

Trends in labour force participation rates in Europe during the Great Recession: The role of demographics and job polarization

By [Guillaume Allègre](#) and Gregory Verdugo

In Europe as in the United States, employment fell considerably during the Great Recession. Moreover, over the last few decades, the labour markets in both regions have been reshaped by the forces of automation and globalization. However, the response of labour force participation to these changes has varied from country to country. One of the most significant developments in the US labour market over the past decade has been the decline in labour force participation. Between 2004 and 2013, the labour force participation rate for the group aged 25 to 54 fell by 2.6 percentage points (from 83.8% to 81.1%), a decline that has persisted well beyond the end of the Great Recession. In the EU-15, on the other hand, the participation rate for this age group increased by 2 percentage points during the same period (from 83.7% to 85.6%), despite low growth and the persistence of high levels of unemployment.

What explains these differences on the two sides of the Atlantic? To answer this question, we examine [here](#) the determinants of the evolution of labour force participation over the last two decades in twelve European countries and compare this with the United States.

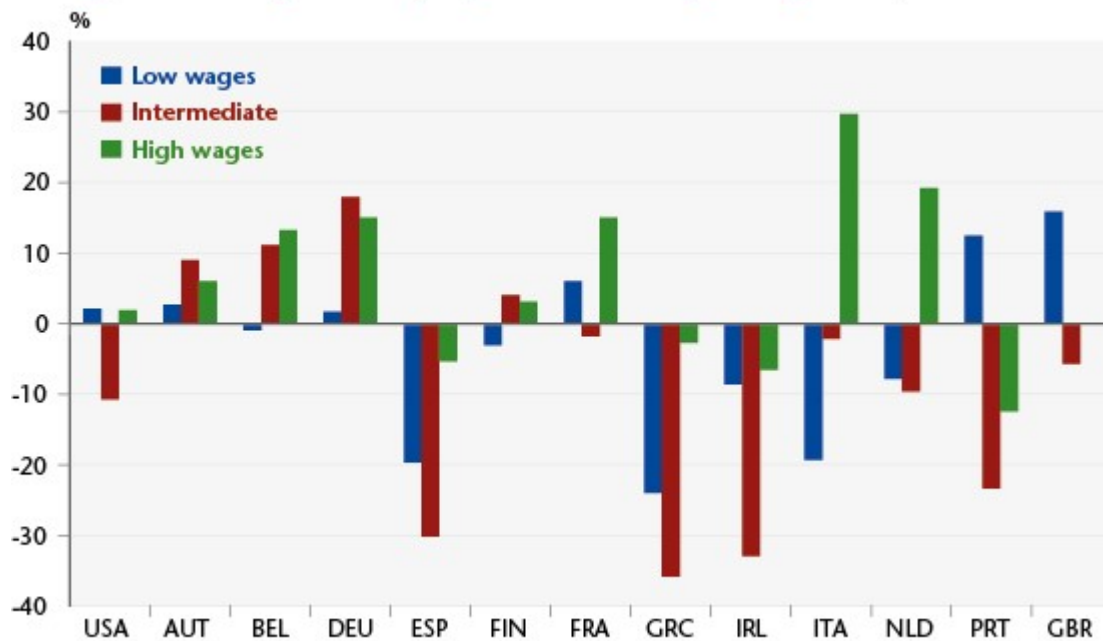
Consistent with previous work on the United States, we found that recent demographic shifts account for a substantial share

of cross-country differences. The share of retired baby boomers increased more rapidly in the United States and triggered a sharper decline in participation rates there than in Europe. Over the past decade, the rate of increase in the number of higher education graduates was twice as high in Europe as in the United States, especially in southern Europe and in particular for women. Women with higher levels of education are more likely to join the workforce, and they have contributed dramatically to the rise in labour force participation in Europe.

However, these changes do not explain everything. For the population with a diploma below the level of the high school baccalaureate, men's labour force participation rates have fallen in all countries. For women, they have increased rapidly, especially in the countries hit hardest by unemployment. In Spain, Greece and Italy, the participation rates for women with a diploma below the baccalaureate level rose by 12, 5.5 and 2 points, respectively, between 2007 and 2013, while these economies were in the midst of a deep recession.

To explain these facts, we investigated the role of changes in patterns of labour demand in recent decades and in particular during the Great Recession. We show that, as in the United States, job polarization (which denotes the reallocation of employment towards the lowest and highest paying occupations at the expense of intermediate professions) accelerated in Europe during the Great Recession (Figure 1). Due to the greater destruction of jobs in intermediate occupations, the recent polarization has been much more intense in Europe.

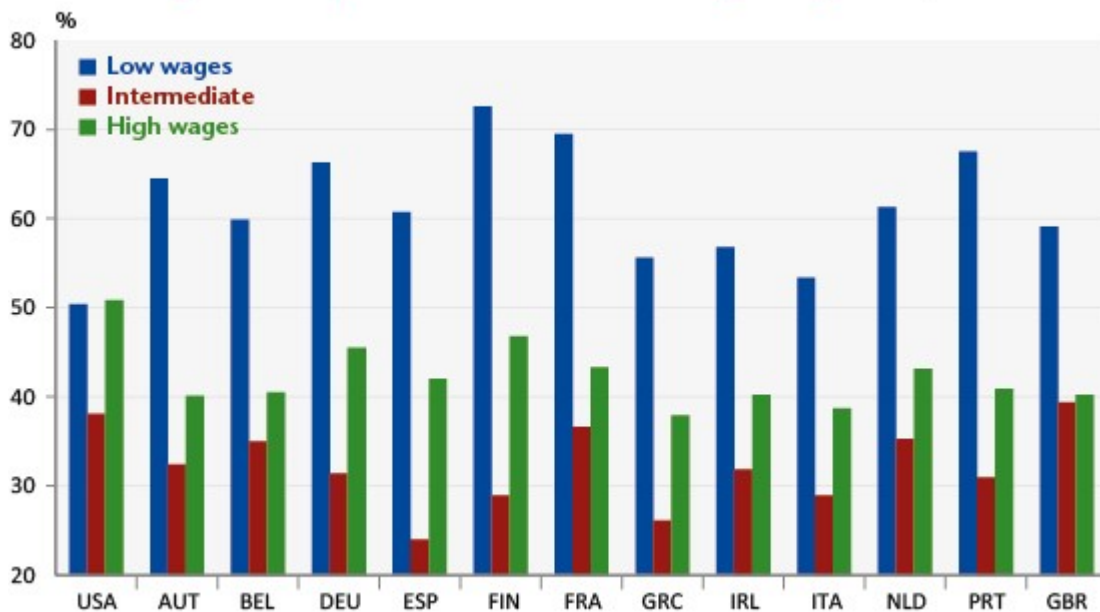
Figure 1. Changes in employment according to wage level, 2007-2013



Source : EU-LFS, CPS (US).

Another important difference with the United States is that occupational segregation between men and women is more pronounced in Europe. The intermediate jobs that are rapidly disappearing are much more likely to employ male workers in Europe, whereas the expansion of low-skilled occupations is disproportionately benefitting women (Figure 2). As a result, in Europe, more than in the United States, job polarization and the destruction of intermediate jobs has led to a decline in labour market opportunities for men that is more dramatic than the decline for women. We find that these asymmetric demand shocks between the genders accounted for most of the increase in labour force participation rates for women with the lowest educational levels during the Great Recession.

Figure 2. Proportion of women according to wage level, 2007



Source : EU-LFS, CPS (US).

For further information: [Gregory Verdugo, Guillaume Allègre, "Labour Force Participation and Job Polarization: Evidence from Europe during the Great Recession", Sciences Po OFCE Working Paper, no. 16, 2017-05-10](#)

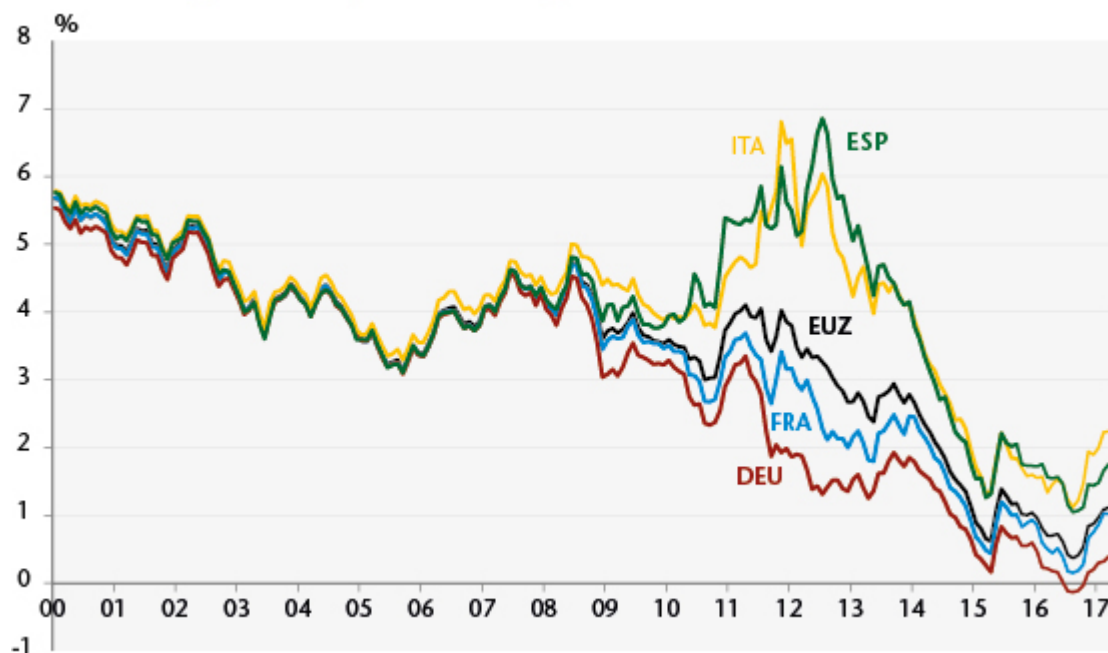
What factors are behind the recent rise in long-term interest rates?

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

Since the onset of the financial crisis, long-term sovereign interest rates in the euro zone have undergone major

fluctuations and periods of great divergence between the member states, in particular between 2010 and 2013 (Figure 1). Long-term rates began to fall sharply after July 2012 and Mario Draghi's famous "whatever it takes". Despite the [implementation](#) and [expansion](#) of the Public Sector Purchase Programme (PSPP) in 2015, and although long-term sovereign interest rates remain at historically low levels, they have recently risen.

Figure 1: Long-term sovereign interest rates in the euro zone



Source : European Central Bank.

