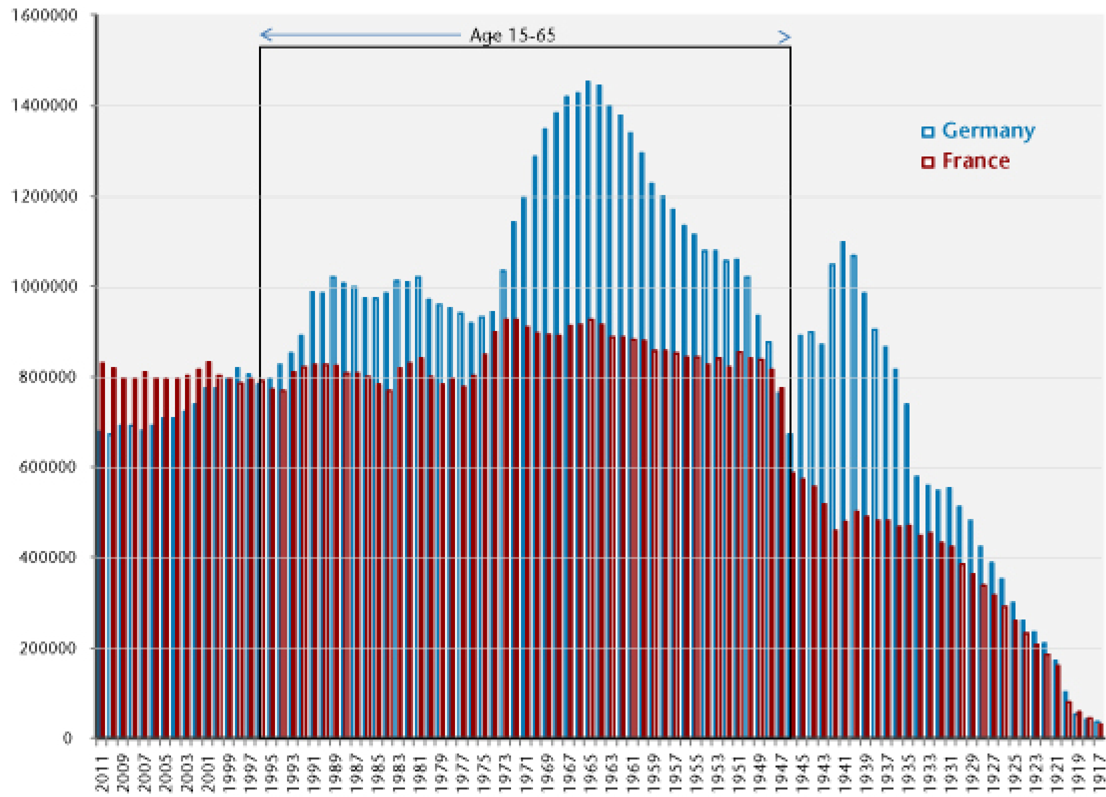
By Gérard Cornilleau

The divergence in the demographic trajectories of Germany and France will have a major impact on social spending, labour markets, productive capacity and the sustainability of public debt in the two countries. The implications are crucial in particular for understanding Germany's concern about its debt.

These demographic differences will require the implementation of heterogeneous policies in the two countries, meaning that the days of a “one-size-fits-all” approach are over.

