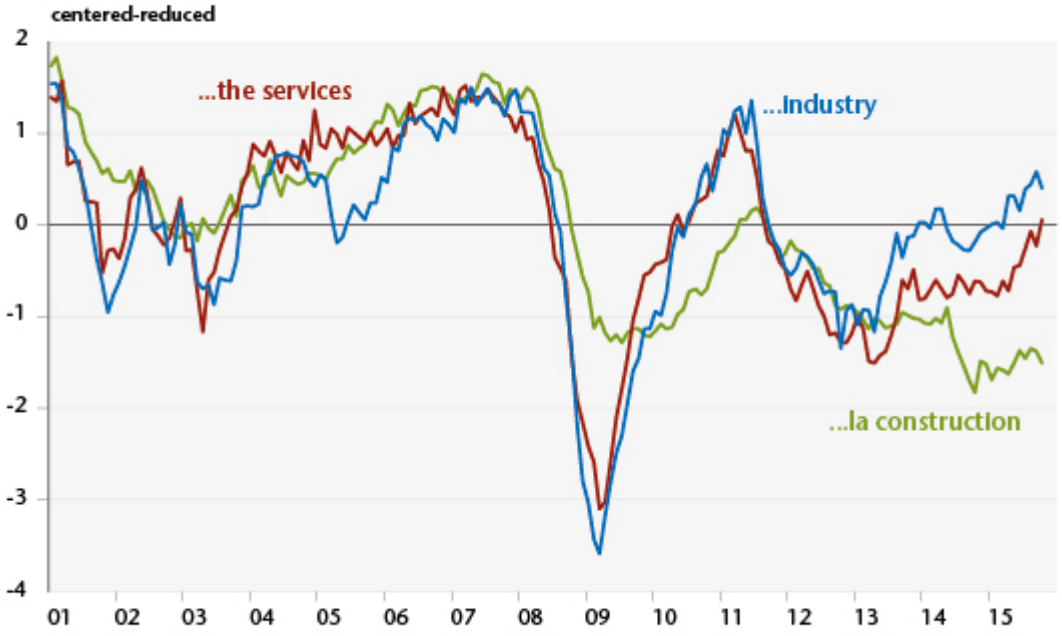
The French economy on the road to recovery

by Hervé Péléraux

The publication of the INSEE's business surveys on October 22 confirms the French economy's positive situation in the second half of 2015, suggesting that the negative performance in the second quarter of 2015 (0%) will turn out to have been merely "an air pocket" after the strong growth seen in the first quarter (+0.7%). The business climate in industry has exceeded its long-term average for the seventh month in a row, and the service sector has been recovering rapidly since May 2015 and has climbed back to its average, the highest level in four years (Figure 1). The business climate in the construction sector nevertheless is still suffering from the crisis that hit it, but its downward trend halted at the end of 2014; despite monthly hiccups, the sector has begun a slow recovery that could signal the end of its woes in the coming quarters.

Figure 1. Business climate in ...



Source : INSEE.

