

# And what if the austerity budget has succeeded better in France than elsewhere? [1]

By [Mathieu Plane](#)

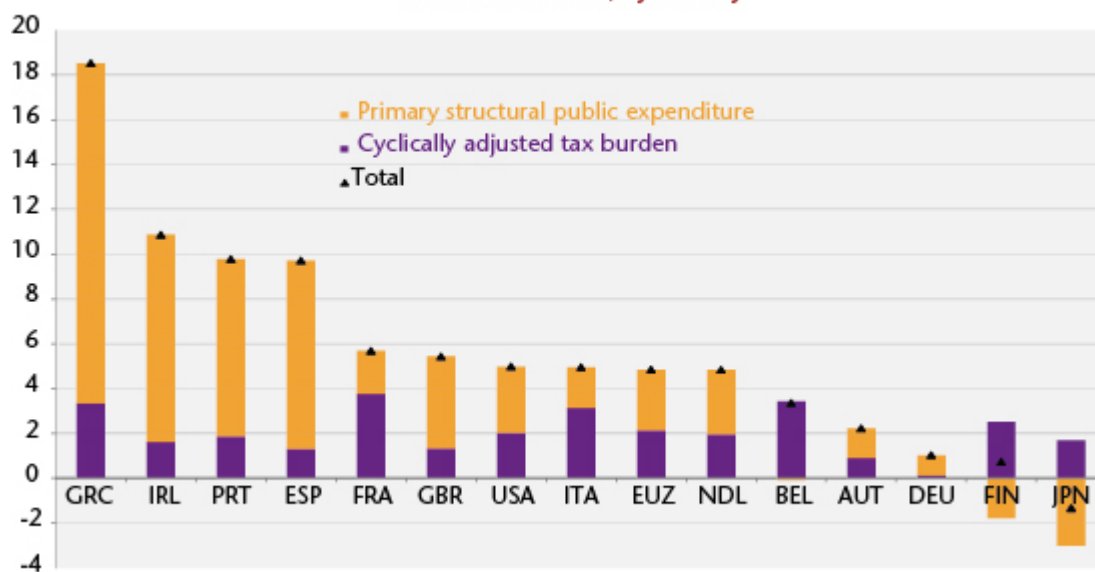
Faced with a rapid and explosive deterioration in their public accounts, the industrialized countries, particularly in Europe, have implemented large-scale austerity policies, some as early as 2010, in order to quickly reduce their deficits. In a situation like this, several questions about France's fiscal policy need to be examined:

- First, has France made a greater or lesser fiscal effort than other OECD countries to deal with its public accounts?
- Second, is there a singularity in the fiscal austerity policy implemented by France and has it had more or less effect on growth and the level of unemployment?

With the notable exception of Japan, between 2010 and 2013 all the major OECD countries implemented policies to reduce their primary structural deficits [2]. According to the [latest OECD figures](#), these policies represented a fiscal effort of about 5 percentage points of GDP over three years on average in the euro zone, the United States and the United Kingdom. In contrast, the differences within the euro zone itself were very large: they range from only 0.7 percentage points in Finland to more than 18 points in Greece. Among the major industrialized countries of the OECD, France is, after Spain, the country that has made the greatest fiscal effort since 2010 from a structural viewpoint (5.7 percentage points of GDP over three years). In the post-World War 2 era, France has never experienced such a brutal and sustained adjustment in its public accounts. For the record, the budget effort that took place in the previous period of sharp fiscal

consolidation from 1994 to 1997 was twice as small (a cumulative negative fiscal impulse of 3.3 GDP points). Between 2010 and 2013, the cyclically adjusted tax burden increased in France by 3.8 GDP points, and the structural effort on public spending represented a gain of 1.9 GDP points over four years (Figure 1). Among the OECD countries, it was France that made the greatest cyclically adjusted increase in the tax burden in the period 2010-2013. Finally, from 2010 to 2013, the structural effort to reduce the public deficit broke down as follows: two-thirds involved an increase in the tax burden and one-third came from public spending. This breakdown is different from that observed on average in the euro zone, where the fiscal effort over the period 2010-13 involved a nearly 60% reduction in public expenditure, rising to over 80% in Spain, Portugal, Greece and Ireland. In contrast, in Belgium, the entirety of the fiscal effort came from a higher tax burden. And in the case of Finland, primary structural public spending in points of potential GDP rose over the period 2010-2013, which was more than offset by the increase in the tax burden.

