

The Preamble of the Treaty of Rome: 60 years later, what conclusions can be drawn?

By [Éloi Laurent](#)

The Treaty establishing the European Economic Community (the more emblematic of the two Treaties of Rome) gave life and body to the ideal of European integration that had been sketched in particular by Victor Hugo. Sixty years after its signature, here is a brief commentary, necessarily subjective, on the Preamble of this founding text (the past and present participles that open each paragraph of the text refer to the six heads of state and government who were signatories to the Treaty on 25 March 1957).

Determined to lay the foundations of an ever closer union among the peoples of Europe,

There are at least two possible readings of the objective referred to in the first paragraph of the EEC Treaty. The first sees in the “union” of “peoples” the union of their governments, and from this perspective it seems very difficult to dispute that since 1957 the European executive authorities have come together and now collaborate closely, with new elements of their sovereignty pooled. But the injunction of Jean Monnet, one of the principal architects of the Treaty, should not be forgotten: “our mission is not to unite states, but to unite people”. What, then, is to be said of the union of nations? A number of more or less anecdotal surveys seem to indicate that [stereotypes die hard in Europe](#) and that Europeans still do not know each other very well.

More fundamentally, it is the confidence placed by Europeans in their union that seems to be a relevant indicator of how solid it is [\[1\]](#). The Eurobarometer of autumn 2016 (published

in December 2016) indicates that confidence in the EU has fallen to 36%, almost fifteen points below its 2004 level (according to Eurostat data, confidence in European institutions fell from 53% in 2000 to 42% in 2014). It is from 2011 that a majority of citizens began to turn away from the European Union, at a time, one might think, when the EU Member States were proving resolutely incapable of proposing a coordinated and effective strategy to get out of the crisis and when the bloc was once again plunging into recession. Confidence in the EU is lower in the euro area than in the non-euro countries, and it is particularly low in the major signatories of the EEC Treaty – Germany, France and Italy – where it fails to rise above 30%.

Resolved to ensure the economic and social progress of their countries by common action to eliminate the barriers which divide Europe,

The central tenet of Europe's strategy over the post-World War 2 years is set out here: by creating and consolidating the "four freedoms" of circulation (of goods, services, capital and persons) and steadily forming a European internal market, called a single market in the 1990s), the drafters intended to promote the prosperity of nations and to break down the mental barriers that have so deeply divided Europeans. The result, sixty years later, is an asymmetric integration: mobility, while high for goods and especially capital, remains low for people and services. Article 117 of the Treaty, which aims at "equalization in the progress" of living conditions, envisages that this will be achieved by the "functioning of the common market, which will promote the harmonization of social systems". Europe's asymmetric integration has instead generated fierce tax and social competition. However, Europeans are strongly attached to their respective social models: according to the Eurobarometer, 82% of them believe that "the market economy should go hand in hand with a high level of social protection". Sixty years after the signing of

the Treaty of Rome, if a European identity does indeed exist, it is centred on this belief.

But while for decades the free movement of people, structurally weak in the EU, has had only a marginal presence in European debates, it played a central role in the decision of the United Kingdom to leave the EU: whereas the British intended to propose a trade-off between the free movement of goods, capital and services, which they intended to keep, and the free movement of people, which they no longer want, the EU's institutions and Member States reaffirmed that the four freedoms form a bloc, to be taken or left together.

Affirming as the essential objective of their efforts the constant improvement of the living and working conditions of their peoples,

There is little doubt that Europeans' living conditions have improved since 1957, but their "constant improvement", affirmed as an "essential goal" by the Treaty of Rome, has come into question empirically in the recent period. According to the United Nations Human Development Index (HDI) [\[2\]](#), an imperfect measure that partly reflects people's living conditions, the situation in European countries, which can be assessed only since 1990 (the date when homogeneous data became available for the EU-28), indicates almost constant progress in the member countries up to 2000, the turning point after which the rate of HDI growth slows, falling to almost zero in 2014. "Employment conditions", which are approximated by the unemployment rate, have also deteriorated since 2000, with the unemployment rate recovering to its 2000 level only in 2016.

