

Can steel revive Europe's industrial policy?

By [Sarah Guillou](#)

The situation of the European steel industry was on the agenda of the European Council's Competitiveness session held on Monday, 29 February 2016. One of the Council's conclusions was to issue a demand to speed up the anti-dumping investigations by two months. This demand follows a letter sent on 5 February to the European Commission by ministers from seven European countries, including France, Germany, Italy and the United Kingdom, urging it to take measures to protect the steel sector vis-à-vis what was deemed unfair competition from China and Russia.

The steel industry, which successively pushed forward Europe's industrial development and then European cohesion through the European Coal and Steel Community (ECSC), subsequently became a theatre for the violent winds of globalization and a symbol of Europe's industrial decline – will it now be the sector that leads a revival of Europe's industrial policy?

In retrospect, a question arises as to whether the difficulties facing the European steel industry, which is subject both to the fussy oversight of the European Competition Commission and to low-cost Chinese imports, are partly a symptom of failings in Europe's industrial policy, which is wedged between a very active competition policy and a timid trade policy?

The history of Europe's steel industry does in fact fall closely in line with the history of Europe's industrial policy: from a central and highly sectoral industry at the time of the ECSC, with a great deal of state aid going to the sector under various exemptions, it then became primarily

horizontal and subject to competition policy. The sector only found its way by means of trade policy in response to increased competition from emerging countries. No steps have been taken in the steel industry towards European alliances or regroupings since the 1980s, and there have been no Europe-wide plans to rationalize production capacity so as to hold down the decline in jobs in the industry. This decline went hand in glove with the development of the continent's specialization in high-tech steel products. But today even those jobs are under threat. Could a different industrial policy save them?

The state of the industry in Europe

Steel now accounts for 360,000 jobs in the European Union. The European sector has lost nearly a quarter of its workforce since 2009, with job losses accelerating: 3,000 jobs lost in the last 6 months.

In terms of production, the steel industry generates a turnover of 180 billion euros, with an output of 170 million tons from 500 production sites in 23 Member States. If countries are ranked individually in terms of international steel producers, Germany comes in 7th place, Italy 11th and France 15th. The sector is dependent on the import of iron ore, alumina and coal. Fortunately, the decline in steel prices has gone hand in hand with lower prices for these commodities. The industry is highly capital-intensive, requiring major investments. At the same time, the transport of steel coils and flat products is inexpensive, making it easier to import them.

The 2008 economic crisis cascaded through the sector, as steel products constitute intermediate consumption for many other industrial sectors as well as for construction. Steelmakers in Europe also face stricter environmental constraints than elsewhere. The steel industry is a major source of CO₂ emissions, and is very sensitive to carbon prices and to

regulatory changes. It is also a key player in the EU's emissions trading system (ETS) for greenhouse gas quotas, and while the crisis has enabled the industry to make profits from the sale of surplus emissions rights, steelmakers who are currently experiencing problems vis-à-vis their non-European competitors will be very sensitive to the forthcoming reform of the system for the 2020-2030 period.

Some companies are now in real trouble, such as Arcelor Mittal, which announced a record loss for 2015 (nearly 8 billion euros), partly due to the need to depreciate its mines and steel stocks. The company, which is heavily in debt because of its many acquisitions in Europe, plans to close some plants. Tata Steel, for its part, has closed sites in Britain. In Japan, Nippon Steel, which just acquired an interest in the capital of the French firm Vallourec and is preparing to buy the Japanese Nisshin Steel, is doing better.

The difficulties facing a sector that built up excess capacity during the crisis have been aggravated by the economic downturn in China. Thus, 2015 was the first year to experience a decline (-3%) in global production (1,622 million tons), after 5 years of growth. Global production did not adjust immediately to falling demand, with prices initially acting as the adjustment variable. The decline in production was the signal for the closures of steel factories and mining operations. This has marked the end of a cycle of rising Chinese production that strongly destabilized the market.

The Chinese tornado

Chinese production doubled in volume between 2000 and 2014, and on its own now accounts for more than twice the combined output of the next four major producing countries, Japan, India, Russia and the United States. This performance is the result of several factors: massive government support; dynamic growth in construction, in infrastructure investment, and in the Chinese market's production of cars and machinery; and

favourable access to iron ore. China produces nearly 50% of the world's steel, i.e. approximately 800 million tons of steel. The second-largest producer is Japan, with 100 million tons. India and the United States are contending for third place, at around 5% of global production. If we count the Europe-28 as a single entity, then it would take second place with 10% (Source: [World Steel Association](#)). But the slowdown in the Chinese economy and the strong inertia characterizing production capacity in the steel industry have created substantial excess capacity, which the authorities are now trying to reduce. Domestically, China needs only about half of its output, so it exports the other half.

The 400 million tons China exports represent twice Europe's output. The price of the Chinese offer is therefore likely to greatly upset the balances in other countries. Any excess capacity is directed onto foreign markets to be gotten rid of at low prices, as Chinese exporters are not going to fail to sell off their steel products. Hence China's exports to Europe rose from 45 million tons in 2014 to 97 million tons in 2015, which exceeds the 43 million tons produced by Germany.

China is also likely to experience a significant decline in its workforce, and some production sites, drowning in massive debt, have already closed. Chinese steelmakers are losing money, and small units are going bankrupt. Large units, however, are often state property, and are weathering the storm (at the cost of heavy indebtedness) and becoming aggressive predators, in terms not only of price but also of acquisition capabilities. The weak position of Europe's firms is also leaving them vulnerable to foreign takeovers. China Hebei Iron and Steel Group is, for instance, about to acquire a Serbian steelmaker, which would be yet another means of entering Europe.

The policy response

The public authorities have long been heavily involved in the

steel sector. It was a strategic sector for post-war economic development, and was the source of European economic construction at a time when the “small steps” policy of Robert Schuman led to putting the coal and steel production of France and Germany under a common authority, later joined by other countries. For a long time the sector then benefited from various public aid measures and subsidies that kept up excess capacity relative to demand, now estimated at 10-15% of output. The sector then was gradually freed from public tutelage, and in the mid-1990s was excluded from the list of sectors in difficulty that were eligible for aid for restructurings and bailouts. Nevertheless, state support never disappeared completely, but today, the European Commission, through the Competition Commission, is relatively strict about applying the market investor principle to assess the legality of public support.

While tracking distortions in competition on the market, the European Commission recently opened an investigation into Italy’s support for the steelmaker Ilva (2 billion euros), and demanded that Belgium repay 211 million euros of aid paid to the steelmaker Duferco. In 2013, the Commission opened an investigation into aid awarded by “Belgian Foreign Strategic Investments Holding” (FSIH), a body created in 2003 by the Walloon management and investment company Sogepa to invest in the steel industry. This aid, paid between 2006 and 2011 by the Walloon government [a Belgian regional government], was considered to constitute unfair competition on the European market. Indeed, for the Commission, private investors would not have voluntarily made such investments.