There may be several ways of interpreting this recent rise in long-term sovereign interest rates in the euro zone. Given the current economic and financial situation, it may be that this rise in long-term rates reflects the growth and expectations of [rising future growth](#) in the euro zone. Another factor could be that the euro zone bond markets are following the US markets: European rates could be rising as a result of rising US rates despite the [divergences](#) between the policy directions of the ECB and of the Fed. The impact of the Fed's monetary policy on interest rates in the euro zone would thus be stronger than the impact of the ECB's policy. It might also be possible that the recent rise is not in line with the zone's fundamentals, which would then jeopardize the recovery from

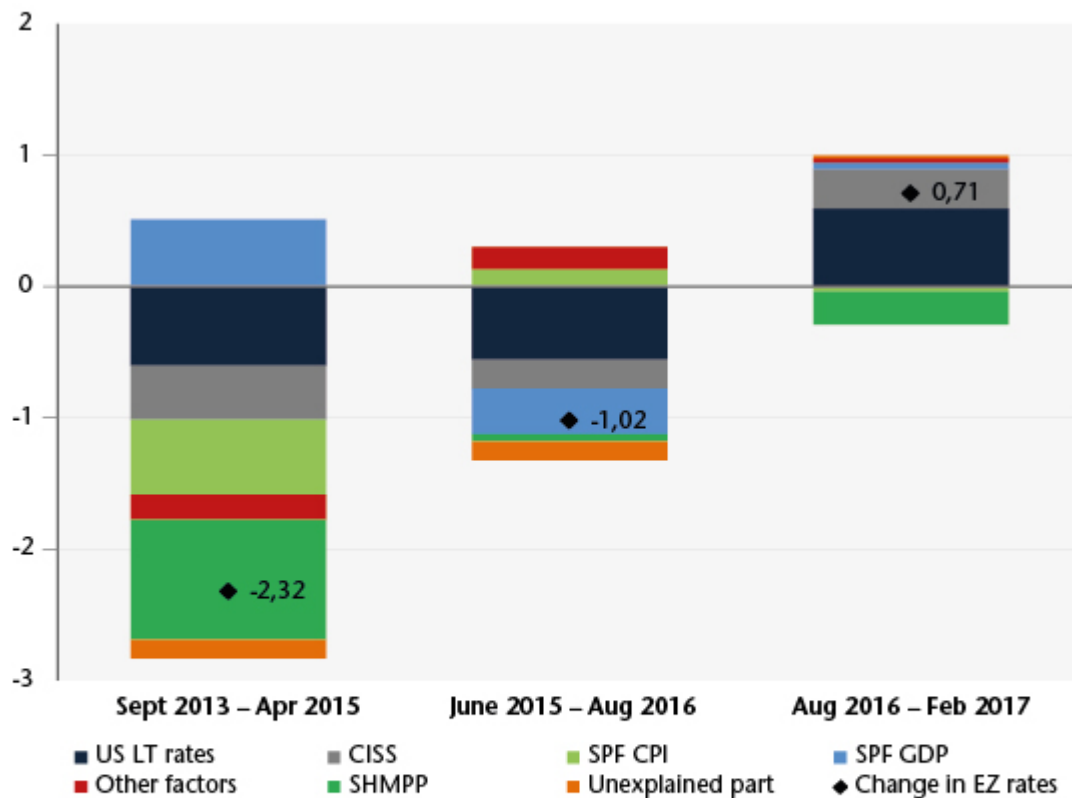
the crisis by making debt reduction more difficult, as public and private debt remains high.

In a recent [study](#), we calculate the contributions of the different determinants of long-term interest rates and highlight the most important ones. Long-term interest rates can respond to private expectations of growth and inflation, to economic fundamentals and to monetary and fiscal policy, both domestic (in the euro zone) and foreign (for example, in the United States). The rates may also react to perceptions of different financial, political and economic risks[\[1\]](#). Figure 2 shows the main factors that are positively and negatively affecting long-term interest rates in the euro zone over three different periods.

Between September 2013 and April 2015, the euro zone's long-term interest rate decreased by 2.3 percentage points. During this period, only expectations of GDP growth had a positive impact on interest rates, while all the other factors pushed rates down. In particular, the US long-term interest rate, inflation expectations, the reduction of sovereign risk and the ECB's unconventional policies all contributed to the decline in euro zone interest rates. Between June 2015 and August 2016, the further decline of about 1 percentage point was due mainly to two factors: the long-term interest rate and the expectations of GDP growth in the United States.

Between August 2016 and February 2017, long-term interest rates rose by 0.7 percentage point. While the ECB's asset purchase programme helped to reduce the interest rate, two factors combined to push it up. The first is the increase in long-term interest rates in the United States following the Fed's tightening of monetary policy. The second factor concerned political tensions in France, Italy and Spain, which led to a perception of political risk and higher sovereign risk. While the first factor may continue to push up interest rates in the euro zone, the second should drive them down given the results of the French presidential elections.

Figure 2: Contributions to changes in long-term sovereign rates in the euro zone



Note: SPF corresponds to the Survey of Professional Forecasters and measures private agent expectations of inflation (CPI – Consumer Price Index) and of GDP (Gross Domestic Product). The CISS (Composite Indicator of Systemic Stress) is an Indicator of stress on the financial markets. The SHMPP (Securities Held for Monetary Policy Purposes), in the Weekly financial statements published by the ECB, measures the amount of purchases of bonds made by the ECB as part of its unconventional policy.

Source: calculation OFCE.

[1] The estimate of the equation for the determination of long-term rates was calculated over the period January 1999 – February 2017 and accounts for 96% of the change in long-term rates over the period. For details on the variables used and the parameters estimated, see the [study](#).

Where are we at in the euro zone credit cycle?

By [Christophe Blot](#) and [Paul Hubert](#)

In December 2016, the European Central Bank announced the continuation of its Quantitative Easing (QE) policy until December 2017. The continuing [economic recovery](#) in the euro zone and the renewal of inflation are now raising questions about the risks associated with this programme. On the one hand, isn't the pursuit of a highly expansionary monetary policy a source of financial instability? Conversely, a premature end to unconventional measures could undermine growth as well as the ECB's capacity to achieve its objectives. [Here](#), we study the dilemma facing the ECB [in French] based on an analysis of credit cycles and banking activity in the euro zone.

The ECB's announcement gives us two signals about the direction of monetary policy. On the one hand, by delaying the end date of QE, the ECB is implicitly announcing that the normalization of monetary policy, in particular a hike in its key rate, will not take place before early 2018. The ECB will thus continue its expansionary policy of increasing the size of its balance sheet. On the other hand, the reduction in monthly purchases is also a sign that it is toning down its expansionary character. The announcement is similar to the "tapering" that began in January 2014 by the US Federal Reserve. Purchases of securities were cut back gradually, until they actually stopped at the end of October 2016.

The undeniably expansionary nature of monetary policy in the euro zone suggests that the ECB still considers it necessary to implement a stimulus in order to achieve its ultimate monetary policy objectives. The first of these is price stability, which is defined as inflation that is lower than

but close to 2% per year. There are no signs of either runaway inflation or growth [\[1\]](#) [\[2\]](#). The securities buyback programme should help to consolidate growth and push inflation towards the 2% target. At the same time, the liquidity issued by the central bank in its securities purchase programmes and the low level of interest rates (short and long term) are fuelling fears that monetary stability might have an [adverse effect](#) on financial stability[\[3\]](#).

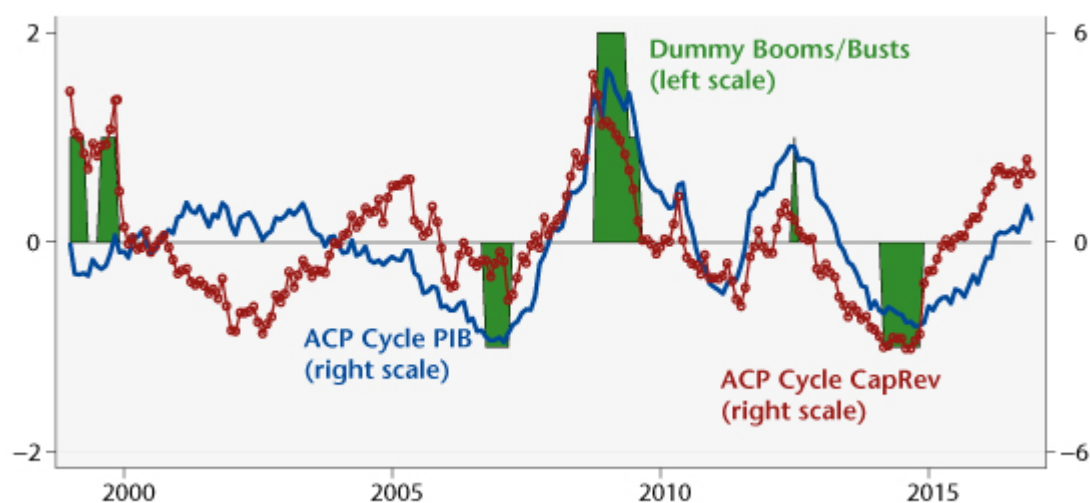
The result leaves the ECB facing a dilemma. Putting a premature end to quantitative easing could keep the euro zone in a state of low inflation and low growth. Unnecessarily prolonging QE, while the US Federal Reserve has begun [normalizing its monetary policy](#), could create a risk of financial instability, resulting in an uncontrolled surge in asset prices, credit, and more broadly the risk taken on by the financial system.

We assess this dual risk using indicators on the activity of the banking system of the euro zone as a whole and of the countries that make it up. Credit, whether granted to households or to non-financial enterprises, is central to bank assets and often at the heart of risks to financial instability[\[4\]](#). Here we propose extending the analysis to the size of the balance sheet and to total loans granted – including credit to other monetary and financial institutions – which makes it possible to measure the risk associated with the banking system as a whole[\[5\]](#).

These different variables are related either to GDP, which makes it possible to capture the disconnection between banking activity and real activity, or to the capital and reserves of the banking system, which makes it possible to capture the leverage effect, i.e. the capacity of the system to absorb losses. Here we focus on quantities rather than prices, using indicators such as the ratio of credit granted on equity and the ratio of credit received on income. These are central to reflecting the transmission of monetary policy and to

assessing the risk of financial instability.

Figure. Credit in the euro zone



Sources : Blot and Herbert (2017) and ECB data.

The graph shows the changes in the credit cycle, relative to GDP (blue line) and relative to the capital and reserves of the banking system (red line) [6]. The green areas indicate periods when credit deviates significantly above or below its long-term trend. In general, the analysis of credit and of the size of the banking system's balance sheet points to a recovery in activity but it does not suggest either a credit boom or an excessive contraction in the euro zone in the recent period. While credit is evolving in a relatively more favorable direction relative to its trend in France and Germany, the cycle does not indicate an excessive increase. The Netherlands and Spain are distinguished by a low level of credit relative to GDP. For the Netherlands, this trend is confirmed by the indicators relative to the banking system's capital and reserves, while in Spain, outstanding loans relative to capital and reserves are at a historically high level, suggesting an excessive level of risk-taking given the economic situation.

[1] Translation errorDespite the recent rebound in inflation, which is largely linked to the rise in oil prices and inflation expectations, inflationary pressures are still

moderate, and getting inflation back to the 2% target is not sufficiently sure to warrant a change in the direction of monetary policy.

[\[2\]](#) Unemployment is still high, fuelling deflation.