But the essential point is undoubtedly the way that Europeans today perceive the possibility of their living conditions improving. The Eurobarometer says that 56% of Europeans now believe that their children will lead harder lives than they did. According to data from the Pew Research Center, [Europeans](#)

[are now the most pessimistic in the world in terms of their economic future.](#)

Recognising that the removal of existing obstacles calls for concerted action in order to guarantee steady expansion, balanced trade and fair competition,

Anxious to strengthen the unity of their economies and to ensure their harmonious development by reducing the differences existing between the various regions and the backwardness of the less favoured regions,

These two paragraphs are aimed at averting two imbalances in Europe, which have in fact been reinforced in recent times: current account imbalances (going against “balanced trade”) and geographical imbalances (undermining the “harmonious development” of the territories of the European Union). On the first point, trade imbalances between EU Member States and in the euro area in particular are now well known and documented, as is the major destabilizing role being played by Germany. On the second point, the success of the single market inherited from the Treaty of Rome has been paradoxical: it brought countries closer together but led to divergence between the regions (and more generally the territories). It can for instance be shown that in the European Union [the gap in economic development between regions is stronger than the gap between countries](#) [3]. This spatial fracture within Europe’s countries, which is found in other countries outside Europe but which the single market has undoubtedly accentuated by the powerful agglomeration effects it generates, is not without consequence for the geographical polarization observed in recent polls, in the United Kingdom, [Austria](#) and France.

Desiring to contribute, by means of a common commercial policy, to the progressive abolition of restrictions on international trade,

The drafters of the Treaty of Rome were right: the EEC and

then the EU have contributed greatly to the liberalization of trade around the planet and therefore to contemporary globalization. While in 1960 the six EEC Treaty countries represented about a quarter of world trade, by 2015 the 28 EU countries accounted for about 34% of world trade. One-third of globalization has involved Europeanization.

Intending to confirm the solidarity which binds Europe and the overseas countries and desiring to ensure the development of their prosperity, in accordance with the principles of the Charter of the United Nations,

Resolved by thus pooling their resources to preserve and strengthen peace and liberty, and calling upon the other peoples of Europe who share their ideal to join in their efforts,

Have decided to create a European Economic Community...

This last section sets out the heart of the European promise: peace based on a market that relies on the law and calls forth enlargement. There is no denying that civil liberties and political rights have progressed on the continent, guaranteeing the Member States the longest period unbroken by war since the sixteenth century. In 1957, only 12 of the current 28 Member States were democracies – all are today. And democracies are far less prone to war than other political regimes. It is no exaggeration to say that Europe is today the most democratic continent in the world, with almost 90% of its countries considered free, compared with only 70% in the Americas, 40% in Asia, 20% in sub-Saharan Africa and only 1% in the Middle East and North Africa (according to data from Freedom House). But the threat has changed in nature: it is no longer primarily international conflict that endangers Europe (although the new Russian imperialism cannot be taken lightly), but internal conflict.

Political instability, already evident in Greece, is rising in

many countries, in Austria, the Netherlands, Finland, Italy and of course France. The European Union has contributed to the deep social resentment that is feeding the very secessionist parties that intend to dismantle it. The response to this risk of disintegration must be on a par with the Treaty of Rome, whose preamble affirms values [\[1\]](#)and sets out horizons. In this respect, the European Commission's tribute is contradictory: the [White Paper on the future of Europe](#), released on 1 March, considers the question of what Europeans want to do together and how they could do it, together or separately. But for the first time in sixty years, the Union is not expanding but shrinking. For the first time in sixty years, Europeans believe their children will have harder lives than they did. For the first time in sixty years, democracy is being threatened on the continent and, aggravating this situation, from within. The greatest danger for European construction is not the crisis: it is complacency about the crisis.

[\[1\]](#) The Eurobarometer, created in the spring of 1974, measures confidence in European institutions and the European Union, and is intended to reveal Europeans to one another through the expression of their respective public opinions.

[\[2\]](#) The HDI aggregates indicators on health, education and income on a parity basis.

[\[3\]](#) If the special case of Luxembourg is left out.

Do we need a universal basic income? The state of the debate

By [Guillaume Allègre](#) and [Henri Sterdyniak](#)

In a situation of continuing high levels of unemployment and poverty, heightening job insecurity, and fear about job losses due to automation, the proposal for a universal basic income has become a part of the economic and social debate in France and in other developed countries. Such a programme would pay a monthly allowance to any person resident in a country with no conditions on means or activity. On 13 October 2016, the OFCE, as part of its mission to stimulate informed economic debate, held a study day, which was attended by researchers who had worked on this project, to develop, support and criticize it. An [e-book](#) brings together most of the contributions that were presented and discussed during the day, some of which were revised to take into account the discussion.

