

France-Germany: The big demographic gap

By [G rard Cornilleau](#)

The divergence in the demographic trajectories of Germany and France will have a major impact on social spending, labour markets, productive capacity and the sustainability of public debt in the two countries. The implications are crucial in particular for understanding Germany's concern about its debt. These demographic differences will require the implementation of heterogeneous policies in the two countries, meaning that the days of a "one-size-fits-all" approach are over.

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

generally been higher than German fertility in the post-war period, with the gap widening since the early 2000s. As a result, the number of births in France is now substantially higher than the number in Germany: in 2011, 828,000 compared with 678,000, *i.e.* 22% more births in France.

Figure 1. Age pyramids in 2011

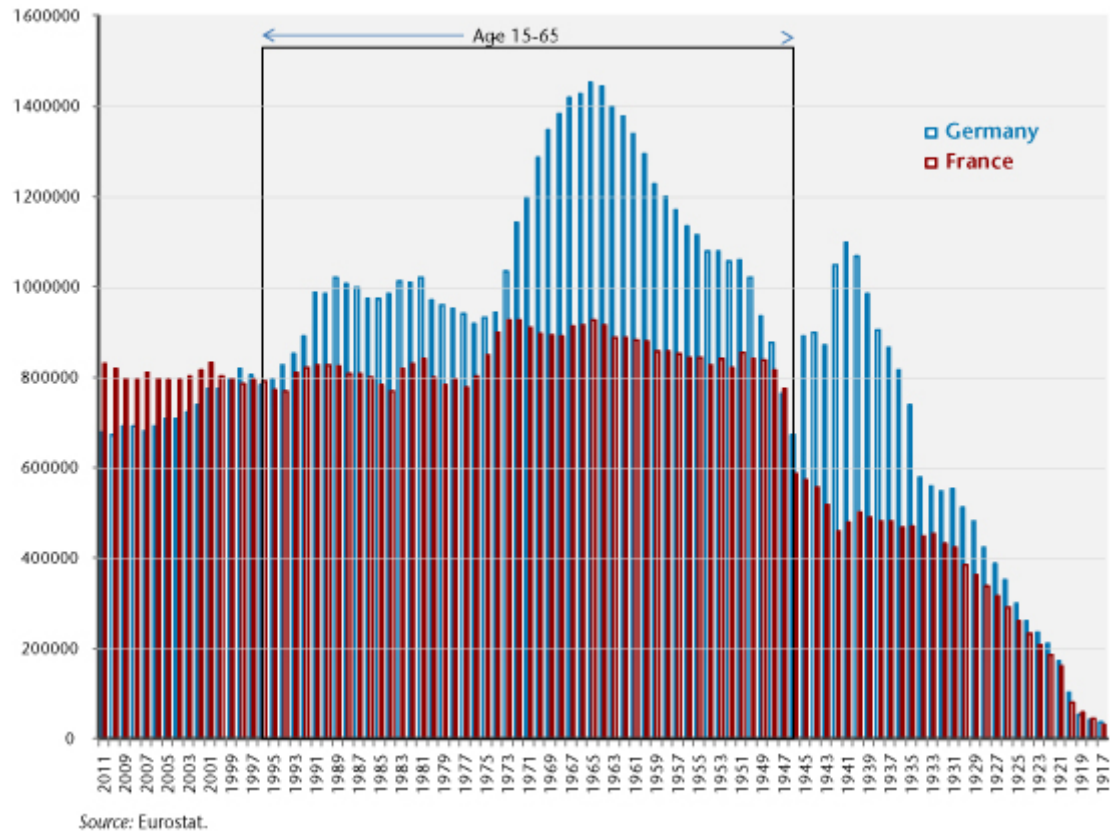
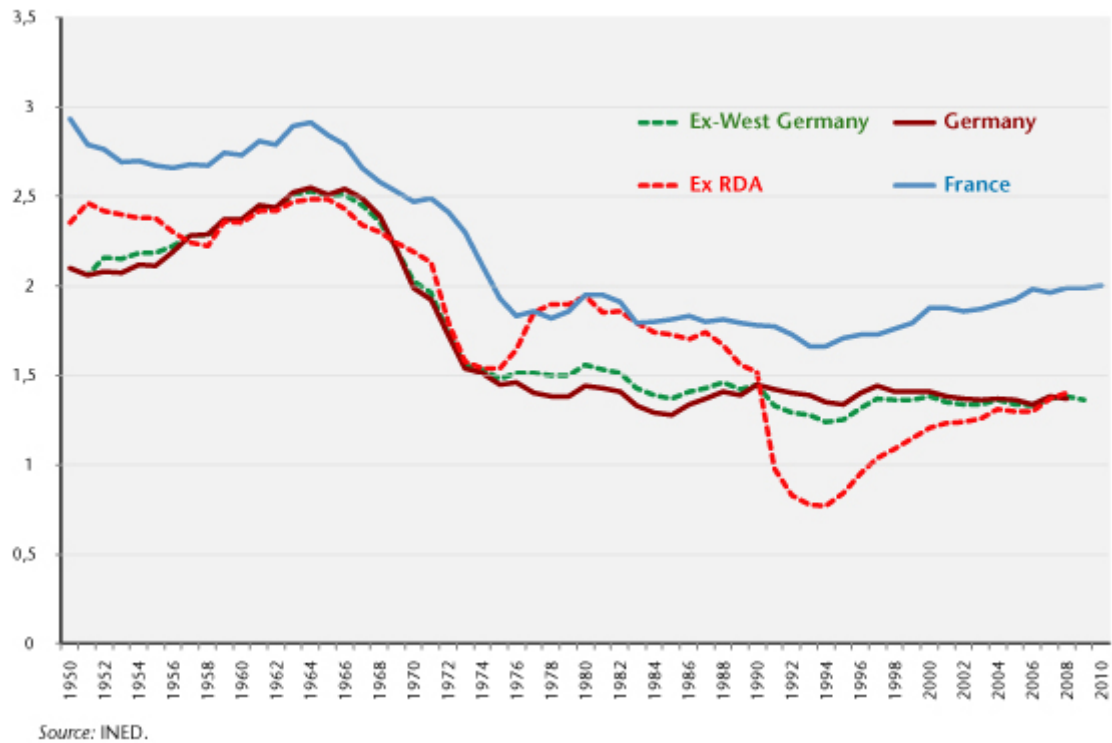


Figure 2. Instantaneous fertility indicators in France and in Germany



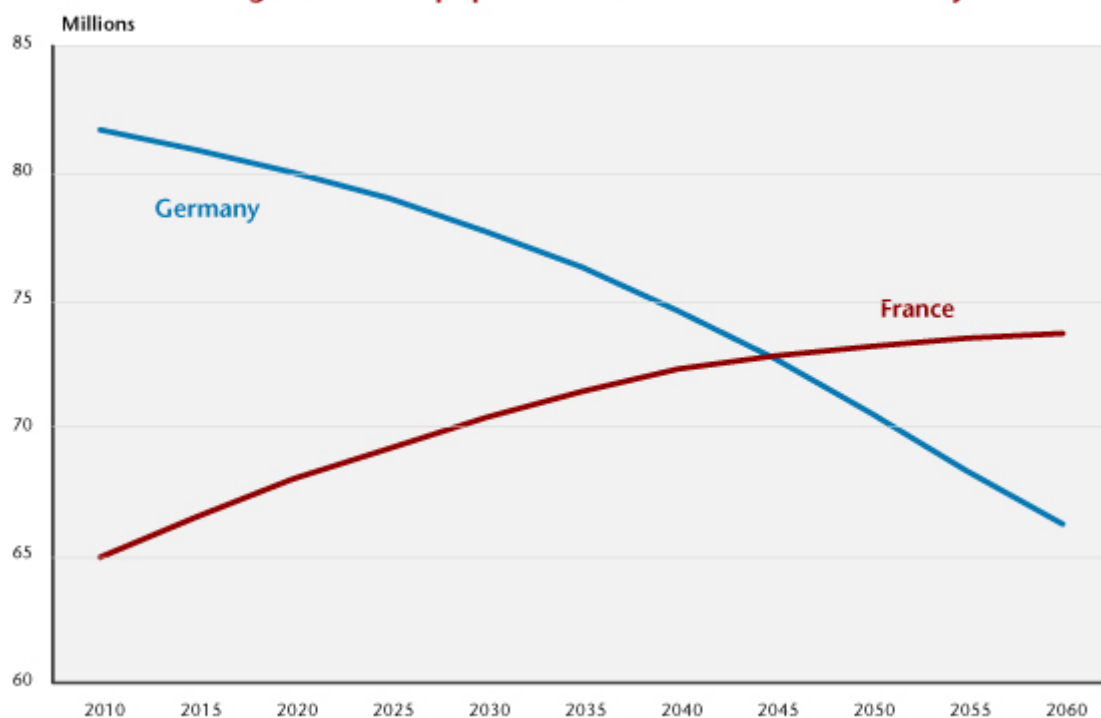
From a demographic standpoint, France and Germany are thus in radically different situations. While France has maintained a satisfactory fertility rate, almost sufficient to ensure the long-term stability of the population, Germany's low birth rate will lead to a substantial and rapid decline in the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

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

Migration is contributing to population growth in both countries, but only moderately. Net migration has been lower in Germany during the most recent period, with a rate of 1.87% between 2000 and 2005 and 1.34% between 2005 and 2010 against,

respectively, 2.55% and 1.62% in France [2]. The net migration rates adopted by the European Commission for France and Germany are similar, with a contribution to population increase by 2060 on the order of 6% in each country [3]. The UN [4] uses a similar hypothesis, with the contribution of migration growing steadily weaker in all countries. This reflects a general slowdown in overall international migration due to rising incomes in the originating countries. In this situation, Germany does not seem to have a large pool of external labour available, as it has limited historical links with the main regions of emigration.