**Figure 1. Contribution of each component to the change in the primary structural balance from 2010 to 2013, by country**

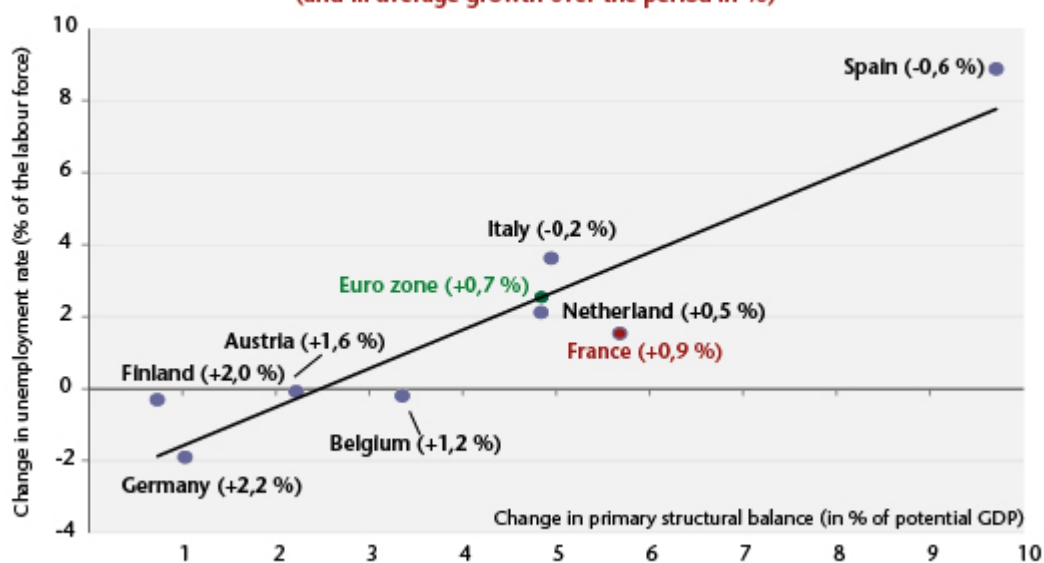


Sources: OECD, OFCE calculations.

While France's substantial budgetary efforts have undeniably had a negative impact on economic activity and employment, it

is nevertheless true that the budget decisions of the various governments since 2010 appear to have affected growth and the labour market relatively less than in most other countries in the euro zone. Within the euro zone-11, from 2010 to 2013 only four countries – Germany, Finland, Austria and Belgium – experienced average growth of over 1% per year, with unemployment rates that not only did not increase, but occasionally even fell. However, these are also the four countries that made the smallest reductions in their structural deficits over this period. France, on the other hand, is among the countries that made the greatest structural effort since 2010, and it has simultaneously managed to contain the rise in unemployment to some extent. Indeed, compared with the Netherlands, Italy and the euro zone average, France's fiscal policy was more restrictive by about 1 GDP point from 2010 to 2013, yet the unemployment rate increased by 40% less than in the Netherlands, 60% less than the euro zone average and more than two times less than in Italy. Likewise, growth in France was higher on average over this period: 0.9% per year, against 0.5% in the Netherlands, 0.7% in the euro zone and -0.2% in Italy.

**Figure 2. Change between 2010 and 2013 in the primary structural balance and the unemployment rate (and in average growth over the period in %)**



Sources: OECD Economic Outlook, November 2012; OFCE calculations.

Why has the French fiscal contraction had less impact on growth and employment than in most other countries? Beyond the

economic fundamentals, some evidence suggests that the budget decisions of the successive governments since 2010 may have led to fiscal multipliers that are lower than in the other countries. After Finland and Belgium, France is the country where public spending played the smallest role in reducing the structural deficit. As illustrated by recent studies, in particular the IMF study and the article signed by economists from the central banks in Europe and the U.S., the European Commission, the OECD and the IMF, targeting fiscal adjustment through raising the tax burden rather than cutting public spending has given France smaller short-term fiscal multipliers than those observed in countries that have made the opposite choice (Greece, Portugal, Ireland and Spain). In the case of France, nearly 50% of the fiscal adjustment was achieved by an increase in the direct taxation of household and business income (Table 1). And as has also been the case for the United States, Belgium and Austria, which achieved between 50% and 75% of their fiscal adjustment by increasing direct taxation, it seems that these countries have also done best at maintaining their growth in the face of the budget cuts. Conversely, the ones that have used this lever the least in their fiscal adjustments are the southern European countries and the Netherlands.