The discussion focused on a number of points:

- What kind of social project do universal income proposals form part of? How would such a programme work in terms of increasing the levels of an allowance and how would it fit in with current social protection schemes?
- Is it possible to finance a universal basic income?
- What would be the financial consequences for different categories of households, especially those in a financially precarious situation?
- What would be the impact on activity, employment, unemployment, wages, working conditions, and in particular on menial labour, part-time work, precarious work, and low-wage jobs?

- Is universal income a response to the “end of work”? Is this latter a credible hypothesis?
- What are other possible ways to fight poverty and precarious work?

The article by **Henri Sterdyniak**, “From social minima to a universal basic income?”, describes the current state of the social assistance system in France, including the social minima and in-work benefits. These programmes are targeted and relatively generous, but the system is complicated, with intrusive controls, and social assistance is often perceived as stigmatizing. The article argues for maintaining the family-oriented character of income tax and social benefits. The author discusses the various arguments for universal basic income proposals and how they would work. If one wants to maintain social insurance benefits (unemployment, pensions) and universal benefits (health), a universal basic income should be financed mainly by an increase in direct taxes on households, which tends to render it unrealistic. On the other hand, it is not socially desirable to abandon the goal of full employment and to permanently exclude a large part of the population from work, even if it is guaranteed an income just above the poverty level. The article argues for a guaranteed minimum income (means-tested) on a short-term basis to promote economic recovery, for the creation of public jobs, and for “last resort” jobs, and in the longer-term for work-sharing by reducing working hours and work rates.

The article by **Guillaume Allègre**, “Universal income: Utopian or pragmatic?” emphasizes that a universal basic income is often assigned two objectives: on the one hand, to manage the end of work and, on the other hand, to simplify the tax-benefit system and eliminate the lack of take-up. For some, the income should be sufficient to live, while for others it should be relatively weak so as not to upset the tax-benefit system. Doubts remain about the reality of the scarcity of work. Moreover, a generalized reduction of working time seems

to be a more sustainable strategy than a universal income, because it deals with all employees instead of cutting society into two. Perhaps a universal basic income should be considered to be a tax-benefit reform that would help mainly to combat the lack of take-up of social benefits. We would go from assistance that must be personally requested to an automatic universal benefit. This raises the corollary question of the individualization of the tax-benefit system. The public authorities are faced with a trade-off between a simplified automatic system on the one hand and a system that offers fine-tuned responses to needs on the other.

The article by **Gaspard Koenig**, "A living income," denounces the current in-work income support system ("RSA"), deeming it paternalistic, unfair and stigmatizing. He argues for a liberal conception of a basic income that allows each individual to be responsible and autonomous and to define his or her own needs. The universal basic income would be 500 euros (250 euros for children) in the form of a tax credit, while a 25% tax would be the only income tax. The reform would not fundamentally change the distribution of wealth but would free the poorest from being haunted by poverty through providing stability and security.

The article by **Guillaume Mathelier**, "A step towards the equality of initial endowments: Towards a well-lived life", assigns society the philosophical and political objective of guaranteeing each individual "a well-lived life". The moral requirement of ensuring the "equality of initial endowments" involves three measures. The first measure concerns the establishment of a living income to cover basic needs from age 18, and comprises on the one hand an egalitarian, universal income, without imposing any requirements, together with a supplemental amount to meet any special or local needs of recipients. The second measure envisages that a living income could be capitalized during childhood and paid at age 18 in the form of an "emancipation capital", which would have a

counterpart consisting of compulsory civic service. Finally, non-monetary rights (public services, preservation of natural vital resources, common goods) must be added to guarantee the philosophical and political objective of a “well-lived life”.

Jean-Marie Monnier and **Carlo Vercellone**, after having challenged the thesis of the end of work in their article “Basic income as primary income”, propose a re-examination of the notion of productive labour in cognitive capitalism where cognitive labour, intangible and collective, tends to spread over all social time and life. The increasingly social and collective nature of work makes it impossible to measure the contribution that each individual makes to production. Thus, basic income would constitute a primary income that is directly related to production, that is, the counterpart of activities that create value and wealth, which are currently unrecognized and unpaid.