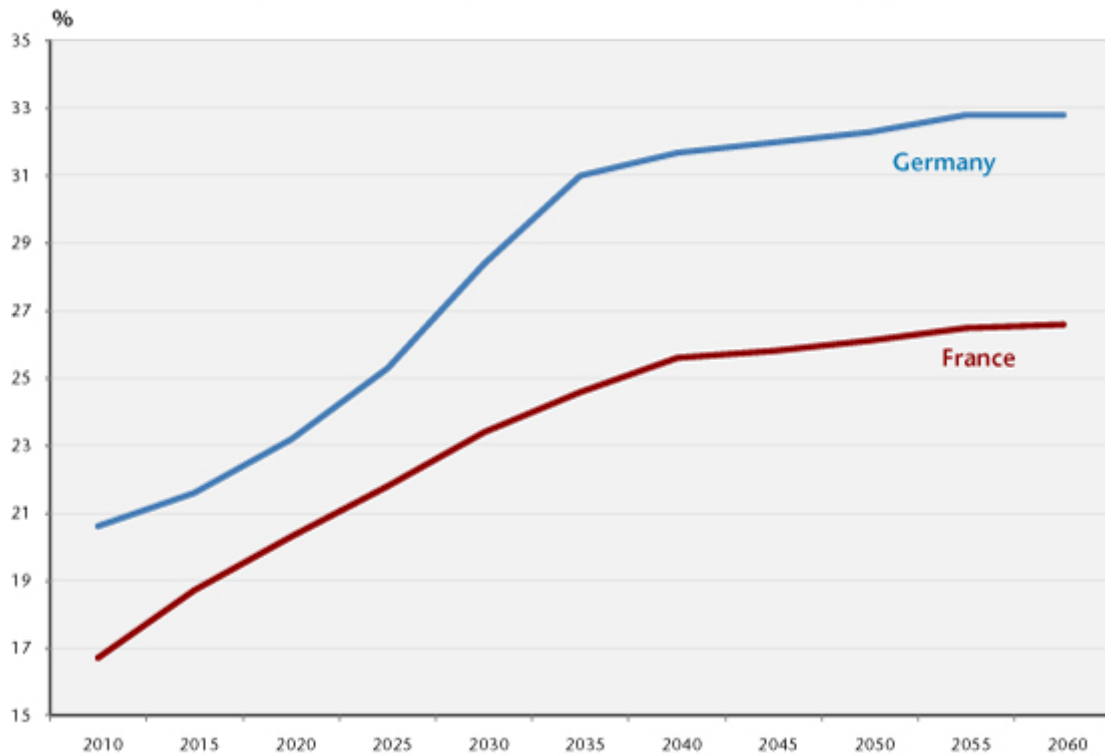
Figure 3. Total populations in France and in Germany



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

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

Figure 4. Share aged 65 and over in the total population



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

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

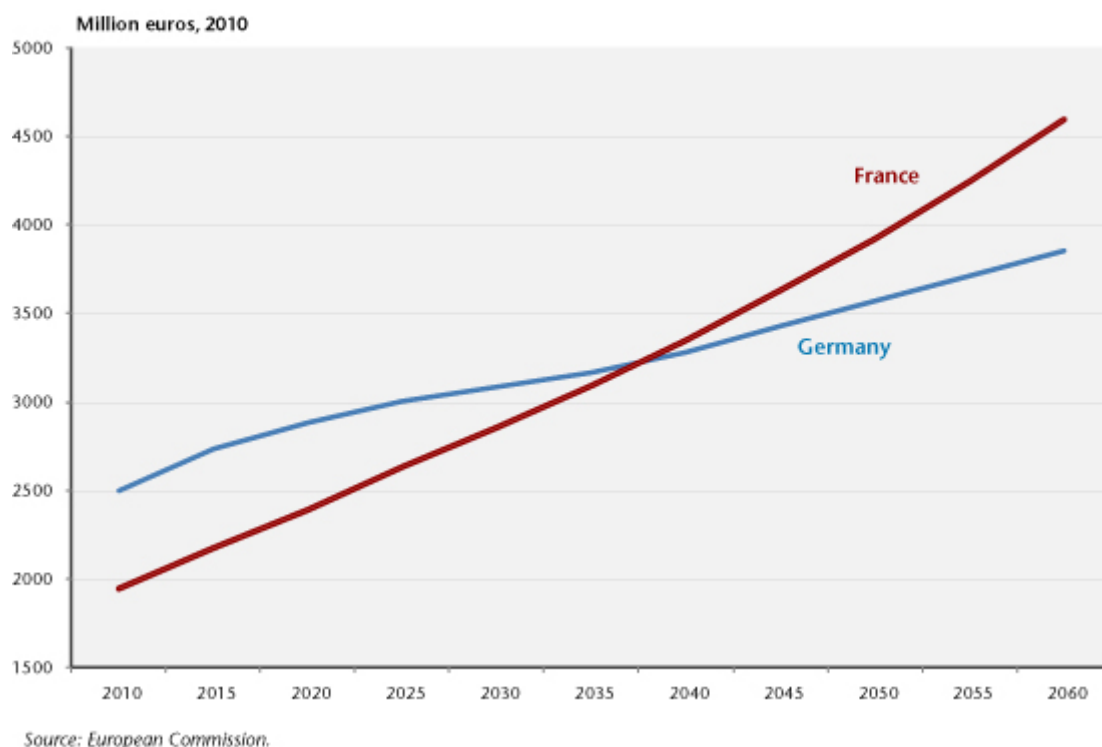
Demography also has an impact on the labour market, which will be subject to changing constraints. Between 2000 and 2011, the French and German workforces increased by the same order of magnitude – +7.1% in Germany and +10.2% in France – but while in Germany two-thirds of this increase resulted from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

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

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

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

Figure 5. GDP in France and in Germany



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

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

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

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

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

[4] *Op. cit.*

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

[6] *Op. cit.*

Must we choose between saving the planet and exiting the crisis?

By [Xavier Timbeau](#)

It is up to our generation and those that follow to find a way for 10 billion people to live decently and sustainably on a planet with finite resources and capacities. As a decent standard of living requires a mode of consumption closer to that of our Western societies than the deprivation that afflicts a large part of the world's inhabitants, the task is immense – but failure is unacceptable. All this requires us to curb climate change, to anticipate falling agricultural yields, to prepare for the impact of rising sea levels, to adapt, and to halt the destruction of biomass and biodiversity

while taking into account the depletion of natural resources, whether renewable or not. The list of constraints is long, and unfortunately it does not stop with these few examples (the interested reader can profit from reading the [OFCE's previous work](#) on this subject).

Yet the crisis facing the developed countries ([the Great Recession](#)) is often put in opposition to the environmental emergency, suggesting that any ethical concern for integrating human society into the limits imposed by the environment is a luxury that we can no longer afford. As we are obliged either to hope for a return to growth or to prepare the liquidation of our economies, *décroissance*, or de-growth, out of a concern for nature would be an idle fantasy, an option that only the most idealistic – and thus someone freed from the constraints of reality – could take “seriously”. How could societies that are experiencing record rates of unemployment, which need to get back to work in order to absorb the excesses of yesteryear (!), societies threatened moreover by emerging powers that will hasten the decline of anyone who fails to comply with the rules of the new world – how could they allow themselves to become absorbed in saving the planet?

The idea that these two priorities (ending the crisis, saving the planet) have themselves to be prioritized (one realistic, the other idealistic) is a very poor way of addressing the challenge of our times. It can only lead to bad policies, to increasing the future cost of the environmental realism so necessary today and prolonging the economic crisis we are going through again and again. Three arguments are often advanced that lead to neglecting environmental issues in favour of economic issues. These arguments are especially questionable.

The first argument is that the solution to the environmental issue has to be postponed – but it can't be. Indeed, and as an example, the capacity of the global ecosystem to absorb carbon dioxide has long been exceeded. Continuing to emit carbon

because oil is cheaper than other energy sources [\[1\]](#) on the pretext that there is no other choice is a dead end. Every time a gas plant is built (shale or not), it has to be worked (to be profitable) at least 50 years. But after 10 years we will take fright at the level of carbon emissions and realize that climate change is threatening not just our comfort, but the very survival of the human species, and it will be obvious that we must reduce CO₂ emissions. So in addition to new investments to change the way we consume energy, it will then be necessary to add the scrapping of the still-unprofitable gas plant. Putting off doing what is needed does not save money – on the contrary, it increases the cost, simply because the environmental constraints cannot be put off. This is currently the diagnosis, for example, even of the [International Energy Agency](#), hardly a den of hard-core ecologists. To stop the planet's climate from heating up by more than 2°C (relative to the pre-industrial era), it is necessary to immediately take the path of reducing CO₂ emissions by around 2t of CO₂ per year per capita (down to 5 to 10 times less than current emissions in the developed countries). Not doing this today means investing in poor solutions that will have to be mothballed before they have become profitable, and resigning ourselves to limiting the increase in the planet's temperature to 3°C or even more. It therefore means paying more for a worse level of climate stabilization that will then cost even more to adapt. Making the reduction of public debt the priority on behalf of future generations is completely hypocritical if it is done at the expense of future generations. In other words, investing in the decarbonisation of the economy, if it is done well, would have a future social profitability well above interest rates on the public debt. Not doing this means impoverishing future generations. Not doing this because cash constraints prohibit it amounts to a denial that we will not be able to justify to future generations.