**Table. Contribution of each component to the change in the primary structural balance between 2010 and 2013, by country**

In % of potential GDP	GRC	IRL	PRT	ESP	FRA	GBR	USA	ITA	EUZ	NLD	BEL	AUT	DEU	FIN	JPN
Primary structural balance (PSB) (= a + b)	18,5	10,9	9,8	9,7	5,7	5,4	5,0	4,9	4,8	4,8	3,4	2,2	1,0	0,7	-1,3
Cyclically adjusted tax burden (a) o/w increase in direct taxes on household and business income	3,3	1,6	1,9	1,3	3,8	1,3	2,0	3,1	2,1	2,0	3,4	0,9	0,1	2,5	1,7
Primary public spending (b)	15,2	9,2	7,9	8,4	1,9	4,1	3,0	1,8	2,7	2,9	-0,1	1,3	0,9	-1,8	-3,0
Contribution of primary public spending to the change in the PSB	82	85	81	87	34	76	59	36	56	60	-2	59	89	-242	225

Sources: OECD Economic Outlook, November 2012; OFCE calculations.

[\[1\]](#) This post makes use of certain parts of the article

published in [\*Alternatives Economiques\*, M. Plane, "L'austérité peut-elle réussir en France ?", Special issue no. 96, 2nd quarter 2013.](#)

[2] The primary structural deficit measures the structural fiscal effort made by general government (*les administrations publiques*). It corresponds to the public balance, excluding interest charges, that would be generated by the government if the GDP of the economy were at its potential level. This measure is used to adjust the public balance for cyclical effects.

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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 -21
...5 years	107	230	82	84	503	-176	-250	327 253

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 -38
...5 years	107	230	82	0	419	-244	-350	175 69

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

## Why France is right to abandon the 3% public déficit target by 2013

By [Mathieu Plane](#)

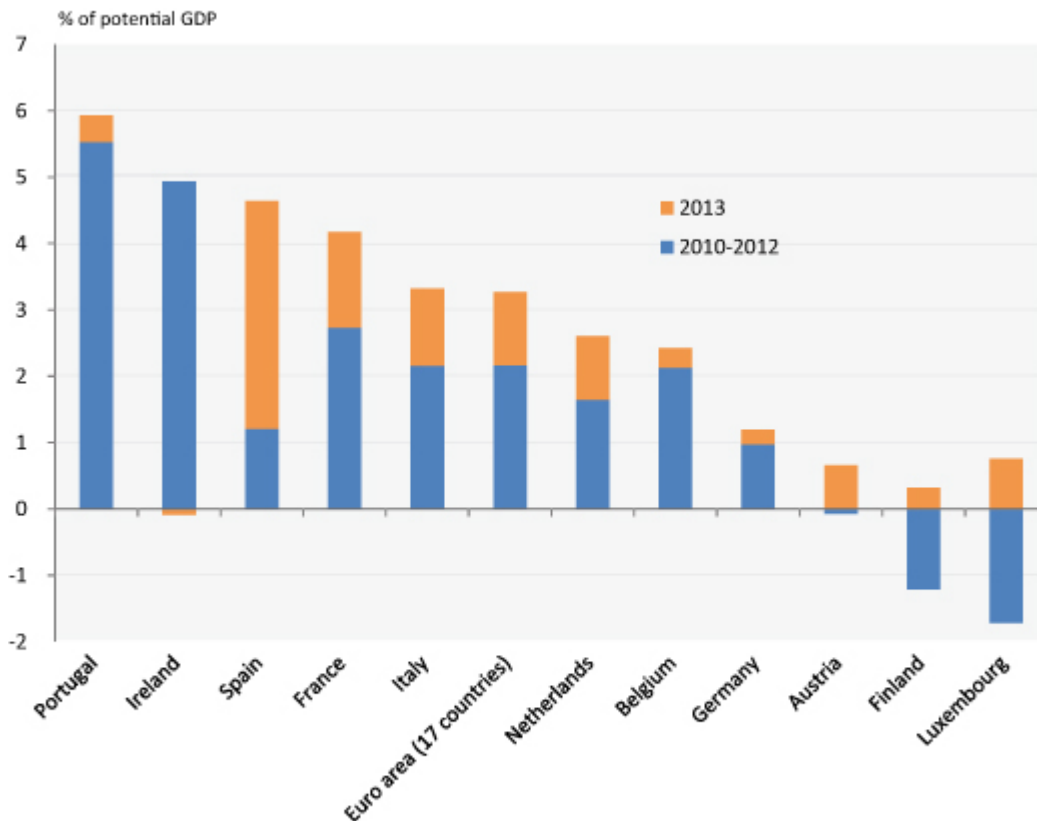
Given the statements by the Minister of Economy and Finance, the government seems to have reached a decision to abandon the goal of a deficit of 3% of GDP by 2013. In addition to the change of tack in the policy announced up to now, which was to bring the deficit down to 3% by 2013 “whatever the cost”, we