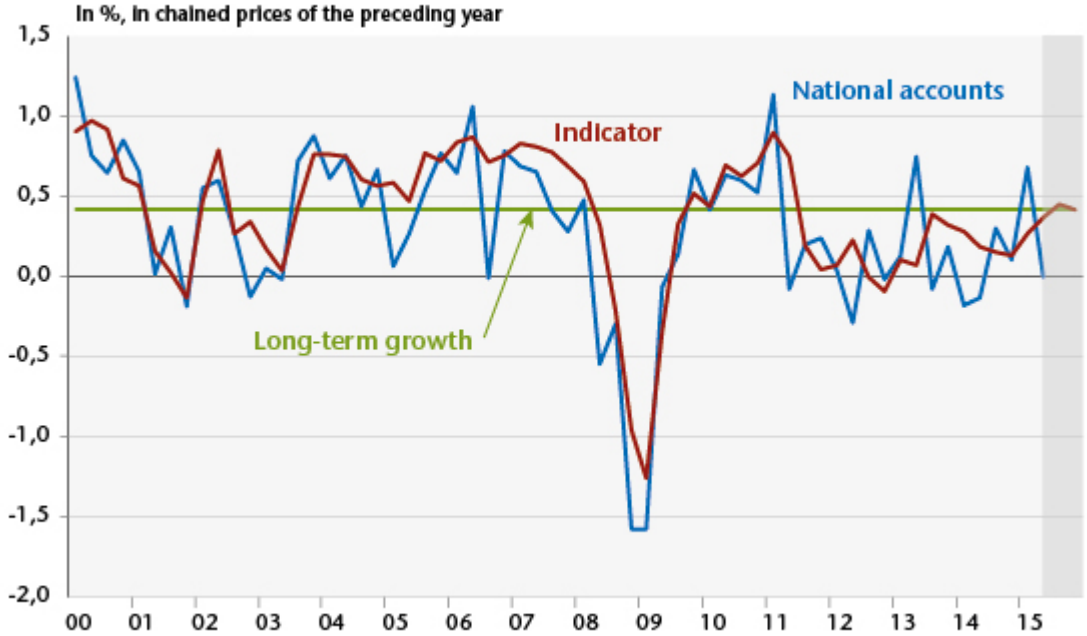
The confidence indicators, which provide qualitative information summarizing the balance of opinion on the various questions posed about business activity, consumer confidence and the situation in commerce, can be converted into quantitative information by means of an econometric equation linking these to the quarterly GDP growth rate[1]. Doing this makes it possible to use these purely qualitative data to estimate the GDP growth rate in the past and near future (two quarters), given that the publication of the surveys precede that for GDP. Among the sectoral indicators available, only the business climate in industry, services and construction provide econometrically useful information to trace the trajectory of the GDP growth rate. The other series are not significant, in particular the indexes for consumer confidence and for confidence in the retail and wholesale trade.

The leading index, which has a significantly more smoothed profile than GDP growth rates, cannot fully capture the volatility of activity and therefore should not strictly speaking be considered a predictor of growth (Figure 2). On the other hand, from a more qualitative viewpoint, it manages to delineate quite correctly the phases during which growth is above or below average (or the long-term) determined by the estimate. From this perspective, the indicator can be seen as marking a turning point in the economic cycle. Since the second quarter 2011, the indicator has not depicted any crossing of the long-term growth rate, despite the false signs of recovery raised by the quarterly GDP figures for Q2 2013 and Q1 2015.

Based on the survey data available up to October, the growth foreseen by the indicator is 0.4% in the third and fourth quarter of 2015, exactly equal to long-term growth[2]. While a signal of recovery is not yet clearly given by the indicator, it should be noted that the information on the fourth quarter, which is limited to the October surveys, is quite partial. The confidence climates, which are extrapolated to the end of the

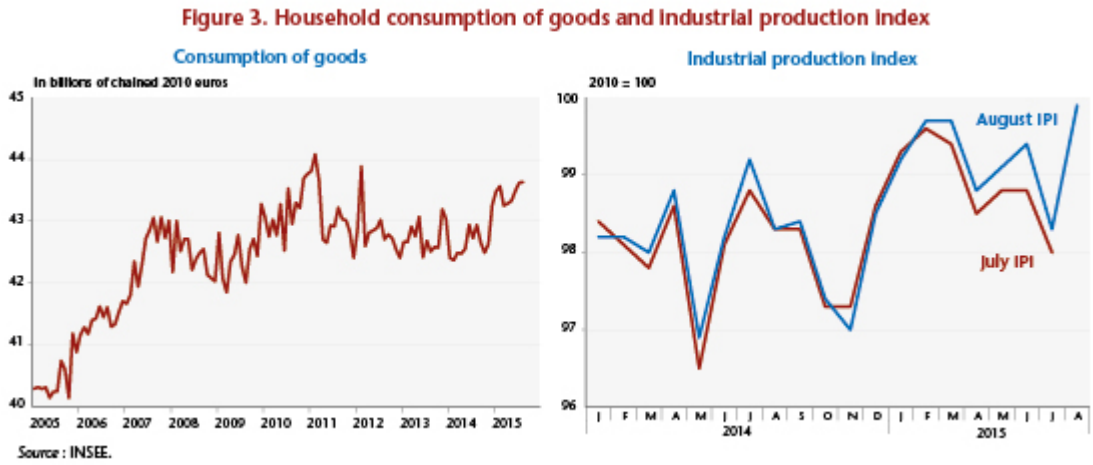
year, are based on conservative assumptions and are likely to be upgraded if the surveys continue to improve from now to December.