These subsidies by the Walloon government therefore constituted aid that put competitors at a disadvantage. The Commission recognized that there is very strong foreign competition, but it considered that the best way to cope with this is to have strong, independent European players. It noted that despite the government aid, the Duferco group wound down

all its activities in Belgium, meaning that the aid merely postponed the departure of a company that was not viable. The Commission is currently supporting the retraining of workers in the Walloon region through the European Globalisation Adjustment Fund. The point is to combat the recourse to public funding in Europe, which would ultimately be detrimental to the sector.

At the same time, so-called “anti-dumping” trade retaliation measures were implemented by the European Commission. In May 2014, following a complaint from Eurofer (the European steel association), the Commission imposed temporary anti-dumping duties of up to 25.2% on imports of certain steel products from the People’s Republic of China and duties of up to 12% on imports from Taiwan. The EC investigation ultimately concluded that China and Taiwan were selling at dumping prices. More recently, Cecilia Malmström, the head of trade policy at the European Commission, wrote to her Chinese counterparts warning them that she was launching three anti-dumping investigations against Chinese exporters (February 2015) in the field of seamless pipes, heavy plates and hot-rolled steels. Provisional anti-dumping duties (of between 13% and 26%) were also set on 12 February 2016 (complaints in 2015) with respect to China and Russia.

Some thirty anti-dumping measures protect the European steel industry, but the Member States where steel has been hit particularly hard by Chinese competition are calling for stronger measures. Politicians are railing against China’s loss-making exports and demanding that Europe take steps. They envy the US, which has acted more quickly and not skimped on the level of the duties it’s enacted, i.e. up to 236%. But the nature of these measures depends on the economic status accorded to China. Anti-dumping measures are not defined in the same way. As long as China is not a market economy, it is assumed that it provides strong support for its economic sectors, and that its prices are thus not market prices. Italy

is struggling in Europe to prevent China from being granted this status, while the United Kingdom is supporting China at the WTO (even though the industry is also in trouble in Britain). The Commission has postponed its decision until summer.

What policy for tomorrow?

Should we allow the production of steel to disappear in Europe? It still represents more than 300,000 jobs there, though this is of course out of more than 35 million jobs in manufacturing in 2014. The sector is symbolic of heavy industry, and a supplier of the transportation and defence industries as well as construction – its disappearance would definitively turn a new page in European industry.

Do we need to recognize that, according to the theory of comparative advantage, it is better to buy cheaper Chinese steel and use the revenue freed up for other, more profitable uses? For example, shouldn't it be used to upskill employees? In theory yes, but the revenue freed up goes to the purchasers of steel, so it is they who should supply the European conversion fund. What about taxing the consumption of the now cheaper steel? The flaw in the reasoning shows up when you realize that what is true with respect to macroeconomic balances is difficult to reconcile with microeconomic imbalances: those who are losing their jobs today are not the consumers who are benefitting. Ultimately, the microeconomic articulations can unsettle the macroeconomic balances.

The loss of know-how is indeed the main challenge, as it is here that resources are really wasted. In so far as skills are a competitive factor, difficulties related to a lack of demand should be considered transitional problems that need to be managed as well as possible. Neither contributions of foreign capital nor government support should be excluded. What justifies these investments are the returns expected from the use of human capital. To deal with these challenges, alliances

on market segments that are not in trouble might be possible, even if they confer excessive market power, so long as they allow margins that make it possible to maintain the business during cyclical difficulties.

This is why competition policy has to be opened up to considerations of industrial policy (which is concerned about expertise) and trade policy (which appreciates the cyclical and / or unfair character of competition).

European actors need to be brought around a table – they are already grouped in Eurofer – and together with the European Commission develop a European plan for managing excess capacity and forging alliances. The Competition Directorate of the European Commission needs to relax its intellectual rigidity and adapt its reading of competition to the nature of contemporary globalization. Although it is based on an indisputable logic in the name of the single market, the approach of the Competition Directorate is sometimes no longer suited to the way that competition is unfolding on the global value chain today, which has no precedent on the 20th century European market. Who would believe that the market power resulting from a European merger would not be challenged very quickly by foreign forces if the new enterprise began to take advantage of its market power? The limits on market power are much stronger in the 21st century, with low inflation and depressed commodity prices an illustration of this. The risk that multinationals might abuse their power is posed less in terms of excessive prices than excesses in the capture of customers and in tax avoidance. This last point seems to have been understood clearly by the European Commission. In addition to this, there is the added competition from new applications driven by the digital industry, which manufacturers cannot escape. In other words, competition is no longer what it used to be: companies' excessive power is no longer expressed much in prices or restrictions on quantities.

Competition policy, industrial policy and trade policy need to

be developed in coordination, with a strengthened Competition Directorate that includes an element of industrial policy and trade policy. While strict controls on competition were a clear priority during the period of forging the single market when competition was essentially focused between the developed countries, today it is urgent to review the linkages between these three policy fields in order to consolidate the future of industry in Europe.

The ECB is extending its QE programme but mixes up its communications

By [Paul Hubert](#)

On Thursday, March 10, after the meeting of its Governing Council, the European Central Bank (ECB) announced a series of additional measures for the quantitative easing of monetary policy. The aim is to prevent the onset of deflation and to boost growth in the euro zone. The key innovation lies in the measure for bank financing at negative rates. While the measures were well received by the markets at the time of the announcement, a lapse in Mario Draghi's communications during the press conference following the Board of Governors meeting greatly undercut some of the impact expected from the decisions taken.

What decisions were taken?

– The three key rates set by the ECB were lowered. The main refinancing rate went down from 0.05% to 0%, while the marginal lending rate was cut from 0.30% to 0.25%. Finally,

the [deposit facility rate](#), which compensates the excess reserves that banks hold on the ECB's balance sheets, is down from -0.30% to -0.40%. It thus now [costs a bank more](#) to have cash on the ECB's balance sheet.

– [Quantitative easing](#) (QE) has been extended in terms of its scale – securities purchases rose from €60 bn to €80 bn per month – but especially in terms of the types of securities eligible for purchase. While heretofore the ECB has bought government bonds (sovereign and/or local authority bonds), it will now buy high-quality corporate bonds, based on rating agency criteria. This measure is a direct response to the drying up of the supply of government securities and is expected to directly influence the conditions for corporations active on the bond markets.

