Lower taxation on business but higher on households

By Mathieu Plane and Raul Sampognaro

Following the delivery of the Gallois Report in November 2012, the government decided at the beginning of Francois Hollande's five-year term to give priority to reducing the tax burden on business. But since 2015, the President of the Republic seems to have entered a new phase of his term by pursuing the objective of reducing the tax burden on households. This was seen in the elimination of the lowest income tax bracket and the development of a new allowance mechanism that mitigates tax progressivity at the lower levels of income tax. But more broadly, what can be said about the evolution of the compulsory tax burden on households and businesses in 2015 and 2016, as well as over the longer term?

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

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

Several major points emerge from this analysis of the recent period. First, tax rates rose sharply in the period 2010-2013, representing an increase of 3.7 percentage points of GDP, with 2.4 points borne by consumers and 1.3 by business. Over this period, fiscal austerity was relatively balanced between households and business, with the two experiencing a tax increase that was more or less proportional to their respective weights in the tax burden [3].

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

In 2015, the tax burden on business will fall by 9.7 billion euros (0.5 GDP point) with the implementation of the CICE tax credit (6 billion), the first Responsibility Pact measures (5.9 billion related to the first tranche of reductions in employer social security contributions, an allowance on the C3S tax base and a “*suramortissement*”, an additional tax reduction, on investment), while other measures, such as those related to pension reform, are increasing corporate taxation (1.7 billion in total). Conversely, the tax burden on households should increase in 2015 by 4.5 billion (0.2 GDP point), despite the elimination of the lowest income tax bracket (-2.8 billion) and the reduction in self-employed contributions (-1 billion). The hike in the ecological tax (carbon tax and TICPE energy tax) and the CSPE together with the non-renewal in 2015 of the exceptional income tax reductions of 2014 represent an increase in taxation on households of, respectively, 3.7 and 1.3 billion. Other measures, such as those affecting the rates of contributions to general, supplemental and civil servant pension schemes (1.2 billion), along with local taxation (1.2 billion), including the modification of the DMTO tax ceiling and measures affecting tourist and parking taxes, are also raising taxes on households.

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

In billion euros

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

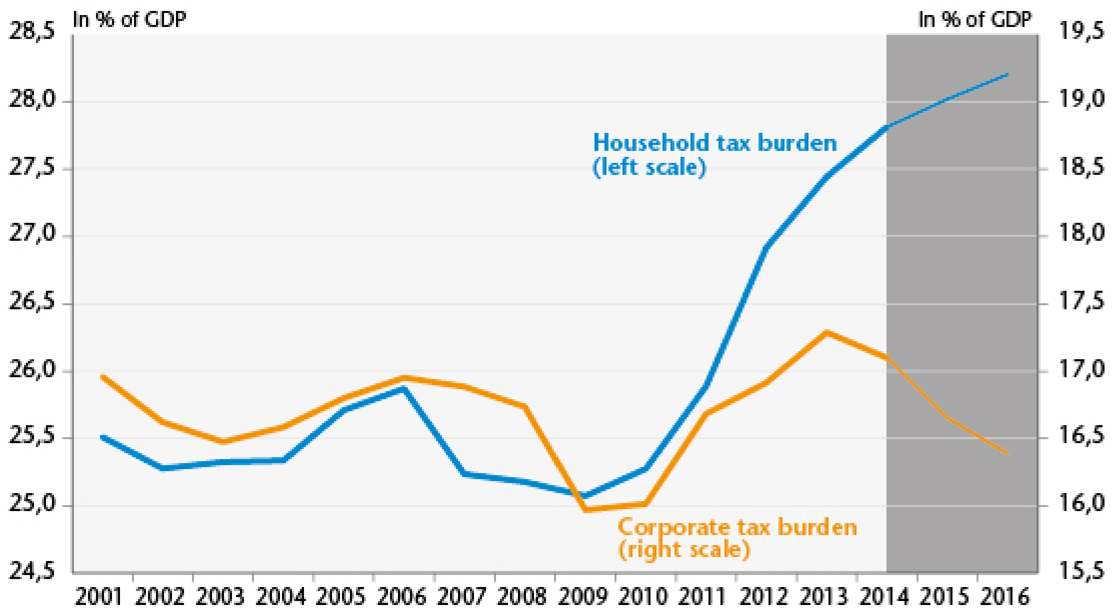
Sources: PLF (Finance Act) 2016; OFCE calculations.

In 2016, the tax burden on business will fall by 5.9 billion (0.3 GDP point), mainly due to the second phase of the Responsibility Pact. Reductions in employer social security contributions on wages lying between 1.6 and 3.5 times the SMIC minimum wage (3.1 billion), the elimination of the corporate income tax (IS) surcharge (2.3 billion), the second allowance on the C3S tax base (1 billion), the implementation of the CICE tax credit (0.3 billion) and the additional tax reduction on investment (0.2 billion) have been only partially offset by tax increases on business, mainly with the hike on pension contribution rates (0.6 billion). However, as in previous years, the tax burden on households will increase in 2016 by 4.1 billion (0.2 GDP point), despite a further reduction in income tax (2 billion). The main measures increasing household taxation are similar to those in 2015, including environmental taxation, with the hike in the carbon tax (1.7 billion) and the CSPE tax (1.1 billion), measures on financing pensions (0.8 billion), and the expected increase in local taxation (1.1 billion). Note that the elimination of the PPE working tax credit in 2016 will mechanically lead to an increase in the household tax burden of 2 billion[4], but this will be offset by an equivalent amount for the new Prime d'activité working tax credit.

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

The need to finance measures both to enhance corporate competitiveness and to reduce the structural deficit is placing the entire burden of the fiscal adjustment on households. Thus, the reduction in income tax in 2015 and 2016 will not offset the rise in other tax measures, most of which were approved in Finance Acts prior to 2015, and seems low in relation to the tax shock that has hit households since 2010. However, how these recent tax changes affect growth and the consequent impact on inequality will depend on the way business makes use of the new resources generated by the massive decline in its tax burden since 2014. These funds could lead to a rise in wages, employment, investment or lower prices or to higher dividends and a reduction in debt. Depending on the way business allocates these, the impact to be expected on the standard of living in France and on inequality will not of course be the same. An evaluation of the impact of these changes on the tax burden will surely lead to future studies and debate.

Figure: Changes in the tax burden on households and business



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

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[1] The tax burden on households includes direct taxes (CSG, CRDS, IRPP, housing tax, etc.), indirect taxes (VAT, TICPE, CSPE, excise taxes, etc.), tax on capital (ISF, DMTG, property tax, DMTO, etc.), and salaried and self-employed social security contributions. The corporate tax burden includes the various taxes on production (value-added tax and corporate property tax (ex-TP), property tax, C3S tax, etc.), taxes on wages and labour, corporate income tax and employer social security contributions.

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

[3] In 2013, 61% of the tax burden was on households and 39% on business. However, over the 2010-2013 period, tax increases

were borne 64% by households and 36% by business, which was more or less their respective weights in taxation.

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

2015-2017 forecasts for the French economy

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

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

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

With GDP growth in 2016 of 1.8%, the year will be marked by a recovery, in particular by rising corporate investment rates. Indeed, all the factors for a renewal of investment are coming together: first, a spectacular turnaround in margin rates since mid-2014 due to a fall in the cost of energy supplies and the impact of the CICE tax credit and France's Responsibility Pact; next, the historically low cost of capital, which has been helped by the ECB's unconventional monetary policy; and finally, an improvement in the economic outlook. These factors will lead to an acceleration of business investment in 2016, which will increase by 4% on average over the year. Household consumption should remain strong in 2016 (+1.6%), driven by job creation in the market sector and by a slight fall in the savings rate. Fuelled by the rise in housing starts and building permits, housing investment will pick up (+3%), after shrinking for four years in a row. Foreign trade will be boosted by the impact of the euro's depreciation and the government's competitiveness policies, and will make a positive contribution to growth (+0.2 GDP point in 2016, the same as in 2015). Once the impact of the downturn in oil prices has fed through, inflation should be positive in 2016, but still low (1% on an annual average, after two years of virtual stagnation), a rate that is close to underlying inflation. The pace of quarterly GDP growth in 2016 will be between 0.5% and 0.6%: this will trigger a gradual closing of the output gap and a slow fall in the unemployment rate, which will end the year at 9.8%. The public deficit will be cut by 0.5 GDP point, due to savings in public spending, notably through the contraction of public investment (-2.6%), low growth in government spending (+0.9%), and the impact of the rise in tax revenues as the economy recovers.

