

Pensions: the Moreau report's poor compromise

By [Henri Sterdyniak](#)

Under pressure from the financial markets and Europe's institutions, the government felt obliged to present a new pension reform in 2013. However, reducing the level of pensions should not now be a priority for French economic policy: it is much more urgent to re-establish satisfactory growth, reform the euro zone's macroeconomic strategy, and give a new boost to France's industrial policy as part of an ecological transition. Establishing a committee of senior officials and experts is a common practice that is used these days to depoliticize economic and social choices and distance them from democratic debate. In this respect, [the Moreau report](#), released on 14 June 2013, seems like a bad compromise. Although it does not call into question the public pension system, it weakens it and does not give itself the means to ensure the system's social viability.

Do the social security accounts have to be balanced during a depression?

The deficit in the pension schemes in 2013 was mainly due to the depth of the recession, which has reduced the level of employment by about 5%, causing a loss of about 12 billion euros in funding for the pension schemes. The central objective of Europe's economic policy should be to recover the jobs lost. Unfortunately, the Moreau report proposes continuing the strategy of a race to the bottom that is being implemented in Europe and France: "the pension schemes must contribute to restoring the public accounts and to France's international credibility" (page 82). The report forgets that lower pensions lead to a decline in consumption, and thus in GDP, and to lower tax revenues and social security

contributions, especially since all the euro zone countries are doing the same thing.

The report recommends reducing the deficit in the pension system relatively quickly by increasing the taxes paid by retirees. It adopts several well-known proposals uncritically. It would align the rates of pensioners' CSG wealth tax with those of the employed. At one time, unlike employees, pensioners did not pay health insurance contributions. They have been hit by the establishment and then increase in the CSG tax. They already pay an additional contribution of 1% on their supplementary pensions. They are suffering from the retreat of the universal health scheme in favour of top-up health insurance. Increasing their CSG rate from 6.6% to 7.5% – the same as for employees – would bring in 1.8 billion euros. But shouldn't it be necessary in exchange to eliminate the 1% contribution on supplementary pensions and make their top-up health insurance premiums (which are not paid by the companies) deductible?

Pensioners are entitled, like employees, to a 10% allowance for business expenses, but with a much lower ceiling. Even for employees, this allowance is much higher than actual business expenses; it offsets to some extent the possibilities of tax evasion by non-employees. The removal of the allowance would lead to 3.2 billion euros more in tax revenue to the state and a 1.8 billion reduction in certain benefits, linked to the amount of taxable income. Retirees would lose 2% of their purchasing power. But it is hard to see how this 5 billion would make its way into the coffers of the pension programmes.

Taxing pension family benefits (which would yield 0.9 billion) is certainly more justifiable, but again it is unclear how and why the product of this tax would go to the pension funds, especially as family benefits are the responsibility of the CNAF (National family benefits fund).

On the other hand, with regard to increasing contributions the

report is very timid in at best proposing an increase of 0.1 percentage point per year for 4 years, *i.e.* ultimately 1.6 billion euros in employee contributions and 1.6 billion in employer contributions.

Most importantly, the report intends to increase the highest pensions (those who pay the full rate of CSG tax) only at the rate of inflation: 1.2 points for 3 years, thereby hitting them with a reduction of 3.6% in their purchasing power. Pensions subject to the reduced rate of CSG would lose only 1.5%. The lowest pensions would be spared. While this disparity in efforts may seem justified, the reliability of the public pension system would be seriously undermined. How can we be sure that this de-indexation will last only three years, that it will not become a more or less permanent management tool, which would especially hit older pensioners whose standard of living is already low? As the pensions received by a retiree are not all currently centralized, it is difficult to have the indexation of pensions vary in accordance with their level. The solution advocated by the report – to take into account the situation of the pensioner *vis-à-vis* the CSG – is hard to manage; making someone's pension level depend on their family's tax situation is just not justifiable. Pensions are a social right, a return on the contributions paid in, and not a tool for adjustments. How can we justify a 3.6% decline in the purchasing power of part of the population while GDP per capita is expected to continue to rise? Should the purchasing power of pensioners be cut when it has not benefited from an increase since 1983, even during periods of wage growth? Respect for the implicit social contract that underpins the pension system means that pensioners should make the same efforts as employees, no more, no less.

Furthermore, in times of economic recession the refrain that *efforts need to be equitably distributed* is dangerous. If everyone makes an effort by accepting less revenue and then

reducing their expenditure, the inevitable result will be a drop in overall consumption, which, given spare production capacity, will be accompanied by a decline in investment and thus in GDP.

Guaranteeing a fall in pensions

In the medium term, the report's main concern is to ensure a decline in the relative level of pensions. Indeed, because of the Balladur reform, since 1993 wages recognized in the general pension scheme have been re-valued based on prices, and not on the average wage. The replacement rate (the ratio of the first pension payment to final salary) falls in line with strong increases in the average wage: at one time the pension system's maximum replacement rate was 50%, but this drops to 41.5% if real wages rise by 1.5% per year, but only to 47% if they rise by 0.5% per year. The mechanism introduced will lead to lowering the average level of pensions by 31% if the real wage increases by 1.5% per year, by 12% if it grows by 0.5% per year or by 0% if it stagnates. However, in recent years, wages have been rising by only 0.5% per year. The relative level of pensions might then recover. It is necessary therefore to increase wages to reduce the relative level of pensions.

