

# How to reform the reduction on payroll taxes?

By Mathieu Bunel, Céline Emond, Yannick L'Horty

More than 20 billion euros are spent every year by the State to compensate the general exemptions from social security contributions, making this the leading employment policy plank in France, both in terms of the total budget and the numbers concerned – more than one employee out of two benefits from the reduction in contributions. In these times of fiscal pressure and the inexorable upward trend in unemployment, questions are being raised about the sustainability of such a scheme, whose scale, which was unified by the 2003 Fillon reform, consists of a reduction that shrinks as the wage rises, up to the level of 1.6 times the minimum wage (SMIC). At the level of the SMIC, the reduction comes to 26 points (28 points for firms with fewer than 20 employees).

In an article published in the [\*Revue de l'OFCE \(Varia, no. 126, 2012\)\*](#), we evaluate the impact of a complete removal of the general exemptions as well as of a number of partial reforms of the thresholds for exemption from social security contributions, using the latest data suited to the analysis. In our estimate, the simple elimination of all general exemptions would lead to the destruction of about 500,000 jobs. We also explore the effects of reorganising the exemption thresholds, by screening a number of possibilities that would affect the various parameters that define the exemption arrangements. In every case, a reduction in the amount of exemptions would have a negative impact on employment, but the extent of the job losses would vary from simple to double depending on the terms of the reform. To ensure the least negative effect would require that the reductions in the exemptions spare the sectors that are most labour-intensive, which means better treatment for the

exemption schedules that are most targeted at low wages. Since the goal is to improve the unemployment figures, it is important to concentrate the exemptions on lower wages, and thus to give a boost to the sectors that are richest in terms of labour.

However, concentrating exemptions too much in the vicinity of the minimum wage would increase the cost to employers of granting wage rises, which would be favourable neither to purchasing power nor to the quality of the jobs that condition future employment. While a new balance can always be sought in order to meet the urgent budget situation, to be sustainable it must be good for today's jobs without neglecting those of the future.

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## **20 billion euros in reductions on employer payroll taxes on low-wages. But will it create jobs?**

By [Eric Heyer](#) and [Mathieu Plane](#)

Every year the State spends nearly 1 percentage point of GDP, *i.e.* 20 billion euros, on general reductions in employer payroll taxes on low wages. It is thus legitimate to ask whether a programme like this is effective. A large number of empirical studies have been conducted to try to assess the impact of this measure on employment, and have concluded that it creates between 400,000 and 800,000 jobs.

As these estimates are performed using sector models, they do

not take into account all the effects resulting from a policy of reduced social contributions on low wages, and in particular the impact of macroeconomic feedback, *i.e.* the effect of income gains, competitiveness gains and the financing of the measure.

In a recent study published in the [Revue de l'OFCE \(Varia, no. 126, 2012\)](#), we have attempted to supplement these evaluations by taking into account all the impacts resulting from a policy of reducing contributions on low wages. To do this, we performed a simulation of this measure using the OFCE's macro-econometric model, *emod.fr*.

We were able to break down the various impacts expected from these reductions on employment costs into two basic categories:

1. An overall "substitution effect", which breaks down into a macroeconomic capital-labour substitution, to which is added what can be called an "assessment effect" linked to the targeting of the measure at low wages;
2. A "volume effect", which can be broken down between rising domestic demand due to lower prices and higher payroll, competitiveness gains due to improved market share internally and externally, and the negative effect of the measure's financing, whether that involves raising the tax burden (*prélèvements obligatoires*) or cutting public spending.

Based on our assessment, summarized in Table 1, the exemptions from employer social contributions on low wages lead to creating 50,000 jobs in the first year and about 500,000 at the end of five years. Of the 503,000 jobs expected within five years, 337,000 would be due to the overall substitution effect, with 107,000 linked to the macroeconomic capital-labour substitution and 230,000 to the "assessment effect" linked to the sharp reduction in labour costs on low wages. In addition, 82,000 jobs are generated by the addition to

household income and 84,000 by competitiveness gains and the positive contribution of foreign trade to the change in GDP. On the other hand, the “volume effect” on employment becomes negative if the measure is financed *ex post*: increasing a representative mix of the fiscal structure reduces the overall impact of the measure by 176,000 jobs at 5 years; reducing a representative mix of the structure of public spending reduces employment by 250,000 at 5 years.