can legitimately conclude that France is right to abandon this goal, and we offer several arguments for this. While in this post we do not review [the economic consequences of the fiscal policy being undertaken in France and the euro zone](#), which has been dictated by nominal targets for the deficit that do not take into account the way it breaks down structurally / cyclically and that have a dangerously pro-cyclical character, we nevertheless present several arguments that the European Commission may find of value:

1 – According to the latest figures from the European Commission on 22 February 2013<sup>[1]</sup>, of the euro zone countries making the greatest fiscal adjustment in 2013 from a structural viewpoint, France, with 1.4 GDP points, comes behind only Spain (3.4) and Greece (2.6). For the 2010-2013 period, the reduction in France's structural deficit represents 4.2 GDP points, which makes France the euro zone country which, alongside Spain (4.6 GDP points), has carried out the largest budget cutbacks of the major countries in the zone, ahead of Italy (3.3 GDP points), the Netherlands (2.6) and of course Germany (1.2) (Figure 1).

Figure 1. Change in the structural deficit of the euro zone countries\*



\* For reasons of scale, we have not put Greece in the figure. Over the 2010-2013 period, Greece's structural fiscal adjustment came to 16.9 GDP points, including 2.6 in 2013.

Sources: European Commission, OFCE calculations.

2 – In 2007, before the crisis, according to the European Commission France had a structural public deficit of -4.4 GDP points, compared with an average of -2.1 for the euro zone and -0.9 for Germany. In 2013, this came to -1.9 GDP points in France, -1.3 for the euro zone, and +0.4 for Germany, which represents an improvement of the structural deficit of 2.5 GDP points for France since the start of the crisis, *i.e.* three times the average for the euro zone and twice that for Germany (Table 1). Leaving aside public investment, France's structural public deficit in 2013 was positive and higher than the euro zone average (1.2 GDP point in France, versus 0.8 for the euro zone average and 1.9 for Germany). Note that France is spending 3.1 GDP points on public investment in 2013 (0.2 GDP point less than in 2007), against a euro zone average of only 2 points (0.6 point less than in 2007) and 1.5 in Germany (equivalent to 2007). However, public investment, which has a positive impact on potential growth, and which also increases

public assets, while not changing the public administration's financial situation, can reasonably be excluded from the calculation of the structural public deficit.