The second argument is that we are not rich enough to be able

to save the planet. Complying with environmental requirements and implementing solutions to reduce our impact on the environment would impoverish us, with very few exceptions, at least at first [\[2\]](#). What was once cheap (e.g. producing energy with reserves accumulated underground over millions of years) would now be done with more work and more infrastructure or capital (and thus more work to produce the capital), and thus in a way that is generally less efficient. Designing products that can be recycled completely, and producing and recycling them so that the materials that compose them can be *indefinitely* reused so as not to tap into the stock of the planet's finite resources, will require more work, more energy (and thus more work) and more capital (and thus more work). Choosing to take the path of respect for the environment thus means less consumption (final consumption, or, if you prefer, fewer services from consumption or a decrease in the flow of material well-being drawn from consumption). But that does not mean a decline in production, or even less a decline in domestic production. Greater concern for the environment will mean a fall in productivity and living standards, but it will also mean job creation (this is the simple corollary). But what happens when jobs are created by reducing productivity in a situation of massive underemployment? It may, though this is not certain, reduce inequality and unemployment. The negative overall effect on income could be compensated for part of the population by the impact on inequality. Since escaping from the rarities of resources (e.g. oil) reduces (or in an extreme case eliminates) the rents associated with those rarities, a reduction in inequality means in particular the primacy of work over property. This is how we can reconcile a reduction in inequality with the environmental transition. Less wealth is consumed, but there is less unemployment, provided that we take the opportunity offered by the environmental transition to reduce inequality, and not just by means of social tariffs but also by the creation of new production.

The third argument frequently advanced is the constraint of

international competition. Since our competitors do not choose to respect the environment, their costs remain low. If we insist on burdening our companies with additional environmental costs (taxes, quotas, standards, right-to-pollute contracts), not only do we lose competitiveness and thereby destroy economic activity and employment, but furthermore, because these activities will be relocated to areas where pollution or CO₂ emissions are "authorized", while the environmental degradation will not recur in our country, it will in others, and will thus ultimately increase. In short, the environmental ideal is incompatible with the harsh laws of globalization. Yet it is this argument that is deeply naive and off target, and not the environmental imperative. There are two types of possible answers, both fully compatible with globalization as it is now [little] regulated. The first involves cooperation through applying the same rules on larger and larger spaces. The European Union and its carbon market is one example. This space can be extended, as was tried by the Kyoto Protocol or as is evidenced by the recent cooperation between the European Union and Australia. But such cooperation cannot be established on a stable basis if there is no possibility of coercion. The second possible answer is thus the environmental tax on imports, which is legitimate under the WTO agreements (protection of the environment is one of the few reasons for an exception to the principle of untaxed free trade). It should be noted, for there to be no doubt about the environmental motivation for this, that the proceeds of such import taxes should be redistributed at least in part to the countries sending the imports, or even reserved for environmental investments. This would remove any suspicion that this is a protectionist tax; it would help promote environmental issues in the developing countries; it would provide a concrete response to the notion of the North's ecological debt vis-à-vis the South; and it would be neutral when establishing an environmental tax system or a market for emissions rights in the countries concerned. It would also make it possible to retain an international division of labour

(and the trade flows that go with it), which is a source of productivity and of a better allocation of capital that is still necessary to deal with all the constraints that we need to respect.

The environmental challenge and finding an exit to the crisis are issues that converge, not conflict. The first cannot be postponed without major costs or irreversible damage. The levers to act on the environment must be the same as those that will help put an end to the crisis, in particular because they reduce inequality and increase employment. There is still the issue of the public debt and the need for more manoeuvring room in the future. But submission to cash constraints ("I have to repay my debts right now or I'll collapse") amounts to the panic of a rabbit caught in the headlights of the car that is about to crush it. Yet this is exactly the kind of fiscal strategy that we are endeavouring to follow. And it is this that is inconsistent with the concern for future generations and for the environment.

[\[1\]](#) Just like trying to become a little more competitive by exploiting shale gas because it is twice as cheap as average oil, while in the end, and despite the more advantageous ratio of energy to carbon emitted, it leads to more emissions.

[\[2\]](#) Subsequently, the environmental constraints will stimulate the technical progress that will ultimately raise our overall productivity again.

Friends of acronyms, here comes the OMT

By [Jérôme Creel](#) and [Xavier Timbeau](#)

We had the OMD with its Orchestral Manœuvres in the Dark, and now the OMT with its Orchestral Manœuvres in the [liquidity] Trap, or more precisely, “Outright Monetary Transactions”, which is undoubtedly clearer. The OMT is a potentially effective mechanism that gives the European Central Bank (ECB) the means to intervene massively in the euro zone debt crisis so as to limit the differences between interest rates on euro zone government bonds. The possibility that a country that comes into conflict with its peers might leave the euro zone still exists, but if there is a common desire to preserve the euro then the ECB can intervene and play a role comparable to that of the central banks of other major states. Opening this door towards an escape route from the euro zone’s sovereign debt crisis has given rise to great hope. Nevertheless, certain elements, such as conditionality, could quickly pose problems.

The OMT is simply a programme for the buyback of government bonds by the European Central Bank, like SMP 1.0 (the Securities Markets Programme) which it replaces but limited to States that are subject to a European Financial Stability Fund / European Stability Mechanism (EFSF / ESM) programme and thus benefiting from European conditional aid. For the ECB to intervene, the country concerned must first negotiate a macroeconomic adjustment plan with the European Commission and the European Council, and apply it. The ECB, potentially members of the European Parliament or the IMF can be a party to this (these institutions – the Commission, the ECB and the IMF – form the Troika of men in black, so famous and feared in Greece). Secondly, and more importantly, the country will be under the supervision of the Troika thereafter.

So if Italy and Spain want to benefit from the purchase of their bonds by the ECB, then their governments will have to submit to an EFSF or ESM adjustment programme. This does not necessarily imply that the plan imposed will be more drastic in terms of austerity than what these governments might have already devised or implemented (the doctrinaire approach in the management of public finances is highly contagious in Europe), but it will require the two countries to submit *ex ante* to outside scrutiny of any adjustment plan they develop and *ex post* to control by the Commission and the Council. If the country under surveillance starts *ex post* to veer away from implementing the adjustment plan, then it could, of course, withdraw from the programme, but its sovereign bonds would no longer be covered by OMTs. They would lose the support of their peers and would thus sail into the financial markets in uncharted waters. That would probably be the first step towards a default or an exit from the euro.

Furthermore, the ECB has not committed itself to absorbing all the bonds issued and thus maintains a real threat capacity: if the country were to rebel, it could be obliged to face higher rates. The OMT thus introduces both a carrot (lower rates) and a stick (to let the rates rise, sell the bonds the ECB holds in its portfolio and thereby push rates upward), upon each new issue. The OMT is therefore akin to being put under direct control (conditionality) with progressive sanctions and an ultimate threat (exiting the programme).

The ECB says that its interventions will mainly cover medium-term securities (maturity between 1 and 3 years), without excluding longer-term maturities, and with no quantitative limits. Note that short / medium-term emissions *usually* represent a small proportion of total emissions, which tend to be for 10 years. However, in case of a crisis, intervention on short-term maturities provides a breath of fresh air, especially as maturing 10-year securities can be refinanced by 3-year ones. This gives the Troika additional leverage in

terms of conditionality: the OMT commitment on securities is only for three years and must be renewed after three years. The financial relief for countries subject to the programme may be significant in the short term. For example, in 2012 Spain, which has not yet taken this step, will have issued around 180 billion euros of debt. If the OMT had reduced Spain's sovereign borrowing rates throughout 2012, the gain would have amounted to between 7 and 9 billion for the year (and this could be repeated in 2013 and 2014, at least). This is because, instead of a 10-year rate of 7%, Spain could be benefitting from the 2% rate at which France borrows for 10 years, or instead of its 4.3% rate at 3 years, Spain could have borrowed at 0.3% (France's 3-year sovereign rate). This is the maximum gain that can be expected from this programme, but it is significant: this roughly represents the equivalent of the budgetary impact of the recent VAT hike in Spain (or a little less than one Spanish GDP point). This would not alter Spain's fiscal situation definitively, but it would end the complete nonsense that saw Spaniards paying much more for their debt to compensate their creditors for a default that they have been striving arduously not to trigger.

It can even be hoped (as can be seen in the easing of Spanish sovereign rates by almost one point following the ECB announcement on Thursday, 6 September 2012, or the almost half a point reduction in Italian rates) that the mere existence of this mechanism, even if Spain or Italy do not use it (and thus do not submit to control), will be enough to reassure the markets, to convince them that there will be no default or exit from the euro and therefore no justification for a risk premium.

The ECB announced that it would terminate its preferred creditor status for the securities. This provision, which had been intended to reduce the risk to the ECB, led to downgrading the quality of securities held outside the ECB and thus reducing the impact of ECB interventions on rates. By

acquiring a government bond, the ECB shifted the risk onto the bonds held by the private sector, since in case of a default the Bank was a preferred creditor that took priority over private holders of bonds of the same type.