The committee of experts gathered around Mrs. Moreau have therefore made two alternative proposals:

- – Either the wages used will be re-valued only as: price + (real wages less 1.5%), which means that, regardless of the wage increase, the maximum replacement rate for general pensions would fall to 41.5%. The relative decline in pensions would therefore be definitively consolidated. On the technical side, the increase in wages recorded will become a tool for adjustment, whereas, objectively, it should be used to calculate the average wage over the career; the oldest wages would be sharply devalued. However, the report acknowledges (page

107) that the current level of pensions corresponds to parity in living standards between active employees and pensioners, and that the proposed change would lead eventually to lowering the standard of living for retirees by 13%. Nevertheless, it considers that “this development is acceptable”. Is this a judgment that should be made by the experts or by the citizens? Moreover, it neglects that this loss would come on top of the impact of the tax reforms and de-indexation that have also been recommended.

- – Or, every year a committee of experts would propose a reduction in the level of the pensions to be paid based on a *demographic factor* that would ensure the system is balanced. In addition to the fact that this would be another blow to democracy (isn't it up to the citizens to arbitrate between pension levels and contribution rates?) and to social democracy (the social partners would merely be *consulted*), and employees would have no guarantee of the future level of their pension, especially given the memory of the precedent set by the appointment of an expert group for the minimum wage (the *SMIC*), which was fiercely opposed to any increase.

Lengthening the contributions period

The Moreau report calls for further lengthening the period of contribution payments required based on the principles of the 2003 Act (extending the contribution period by two years for every three year increase in life expectancy at age 60). The required contribution period would then be 42 years for the 1962 cohort (2024), 43 years for the 1975 cohort (2037), and 44 years for the 1989 cohort (in 2051). As the average age when vesting begins is currently 22 years, this would lead to an average retirement age of 65 in 2037 and 66 in 2051. This announcement is certainly designed to reassure the European Commission and the financial markets, but it leads above all to worrying the younger generations and reinforcing their fear

that they will never be able to retire.

Is it really necessary to announce a decision for the next 25 years without knowing what the situation will be in 2037 or 2051 with respect to the labour market, job needs, social desires or environmental constraints? Eventually, like all the developed countries France cannot escape the need to revise its growth model. Is it really necessary to do everything possible to increase production and private sector employment at a time when ecological constraints should be pushing us to decrease material output? Maintaining the possibility of a period of active retirement in good health is a reasonable use of productivity gains. Reform should not go beyond a retirement age of 62 years and a required contribution period of 42 years. So if the “long career” approach is maintained, people who start work at age 18 can retire at 60, and those who start at age 23 will stay on until 65. But working conditions and career development programmes need to be overhauled so that everyone can actually stay in work until those ages. This also implies that young people seeking their first job receive unemployment benefits, and that the youthful years of precarious employment are validated.

Taking the arduous character of work into account

The convergence of public, supplementary and private pension programmes likewise involves taking into account how arduous jobs are, by distinguishing between professions that are difficult to exercise after a certain age, meaning some kind of mid-term conversion is necessary, and jobs that are too tough, which can reduce life expectancy and thus should be phased out. For those who still have to do such jobs, periods of heavy work should give rise to possible bonus contribution periods and reductions in the age requirements. Common criteria should be applied in all the pension systems. In offering only one year's bonus for 30 years of hard labor, the Moreau report does not go far enough. This is almost insulting and makes it impossible to open up negotiations on a plan to

align the different systems.

What is to be done?

Whereas the [COR report](#) declared only a limited deficit (1% of GDP in 2040), the Moreau report proposes inflicting a triple penalty on future pensioners: de-indexation, a lower guaranteed replacement rate and the automatic extension of the contributions period required. This is no way to reassure the young generations or to highlight the advantages of the old-age pension system.

Pension reform is not a priority for the year 2013. In the short term, concern should be focused not on the financial imbalances in the regimes induced by the crisis but mainly on getting out of the depression. A strategy of a race to the bottom economically and socially, which is what de-indexation would lead to, must be avoided.

In the medium term, in order to convince young people that they will indeed enjoy a satisfying retirement, the goal should be to stabilize the pension / retirement ratio at close to its current level. The State and the unions must agree on target levels for the net replacement rate for normal careers: 85% for the minimum wage level; 75% for below the social security ceiling (3000 euros per month); and 50% for one to two times that ceiling.

To guarantee the pay-as-you-go pension system, the government and the unions must state clearly that a gradual increase in contributions will be required to bring the system into equilibrium, if necessary, once a strategy of extending the length of careers has been implemented at the company level that corresponds to the state of the labour market and actual workforce needs.