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

Investment behaviour during the crisis: a comparative analysis of the main advanced economies

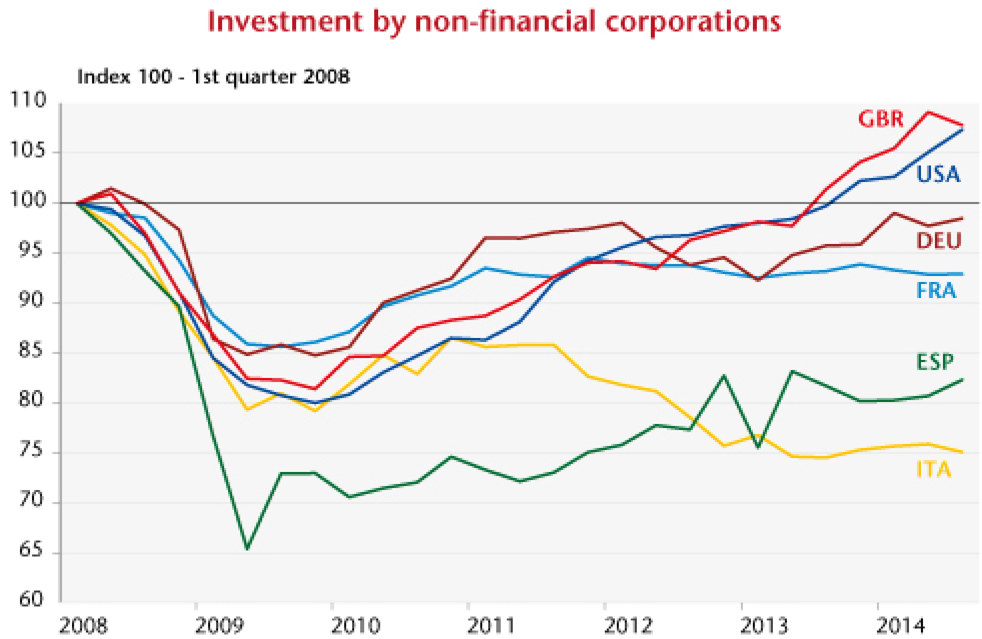
By Bruno Ducoudré, Mathieu Plane and Sébastien Villemot

This text draws on the special study, Équations d'investissement : une comparaison internationale dans la crise [Investment equations : an international comparison during the crisis], which accompanies the 2015-2016 Forecast for the euro zone and the rest of the world.

The collapse in growth following the subprime crisis in late 2008 resulted in a decline in corporate investment, the largest since World War II in the advanced economies. The stimulus packages and accommodative monetary policies implemented in 2009-2010 nevertheless managed to halt the collapse in demand, and corporate investment rebounded significantly in every country up to the end of 2011. But since 2011 investment has followed varied trajectories in the different countries, as can be seen in the differences between, on the one hand, the United States and the United Kingdom, and on the other the euro zone countries, Italy and Spain in particular. At end 2014, business investment was still 27% below its pre-crisis peak in Italy, 23% down in Spain, 7% in France and 3% in Germany. In the US and the UK, business investment was 7% and 5% higher than the pre-crisis peaks (Figure).

Our study estimates investment equations for six major countries (Germany, France, Italy, Spain, the UK and USA) in an effort to explain trends in investment over the long term, while paying particular attention to the crisis. The results show that using the traditional determinants of corporate investment – the cost of capital, the rate of profit, the rate of utilization of production capacity and business expectations – it is possible to capture the main developments in investment for each country in recent decades, including since 2008.

Thus, since the onset of the crisis, differences in decisions on taxation and on how tight to make fiscal policy and how expansive to make monetary policy have led to differences between countries in terms of the dynamics of the economy and real capital costs and profit rates, which account for the current disparities in corporate investment.



Sources: National accounts, authors' calculations.

France: Recovery … at last!

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

The OFCE's forecast for the French economy in 2015-2016 is now available.

Not since the beginning of the subprime crisis has the French economy been in such a favourable situation for a recovery. The fall in oil prices, the ECB's proactive and innovative policy, the easing of fiscal consolidation in France and the euro zone, the gathering impact of the CICE tax and the implementation of the Responsibility Pact (representing a tax transfer to business of 23 billion euros in 2015 and nearly 33 billion in 2016) all point in the same direction. The main obstacles that have held back French activity over the last four years (over-calibrated fiscal austerity, a strong euro, tight financial conditions, and high oil prices) should all be out of the way in 2015 and 2016, with pent-up growth finally released. The supply policy being pushed by the government, whose impact on business is still pending, will be all the more effective thanks to the positive demand shock from foreign trade, which will allow the economic rebalancing that was lacking up to now.

French GDP will grow by 1.4% in 2015, with the pace accelerating in the course of the year (to 2% yoy). The second half of 2015 will mark the turning point in the recovery, with the corporate investment rate picking up and the unemployment rate beginning to fall, ending the year at 9.8% (after 10% in late 2014). 2016 will then be the year of recovery, with GDP growth of 2.1%, a 4% increase in productive investment and the creation of nearly 200,000 private sector jobs, pushing the unemployment rate down to 9 5% by end 2016. In this positive context, the public deficit will fall significantly, and is expected to be 3.1% of GDP in 2016 (after 3.7% in 2015).

Obviously this virtuous cycle will only take effect if the macroeconomic environment remains favourable (low oil prices, a competitive euro, no new financial tensions in the euro zone, etc.) and if the government limits itself to the budget savings already announced.

France – the sick man of Europe?

by Mathieu Plane – Economist at OFCE (French Economic Observatory – Sciences Po)

The year 2014 was marked for France by the risk of European Commission sanctions for the failure of its budget to comply with Treaties; by the downgrade by Fitch of French government debt (following the one by S&P a year earlier); by the absence of any sign of a in the unemployment rate; by a rising deficit after four years of consecutive decline; and by the distinction of being the only country in Europe to run a significant current account deficit: economically, it seemed like the country’s worst year since the beginning of the crisis, in 2008. France did not of course go through the kind of recession it did in 2009, when the Eurozone experienced a record fall in GDP (-4.5% and -2.9% for the EMU and for France respectively). But for the first time since the subprime bubble burst, in 2014 French GDP grew more slowly (0.4%) than eurozone average (0.8%). The country’s weakening position is fuelling the view that France may be the new sick man of Europe, a victim of its leaders’ lax fiscal approach and its inability to reform. Is this really the case?

It is worth noting first that the French economic and social model proved its effectiveness during the crisis. Thanks to its system of social safety nets, to a combined (consumers, business, government) debt level that is lower than the Eurozone average, while the household savings rate that is higher, to a low level of inequality, and to a relatively solid banking system, France weathered the crisis better than most of its European partners. Indeed, between early 2008 and late 2013, French GDP grew by 1.1%, while during that same period the Eurozone as a whole contracted by 2.6%; France also avoided the recession in 2012 and 2013 that most Eurozone countries experienced. Looking at Europe for the six years from 2008 to 2013, France’s economic performance was relatively close to that of Germany (2.7%), better than that of the UK (-1.3%) and well ahead of Spain (-7.2%) and Italy (-8.9%). Similarly, during this period investment in France contracted less than in the Eurozone as a whole (-7.7% versus -17%), and unemployment increased less (+3 points versus

+4.6). Finally, the French economy’s ability to stand up better to the crisis was not linked with a greater increase in public debt compared to the Eurozone average (+28 GDP points for both France and the Eurozone) or even the United Kingdom (+43 points).

Nevertheless, France has seen its position in the Eurozone deteriorate in 2014. This was marked not only by lower growth than its partners, but also by higher unemployment (the Eurozone rate has gradually fallen), an increase in public debt (which virtually stabilized in the Eurozone), a decline in investment (which improved slightly in the euro zone), an increase in its public deficit (while that of the Eurozone fell) and a substantial current account deficit (the euro zone is running a significant surplus). Why this divergence?