The article by **Jean-Eric Hyafil**, “Implementing a basic income: Difficulties and solutions”, offers an example of a simple reform that introduces a universal basic income at the level of France’s current income support (RSA) for a single person (475 euros), which is financed through a restructuring of income tax. The purpose of the exercise is to use this example to highlight the stakes and difficulties involved in a tax reform that introduces a universal basic income and some solutions for rendering it possible. The budgetary accounting involved in a reform like this is considered, along with its redistributive effects, the question of the future of “income tax niches”, the issue of the individualisation or couple-based character of income tax, the mobilization of financial resources other than income tax to finance a universal basic income, etc.

The article by **Anne Eydoux**, “Conditionality and unconditionality: Discussion of two myths about employment and solidarity”, denounces two myths: first, that income support (RSA) and unemployment benefits discourage work, and second,

that waged employment is coming to an end and could be replaced by a universal basic income. The article shows that it is the weakness of the jobs offer and the employment reforms that are behind the persistence of unemployment and the development of precarious employment. The proposal for a universal basic income amounts to distributing resources without organizing the production needed to generate them. It neglects the centrality of work and renounces the goal of full employment. The article suggests avenues other than a universal basic income, in particular reducing the conditionality of social benefits, but also increasing the wages of jobs deemed unskilled and reducing working hours.

In “A basic income: A remedy or a trap?”, **Jean-Marie Harribey** denounces the inconsistencies of the basic income project. He rejects the thesis of the end of work and the abandonment of the objective of full employment. He argues that work that is socially validated by the market or by a political decision is the only source of value, unlike domestic work, voluntary work or leisure activities, meaning that a basic income would of necessity constitute an income transfer. But distributing more income necessarily requires producing more, which is in contradiction with the thesis that a universal basic income would make it possible to escape the necessity of work. The article denounces the project's risks: the divide between those who would have a job and those who would be excluded, and the calling into question of social rights. It proposes the collective reduction of working time and a guaranteed allowance for adults.

The article by **Denis Clerc**, “A basic income: Much ado about not much?”, presents an analysis of universal income proposals, which he criticizes for requiring a lot of gross transfers to produce only weak redistributive effects. The same result could be achieved much more simply by boosting the incomes of the poorest strata (through benefits or the creation of socially useful jobs partially financed by the

community) and taxing the richest strata. He worries that raising taxes on the wealthiest would encounter political and economic obstacles. He hopes that experiments might be put in place and that decisions would not be taken until the results were known.

Paul Ariès in "For a demonetarized universal basic income: Defending and extending the sphere of the free" proposes an individual autonomy allocation, which to the maximum possible would be given in a demonetarized form: one part in the national currency, one part in a regional currency if possible so as to facilitate the relocation of activities towards those with high social and ecological value added, and the essential part in the form of rights of access to common goods. The aim is to extend the sphere of what's free. This free component would be used to democratize the functioning of the public services, to rethink existing products and services ecologically and socially, to decide what should be free and therefore produced as a priority, and to establish the commons, i.e. relationships based on reciprocal giving.

The text by **Bernard Friot**, "Continuing to affirm a non-capitalist production of value thanks to the political status of the producer", rejects both the basic income project (which would allow capital to no longer assume the responsibilities of employers and to organize a fall in wages and job insecurity) as well as the Keynesian response of full employment, shorter working hours and redistributive taxation. Workers must fight not for a better distribution of value, but for the production of an alternative value. They must replace capitalist institutions (profit-seeking ownership, credit, labour market) by institutions inspired by social welfare and the civil service: non-capitalist production, personal skills, lifetime wages, and the financing of investment through an economic contribution.

The article by **Mathieu Grégoire**, "The part-timers regime: A wage model for all discontinuous employment?", starts with the

experience of setting up and maintaining France's regime governing entertainment professionals (*intermittents du spectacle*). The latter organizes the socialization of wages through a framework of mechanisms ensuring interprofessional solidarity and not through a public subsidy financed by the taxpayer. Furthermore, the struggle for an unconditional income must develop through the extension of the wage relationship and the requirement of a wage for all and not through redistributive mechanisms. Based on the system for entertainment professionals, all employees in discontinuous employment should be provided with a right to an indirect socialized salary.

In any event, the debate on a universal basic income will not have been in vain if it allows for progress on two important points: the level and conditions of access to minimum social benefits, and the evolution of work.