Reforming the conjugal quotient

By [Guillaume Allègre](#) and [Hélène Périvier](#)

As part of a review of family benefit programmes ([the motivations for which are in any case debatable](#)), the government has announced plans to reduce the cap on the family quotient benefit in the calculation of income tax (IR) from 2014. The tax benefit associated with the presence of dependent children in the household will be reduced from 2000 to 1500 euros per half share. Opening discussion on the family quotient should provide an opportunity for a more general review of how the family is taken into account in the calculation of income tax, and in particular the taxation of couples.

How are couples taxed today?

In France, joint taxation is mandatory for married couples and civil partners (and their children), who thus form part of one and the same household. It is assumed that members of a household pool their resources fully, regardless of who actually contributes them. By assigning two tax shares to these couples, the progressive tax scale is applied to the couple's average revenue $[(R1 + R2) / 2]$. When the two spouses earn similar incomes, the marital quotient does not provide any particular advantage. In contrast, when the two incomes are very unequal, joint taxation provides a tax advantage over separate taxation.

In some configurations, separate taxation is more advantageous than joint taxation; this is due partly to the particular way that the employment bonus and tax reduction [1] operates, and

to the fact that separate taxation can be used to optimize the allocation of the children between the two tax households, which by construction does not permit joint taxation. Tax optimization is complex, because it is relatively opaque to the average taxpayer. Nevertheless, in most cases, marriage (or a “PACS” civil partnership) provides a tax benefit: 60% of married couples and civil partners pay less tax than if they were taxed separately, with an average annual gain of 1840 euros, while 21% would benefit from separate taxation, which would save them an average of 370 euros ([Eidelman, 2013](#)).

Why grant this benefit just to married couples and civil partners?

The marital quotient is based on the principle that resources are fully pooled by the couple. The private contract agreed between two people through marriage or a PACS constitutes a “guarantee” of this sharing. In addition, the marriage contract is subject to a maintenance obligation between spouses, which binds them beyond the wedding to share part of their resources. However, the Civil Code does not link “marriage” to the “full pooling” of resources between spouses. Article 214 of the Civil Code provides that spouses shall contribute towards the expenses of the marriage “in proportion to their respective abilities”, which amounts to recognizing that the spouses’ abilities to contribute may be unequal. Since 1985, Article 223 has established the principle of the free enjoyment of earned income, which reinforces the idea that marriage does not mean that the spouses share the same standard of living: “each spouse is free to practice a profession, to collect earnings and wages and to spend them after paying the costs of the marriage”. The professional autonomy of the spouses and the right to dispose of their wages and salaries are fully recognized in the Civil Code, whereas the Tax Code is limited to an overview of the couple’s income and expenditures.

In addition, there is some dissonance between the social and

the tax treatment of couples. The amount of the RSA benefit [income support] paid to a couple is the same whether they are married or common-law partners. As for the increased RSA paid to single mothers with children, being single means living without a spouse, including a common law partner. Cohabitation is a situation recognized by the social system as involving the pooling of resources, but not by the tax system.

Do couples actually pool their resources?

Empirical studies show that while married couples tend to actually pool all their income more than do common-law partners, this is not the case of everyone: in 2010, 74% of married couples reported that they pooled all their resources, but only 30% of PACS partners and 37% of common-law couples. Actual practice depends greatly on what there is to share: while 72% of couples in the lowest income quartile report pooling their resources fully, this is the case for only 58% of couples in the highest quartile ([Ponthieux, 2012](#)). The higher the level of resources, the less the couple pools them. Complete pooling is thus not as widespread as assumed: spouses do not necessarily share exactly the same standard of living.

Capacity to contribute and number of tax shares allocated

The tax system recognizes that resources are pooled among married couples and civil partners, and assigns them two tax shares. The allocation of these tax shares is based on the principle of ability to pay, which must be taken into account to be consistent with the principle of equality before taxation: in other words, the objective is to tax the standard of living rather than income *per se*. For a single person and a couple with the same incomes, the singleton has a higher standard of living than the couple, but due to the benefits of married life it is not twice as high. To compare the living standards of households of different sizes, equivalence scales have been estimated ([Hourriez and Olier, 1997](#)). The INSEE allocates a 1.5 share (or consumption unit) to couples and a 1

share to single people: so according to this scale, a couple with a disposable income of 3000 euros has the same standard of living as a single person with an income of 2000 euros. However, the marital quotient assigns two shares to married couples but one to the single person. It underestimates by 33% the standard of living of couples relative to single people, and therefore they are not taxed on their actual ability to contribute.

Moreover, once again there is an inconsistency between the treatment of couples by social policy and by fiscal policy: social security minima take into account the economies of scale associated with married life in accordance with the equivalence scales. The base RSA (*RSA socle*) received by a couple (725 euros) is 1.5 times greater than that received by a single person (483 euros). There is an asymmetry in the treatment of spouses depending on whether they belong to the top of the income scale and are subject to income tax, or to the bottom of the income scale and receive means-tested social benefits.

What family norms are encapsulated in the marital quotient?