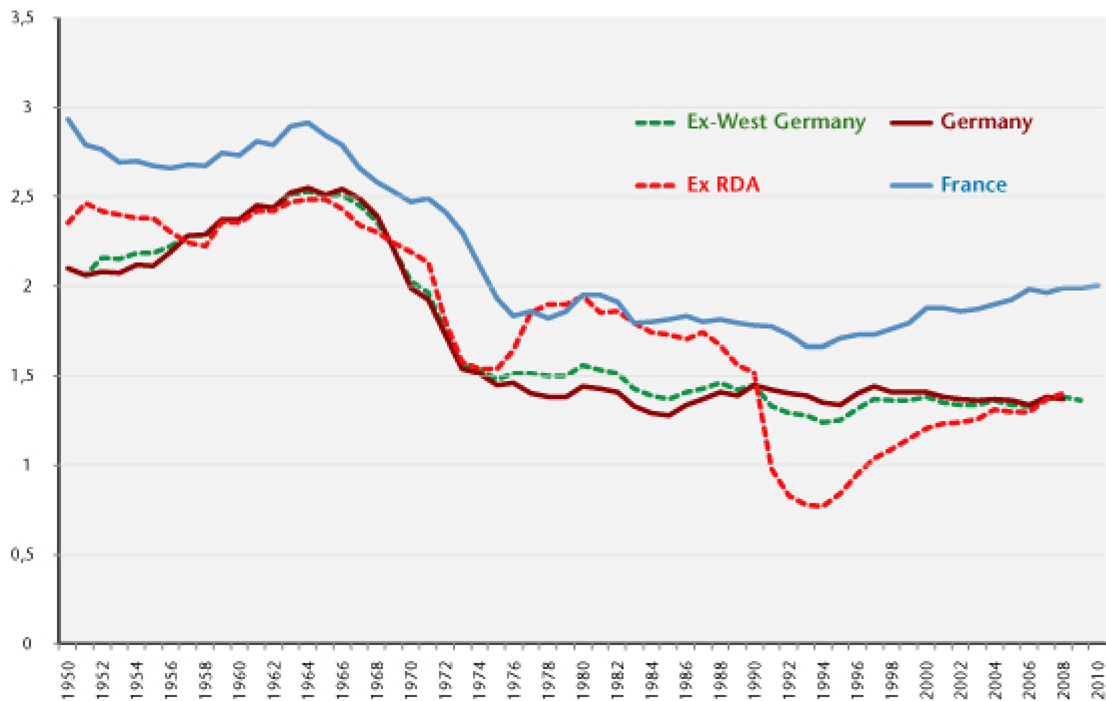
The demographic trajectories of France and Germany are the product of Europe’s history, and in particular its wars. The superposition of the age pyramids (Figure 1) is instructive in this regard: in Germany the most numerous generations are those born during the Nazi period, up to 1946; then come the cohorts born in the mid-1960s (the children of the generations born under the Nazis). In contrast, in France the 1930s generation is not very numerous. As a consequence, the baby-boomer generation which, as can be easily understood, kicked off earlier than in Germany (starting in 1945, at a time of a baby crash in Germany that ended only in the early 1950s, with the German baby boom peaking somewhat late, in the 1960s), was limited in scale, as people of childbearing age were not numerous. On the other hand, the birth rate in France slowed much less in the wake of the 1970s crisis, and most of all it has risen again since the early 1990s. This has resulted in the fertility rate remaining close to 2 children per woman of childbearing age, so that the size of the generations from 1947 to the present has remained virtually constant. German reunification led to a collapse in the birth rate in former East Germany, which converged with the rate in ex-West Germany in the mid-2000s (Figure 2). Overall, French fertility has generally been higher than German fertility in the post-war period, with the gap widening since the early 2000s. As a result, the number of births in France is now substantially higher than the number in Germany: in 2011, 828,000 compared with 678,000, *i.e.* 22% more births in France.

## Figure 1. Age pyramids in 2011




*Source:* Eurostat.

## Figure 2. Instantaneous fertility indicators in France and in Germany




*Source:* INED.

From a demographic standpoint, France and Germany are thus in radically different situations. While France has maintained a satisfactory fertility rate, almost sufficient to ensure the long-term stability of the population, Germany's low birth rate will lead to a substantial and rapid decline in the total population and to much more pronounced ageing than in France (Figures 3 and 4).

According to the population projections adopted by the European Commission [1], Germany should lose more than 15 million inhabitants by 2060, while France gains just under 9 million. By 2045, the populations of the two countries should be the same (a little under 73 million), while in 2060 France will have approximately 7 million more people than Germany (73 million against 66 million).

Migration is contributing to population growth in both countries, but only moderately. Net migration has been lower in Germany during the most recent period, with a rate of 1.87‰ between 2000 and 2005 and 1.34‰ between 2005 and 2010 against, respectively, 2.55‰ and 1.62‰ in France [2]. The net migration rates adopted by the European Commission for France and Germany are similar, with a contribution to population increase by 2060 on the order of 6% in each country [3]. The UN [4] uses a similar hypothesis, with the contribution of migration growing steadily weaker in all countries. This reflects a general slowdown in overall international migration due to rising incomes in the originating countries. In this situation, Germany does not seem to have a large pool of external labour available, as it has limited historical links with the main regions of emigration.