While France does have a problem with competitiveness, note that almost half of its current account deficit is cyclical due to more dynamic imports than its major trading partners, which generally have worse output gaps. Furthermore, until 2013, the country’s fiscal adjustment was focused more on the tax burden than on public spending. Conversely, the focus in 2014 was more on public spending. Given France’s position in the business cycle and its budget decisions, the fiscal multiplier in 2014 was higher than in previous years, so that fiscal consolidation imposed a heavy toll in terms of growth. In terms of competitiveness, French industry is caught in the middle of the Eurozone between, on the one hand, peripheral countries of the euro area, including Spain, which have entered into a spiral of wage deflation fuelled by mass unemployment, and the core countries, especially Germany, which are reluctant to give up their excessive trade surpluses through higher domestic demand and more inflation. Faced with the generalization of wage devaluations in the Eurozone, France had no choice but to respond with a policy to improve the competitiveness of its businesses by cutting labour costs. Thus, the CICE tax credit and the Pact of Responsibility represent a total transfer of 41 billion euros to the firm system, mainly financed by households. While the positive impact of these transfers will be felt over the medium-to-long term, the financing effort together with the country's fiscal consolidation effort had an immediate adverse effect on purchasing power, which goes a long way in explaining the poor growth performance of 2014. Finally, 2014 also saw a steep fall in housing investment (-7%), the largest drop since the real estate crisis of the early 1990s (excluding 2009).

There are several reasons why France's poor performance is not likely to be repeated in 2015: first, in order to halt the decline in construction, emergency measures were taken in August 2014 to free up housing investment, with the first effects to be felt in 2015. Second, the programmes enacted to improve business competitiveness will begin to take full effect from 2015: the CICE tax credit and the Responsibility Pact will slash business costs by 17 billion euros in 2015, up significantly from only 6.5 billion in 2014. Third, the slowdown in the fiscal consolidation programmes of our commercial partners and the introduction of a minimum wage in Germany will both help French exports. In addition, the lower exchange rate for the euro and falling oil prices are powerful levers for boosting the French economy in 2015, and together could amount to one extra point of growth. Given the ECB's policy on quantitative easing, interest rates should also remain low for at several more quarters. Finally, although timid, the Juncker plan along with marginal changes in Europe's fiscal rules will favour a pickup in investment. These factors will put some wind in the sails of French growth by helping to offset the negative impact of the reduction in public spending for 2015, so that the economy finally reaches a pace that will be sufficient to begin to reverse the unemployment curve and reduce the public deficit.

While France is not the sick man of Europe, it is nevertheless still very much dependent, like all euro zone countries, on

Europe having strong macroeconomic levers. Up to now, these have had a negative impact on business, be it through overly restrictive fiscal policies or a monetary policy that has proved insufficiently expansionary in the light of other central banks' action. In an integrated currency zone, deflation cannot be fought on a national basis. The choice of a European policy mix that is more geared towards growth and inflation is a first since the start of the sovereign debt crisis. Boosted by lower oil prices, let us hope that these levers will prove strong enough to halt the depressive spiral that the Eurozone has been going through since the onset of the crisis. The recovery will be European, before being French, or there won't be one.

Austerity and purchasing power in France

By Mathieu Plane

Is France implementing an austerity policy? How can it be measured? Although this question is a subject of ongoing public debate, it hasn't really been settled. For many observers, the relative resilience of wage dynamics indicates that France has not carried out an austerity policy, unlike certain neighbours in southern Europe, in particular Spain and Greece, where nominal labour costs have fallen. Others conclude that France cannot have practiced austerity since government spending has continued to rise since the onset of the crisis[1]. The 50 billion euros in savings over the period 2015-17 announced by the Government would therefore only be the beginning of the turn to austerity.

Furthermore, if we adhere to the rules of the Stability and Growth Pact, the degree of restriction or expansion of a fiscal policy can be measured by the change in the primary structural balance, which is also called the fiscal impulse. This includes on one side the efforts made on primary public spending (*i.e.* excluding interest) relative to the change in potential GDP, and on the other side the change in the tax burden in GDP points. Thus, over the period 2011-13, France's primary structural balance improved by 2.5 percentage points of GDP according to the OECD, by 2.7 points according to the European Commission, and by 3.5 points according to the OFCE. While there are significant differences in the measurement of fiscal austerity during this period, the fact remains that, depending on the method of calculation, it amounted to between 55 and 75 billion euros over three years[2].

A different way of measuring the extent of fiscal austerity involves looking at the change in the components of household purchasing power. Purchasing power can in fact be used to identify the channels for transmitting austerity, whether this is through labour income or capital, benefits or the tax burden on households[3]. Changes in the components of income clearly show that there was a pre-crisis and a post-crisis in terms of the dynamics of purchasing power per household.

Over the period 2000-2007, purchasing power grew by more than 4000 euros per household …

This corresponds to an average increase of about 500 euros per year per household [4] (Table) over the eight years preceding the subprime crisis, a growth rate of 1.1% per year. On the resource side, real labour income per household (which includes the EBITDA of the self-employed), supported by the creation of more than 2 million full-time equivalent jobs over the period 2000 to 2007, increased on average by 0.9% per year. But it is above all real capital income per household (which includes the imputed rents of households occupying the accommodation that they own) that increased dramatically over this period, rising twice as fast (1.7% on average per year) as real labour income. As for social benefits in cash, these increased by 1% on average in real terms in this period, *i.e.* a rate equivalent to the rate for total resources. As for levies, tax and social contributions from 2000 to 2007 have helped to reduce purchasing power per household by 0.9 points per year, which corresponds to about 100 euros per year on average. Breaking down the increase in levies, 85% came from social contributions (employees and self-employed), mainly due to hikes in premiums related to pension reform. Taxes on income and wealth contributed to cutting purchasing power per household by only 14 euros per year, despite a sharp increase in capital income and property prices over the period 2000-2007. During this period, taxes on households deflated by consumer prices increased by less than 2%, whereas real household resources grew by almost 9% and real capital income by 14%. The reduction in income tax, which began under the Jospin government, and was continued by Jacques Chirac during his second term, explains in large part why taxes have had so little negative impact on purchasing power during this period.

Changes in the components of purchasing power per household (in 2013 euros)

		Labour income (incl. EBITDA of IU)*	Capital income (incl. imputed rent**)	Social benefits in cash	Other resources	Total resources	Tax on income and wealth	Social contri-butions (salaried and non-salaried)	Total contribu-tions	Purchasing power per household
Cumulative change	**2000-2007**	2283	1376	1120	34	**4814**	-110	-668	-778	4036
	2008-2015 *o/w:*	-1059	-911	1502	-61	**-529**	-785	-318	-1102	-1631
	2008-10	-293	-613	1021	-1	**114**	36	-36	0	114
	2011-13	-680	-314	355	-60	**-699**	-789	-143	-932	-1631
	2014-15	-85	16	125	0	**56**	-31	-139	-170	-114
Average annual change	**2000-2007**	285	172	140	4	**602**	-14	-83	-97	504
	2008-2015 *o/w:*	-151	-130	215	-9	**-76**	-112	-45	-157	-233
	2008-10	-98	-204	340	0	**38**	12	-12	0	38
	2011-13	-227	-105	118	-20	**-233**	-263	-48	-311	-544
	2014-15	-43	8	63	0	**28**	-16	-69	-85	-57

* IU = Individual undertakings.
** The notion of an imputed or fictive rent covers the service that is rendered to the owner of an accommodation by that accommodation, that is, the rent that owners would have to pay if they were tenants.
Sources: Insee national accounts, author's calculations, France's 2015 Budget Act.

…but over the period 2008-2015, purchasing power per household

fell by more than 1600 euros

The crisis marks a sharp turn with respect to past trends. Indeed, over the period 2008-2015, purchasing power per household fell, on average, by almost 1630 euros, or 230 euros per year.

Over the eight years since the start of the crisis, we can distinguish three sub-periods:

– The first, from 2008 to 2010, following the subprime crisis and the collapse of Lehman Brothers, is characterized by the relatively high resistance of purchasing power per household, which increased by nearly 40 euros per year on average, despite the loss of 250,000 jobs over this period and the sharp decline in capital income (200 euros on average per year per household). On the one hand, the sharp drop in oil prices from mid-2008 had the effect of supporting real income, including real wages, which increased 0.9% annually. On the other hand, the stimulus package and the shock absorbers of France's social security system played their countercyclical role by propping up average purchasing power through a sharp rise in social benefits in kind (340 euros on average per year household) and a slightly positive contribution by taxes to purchasing power.