– The most significant innovation concerns the [new Targeted Longer-Term Refinancing Operations](#) (TLTRO), which are intended to reboot the channels of bank lending and to provide financing to banks *on the condition that* they finance the real economy. These loans to banks will be at a zero or even negative rate, based on various [criteria](#), including the amount of loans that the banks provide to households and businesses. In other words, the ECB will pay banks meeting these criteria, so that they in turn lend.

What is the expected impact?

The effect to be expected from these measures depends on the situation of the credit market. Numerous [studies](#) show that in normal times these measures have a positive effect on the economy. However, this holds true only if it is the *supply* of credit that is currently constricted in the euro zone. Conversely, if the problem lies in the demand for credit on the part of consumers and businesses who have poor prospects in terms of income and profits, then these measures will have little effect. In granting banks such favourable conditions, it is easy to imagine that the ECB is betting on increasing

the solvent demand for credit, that is to say, that the ECB is providing banks with strong incentives to lend to households and individuals that might have appeared non-creditworthy in previous conditions. Another expected effect of the lower deposit facility rates and the increase in QE will pass through the channel of a lower exchange rate for the euro, which will promote euro zone exports and increase imported inflation, and therefore overall inflation in the euro zone. This channel is potentially even more important given that the US Federal Reserve has initiated a period of monetary tightening.

Nevertheless, a more relevant economic policy would be to make use of fiscal policy to support demand, especially as the conditions for State financing are at historically low levels: the French state in 2016 is earning money from issuing [debt of less than 4 years](#). Monetary policy would then have all the more effect.

Why announce that there's no manoeuvring room left?

At the press conference following the meeting of the Governing Council, Mario Draghi announced that the ECB didn't expect "to reduce rates further", which had the effect of completely changing the financial markets' interpretation of the decisions announced just before that. While the aim of these very expansionary decisions is to further ease monetary and financial conditions and to lower the exchange rate for the euro, the announcement that future changes in the ECB's monetary policy could only be in a more restrictive direction transformed investor expectations.

As one of the main channels for the transmission of monetary policy involves expectations, several studies conducted on data from the US [\[1\]](#), Britain [\[2\]](#) and the euro zone [\[3\]](#) show that a central bank's communications need to be consistent with its decisions, otherwise the impact expected from monetary policy will be limited. This is called the "signal

effect” of monetary policy. Mario Draghi’s short statement is one such example. The following graph shows the exchange rate of the euro vis-à-vis the dollar during the course of 10 March. The sharp drop at mid-day corresponds to the publication of the decisions taken by the Board of Governors, while the equally sharp rise corresponds to the contradictory message issued a few minutes later at the press conference. We thus see that as a series of highly expansionary measures – one of whose goals is to push down the euro – was announced, the euro eventually rose vis-à-vis the US dollar as if restricting measures had been put in place.

This does not necessarily mean that these decisions will have no effect, but that some of the effect will be lessened, or even disappear. [Some transmission channels other than the signal effect](#) remain operative. While the exchange rate channel has now been limited by the restrictive effect generated by the channel of expectations, we will see in the weeks and months to come whether capital movements induced by the decisions taken will have the effect expected on the euro exchange rate.

Figure. Euro-dollar exchange rate, day of 10 March 2016.



Source: Boursorama.

[1] Hubert, Paul (2015), [“The Influence and Policy Signalling](#)

[Role of FOMC Forecasts](#)", *Oxford Bulletin of Economics and Statistics*, 77(5), 655-680.

[2] Hubert, Paul, and Becky Maule (2016), "[Policy and Macro Signals as Inputs to Inflation Expectation Formation](#)", *Bank of England Staff Working Paper*, No. 581.

[3] Hubert, Paul (2015), "[ECB Projections as a Tool for Understanding Policy Decisions](#)", *Journal of Forecasting*, 34(7), 574-587, or Hubert, Paul (2016), "[Disentangling Qualitative and Quantitative Central Bank Influence](#)", *OFCE Working Paper*, No. 2014-23.

Matteo Renzi's Jobs Act: A very guarded optimism

By Céline Antonin

At a time when the subject of labour market reform has aroused passionate debate in France, Italy is drawing some initial lessons from the reform it introduced a year ago. It should be noted that the labour market reform, dubbed the Jobs Act, had been one of Matteo Renzi's campaign promises. The Italian labour market has indeed been suffering from chronic weaknesses, including segmentation, a duality between employees with and without social protection, high youth unemployment, and a mismatch between costs and labour productivity. Renzi's reform takes a social-liberal approach, advocating flexicurity, with the introduction of a new permanent employment contract with graduated protection, lower social charges on companies, and better compensation and support for the unemployed. Although the initial assessment is surely positive in terms of both unemployment and job

creation, there's no cause for hasty triumphalism: the reform has been implemented in especially favourable circumstances, marked by a return of growth, an accommodative policy mix, and a stagnating work force.

Jobs Act Italian-style: The key points

The Jobs Act is actually the latest in a series of measures adopted since the Fornero Act of 2012 that are aimed at a more flexible labour market. Act I of the Jobs Act, the Poletti Decree (DL 34/2014), was adopted on 12 May 2014, but went relatively unnoticed because it targeted fixed-term contracts and apprenticeships. It allowed in particular extending the duration of fixed-term contracts from 12 to 36 months, suppressing gap periods, and allowing for more fixed-term contracts to be renewed, all while limiting the proportion of fixed-term contracts within a single company[1].

The real change came with Act II of the Jobs Act, for which the Italian Senate passed enabling legislation on 10 December 2014. The eight implementing decrees adopted in the first half 2015 have four key points:

- The elimination of Article 18 of the Labour Code, which allowed reinstatement in cases of manifestly unfair dismissal: the reinstatement requirement was replaced by a requirement for indemnification that is capped[2], with reinstatement still being required in case of a dismissal involving discrimination;
- The creation of a new form of permanent (open-ended) contract and graduated protection, lying between permanent contracts and fixed-term contracts: dismissal was facilitated during the first three years on the job, with severance pay that increases with employee seniority;
- The suppression of the abuse of what are called “collaboration contracts”, [3]precarious contracts that are often used to disguise an actual employment relationship,

affecting about 200,000 people. These contracts will be transformed into wage labour contracts from 1 January 2016 (1 January 2017 for public administrations), except for a few limited cases;

– The reform of unemployment insurance, with an extension of compensation schemes. The benefit period, for instance, is extended to two years (from 12 months previously). As for compensation for short-time working (“technical unemployment”), this is extended to cover apprentices and companies with 5-15 employees[4]. A National Employment Agency (ANPAL), which introduces a one-stop system that helps to link training and employment, was also established.