**Table. Public deficit and structural deficit with and without public investment**

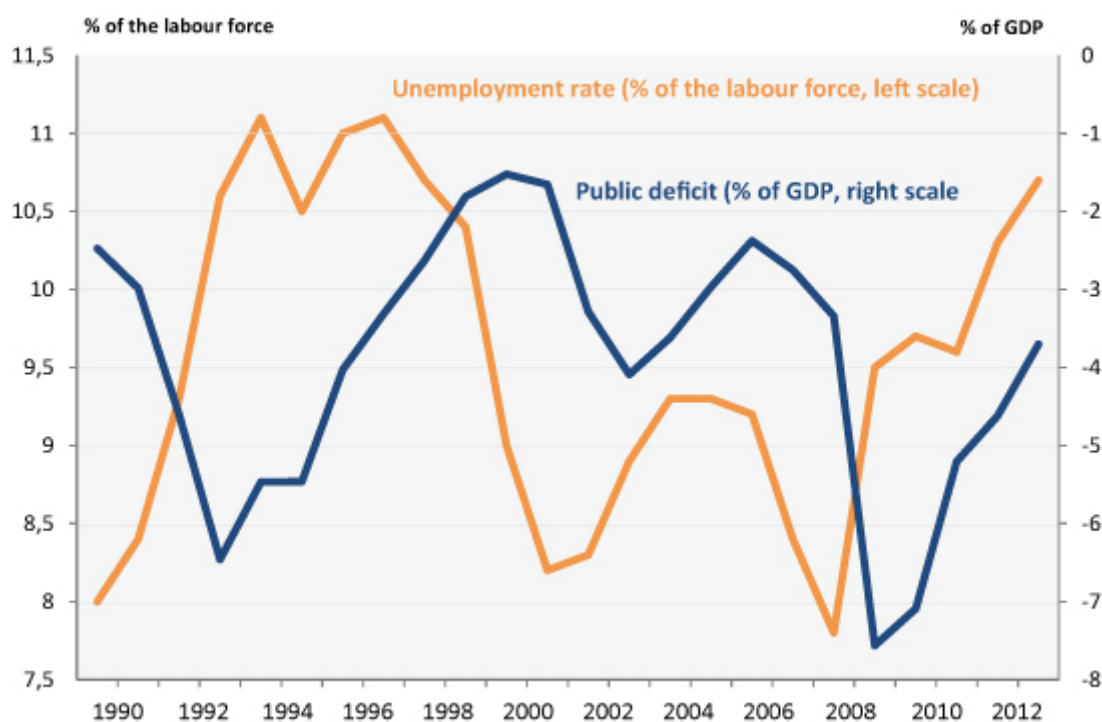
In GDP points	Public balance				Structural public balance				SPB w/o public investment			
	FRA	DEU	EZ	FRA-EZ diff.	FRA	DEU	ZE	FRA-EZ diff.	FRA	DEU	EZ	FRA-EZ diff.
<b>2007</b>	-2.8	0.2	-0.7	<b>-2.1</b>	-4.4	-0.9	-2.1	<b>-2.3</b>	-1.1	0.6	0.5	<b>-1.6</b>
<b>2013</b>	-3.7	-0.2	-2.8	<b>-0.9</b>	-1.9	0.4	-1.3	<b>-0.6</b>	1.2	1.9	0.8	<b>0.4</b>
<b>Change 2007-2013</b>	-0.9	-0.4	-2.1	<b>1.2</b>	2.5	1.3	0.8	<b>1.6</b>	2.3	1.3	0.3	<b>2.1</b>

Sources : European Commission, OFCE calculations.

3 – In 2013, the public deficit, even at 3.7% of GDP according to the European Commission, is once again at a level close to that of 2008, similar to that of 2005, and below that of 2004 and of the entire 1992-1996 period. The public deficit figure expected for 2013 corresponds to the average over the past thirty years, and thus no longer seems so exceptional, which is easing the pressure that France could experience on the financial markets. In contrast, according to the European Commission the unemployment rate in France in 2013 will reach 10.7% of the workforce, which is very close to its historic peak in 1997 (Figure 2). With an unemployment rate in 2013 that is 1.3 percentage points higher than the average over the last thirty years, an exceptional situation now characterizes the labour market more than it does the government deficit. While new austerity measures would help to reduce the deficit, however painfully, due to the [high value of the fiscal multiplier in the short term](#) they will lead on the other hand to going well beyond our historic unemployment peak. Indeed, as we showed in our [latest forecast in October 2012](#), if France really tries to meet its budget commitment for 2013 “whatever the cost”, this will require a new fiscal tightening of over 20 billion euros, in addition to the [36 billion euros already](#)

[planned](#). This would lead to a recession, with GDP down -1.2% and 360,000 job losses (instead of expected growth of 0% and the loss of about 160,000 jobs), with the unemployment rate reaching 11.7% of the labour force by late 2013.

Figure 2. Public deficit and unemployment rate



Source: European Commission.

To restore its public accounts since 2010, France has undertaken a historic fiscal effort, well beyond the average of its European partners, which has cost it in terms of growth and employment. Adding another layer of austerity in 2013 to the already historic build-up of austerity would lead us this year straight into a recession and an unprecedented worsening in the labour market. If there is a choice, are a few tenths of a point in the public deficit worth such a sacrifice? Nothing is less certain. It is thus essential to put off the goal of reducing the deficit to 3% of GDP to at least 2014.