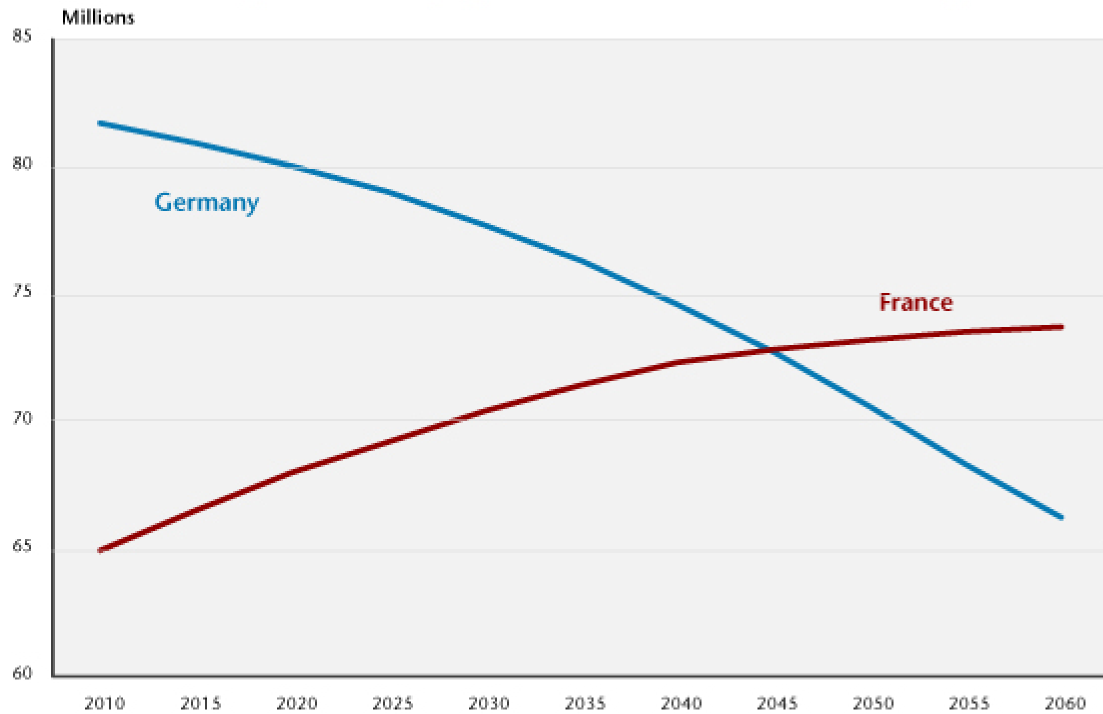
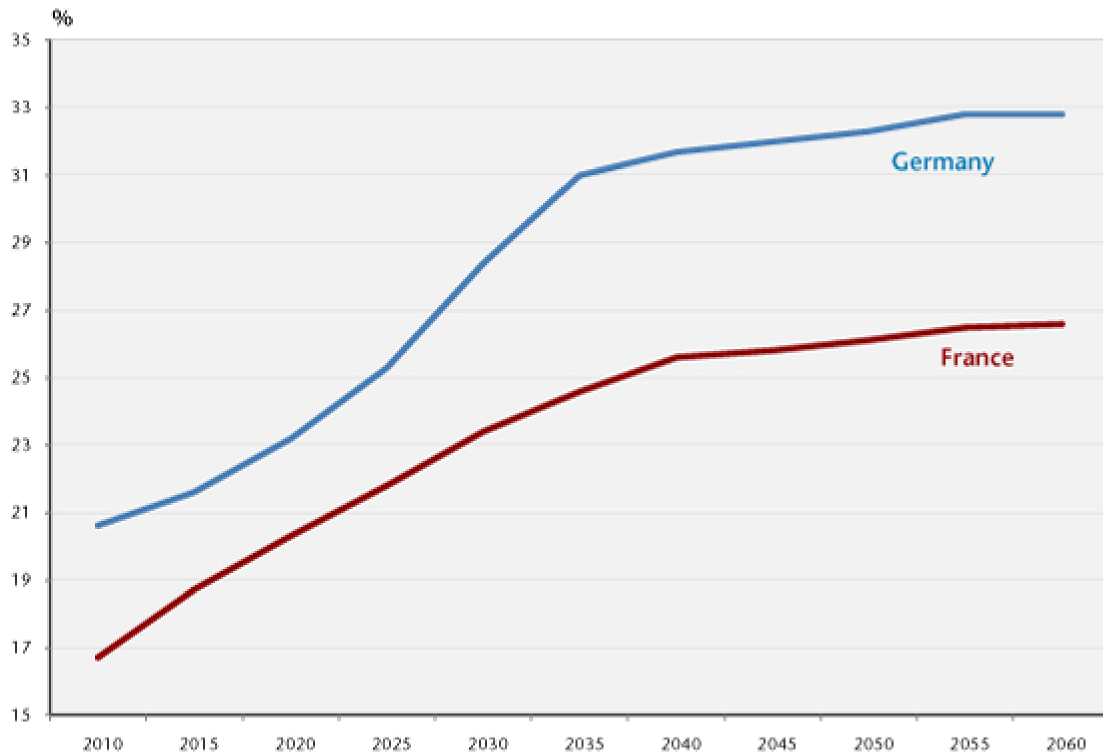



Figure 3. Total populations in France and in Germany

*Source: European Commission, "The 2012 Ageing Report".*

This inversion in demographic weight thus seems inevitable, and it will be accompanied by a divergence in the average age of the population, with considerably more graying of the population in Germany than in France (Figure 4). By 2060, the share in the total population of those aged 65 or older will reach almost one-third in Germany, against a little less than 27% in France.