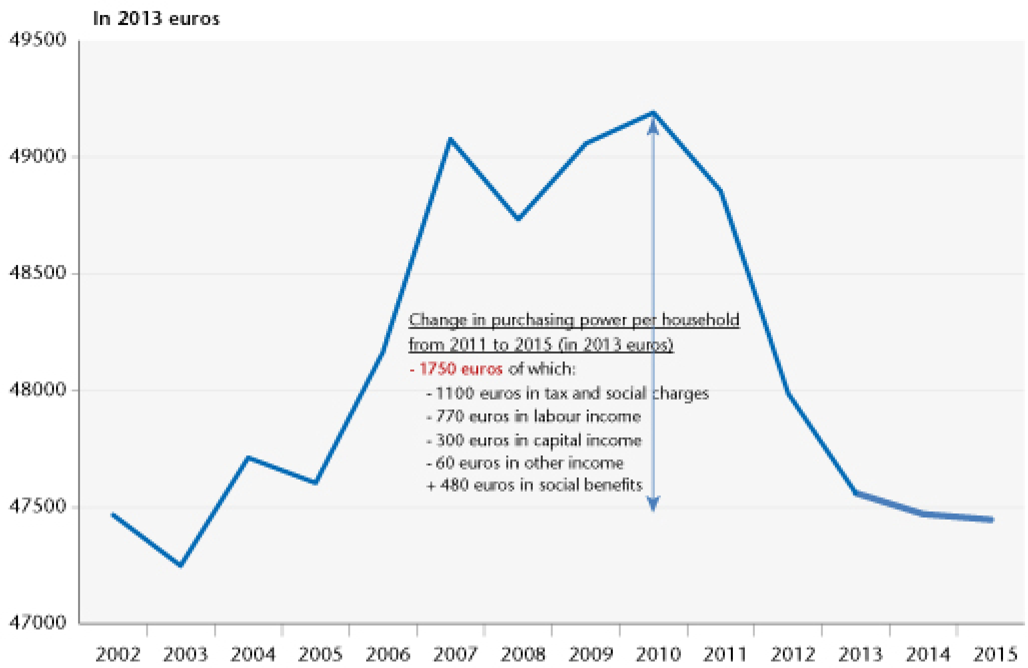
– The second period, from 2011 to 2013, is marked by intense fiscal consolidation; this is a period in which the tax burden increased by about 70 billion euros in three years, with a massive impact on purchasing power. Higher tax and social security charges wound up eroding purchasing power by 930 euros per household, more than 300 euros on average per year. Moreover, the very small increase in employment (+32,000) and stagnating real wages, combined with the impact of an increase in the number of households (0.9% annually), led to a reduction in real labour income per household of almost 230 euros per year. In addition, real capital income per household continued to make a negative contribution to purchasing power from 2011 to 2013 (-105 euros on average per year per household). Finally, although social benefits were slowing compared to the previous period, they were the only factor making a positive contribution to purchasing power (about 120 euros per year per household). In the end, purchasing power per household fell by 1,630 euros in three years.

– The third period, 2014 and 2015, will see yet another slight reduction in household purchasing power, amounting to about 110 euros in two years. The weak situation of employment and real wages will not offset the increase in the number of households. Thus, real labour income per household will decline slightly over the two years (-43 euros per year on average). Real capital income will, in turn, be roughly neutral in terms of its effect on purchasing power per household. Although they are not rising as much, tax and social contributions will continue to weigh on purchasing power due to the ramp-up of certain tax measures approved in the past (environmental taxes, higher pension contributions, local taxes, etc.). In total, the increase in the rate of levies on households in 2014-15 will reduce purchasing power per household by 170 euros. In addition, the expected savings on public spending will hold back growth in social benefits per household, which will rise by only about 60 euros per year on average, a rate that is half as high as the pre-crisis period despite the worsening social situation.

While this analysis does not tell us about the distribution per quantile of the change in purchasing power per household, it nevertheless provides a macro view of the impact of austerity on purchasing power since 2011. Out of the 1750 euros per household lost in purchasing power from 2011 to 2015 (see Figure), 1100 euros is directly related to higher taxes and social contributions. In addition to the direct impact of austerity, there is the more indirect impact on the other components of purchasing power. In fact, by cutting activity through the mechanism of the fiscal multiplier, France's austerity policy has had a massive impact on the labour market, by either reducing employment or holding down real wages. While the magnitude is difficult to assess, the fact remains that real labour income per household fell by 770 euros in five years. Finally, while since the onset of the crisis social benefits have up to now acted as a major shock absorber for purchasing power, the extent of savings in public spending planned from 2015 (out of the 21 billion euros in savings in 2015, 9.6 billion will come from social security and 2.4 billion from spending on state interventions) will have a mechanical impact on the dynamics of purchasing power.

Thus, with purchasing power per household falling in 2015 to its level of thirteen years ago and having suffered a historic decline in 2011-13 in a period of unprecedented fiscal consolidation, it seems difficult to argue on the one hand that France has not practiced austerity so far and on the other hand that it is not facing any problem with short-term demand.

Purchasing power per household



Sources: Insee national accounts, author's calculations, France's 2015 Budget Act.

[1] Since 2011, the rate of growth of public spending in volume has been positive, but has halved compared to the decade 2000-10 (1.1% in volume over the period 2011-14, against 2.2% over the period 2000-10). Moreover, in the last four years, it has increased at a rate slightly below the rate of potential GDP (1.4%). From an economic point of view, this corresponds to an improvement in the structural balance due to an adjustment in public spending of 0.5 percentage point of GDP over the period 2011-14.

[2] These differences in the measurement of austerity come from differences in a number of evaluation factors, such as the level of potential GDP and its growth rate, which serve as the benchmark for calculating the structural fiscal adjustment.

[3] It is important to note that gross disposable income includes only income related to cash benefits (pensions, unemployment benefits, family allowances, etc.) but not social transfers in kind (health care, education, etc.) or public collective expenditures that benefit households (police, justice, defence, etc.).

[4] Here we use the concept of average purchasing power per household and not purchasing power per consumption unit.

Devaluation through wages in the euro zone: a lose-lose

adjustment

by Sabine Le Bayon, Mathieu Plane, Christine Rifflart and Raul Sampognaro

Since the outbreak of the financial crisis in 2008 and the sovereign debt crisis in 2010-2011, the euro zone countries have developed adjustment strategies aimed at restoring market confidence and putting their economies back on the path to growth. The countries hit hardest by the crisis are those that depended heavily on the financial markets and had very high current account deficits (Spain, Italy, but also Ireland, Portugal and Greece). Although the deficits have now been largely resolved, the euro zone is still wallowing in sluggish growth, with deflationary tendencies that could intensify if no changes are made. Without an adjustment in exchange rates, the adjustment is taking place through jobs and wages. The consequences of this devaluation through wages, which we summarize here, are described in greater depth in the special study published in the dossier on the OFCE's forecasts (*Revue de l'OFCE*, no. 136, November 2014).

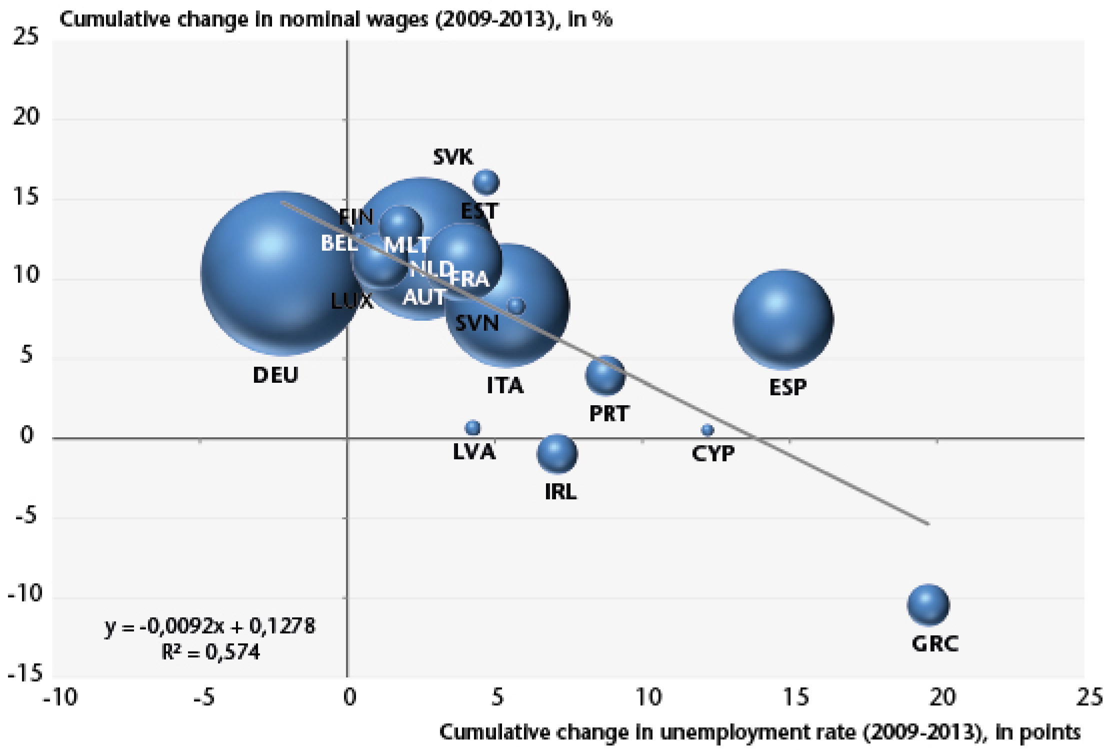
An adjustment driven by moderation in wage increases …

Faced with falling demand, companies have adapted by making heavy cutbacks in employment in order to cut costs, which has led to a steep rise in unemployment. The number of jobless in the euro zone was 7 million higher in September 2014 than in March 2008. The situation is especially glum in countries like Greece, where the unemployment rate is 26.9%, Spain (24.2%), Portugal (13.8%) and Italy (12.5%). Only Germany has experienced a reduction in unemployment, with a rate of 5.0% of the active population.