For more, see the e-book: [Guillaume Allègre and Henri Sterdyniak \(coord.\), 2017 : « Faut-il un revenu universel ? L'état du débat », OFCE ebook](#)

The European economy in 2017 – or, the post-Brexit EU

By [Jérôme Creel](#)

The just released [L'économie européenne 2017](#) provides a broad overview of the issues being posed today by the European Union project. Brexit, migration, imbalances, inequality, economic rules that are at once rigid and flexible... the EU remains an

enigma. Today it gives the impression of having lost the thread of its own history or to even to be going against History, such as the recent international financial crisis or in earlier times the Great Depression.

A few months after the bankruptcy of Lehman Brothers, the G-20 Summit of the heads of State and Government held in London in April 2009 drew up a list of recommendations to revive the global economy. These included implementing active fiscal and monetary policies, supporting the banks and improving banking regulation, rejecting the temptation of protectionism, fighting against inequality and poverty, and promoting sustainable development.

These recommendations were in contrast to the policies implemented shortly after the Great Depression back in the 1930s. At that time, economic policies started with restrictive measures, thereby fueling the crisis and rising inequality. Protectionism in that epoch became not just a temptation but a reality: tariff and non-tariff barriers were erected in an effort to protect local business from international competition. We know what happened later: the rise of populism and extremism that plunged Europe, and then the world, into a terrible war. The economic lessons learned from the catastrophic management of the 1930s crisis thus contributed to the recommendations of the London G-20 Summit.

What now remains of these lessons in Europe? Little, ultimately, other than a resolutely expansionary monetary policy and the establishment of a banking union. The first is meant to alleviate the current crisis, while the second is intended to prevent a banking crisis in Europe. While this is of course not nothing, it is based on a single institution, the European Central Bank, and is far from sufficient to answer all the difficulties hitting Europe.

Brexit is one of these: as the first case of European disintegration, the departure of the United Kingdom poses the

issue of the terms of its future partnership with the European Union (EU) and re-raises the question of protectionism between European states. The temptation to turn inwards is also evident in the way that the refugee crisis has been managed, which calls for the values of solidarity that have long characterized the EU. Differences between EU Member States in terms of inequality, competitiveness and the functioning of labour markets require differentiated and coordinated policies between the Member States rather than the all-too homogeneous policies adopted up to now, which fail to take an overall view.

This is particularly true of the policies aimed at reducing trade imbalances and those aimed at cutting public debts. By applying fiscal rules to manage the managing public finances, even if these are not perfectly respected, and by imposing quantitative criteria to deal with economic and social imbalances, we lose sight of the interdependencies between the Member States: fiscal austerity is also affecting our partners, as is the search for better price competitiveness. Is this useful and reasonable in a European Union that is soon to be the EU-27, which is seeing rising inequalities and struggling to find a way to promote long-term growth?

L'économie européenne 2017 takes stock of the European Union in a period of severe tensions and great uncertainty, following a year of average growth and before the process of separation between the EU and the UK really begins. During this period, several key elections in Europe will also serve as stress tests for the EU: less, more or better Europe – it will be necessary to choose.

Could Trump really re-industrialize the United States?

By [Sarah Guillou](#)

Callicles to Socrates: "What you say is of no interest to me, and I will continue to act as I have previously, without worrying about the lessons you claim to give." Gorgias, Chapter 3

Only 8% of the jobs in the United States are now in industry. Donald Trump, the new President of the United States, wants to reindustrialize America and is speaking out against the opening of factories abroad and the closing of local factories. Is there any economic rationale for the indiscriminate communications of the new US President?