The ECB explained that its OMT operations will be fully sterilized (the impact on the liquidity in circulation will be neutral), which, if it is taken at its word, implies that other types of operations (purchases of private securities, lending to banks) will be reduced correspondingly. What do we make of this? The example of the SMP 1.0 can be drawn on in this regard. SMP 1.0 was indeed also accompanied by sterilization. This sterilization involved short-term deposits (1 week, on the ECB's liabilities side), allocated in an amount equal to the sums involved in the SMP (209 billion euros to date, on the ECB's assets side). Each week, the ECB therefore collects 209 billion euros in short-term fixed-term deposits. This is therefore a portion of bank deposits that the ECB assigns to the sterilization instrument, without there being sterilization in the strict sense (because this does not prevent an increase in the size of the ECB's balance sheet nor does it reduce the potential liquidity in circulation). The mention of sterilization in the OMT appears to be an effort at presenting this in a way that can convince certain states, such as Germany, that this monetary policy will not be inflationary and therefore not contrary to the mandate imposed on the Bank by the Treaty on the European Union. Currently, and because the crisis remains unresolved, private banks have substantial deposits with the ECB (out of fear of entrusting these deposits to other financial institutions), which gives it considerable flexibility to prevent the announced sterilization from affecting the liquidity in circulation (the ECB has a little more than 300 billion euros in deposits that are not mobilized for sterilization). The ECB can then probably use the current accounts (by blocking them for a week), which poses no difficulty since the ECB lends to the banks on tap through long-term refinancing operations (LTROs).

At worst, the ECB would lose money in the sterilization operation in case of a gap in compensation between the fixed-term deposits and the loans granted to banks. Sterilization could therefore lead to this kind of absurd accounting, but wind up, in a situation of monetary and financial crisis, having no impact on liquidity. On the other hand, if the situation normalizes, the constraint of sterilization would weigh more heavily. We're not there yet, but when we do get there, the ECB needs to limit lending to the economy or to accept an increase in liquidity if the OMT continues to be implemented for some euro zone members.

The deal that is now on the table places the euro zone countries in a formidable dilemma. On the one hand, acceptance of the Treaty on Stability, Coordination and Governance of the euro zone (TSCG) determines eligibility for the EFSF and the ESM [\[11\]](#), and therefore now determines eligibility for the OMT programme. Refusing to sign the fiscal treaty means rejecting in advance the potential intervention of the ECB, and thus accepting that the crisis continues until the breakup of the euro zone or until a catastrophic default on a sovereign debt. On the other hand, signing the treaty means accepting the principle of an indiscriminately restrictive fiscal strategy (the rule on public debt reduction included in the TSCG will be devastating) that will trigger a recession in the euro zone in 2012 and perhaps in 2013.

Signing the treaty also means relieving the pressure of the markets, but only to wind up submitting solely to the Troika and to the baseless belief that the fiscal multipliers are low, that European households are Ricardian and that the sovereign debt is still holding back growth. It is true that lowering sovereign interest rates, particularly those of Italy and Spain, will create some breathing room. But the main gain from lower rates would be to spread the fiscal consolidation over a longer period of time. Interest rates place a value on time, and reducing them means granting more time. The debts

contracted at negative real interest rates are not ordinary debts, and do not represent the same kind of burden as debts issued at prohibitively high rates.

It would be a terrible waste to gain new maneuvering room (the OMT) only to bind one's hands immediately (the TSCG and the Troika's blind fiscal strategy). Only a change in fiscal strategy would make it possible to take advantage of the door opened by the ECB. In short, saving the euro will not help if we do not first save the EU from the disastrous social consequences of fiscal blindness.

[\[1\]](#) Paragraph 5 of the preamble to the Treaty establishing the European Stability Mechanism states: "This Treaty and the TSCG are complementary in fostering fiscal responsibility and solidarity within the economic and monetary union. It is acknowledged and agreed that the granting of financial assistance in the framework of new programmes under the ESM will be conditional, as of 1 March 2013, on the ratification of the TSCG by the ESM Member concerned and, upon expiration of the transposition period referred to in Article 3(2) TSCG on compliance with the requirements of that article."

The crisis in the automobile industry: shortcomings **strategic shouldn't**

conceal the impact of fiscal austerity

By [Jean-Luc Gaffard](#)

The crisis in the automobile industry, illustrated by the closure of the PSA site in Aulnay, reveals not only structural difficulties but also strategic errors made by the manufacturers with respect to their industrial organization and range positioning. The industry's need to restructure cannot, however, obscure the very real macroeconomic dimensions of the crisis in the short term.

New car registrations in France fell 15.5% in July on an annual basis, after adjusting for working days. In the first seven months of the year, the decline in the automotive market stood at 13.5% in unadjusted data and 14.1% in adjusted data. PSA was down 9.9% in July in terms of unadjusted data. The Renault group has seen its share of registrations fall by 11.2%, with a drop of 26.6% for the Renault brand but a near doubling of registrations for the low-cost Dacia brand. Also in July, the decline in new car sales in Spain accelerated, with a drop of 17.2%. In Italy, new car registrations plummeted 21.4%. Finally, while German production increased by 5% due to exports, new car registrations there fell by 5%.

These catastrophic figures are first and foremost the result of the collapse of aggregate demand in the countries of the European Union as a result of falling revenues combined with greater inequality in distribution. The middle class is maintaining or increasing its savings rate and either deferring purchases in time or buying lower-cost products, particularly cars, while at the same time the increase in inequality has led to growth in the market for luxury vehicles, particularly in Europe and China.

It is not surprising, in this context, that PSA, which has a mid-range positioning, recorded a fall in sales and that Renault limited the damage only thanks to sales of its low-cost brand. Nor is it surprising to see strong growth for the Asian brands, Korean in particular, which are also positioned on the low-cost segment. Finally, it is not surprising that German manufacturers racked up exceptional results, as they are strongly positioned on the top of the range: BMW, Audi and Porsche recorded sales increases in the first half-year of 8%, 22.5% and 12.3%, respectively.

This state of affairs cannot of course absolve manufacturers of their strategic responsibilities, but it should lead the government to prioritize the underlying causes and, even more, to take the measure of what is needed in the short term, even while it continues to provide long-term support for the industry.

Nobody can doubt the relevance and effectiveness of the strategy adopted by Germany's firms, which is based on the international fragmentation of their production process, the conservation and development in the home country of their technological capacity and a better analysis of market expectations in the emerging economies, first of all China. This strategy proved to be especially successful as competitive devaluations became impossible with the advent of the single currency, an impossibility that has wound up exposing the errors in the positioning of their French competitors, including PSA, in light of the reality of global markets. The intensified rivalry between firms due to the steady weakening in European domestic demand, which has recently accelerated, could only lead to widening gaps in performance in terms of sales volumes, market share and ultimately profit margins.

There is certainly no question but that the future of the French automobile industry requires a substantial effort at organizational and technological innovation together with the

internationalization of production and the strengthening of local production relationships, as well as a search for market niches to make competition less price-sensitive. Public measures aimed at strengthening the production network through a site policy and support for outsourcing respond to this strategic challenge. The emphasis on the development of electric and hybrid vehicles is, however, questionable. The electric vehicle market could well remain marginal, and this will not change as a result of heavily subsidized prices to boost sales among specific urban groups. As for the market for hybrid vehicles, this is still limited in volume, and foreign (Japanese) competition already has a solid footing. Shouldn't we worry about the fate of mid-range vehicles: while their market is clearly suffering from the crisis in Europe, might it not thrive in Europe as it emerges from the crisis and even develop in the emerging economies as a genuine middle class emerges there? In other words, a productive recovery in the automotive sector, while it must involve improvements in quality, is still a matter of demand – and demand needs to be considered at a global level, with as a consequence the corresponding strategic choices concerning the location and segmentation of production activities.

In any event, a recovery in production in one direction or another will take time, and time is likely to be lacking if in the short term there is no pick-up in demand. In other words, the immediate problem is as much if not more macroeconomic rather than microeconomic. The surest way to bury the French automotive industry, thus losing an important accumulation of human capital, is to pursue a fiscal austerity policy that merely depresses demand without addressing the issue of sovereign debt.

The situation on the labour market in France*

By [Eric Heyer](#)

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

- a public deficit that at end 2012 is likely to come to about 4.5 GDP points, or close to 100 billion euros;
- a lack of jobs, which is leading to mass unemployment.

While the first point is the object of great attention, and while it has been and remains the main or even the sole concern of every EU summit over the last three years and is at the heart of the European strategy on the crisis, it must be acknowledged that this is not unfortunately the case for the second point. However, it is not unreasonable to ask whether the priority in a country as rich as France should actually be to reduce the deficit at all costs even if this may worsen the plight of society's most vulnerable and make it more difficult for them to access the labour market.

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

And this figure undoubtedly underestimates the real situation. The French economy is currently creating only mini part-time jobs that don't last long; in the last quarter, 4.5 million job contracts were signed: 3 out of 4 of these were contracts

lasting less than one month (mostly 1 day to 1 week). Someone who signed one of these contracts and is looking for a job at the end of the same month is not counted as unemployed. Their inclusion would increase the jobless numbers and push the French economy a little further into mass unemployment.

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

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

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

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

So how can a further explosion of unemployment be stopped in

the near future?

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

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

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

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

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

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

Youth “jobs of the future”: What impact on employment and government finances?

[Éric Heyer](#) and [Mathieu Plane](#)

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

These full-time jobs, which are planned to last a maximum of five years and are paid at least the minimum wage (SMIC), will be 75% funded by the State, with the rest of the cost being borne by local authorities, associations, foundations and business. According to the Minister of Labour and Employment, Michel Sapin, the goal is to create 100,000 jobs starting in 2013.

The ex-ante cost of the measure

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

finances therefore comes to 23,015 euros per contract. When fully implemented, the cost of creating 150,000 “jobs for the future” is estimated at 3.45 billion euros a year.