As is suggested by the Phillips curve, runaway unemployment has eventually affected the conditions governing wage increases, especially in the most crisis-ridden countries

(Figure 1). While between 2000 and 2009 wage growth was more dynamic in the peripheral countries (3.8% annually) than in the countries in the euro zone core (+2.3%) [1], the situation reversed after 2010. Nominal wage growth slowed in the peripheral countries (0.8%), but stayed close to the pre-crisis rate (+2.6%) in the core countries. This heterogeneity is due to differences in how much unemployment has worsened in the different countries. According to Buti and Turrini (2012) [2] from the European Commission, reversing the trend in wage dynamics will be a major factor driving the rebalancing of current account positions in the euro zone.

Figure 1. Changes in unemployment rates and nominal compensation per employee



Note: The size of the bubble is proportional to the GDP of each country in the euro zone.
Sources : Eurostat, OFCE calculations.

Furthermore, an analysis at the macroeconomic data level masks the extent of the ongoing wage moderation, as the effects of the crisis are concentrated on the most vulnerable populations (young, non-graduate employees) earning the lowest wages. The deformation of the structure of employment in favour of more skilled and more experienced workers (see the OFCE post: On the difficulty of carrying out structural reforms in a context of high unemployment) is also pushing up mid-level wages. As can be seen in a number of studies based on an analysis of the macroeconomic data [3], wage growth after correcting for these composition effects is below the increase in the average salary.

… that compresses domestic demand and is not very effective in terms of competitiveness

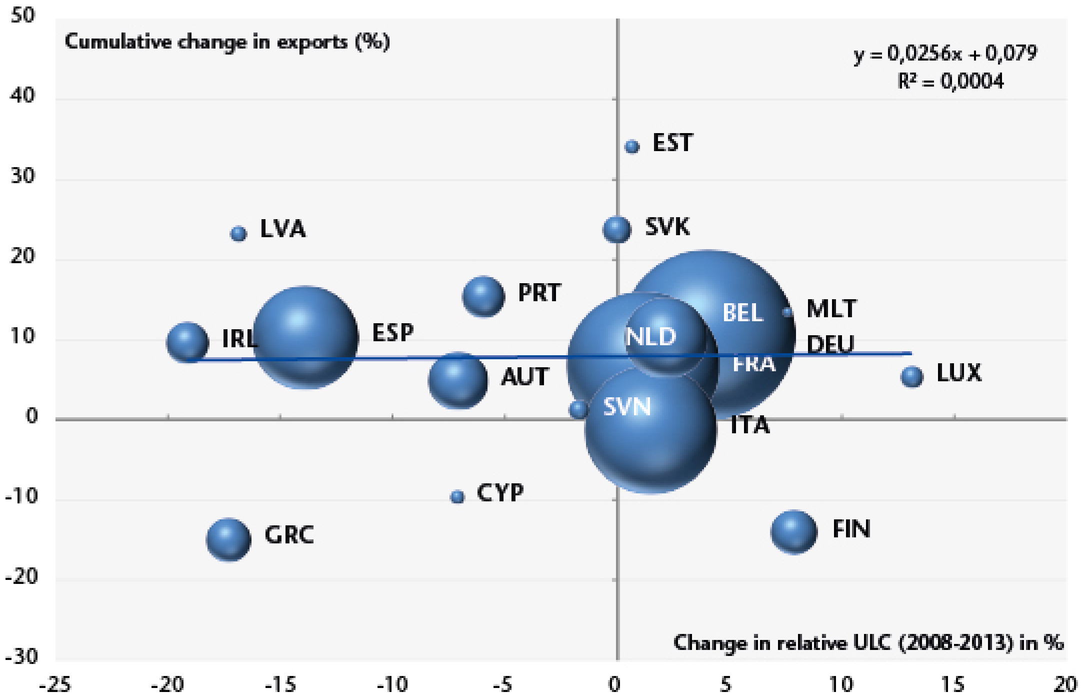
Underlying this policy of deflationary adjustment through wages, what is important for companies is to improve competitiveness and regain market share. Thus, compared with the beginning of 2008, unit labour costs (ULC) [4] fell in the countries deepest in crisis (Spain, Portugal and Ireland), slowed in Italy and continued their upward progression in the countries in the euro zone core, *i.e.* those facing the least financial pressure (Germany, France, Belgium and the Netherlands).

The most significant adjustment took place in Spain. Deflated by inflation, its ULC has fallen by 14% since 2008, 13 points of which are explained by the recovery in productivity, which was achieved at the expense of massive cuts in employment. Real wages increased only 1% over the period. Conversely, in Italy, the adjustment has focused on wages, whose purchasing power has fallen by 5%. However, this decline was not sufficient to offset the fall in productivity, and thus to prevent an increase in the real ULC. In Germany, after the real ULC rose in 2008, real wages continued to rise, but less than gains in productivity. In France, real wages and productivity have risen in tandem at a moderate pace. The ULC, deflated by inflation, has thus been stable since 2009 but has still worsened compared to 2008.

Even though this deflationary strategy is intended to restore business competitiveness, it is a double loser. First, as the strategy is being implemented jointly in all the countries in the euro zone, these efforts wind up neutralizing each other. Ultimately, it is the countries that carry the strategy furthest that win the “bonus”. Thus, among the euro zone’s larger economies, only Spain can really benefit due to the sharp reduction in its ULC, which reflects not only its own efforts but also some continued wage growth among its key partners. France and Italy are not experiencing any gain, and Germany has seen a deterioration in its ULC of about 3% between 2008 and 2013. Moreover, while the wage devaluation might have helped to boost activity, this will have been accomplished through a rebound in exports. But it is difficult to find any correlation between exports and wage adjustments during the crisis (Figure 2). These results have already been pointed out by Gaulier and Vicard (2012). Even if the countries facing the deepest crisis (Spain, Greece, Portugal) might gain market share, the volumes exported by each of them are in the short/medium term not very sensitive to changes in labour costs. This might be explained by companies’ preference to rebuild their margins rather than to lower export prices. Even in countries where the relative ULC fell sharply, the prices of exports rose significantly (6.2% in Greece, 3.2% in Ireland since 2008, etc.).