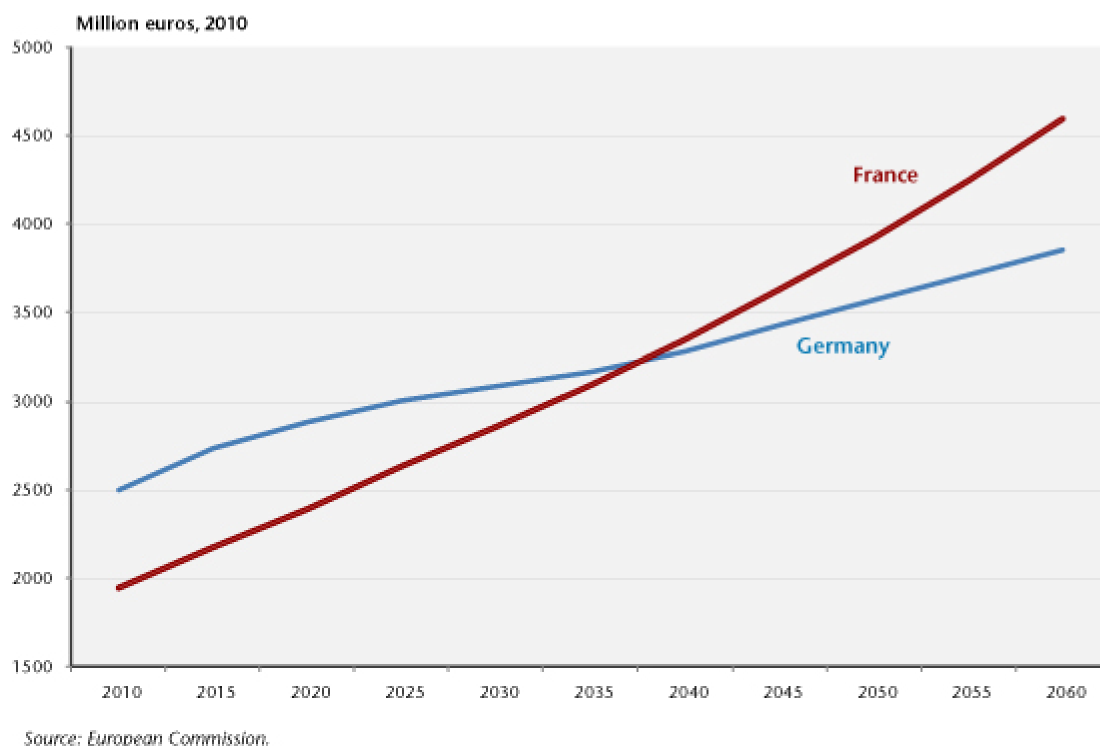

As a consequence, and in light of the reforms implemented in the two countries, the share of GDP that goes to public spending on pensions would increase a little in France and a lot in Germany. According to the Report of the European Commission (*op. cit.*), between 2010 and 2060 this share would rise in France from 14.6% to 15.1% of GDP, up 0.5 GDP point, but by 2.6 points in Germany, from 10.8% to 13.4%. This is despite the fact that the German reform of the pension system provides for postponing the retirement age to 67, while the French reform postpones it only to 62.

Demography also has an impact on the labour market, which will be subject to changing constraints. Between 2000 and 2011, the French and German workforces increased by the same order of magnitude – +7.1% in Germany and +10.2% in France – but while in Germany two-thirds of this increase resulted from higher labour force participation rates, in France 85% of the increase was due to demography. In the near future, Germany will come up against the difficulties of further increasing its rate. Germany's family policy now includes provisions,

such as parental leave, which aim to encourage female employment through a better reconciliation of work and family life, but female participation rates are already high, so that the problem now is more that of increasing the fertility rate than the labour supply. France, which is starting from a lower participation rate, especially because older workers leave the labour market much earlier than in Germany, has greater reserves to draw on. In recent years, the disappearance of early retirement and the increase in the working years required to receive a full pension have begun to have an impact, with the employment rate of older workers rising significantly, even during the crisis [5]. The employment of older workers has also increased in Germany, but it is not possible to continue to make significant increases in this area indefinitely. The most likely result is a long-term convergence in employment rates between France and Germany. Ultimately, then, according to the projections of the European Commission [6], the German participation rate is likely to increase by 1.7 points between 2010 and 2020 (from 76.7% to 78.4%), while the French rate increases by 2.7 points (from 70.4% to 73.1%). By the year 2060, the French participation rate will increase more than twice as much as the German rate (4.2 points against 2.2). But France's rate would still be lower than Germany's (74.7% against 78.9%), meaning that France would still have reserves to draw on.