Note that only measures related to experimentation with a national minimum wage[5], which are contained in the enabling law in December 2014, were not addressed.

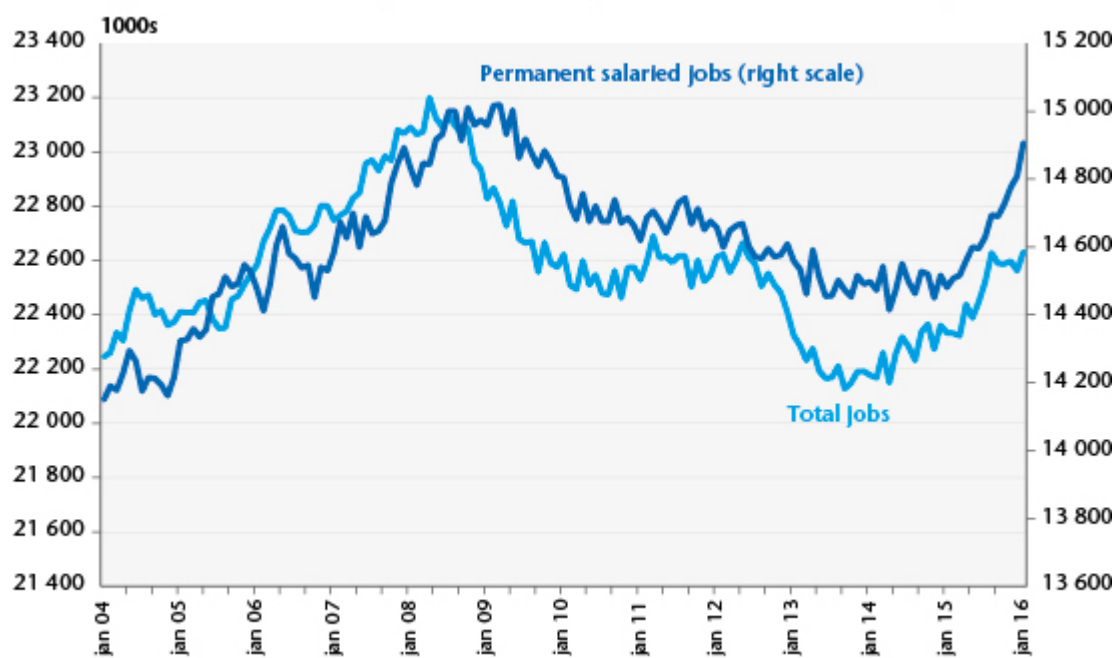
Alongside the Jobs Act, Italy opted to lower taxes on labour: in 2015, the wage part of the IRAP (equivalent to a business tax) for those employed on permanent contracts was eliminated, reducing the amount of the IRAP by about one-third. Above all, Italy’s 2015 Budget Act eliminates social security contributions for 3 years on the new open-ended contracts with graduated protection, up to a limit of 8,060 euros per year for new hires taken on between January 1 and December 31, 2015 who did not have permanent job contracts in the six months preceding their hiring. This measure is expected to cost 3.5 billion euros between now and 2018. It was extended in 2016: companies that hire employees on the new permanent contracts in 2016 will be exempt from 40% of social security contributions for 2 years.

Strong jobs growth and a lower unemployment rate

There has been strong growth in employment, in particular permanent jobs, since the start of 2015: between January 2015 and January 2016, the number of employed increased by 229,000,

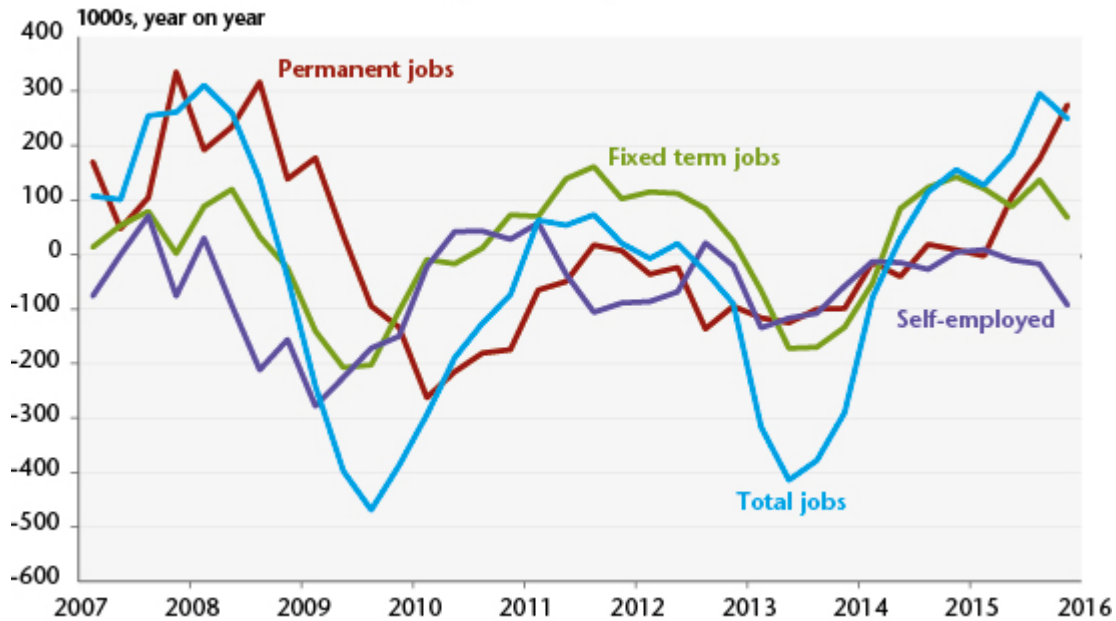
with strong growth in the number of salaried employees (+377,000) and a decline in the number of self-employed (-148,000). Among employees, there was a sharp increase in the number of permanent positions (+328,000). The number of permanent employees has now returned to the 2009 level of 22.6 million (Figure 1); as for total employment, even if it has not yet reached its pre-crisis level, the decline in the 2012-2014 period has been overcome. At the same time, the annual rate of job creation has returned to its pre-crisis level, with growth of about 250,000 per year (Figure 2).

Figure 1. Number of jobs (total and permanent), 2004-January 2016



Sources : Istat, author's calculations.