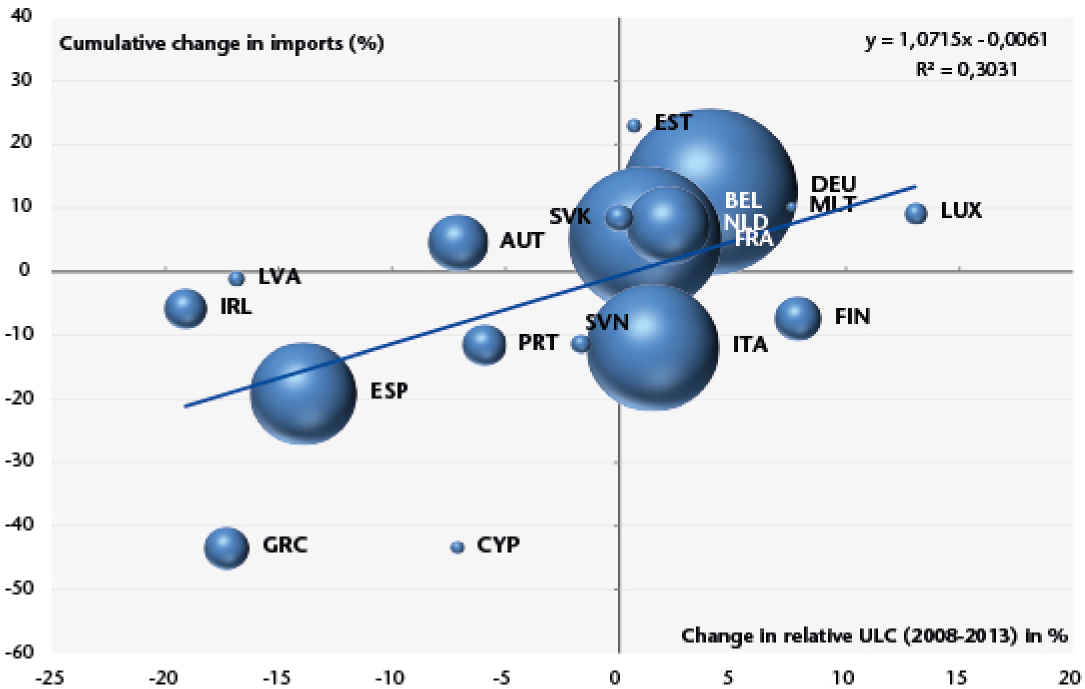
Finally, in an effort to improve their cost competitiveness, companies reduced their payroll by cutting employment and / or wages. This strategy of competitive disinflation results in pressure on household incomes and thus on their demand for goods, which slows the growth of imports. Indeed, in contrast to what is observed for exports, there is a close and positive relationship between changes in the relative ULC and in import volumes over the period 2008-2009 (Figure 3). In other words, the greater the adjustment effort in the ULC with respect to competitor countries, the slower the growth in import volumes.

Figure 2 : Change in relative ULC and exports, in volume



Note: The size of the bubble is proportional to the GDP of each country in the euro zone.
Sources : Eurostat, OFCE calculations.

Figure 3. Change in relative ULC and imports, in volume



Note: The size of the bubble is proportional to the GDP of each country in the euro zone.
Sources : Eurostat, OFCE calculations.

This non-cooperative strategy to rebalance the current account can permanently affect an economic recovery in a context where reducing the debt of both private and public agents will become even more difficult if deflationary pressures are felt in an ongoing way (due to increases in real terms in debt and interest rates). The imbalances in the current accounts of the various euro zone countries will thus be dealt with *mainly* by a contraction of imports. The correction of such imbalances by means of a wage devaluation, as was the case in 2010-2011, is therefore doubly expensive: a low impact on competitiveness, relative to competitors, due to the simultaneous implementation of the strategy in the various euro zone countries, and an increased risk of deflation, making it more difficult to shed debt, thereby fuelling the possibility of a scenario of prolonged stagnation in the euro zone.

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[1] Germany, France, Belgium and the Netherlands. The peripheral countries include Spain, Italy, Portugal and Greece.

[2] Buti and Turrini (2012), "Slow but steady? Achievements and shortcomings of competitive disinflation within the Euro Area".

[3] For a comparison of a number of euro zone countries at the start of the crisis, see ECB (2012), "Euro Area Labor Markets and the Crisis". For the case of Spain, see Puente and Galan (2014), "Un analisis de los efectos composición sobre la evolución de los salarios". Finally, for the French case, see Verdugo (2013) "Les salaires réels ont-ils été affectés par les évolutions du chômage en France avant et pendant la crise?" and Audenaert, Bardaji, Lardeux, Orand and Sicsic (2014), "Wage resilience in France since the Great Recession".

[4] The unit labour cost is defined as the cost of labour per

unit produced. This is calculated as the ratio between compensation per capita and average labour productivity.

On the difficulty of carrying out structural reforms in a period of high unemployment

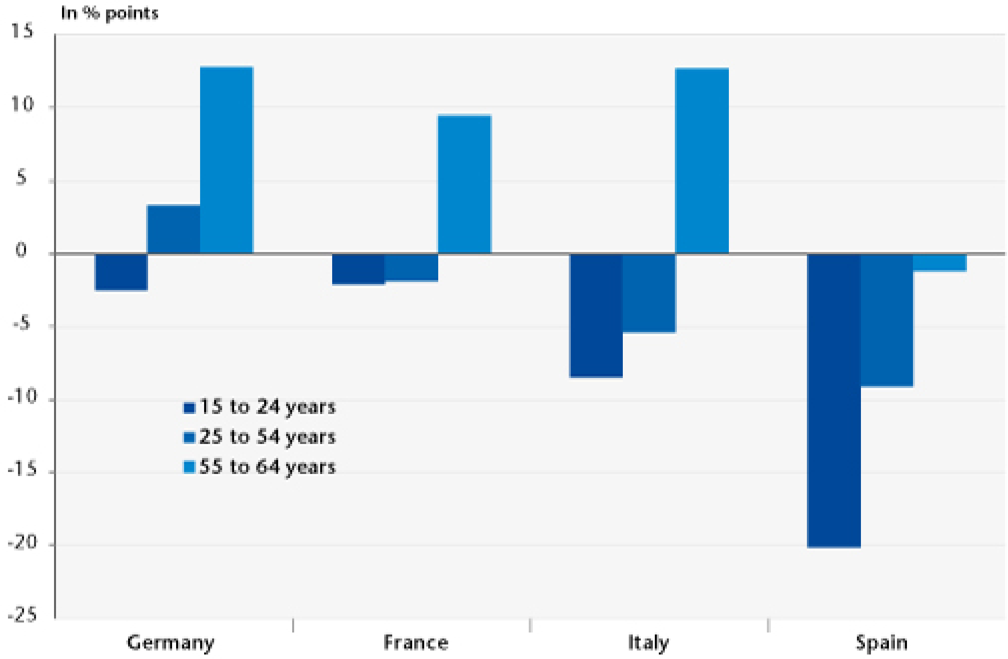
By Sabine Le Bayon, Mathieu Plane, Christine Rifflart and Raul Sampognaro

Structural reforms aimed at developing a more flexible labour market are often attributed all the virtues of fighting against mass unemployment and limiting the segmentation of the labour market between "insiders" on stable contracts and "outsiders" who are unemployed or on precarious contracts. When the economy is growing, these measures can facilitate job creation for the benefit of the outsiders, but the results are likely to be more uncertain in a context of mass unemployment and sluggish growth. Structural reforms can indeed reduce the labour market duality arising from regulatory measures but they cannot combat the duality of the labour market inherent in human capital, which is exacerbated during periods of mass unemployment: given the same qualifications it is experience that makes the difference, and given equal experience it is qualifications that make the difference. High unemployment therefore strengthens the phenomenon of "queuing" to access more stable jobs. Structural reforms aimed at streamlining the labour market will thus primarily affect employees who have less qualifications and experience without however enabling outsiders to gain access to more stable employment. This means that inequality between workers is likely to rise, with no positive impact on employment due to the sluggishness of the economy. Only macroeconomic management that takes on board the goal of returning to full employment could lead to successful structural reform.

As we show in a special study, "La dévaluation par les salaires dans la zone euro: un ajustement perdant-perdant" [Devaluation through wages in the euro zone: a lose-lose adjustment] (*Revue de l'OFCE*, no. 136, November 2014), labour market segmentation has increased during the crisis despite the implementation of structural reforms in the euro zone countries. Since 2008, the employment rate [1] of seniors and of the better qualified has fared better than for other population groups in the four largest countries in the euro zone (Figures 1 and 2).

The sharp decline in the youth employment rate since 2008 is general – including in Germany, where the labour market has remained dynamic – and contrasts with the increase in the employment rate of older workers (or the small decline in Spain). The difference between these two categories is between 12 percentage points in France and 21 points in Italy (15 points in Germany and 19 in Spain). The adjustment in the employment rate of the 25-54 age group lies in an intermediate position. The resistance of the employment rate of older workers to the crisis is probably due to a combination of two factors: the introduction of pension system reforms in recent years (lengthening contribution periods and / or raising the legal retirement age) and the relatively higher cost of dismissing senior citizens, who more often occupy higher positions in the job hierarchy. In a crisis, it is likely that this has led to a substitution effect with the employment of older workers coming at the expense of the young.