**Table 1. Impact on employment of the exemptions on employer social security contributions on low wages without taking into account the reaction of our trade partners**

1000s

| Effect at... | Substitution effect |                   | Volume effect   |                 | Total w/o financing | Ex post financing |                     | Total w/ financing |
|--------------|---------------------|-------------------|-----------------|-----------------|---------------------|-------------------|---------------------|--------------------|
|              | Capital/Labour      | Assessment effect | Domestic demand | Competitiveness |                     | Tax mix           | Public spending mix |                    |
| ...1 year    | 4                   | 24                | 13              | 9               | 50                  | -26               | -71                 | 24<br>-21          |
| ...5 years   | 107                 | 230               | 82              | 84              | 503                 | -176              | -250                | 327<br>253         |

Source: OFCE calculations, *e-mod.fr*.

Some of the jobs created come from competitiveness gains related to taking market share from our trading partners due to lower prices of production following the reduction in labour costs. This price-competitiveness mechanism works only if, first, firms pass on the reductions in social contributions in their prices of production, and second, our trading partners are willing to lose market share without a fight. We therefore simulated a polar opposite case in which it is assumed that our trading partners respond to this type of policy by enacting similar measures, which would negate our external gains.

While this does not modify the impact on employment related to the “substitution effect”, this assumption does change the “volume effect” of the measure, eliminating 84,000 jobs from gains in market share and increasing the negative effect of *ex post* financing due to the measure’s multiplier effect on

weaker activities. In total, in the scenario in which the measure is funded *ex post* and does not allow gains in competitiveness, the exemptions on employer social security contributions on low wages would create between 69,000 and 176,000 jobs within five years, depending on how it is financed (Table 2). This result puts the initial figure of 500,000 jobs into perspective.

**Table 2. Impact on employment of exemptions on employer social security contributions on low wages if our trade partners do adopt a similar policy**

1000s

| Effect at... | Substitution effect |                   | Volume effect   |                 | Total w/o financing | Ex post financing |                     | Total w/ financing |
|--------------|---------------------|-------------------|-----------------|-----------------|---------------------|-------------------|---------------------|--------------------|
|              | Capital/Labour      | Assessment effect | Domestic demand | Competitiveness |                     | Tax mix           | Public spending mix |                    |
| ...1 year    | 4                   | 24                | 13              | 0               | 41                  | -35               | -79                 | 6<br>-38           |
| ...5 years   | 107                 | 230               | 82              | 0               | 419                 | -244              | -350                | 175<br>69          |

Source: OFCE calculations, *e-mod.fr*.

## The tax credit to encourage competitiveness and jobs – what impact?

By [Mathieu Plane](#)

Following the submission to the Prime Minister of the [Gallois Report on the pact for encouraging the competitiveness of French industry](#), the government decided to establish the tax credit to encourage competitiveness and jobs (“the CICE”). Based on the rising trade deficit observed over the course of

the last decade, the sharp deterioration in business margins since the onset of the crisis and growing unemployment, the government intends to use the CICE to restore the competitiveness of French business and to boost employment. According to our assessment, which was drawn up using the e-mod.fr model as described in an article in the [Revue de l'OFCE \(issue 126-2012\)](#), within five years the CICE should help to create about 150,000 jobs, bringing the unemployment rate down by 0.6 point and generating additional growth of 0.1 GDP point by 2018.