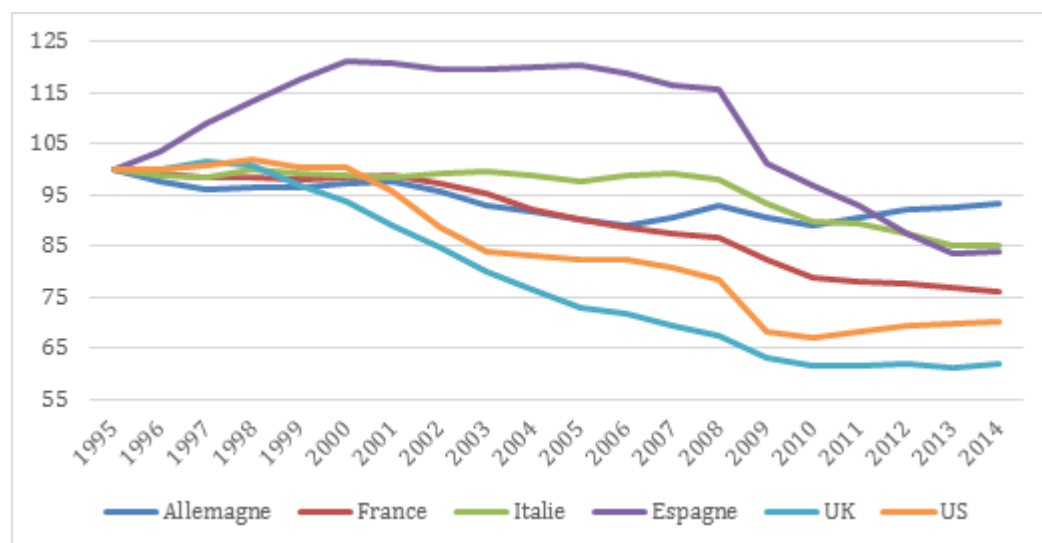
Trump's statements about manufacturing abroad by major American corporations are disturbing to an economist. It is as if threatening the multinationals, raising tariffs on their imports, and menacing them with punitive taxes will suffice to get them to reconsider their decisions to outsource. Beyond the fact that Trump's method is the antithesis of the rule of law, what is surprising to an economist is that these statements ignore not only everything that is known about the logic of globalizing value chains but also the nature of past trends in industrial production and its future prospects. They therefore raise more perplexity than support (see the [note of X. Ragot](#) on macroeconomic policy).

The only truth in Trump's rhetoric is the fact of intense American deindustrialization. So let's start from the state of American industry to understand the grounds for the working-class nostalgia on which this rhetoric is based.

America's worn-out industrial fabric – fertile terrain for blue-collar nostalgia

Donald Trump taps into the wellsprings of voter nostalgia for a time when the manufacturing sector was in full swing. It is clear that America's deindustrialization was intense, even though it opened up commercially much less than Europe did. For the many workers who lack social protection it has been brutal. The countries where the discourse in favor of re-industrialization has been most widespread are those where the decline in industrial employment was most pronounced, namely the United States, the United Kingdom and France. All three have lost more than a quarter of manufacturing jobs since 1995^[1].

Figure 1: Changes in jobs in manufacturing (base 100 in 1995)



Source: EU Klems for European countries. Federal Bank of St Louis (FRED) for the United States.

Figure 1 shows the similarity in the trends in these three economies since the end of the 1990s: France started to lose jobs a little after the United States and United Kingdom, and the end of this trend, which can be seen in the US and UK as of 2009, is still not clearly visible in France, which has continued to shed jobs, although at a slower pace than at the

beginning of the period.

The United States lost more than 5 million jobs since 1995, compared to more than 1.5 million in the United Kingdom and 900,000 in France, representing 29%, 38% and 24%, respectively, of the losses over the period. Of course, at first gains in productivity permitted a smaller decline in value-added, but this was less the case from 2000 onwards, given the slowdown in productivity gains in the manufacturing sector. It should also be noted that manufacturing employment has risen since 2010 in the US, but once again slowed from 2015 (see [Bidet-Mayer and Frocain, 2017](#)).

The causes of deindustrialization have been clearly identified. Deindustrialization has affected all the old industrial powers because of both technical progress and the shift of manufacturing value into industrial services. At the global level, manufacturing output now represents only 16% of GDP, making the 12% American level quite honorable. Moreover, the United States is still a major player in global manufacturing, second only to China in the volume of production.

Finally, once it is understood that the incorporation of technology in manufacturing value-added will not slow its pace and that the robotization of the repetitive tasks specific to mass production will continue or even accelerate, it is certain that future industrial production will be even less job-rich (on this topic see [M. Muro](#)).

In terms of the rise of the Trump electorate, only a small fraction of the voters located in a small part of the northern United States were actually victims of deindustrialization. But industry is a symbolic sector, an emblem of the economic power of yesteryear, of martial imperial power, of the birth of the consumer society and then of the emergence of Asia's economic powers, the new homes of the world's factories. This particularly affects a section of the middle and working class

that has not seen its income improve over the last 20 years (as is suggested in the “elephant” graphic of [Branko Milanovic](#))[21]. Finally, America’s deindustrialization can be seen as symmetric with the industrialization of China and other emerging countries like Mexico, whose economic success is taken as a scapegoat by this middle class. But while globalization has had differentiated effects on individuals based on their qualifications, it cannot be superimposed on deindustrialization.