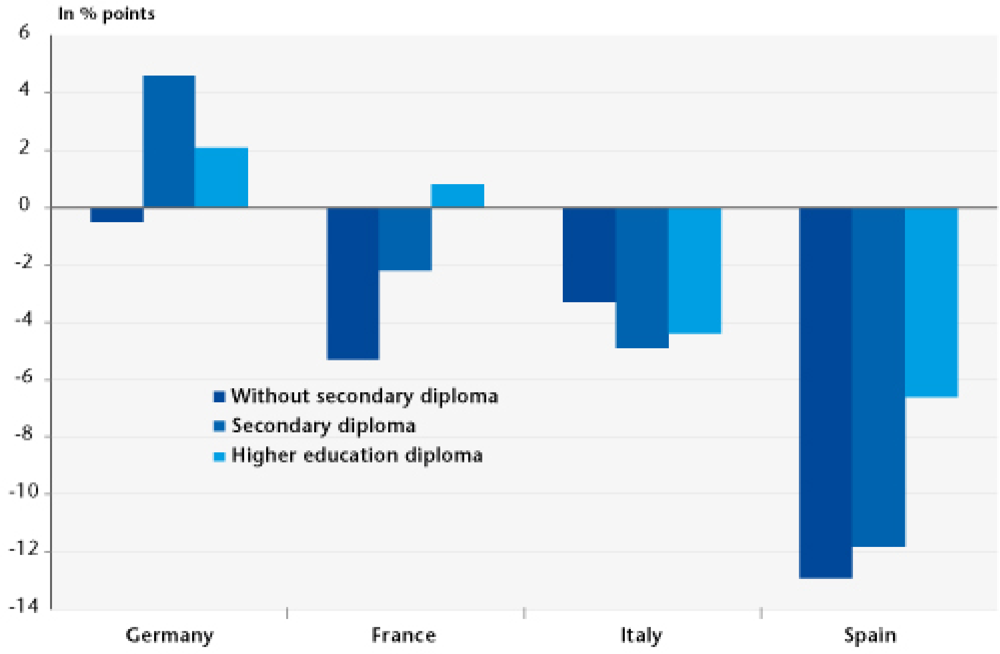
Figure 1 : Changes in employment rate by age group between 2008 (Q1) and 2014 (Q2)



Sources : Eurostat, OFCE calculations.

The adjustments in employment rates were also more striking for people without a high school diploma, with the exception of Italy, where the diploma does not seem to provide protection from unemployment or inactivity. In France, the adjustment in the employment rate clearly decreased with the type of degree. In Germany, the employment rate for those with less education has declined during the crisis while it has increased for the other categories. In Spain, the employment rate of university graduates has withstood the crisis better than the rate of other population groups. In addition to these developments in employment rates by educational category, wage income in Italy, Spain and France has fallen for the initial income deciles. This adjustment in the wage incomes of the lower deciles is probably due to a reduction in total working hours over the year (part-time work, shorter temporary contracts or longer periods of unemployment between contracts, reducing average compensation over the year). Thus, in the countries hit hardest by the crisis, the most vulnerable populations, with the least human capital, have found themselves more exposed to a deteriorating labour market, whether this has been felt through falling employment rates or a reduction in annual wage earnings.

Figure 2 : Changes in employment rate by level of diploma between 2008 (Q1) and 2014 (Q2)



Sources : Eurostat, OFCE calculations.

In the context of a deteriorating labour market, by accepting a slight downgrade the most qualified unemployed workers would be the first to find jobs, chasing out those who might otherwise have gotten it, who would themselves do the same thing at a lower level. This could explain why, at the end of the queue, it is the least skilled who are, regardless of labour legislation, the victims of unemployment and precarious employment.

The existence of a “spontaneous” segmentation in the labour market and the phenomenon of “queuing” may thus limit the success of a strategy of structural reforms and wage devaluation. In such a case, a more flexible labour market combined with a reduction in social welfare could increase inequalities between groups in the workforce without increasing the creation of full-time equivalent jobs.

[1] This is the ratio of the employed to the working-age population.

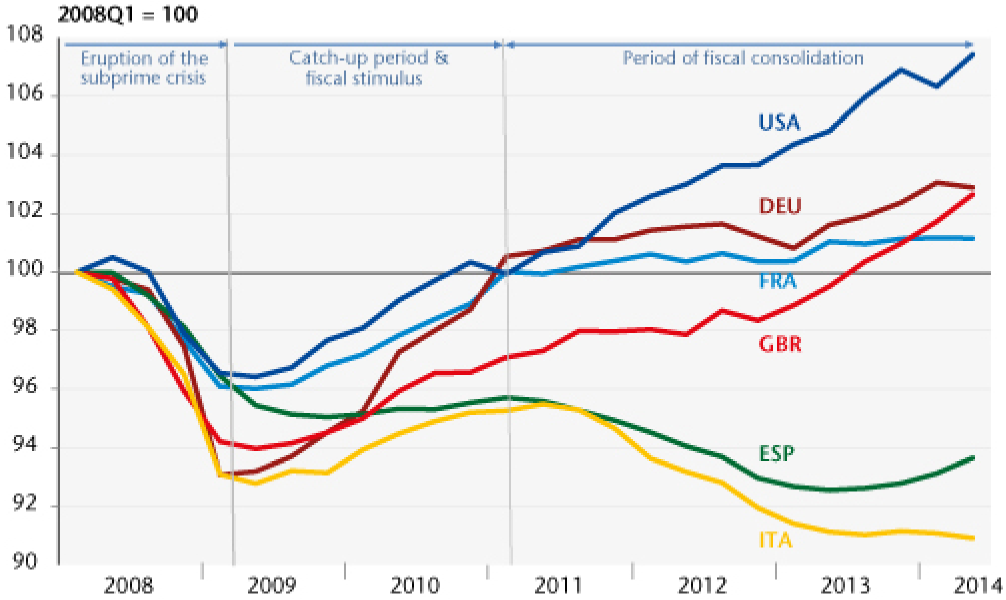
France: duty-free growth

By Bruno Ducoudré , Éric Heyer, Hervé Péléraux, Mathieu Plane

This post summarizes the 2014-2015 outlook for the French economy

In early 2011, France was one of the few developed countries to have regained its pre-crisis level of GDP. Economic growth exceeded 2%, even reaching 3% yoy in the first quarter of 2011. Since then the situation has changed: the recovery was interrupted, and while the economy is experiencing positive growth, the rate is close to zero (Figure 1). Four types of shock explain why the post-recession recovery in 2011 died out. Growth was already being battered by austerity and by deteriorating credit conditions, and was then also hit by fluctuations in oil prices and by the impact of price competitiveness in 2012 as a result first of wage deflation in France's competitors and then in 2013 of the rise of the euro (Table 1).

Figure 1. Comparative development of GDP in France and in its main partners



Sources: National accounts.

In 2014, the improvement expected on the economic front did not occur: the stimulus due to the gradual easing of austerity is being offset by the powerful brake exerted by the significant appreciation of the euro that has taken place since mid-year as well as by the collapse in consumer investment in housing. As in the previous two years, growth is expected to come to 0.4%, which is not enough to reverse the rise in unemployment or to reduce the public deficit significantly. Worse, while the public deficit has been cut by over 3 GDP points since 2009, it is now expected to rise slightly once again, reaching 4.5% of GDP (Tables 1 and 2).

Table 1. The brakes on French growth (2013 – 2015)

In points of growth

	2013	2014	2015
GDP growth	0,4	0,4	1,1
Impact on GDP of			
... changes in oil prices	-0.1	0.0	0.0
Direct impact on the French economy	*-0.1*	*0.0*	*0.0*
Impact via addressed demand	*0.0*	*0.0*	*0.0*
... price competitiveness	-0.1	-0.4	0.2
Impact of change in euro exchange rate	*-0.1*	*-0.2*	*0.1*
Effect of Intra-euro zone competitiveness	*0.0*	*-0.2*	*0.1*
... credit conditions	-0.1	-0.2	-0,1
Direct impact on the French economy	*-0.1*	*-0.1*	*-0.1*
Impact via addressed demand	*0.0*	*-0.1*	*0.0*
... austerity measures	-1.5	-1.2	-1.0
Direct impact on the French economy	*-0.9*	*-0.8*	*-0.6*
Impact via addressed demand	*-0.6*	*-0.4*	*-0.4*
Achievement	-0.1	0.3	0.1
Cumulative effect of shocks	-1.9	-1.6	-0.8
Other factors (housing investment, underestimation of accounts, declining potential, etc.)	-0.1	-0.4	-0.5
Spontaneous growth rate (excluding shocks)	2.4	2.4	2.4

Sources: INSEE, quarterly accounts; OFCE emod.fr forecast 2014-2015, made in October 2014.