The CICE, which is open to all companies that are assessed on their actual earnings and are subject to corporation tax or income tax, will amount to 6% of the total wage bill for wages below 2.5 times the minimum wage (SMIC), excluding employer contributions. It will come into force gradually, with a rate of 4% in 2013. The CICE's impact on corporate cash flow will be felt with a lag of one year from the base year, meaning that the CICE will give rise to a tax credit on corporate profits from 2014. On the other hand, some companies could benefit in 2013 from an advance on the CICE expected for 2014. The CICE should represent about 10 billion euros for the 2013 fiscal year, 15 billion in 2014 and 20 billion from 2015. As for the financing of the CICE, half will come from additional savings on public spending (10 billion), the details of which have not been spelled out, and half from tax revenue, *i.e.* an increase in the standard and intermediate VAT rate from 1 January 2014 (6.4 billion) and stronger environmental taxation.

This reform is similar in part to a fiscal devaluation and in some respects bears similarities to the mechanisms of the "quasi-social VAT" ([see Heyer, Plane, Timbeau \[2012\], "Economic impact of the quasi-social VAT" \[in French\]](#)) that was set up by the Fillon government but eliminated with the change of the parliamentary majority as part of the second supplementary budget bill in July 2012.

According to our calculations using 2010 DADS data, the CICE would lower average labour costs by 2.6% in the market sector. The sectors where labour costs would be most affected by the measure are construction (-3.0%), industry (-2.8%) and market services (-2.4%). The ultimate sectoral impact of the measure depends both on the reduction in labour costs and on the weight of wages in value added in a given sector. Overall, the CICE would represent 1.8% of the value added of industrial enterprises, 1.9% of the value added in construction and 1.3% in market services. In total, the CICE would represent 1.4% of the value added in market sector companies. According to our calculations, the total value of the CICE would be 20 billion euros: 4.4 billion in industry, 2.2 billion in construction and 13.4 billion for market services. Industry would therefore recover 22% of the total spending, *i.e.* more than its share of value added, which is only 17%. While this measure is intended to revive French industry, this sector would nevertheless not be the primary beneficiary of the measure in absolute value, but, along with the construction sector, has the best exposure relatively speaking due to its wage structure. Furthermore, industry can benefit from knock-on effects related to reductions in the prices of inputs generated by the lowering of production costs in other sectors.

The expected effects of the CICE on growth and employment differ in the short and long term (see graphic). By giving rights in 2014 based on the 2013 fiscal year, the CICE will have positive effects in 2013, especially as the tax hikes and public spending cuts will not take effect until 2014. The result will be a positive impact on growth in 2013 (0.2%), although it will take longer to affect employment (+23,000 in 2013) due to the time it takes employment to adjust to activity and the gradual ramping-up of the measure.

On the other hand, the impact of the CICE will be slightly recessive from 2014 to 2016, as the loss in household purchasing power linked to higher taxes and the cuts in public

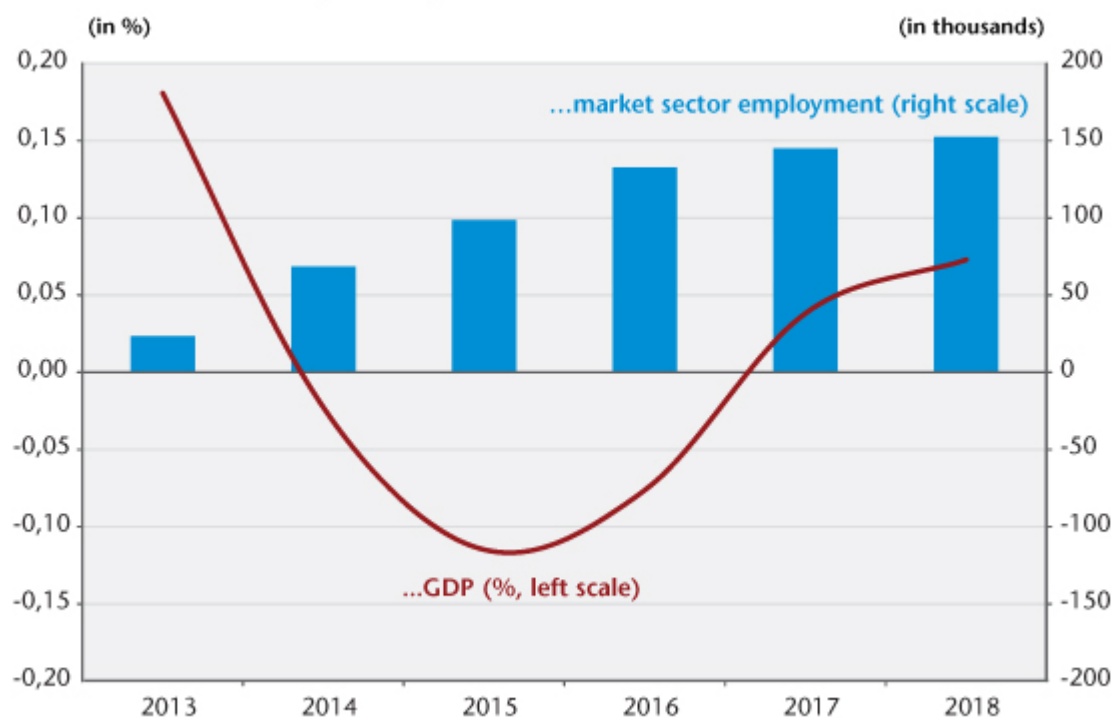
spending (household consumption and public demand will contribute -0.2 GDP point in 2014 and then -0.4 point in 2015 and 2016) will prevail over lower prices and the recovery of business margins. Apart from the first year, the CICE's positive impact on growth related to income transfers will be slow to be seen, as gains in market share related to lower prices and to higher business margins are dependent on a medium / long-term supply-side mechanism, with demand-side impacts being felt more rapidly.