Starting from this nostalgia for the industrial might of yesteryear, Trump chose to become personally involved in companies’ outsourcing decisions in order to win the vote of these middle class forces who’d suffered from deindustrialization. His interventions have consisted in directly going after companies by calling on them to modify their decisions. Let’s take a look at the most striking episodes in order to grasp the respective motivations of the actors.

Symbolic, eye-catching industrial symbols

First there was the case of Carrier, an equipment manufacturer in Indiana that makes heaters and air conditioners, which in February 2016 announced its decision to move 1,400 jobs to Mexico. Having seized on this case during his campaign, once elected Trump went on to negotiate in November with the heads of the company. In exchange for relief on taxes, charges and regulations, Trump demanded that some of the jobs be kept in Indiana. The local authorities also joined in the negotiations in an effort to coax the company. On November 30, the company announced its intention to retain 1000 jobs on the site. This victory was highly symbolic, in every sense of the word, given that the American economy creates more than 180,000 jobs every month. Carrier’s parent company, United Technologies, conceded that this turnaround will not cost it that much, especially if it gets an attentive ear from the President, and also because United Technologies is a manufacturer of military equipment

and is heavily dependent on public procurement (10% of its sales according to the *New York Times*).

Then there was the episode involving Foxconn, a Taiwanese company that assembles products by Apple – its biggest customer – that decided to set up an assembly plant in the United States, a decision that Trump then brandished as a personal victory. Foxconn already owns production units in the US. This was not *a priori* a relocation of activities, as the company does not envisage simultaneously “disinvesting” in Taiwan. If the company decides to invest in the US, it is because it has good reasons to do so. Among these are expectations about the growth of the US market, the trade obstacles that Trump is threatening to erect and the pressure that its main client (Apple) might bring to bear.

Finally, Trump has tackled the automotive industry. He had already lambasted Ford Motors’ plan to build a plant in Mexico back in the spring of 2016. On 3 January 2017, the company decided to cancel its USD 1.6 billion project in the state of San Luis Potosi in Mexico and announced a USD 700 million investment in a plant in Flat Rock, Michigan, to build electric cars and autonomous cars. Was this a turnaround by the company? In fact, the Mexican plant was designed to build the Ford Focus, small models for which demand has fallen sharply in favour of SUVs and other “crossovers”. Ford’s decision indicates that it is trying to reduce production of this range of vehicles, while Trump’s policy should lead to a revival of American demand for automobiles outside this range. The car maker is nevertheless confirming its decision to shift its production capacity for the Focus model from Wayne, Michigan to Hermosillo, Mexico ([The Economist, Wheel Spin, 2017](#)). These decisions therefore reflect more a repositioning by the company rather than a relocation.

The threat of a 35% customs duty on vehicles from Mexico or a tax on revenue from imports is obviously being taken seriously by manufacturers. In 2015, the United States imported more

than 2 million vehicles from Mexico. Car makers have every interest in showing clean hands in order to obtain other benefits, such as the relaxation of emission regulations. In addition, with the ex-president of ExxonMobil, Rex Tillerson, assuming the post of Secretary of State and defending fossil fuels and Trump's economic recovery programme, manufacturers anticipate a pick-up in purchases.

The series of challenges and reactions is continuing ([Hyundai](#), [Toyota](#), [BMW](#), etc.). Trump is going through all the manufacturers and suspects that any production overseas represents a raid on American jobs. It is not by chance that he is focusing on the automotive industry, as this sector is emblematic of the American way of life, a symbol of US industrial power at a time when the rust belt was still glitzy. But the sector is now highly globalized, and one wonders how at this point Trump can ignore or deny the way the industry is organized and go on deceiving his supporters.

Is there really a pool of jobs to relocate?

Globalization can affect the way companies organize production in two ways. First, in combination with technical progress, it can lead to the disappearance of manufacturing following complete outsourcing, while maintaining control over the chains where profits are realized. This is for instance the case of Apple, which does not have its own plants abroad. Apple cannot be compelled to bring back what it has not taken away! If tariffs increase, Apple will import more expensive components, the State will recover part of the rent from innovation and consumers will pay part of the tax. Second, globalization may also result in outsourcing production, and in this case the company does own production sites abroad, such as in the automotive sector as well as in textiles and toys, like Mattel. Jobs have indeed been displaced, but sometimes the skills as well, which it is not necessarily easy to find again in the home country.