[\[3\]](#) A recent analysis by Borio and Zabai (2016) of the effectiveness of unconventional monetary policy suggests that its effectiveness could decrease even as the risks involved increase. The role of asset prices has been studied by Andrade et al. (2016), showing that asset prices had reacted, as expected, following the measures taken by the ECB, and by Blot et al. (2017) on an assessment of the risk of bubbles.

[\[4\]](#) See Jorda *et al.*, 2013 and 2015.

[\[5\]](#) Translation errorThe Basel III legislation is based on risk indicators calculated at the level of banking establishments, while our approach is based on macroeconomic indicators.

[\[6\]](#) Translation errorThese cycles are obtained using a principal component analysis (PCA) of several types of trend / cycle breakdowns: the Hodrick-Prescott filter, the Christiano-Fitzgerald filter, and the moving average.

Is the recovery on the right path?

Analysis and Forecasting Department

This text is based on the 2016-2018 outlook for the world

economy and the euro zone, a full version of which is available [here](#) [in French].

The growth figures for 2016 have confirmed the picture of a global recovery that is gradually becoming more general. In the euro zone, which up to now had lagged behind, growth has reached 1.7%, driven in particular by strong momentum in Spain, Ireland, the Netherlands and Germany. The air pocket that troubled US growth at the start of the year translated into slower GDP growth in 2016 than in 2015 (1.6% vs. 2.6%), but unemployment has continued to decline, to below the 5% threshold. The developing countries, which in 2015 were hit by the slowdown in the Chinese economy and in world trade, picked up steam, gaining 0.2 point (to 3.9%) in 2016.

With GDP growing at nearly 3%, the world economy thus seems resilient, and the economic situation appears less gloomy than was feared 18 months ago – the negative factors have turned out to be less virulent than expected. The Chinese economy's shift towards a growth model based on domestic demand has led not to its abrupt landing but to a controlled slowdown based on the implementation of public policies to prop up growth. Even though the sustainability of Greece's debt has still not been resolved, the crisis that erupted in the summer of 2015 did not result in the disruption of the monetary union, and the election of Emmanuel Macron to the presidency of the French Republic has calmed fears that the euro zone would break up. While the question of Brexit is still on the table, the fact remains that until now the shock has not had the catastrophic effect some had forecast.

This pattern is expected to continue in 2017 and 2018 as a result of monetary policies that will continue to boost economic activity in the industrialized countries and somewhat scaled down fiscal efforts. US fiscal policy should become even more expansionary, allowing for a rebound in growth, which should once again surpass 2% in 2018. While oil prices have recently risen, they are not expected to soar, which will

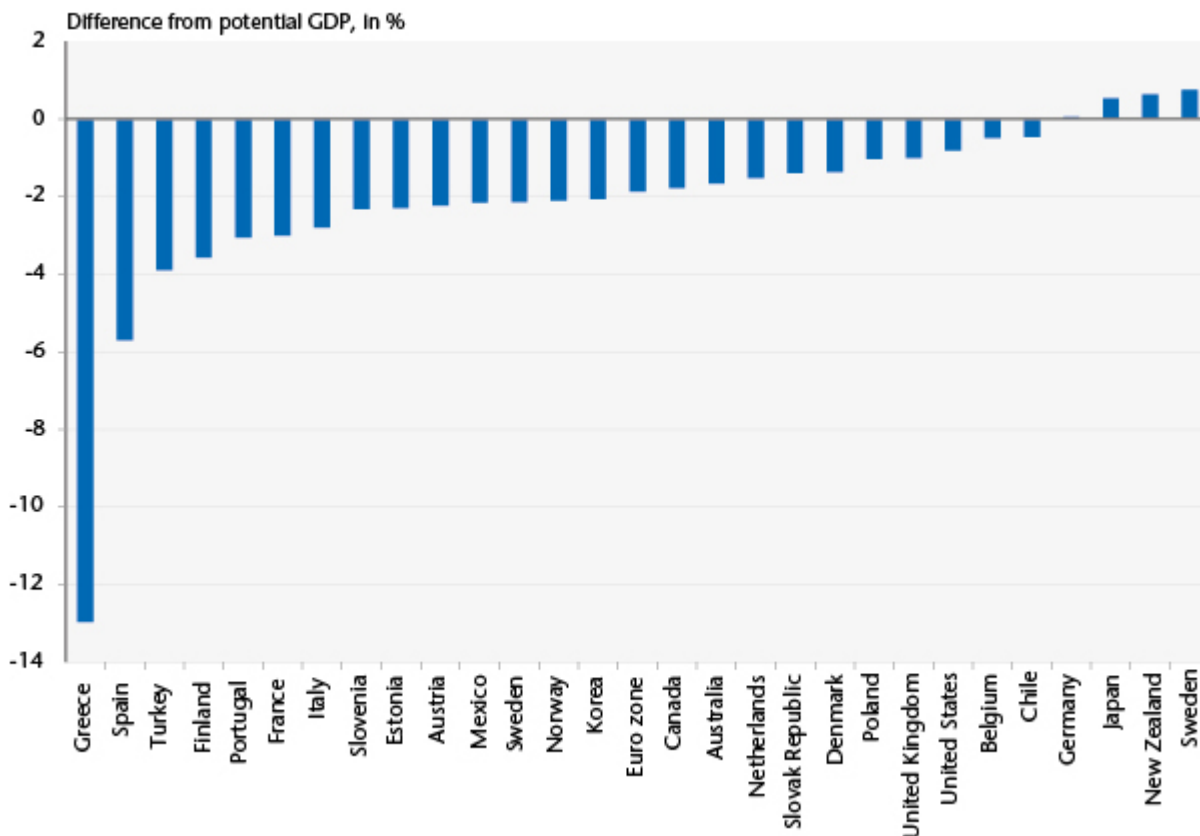
limit the negative impact on household purchasing power and business margins. The rise should even revive the previously moribund rate of inflation, thereby lowering the deflationary risk that has hovered over the euro zone. Pressure on the European Central Bank to put an end to unconventional measures could mount rather quickly.

Although the recovery process is consolidating and becoming more widespread, output in most of the developed economies is still lagging behind in 2016, as is illustrated by the gap in output from the potential level, which is still negative (Figure). This situation, which contrasts sharply with the past cyclical behavior of economies as GDP swung back towards its potential, raises questions about the causes for the breakdown in the growth path that has been going on for almost ten years now. One initial element in an explanation could be the weakening of potential GDP. This could be the result of the scale of the crisis, which would have affected the level and / or growth of the supply capacity of the economies due to the destruction of production capacity, the slowdown in the spread of technological progress and the de-skilling of the unemployed.

A second factor would be the chronic insufficiency of demand, which would keep the output gap in negative territory in most countries. The difficulty in once again establishing a trajectory for demand that is capable of reducing underemployment is related to the excessive indebtedness of private agents prior to the recession. Faced with swelling liabilities, economic agents have been forced to cut their spending to shed debt and restore their wealth. In a situation like this, unemployment or underemployment should continue to fall, but this will take place more slowly than in previous recovery phases. Ten years after the start of the Great Recession, the global economy has thus still not resolved the macroeconomic and social imbalances generated by the crisis. The recovery is therefore well under way, but it is still not

fast enough.

Figure: Output gaps in 2016



Beyond the unemployment rate. An international comparison since the crisis

By [Bruno Ducoudré](#) and [Pierre Madec](#)

[According to figures from the French statistics institute \(INSEE\) published on 12 May 2017](#), non-agricultural commercial employment in France increased (+0.3%) in the first quarter of 2017 for the eighth consecutive quarter. Employment rose by 198,300 in one year. Despite the improvement on the jobs front

experienced since 2015, the impact of the crisis is still lingering.

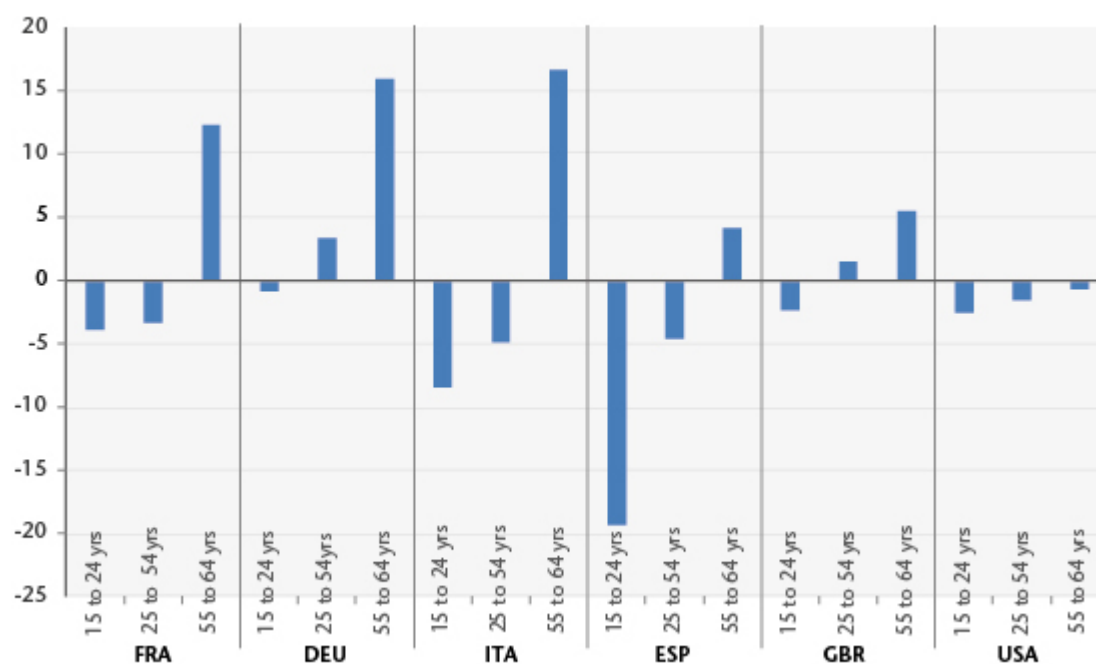
Since 2008, employment trends have differed significantly within the OECD countries. Unemployment rates in the United States, Germany and the United Kingdom are now once again close to those seen before the onset of the crisis, while the rates in France, Italy and particularly Spain still exceed their pre-crisis levels. Changes in unemployment reflect the gap between changes in the active population and changes in employment. An improvement in unemployment could therefore mask less favourable developments in the labour market, in terms of employment behaviour (changes in the labour force participation rate and the “unemployment halo”) or an increase in precarious employment (involuntary part-time work, etc.). In this paper we take another look at the contribution of changes in participation rates and in working time duration relative to changes in unemployment rates and to a broader measure of the unemployment rate that encompasses the “halo of unemployment” and involuntary part-time work.

Unemployment rates are marked by the crisis and reforms

With the exception of the United States, employment rates have changed considerably since 2008. In France, Italy and Spain, the employment rate for 15-24 year-olds and for those under age 55 more generally has fallen sharply (Figure 1). Between the first quarter of 2008 and the last quarter of 2016, the employment rate for 18-24 year-olds fell by 19 percentage points in Spain, by more than 8 percentage points in Italy and by almost 4 percentage points in France, while at the same time the unemployment rates in these countries rose by 9, 5 and 3 percentage points respectively. The poor state of the economy in these countries, accompanied by negative or weak job creation, has hit young people entering the labour market hard. Conversely, over this same nine-year period, the employment rate of individuals aged 55 to 64 increased in all the above countries. In France, as a result of successive

pension reforms and the [elimination of the job search exemption](#), the employment rate of older workers increased by 12.3 percentage points in nine years to 50% in Q4 2016. In Italy, even though the labour market worsened, the employment rate of 55-64 year-olds has risen by almost 18 percentage points.