The impact of the measure

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

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

The state aid (75% of the gross salary) allows a reduction in the cost of labour of 52% at the SMIC level, *i.e.* a total reduction of 71% of the actual cost of a minimum wage job if one includes the reductions in charges. With the impact of employment elasticities at a maximum labour cost at the level of the SMIC (1.2 according to a DGTPE study in 2007), the 50,000 “jobs of the future” in the market sector would generate 27,300 jobs. The *ex-ante* cost to the public finances would be 0.05 GDP point, and 0.03 GDP point *ex post*.

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

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

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

Source : OFCE calculations.

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

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

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

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

Source : OFCE calculations.

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Rent control: What is the expected impact?

Sabine Le Bayon, Pierre Madec and Christine Rifflart

[The decree on rent control](#), which was published in the *Journal officiel* on 21 July, takes effect on 1 August 2012 for one year. The measure was announced in January 2012 during François Hollande's presidential campaign. It has now been adopted, while awaiting the major reform of landlord-tenant rental relations that is scheduled for 2013.

Difficulties in finding housing and deteriorating living conditions for an increasing share of the population point to growing inequality in housing. This inequality is undermining social cohesion, which is already being hit by the economic crisis. For many people, homeownership is becoming a problematic proposition due to the rising cost of buying, while applications for the allocation of social housing remain on hold for lack of space, and the private rental market is becoming increasingly expensive in large cities because of the soaring price of property. Rent control in these cities is serving as an emergency measure to slow the price increases. This poses a challenge of keeping investors in the private rental market, which is already characterized by a shortage in housing supply and very low rental returns (1.3% in Paris after capital depreciation).

The decree aims to significantly lower market rents [2], which are being driven up by rents at the time of re-letting, *i.e.* during a change of tenant. Unlike rent during the lease period or upon renewal of a lease, which are indexed to the IRL rental benchmark, until 31 July 2012 rents for new tenants were set freely. In 2010, this applied to nearly 50% of re-lettings in the Paris area (60% in Paris). Now, in the absence of major renovations, these will be subject to control. Only rents for new housing that is being let for the first time or renovated properties (where the renovation represents more than one year's rent) will remain uncontrolled (Table 1).

Table 1. The method of setting rent under current law

Legal framework set by	Renewal of lease	Re-letting	First letting and new housing
Act of 6 July 1989 as modified	<ul style="list-style-type: none"> - Indexed to the IRL - In case of obvious under valuation, re-evaluation over 3 years or 6 years if the difference is greater than 10% - In case of renovations, increase agreed in advance between the landlord and tenant 	Uncontrôle	Uncontrôle
Decree for the Paris region	<ul style="list-style-type: none"> - Indexed to the IRL - In case of obvious under- or renovation for an amount at least greater than 1 year's rent, authorized increase of half the difference between the last rent and the market rent or of 15% of the actual cost of the renovation (tax incl.) 	Uncontrôle	Uncontrôle
Decree of 21 July 2012 (applicable in the relevant municipalities)	<ul style="list-style-type: none"> - Indexed to the IRL - In case of obvious under-valuation or of renovation for an amount at least greater than 1 year's rent in the private or common areas, authorized increase of either half of the difference between the last rent and the market rent or of 15% of the actual cost of the renovation (tax incl.) 	<ul style="list-style-type: none"> - Indexed to the IRL - In case of an obvious under-valuation or of renovation for an amount between 6 month's rent and 1 years' rent in the private or common areas, authorized increase either of half of the difference between the last rent and the market rent or of 15% of the actual cost of the renovation (tax incl.) - Uncontrolled if renovation of at least 1 year's rent 	Uncontrôle

By using the [data from the Observatoire des Loyers de l'Agglomération Parisienne](#), along with the hypotheses set out in the [OFCE Note \(no. 23 of 26 July 2012\)](#), "Rent control: what is the expected impact?", we evaluated the impact this decree would have had if it had been implemented on 1 January 2007 and made permanent until 2010. According to our calculations, this decree would have resulted not only in sharply slowing increases in rents for re-lettings during the first year it

was applied (+1.3% in the Paris area, against 6.4% observed), but also in stabilizing or even reducing rents at the time of the next re-letting, *i.e.* in our example, three years later (in 2010, 0% in Paris and -0.6% in the Paris region). Finally, in 2010, rents would have been 12.4% lower in Paris and 10.7% lower in the Paris region than they would have been in the absence of the measure. This means that in Paris, rents would have been about €20.1 per sq.m instead of the rate of €22.6 per sq.m actually observed (Table 2). For an average size dwelling (46 sq.m) re-let in Paris, the monthly rent would thus have been €924 instead of €1,039, a savings for the tenant of €115 per month. For the Paris region as a whole, using the same assumptions, the rent upon re-letting would have fallen on average to €15.9 per sq.m, instead of the actual €17.8 per sq.m. For an average rental area upon re-letting of 150 sq.m, the gain would be €95 per month!

Over the longer term, the decree would make it possible to reduce the gap between sitting tenants in place for more than 10 years and new tenants (a gap of 30% in 2010 in the Paris region and 38% in Paris itself), and to improve market fluidity.

Currently, what possibility is there of moving if the mere fact that a couple has children increases the price per sq.m by over 15% in the Paris region? Similarly, the financial incentive to move for a couple living in a four-room 80 sq.m dwelling whose children have left home is zero, because the rent for a 60 sq.m unit with 3 rooms would cost just as much. This premium on being sedentary increases the pressure on the rental market and encourages households to stay in properties that are not suited to their needs, and even hampers labour market mobility.

Can this measure encourage mobility and restore household purchasing power? In the short term, it will certainly benefit the most mobile households by limiting the increase in the share of their budget spent on housing [3]. But these are the

households facing the least constraints on income, that is to say, those with high incomes or a relatively low share of income spent on housing. It will also benefit households that are forced to move or those who are running up against the limits on their finances. For all these households, the increase in the share of income on housing will be lower than it would have been without the decree. In contrast, for low-income households whose share is already high [4], the decree won't change anything, because they can ill afford the additional cost of re-letting.

Table 2. Simulated change in rents upon re-letting in the Paris region using the hypothesis that the decree took effect on 01 Jan 2007

	Rents noted letting on 31/12/2006	Rents after re-letting on 01/01/2007	Change in 2007	Rents on 31/12/2009 after indexing to IRL and before re-letting	Rents on 01/01/2010 after letting	Change in 2010	Gap between observed and simulated rents upon re-letting in 2010
PARIS		19 €/m ²	2.2 %	20.1 €/m ²	20.1 €/m ²	0 %	-12.4 %
Actual	18.6 €/m ²	(20.1 €/m ²)	(+ 8.3 %)	(20,9 €/m ²)	(22,6 €/m ²)	(+8,3 %)	
PARIS REGION		15.4	1.3%	16 €/m ²	15.9 €/m ²	-0.6 %	-10.7 %
Actual	15.2 €/m ²	(16.2 €/m ²)	(+ 6.4)	(16.9 €/m ²)	(17.8 €/m ²)	(+5.7 %)	

What are the risks?

While there are real benefits to be expected, these would still need to be made viable by the application of this decree, or at least by the next Act. Besides the difficulty of implementing the decree (absence both of reliable mechanisms to monitor rents in the areas concerned and of a legal framework to allow tenants to assert their new rights), the impact of this measure will be positive for tenants only if the rental supply does not shrink (by maintaining current investors in the market and continued new investment) and if landlords do not seek to offset future rent control by raising the rent at the time of the first let.

Likewise, the realization of improvements in line with the Grenelle 2 environmental consultation or simply maintenance

work could wind up being abandoned due to the lengthening of the amortization period for landlords compared with the previous situation. Conversely, some owners might be encouraged to carry out major renovations (in excess of one year's rent) and "to upgrade the dwelling" in order to be able to freely determine the rent. This would give the landlord a margin of safety to offset any subsequent shortfall. These increases, if they occurred, would penalize less creditworthy tenants and would promote the process of gentrification already at work in the areas under greatest pressure. We could then see increasing differences between the market for "rundown housing" and that for renovated housing.

This decree should in the short term limit the extent of disparities in the areas under greatest pressure, at no cost to the government. But it will not solve the problem for the poorest households of the share of income going to housing: to do this, it is necessary to increase the stock of social housing, to improve its fluidity and to significantly upgrade housing subsidies [5], which would require a major financial effort. The fundamental problem remains the lack of supply, particularly in urban areas, where by definition the available land is scarce and expensive, with higher rents simply passing on the price of property. However, to ease housing prices, more land needs to be available, with a greater density where possible, transport needs to be developed to facilitate the greater distance travelled between residential areas and workplaces, and so on. These are the levers that need to be used if we are to improve the housing conditions of less well-off households.

[1] The decree applies in municipalities where the rent increases seen over the period 2002-2010 were more than double the increase in the IRL benchmark (*i.e.* 3.2% per year) and the

market rent per sq.m exceeds the national average outside the Paris region (€11.1 /sq.m) by 5%. This includes nearly 1,400 communes in 38 cities (27 in metropolitan France and 11 in overseas departments).

[2] There are two types of rent: the average rent is the rent of all rental housing, whether vacant or occupied; and the market rent is the rent of all dwellings available on the rental market, *i.e.* new rental accommodation and re-lettings. This is very close to the rent for re-lettings, as residences for first-time lets represent only a small portion of the available supply.

[3] This share has increased for 15 years for households in the private rental sector, and particularly the less well-off.