The marital quotient was designed in 1945 in accordance with a certain family norm, that of Monsieur Gagnepain and Madame Aufoyer ["Mr Breadwinner and Ms Housewife"]. It contributed together with other family programmes to encouraging this type of family organization, *i.e.* the one deemed desirable. Until 1982, tax was based solely on the head of the family, namely the man, with the woman viewed as the man's responsibility. But far from being a burden on her husband, the wife produced a free service through the domestic work she performed. This home production (the care and education of children, cleaning, cooking, etc.) has an economic value that is not taxed. Single earner couples are thus the big winners in this system, which gives them an advantage over dual earner couples, who must pay for outsourcing part of the household and family work.

In summary, the current joint taxation system leads to penalizing single persons and common-law couples compared to married couples and civil partners, and to penalizing dual-earner couples compared to single-earner couples. The very foundations of the system are unfavourable to the economic liberation of women.

What is to be done?

The real situation of families today is multiple (marriage, cohabitation, etc.) and in motion (divorce, remarriage or new partnerships, blended families); women's activity has profoundly changed the situation in the field. While all couples do not pool their resources, some do, totally or partially, whether married or in common law unions. Should we take this into account? If yes, how should this be done in light of the multiplicity of forms of union and the way they constantly change? This is the challenge we face [in reforming the family norms and principles that underpin the welfare state](#). Meanwhile, some changes and rebalancing could be achieved.

Currently, the benefit from joint taxation is not capped by law. It can go up to 19,000 euros per year (for incomes above 300,000 euros, an income level subject to the highest tax bracket) and even to almost 32,000 euros (for incomes above 1,000,000 euros) if you include the benefit of joint taxation for the exceptional contribution on very high incomes. For comparison, we note that the maximum amount of the increase in the RSA for a couple compared to a person living alone is 2900 euros per year. The ceiling on the family quotient (QF), which is clear, is 1500 euros per half share. A cap on the marital quotient of 3000 euros (twice the cap on the QF) would affect only the wealthiest 20% of households (income of over 55,000 euros per year for a single-earner couple with two children). At this income level, it is likely that the benefit from joint taxation is related to an inequality in income that is the result of specialization (full or not) between the spouses in

market and non-market production or that resources are not fully shared between the partners.

Another complementary solution would be to leave it up to every couple to choose between a joint declaration and separate declarations, and in accordance with the consumption scales commonly used to accord the joint declaration only 1.5 shares instead of 2 as today. The tax authorities could calculate the most advantageous solution, as households do not always choose the right option for them.

A genuine reform requires starting a broader debate about taking family solidarity into account in the tax-benefit system. In the meantime, these solutions would rebalance the system and turn away from a norm that is contrary to gender equality. At a time when the government is looking for room for fiscal maneuvering, why prohibit changing the taxation of couples?

[\[1\]](#) A tax reduction [*décote*] is applied to the tax on households with a low gross tax (less than 960 euros). As the reduction is calculated per household and does not depend on the number of persons included in the household, it is relatively more favourable for singles than for couples. It helps ensure that single people working full time for the minimum wage are not taxable. For low-income earners, the reduction thus compensates the fact that single persons are penalized by the marital quotient. No similar mechanism is provided for high-income earners.

Competitiveness: danger zone!

By [Céline Antonin](#), [Christophe Blot](#), Sabine Le Bayon and [Catherine Mathieu](#)

The crisis affecting the euro zone is the result of macroeconomic and financial imbalances that developed during the 2000s. The European economies that have provoked doubt about the sustainability of their public finances (Spain, Portugal, Greece and Italy [\[1\]](#)) are those that ran up the highest current account deficits before the crisis and that saw sharp deteriorations in competitiveness between 2000 and 2007. Over that same period Germany gained competitiveness and built up growing surpluses, to such an extent that it has become a model to be emulated across the euro zone, and especially in the countries of southern Europe. Unit labor costs actually fell in Germany starting in 2003, at a time when moderate wage agreements were being agreed between trade unions and employers and the coalition government led by Gerhard Schröder was implementing a comprehensive programme of structural reform. This programme was designed to make the labour market [\[2\]](#) more flexible and reform the financing of social protection but also to restore competitiveness. The concept of competitiveness is nevertheless complex and reflects a number of factors (integration into the international division of production processes, development of a manufacturing network that boosts network effects and innovation, etc.), which also play an important role.