**Figure 1. Change in employment rate by age
between Q1 2008 and Q4 2016**



Sources: OECD, OFCE calculations.

A sharp impact of the participation rate on unemployment, offset by a reduction in working time

During the course of the crisis, most European countries reduced the actual working hours to a greater or lesser extent by means of partial unemployment schemes, the reduction of overtime and the use of time-savings accounts, but also through the expansion of part-time work (particularly in Italy and Spain), including involuntary part-time work. On the other hand, the favourable trend in unemployment in the US (Table 1) is explained partly by a significant decline in the labour force participation rate of people aged 15 to 64 (Table 2). The rate in the last quarter of 2016 was 73.1%, i.e. 2.4 points less than at the beginning of 2007.

Table 1. Change in ILO unemployment rate (in % points)

	Q1 2007 – Q4 2011	Q1 2012 – Q4 2016	Q1 2007 – Q4 2016
DEU	-3,4	-1,7	-5,1
ESP	14,6	-4,2	10,3
FRA	0,9	0,7	1,6
ITA	3,1	2,7	5,8
GBR	2,9	-3,6	-0,7
USA	4,1	-3,8	0,4

Source: National accounts, OFCE calculations.

Table 2. Change in the participation rate (in % points)

	Q1 2007 – Q4 2011	Q1 2012 – Q4 2016	Q1 2007 – Q4 2016
DEU	2,1	0,6	2,8
ESP	2,5	0,0	2,5
FRA	0,6	1,2	1,8
ITA	0,5	2,7	3,2
GBR	0,2	1,7	1,9
USA	-2,3	-0,2	-2,4

Sources: National accounts, OFCE calculations.

Assuming that a one percentage point increase in the labour force participation rate leads, holding employment constant, to a 1 percentage point increase in the unemployment rate, it is possible to measure the impact of these adjustments (working hours and participation rate) on unemployment, by calculating an unemployment rate at constant employment and controlling for these adjustments. Except in the United States, all the countries studied saw a greater increase in their labour force (employed + unemployed) than in the general population, owing, among other things, to pension reforms. Mechanically, absent job creation, this demographic growth has the effect of increasing the unemployment rate of the countries concerned.

If the labour force participation rate remained at its 2007 level, the unemployment rate would fall by 1.7 percentage points in France, 2.8 percentage points in Italy and 1.8 percentage points in the United Kingdom (Table 3). On the other hand, without the large contraction in the US labour force, the unemployment rate would have been at least 2.3

percentage points higher than in 2016. It also seems that Germany experienced a significant decline in the level of its unemployment (-5.1 points), even though the participation rate rose by 2.8 percentage points. For an unchanged employment rate, the German unemployment rate would be 1.3% (Figure 2).

As regards working hours, the lessons seem quite different. It seems that if working time had been maintained in all the countries at its pre-crisis level, the unemployment rate would be higher by 3.4 points in Germany, 3.1 points in Italy and 1.5 points in France. In Spain and the United Kingdom, working time has changed very little since the crisis. By controlling for working time, the unemployment rate changes in line with what was observed in these two countries. Finally, without adjusting for working time, the unemployment rate in the United States would be 1 point lower.

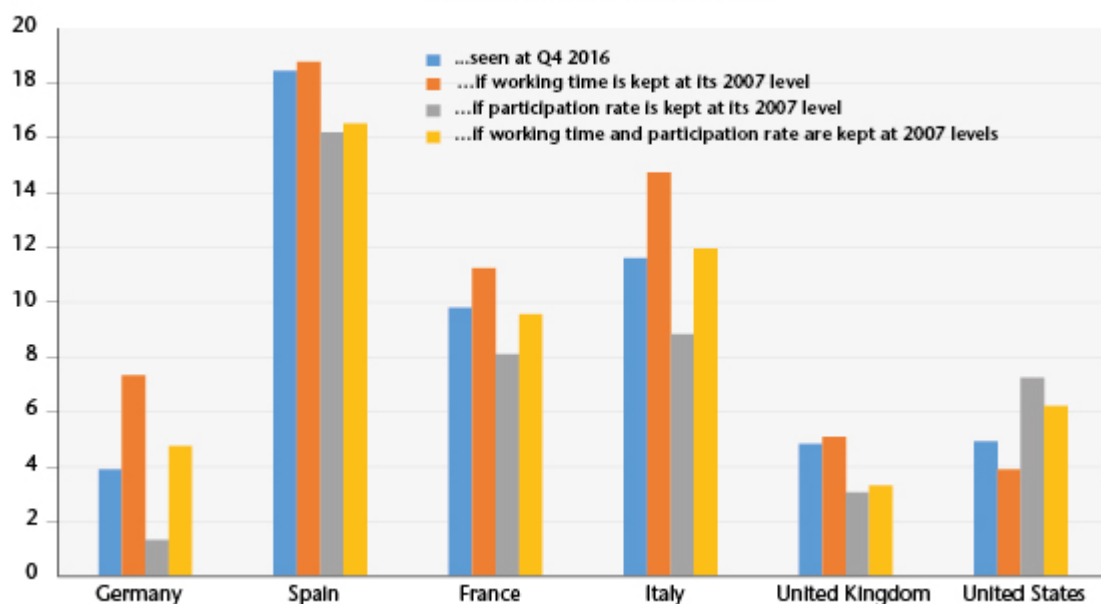
Table 3. Difference between the unemployment rate seen at Q4 2016 and the unemployment rate in case of (in % points)

	...keeping working time at its 2007 level	... keeping the participation rate at its 2007 level	...keeping working time and the participation rate at their 2007 levels
DEU	-2,6	3,4	0,9
ESP	-2,2	0,3	-1,9
FRA	-1,7	1,5	-0,2
ITA	-2,8	3,1	0,3
GBR	-1,8	0,3	-1,5
USA	2,3	-1,0	1,3

Sources: National accounts, OECD, OFCE calculations.

Note that this trend towards a reduction in working hours is an old one. Indeed, since the end of the 1990s, all the countries studied have experienced large reductions in working time. In Germany, this decline averaged 0.5% per year between 1998 and 2008. In France, the transition to the 35-hour work week resulted in a similar decrease (-0.6% per year) over that period. Overall, between 1998 and 2008, working hours were down 5% in Germany, 6% in France, 4% in Italy, 3% in the United Kingdom and the United States, and 2% in Spain.

Figure 2. Unemployment rate...



Sources: National accounts, OECD, OFCE calculations.

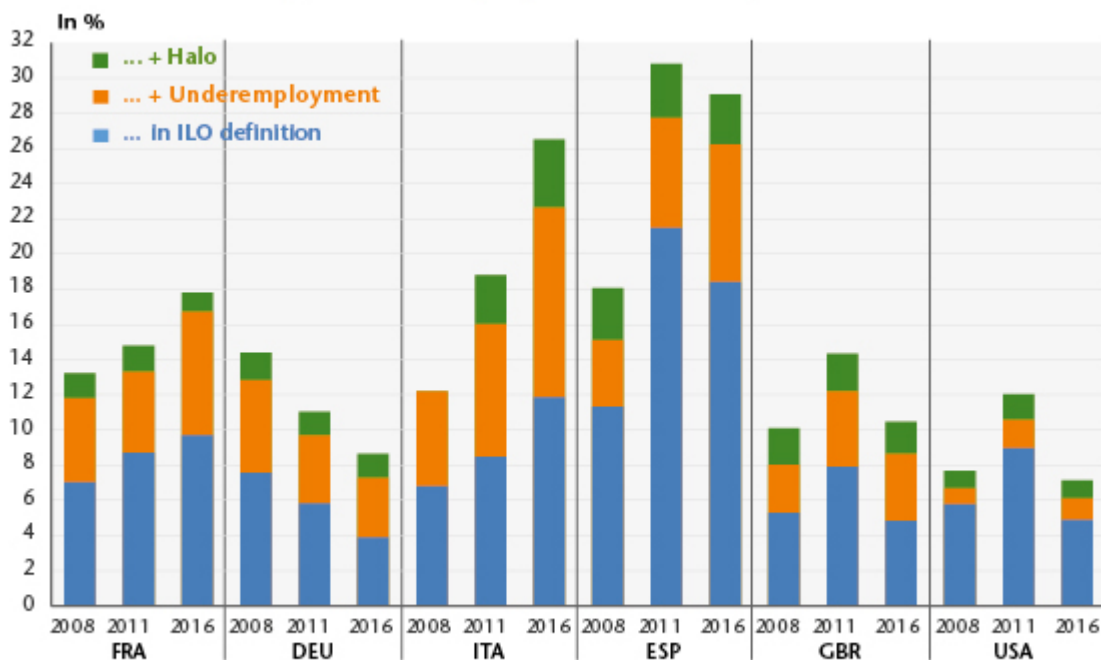
Beyond the “unemployment rate”

In addition to obscuring the dynamics affecting the labour market, the ILO's (International Labour Organization) strict definition of unemployment does not take into account situations on the margins of unemployment. So people who wish to work but are considered inactive in the ILO sense, either because they are not quickly available for work (in under two weeks) or because they are not actively seeking employment, form what is called a “halo” of unemployment.

The OECD's databases can be used to integrate into the unemployed category people who are excluded by the ILO definition. Figure 3 shows for the years 2008, 2011 and 2016 the observed unemployment rate, to which are added, first, people who are employed and declare that they want to work more, and second, individuals who are inactive but want to work and are available to do so. In Germany, the United Kingdom and the United States, changes in these various measures seem to be in line with a clear improvement in the labour market situation. On the other hand, between 2008 and 2011, France and Italy experienced an increase in their unemployment rates, especially from 2011 to 2016, both in the ILO's strict sense of the term and in a broader sense. In

Italy, the ILO unemployment rate increased by 3.4 percentage points between 2011 and 2016. At the same time, underemployment rose by 3.2 percentage points and the proportion of individuals maintaining a “marginal relationship” with employment by 1 percentage point. Ultimately, in Italy, the unemployment rate including some of the jobseekers excluded from the ILO definition came to 26.5% in 2016, more than double the ILO unemployment rate. In France, because of a lower level of unemployment, these differences are less significant. Despite this, between 2011 and 2016, underemployment increased by 2.4 points while unemployment in the strict sense grew “only” by 1 percentage point. In Spain, although there was notable improvement in ILO unemployment over the period (-3 points between 2011 and 2016), underemployment continued to grow strongly (+1.5 points). By 2016, Spain’s ILO unemployment rate was 7 percentage points higher than it was in 2008. By including jobseekers excluded from the ILO measure, this difference comes to 11.0 percentage points.

Figure 3. Unemployment rate at Q4 2016...



Note : For 2016, as all the data were not available, we assume that the “halo” changed in line with 2015.