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[\[1\]](#) We have a different evaluation of the level of the structural deficit. For example, for 2013 we evaluate the improvement in France's structural public deficit at 1.8 GDP points, but in order not to prejudice the analysis we are using the figures provided by the Commission.

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# 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.

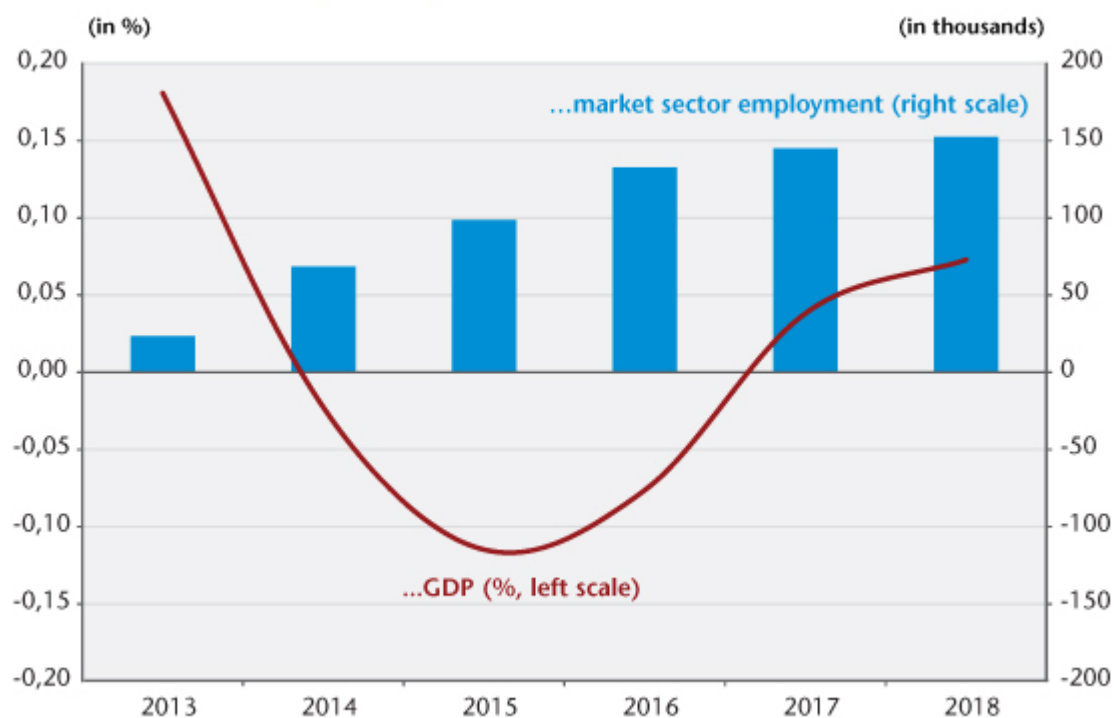
On the other hand, the impact of the CICE will be slightly recessive from 2014 to 2016, as the loss in household purchasing power linked to higher taxes and the cuts in public spending (household consumption and public demand will contribute -0.2 GDP point in 2014 and then -0.4 point in 2015 and 2016) 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.

## 2013: what impact will the (national) fiscal measures have on growth?

By [Mathieu Plane](#)

*This text supplements the [October 2012 forecasts for the French economy](#)*

After having detailed the multiplier effects expected for the different fiscal policy instruments, the average domestic fiscal multiplier associated with the austerity measures being implemented in France in 2013 will be 0.9. This policy will cut GDP by 1.7% in one year alone. After a cumulative fiscal effort of 66 billion euros in 2011 and 2012, the structural

saving expected for 2013 represents about 36 billion euros (1.8 GDP points) if we include both the measures in the 2013 budget bill (*Projet de loi de finances – PLF*) and the various measures adopted previously (Table). The fiscal shock resulting from the PLF for 2013 comes to 28 billion euros, of which 20 billion is solely on tax and social security contributions (*prélèvements obligatoires – P0*). Of the remaining 8 billion, an increase of nearly 5 billion euros in tax and social security contributions is from the second supplementary budget (*Loi de finances rectificative – LFR*) for the summer of 2012, the rest being mainly due to the first LFR for 2012 and to the hike in contributions resulting from the revision of the pension reform in summer 2012.