This divergence in demographics between the two countries has major consequences in terms of long-term average potential growth. Again according to the projections of the European Commission (which are based on the assumption of a convergence in labour productivity in Europe around an annual growth rate of 1.5%), in the long term potential growth in France will be double the level in Germany: 1.7% per year by 2060, against 0.8%. The difference will remain small until 2015 (1.4% in France and 1.1% in Germany), but will then grow quickly: 1.9% in France in 2020, against 1% in Germany.

Just as for the population figures, this will result in a reversal of the ranking of French and German GDPs by about 2040 (Figure 5).




The demographic situations of France and Germany thus logically explain why there is more concern in Germany than in France for the outlook on age-related social spending. This should lead to a more nuanced analysis of the countries' public debts: given the same ratios of debt to GDP in 2012, over the long term France's public debt is more sustainable than Germany's.

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[1] Cf. "The 2012 ageing report", *European Economy* 2/1012.

[2] Cf. United Nations, Department of Economic and Social Affairs, Population Division (2011). *World Population Prospects: The 2010 Revision*, CD-ROM Edition.

[3] Net migration is projected to be slightly higher in Germany than in France, at a level of 130,000 per year in 2025-2030, but under 100,000 in France. But the overall

difference is very small: in 2060, cumulative net migration between 2010 and 2060 would increase the population by 6.2% in Germany and by 6% in France (as a percentage of the population in 2010).

[4] *Op. cit.*

[5] See the summary of changes in the labour force in 2011 by the Insee: http://www.insee.fr/fr/ffc/ipweb/ip1415/ip1415.pdf
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[6] *Op. cit*.

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# The situation on the labour market in France*

By Eric Heyer

The French economy is facing a number of imbalances, with the two main ones being:

– a public deficit that at end 2012 is likely to come to about 4.5 GDP points, or close to 100 billion euros;

– a lack of jobs, which is leading to mass unemployment.

While the first point is the object of great attention, and while it has been and remains the main or even the sole concern of every EU summit over the last three years and is at the heart of the European strategy on the crisis, it must be acknowledged that this is not unfortunately the case for the

second point. However, it is not unreasonable to ask whether the priority in a country as rich as France should actually be to reduce the deficit at all costs even if this may worsen the plight of society’s most vulnerable and make it more difficult for them to access the labour market.

Since the beginning of the crisis in early 2008, the French economy has destroyed more than 300,000 jobs, and the number of unemployed as defined by the International Labour Office has increased by 755,000. More than 2,700,000 French are now without jobs, i.e. 9.6% of the active population.

And this figure undoubtedly underestimates the real situation. The French economy is currently creating only mini part-time jobs that don’t last long; in the last quarter, 4.5 million job contracts were signed: 3 out of 4 of these were contracts lasting less than one month (mostly 1 day to 1 week). Someone who signed one of these contracts and is looking for a job at the end of the same month is not counted as unemployed. Their inclusion would increase the jobless numbers and push the French economy a little further into mass unemployment.

Moreover, and this is more disturbing, the unemployed are getting older while remaining jobless – the number of long-term unemployed is continuing to shoot upwards – and thereby lose out in terms of both job skills and financially as they shift from unemployment benefits onto the social minima; in a study we conducted at OFCE for the National Observatory on Poverty and Social Exclusion (ONPES), we estimated that in France 100 additional unemployed during this crisis will lead to 45 more people in poverty in 2012. Thus, even stabilizing unemployment would not lead to halting the deterioration of people’s situation – on the contrary.

It is therefore urgent to reverse current trends with respect to employment and unemployment.

The surest way to do this is to put the French economy onto a

trajectory of dynamic growth: recall that low but positive growth is not enough for the French economy to create jobs again, as, given gains in productivity, the country's economy needs to grow by more than 1% in order to unleash a spiral of job creation. Moreover, given the continuation of demographic growth and the postponement of the retirement age, the labour force is increasing by 150,000 people every year. It is thus necessary to create more than 150,000 jobs in France before unemployment will begin to fall, which corresponds to growth of over 1.5%.