Sources : OCDE, calculs OFCE.

Universal basic income: An ambition to be financed

By [Pierre Madec](#) and [Xavier Timbeau](#)

This evaluation of Universal Basic Income (UBI), the flagship proposal of French presidential candidate Benoît Hamon, highlights a potentially important impact of the measure on the living standards of the least well-off households and on inequalities in living standards. If implemented, a universal basic income would have the effect of making France one of the most egalitarian countries in the European Union. In return, the “net” cost of the programme could be high, around 45 to 50 billion euros. Given the measure’s cost, financing it through an income tax reform could make the French socio-fiscal system even more redistributive, but would lead to a considerable increase in the marginal tax rates borne by the wealthiest households.

By making it one of the flagship proposals of his election programme for the presidency, Benoît Hamon has revived the debate around a universal basic income (UBI). It is a radical project, the subject of numerous controversies (see, for example, Allègre and Sterdyniak, 2017), so the quantification of the programme is needed. Starting from Benoît Hamon’s proposal, which has been significantly modified in recent weeks, we attempt here, using a number of important assumptions (total or partial individualization, dependence on other social benefits) to make an initial evaluation. The idea here is neither to enter into the debate as to whether the modalities of application chosen are relevant, such as the exclusion of pensioners, nor to judge how close the proposal in its present form comes to an ideal of universality. Rather

the aim is to avoid this type of debate and to qualify and quantify the effects of the implementation of the UBI as proposed by the presidential candidate.

The latest version of the first step in the Universal Basic Income can be summarized as follows: "A basic income corresponds to a rise in net income that starts at 600 euros for people without resources and then disappears at 1.9 times the minimum wage (SMIC)."

Put like this, the proposal is for a differential allocation making it possible not to give rise to an artificial tax increase among those whose income situation is not changed by the universal income.

For married couples, the programme is not automatically individualized since it would still be possible to choose to maintain joint taxation. Couples with a family quotient that is less than the potential amount of the UBI should choose individualization. This is the case for couples with low incomes and not much income differential. Conversely, couples for whom the family quotient provides a bigger advantage than the basic income should choose to stick with joint taxation[\[1\]](#). This would be the case for couples in which one of the individuals has a very high income and the other has no income[\[2\]](#).

For the most modest households the UBI replaces the RSA (income supplement for the working poor) and the Prime d'activité (working tax credit), and the calculation of social benefits (housing and family allowances, disabled adult allowance, scholarships, etc.) is not modified, as their amounts are included in the resources used to calculate the universal income.

In the general framework, for all tax households whose gross resources are less than 1.9 times the SMIC, i.e. 2,800 euros gross per month, the UBI is equal to the difference between

the base amount of 600 euros per month (7,200 euros per year) and 27.4% of the tax household's gross resources. For non-taxable households, the UBI is considered a tax on negative income. For taxable households with gross resources of between 1.5 and 1.9 times the SMIC (3.8 SMIC in the case of a married couple), the UBI reduces the income tax due, thereby increasing the household's disposable income, with this additional income cancelling out at 1.9 SMIC. The measure's cost to the public finances for these households therefore corresponds to the difference between the amount of the UBI and the income tax currently paid. For tax households with gross resources of more than 1.9 times the gross SMIC (3.8 SMIC for married couples), the current system applies and there is no gain (Figure 1).

Formally, the monthly amount of UBI received by a tax household composed of a single adult and with resources of less than 1.9 times the gross SMIC is based on the following formula:

$$UBI = 600 - 0.274 \times GR$$

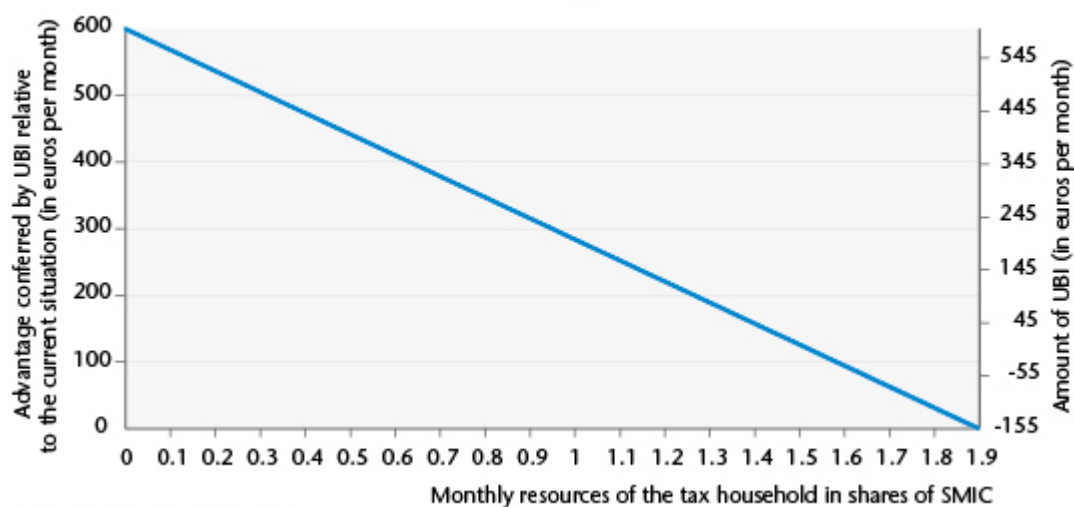
GR, gross resources, corresponds to the gross taxable income, as defined in the tax code, of the tax household, increased by a factor of 1.33 used to approximate the conversion between taxable income and gross resources including charges and contributions, the tax base for the calculation of the UBI. In the case of a married couple, the UBI is calculated as follows, since the UBI as proposed is not then individualized:

$$UBI = [600 - 0.274 \times GR/2] \times 2$$

In order to measure the measure's redistributive impact, we have drawn on the micro-simulation model of the DREES and INSEE known as *INES* ([\[3\]](#) see the box). As the last operational version of the model dates from 2015, the results presented must be interpreted in line with the legislation of 2015. In fact, measures such as the Prime d'activité credit, introduced

in 2016, are not taken into account, in contrast to the Prime pour l'emploi in-work tax credit (PPE).

Figure 1. Amounts of UBI and advantages conferred in shares of SMIC for a tax household composed of one adult



Source: Authors' calculations.

As of January 2018, people over age 18 who are still reported in their parents' tax household and who are UBI eligible must leave their parents' tax household in order to benefit from the UBI. It should be noted that this case is not dealt with in our evaluation, given the complexity of taking into account transfers between parents and children when they are not in the same tax household. We will therefore focus on households in which the reference person was aged between 18 and 64, i.e. 20 million households out of the 28.3 million total households in France, as the rest, pensioners, are not eligible for the measure.

The UBI has been modelled as an additional line in the calculation of income tax, with the amount of UBI being subtracted, subject to conditions of age, resources and marital status explained above, from the latter.

Subject to these assumptions, the UBI should benefit 11.6 million households in which the reference person is aged 18 to 64, at a gross cost of around 51 billion euros, i.e. an average of 4,400 euros per year and per beneficiary household.

The gross cost is not the cost to the public purse. Indeed, the implementation of the UBI would de facto lead to the elimination of the base RSA income supplement and the Prime d'activité tax credit from the tax-benefit system. In 2016, these two programmes had a fiscal cost of close to 15 billion euros (10 billion euros for the RSA and 5 billion for the Prime d'activité). Moreover, the interactions between universal income and these other social benefits are not yet completely set out in Benoît Hamon's proposal[\[4\]](#). If the amount received from UBI were to be taken into account for the calculation of the other social benefits, the amounts paid for these would fall significantly. The gross cost of universal income would remain unchanged, but savings could be realized on social benefits.

We assume here that the amount received in social benefits by the household is taken into account for the final calculation. In other words, we subtract from the amount of UBI received by the household 27.4% of the total amount of social benefits received in cash (housing and family allowance, scholarships, disabled adult allowance, etc., i.e. 32 billion euros per year for potential UBI beneficiaries). While including the benefits in the calculation of the amount of UBI is complicated by the structure of the microsimulation model, it is possible to estimate the reduction in the overall amount of UBI paid by taking into account total social benefits, about 6 billion euros.

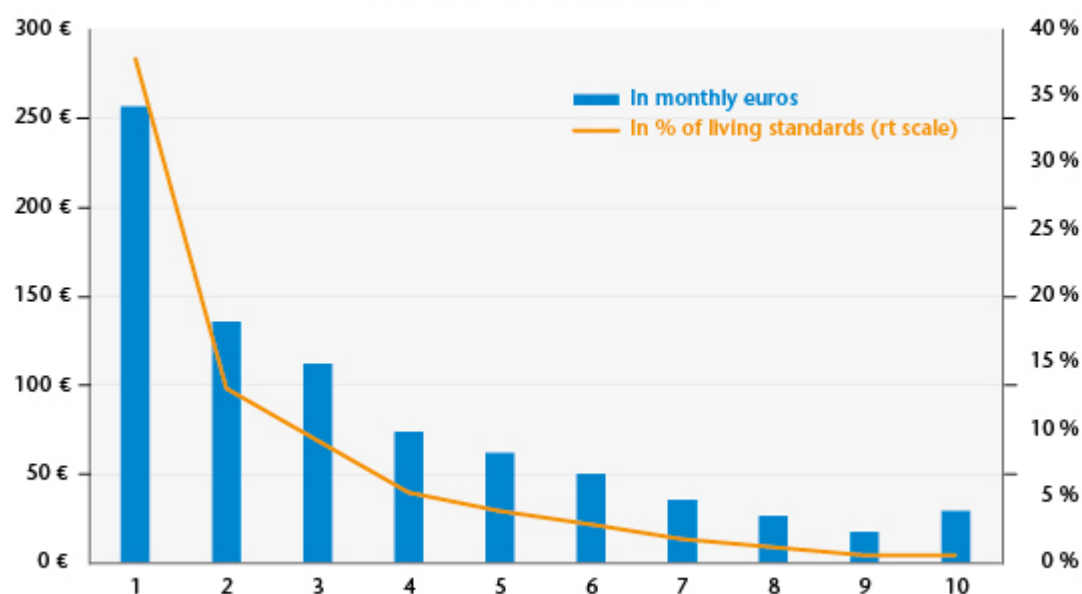
If this option is chosen – which we assume in the absence of further clarification – UBI's "net" cost, excluding the 18-25 year-olds fiscally reporting under their parents, would be on the order of 30 billion euros, which is close to the amount declared by the candidate, to which, once again, it will be necessary to add the amount owed to individuals between the ages of 18 and 24 who are currently reported fiscally by their parents. In 2015, of the 5.2 million individuals aged 18 to 24, 1.7 million were fiscally independent of their parents.

The additional gross cost if no 18-24 year-olds were included on their parents' tax statements would therefore be on the order of 25 billion euros, from which should be subtracted 27.4% of the scholarships (0.115 billion euros per year) and housing benefits paid (1.4 billion euros per year), as well as the tax benefits currently enjoyed by the parents of the said individuals (benefit of up to 1,500 euros per year and per child, to a maximum of 5.2 billion if all households are at the ceiling).