Figure 2. GDP growth rate observed and estimated by the indicator



Source : INSEE, OFCE calculations and forecasts.

The quantitative information available at this time for the third quarter of 2015 also gives cause for optimism, after the disappointment of the second quarter. Under the impact of the disinflation brought on by lower energy prices, which enabled a sharp rebound in purchasing power, household consumption of goods recovered sharply at the beginning of the year (Figure 3). The rise was interrupted in the second quarter, due to poor sales in March, which pulled down the figures, but consumption has resumed its upward trajectory continually since then. The carry-over in August for the third quarter was clearly positive (+0.6%), which suggests that the consumption of goods will again contribute positively to GDP growth for the quarter.



The projection of a return to growth in the third quarter is also confirmed by trends in the industrial production index (IPI), which rose sharply in August (+1.6% for the total IPI, and +2.2% for the manufacturing index itself). This rebound followed a drop in production after the peak in February-March 2015[3], which contributed to the poor performance of GDP in the second quarter (Figure 3), and nourished the idea that the second quarter was not an “air pocket” but the continuation of a long phase of stagnation for a France that was unable to take advantage of the favourable winds blowing from outside[4]. The carry-over in industrial production in August now stands at 0.3%, while it was -0.7% in the old series available in July.

The recent trends in the monthly indicators augur a renewal of growth in the third quarter of 2015. The extrapolation of GDP growth using the leading indicator, supplemented by the already available quantitative data, also points to a 0.4% increase in activity in the third quarter, which, if it is realized, would then put the economy on a firm track to finally initiate a recovery.

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[1] For greater detail, see: « France : retour sur désinvestissement, Perspectives 2015-2017 pour l’économie

française » [The 2015-2017 forecast for the French economy], pp. 34-37.

[2] The long-term growth considered here is not the potential growth estimated by its structural determinants using a production function, but the average GDP growth rate as reflected in the estimate of the indicator.

[3] It should be noted that the statistical revisions can change the perception of the economy's dynamics in the very short term. The IPI series published on 9 October 2015 by the INSEE has revised the level of the index significantly upwards compared to the previous publication. The IPI is still on a downward trend between February and July 2015, but the trajectory described is less negative, and the quarterly average of the index in the second quarter of 2015 is affected: according to the old series, it stood at -0.7%, compared with -0.4% according to the revised series.

[4] See Heyer E. and R. Sampognaro, 2015, « L'impact des chocs économiques sur la croissance des pays développés depuis 2011 », [The impact of economic shocks on the growth of the developed countries since 2011], *Revue de l'OFCE*, no. 138, June 2015.

Is Emmanuel Macron approving a new industrial policy for France?

By Sarah Guillou

Support for industry is an economic issue that wins adherence

from both Right and Left. The entire French political spectrum agrees on the importance of industry for the economy's future. There is also a consensus among economists, who bring together a variety of sensitivities in recognizing the leading role industry plays in driving growth, mainly through exports and innovations – the manufacturing sector is responsible for over 70% of total exports and more than 75% of total R&D spending. This consensus is even international, to such an extent that, paraphrasing Robert Reich, it could be said that, "on the battlefield of national economic ambition, industry is the new boots on the ground".

In France, everyone also agrees on deploring the decline in industrial jobs and more generally the de-industrialization that has seen industry's share of total employment fall from 25% in 1990 to 10% in 2014. Deindustrialization, which has intensified since the 2007 crisis, crystallizes all the concerns about globalization and all the reproaches made to the French fiscal and regulatory environment.

Governments in general have been quick to support industry and have set up programmes to support innovation, SMEs and R&D spending. The research tax credit (CIR) set up in 1983 has been reinforced by government after government, and perfectly illustrates the political consensus on the matter. But since then numerous programmes to aid companies have been added, creating a tangle of schemes and local and national institutions, leading a recent OECD report to label the result relatively incoherent.

Unfortunately, it is clear that France's economic and political consensus has not led to making its industry a global singularity in terms of performance. The country's industrial policy has been unable to counteract the inexorable decline of industry in the face of the service sector.

But judging industrial policy in this way misconstrues its possible objectives. To understand what industrial policy

involves, we need to shed our old habits.