[4] In 2010, more than half of private sector tenants spent an income share on housing (net of housing benefit) of over 26.9%, but above all, the share was 33.6% for the poorest 25% of households.

[5] According to the IGAS report "Evaluation of personal housing assistance", in 2010, 86.3% of rents in the private rental sector were greater than the maximum rent taken into account for calculating housing benefit. Any increase in rent is thus borne entirely by the tenant.

Social action, but no end of the crisis

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

By [Eric Heyer](#), [Mathieu Plane](#), [Xavier Timbeau](#)

The initial decisions of the five-year programme are coming amidst an extremely difficult and very uncertain economic situation. In a recent [OFCE Note](#) (No. 23 of 26 July 2012), we first analyze the macroeconomic context for François Hollande's five-year programme and the XIVth legislature. This analysis details the likely consequences for the next five years of the strategy currently being implemented in Europe. We evaluate both the cost to the public finances as well as the impact on economic activity, employment and the distribution of income. In part two, we analyze the public policy choices being given priority by the new government, including both those aimed at the young (generation contracts, jobs of the future), at some seniors (revision of the pension reform), and at the middle and lower classes (allowance for the start of school, boost to the minimum wage, Livret A bank accounts, rent control, revised taxation of overtime), as well as those intended to revive certain public expenditures that are deemed essential (public jobs in education, the justice system and the police in the "public finance" section, and public early childhood services).

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

price for the crisis (almost 300,000 jobs lost), with all signs indicating that the job losses and closures of industrial sites might be irreversible.

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

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

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

This strategy for ending the crisis is risky, to say the least, because it does not take full account of the crisis facing Europe today. It might be justified if we were already on course to end the crisis and if the point were simply to set priorities. But Europe remains in a situation of extreme uncertainty, living in the expectation of a massive failure of one or another Member State in the euro zone, fearing the collapse of this or that financial institution, and suffering the consequences of a spiral of austerity that is being fueled by rising sovereign interest rates. In this situation, everything is coming together to strengthen the existence of a liquidity trap and to generate high fiscal multipliers. Given this, *ex ante* reductions in the deficit through tax hikes and spending cuts is weighing heavily on activity, and thus limiting or even cancelling out any actual deficit reductions. The factors pushing up the public debt are not being reversed, and the reduction in activity is heightening the risk that the unsustainable private debt will be socialized. The increase in sovereign interest rates is being fueled by an inability to meet deficit reduction targets and by rising public debt, and is thus pushing public deficits higher, forcing even more austerity.

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

In the first part of the Note, we analyze the macroeconomic context for François Hollande's five-year programme and the XIVth legislature. This analysis details the likely consequences for the next five years of the strategy currently being implemented in Europe. The value of the fiscal multiplier is a critical parameter, and we show that the current strategy is valid only if the multipliers are low (*i.e.* on the order of 0.5). However, a slew of empirical evidence indicates that, in the exceptional situation we are experiencing today, the budget and fiscal multipliers may be larger than 0.5 (between 1 and 1.5, see the Note). We detail in a second part the measures taken in the Supplementary Budget Act of July 2012 (for 2012) and the elements outlined in the budget orientation debate in preparation for the Budget Act for 2013 and for the period 2012-2017. To succeed in reducing the public deficit to 3%, it seems that there must be over 10 billion euros in additional tax revenue or in savings on expenditure, *ex ante*.

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

and Gérard Cornilleau evaluate the increased opportunities for retiring at age 60 and analyze the possible paths to a more large-scale reform of the pension system. Hélène Périvier evaluates the possibilities for an early childhood public service, the eventual cost of which could be covered in part by an increase in activity that would generate more than 4 billion euros. Eric Heyer and Mathieu Plane analyze the impact of a boost in the minimum wage (SMIC) and conclude that, given the small spillover of increases in the SMIC onto the rest of the wage structure, the impact on the cost of labour is limited by the greater reduction in social charges on low wages. While the effect on employment is small, it would cost the public purse 240 million euros. Sabine Le Bayon, Pierre Madec and Christine Riffart evaluate rent control. Hervé Péléraux discusses the compensation of Livret A bank accounts and the impact of doubling their ceiling. Céline Antonin and Evens Salies evaluate the new taxes on the oil companies, which could provide 550 million euros in tax revenue in 2012, at the risk that this tax might ultimately be passed on to the end consumer.

Obama 2012: “Yes, we care!”

By Frédéric Gannon (Université du Havre) and [Vincent Touzé](#)

On Thursday, 28 June 2012, the United States Supreme Court [delivered its verdict](#). The principle that individuals are obliged to take out health insurance or else face a financial penalty, a central plank in the 2010 reform [1] of the health insurance system (the Affordable Care Act [2]), was held to be constitutional. This reform had been adopted in a difficult political context. It includes a variety of measures intended to significantly reduce the number of Americans without health

coverage. Although it will increase federal spending, new revenues and spending cuts will make it possible to reduce the deficit.

From September 2009 to March 2010, there was a lengthy process of drafting and approving the law, with an uncertain outcome due to the lack of a majority in the Senate [3]. Since the law passed by the House of Representatives and signed on 23 March 2010 by President Obama differed from the version passed by the Senate, amendments were introduced in a Reconciliation Act that was passed on March 30th. Opponents of the reform (26 states, numerous citizens and the National Federation of Independent Business) then decided to take the fight to the US Supreme Court. Their hopes rested mainly on the possible unconstitutionality of the law, which centered on the individual's obligation to take out health insurance, called the "individual mandate", and on the expansion of the Medicaid public insurance program.

The favourable judgment of the Supreme Court was obtained with a narrow majority: five judges voted for [4] and four against [5]. The political inclinations of the judges did not seem to have worked against the law, since Chief Justice John G. Roberts, an appointee of George W. Bush, gave his approval. The Supreme Court majority considered that the financial penalty for a failure to take out insurance is a tax [6] and that it had no cause to rule on the merits of such a tax. It passed this responsibility to Congress (the upper and lower houses) which, in this case, has already debated and approved the law. Consequently, this point of law is valid.

According to the Supreme Court, the financial penalty for failing to purchase health insurance could be viewed as an individual obligation to purchase [7], and "the Commerce Clause does not give Congress that power". But from a functional standpoint, this penalty can be regarded as a tax, in which case Congress has discretion to "lay and collect Taxes" (Taxing Clause). Hence the positive verdict of the

Supreme Court. However, the Court believes that “the Medicaid expansion violates the Constitution” because the “threatened loss of over 10 percent of a State’s overall budget is economic dragooning that leaves the States with no real option but to acquiesce in the Medicaid expansion”.

The Supreme Court decision represents a major victory for President Barack Obama, who had made a reform to ensure more equal access to the health insurance system one of the spearheads of his 2008 election campaign. His Democratic predecessor in the White House, Bill Clinton, previously had to abandon a similar reform due to fierce opposition from the Republicans and growing divisions among the Democrats. In order to give himself every chance of success, Obama has had to be more strategic in the programming of both the reform and the way it was presented [8]. To do this, he also assembled a team of experienced specialists [9].

The Act represents a real cultural revolution in a country where the health insurance system excludes nearly 50 million people. Besides the individual mandate requiring Americans to purchase health insurance, the ACA’s main measures are:

- The creation of “exchanges” for insurance contracts where people can buy health coverage, with a government subsidy that depends on the level of income;
- Expansion of the Medicaid public health insurance program [10] (public coverage for all households with incomes below 133% of the federal poverty level) and financial penalties on states that choose not to implement this expansion (elimination of all federal funding of the Medicaid program);
- A requirement that employers offer health insurance to their employees (application of financial penalties if the obligation is not met, with exceptions for small businesses);
- New regulations on the private insurance market (obligation to offer coverage to all individuals, with

no conditions on their health status).

Beginning in 2014, millions of uninsured American households should benefit from the expansion of Medicaid, which the Supreme Court has now ruled unconstitutional – this raises numerous questions [11]. How many States will be tempted not to expand Medicaid? What are the consequences for the poor households [12] who were to benefit from this expansion? Will they have the means to afford subsidized private insurance [13]? Will they be penalized financially if they do not buy insurance? Will they be encouraged to migrate to States that have adopted the expansion [14]? It is reasonable to expect that few States [15] will boycott the expansion of Medicaid, as the ACA offers them other strong incentives (federal assumption of 100% of the additional cost from 2014 to 2016, then 95% after 2017, and 90% after 2020; loss of some federal funds if no expansion). However, adjustments in the law will likely be useful if policymakers want to avoid excluding those who are too poor to afford subsidized private insurance.

The law will come into force gradually, with the various measures to apply from 2014. According to the latest [report by the Congressional Budget Office](#) (2012), annual government expenditure (expansion of Medicaid and private insurance subsidies) should rise by about \$265 billion per year [16] by 2022 (the estimated total cost between 2012 and 2022 is \$1,762 billion), and the number of uninsured should fall by about 33 million [17]. The reform also provides for an increase in tax revenue (higher compulsory levies and new taxes) and a reduction in federal spending (primarily substitutions between the expanded Medicaid program and the old program). This will result in amply offsetting the cost of the reform. In a previous [report in March 2011](#), the CBO estimated that the total reduction in the deficit over the period 2012-2021 will come to \$210 billion. In the name of hallowed liberties, however, there is still strong opposition to the individual mandate [18], but over time it can be hoped that this

mandatory principle will come to be viewed first and foremost as a basic right that protects all citizens.

[1] For an overview of the health insurance system and the reform, see Christine Rifflart and Vincent Touzé, “La réforme du système d’assurance santé américain”, [*Lettre de l’OFCE, n°321*](#), 21 June 2010. Also see the [Wikipedia article on this subject](#).