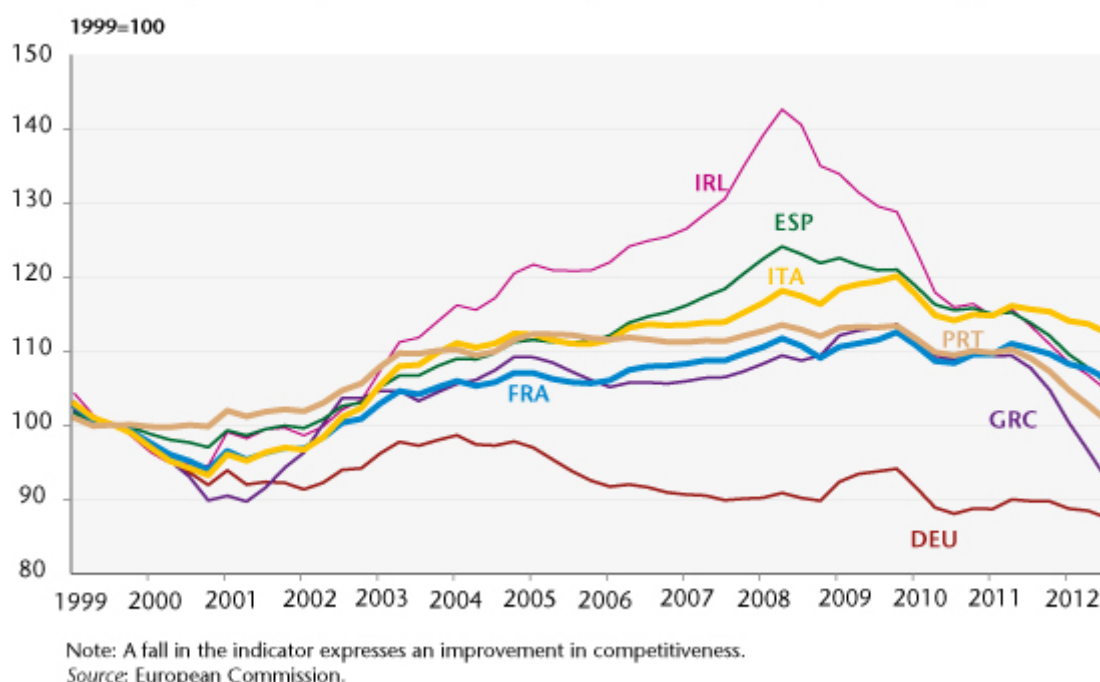
In addition, as is highlighted in a [recent analysis by Eric Heyer](#), Germany's structural reforms were accompanied by a broadly expansionary fiscal policy. Today, the incentive to improve competitiveness, strengthened by the implementation of improved monitoring of macroeconomic imbalances (see [here](#)), is part of a context marked by continued fiscal adjustment and high levels of unemployment. In these conditions, the implementation of structural reforms coupled with a hunt for

gains in competitiveness could plunge the entire euro zone into a deflationary situation. In fact, Spain and Greece have already been experiencing deflation, and it is threatening other southern Europe countries, as we show in [our latest forecast](#). This is mainly the result of the deep recession hitting these countries. But the process is also being directly fueled by reductions in public sector wages, as well as in the minimum wage (in the case of Greece). Moreover, some countries have cut unemployment benefits (Greece, Spain, Portugal) and simplified redundancy procedures (Italy, Greece, Portugal). Reducing job protection and simplifying dismissal procedures increases the likelihood of being unemployed. In a context of under-employment and sluggish demand, the result is further downward pressure on wages, thereby increasing the deflationary risks. Furthermore, there has also been an emphasis on decentralizing the wage bargaining process so that they are more in tune with business realities. This is leading to a loss of bargaining power on the part of trade unions and employees, which in turn is likely to strengthen downward pressure on real wages.

The euro zone countries are pursuing a non-cooperative strategy that is generating gains in market share mainly at the expense of other European trading partners. Thus since 2008 or 2009 Greece, Spain, Portugal and Ireland have improved their competitiveness relative to the other industrialized countries (see graph). The continuation of this strategy of reducing labor costs could plunge the euro zone into a deflationary spiral, as the countries losing market share seek in turn to regain competitiveness by reducing their own labour costs. Indeed, this non-cooperative strategy, initiated by Germany in the 2000s, has already contributed to the crisis in the euro zone (see the box on p.52 of the [ILO report](#) published in 2012). It is of course futile to hope that the continuation of this strategy will provide a solution to the current crisis. On the contrary, new problems will arise, since deflation [\[3\]](#) will make the process of reducing both public

and private debt more expensive, since debt expressed in real terms will rise as prices fall: this will keep the euro zone in a state of recession.

Figure 1. Competitiveness measured by unit labour costs (total economy)



[1] The Irish case is somewhat distinct, as the current account deficit seen in 2007 was due not to trade, but a shortfall in income.

[2] These reforms are examined in detail in a report by the Conseil d'analyse économique (no. 102). They are summarized in a special study [La quête de la compétitivité ouvre la voie de la déflation](#) ("The quest for competitiveness opens the door to deflation").

[3] For a more comprehensive view of the dynamics of debt-driven deflation, see [here](#).

A fiscal policy to promote structural reform – lessons from the German case

By [Eric Heyer](#)

“France should copy Germany’s reforms to thrive”, Gerhard Schröder entitled [an opinion piece in the Financial Times on 5 June 2013](#). As for the European Commission (EC), its latest annual recommendations to the Member states, released on 29 May, seem to take a step back from its strategy of a rapid and synchronized return to balancing the public finances, which has been in place since 2010. The EU executive’s priority now seems to be implementation of structural reforms of the labour and services markets in the euro zone countries. These countries will of course continue to consolidate their public finances, but the EC has given them an extra year or two to do this. While, for example, France will further consolidate its accounts over the coming two years (the fiscal effort demanded of the French government by the EC comes to 0.8 percent of GDP, or 16 billion euros per year), it has been given another two years to bring its deficit below 3% of GDP (2015 instead

Tableau. New fiscal targets after postponement

		2013	2014	2015	2016
France	Government deficit (% of GDP)	3,9	3,6	2,8	
	Fiscal impulse (GDP points)	-1,3	-0,8	-0,8	
Spain	Government deficit (% of GDP)	6,5	5,8	4,2	2,8
	Fiscal impulse (GDP points)	-1,1	-0,8	-0,8	-1,2
Netherlands	Government deficit (% of GDP)	3,6	2,8		
	Fiscal impulse (GDP points)	-0,6	-0,7		

Source : European Commission.

of 2013).