The measure, which is targeted at low-income households and not funded by an increase in household taxation or a decrease in social benefits, would have a positive impact on the bottom of the distribution of living standards (Figure 2) [\[5\]](#).

On average, households in the first decile of living standards should see their standard of living rise by 257 euros per month per consumption unit, i.e. a 38% increase in their average standard of living. The gain for households in the second decile should be roughly half as much, i.e. 137 euros per month per consumption unit, which represents a 13% increase in their average standard of living.

Figure 2. Average monthly gains by consumption unit and living standards decile



Source: INSEE Tax and revenue [Revenus fiscaux et sociaux] survey 2013 (updated 2015); Drees, Ines 2015 model, Authors' calculations.

Given that, unlike many benefits, the UBI is allocated not to households but to *tax* households, some members (not taxed jointly but cohabiting as unmarried couples not in PACS civil partnerships) of some households in the upper deciles of the distribution of living standards should receive the UBI (and the highest decile more than the ninth decile due to a composition effect). In other words, there are tax households with low gross incomes among households with high living standards[\[6\]](#).

Based on these assumptions, the median standard of living would be raised by 3.6%, and the poverty rate, i.e. the share of French households with resources under 60% of the median level, i.e. about 1,000 euros / month / consumption unit, would come to 8.5%, versus 13.4% at present. The median standard of living of the poorest households – those with a standard of living below the poverty line – would rise by 11%. The intensity of poverty, measured as the relative gap between the median standard of living of the poor and the poverty line, would also fall by a third, from 17% today to 11%.

Finally, the Gini coefficient of living standards, an indicator of inequality, would be reduced by 0.04 to a level of 0.26, thus moving France from a median situation in terms of the Gini at the European level to being among the least unequal countries – the European median of the Gini in 2015 was 0.30 (and the lowest 0.25).

Excluding the young people (aged 18-24) reported on their parents' taxes, the net cost of the UBI would be on the order of 30 billion euros. By adding them, subject to a more detailed assessment, the net cost would be on the order of 49 billion. This is a long way from the 400 billion once bandied about, but it is still not negligible[\[7\]](#). If the UBI were to be financed by a reform of personal taxation, this would lead to a considerable increase in the marginal rates of the highest deciles of the income distribution. Note that personal income tax brings in 74 billion euros annually. Another tax

base, such as wealth, could also be used, but this would lead to a significant hike in wealth taxes. Property taxes and the ISF wealth tax currently bring in a little less than 30 billion euros. Moreover, the redistributive effects of the UBI – which are significant, in our assessment – would be amplified by an increase in taxation that is already progressive.

Box: The *Ines* micro-simulation model (Sources: INSEE, DREES)

Ines is the acronym for “Insee-Drees”, the two organizations that are jointly developing the model. The model is based on the INSEE’s [Tax and Social Revenue surveys \(ERFS\)](#), which include several hundred details on each individual and accurate and reliable data on income taken from tax returns. It can be used to simulate all recent legislative years using more recent ERFS years.

The model is used to carry out [studies at annual intervals](#), but it is also used for in-depth studies in order to inform the economic and social debate in the areas of monetary redistribution, taxation and social protection. Finally, it is sometimes used to aid reflection in response to specific requests from various high government councils, supervisory ministries or control bodies (IGF financial inspectorate, Court of Auditors [*Cour des comptes*], Igas social inspectorate).

The *Ines* model simulates:

- **Social charges and direct taxes:** social contributions, CSG wealth tax, CRDS debt contribution and income tax (including the Prime pour l’emploi credit);
- **Social benefits** other than those corresponding to replacement income: personal aid for housing; the main social

minima: the Revenu de solidarité active (RSA) income supplement; the Disabled adult allowance (AAH) and its complements; pension supplements and the Supplementary disability allowance (ASI); family benefits: the Family allowance (AF), the Family complement, the Back-to-school allowance (ARS) and high school scholarships, the Young child benefit (Paje) and its complements (Free choice of activity complement – CLCA – and Free choice of childcare complement – CMG), public subsidies for childcare in collective and family kindergartens, the Family support allowance (ASF) and the Disabled child education allowance (AEEH); and the Prime d'activité credit.

The main omissions relate to local taxes and subsidies (property tax, for example) and the Solidarity tax on wealth (IS). Retirement pensions, unemployment benefits and housing tax are not simulated but are presented in the data. Indirect levies are strictly speaking also outside the scope of the *Ines* model. The model simulates, using ranges, the different benefits to which each household is entitled and the taxes and levies that it has to pay. *Ines* draws on the INSEE's [Tax and Social Revenue surveys \(ERFS\)](#), which bring together socio-demographic information from the Employment Survey, administrative information from the CNAF, the CNAV and the CCMSA, and details of the income reported to the tax authorities for the calculation of income tax.

Ines is a so-called “static” model: it does not take into account any changes in household behaviour, for example in terms of birth rates or labour market participation, which could be induced by changes in tax-benefit law. Since 1996, the model has been updated annually during the summer in order to simulate the most recent legislation and cover the preceding year. For example, in the summer of 2016, *Ines* was updated to simulate the legislation for 2015. Based on these updates, the INSEE and DREES teams contribute annually to the INSEE's *Social Portrait*, in which they analyse the

redistributive balance sheet for the tax and benefit measures enacted during the preceding year. The latest publication is entitled “Tax and benefit reforms in 2015 are leading to a slight redistribution from the richest 30% to the rest of the population” ([André, Biotteau, Cazenave, Fontaine, Sicsic, Sireyjol](#)).

[1] Recall that the family quotient gives entitlement to a maximum tax reduction of 30,000 euros per year. The abolition of the family quotient would yield 5.5 billion euros (HCF, 2011) but would cost all the UBI paid to partners with a lower income who have chosen individualization.

[2] We have chosen not to take into account these tax optimization mechanisms within households, but it is understood that this means the evaluation proposed for the cost of the measure is underestimated.

[3] The source code and documentation for the *INES* micro-simulation model was opened to the public in June 2016 (<https://adullact.net/projects/ines-libre>). We have been using the 2015 open access version since 1 October 2016.

[4] In particular, the use of a micro-simulation model such as *INES* makes it possible to explore the consequences of different choices that can be made about the situation of the persons covered, the net redistribution effected and what has to be financed. A change in the rules for allocating or calculating a social benefit can have significant impacts on the net cost and the redistributive effects.

[5] The proposed measure significantly alters the distribution of living standards. Due to this, some households see their membership in a decile of living standards change positively or negatively. The deciles are maintained here at their pre-

reform level.

[\[6\]](#) By way of illustration, the average age of the reference persons in households in the upper decile of the standard of living benefiting from the UBI is over 55. It can thus be assumed that these households are home to young adults who are fiscally independent but have few resources.

[\[7\]](#) The evaluation presented here is called “static”. It therefore does not take into consideration any possible changes in individual behaviour with respect to employment due to the impact of this measure.

Inequality in Europe

By [Guillaume Allègre](#)

In the preamble to the Treaty establishing the European Economic Community, the Heads of State and Government declare that they are “[r]esolved to ensure the economic and social progress of their countries by common action to eliminate the barriers which divide Europe”. Article 117 adds that “Member States agree upon the need to promote improved working conditions and an improved standard of living for workers, so as to make possible their harmonisation while the improvement is being maintained”. Sixty years after the Treaty of Rome, what is the state of economic and social inequality in Europe? How did this change during the crisis?

Every year Eurostat measures inequality in the different EU Member States. The Great Recession has led to widening inequality within the countries of Europe. The Gini index of

equivalent disposable income rose from 30.6 in 2007 to 31 in 2015 on average in the 28 EU Member States. However, part of the increase is due to large breaks in the series in France and Spain in 2008. Inequality is thus clearly lower in Europe than in the United States: for 2014, the Gini index of disposable income is estimated at 39.4 in the United States, while in the European Union it ranges from 25 (Czech Republic) to 37 (Bulgaria). The United States is therefore more unequal than any country in the EU and much more unequal than most countries.

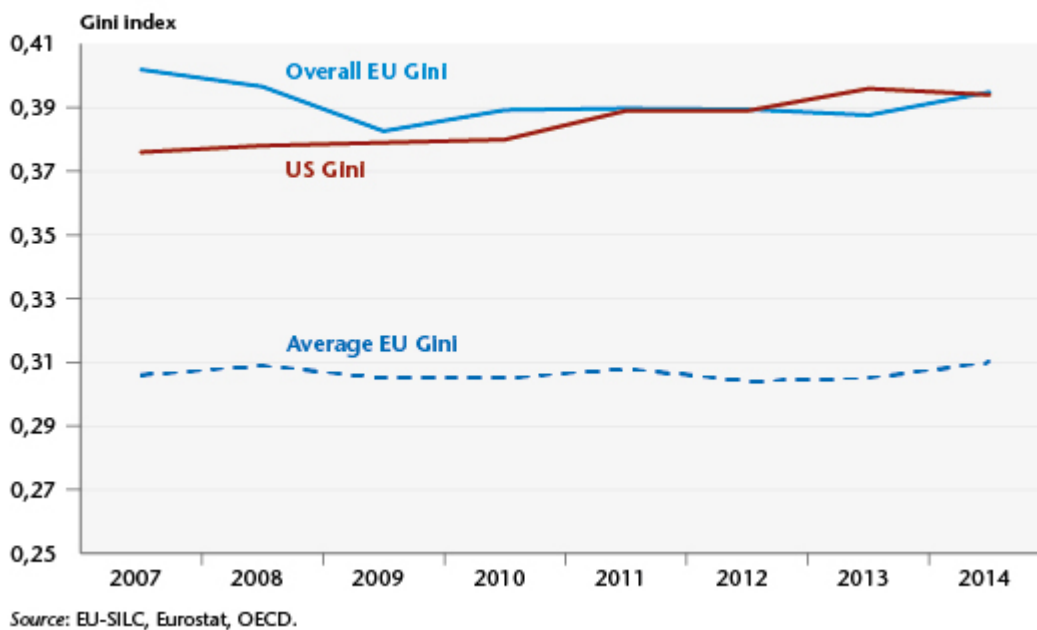
However, the presentation of an average Gini index in the European Union may be misleading. Indeed, it takes into account only inequalities within the European countries and not inequalities between countries. However, there are significant inequalities between European countries. In the national accounts, household income based on EU consumer purchasing power in 2013 ranged from 37% of the European average (Bulgaria) to 138% (Germany), i.e. a ratio of 1 to 4.

At the European level, Eurostat calculates an average of national inequalities, as well as the international inequalities. On the other hand, Eurostat does not calculate inequalities between European citizens: what would inequality be if national barriers were eliminated and European inequality was calculated at the European level in the same way that one calculates inequality within each nation? It might seem legitimate to calculate inequality between European citizens like this insofar as the European Union constitutes a political community with its own institutions (Parliament, executive, etc.).

The EU-SILC database, which provides the equivalent disposable income (in purchasing power parity) of a representative sample of households in each European country makes such a calculation possible. The result is that the overall level of inequality in 2014 in the European Union is the same as that in the United States (graph). What conclusion should be drawn?