[2] This legislation reconciles the two laws, the *Patient Protection and Affordable Care Act* and the *Health Care and Education Reconciliation Act*.

[3] “Health Care Reform: Recent Developments”, [*The New York Times, June 29*](#), 2012.

[4] Stephen Breyer, Elena Kagan, Ruth Bader Ginsburg, and Sonia Sotomayor, along with Chief Judge John G. Roberts.

[5] Clarence Thomas, Anthony Kennedy, Antonin Scalia and Samuel Alito.

[6] Floyd Norris, “Justices Allow the Term ‘Tax’ to Embrace ‘Penalty’”, [*The New York Times, June 28*](#), 2012.

[7] The legal position of the Obama administration has been to argue that the portion of the obligation to purchase insurance tantamount to a tax is the penalty paid by those who do not meet this requirement. This penalty has a regulatory function: it is designed based on the logic of an incentive, and not from the perspective of new tax revenue. Judge Jeffrey Sutton explained that if the government had clearly specified that the obligation to buy insurance was a tax, it would have been easier to justify in terms of its constitutionality. Most tax allowances or tax rebates are positive incentives (tax breaks on the acquisition of cleaner vehicles, for example). The health insurance requirement acts instead as a negative

incentive by imposing a penalty / fine on those who decide not to buy insurance. Faced with these alternatives, they will choose in all rationality – according to a Pigouvian perspective – the option that they consider the most profitable or the least costly.

[8] Ezra Klein, “Barack Obama, Bill Clinton and Health-Care Reform”, [*The Washington Post*, July 26](#), 2009.

[9] Robert Pear, “Obama Health Team Turns to Carrying Out Law”, [*The New York Times*, April 18](#), 2010.

[10] Medicaid is a public health insurance program for the poorest households (about 35 million beneficiaries). The numerous criteria (income, age, degree of invalidity, state of health, etc.) lead to excluding a non-negligible portion of society’s poorest. Hence more than 20 million people living below the federal poverty level do not have access to Medicaid. On the other hand, Medicare, the other public health insurance program, which is only for those aged 65 and over, broadly covers this age group.

[11] Urban Institute-Health Policy Center, “Supreme Court Decision on the Affordable Care Act: What it Means for Medicaid”, [*Policy Briefs*, June 28](#), 2012.

[12] Genevieve M. Kenney, Lisa Dubay, Stephen Zuckerman and Michael Huntress, “Making the Medicaid Expansion an ACA Option: How Many Low-Income Americans Could Remain Uninsured?”, [*Policy Briefs, Urban Institute – Health Policy Center*, June 29](#), 2012.

[13] In the absence of an expansion of *Medicaid*, their health insurance spending will be capped at 2% of their income.

[14] This notion of voting with their feet was put forward in an article by Charles M. Tiebout (1956): “A Pure Theory of Local Expenditures”, *The Journal of Political Economy*, 1956, vol. 64/5, pp. 416-424.

[15] Brett Norman, “Lew: ‘Vast majority’ of states will expand Medicaid”, [*Politico*, 1st July 2012](#).

[16] In 2022, 136 billion dollars will finance public health insurance for 17 million poor people (expansion of Medicaid) and 127 billion dollars will go to subsidies for the purchase of private insurance by 18 million people.

[17] In 2022, the 27 million uninsured remaining will consist of illegal immigrants (ineligible for public and private insurance programs) and those eligible for Medicaid who do not want to take out insurance as well as those ineligible for Medicaid who also do not want insurance.

[18] Susan Stamper Brown, “Time To Clean Up The Obamacare Mess”, [*The Western Center for Journalism*, June 26, 2012](#).

Banking union: a solution to the euro crisis?

By Maylis Avaro and [Henri Sterdyniak](#)

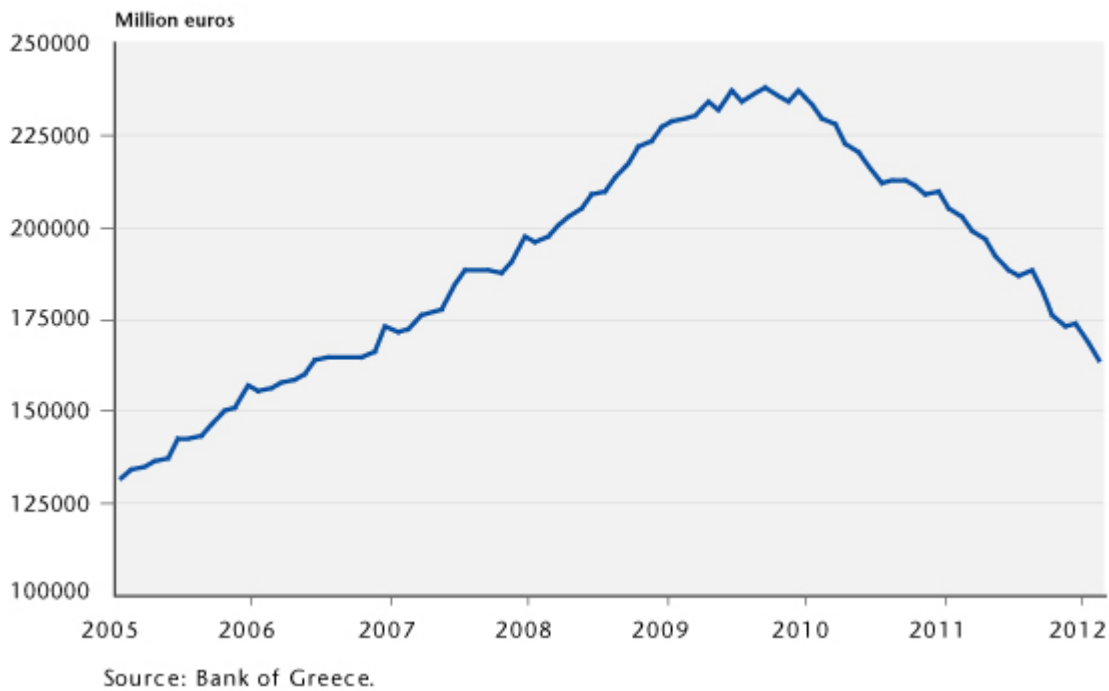
The European summit on 28th and 29th June marked a new attempt by Europe’s institutions and Member states to overcome the crisis in the euro zone. A so-called Growth Pact was adopted, but it consists mainly of commitments by the Member states to undertake structural reform, and the limited funds made available (120 billion over several years) were for the most part already planned. The strategy of imposing restrictive

fiscal policies was not called into question, and France pledged to ratify the Fiscal Compact. The interventions of the European Financial Stability Facility (EFSF) and the European Stability Mechanism (ESM) will now be less rigid, as, without additional conditions, they can help countries that the financial markets refuse to finance so long as they meet their objectives in terms of fiscal policy and structural reform. But euro-bonds and the mutual guarantee of public debt were postponed. The summit also launched a new project: a banking union. Is this an essential supplement to monetary union, or is it a new headlong rush into the unknown?

The current crisis is largely a banking crisis. The European banks had fed financial bubbles and housing bubbles (especially in Spain and Ireland), and they had invested in mutual funds and hedge funds in the United States. After major losses during the crisis of 2007-2010, the Member states came to their rescue, which was particularly costly for Germany, the UK, Spain and above all Ireland. The sovereign debt crisis in the euro zone has compounded their woes: the sovereign debt that they hold has become a risky asset. The problem of regulating the banks has been raised at the international level (new Basel III standards), in the United States (Volcker's rule and Dodd-Frank law) and in Britain (Vickers report).

In June 2012, doubts about the soundness of Europe's banks surfaced yet again. The measures taken since 2008 to stabilize the financial system have proved insufficient. When Bankia, Spain's fourth-largest bank, announced that it was requesting State assistance of 19 billion euros, worries about the balance sheets of Spanish banks rose sharply. The rate of bad loans of the country's banks, whose balance sheets were hit hard by the real estate crash, rose from 3.3% at end 2008 to 8.7% in June 2012 [1]. Furthermore, many Greeks, fearing an exit from the euro zone, began to reduce their deposits in the banks there [2].

Total deposits of business and consumers in Greece's banks



In response to these dangers, the proposal for a European banking union was given a new boost by Mario Monti. Italy's PM suggested developing the proposals in preparation for the European Commission Single Market DG, an idea that currently has the support of the Commission, the European Central Bank, and several Member states (Italy, France, Spain, etc.) On the other hand, Germany believes that a banking union is impossible without a fiscal union. While Angela Merkel acknowledged [3] that it was important to have a European supervisory authority, with a supranational banking authority with a better general overview, she clearly rejected the idea of Germany taking a risk of further transfers and guarantees without greater fiscal and policy integration [4]. The euro zone summit meeting on 29 June asked the Commission to make proposals shortly on a single monitoring mechanism for the euro zone's banks.

This kind of banking union would rest on three cornerstones:

- a European authority in charge of centralized oversight of the banks,

- a European deposit guarantee fund,
- a common mechanism for resolving bank crises.

Each of these cornerstones suffers specific problems: some are related to the complex way the EU functions (Should a banking union be limited to the euro zone, or should it include all EU countries? Would it be a step towards greater federalism? How can it be reconciled with national prerogatives?), while others concern the structural choices that would be required to deal with the operations of the European banking system.