In 2015, growth will pick up some, to +1.1%, due to the weakening of the negative factors that have stifled it since 2010, in particular credit conditions and austerity. Furthermore, the effect of price competitiveness, a factor that has played a very negative role in 2014, will be reversed, due first to the depreciation of the euro, and second to the rising impact of the CICE tax credit, whose primary goal is to ensure lower export prices. But with GDP growth of 1.1% next year, the path towards expansion is still a long way from what can usually be seen during a post-crisis recovery (i.e. 2.4%). As the output gap is not closing, the anticipated growth cannot be deemed a recovery. Companies will benefit from this renewed pick-up to gradually restore their financial situation. This strategy is based primarily on increasing productivity, which will help to reduce surplus capacity and restore profit margins. The unemployment rate in metropolitan France will rise slightly to 9.9% in late 2015, and to 10.3% for France as a whole. The counterpart to loosening the austerity reins is a public deficit that is higher than what was originally programmed. It is expected to be 4.3% of GDP in 2015, departing significantly from its path back towards 3%.

Table 2. Summary of forecast for 2014 and 2015

%, annual average

	2010	2011	2012	2013	2014*	2015*
GDP growth rate	2.0	2.1	0.4	0.4	0.4	1.1
Imports	8.5	6.5	-1.2	1.9	2.4	1.2
Household consumption	1.7	0.3	-0.5	0.3	0.2	1.3
Government consumption	1.2	1.0	1.7	2.0	1.8	1.1
Total investment	1.9	2.1	0.3	-0.8	-2.2	-1.6
Exports	8.6	7.1	1.2	2.4	2.5	2.6
Contribution to growth						
Domestic demand excl. inventory	1.8	1.0	0.3	0.4	0.0	0.6
Change in inventory	0.3	1.1	-0.6	-0.2	0.4	0.1
Trade balance	-0.1	0.0	0.7	0.1	0.0	0.4
Growth rate of euro zone GDP	1.9	1.6	-0.6	-0.4	0.9	1.4
Other indicators						
Inflation *(consumption deflator)*	1.2	1.8	1.4	0.6	0.6	0.7
Savings rate *(% of GDI)*	15.8	15.7	15.3	15.1	15.5	15.2
Unemployment rate	8.9	8.8	9.4	9.9	9.7	9.8
Public deficit *(GDP points)*	-6.8	-5.1	-4.9	-4.1	-4.5	-4.3
Public debt *(GDP points)*	81.5	85.0	89.2	92.2	95.4	97.4
GDP growth rate (year-on-year)	2.2	1.5	0.0	0.8	0.4	1.4

*OFCE e-mod.fr forecast for 2014 and 2015
Sources: INSEE, quarterly accounts; OFCE.

In order to meet its commitments on structural efforts and nominal deficits, the government could decide to vote to make an additional effort of 8 billion euros. This would correspond to a 1.2 point hike in the standard rate of VAT. If that happens, GDP would grow no more than 0.8% next year, and the deficit would be reduced by only 0.2 GDP point, compared to our baseline scenario (Table 3).

Table 3. Impact on the French economy of an 8 billion euro hike in VAT

In %, difference from central accounts

Impact on ...	2015
... GDP	-0.3
... General government financing capacity (% GDP)	0.2
... Market sector employment (%)	-0.1
... Unemployment rate (percentage points)	0.1

Source: OFCE emod.fr forecast 2014-2015, made in October 2014.

The strange forecasts of the European Commission for 2014

By Mathieu Plane

The figures for French growth for 2014 published by the European Commission (EC) in its last report in May 2013 appear to reflect a relative consensus. Indeed, the Commission expects GDP to grow by 1.1% in 2014, which is relatively close to the forecasts by the OECD (1.3%) and the IMF (0.9%) (Table 1). However, these forecasts of broadly similar growth hide some substantial differences. First, in defining future fiscal policy, the Commission, unlike the other institutions, considers only the measures already approved. While the Commission's growth forecasts for 2013 included the measures enacted by the Finance Act for 2013 (and therefore the austerity measures), the forecasts for 2014 do not include any forthcoming fiscal measure, even though according to the stability programme submitted to Brussels in April 2013 the government plans austerity measures amounting to 20 billion euros in 2014 (a fiscal impulse of -1 GDP point). The exercise carried out by the Commission for 2014 is thus closer to an economic framework than an actual forecast, as it fails to include the most likely fiscal policy for the year. As a result, the French government has no reason to rely on the Commission's growth forecast for 2014 as it makes radically different assumptions about fiscal policy. But beyond this difference, there is also a problem with the overall coherence of the economic framework set out by the Commission for 2014. It is indeed difficult to understand how for 2014 the Commission can forecast an increase in the unemployment rate with a significantly worsened output gap and a positive fiscal impulse.

Overall, all the institutions share the idea that the output gap in France is currently very wide, lying somewhere between -3.4 percent of GDP (for the EC) and -4.3 percent (for the OECD) in 2013 (Table 1). Everyone thus believes that current GDP is very far from its long-term trajectory, and this deficit in activity should therefore lead, in the absence of an external shock or a constraint on fiscal and monetary policy, to a spontaneous catch-up in growth in the coming years. This should result in a growth rate that is higher than the potential, regardless of the latter's value. So logically, if there is a neutral or positive fiscal stimulus, GDP growth should therefore be much greater than the trend potential. For the IMF, the negative fiscal impulse (-0.2 percent of GDP) is more than offset by the spontaneous catch-up of the economy, resulting in a slight closing of the output gap (0.2) in 2014. For the OECD, the strongly negative fiscal impulse (-0.7 percent of GDP) does not allow closure of the output gap, which continues to widen (-0.3), but less than the negative impact of the impulse due to the spontaneous process of catching up. In both these cases (OECD and IMF), the restrictive fiscal policy holds back growth but leads to an improvement in the public accounts in 2014 (0.5 percent of GDP for the OECD and 0.3 for the IMF).

As for the Commission, its budget forecasts include a positive fiscal impulse for France in 2014 (+0.4 GDP point). As we saw above, the Commission takes into account only the fiscal measures already approved that affect 2014. However, for 2014, if no new fiscal measures are taken, the tax burden should spontaneously decrease due to the fall between 2013 and 2014 in the yield of certain tax measures or the partial financing of other measures (such as the CICE Tax credit for competitiveness and jobs). This could of course result in a positive fiscal impulse in 2014. But despite this impact, which is similar to a stimulus policy (on a small scale), the closure of the output gap (0.1 percent of GDP) is less than the fiscal impulse. This suggests implicitly that fiscal policy has no effect on activity and especially that there is no spontaneous catch-up possible for the French economy despite the very large output gap. But it is not clear why this is the case. Suddenly, the government balance deteriorates in 2014 (-0.3 percent of GDP) and the unemployment rate rises by 0.3 percentage points (which may seem paradoxical with an output gap that doesn't worsen). The French economy is thus losing on all fronts according to the major macroeconomic indicators.

In view of the potential growth, the output gaps and the fiscal impulses adopted by the Commission (the OECD and the IMF), and based on incorporating relatively standard assumptions (a short-term fiscal multiplier equal to 1 and spontaneous closure of the output gap in 5 years), one would have expected the Commission to go for growth in France in 2014 of 2.1% (1.7% for the OECD and 1.2% for the IMF), and thus a steep reduction in unemployment.

Paradoxically, we do not find this same logic in the Commission's forecasts for Germany and the euro zone as a whole (Table 2). In the case of Germany, despite a slight deterioration in the output gap in 2013 (-1 GDP point), which would normally point to some spontaneous catch-up by the German economy in 2014, and an almost neutral fiscal impulse

(0.1 GDP point), Germany's growth in 2014 is expected to be 1.8%, thus permitting the output gap to close by 0.5 GDP point, resulting in a fall in the unemployment rate and a reduction in Germany's public deficit in 2014.

In the case of the euro zone, we find the same scenario: a marginally positive fiscal impulse (0.2 percent of GDP) and a rapid reduction in the output gap (0.7 percent of GDP), which translates both into an improvement in the public accounts despite the positive fiscal impulse and a fall in the unemployment rate (even if we would have expected a greater reduction in the latter in light of the improvement in the output gap).

Given the potential growth, the output gaps and the fiscal impulses adopted for each country by the Commission, the forecast for 2014 could have been for growth of 2.1% in France, 1.6% in Germany and 1.3% for the euro zone.

Finally, why would France, despite a greater output gap than Germany and the euro zone and a stronger positive fiscal impulse, experience an increase in its unemployment rate in 2014 while the rate falls in the other countries? Should we interpret this as reflecting that it is a problem or even impossible for the Commission to include in a forecast that a policy without fiscal consolidation could lead to growth and reduce unemployment spontaneously in France?