However, in light of the austerity policies being implemented in France and by our European partners, this level of growth seems unthinkable in 2012 and 2013.

So how can a further explosion of unemployment be stopped in the near future?

The first step would be to change Europe's strategy by establishing, among other things, a "more moderate" austerity.

The second step would be to adopt the strategy Germany is using for the crisis, that is to say, to reduce working time by massively resorting to part-time work and to partial unemployment schemes. Remember that 35% of German employees are hired part-time, as against 17% in France. Furthermore, during the crisis 1.6 million Germans have been on a partial unemployment programme, compared with 235,000 in France. All this has helped Germany to keep unemployment down during the crisis.

The last solution is to use what in France is called the "social treatment of unemployment". As the private sector is still destroying jobs, the public sector would offset part of this by creating subsidized jobs.

The government seems to be taking this last path: 100,000 "jobs for the future" will be created in 2013 and 50,000 in 2014.

In the short term, given the economic situation, this strategy seems to be the most effective and the least expensive. However, in the medium term, it cannot replace a policy of growth.

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* This text is taken from a series of reports by Eric Heyer for the programme "Les carnets de l'économie" on France Culture radio. It is possible to listen to the series on France Culture.

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# Youth "jobs of the future": What impact on employment and government finances?

Éric Heyer and Mathieu Plane

The bill aimed at creating 150,000 "jobs for the future" [*emplois d'avenir*] for unemployed youth will be submitted to Parliament in October 2012. These 150,000 "jobs for the future" are to be reserved primarily for young people from deprived areas. What will be the net impact on employment and public finances?

These full-time jobs, which are planned to last a maximum of five years and are paid at least the minimum wage (SMIC), will be 75% funded by the State, with the rest of the cost being borne by local authorities, associations, foundations and business. According to the Minister of Labour and Employment, Michel Sapin, the goal is to create 100,000 jobs starting in

2013.

***The* ex-ante *cost of the measure***

The gross annual cost of a “jobs for the future” contract paid at the SMIC on the basis of a 35-hour full-time week is 24,807 euros. The cost per job for the public finances is 12,831 euros for 75% of the gross wage and 4,807 euros for the exemption from employer social contributions. To this should be added the remaining cost for the employer, or 7,276 euros, when the employer is not a public entity. Based on the assumption that two-thirds of the “jobs for the future” created would be in the non-market sector and one-third in the market sector, the total average annual cost for the public finances therefore comes to 23,015 euros per contract. When fully implemented, the cost of creating 150,000 “jobs for the future” is estimated at 3.45 billion euros a year.

***The impact of the measure***

By assuming the creation of 100,000 subsidized jobs in the non-market sector and 50,000 in the market sector, the impact would be as follows:

With relatively weak deadweight and substitution effects in the non-market sector (20% according to Fontaine and Malherbet, 2012), 100,000 “jobs for the future” would lead to the net creation of 80,000 jobs over the presidential term. The *ex-ante* annual cost to the public finances for 100,000 “jobs for the future” in the non-market sector would be 0.12 GDP point, but *ex post* this would be only 0.07 GDP point because of the extra income – and thus tax and social security revenue – generated by the jobs created.

The state aid (75% of the gross salary) allows a reduction in the cost of labour of 52% at the SMIC level, *i.e.* a total reduction of 71% of the actual cost of a minimum wage job if one includes the reductions in charges. With the impact of employment elasticities at a maximum labour cost at the level

of the SMIC (1.2 according to a DGTPE study in 2007), the 50,000 "jobs of the future" in the market sector would generate 27,300 jobs. The *ex-ante* cost to the public finances would be 0.05 GDP point, and 0.03 GDP point *ex post*.

Ultimately, the measure would eventually create 107,300 jobs (about 25% of these in the market sector), *i.e.* an annual net creation of 72%. The *ex-ante* cost for the public finances would be 0.17 GDP point, but the *ex-post* impact of the measure on the public balance would be only -0.1 GDP point because of the extra tax and social security revenue generated by the jobs created and the consequent income gains (Table 1).

**Table 1. Impact at 5 years of the measure on employment and the public finances**

| Création of… | Jobs (1 000) | Net creation (%) | *Ex ante* public balance (in GDP points) | *Ex post* public balance (in GDP points) |
|---|---|---|---|---|
| … 100,000 in the non-market sector | 80 000 | 80 % | 0.12 | 0.07 |
| 50,000 in the non-market sector | 27 300 | 55 % | 0.05 | 0.03 |
| **Total (150,000 jobs for the future)** | **107 300** | **72 %** | **0.17** | **0.10** |

*Source* : OFCE calculations.