Figure 2. Annual change in number of jobs by contract type, Q1 2007 – Q4 2015

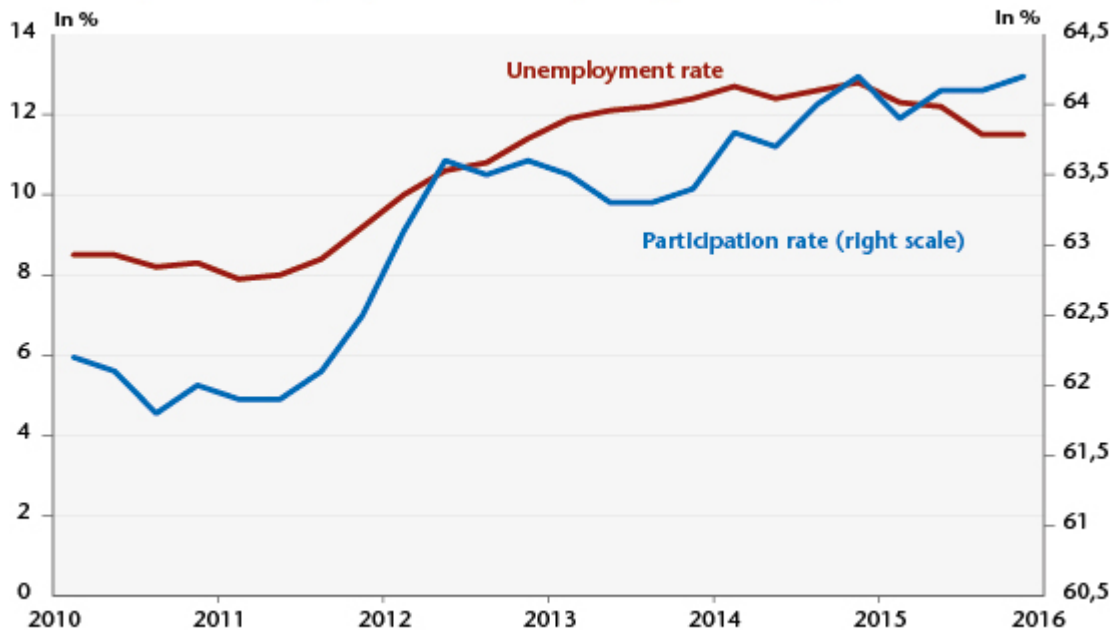


Sources : Istat, author's calculations.

In addition to new hires on permanent contracts, the Jobs Act has led to replacing precarious jobs with permanent jobs with increasing guarantees. Thus, 5.4 million new jobs were created in 2015 (+11% compared to 2014) [6], mainly permanent jobs. Of the 2.4 million permanent jobs created, there were 1.9 million new open-ended contracts and 500,000 fixed-term contracts that were converted into open-ended contracts (including 85,000 apprenticeship contracts), up sharply from 2014. There were also fewer collaboration contracts (a 45% decrease from Q3 2014 to Q3 2015) and apprenticeship contracts (-24.6%). Note also the 4.3% increase in the number of resignations and the 6.9% decrease in layoffs.

The corollary to this jobs growth is a marked fall in the unemployment rate (Figure 3), which fell to 11.4% in the last quarter of 2015 (from 12.8% one year earlier). However, the decline in unemployment was also due to stagnation in the labour force in 2015, unlike previous years that were marked by the pension reform.

Figure 3. Unemployment rate and participation rates, 2010-2015



Sources : Istat, author's calculations.

Uncertainties remain

Matteo Renzi seems to have won his bet. Yet this fall in unemployment should not be over-interpreted, as a number of positive factors have undoubtedly contributed to strengthening this trend.

First, there was a windfall effect related to the announcement of the exemptions on social contributions for hiring new permanent employees, which led some companies to put off new hiring planned for 2014 until 2015 (which led to a rise in unemployment in late 2014). Moreover, part of the fall in unemployment is related to the impact of replacing precarious short-term contracts with the new permanent contracts with graduated protection (see above). The question is whether the new flexibilities allowed by these new contracts will be used over the next three years, and consequently whether there will be an increase in contract terminations.

In addition, the stagnation of the work force (Figure 3) has significantly amplified the downward trend in unemployment. With the improvement observed in the labour market, we expect in the future that the growth in the workforce that began in

the last quarter of 2015 will continue due to what is called in French an “effet de flexion”, or “bending effect”, [7] which would absorb some of the impact of the job creation in 2016 and 2017.

Furthermore, the Jobs Act was adopted when the economy was emerging from a recession, with a recovery that, while soft (+0.6% growth in 2015), still exceeded the growth potential [8]. The easing of fiscal constraints had a stimulus effect in 2015, which may partially explain the fall in unemployment. As for monetary conditions, they are particularly favourable, as Italy is one of the main beneficiaries of the quantitative easing measures taken by the ECB.

Notwithstanding these qualifications, it is undeniable that the cut in the social contributions level has had a positive impact. The February 2016 report of the National Social Security Institute (INPS) showed that, of the 2.4 million new permanent jobs created in 2015, 1.4 million benefited from exemptions on employer contributions, or almost two-thirds of these new jobs. Moreover, the reduction of precarious job contracts and their replacement by permanent contracts, even if they offer less protection than before, is a rather encouraging sign for access to long-term employment by groups that have traditionally been more marginal (self-employed, collaboration contracts).

Perhaps the main regret about this reform is the absence of a component aimed explicitly at vocational training, which is one of the main weaknesses of Italy's labour market. The country holds a dismal EU record for the number of young people (15-24) who are neither in employment nor in school or training. Moreover, the workforce has insufficient training, and investment in research and development is low, which results in low productivity. It is legitimate to want to take action on labour costs and the duality of the labour market, but this will not be enough to solve the problem of productivity and the inadequacy of the workforce. Matteo Renzi

would therefore do well to foresee an Act III in his labour reforms to finally pull the country out of its stagnation.

[1] See [C. Antonin, Réforme du marché du travail en Italie : Matteo Renzi au pied du mur](#), [Labour market reform in Italy: Matteo Renzi with his back to the wall], *Note de l'OFCE no. 48*.

[2] The monetary payment is determined by a scale based on the employee's seniority. It is equivalent to two months of the final salary per year of service, for a total that cannot be less than 4 months of salary and is capped at 24 months.

[3] "Intermediate status between salaried employment and self-employment, for workers not subject to a hierarchical subordination but 'coordinated' with the company and creator of certain social rights. These are self-employed workers who are, in fact, dependent on a single client company (which exercises limited management powers, for example in terms of the organization of work and the working time)." [E. Prouet, Contrat de travail, les réformes italiennes](#) [The job contract, the Italian reforms], France Stratégie, *La Note d'Analyse*, no. 30, May 2015.

[4] Other measures concerning short-time work ("chomage technique") are also planned, including that an employee on short-time work may not have their hours cut by more than 80% of their total work hours. Furthermore, the period during which a company may resort to this procedure is a maximum of 24 months over five rolling years.