As to the institution that will exercise the new banking supervisory powers, the choice being debated is between the European Banking Authority (EBA) and the ECB. The EBA was established in November 2010 to improve oversight of the EU banking system, and it has already conducted two series of “stress tests” on the banks. As a result of the tests, in October 2011 Bankia reported a 1.3 billion euro shortage of funds. Five months later, the deficit was 23 billion; the EBA’s credibility suffered. In addition, the London-based EBA has authority over the British system, while the United Kingdom does not want to take part in the banking union. The ECB has, for its part, received support from Germany. Article 127.6 of the Treaty on the Functioning of the European Union [5], which was cited at the euro zone summit of June 29th as a basis for the creation of a European Banking Authority, would make it possible to give the ECB supervisory authority. On 12 June, the Vice-President of the ECB, Mr. Constancio, said that, “the ECB and the Eurosystem are prepared” to receive these powers; “there is no need to create a new institution”.

European oversight implies a common vision of banking regulation. There must be agreement on crucial issues, such as: “Does commercial banking need to be separated from investment banking?” “Should banks be prohibited from operating on the financial markets for their own account?” “Should public or mutual or regional banks be encouraged

rather than large internationalized banks?" "Should banks be encouraged to extend credit primarily to businesses and government in their own country, or on the contrary to diversify?" "Should the macro-prudential rules be national or European?" In our opinion, entrusting these matters to the ECB runs the risk of taking a further step in the depoliticization of Europe.

Applying the guidelines of this new authority will be problematic. A banking group in difficulty could be ordered to divest its holdings in large national groups. But would a country's government expose a national champion to foreign control? Governments would lose the ability to influence the distribution of credit by banks, which some people might find desirable (no political interference in lending), but in our opinion is dangerous (governments would lose a tool of industrial policy that could be used to finance Small and Medium Enterprises [SMEs] and Economic and technological intelligence [ETI] projects or to support the ecological transition).

For example, in a case involving Dexia, the opposition between the European Commission on the one hand and France, Belgium and Luxembourg on the other is blocking a restructuring plan. The plan includes the takeover of Dexia Credit Local's financing of local authorities by a banking collectivity that would be created based on cooperation between La Banque postale and the Caisse des depots. In the name of fair competition, Brussels is challenging the financing of local communities by such a bank, as Dexia has received public funding for its restructuring plan. This is threatening the continuity of the financing of the French local authorities, and could put a halt to their plans; in particular, it could prevent France from providing specific secure mechanisms for financing local authorities through local savings.

The purpose of a deposit guarantee fund is to reduce the risk of a massive withdrawal of deposits during a banking panic.

This fund could be financed through contributions by the European banks guaranteed by the fund. According to Schoenmaker and Gros [6], a banking union must be created under a “veil of ignorance”, that is to say, without knowing which country poses the greatest risk: this is not the case in Europe today. The authors propose a guarantee fund that at the outset would accept only the strongest large transnational banks, but this would immediately heighten the risk of the zone breaking apart if depositors rushed to the guaranteed banks. The fund would thus need to guarantee all Europe’s banks. According to Schoenmaker and Gros, assuming a 100,000 euro ceiling on the guarantee, the amount of deposits covered would be 9,700 billion euros. The authors argue that the fund should have a permanent reserve representing 1.5% of the deposits covered (*i.e.* about 140 billion euros). But this would make it possible to rescue only one or two major European banks. During a banking crisis, amidst the risk of contagion, such a fund would have little credibility. The guarantee of deposits would continue to depend on the States and on the European Stability Mechanism (ESM), which would have to provide support funds, ultimately by requiring additional contributions from the banks.

The authority in charge of this fund has not yet been designated. While the ECB appears well positioned to undertake supervision of the banking system, entrusting it with management of the deposit guarantee fund is much more problematic. According to Repullo [7], deposit insurance should be separated from the function of lender of last resort. Indeed, otherwise the ECB could use its ability to create money to recapitalize the banks, which would increase the money supply. The objectives of monetary policy and of support for the banks would thus come into conflict. What is needed is a body that handles deposit insurance and crisis resolution and is separate from the ECB, and which must have a say on the behavior of the banks, and which would be additional to the EBA, the ECB, and the national regulators.

The ECB on the other hand would continue to play its role as lender of last resort. But it is difficult to see how such a complicated system would be viable.

As the risk of a country leaving the euro zone cannot yet be dismissed, the question arises as to what guarantee would be offered by a banking union in the case of a conversion into national currency of euro-denominated deposits. A guarantee of deposits in the national currency would, in the case of an exit from the euro, heavily penalize customers of banks that suffer a devaluation of the national currency against the euro, whose purchasing power would decline sharply. This kind of guarantee does not solve the problem of capital flight being experienced today by countries threatened by a risk of default. What is needed is a guarantee of deposits in euros, but in today's situation, given the level of risk facing some countries, this is difficult to set up.

German and Finnish politicians and economists such as H. W. Sinn are, for instance, denouncing an excessive level of risk for Germany and the Nordic countries. According to several German economists, no supranational authority has the right to impose new burdens (or risk levels) on the German banks without the consent of Parliament, and the risk levels need to be explicitly limited. The German Constitutional Court might oppose the deposit guarantee fund as exposing Germany to an unlimited level of risk. Moreover, according to George Osborne, the Chancellor of the British Exchequer, a bank deposit guarantee at the European level would require an amendment to existing treaties and the consent of Great Britain.

On 6 June, the European Commission began to develop a common framework for resolving banking crises by adopting the proposal of Michel Barnier, which has three components. The first is to improve prevention by requiring banks to set up *testaments*, that is, to provide for recovery strategies and even disposal plans in case of a serious crisis. The second

gives the European banking authorities the power to intervene to implement the recovery plans and to change the leadership of a bank if it fails to meet capital requirements. The third provides that, if a bank fails, the national governments must take control of the establishment and use resolution tools such as divestiture, the creation of a defeasance bank, or "bad" bank, or an internal bailout (by forcing shareholders and creditors to provide new money). If necessary, the banks could receive funds from the ESM. Bank-related risks would therefore be better distributed: the shareholders and creditors not covered by the guarantee would be first to be called upon, so that the taxpayers would not pay to reimburse the creditors of insolvent banks. In return, bank loans and shares would become much riskier; bank reluctance about inter-bank credit and the drying up of the interbank market due to the crisis would persist; and the banks would find it difficult to issue securities and would have to raise the level of compensation. However, Basel III standards require banks to link their lending to the level of their capital. This would pose a risk of constraining the distribution of credit, thereby helping to keep the zone in recession. Based on the decisions of the summit on 29 June, Spain could be the first country whose banks would be recapitalized directly by the ESM. However, this would not take place until early 2013; the terms of the procedure and the impact of ESM aid on the governance of the recapitalized banks still need to be determined. As can be seen in the Dexia example, what terms are set for the reorganization of a bank can have serious consequences for the country concerned: are governments (and citizens) willing to lose all power in this domain?

A banking union can help break the correlation between a sovereign debt crisis and a banking crisis. When the rating agencies downgrade a country's debt, the securities suffer a loss in value and move into the category of "risky assets", becoming less liquid. This increases the overall risk faced by the banks in the country concerned. If a bank is facing too

much overall risk and it is no longer able to meet the capital requirements of Basel III, the State must recapitalize it, but to do this it must take on debt, thereby increasing the risk of a default. This link between the banks' fragile balance sheets and public debt generates a dangerous spiral. For instance, since the announcement of the bankruptcy of Bankia, Spain's 10-year refinancing rates reached the critical threshold of 7%, whereas last year the rates were about 5.5%. In a banking union, the banks would be encouraged to diversify on a European scale. However, the crisis of 2007-09 demonstrated the risks of international diversification: many European banks lost a great deal of money in the US; foreign banks are unfamiliar with the local business scene, including SMEs, ETIs and local government. Diversification based on financial criteria does not fit well with a wise distribution of credit. Moreover, since the crisis, European banks are tending to retreat to their home countries.

The proposal for a banking union assumes that the solvency of the banks depends primarily on their own capital, and thus on the market's evaluation, and that the links between a country's needs for financing (government, business and consumers) and the national banks are severed. There is an argument for the opposite strategy: a restructuring of the banking sector, where the commercial banks focus on their core business (local lending, based on detailed expertise, to businesses, consumers and national government), where their solvency would be guaranteed by a prohibition against certain risky or speculative transactions.

Would banking union promote further financialization, or would it mark a healthy return to the Rhineland model? Would it require the separation of commercial banks and investment banks? Would it mean prohibiting banks whose deposits are guaranteed to do business on the financial markets for their own account?

[1] According to the Bank of Spain.

[2] The total bank accounts of consumers and business fell by 65 billion in Greece since 2010. Source: Greek Central Bank.

[3] “La supervision bancaire européenne s’annonce politiquement sensible”, *Les Echos Finance*, Thursday 14 June 2012, p. 28.

[4] “Les lignes de fracture entre Européens avant le sommet de Bruxelles”, *AFP Infos Economiques* 27 June 2012.

[5] Art 127.6: “The Council, acting by means of regulations in accordance with a special legislative procedure, may unanimously, and after consulting the European Parliament and the European Central Bank, confer specific tasks upon the European Central Bank concerning policies relating to the prudential supervision of credit institutions and other financial institutions with the exception of insurance undertakings.”

[6] D. Schoenmaker and Daniel Gros (2012), “A European Deposit Insurance and Resolution Fund”, *CEPS working document*, No. 364, May.

[7] Repullo, R. (2000), “Who Should Act as Lender of Last Resort? An Incomplete Contracts Model”, *Journal of Money, Credit, and Banking* 32, 580-605.