This change in course – or at least in tone – by the EC, which had emphasized the enactment of extreme austerity reforms,

should be welcomed. However, it is important to consider whether the new environment, in particular the fiscal situation, will be favourable enough to ensure that the structural reforms are effective. An examination of the economic context in which Germany introduced its reforms in the early 2000s, which became a benchmark for the countries of southern Europe, provides some important lessons. While the purpose here is not to go into these reforms in depth, it is nevertheless useful to remember that they were enacted while the German economy had a substantial trade deficit (-1.8 percent of GDP in 2000 against a surplus of 1.4 percent for France at that same time) and was considered a “low achiever” in Europe. These reforms led to a significant reduction in the share of wages in value added, boosting the margins of German business, and helped to quickly restore the competitiveness of the German economy: by 2005, Germany was once again generating a large trade surplus while France ran a deficit for the first time since 1991. The non-cooperative character of the the euro zone ([OFCE, 2006](#)) and the steep increases in Germany in poverty – ([Heyer, 2012](#)) and Figure 1 – and in wealth inequality ([de Grauwe et Yi, 2013](#)) were the hidden fruit of this strategy. Europe’s “low achievers” today are the southern European countries, and the pressure to take steps to boost competitiveness has shifted from Germany to France, Italy and Spain. Despite this parallel, the question remains: is the economic environment similar today? Figures 1 and 2 summarize the economic situation in Germany at the time the structural reforms were implemented. Two main points stand out:

1. These reforms were carried out **in a context of strong global growth**: the world experienced average growth of over 4.7% per year in 2003-2006 (Figure 1). By comparison, the figure for growth is likely to be less than 3% over the next two years;
2. In addition, the fiscal situation of the German economy in the early 2000s was not good: in 2001, the general

government deficit for Germany exceeded 3%, and came close to 4% in 2002, the year before the enactment of the first Hartz reform. Government debt then exceeded the threshold of 60% of GDP allowed by the Maastricht Treaty for the first time. Despite this poor fiscal performance – with public debt approaching 70% in 2005 – it is interesting to note that the German government continued to maintain a highly expansionary fiscal policy for as long as the reforms had not been completed: in the period 2003-2006, the fiscal impulse was positive at on average 0.7 GDP point each year (Figure 2). Thus, during this period **the German government supported its structural reforms with a highly accommodative fiscal policy.**