[5] There is no national minimum wage in Italy, with minimum wages instead set at the industry level, as was the case in Germany before 2015.

[6] This figure of 5.4 million represents gross job creation, including all forms of employment (including very short-term

contracts), and without taking into account job destruction. In terms of net job creation between January 2015 and January 2016, we accept the figure of 229,000.

[7] When unemployment rises, working-age people are discouraged from reporting for the labour market. Conversely, when employment picks up again, some people are encouraged to return to the labour market, slowing the decline in unemployment; this phenomenon is called the “effet de flexion” in French, or the bending effect.

[8] Labour productivity tends to grow relatively slowly in Italy; consequently, an increase in production tends to create more jobs in Italy than in France for example, where labour productivity is higher.

Do QE programmes create bubbles?

By [Christophe Blot](#), [Paul Hubert](#) and Fabien Labondance

Has the implementation of [unconventional monetary policies](#) since 2008 by the central banks created new bubbles that are now threatening financial stability and global growth? This is a question that comes up regularly (see [here](#), [here](#), [here](#) or [here](#)). As [Roger Farmer](#) shows, it is clear that there is a strong correlation between the purchase of securities by the Federal Reserve – the US central bank – and the stock market index (S&P 500) in the United States (Figure 1). While the argument may sound convincing at first glance, the facts still need to be discussed and clarified. First, it is useful to

remember that correlation is not causation. Secondly, an increase in asset prices is precisely a transmission channel for conventional monetary policy and quantitative easing (QE). Finally, an increase in asset prices cannot be treated as a bubble: developments related to fundamentals need to be distinguished from purely speculative changes.

Higher asset prices is a factor in the transmission of monetary policy

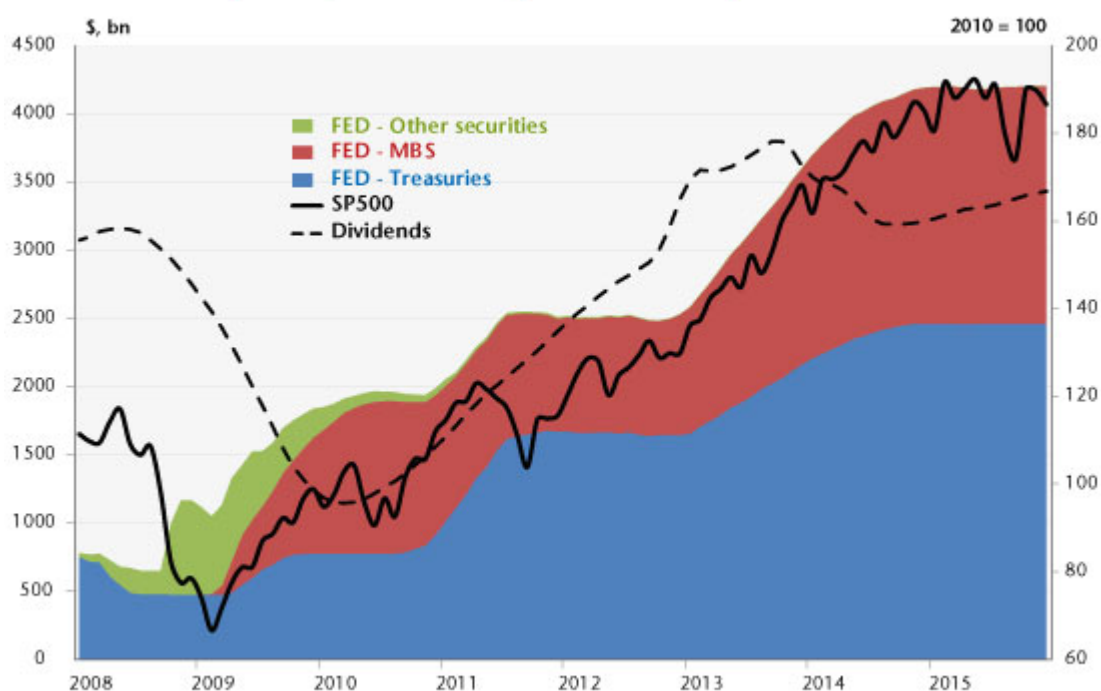
If the ultimate goal of central banks is macroeconomic stability [1], the transmission of their decisions to the target variables (inflation and growth) takes place through various channels, some of which are explicitly based on changes in asset prices. Thus, the effects expected from QE are supposed to be transmitted in particular by so-called portfolio effects. By buying securities on the markets, the central bank encourages investors to reallocate their securities portfolio to other assets. The objective is to ease broader financing conditions for all economic agents, not just those whose securities are targeted by the QE programme. In doing this, the central bank's actions push asset prices up. It is therefore not surprising to see a rise in equity prices in connection with QE in the US.

Every increase in asset prices is not a bubble

Furthermore, it is necessary to make sure that the correlation between asset purchases and their prices is not just a statistical artefact. The increase observed in prices may also reflect favourable fundamentals and be due to improved growth prospects in the United States. The standard model for determining the price of a financial asset identifies its price as equal to the present value of anticipated income flows (dividends). Although this model is based on numerous generally restrictive assumptions, it nevertheless identifies a first candidate, changes in dividends, to explain changes in stock prices in the United States since 2008.

Figure 1 shows a clear correlation between the series of dividends [2] paid and the S&P 500 index between April 2010 and October 2013. Part of the rise in equity prices can be explained simply by the increase in dividends: the usual determinant of stock market prices. Looking at this indicator, only the period starting at the beginning of 2014 could then indicate a disconnect between dividends and share prices, and thus possibly point to an over-adjustment.