The implementation of the CICE will gradually generate gains in market share that will make a positive contribution to activity by improving the foreign trade balance (0.4 GDP point in 2015 and 2016), whether through increased exports or reduced imports. From 2017, the external balance will not contribute as much to the economy (0.3 GDP point) due to the improved purchasing power of households, resulting in slowing the reduction in imports. Despite the higher margins and the improved profitability of capital, productive investment will fall off slightly due to the substitution effect between labour and capital and the negative accelerator effect related to the fall in demand.

With the decline in the cost of labour relative to the cost of capital, the substitution of labour for capital will gradually boost employment to the detriment of investment, which will lead to job-rich GDP improvements and to lower gains in productivity. This dynamic will result in steady gains in employment despite the slight fall-off in activity between 2014 and 2016. Due to the rise in employment and the fall in unemployment, but also to possible wage compensation measures in companies arising from the greater fiscal pressure on households, wages will regain part of their lost purchasing power based on an increase in real pay. This catch-up in purchasing power will help to generate growth, but will limit the impact on employment and productivity gains.



Graphic. Impact of the CICE tax credit on...



Source : e-mod.fr, OFCE calculations.

# France: will the war of the 3% take place?

By [Eric Heyer](#)

*This text summarizes the [OFCE's October 2012 forecasts for the French economy](#).*

The French economy is expected to see average annual growth of 0.1% in 2012 and 0.0% in 2013. This performance is particularly poor and far from the path that an economy recovering from a crisis would normally experience.

Four years after the onset of the crisis, the French economy has real potential for a rebound: this should lead to spontaneous average growth of about 3.0% per year in 2012 and

2013, making up some of the output gap built up since the start of the crisis. But this spontaneous recovery is being hampered, mainly by the establishment of budgetary savings plans in France and throughout Europe. The fiscal consolidation strategy imposed by the European Commission is likely to slice nearly 6 percentage points off GDP in France during 2012 and 2013.

**Table 1. The brakes on growth in France**

En points of GDP

| Rythm                       | ... quaterly |      | ... annually |      |
|-----------------------------|--------------|------|--------------|------|
|                             | 2012         | 2013 | 2012         | 2013 |
| <i>Spontaneous recovery</i> | 0,8          | 0,8  | 2,1          | 3,1  |
| <i>Budget impact</i>        | -0,4         | -0,4 | -1,6         | -1,7 |
| <i>Oil shock</i>            | -0,05        | 0,0  | -0,2         | 0,0  |
| <i>External environment</i> | -0,4         | -0,3 | -1,4         | -1,2 |
| <i>Achievement</i>          |              |      | -1,0         | -0,2 |
| <i>Growth forecasts</i>     | -0,04        | 0,04 | 0,1          | 0,0  |

Sources : INSEE, OFCE calculations.