Figure 1. Growth, unemployment rate and poverty rate in Germany

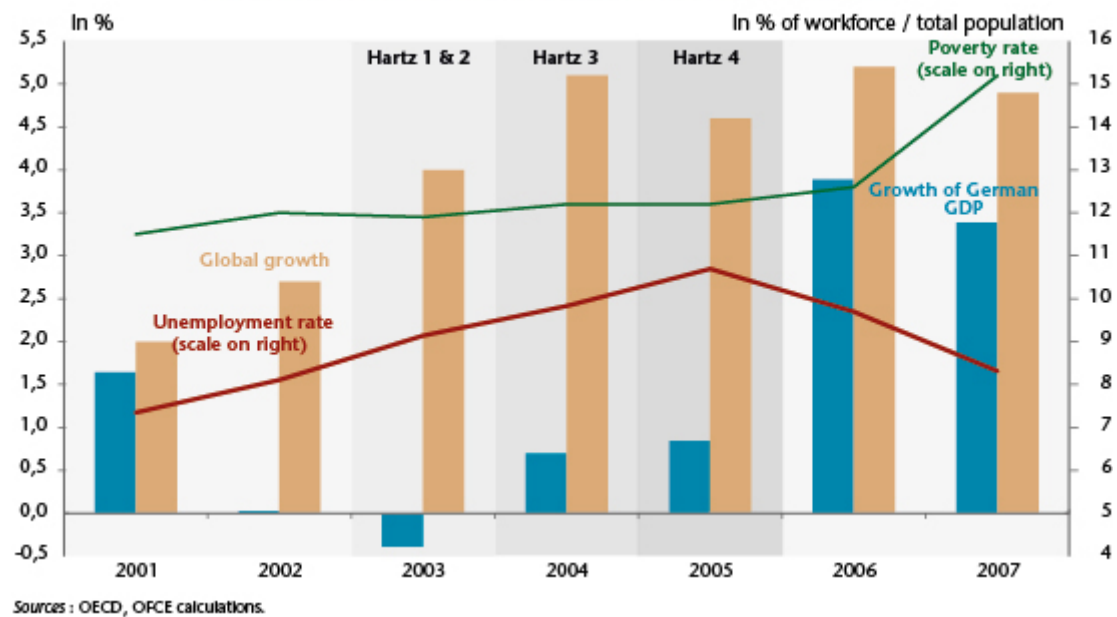
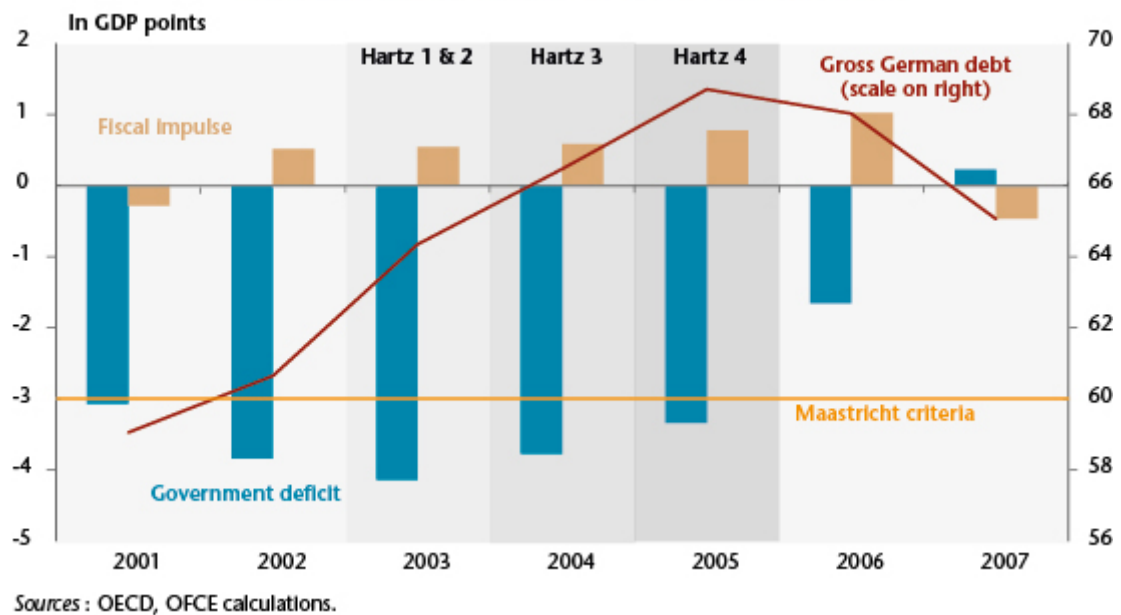


Figure 2. State of deficit and fiscal policy in Germany



Thus not only was the structural reform of the labour market conducted under Schröder implemented in a very favourable economic environment (strong global growth and a strategy that differed from the other European countries), but it was also accompanied by a particularly accommodative fiscal policy, given in particular the poor state of Germany's public finances. This situation differs greatly from contemporary conditions:

1. Global growth is likely to be under 3% over the coming two years;
2. The EC is asking a large number of European countries to implement the same structural reforms simultaneously, which in a highly integrated euro zone limits their effectiveness; and
3. Despite the extra time being granted for deficit reduction, fiscal policy will remain very tight: as is indicated in Table 1, the fiscal impulses for France and Spain will still be very negative (-0.8 GDP point per year) as the structural reforms in these countries are being implemented.

So while the pressure to boost the competitiveness of the countries of southern Europe is similar to that facing Germany

in the early 2000s, the external environment is less favourable and there is greater pressure to reduce the public debt. On this last point, the German example teaches us that it is difficult to juggle structural reforms to boost business competitiveness with efforts to reduce the public debt.

Monetary policy and property booms: dealing with the heterogeneity of the euro zone

By [Christophe Blot](#) and Fabien Labondance

The transmission of monetary policy to economic activity and inflation takes place through various channels whose role and importance depend largely on the structural characteristics of an economy. The dynamics of credit and property prices are at the heart of this process. There are multiple sources of heterogeneity between the countries of the euro zone, which raises questions about the effectiveness of monetary policy but also about the means to be used to reduce this heterogeneity.