If we look at the glass as half-empty, we could emphasize that European inequality is at the same level as in the world's most unequal developed country. If we look at the glass as half-full, we could emphasize that the European Union does not constitute a nation with social and fiscal transfers, that it has recently expanded to include much poorer countries and that, nevertheless, inequality is no greater than in the United States.

Figure: Inequality in disposable income in Europe and the United States, 2007-2014



Overall inequality in the European Union can be seen to decline slightly between 2007 and 2014. The Theil index, another indicator of inequality, can be used to break down the change in European inequalities between what comes from changes in inequality between countries and what comes from changes within countries. Between 2007 and 2014, the Theil index fell from 0.228 to 0.214 (-0.014). Inequality within countries was generally stable (+0.001) whereas inequality between countries declined (-0.015). These developments are similar to what has been observed by Lakner and Milanovic at the global level ([“Global Income Distribution: From the Fall of the Wall to the Great Recession”](#)): rising national inequalities and declining inequalities between countries (in

particular due to China and India catching up).

So far, the main instrument used by the European Union to reduce inequality in Europe has been the opening of borders. But while opening up borders can help the EU's less affluent countries (notably Bulgaria and Poland) to catch up, it can also have an impact on inequality within countries. However, Europe does not as yet have a social policy. This sphere falls above all within the competence of the States. But opening up the borders is exacerbating social and fiscal competition. For instance, the higher marginal rates of personal income tax (IRPP) and corporate income tax (IS) have dropped significantly since the mid-1990s, while the VAT rate has increased (A.Bénassy-Quéré et al., "[Reinforcing tax harmonization in Europe](#)" [in French]).

In France, the government has committed to lower the corporate income tax rate from 33.3% to 28% by 2020. This follows a trend towards [lowering taxation on business but raising it on households](#). The impact on inequality has so far been counterbalanced by the fact that [the rise in taxation has focused on the wealthiest households](#). However, the French Presidential candidates Fillon and Macron advocate a substantial reduction in the taxation of capital income (withholding tax and the reduction of the ISF wealth tax on real estate for Macron; elimination of the wealth tax for Fillon) in the name of competitiveness. The [dangers of fiscal and social competition](#) are thus beginning to make themselves felt.

The Treaty of Rome and equality

By [Hélène Périvier](#)

The Treaty of Rome: Article 119, Title VIII, “Social Policy, Education, Vocational Training, and Youth”, Chapter 1: Social Provisions: *Each Member State shall during the first stage ensure and subsequently maintain the application of the principle that men and women should receive equal pay for equal work.*



Europe’s institutions take pride in the fact that one of their founding values is the principle of equality between women and men^[1]. Indeed, as early as the Treaty of Rome, the question of equal pay was the subject of negotiations that resulted in the adoption of Article 119, guaranteeing “the application of the principle that men and women should receive equal pay for equal work”.

On closer inspection, the motives that led the signatory countries to adopt this article are not linked, at least not directly, to considerations of justice or to egalitarian values that the Member States might have upheld right at the outset, thereby making equality a founding “value” of Europe’s institutions. No, the motives are above all economic in nature.

The Treaty of Rome is aimed at economic integration and not at

a political or social union. Re-examining the genealogy of Article 119 sheds light on the tension between economic issues related to the organization of trade and production and social issues, particularly those related to justice and equality.

Guaranteeing fair competition

Article 119 seeks to organize fair competition within the new space for the free movement of goods, services and people. Of the six countries signing the Treaty, it was France that demanded an article on equal pay. Indeed, unlike some of its partners, including Germany, France had already adopted legislation on women's wages and equal pay. In the framework of restructuring industrial relations after the Second World War, the French State had developed occupational classifications and a wage hierarchy that led in some branches to affirming the principle of equal pay, even if there was still substantial potential for discrimination (Saglio, 2007). In July 1946, the Croizat decision abolished the 10% reduction on women's wages. Finally, the Law of 11 February 1950 generalized collective bargaining agreements and introduced the principle of "equal pay for equal work" (Silvera, 2014).

France therefore feared that an opening up to competition in the market for goods and services would disadvantage productive sectors in which the proportion of women was high, especially in textiles (Rossilli, 1997). In 1956, the International Labour Organization (ILO), conscious of these issues, commissioned a report by a committee chaired by the economist Ohlin on the social consequences of European economic integration. The question of equal pay was raised explicitly (point 162, p. 64), and data at hand, the report denounced the risk of unfair competition in highly feminized industries (Ohlin, 1956) [\[2\]](#). The differences in social rights between Member States called for labour market regulation in order to avoid distorting competition within the common market. The discussions, which led to Article 119, did not include discussion of women's rights or fair pay for women's

work (Hoskyns, 1996).

Principles of supranational justice and economic pragmatism

The inclusion in the Treaty of Rome of the principle of equal pay was thus motivated by economic and not ethical considerations, and it is for economic reasons that, even though the principle was announced, it was not applied immediately, as it would have led to a massive increase in wage costs (unless men's wages were cut). Despite all this, principles of justice were not completely alien to this process. Indeed, they were part of the international approach to the affirmation of human rights in the post-war years: the United Nations Universal Declaration of Human Rights of 1946 [\[3\]](#) affirms equal rights in its preamble, and the 1944 Declaration of Philadelphia, which underpinned the mandate of the ILO, states that, "all human beings, irrespective of race, creed or sex, have the right to pursue both their material well-being and their spiritual development in conditions of freedom and dignity, of economic security and equal opportunity" [\[4\]](#). The ILO Equal Remuneration Convention (No. 100), adopted in 1951, states that, "Each Member shall, by means appropriate to the methods in operation for determining rates of remuneration, promote and, in so far as is consistent with such methods, ensure the application to all workers of the principle of equal remuneration for men and women workers for work of equal value" [\[5\]](#). Some European countries adhered to the stated principles faster than others, including Belgium and France, which ratified Convention 100 respectively in 1952 and 1953. These countries pulled along their partner signatories to the Treaty of Rome in their path, in order to limit the distortion of competition that would result from a lack of uniform adherence to this principle of justice in an integrated economic area.

In looking further back at the genesis of texts pertaining to equal pay, economic motivations can also be found: the founding text of the ILO in 1919 does include the principle of

equal pay, regardless of gender, for work of equal value (Section II., Article 427, 7) [\[6\]](#). This particular attention to equality is explained partly by the trade unions' fear that men's wages might fall. Indeed, during the war, women had worked for lower wages doing jobs reserved for men in peacetime. Demanding equal pay made it possible to contain this unfair competition represented by women (Ellina, 2003; Hoskyns 1996).

The metamorphosis of Article 119

It is fruitless to seek the historical roots of the affirmation of the principle of equal pay, as the economic argument is articulated around considerations of justice. This dialectic led the actors of the moment to draw on one or to reaffirm the other. During the Treaty of Rome negotiations, differences between countries concerning entitlement to paid leave, the regulation of working time and the payment of overtime were also identified as sources of the distortion of competition. It is thus not so much the place of gender equality in the negotiations between the signatory countries that is to be questioned as the very nature of a Treaty that aims at economic integration and not the harmonization of the social policies of the signatory countries. At the time, economic integration was probably the least confrontational perspective from which to negotiate and bring about a rapprochement between European countries.

Article 119 of the Treaty of Rome, although intended to regulate competition, has become a pillar of the construction of European law on equality and the fight against discrimination. In the late 1970s, under the impetus of feminist movements, this principle was used more and more and became a founding principle of Europe's institutions (Booth and Bennett, 2002). In 1971, the Court of Justice of the European Communities referred to it in declaring that the elimination of discrimination on the grounds of sex is one of the general principles of Community law (see the Defrenne

judgment^[7]). In 1976, the scope of equal pay was extended by the 1976 Directive (76/207) to cover all the terms of hiring and training as well as working conditions (Milewski and Sénac, 2014). As a tool for regulating the common market, it has become a principle of law.

Finding the spirit of Philadelphia once again

The principle of equality as set out in the Declaration of Philadelphia does not rely on the economic interest of promoting gender equality but affirms this principle as a value in itself. During the negotiations preceding the signing of the Treaty of Rome, the harmonization of social provisions was achieved by generalizing the principle of equal pay to countries that had not yet taken it on board, not by asking countries that had already adopted it to abandon it. In this approach, the principle of justice takes precedence over the economic perspective: the evaluation of the economic consequences of having a principle of equal pay that had not been generalized in an integrated economic space led to its adoption by all the member countries in this space, and ultimately to strengthening it.

Since the 2000s, there has been a shift in the promotion of policy on equality: it is no longer a question of analyzing the economic consequences of the principles of justice or conversely of denouncing the infringement of the principles of justice of certain economic policies, but rather of overturning the hierarchy between the two perspectives. Equality is promoted in the name of the real or phantom economic benefits that it would produce. Supranational organizations, European institutions and national forces all tout the virtues of equality in terms of economic prosperity. The assertion of the principle of justice in itself is no longer sufficient to establish the merits of equality policies, which are a priori considered costly. Equality, which is often reduced to increasing women's participation in the labour market and their access to positions of

responsibility, is a source of growth and wealth. It is no longer a question of a complex articulation between economic forces and founding principles, but rather the justification of these principles based on the profitability or efficiency of the market economy (Périvier and Sénac, 2017, Sénac, 2015). This approach, far from anecdotal, is endangering equality as a principle of justice, and distances us from the humanist approach of the supranational institutions during the first half of the 20th century. Have we lost the spirit of Philadelphia (Supiot, 2010)?

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Notes:

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[6] http://www.ilo.org/public/libdoc/ilo/1920/20B09_18_fren.pdf

[7]

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European banking regulation: When there's strength in union

By [Céline Antonin](#), [Sandrine Levasseur](#) and [Vincent Touzé](#)

At a time when America, under the impulse of its new president Donald Trump, is preparing to put an end to the banking regulation adopted in 2010 by the Obama administration [\[1\]](#), Europe is entering a third year of the Banking Union (Antonin et al., 2017) and is readying to introduce new prudential regulations.

What is the Banking Union?

Since November 2014, the Banking Union has established a unified framework that generally aims to strengthen the financial stability of the euro zone [\[2\]](#). It has three specific objectives:

- To guarantee the robustness and resilience of the banks;
- To avoid the need to use public funds to bail out failing banks;
- To harmonize regulations and ensure better regulation and public supervision.

This Union is the culmination of lengthy efforts at regulatory

coordination following the establishment of the free movement of capital in Article 67 of the Treaty of Rome (1957): “During the transitional period and to the extent necessary to ensure the proper functioning of the common market, Member States shall progressively abolish between themselves all restrictions on the movement of capital belonging to persons resident in Member States and any discrimination based on the nationality or the place of residence of the parties or on the place where such capital is invested.”

The Banking Union was born out of the crisis. While the Single European Act of 1986 and the 1988 EU Directive allowed the free movement of capital to take effect in 1990, the financial crisis of 2008 revealed a weakness in Europe’s lack of coordination in the banking sphere.