In total, the fiscal effort in 2013 can be broken down between tax and social contributions of about 28 billion euros (1.4 GDP points) and structural savings on primary public expenditure of 8 billion (0.4 GDP point). The burden of higher taxes and social contributions breaks down to nearly 16 billion euros for households and more than 12 billion for business. This breakdown does not take into account the competitiveness measures announced on 6 November by the Prime Minister. The tax credits for competitiveness and employment (CICE) will not have any fiscal impact in 2013, with the exception of the possible establishment in 2013 of an advance on their future tax credits for some companies short of cash.

Based on the variants in the fiscal multiplier, made with e-mod.fr according to the economy's position in the cycle, for the main taxes and social security contributions as well as for the key components of public expenditure [\[1\]](#) and based on the different evaluations we were able to carry out, particularly in the context of [the assessment of the Five-year economic programme](#), we applied a specific fiscal multiplier to each measure for 2013 (Table). The short-term multipliers take into account only the direct effects of the measures on domestic activity, regardless of the fiscal policies of our

trading partners, which amplify the impact of national policy. It is also assumed that monetary policy remains unchanged. The long-term multiplier values differ from the short-term ones, being generally lower unless a long-term negative output gap is maintained.

Of the 16 billion euro increase in tax and social security contributions on households in 2013, the discretionary increase in personal income tax (IR) will be 6.4 billion, including 3.2 billion from the 2013 Budget Act (*Loi de finances*) – against 4 billion in the PLF, as the proposal to tax capital gains on securities at the income tax scale will be largely amended, and the yield from the measure could decrease by about 0.8 billion, with the shortfall being able to be offset by the extension of the exceptional 5% contribution from the IS tax on large corporations), and with the rest coming from the supplemental LFR for 2012 (including 1.7 billion solely from the de-indexation of the personal income tax schedule). While the increase in personal income tax from the 2013 PLF is targeted at high earners, the amount this will contribute (3.2 billion) represents only 11% of the increase in tax and social security contributions (20% if we limit ourselves to households) in 2013, and less than 9% of the total fiscal effort. According to our calculations, the average fiscal multiplier associated with the different measures that increase personal income tax will be 0.7 in 2013.

The increase in taxes and social contributions from households will come mainly from the increase in payroll taxes and social security contributions (8.7 billion euros) set out in the Social Security budget act (PLF) for 2013 (2.9 billion) and the measures in the supplemental LFR for 2013 (5.3 billion, which includes changes to the tax exemption on overtime, a limitation on tax breaks and employee savings, a higher CSG wealth tax on income from capital, etc.) and pension reform, with an increase in the contribution rate (0.5 billion). The

average fiscal multiplier related to these measures is 0.9. Finally, the reform of inheritance tax will raise a further 1.1 billion in tax and social contributions. On the other hand, the revenue from the ISF wealth tax will be 1.3 billion lower than in 2012. Indeed, the yield from the one-off wealth tax contribution set up under the supplemental LFR for 2012 will be greater than from the one set up under the new reform in 2013. The fiscal multiplier for these two measures is 0.3.

In total, according to our calculations, the increase in levies on households in 2013 will on average have a multiplier of 0.8 and will amputate growth by 0.6 GDP point.

For business, the measures adopted mainly involve an increase in the corporate income tax as provided in the budget bill (PLF) for 2013 (8 billion euros, of which 4 billion is related to the reform of the deductibility of financial expenses). The average multiplier for the increase in the corporate income tax (IS) is estimated at 0.7 in 2013. 2.3 billion euros will come from a rise in social security contributions and payroll taxes with a fiscal multiplier of unity. Finally, other measures such as the sectoral measures on the taxation of insurance or the exceptional contribution of the oil industry will increase the tax burden on business by 1.9 billion in 2013, with an average fiscal multiplier estimated at 0.5.

In our assessment, the increase in taxes and social contributions from companies will on average have a multiplier of 0.8 and will reduce GDP by 0.5 GDP point in 2013.

In addition, the short-term fiscal multiplier associated with public expenditure in a low phase of the cycle is, in our model, 1.3, so it is higher than that associated with tax and social contributions. This result is consistent with the most recent empirical literature (for details, see the box, "[Fiscal multipliers: size matters!](#)") The estimated loss of activity resulting from tightening up on public expenditure will come to 0.5 GDP point in 2013.