By setting a pace that is far from its potential, the expected growth will increase the output gap accumulated since 2008 and will lead to a further deterioration on the labour market. The unemployment rate will rise steadily and hit 11% by late 2013.

Moreover, the reduction of the budget deficit expected by the Government due to the implementation of its consolidation strategy – the target for the general government deficit is 3% of GDP in 2013 – will be partially undermined by the shortfall in tax revenue due to weak growth. The general government deficit will come to 3.5% in 2013.

Under these conditions, should the government do whatever it can to fulfil its commitment to a 3% deficit in 2013?

In a context of financial uncertainty, being the only State not to keep its promise of fiscal consolidation is a risk, *i.e.* of being punished immediately by an increase in the financial terms on the repayment of its debt. This risk is real, but limited. The current situation is that of a

“liquidity trap” and abundant savings. The result is a “flight to quality” phenomenon on the part of investors seeking safe investments. But among these are both German and French government bonds. Under these conditions, reducing the government deficit by 1 GDP point instead of 1.5 point would have very little impact on French bond rates.

However, maintaining a target of a 3% deficit in 2013 could have a dramatic impact on economic activity and employment in France. We simulated a scenario in which the French government maintains its budgetary commitment regardless of the costs and the economic situation. If this were to occur, it would require the adoption of a new programme of budget cuts in the coming months in the amount of 22 billion euros.

This strategy would cut economic activity in the country by 1.2% in 2013. It would lead to a further increase in the unemployment rate, which would reach 11.7% at year end, nearly 12%. As for employment, this obstinacy would intensify job losses, costing nearly 200,000 jobs in total.

A darker scenario is also possible: according to our forecasts, and taking into account the draft budget bills known and approved, no major European country would meet its deficit reduction commitments in 2013. By underestimating the difficulty of reaching inaccessible targets, there is a high risk of seeing the euro zone countries locked into a spiral where the nervousness of the financial markets would become the engine driving ever greater austerity. To illustrate this risk, we simulated a scenario in which the major euro zone countries (Germany, France, Italy and Spain) implement new austerity measures to meet their deficit targets in 2013. Adopting such a strategy would result in a strong negative shock to economic activity in these countries. For the French economy, it would lead to additional austerity that either at the national level or coming from its euro zone partner countries would cause a severe recession in 2013. French GDP would fall by more than 4.0%, resulting in a further increase

in the unemployment rate, which would approach 14%.

**Table 2. Illustrative scenarios of risks to French growth**

| In %  | 2011 | 2012* | 2013* |
|---|------|-------|-------|
| <b>Central scenario</b>   |      |       |       |
| GDP   | 1,4  | 0,1   | 0,0   |
| Gov't deficit (in GDP points)   | -7,1 | -4,4  | -3,5  |
| Unemployment rate   | 9,4  | 10,2  | 11,0  |
| Market employment   | 104  | -95   | -166  |
| <b>Scenario where France alone meets its budget commitments</b>         |      |       |       |
| GDP   |      |       | -1,2  |
| Gov't deficit (in GDP points)   |      |       | -3,0  |
| Unemployment rate   |      |       | 11,7  |
| Market employment (in 1000s)  |      |       |       |
| Change  |      |       | -361  |
| Deviation from central scenario   |      |       | -195  |
| <b>Scénario where euro zone countries meet their budget commitments</b> |      |       |       |
| GDP   |      |       | -4,6  |
| Gov't deficit (in GDP points)   |      |       | -3,0  |
| Unemployment rate   |      |       | 18,8  |
| Market employment (in 1000s)  |      |       |       |
| Change  |      |       | -910  |
| Déviation from central scenario   |      |       | -744  |

\* OFCE forecast October 2012

Sources : INSEE ; OFCE calculations e-mod.fr.

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

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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# 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.