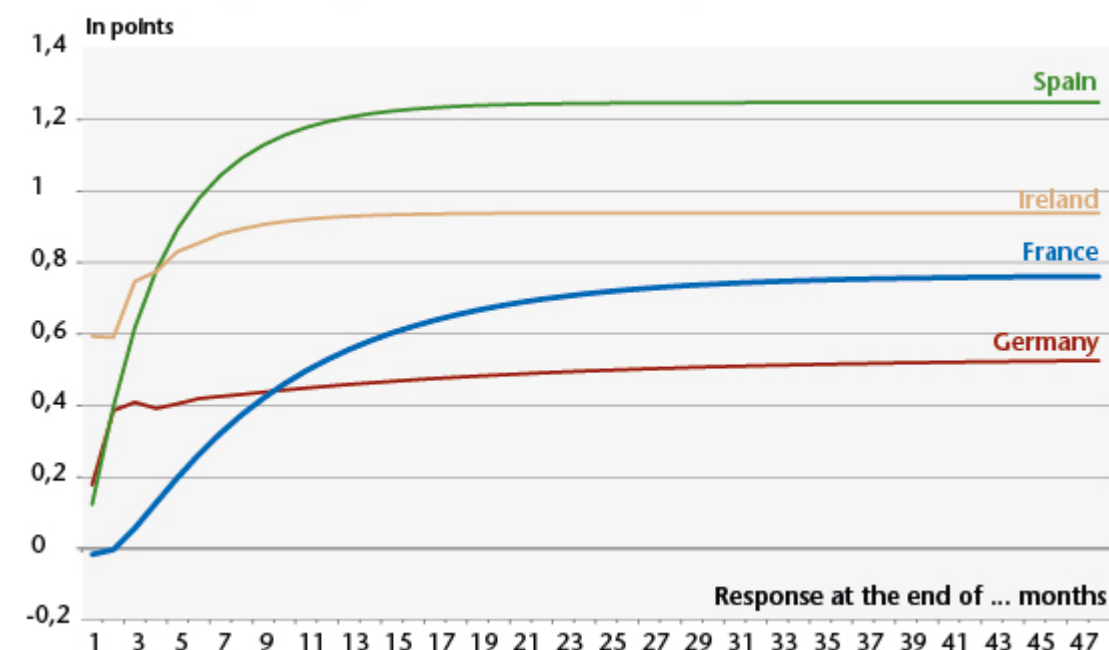
The possible sources of heterogeneity between countries include the degree of concentration of the banking systems (*i.e.* more or fewer banks, and therefore more or less competition), the financing arrangements (*i.e.* fixed or variable rates), the maturity of household loans, their levels of debt, the proportion of households renting, and the costs of transactions on the housing market. The share of floating rate loans perfectly reflects these heterogeneities, as it is

91% in Spain, 67% in Ireland and 15% in Germany. In these conditions, the common monetary policy of the European Central Bank (ECB) has asymmetric effects on the euro zone countries, as is evidenced by the divergences in property prices in these countries. These asymmetries will then affect GDP growth, a phenomenon that has been observed both “before” and “after” the crisis. These issues are the subject of an article that we published in the OFCE’s [Ville et Logement](#) (Housing and the City) issue. We evaluated heterogeneity in the transmission of monetary policy to property prices in the euro zone by explicitly distinguishing two steps in the transmission channel, with each step potentially reflecting different sources of heterogeneity. The first describes the impact of the interest rates controlled by the ECB on the rates charged for property loans by the banks in each euro zone country. The second step involves the differentiated impact of these bank rates on property prices.

Our results confirm the existence of divergences in the transmission of monetary policy in the euro zone. Thus, for a constant interest rate set by the ECB at 2%, as was the case between 2003 and 2005, the estimates made during the period preceding the crisis suggest that the long-term equilibrium rate applied respectively by Spanish banks and Irish banks would be 3.2% and 3.3%. In comparison, the equivalent rate in Germany would be 4.3%. Moreover, the higher rates in Spain and Ireland amplify this gap in nominal rates. We then show that the impact on bank rates of changes in the ECB’s key rate is, before the crisis, stronger in Spain and Ireland than it is in Germany (figure), which is related to differences in the share of loans made at floating rates in these countries. It should be noted that the transmission of monetary policy was severely disrupted during the crisis. The banks did not necessarily adjust supply and demand for credit by changing rates, but by tightening the conditions for granting loans. [1] Furthermore, estimates of the relationship between the rates charged by banks and property prices suggest a high degree of

heterogeneity within the euro zone. These various findings thus help to explain, at least partially, the divergences seen in property prices within the euro zone. The period during which the rate set by the ECB was low helped fuel the housing boom in Spain and Ireland. The tightening of monetary policy that took place after 2005 would also explain the more rapid adjustment in property prices observed in these two countries. Our estimates also suggest that property prices in these two countries are very sensitive to changes in economic and population growth. Property cycles cannot therefore be reduced to the effect of monetary policy.

Figure. Impact on bank rates of a 1 point hike in ECB rates



Source : Authors' calculations.

To the extent that the recent crisis has its roots in the macroeconomic imbalances that developed in the euro zone, it is essential for the proper functioning of the European Union to reduce the sources of heterogeneity between the Member states. However, this is not necessarily the responsibility of monetary policy. First, it is not certain that the instrument of monetary policy, short-term interest rates, is the right tool to curb the development of financial bubbles. And second, the ECB conducts monetary policy for the euro zone as a whole by setting a single interest rate, which does not permit it to

take into account the heterogeneities that characterize the Union. What is needed is to encourage the convergence of the banking and financial systems. In this respect, although the proposed banking union still raises many problems (see [Maylis Avaro and Henri Sterdyniak](#)), it may reduce heterogeneity. Another effective way to reduce asymmetry in the transmission of monetary policy is through the implementation of a centralized supervisory policy that the ECB could oversee. This would make it possible to strengthen the resilience of the financial system by adopting a means of regulating banking credit that could take into account the situation in each country in order to avoid the development of the bubbles that pose a threat to the countries and the stability of the monetary union (see [CAE report no. 96](#) for more details).

[1] [Kremp and Sevestre \(2012\)](#) emphasize that the reduction in borrowing volumes is not due simply to the rationing of the supply of credit but that the recessionary context has also led to a reduction in demand.