Figure 1. Quantitative easing and stock market prices in the US



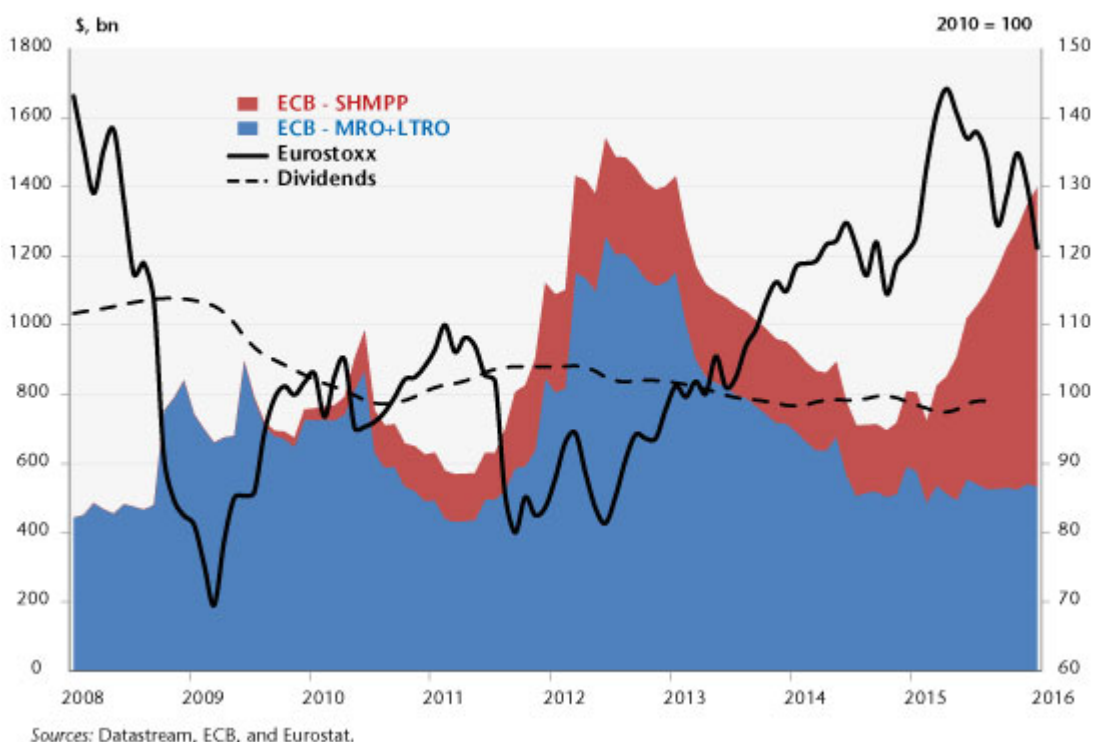
Sources: Datastream, Federal Reserve, and Bureau of Economic Analysis.

A correlation that isn't found in the euro zone

If the theory that unconventional monetary policies create bubbles is true, then it should also be observed in the euro zone. Yet performing the same graph as the one for the United States does not reveal a link between the liquidity provided by the European Central Bank (ECB) and the Eurostoxx index (Figure 2). The first phase in the increase in the size of the ECB's balance sheet, via its refinancing operations starting in September 2008, came at a time when stock markets were collapsing, following the bankruptcy of Lehman Brothers. Likewise, the very long-term refinancing operations carried

out by the ECB at the end of 2011 do not seem to be correlated with the stock market index. The rise in share prices coincides in fact with Mario Draghi's statement in July 2012 that put a halt to concerns about a possible breakup of the euro zone. It is of course possible to argue that the central bank has played a role, but any link between liquidity and asset prices is simply not there. At the end of 2012, the banks paid back their loans to the ECB, which reduced the cash in circulation. Finally, the recent period is once again illustrating the fragility of the argument that QE creates bubbles. It is precisely at a time when the ECB is undertaking a programme of large-scale purchases of securities, along the lines of the Federal Reserve, that we are seeing a fall in world stock indices, in particular the Eurostoxx.

Figure 2. Quantitative easing and the stock market index in the euro zone



So does this mean that there is no QE-bubble link?

Not necessarily. But to answer this question, it is necessary first to identify precisely the portion of the increase that is due to fundamentals (dividends and companies' share prospects). A bubble is usually defined as the difference

between the observed price and a so-called fundamental value. In a forthcoming working paper, we endeavour to identify periods of over- or undervaluation of a number of asset prices for both the euro zone and the United States. Our approach involves estimating different models of asset prices and thereby to extract a component that is unexplained by fundamentals, which is then called a “bubble”. We then show that for the euro zone, the ECB’s monetary policy broadly speaking (conventional and unconventional) does not seem to have a significant effect on the “bubble” component (unexplained by fundamentals) of asset prices. The results are stronger for the United States, suggesting that QE might have a significant effect on the “bubble” component of some asset prices there.

This conclusion does not mean that the central banks and the regulators are impotent and ignorant in the face of this risk. Rather than trying to dissect every movement in asset prices, the central banks should focus their attention on financial vulnerabilities and on the ability of agents (financial and non-financial) to absorb sharp fluctuations in asset prices. The best prevention against financial crises thus consists of continuously monitoring the risks being taken by agents rather than trying to limit variations in asset prices.

[\[1\]](#) We prefer a broad definition of the end objective that takes into account the diversity of institutionalized formulations of the objectives of central banks. While the mandate of the ECB is primarily focused on price stability, the US Federal Reserve has a dual mandate.

[\[2\]](#) The series of dividends paid shows strong seasonality, so this has been smoothed by a moving average over 12 months.

A new EU arrangement for the United Kingdom: European lessons from the February 19th agreement

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

Following the demand made by David Cameron on 10 November 2015 for a new arrangement for the United Kingdom in the European Union, the European Council came to an agreement at its meeting of 18 and 19 February. On the basis of this text, the British people will be called to the polls on 23 June to decide whether to stay in the EU. This episode raises a number of questions about the functioning of the EU.

– The United Kingdom has challenged European policy on matters that it deems crucial for itself and largely got what it wanted. Its firmness paid off. This has given rise to regrets on this side of the Channel. Why didn't France (and Italy) adopt a similar attitude in 2012, for instance, when Europe imposed the signing of the fiscal treaty and the implementation of austerity policies? This is a cause for concern: will what has been accepted for a big country be tolerated for a smaller one? The UK's threat to leave is credible because the EU has become very unpopular among the population (especially in England), and because the UK is independent financially (it borrows easily on the capital markets) and economically (it is a net contributor to the EU budget). A country that is more dependent on Europe would have little choice. This raises worries: won't we see other countries follow suit in the future? Will Europe be able to avoid becoming a Europe à la carte (each country taking part in the activities that interest it)? But is a model based on forced participation preferable? Europe must allow a country

to abstain from policies that it deems harmful.

– The United Kingdom will therefore organize a referendum, which is satisfactory from a democratic perspective. The most recent referendums have hardly yielded favourable results for European construction (France and the Netherlands in 2005, Greece in July 2015, Denmark in December 2015). The British will be limited to choosing between leaving the EU (the February agreement clearly rejects the possibility of new renegotiations if the referendum results in a majority in favour of an EU exit) or staying with a reduced status; the possibility of the UK remaining in the EU and seeking to strengthen its social dimensions, as advocated by some of the Labour Party and the Scottish Nationalists, will not be offered. Too bad.