Indeed, the lessons of the financial crisis are threefold:

- A poorly regulated banking and financial system (the American case) can be dangerous for the proper functioning of the real economy, in the country but also beyond;
- Regulation and supervision that is limited to a national perspective (the case of European countries) is not effective in a context where capital movements are globalized and numerous financial transactions are conducted outside a country’s borders;
- The banking and sovereign debt crises are linked (Antonin and Touzé, 2013b): on the one hand, bailing out banks by using public funds increases the public deficit, which weakens the State, while the problematic sustainability of the public debt weakens the banks that hold these debt securities in their own funds.

The Banking Union provides a legal and institutional framework for the European banking sector, based on three pillars:

(1) The European Central Bank (ECB) is the sole supervisor of

the major banking groups;

(2) A centralized system for the regulation of bank failures includes a common bailout fund (the Single Resolution Fund) and prohibits the use of national public funding;

(3) By 2024, and subject to the definitive agreement of all the members of the Banking Union, a common fund must ensure that bank deposits held by European households are guaranteed for up to 100,000 euros, with deposits guaranteed by each State from 2010.

The Banking Union is not fully completed. The adoption of the third pillar is lagging behind due to the difficulties being experienced by the banks in Greece and Italy, which have not been entirely resolved due to the continuing risk of default on existing loans. The European deposit guarantee “will have to wait until sufficient progress has been made to reduce and harmonize banking risks” (Antonin et al., 2017).

Towards stronger regulation and greater financial stability

The Banking Union has come into existence alongside the new Basel III prudential regulations that have been adopted by all Europe’s banks since 2014 following a European directive and regulation. The Basel III regulations require banks to maintain a higher level of capital and liquidity by 2019.

The establishment of the Banking Union coupled with the ECB’s highly accommodative monetary policy has helped to put an end to the crises in sovereign debt and the European banking sector. The ECB’s massive asset purchase programme is helping to improve the balance sheet structure of indebted sectors, which is reducing the risk of a bank default. Today, the Member States, business and households are borrowing at historically low interest rates.

The establishment of a stable, efficient European banking and financial space requires further steps to regulate both a

unified European capital market and the banks' financial activities (Antonin et al., 2014).

The main objective of a union of the capital markets is to provide a common regulatory framework to facilitate the financing of European companies by the markets and to channel the abundant savings in the euro area towards long-term investments. This would allow for a more coherent and potentially more demanding level of regulation of the issue of financial securities (equities, bonds, securitization operations).

The Banking Union could also be strengthened by drawing on the 2014 Barnier proposal for a high level of separation of deposit and speculative activities. The ECB's unique supervisory role (pillar 1) enables it to ensure that speculative activities don't disrupt normal business. This supervisory role could be extended to embrace all financial activities, including the infamous credit system of "shadow banking" that parallels conventional lending. The separation of activities also strengthens the credibility of the common bail-out funds (pillar 2) and guarantee funds (pillar 3). Indeed, it is becoming more difficult for banks to be too big, which reduces the risk of bankruptcies that are costly for savers (internal bailout and limits on common funds).

Defending a European model of banking and financial stability

At a time when the United States is currently abandoning the more stringent regulation of its banks in an effort to boost their short-term profitability, Europe's Banking Union is a remarkable defensive tool for preserving and strengthening the development of its banks while demanding that they maintain a high level of financial security.

While the US courts are not hesitating to impose heavy fines on European banks [\[3\]](#), and China's major banks now occupy four out of the top five positions in global finance (Leplâtre and

Grandin de l'Eprevier, 2016), a coordinated approach has become crucial for defending and maintaining a stable and efficient European banking model. In this field, a disunited Europe could seem weak even while its surplus savings make it a global financial power. The crisis has of course hurt many European economies, but we must guard against the short-term temptations of an autarkic withdrawal: a European country that isolates itself becomes easy prey in the face of a changing global banking system.

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[1] The Dodd-Frank Wall Street Reform and Consumer Protection Act adopts the Volcker rule “which prohibits banks from ‘playing’ with depositors’ money, which led to a virtual ban on the proprietary speculative activities of banking entities as well as on investments in hedge funds and private equity funds” (Antonin and Touzé, 2013a).

[2] The Banking Union is compulsory for euro area countries and optional for the other countries.

[3] Recent events have shown that US justice can prove to be extremely severe as large fines are imposed on European banks: 8.9 billion dollars for BNP Paribas in 2014, and 5.3 billion for Credit Suisse and 7.2 billion for Deutsche Bank in 2016.

Europe’s competition policy – or extending the domain of

integration

By [Sarah Guillou](#)

The principle of “fair competition” was set out in the general principles of the Preamble to the Treaty of the European Communities (TEC) in 1957, as was the commitment that the Member States will enact policies to ensure this fairness. Competition policy – overseen by the Competition Directorate – is the benchmark policy for market regulation, but also for industrial strategy and, more recently, for fiscal regulation.

The need for a competition policy flows directly out of Europe’s project to establish a common market, and numerous attempts at industrial policy have come to grief on the altar of Articles 81 to 89 of the TEC (and now Articles 101 to 109 of the Treaty on the Functioning of the European Union), which establish the framework for competition. In practice, the two policies are clearly complementary in the European Union, and the space granted to the former develops thanks to the set of exceptions to the latter.

Competition as a general framework in the European Union

As a foundation of the common market, respect for and controls on market competition is a general principle underlying all European policy. More fundamentally, competition can be considered a *constitutional* principle of the European Union. It makes it possible to define the European space, the common space whose existence depends on controls on competition between States. Europe’s competition law is therefore developed first of all to control economic competition between the States. The aim is to prevent the States from adopting policies that create benefits for companies in their own territory and discriminate against companies from other States.

Within the European Commission, the Competition Directorate

therefore has a significant role and responsibility. Supervision of competition is exercised through the control of mergers and cartels on the one hand, and the control of State aid on the other. To monitor cartels or any other abuse of a dominant position, competition law is exercised *ex post* to protect consumers and competitors from predatory behavior and abusive pricing. Control over concentration developed generally from the second half of the 1980s, in synch with the increase in the size of mergers and the opportunities for European rapprochements, which resulted from the success of the single market. Moreover, mergers and acquisitions are increasingly the subject of negotiations between the companies involved and the European Commission and conclude with a transfer of activity. For example, the acquisition of Alstom's energy division by General Electric in 2015 was accompanied by the sale of part of the gas turbine business to the Italian company Ansaldo Energia. This control has given the Commission an active role in the structuring of the market, which amounts to a super power, but since the 1990s, fewer than 1% of notifications concerning concentrations have led to a veto by the Commission.

European supervision of aid has been relatively continuous since it presupposes a permanent exercise of supervision of "undistorted competition" in the European area. It is a tool both to control any distortions of competition created by a Member State granting advantages to its companies and to fight against a race to "who grants most" in terms of subsidies. Thus, Article 87 (1) of the Treaty establishing the European Community states that State aid is considered to be incompatible with the common market, and Article 88 gives the Commission a mandate to monitor such aid. But Article 87 also specifies the criteria the Commission uses to investigate aid.

Business subsidies are subject to the Commission's authorization if they exceed 200,000 euros over three years and they are not included in the set of exemptions decided by

the EU. The majority of aid investigated is authorized (almost 95%). As for France, the percentage of aid disallowed out of the amount granted is in line with the European average. There have of course been some noteworthy decisions, such as when EDF was required to repay 1.4 billion euros in 2015 following tax assistance dating back to 1997. But the Commission also recently allowed the French State to acquire an interest in the capital of PSA Peugeot Citroën (2015). Similarly, the Commission authorized the public-private partnership underpinning the construction of the Hinkley Point nuclear power plant in Great Britain.

Some recent developments in the exercise of this control should be noted. The regulation of State aid has been used to examine the provisions of tax agreements negotiated by companies with certain governments such as Ireland, Luxembourg and the Netherlands. By favouring some companies to the detriment of their competitors, these tax agreements create not only distortions in competition but also competition between States to attract the profits and jobs of the large multinationals. For example, in October 2016, the Commissioner for Competition, Margarethe Vestager, described the tax agreement that Apple had received in Ireland as unauthorized State aid, and accordingly required the Irish government to recover 13 billion euros from Apple. This use of the regulatory power over State aid constitutes a turning point in competition policy, in that it recalls that the object of competition policy is to ensure that competition between States does not go against the notion of $\square\square$ a common market.

Industrial policy is expressed in the exceptions to competition policy

Note that while competition policy is well defined at European level, there are many meanings of industrial policy in Europe, almost as many as there are members. This makes it more difficult to find policy compromises prior to the definition of such a policy. Moreover, the institutional logic and the

economic logic are not the same. As already noted, competition policy has a strong institutional anchorage, which is not the case with industrial policy. Even though the European Coal and Steel Community was at the origin of the European Community, industrial policy is not at the heart of the European project. Moreover, the economic logic is different: competition policy is defined with reference to space (the relevant market), whereas industrial policy can be understood only by integrating the life cycle of companies and industries, and therefore in reference to each country's industrial history. In a shared sense, industrial policy can be defined as policy that is aimed at orienting an economy's sectoral and / or technological specialization. It is therefore easy to grasp the dependence of industrial policy on national preferences. The tool favoured by the States to express this policy is aid to companies, whether directly or indirectly.

State aid is classified according to 15 objectives, ranging from "preservation of the heritage" to aid for "research and development and innovation". For the EU as a whole, the three categories that are largest as a percentage of total aid are: environmental protection (including aid for energy savings), regional aid, and aid for R&D and innovation. The amounts involved are far from negligible: in 2014, for example, 15 billion euros for France and 39 billion for Germany. A higher amount of aid in 2014 was due largely to an increase in aid for renewable energy as a result of the adoption in 2014 of revisions on the rules on this type of aid. Germany is the country that contributed the most to this increase. Support for renewable energies is indeed at the heart of its industrial policy.

European industrial policy develops as exemptions to the application of control on aid and hence to competition policy. These exemptions are set out in the general regulations on exemptions by category. There are many Block Exemptions, which revolve around the following five themes: innovation and R&D,

sustainable development, the competitiveness of EU industry, job creation, and social and regional cohesion. It can be seen in this set of exemptions that supervision is also the expression of Europe's policy choices on orienting public aid, and thence directing public resources towards uses that are in line with these choices. These choices are the result of a relative consensus on the future of the European economy which shapes industrial policy. The largest categories of aid are research and development and environmental protection. In a word, the European economy will be technological and sustainable. This is a policy of orientation and not a policy of resources, and it takes shape within the overarching framework of the policy on competition.

What future for Europe's competition policy?

It seems that, given the primacy of competition policy and its foundational role for Europe's union, competition policy is the conductor of microeconomic policy. It has, up to now, proved capable of adapting. Thus, in compliance with the European project, economic constraints and societal orientations have led to changes in the definition of exemptions on the control of aid, which have allowed for the expression of industrial policy. Similarly, it has seized upon the fiscal hyper-differentiation between certain States, which sharply contravened European integration and the common market.

Competition policy must not be weakened in authority or scale, but it must retain its capacity to adapt both to industrial orientations and to the deployments of Member States' strategies on competition with each other. It is also an essential counter-power to the growing strength of the multinationals, and governments must support it in this sense rather than becoming the mouthpieces of their national champions.