According to statements by the Minister of Labour and Employment, two-thirds of the "jobs for the future" will be set up in 2013. To assess the impact of this measure over the presidential term, we started from the assumption that 25,000 full-time "jobs for the future" with a term of 5 years would be created each quarter from the beginning of 2013 until mid-2014.

Based on this profile for the implementation of the "jobs for the future", the net new job creation expected in 2013 would be 71,600, with 35,700 in 2014, and then 0 from 2015 to 2017. The *ex-post* impact on the public balance would be 0.04 GDP point in 2013 and 0.06 point in 2014, *i.e.* a cumulative impact on the public finances of 0.1 GDP point over time.

Table 2. Impact of the measure on employment and the public finances from 2013 to 2017

| | 2013 | 2014 | 2015 | 2016 | 2017 |
|---|---|---|---|---|---|
| Jobs for the future (1000s) | 100 000 | 50 000 | 0 | 0 | 0 |
| Net job creation (1000s) | 71 600 | 35 700 | 0 | 0 | 0 |
| *Ex-ante* annual cost (billion euros) | 1.44 | 3.31 | 3.45 | 3.45 | 3.45 |
| *Ex ante* impact on public balance (GDP pts) | 0.07 | 0.09 | 0.01 | 0.00 | 0.00 |
| *Ex post* impact on public balance (GDP pts) | 0.04 | 0.06 | 0.00 | 0.00 | 0.00 |

*Source* : OFCE calculations.

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# Social action, but no end of the crisis

**Evaluation of the five-year economic programme (2012-2017)**

By Eric Heyer, Mathieu Plane, Xavier Timbeau

The initial decisions of the five-year programme are coming amidst an extremely difficult and very uncertain economic situation. In a recent *OFCE Note* (No. 23 of 26 July 2012), we first analyze the macroeconomic context for François Hollande's five-year programme and the XIVth legislature. This

analysis details the likely consequences for the next five years of the strategy currently being implemented in Europe. We evaluate both the cost to the public finances as well as the impact on economic activity, employment and the distribution of income. In part two, we analyze the public policy choices being given priority by the new government, including both those aimed at the young (generation contracts, jobs of the future), at some seniors (revision of the pension reform), and at the middle and lower classes (allowance for the start of school, boost to the minimum wage, Livret A bank accounts, rent control, revised taxation of overtime), as well as those intended to revive certain public expenditures that are deemed essential (public jobs in education, the justice system and the police in the “public finance” section, and public early childhood services).

François Hollande was elected President of the French Republic at a time when France and Europe are going through an unprecedented crisis. Unemployment in metropolitan France has increased by over 2 percentage points since the crisis began and is now (in ILO terms, 9.6% of the workforce in first quarter 2012) approaching the record levels of 1997 (10.5%). Gross domestic product per capita in terms of purchasing power has fallen since 2008 by 3%. If the growth trend for the five years preceding the crisis had continued at that same rate from 2008 until early 2012, GDP per capita would now be 8% higher than it is. The current account has deteriorated during the crisis by 1.5 GDP points (25.7 billion euros, 10 billion of which is for the oil bill), thus worsening France’s net balance of trade by 7.8 GDP points. The public debt increased by 577 billion (nearly 30 GDP points), and at the beginning of 2012 represented almost 90% of GDP. Industry has paid a heavy price for the crisis (almost 300,000 jobs lost), with all signs indicating that the job losses and closures of industrial sites might be irreversible.

Yet this dire situation, which can be chalked up to the crisis

that began in 2008, is not over. Due to the impact of austerity policies implemented at a time of panic at seeing financing of the public debt dry up, the sovereign debt crisis is threatening the euro zone with a prolonged recession in 2012 and 2013. And the even worse scenario looming on the horizon – the disintegration of the euro zone – would transform the threats of recession into the risk of a major depression.

Assessments of the situation differ depending on the elements available. Some measures have been implemented by decree, while others are being discussed by the legislature, but the proposed bills do permit a quantitative analysis. Others are in the planning stage, with the main trade-offs still to be made, so our assessment tries to explore the main points.

Our assessment of the economic strategy for the five-year programme does not stop there. The outlines of the premises for a strategy to end the crisis can now be seen. The deficit reduction commitments and the initial steps taken in this direction in the budget packages in July 2012, such as those announced during the budget orientation debate of June 2012, point to a strategy whose first step is the achievement of a reduction in the public deficit to 3% of GDP by the end of 2013, regardless of the cost. Based on this fiscal virtue, this amounts to a strategy to end the crisis by stabilizing the state of the public accounts, thereby reassuring the financial markets and other economic agents and establishing the conditions for a strong future recovery. This strategy is based on cutting public expenditures and raising taxes (see the "public finance" section, government tax proposals and the taxation of the oil companies).