On the one hand, opposing industry to services is outdated and is merely a statistical artefact. The services sector is poised to take over innovation and exports, but our statistics have not yet taken stock of these changes. We are still not very clear on how to measure productivity in services or how to understand the channels for innovation in this sector, which do not necessarily pass through R&D. Note, however, that among the companies that benefit from the CIR research tax credit, the number of services firms is increasing every year, reflecting their growing contribution to private R&D spending. Services are a very heterogeneous category: the "Information and communication" category, for example, is less distant from the manufacturing sector than from the real estate business. Furthermore, exports of services are still not well measured (or declared) and are not always very distinguishable from movements of capital. Veiled behind these imperfections in statistics, globalization is not sparing the services sector, which will form an increasing share of international transactions.

Still, for the moment, it is undeniable that the manufacturing sector governs R&D's share of GDP and that the decline in France's market share reveals the productive difficulties companies are experiencing. But we must begin now to anticipate the changes taking place in the boundaries between sectors and not become locked into a reading of economic activity that is incapable of grasping the areas where added value will be created in the future. Re-industrialization in the sense of increasing the role of manufacturing (or "a return to the age of doing") is not necessarily the salvation of the economy of the future.

At the same time, industrial policy as such was not responsible for de-industrialization, nor is it able to counteract the decline in industrial employment.

The reasons for de-industrialization – beyond the important role played by technical progress – are to be found in the conditions governing the exercise of economic activity in France relative to the rest of the world: from the incentives to innovate to the incentives to invest, from taxation to regulation, from skills to productivity.

To put it another way, industrial policy was not the cause of the difficulties of Alstom, of AREVA or of Nokia's takeover of Alcatel-Lucent, and even less so of the logistics merger of Norbert Dentressangle and XPO.

It should be recognized that France's industrial policy is sometimes erroneously confused with what some call "industrial engineering". As public companies have historically been the spearhead of industrial policy, policy had the distinctive feature of combining industrial logic with the logic of the economic and political powers, and the two were not always in synch. These inconsistencies could exacerbate the difficulties facing State-owned enterprises.

Industrial policy should content itself with boosting technological trajectories and promoting business growth. The renovation of industrial policy will involve a comprehensive approach to future technologies. The mechanisms for this will include the development of public-private partnerships and the outsourcing of operations to long-term independent administrative agencies. In this respect the political consensus needs to be extended to include the means for this in order to ensure the continuity of these agencies, so as to stabilize the institutional landscape in which business operates.

Industrial policy is the expression of technological orientations. It can be more or less interventionist and can go beyond more or less simple declarations of intent based on the budgets it is given, depending on overall budgetary constraints. It is especially critical that public funds are

committed or private funds are directed so as to finance the demand placed on business. But it is necessary for this public financing to correspond to a genuine request by the State, such as the need for defence equipment to meet foreign policy or the conquest of space, or to a real decision to involve society in its use, such as green energy. Furthermore, in a democracy, the State's request needs to have the support of society, which should be willing to finance, for example, green energy by paying more for carbon and fuel, along the lines of what has been done in Germany.

In this sense, Emmanuel Macron's approach to industrial policy reflects a positive development. Cutting 34 future projects down to fewer than a dozen is relevant, because it helps to clarify the State's commitments and make them more credible. In addition, the digital commitment is the transcription of a technological choice. At the moment "re-industrialization" is focused around the industries of the future, the digitization and modernization of industrial facilities. It would be more honest to dispense with the goal of "re-industrialization" since what is needed is to deal with the economy as a whole and modernize the means of production in order to make France's productive tissue out of a new stronger fabric.

However, the stated objectives are not based on very risky technological choices and do not commit many resources: a 2.5 billion euro tax benefit for companies investing in their productive facilities over the next 12 months (the accelerated capital cost allowance – *"sur-amortization"* – announced a month ago) and 2.1 billion euros in additional development loans by BPI France for SMEs and ETI over the coming two years. This will thankfully not entail creating another intermediation body for the new policy. As for the role of the State shareholder, the speech was more serene vis-à-vis globalization and more encouraging with regard to European cooperation – as has been shown in the reaction to Nokia's merger process with Alcatel Lucent. The Minister's decisions

do not however seem to be departing from a full neutrality, as can be seen in the case of the double voting shares that the State has imposed on Renault.

The overhaul of industrial policy remains modest in terms of resources and goals, but it has the merit of setting objectives for policy that it might actually be able to meet.