In total, the average domestic fiscal multiplier associated with the austerity policy being implemented in France in 2013 will be 0.9, and this policy will reduce GDP by 1.7%. This result is in the lower range of the [latest work of the IMF](#); using recent data on 28 countries, it has estimated the actual multipliers at between 0.9 and 1.7 since the beginning of the Great Recession.

## Main measures affecting the structural public deficit in 2013

	Measures (in bn)	Fiscal multiplier estimated in the short term	Impact on GDP (%)
<b>Households</b>	<b>15.7</b>	<b>0.8</b>	<b>-0.6</b>
<b>Income tax</b>	<b>6.4</b>	<b>0.7</b>	<b>-0.2</b>
PLF 2013 (taxation of capital income at IR tax rate, new brackets, etc.)*	3.2	0.6	-0.1
LFR II 2012 (reversal of tax exemption of overtime)	0.5	0.4	0.0
LFR I 2012 (de-indexation of IR brackets, suppression tax breaks and Scellier scheme, etc.)	2.7	0.8	-0.1
<b>ISF wealth tax</b>	<b>-1.3</b>	<b>0.3</b>	<b>0.0</b>
PPLF 2013 (reform of ISF wealth tax)	1.0	0.3	0.0
LFR II 2012 (repercussions from one-off 2012 contribution)	-2.3	0.3	0.0
<b>Inheritance tax</b>	<b>1.1</b>	<b>0.3</b>	<b>0.0</b>
LFR II 2012 (reversal of breaks on inheritance tax)	1.1	0.3	0.0
<b>Social contributions and payroll tax</b>	<b>8.7</b>	<b>0.9</b>	<b>-0.4</b>
Social security PLF 2013 (reform of self-employed payroll tax, higher tax on beer and tobacco, etc.)	2.9	1.0	-0.1
LFR II 2012 (reversal of overtime exemption, limitation of tax breaks and employee savings, higher CSG wealth tax, capital income, etc.)	5.3	0.8	-0.2
Pension reform (higher contributions)	0.5	1.0	0.0
<b>Other</b>	<b>0.8</b>	<b>0.6</b>	<b>0.0</b>
PLF 2013 (higher tax on vacant housing, tougher "automobile malus", etc.)	0.9	0.6	0.0
LFR II 2012 (lower VAT on books)	-0.1	1.0	0.0
<b>Business**</b>	<b>12.2</b>	<b>0.8</b>	<b>-0.5</b>
<b>Corporate income tax</b>	<b>8</b>	<b>0.7</b>	<b>-0.3</b>
PLF 2013 (limits on financial expenses deductibility, reform of the "cinquième acompte", etc.)	8	0.7	-0.3
<b>Payroll tax and social contributions</b>	<b>2.3</b>	<b>1.0</b>	<b>-0.1</b>
Social security PLF 2013 (higher CNRACL contribution rate, reform on wage tax, etc.)	1.8	1.0	-0.1
Pension reform	0.5	1.0	0.0
<b>Other</b>	<b>1.9</b>	<b>0.5</b>	<b>-0.1</b>
PLF 2013 (sectoral measures on taxation of business insurance) (sectoral measures on taxation of business insurance)	1.3	0.8	-0.1
LFR II 2012 (one-off contribution of oil industry, taxation of financial transactions, etc.)	0.6	0.2	0.0
<b>Total Business and Household Taxes and Contributions</b>	<b>27.9</b>	<b>0.8</b>	<b>-1.1</b>
<b>Structural saving on primary public expenditure</b>	<b>8.0</b>	<b>1.3</b>	<b>-0.5</b>
<b>Total fiscal impulse</b>	<b>35.9</b>	<b>0.9</b>	<b>-1.7</b>

\* This amount incorporates the downward revision of the yield initially foreseen in the PLF 2013 of the measure taxing capital gains at the personal income tax rate, which is to be offset by the extension of the exceptional 5% corporate income tax contribution for large corporations.

\*\* This breakdown does not measure the final fiscal impact that is to be borne by households if the increase in business taxes is passed on in prices.

Sources : PLF 2013, Social security PLF 2013, LFR I and II 2012, OFCE calculations.

[1] For more on this, see Creel, Heyer, Plane, 2011, "Petit précis de politique budgétaire par tous les temps", *Revue de l'OFCE*, no. 116, January 2011.



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# 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
<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.