This strategy for ending the crisis is risky, to say the least, because it does not take full account of the crisis facing Europe today. It might be justified if we were already on course to end the crisis and if the point were simply to set priorities. But Europe remains in a situation of extreme

uncertainty, living in the expectation of a massive failure of one or another Member State in the euro zone, fearing the collapse of this or that financial institution, and suffering the consequences of a spiral of austerity that is being fueled by rising sovereign interest rates. In this situation, everything is coming together to strengthen the existence of a liquidity trap and to generate high fiscal multipliers. Given this, *ex ante* reductions in the deficit through tax hikes and spending cuts is weighing heavily on activity, and thus limiting or even cancelling out any actual deficit reductions. The factors pushing up the public debt are not being reversed, and the reduction in activity is heightening the risk that the unsustainable private debt will be socialized. The increase in sovereign interest rates is being fueled by an inability to meet deficit reduction targets and by rising public debt, and is thus pushing public deficits higher, forcing even more austerity.

One response to this dynamic that is bringing about the collapse of the euro would be one form or another of pooling public debts in Europe. This would require relatively complete control of the budgets of member countries by a federal body with strong democratic legitimacy. A response like this would therefore mean “more Europe”, and would make it possible to define “more moderate” austerity policies for France as well as its major trading partners. It would make putting an end to involuntary mass unemployment and the liquidity trap prerequisites to an improvement in the public finances. It would also make it possible to ensure the sustainability of public finances without leading to the lost decades that are now gestating.

In the first part of the Note, we analyze the macroeconomic context for François Hollande’s five-year programme and the XIVth legislature. This analysis details the likely consequences for the next five years of the strategy currently being implemented in Europe. The value of the fiscal

multiplier is a critical parameter, and we show that the current strategy is valid only if the multipliers are low (*i.e.* on the order of 0.5). However, a slew of empirical evidence indicates that, in the exceptional situation we are experiencing today, the budget and fiscal multipliers may be larger than 0.5 (between 1 and 1.5, see the Note). We detail in a second part the measures taken in the Supplementary Budget Act of July 2012 (for 2012) and the elements outlined in the budget orientation debate in preparation for the Budget Act for 2013 and for the period 2012-2017. To succeed in reducing the public deficit to 3%, it seems that there must be over 10 billion euros in additional tax revenue or in savings on expenditure, *ex ante*.

We then present an evaluation of eleven measures. Guillaume Allègre, Marion Cochard and Mathieu Plane have estimated that the implementation of the *contrat de génération* [“generation contract”] could create between 50,000 and 100,000 jobs, at the cost of a strong deadweight effect. Eric Heyer and Mathieu Plane point out that in the short term, subsidized *emplois avenir* [“jobs for the future”]-type contracts can help to reduce unemployment. Eric Heyer shows that the revision of taxation on overtime will help to cut the public deficit by 4 billion euros, without hurting the labour market. Guillaume Allègre discusses the consequences of increasing the *Allocation de rentrée scolaire* [allowance for the start of school] and shows that it mainly benefits the lowest five deciles in terms of standard of living. Henri Sterdyniak analyzes the possibilities for fiscal reform. The point is not to evaluate the government’s proposals for fiscal reform, but to provide a comprehensive overview of the current system’s margin for change and its inconsistencies. Henri Sterdyniak and Gérard Cornilleau evaluate the increased opportunities for retiring at age 60 and analyze the possible paths to a more large-scale reform of the pension system. Hélène Périvier evaluates the possibilities for an early childhood public service, the eventual cost of which could be covered in part

by an increase in activity that would generate more than 4 billion euros. Eric Heyer and Mathieu Plane analyze the impact of a boost in the minimum wage (SMIC) and conclude that, given the small spillover of increases in the SMIC onto the rest of the wage structure, the impact on the cost of labour is limited by the greater reduction in social charges on low wages. While the effect on employment is small, it would cost the public purse 240 million euros. Sabine Le Bayon, Pierre Madec and Christine Rifflart evaluate rent control. Hervé Péléraux discusses the compensation of Livret A bank accounts and the impact of doubling their ceiling. Céline Antonin and Evens Salies evaluate the new taxes on the oil companies, which could provide 550 million euros in tax revenue in 2012, at the risk that this tax might ultimately be passed on to the end consumer.