– The United Kingdom is explicitly exempted from the need to deepen the EMU or from an “ever closer union” or “deeper integration”, all formulas contained in the treaties. The proposed arrangement clarifies that these notions are not a legal basis to extend the competences of the EU. States that are not members of the euro zone retain the right to take part or not in further integration. This clarification is, in our opinion, welcome. It would not be legitimate for the Union’s powers to be extended continuously without the consent of the people. In the recent period, the five presidents and the EU Commission have proposed new steps towards European federalism: creating a European Fiscal Committee; establishing independent Competitiveness Councils; conditioning the granting of Structural Funds on fiscal discipline; implementing structural reforms; creating a European Treasury department; moving towards a financial union; and partially unifying the unemployment insurance systems. These moves would strengthen the technocratic bodies to the detriment of democratically elected governments. Wouldn’t it be necessary to explicitly request and obtain the agreement of the peoples before embarking on such a path?

– The exit of the United Kingdom, a certain distancing by some Central and Eastern Europe countries (Poland, Hungary), plus the reluctance of Denmark and Sweden could push towards an explicit move to a two-tier Union, or even, to take David Cameron's formulation, to an EU in which countries are heading to different destinations. The countries of the euro zone would for their part accept new transfers of sovereignty and would build a stronger fiscal and political union. In our opinion this proposal should be submitted to the people.

– At the same time, the draft agreement provides that the Eurogroup has no legislative power, which remains in the hands of the Council as a whole. The UK has had it clarified that a non-member state of the euro zone could ask the European Council to take up a decision on the euro zone or the banking union that it believes harms its interests. The principle of the euro zone's autonomy has thus not been proclaimed.

– The United Kingdom has had it clarified that it is not required to contribute financially to bail out the euro zone or the financial institutions of the banking union. This may be considered discomfoting vis-à-vis the European principle of solidarity, but it is understandable. This is because the establishment of the euro zone has abolished the principle: "Every sovereign country is fully backed by a central bank, a lender of last resort", which is posed by the bailout problem. The UK (and its banks) are backed by the Bank of England.

– The United Kingdom has had the principles of subsidiarity reviewed. A new provision states that parliaments representing 55% of the Member States may challenge a law that does not respect this principle. The UK has had it noted that the issues of justice, security, and liberty remain under national competence. It is a pity that countries devoted to their specific social systems and their wage bargaining systems have not done the same.

– It is understandable that countries concerned about national

sovereignty are annoyed (if not more) by the EU's relentless intrusions into areas under national jurisdiction, where Europe's intervention does not bring added value. It is understandable that these countries are refusing to have to incessantly justify to Brussels their economic policies or their economic, social or legal regulations when these have no impact on other Member States. Europe must undoubtedly take these feelings of exasperation into account.

– As regards the banking union, the draft text is deliberately confusing. It is recalled that the “single rule book” managed by the European Banking Agency (EBA) applies to all banks in the EU, and that financial stability and equal competitive conditions must be guaranteed. But at the same time, it says that Member States that do not participate in the banking union retain responsibility for their banking systems and can apply special provisions. Moreover, countries that are not members of the euro zone have a right of veto on the EBA. This raises the question of the very content of the banking union. Will it make it possible to take the measures needed to reduce the scale of speculative financial activity in Europe and steer the banks towards financing the real economy? Or is the objective to liberalize the markets for the development of financial activity in Europe so as to compete with London and non-European financial centres? In the first case, what was needed was to clearly take in hand the market in London, telling it that membership in the EU requires close monitoring of financial activities. And that its departure would allow the EU to take capital control measures to limit speculative activities and encourage banks in the euro zone to repatriate their activities.

– Likewise, Belgium, Luxembourg, the Netherlands and Ireland would have needed to be told that EU membership means the end of tax avoidance schemes for the multinationals.

– The United Kingdom has had a declaration passed affirming the need both to improve regulations and repeal unnecessary

provisions to improve competitiveness while at the same time maintaining high standards of protection for consumers, labour, health and the environment. This compatibility undoubtedly amounts to wishful thinking.

– The text recognizes that the disparity in wage levels and social protection in European countries is hardly compatible with the principle of the free movement of persons in Europe. This has long been an unspoken part of European construction. The United Kingdom, which was one of the only countries not to take interim measures to restrict the entry of foreign workers at the time of the accession of central and eastern European countries in 2004, is now demanding that such measures be provided for in any future accessions. The draft agreement states that a European person's stay in a country other than his or her own is not the responsibility of the host country, meaning that the person either must have sufficient resources or must work.

– The question of the right to family benefits when children are not living in the same country as their parents is a tangled web. In most countries, family benefits are universal (not dependent on parental contributions). Both principles cannot be met at the same time: that all children living in a country are entitled to the same benefit; and that everyone working in a given country is entitled to the same benefits. The United Kingdom has won the right to be able to reduce these allowances based on the standard of living and family benefits in the child's country of residence. But fortunately this right cannot be extended to pension benefits.

– Most European countries currently have mechanisms to promote the employment of unskilled workers. Thanks to exemptions on social contribution, to tax credits and to specific benefits (like in-work credits or housing benefits in France), the income that they receive is largely disconnected from their wage costs. The British example shows that these programmes can become problematic in case of the free movement of

workers. How does a country encourage its own citizens to work without attracting too many foreign workers? Here is another of the unspoken issues of open borders. It is paradoxical that it is the United Kingdom that is raising the question, while it is near full employment and is claiming that the flexibility of its labour market allows it to easily take in foreign workers. In any case, the UK was granted that a country facing an exceptional influx of workers from other EU Member States can obtain the right from the Council, for seven years, to grant non-contributory aid to new workers from other member countries in a graduated process over a period of up to four years from the start of their employment. The UK has also had it clarified that it can use this right immediately. This is a challenge to European citizenship, but this concept had already been chipped away for the inactive and unemployed.

The European Union, as currently constructed, poses many problems. The Member States have divergent interests and views. Because of differences in their national situations (the single monetary policy, freedom of movement of capital and people), many arrangements are problematic. Rules without an economic foundation have been introduced into fiscal policy. In many countries, the ruling classes, the political leaders, and the top officials have chosen to minimize these problems so as not to upset European construction. Crucial issues concerning the harmonization of taxes, social conditions, wages and regulations have been deliberately forgotten.

The UK has always chosen to keep its distance from European integration, safeguarding its sovereignty. Today it is putting its finger on sensitive points. To rejoice at its departure would be irrelevant. To use this to move mindlessly towards an "ever closer union" would be dangerous. Europe should seize this crisis to acknowledge that it has to live with a contradiction: national sovereignty must be respected as much as possible; Europe has no meaning in and of itself, but only

if it implements a project that supports a specific model of society, adapting it to integrate the ecological transition, to eradicate poverty and mass unemployment, and to solve European imbalances in a concerted and united manner. If the agreement negotiated by the British could contribute to this, it would be a good thing – but will Europe's countries have the courage to do so?