Mexico's cost advantage is also not about to disappear: the wage costs in Indiana per hour are equivalent to the wage costs in Mexico per day. The same is true for the cost in China. The relocation of this type of employment would entail a sharp drop in wages, unless higher customs duties (which raise foreign wages), lower energy and tax costs and higher productivity (which reduce American wages) led to a new trade-off. But this would require major changes that would inevitably impact the rest of the non-manufacturing economy, i.e. 92% of jobs.

In the end, the job content of imports is not "relocatable" in its entirety. Moreover, a large portion of imports fuel exports: in other words, a major part of Chinese and Mexican jobs activate American jobs whose output is sold abroad because the development of the emerging countries has led to the solvency of demand. There is such interdependence today that no one knows what the consequences of a new employment equilibrium would be for future prices, profits, investments and jobs.

What would be the consequences of industrial relocation?

Consider again the case of Foxconn. If this company invests, it would be to serve the US market. Since production costs are higher there, this implies three possible non-mutually exclusive strategies. The company cuts its margins (Apple too) in order not to reduce its market share: Foxconn and Apple accept this reduction in margins in order to offset the negative impact on sales due to the stigma cast by Trump on the company. The second strategy would be to increase the prices of products on the US market: this would mean consumers are financing the few jobs created. The third strategy: the company develops different production processes, including intensive automation that cuts the labour costs while also reducing logistics costs to serve the US market. At the end of the day, Foxconn's decision, if it is confirmed, is a fairly standard economic rationale. The Trump effect figures in this

mix in so far as it requires Apple to justify its strategy of localization. But if Trump's messages were to jeopardize the company's financial health (though it does of course have margins), then this would jeopardize a flagship of the US economy.

In the case of manufacturers, the multiplication of investments, if confirmed, will inflate both the supply of labour as well as supply of domestic production. This would increase competition among businesses. Not only would wages increase, but margins would be reduced due to higher production costs, higher prices for imported components and heightened competition in the domestic market. It is far from certain that it is US manufacturers who would come out on top. At that point, if it came to accepting the Chinese taking holdings in their capital, they would be hoisted on their own petard! The investment decisions taken by the car makers as a whole could even result in labour shortages – the US job market is close to full employment – leading to higher wages (and hence production costs), resulting in turn in either accelerating robotization or bringing in foreign workers.

So ultimately, if we ask ourselves what would be the impact of additional investments on America, it all depends on what incentives they are responding to. If these respond to new, tighter constraints being put on companies by the new government, then microeconomic theory tells us that a company's output will fall or else be more expensive. If an external event increases a company's costs, it produces less 1) either immediately because it increases its prices, or 2) in the medium to long term because its margins are falling (it has not increased its prices) and it is investing less, or 3) in the long term because it leaves the market. If they are responding to expectations of an increase in demand, then Trump will need to stick to his promises of a recovery. Finally, if investment is made in exchange for fiscal expenditure (lower taxes, investment subsidies, financial

support), then the cost to the public purse will result in lower present or future expenditure. In short, the investment will take place if it benefits the company: whether it locates in the country of origin or abroad, it is always conditional on the promise of future income.

But why defend the multinationals and renounce protectionism?

Proponents of protectionist measures respond: 1) what does it matter if firms produce less in total, if the distribution of their output is more advantageous to the domestic territory; 2) what does it matter if they make less profit, as these multinationals already make so much! This neglects that companies also have integrated strategies – that is, global strategies – and that if they earn less profits, they will invest less, which will eventually impact their future growth. It also neglects that the multinationals are the ones that invest the most in R&D, and that if their stock market value rises they do not distribute all the dividends. It neglects that trade, while not balanced, is bilateral, that is, if we reduce the incomes of our partners by reducing their exports, we reduce our own exports. In other words, if the income of Mexicans falls substantially, they will buy a lot less American goods. Furthermore, protectionism – which always winds up being bilateral (retaliation requires it) – protects not the weak, but the profiteers.

Some argue that protectionist measures are a means of relocating production sites to consumption sites (in order to avoid barriers), and hence to recover activities that have been outsourced. It must be emphasized that protectionism protects the giants, the businesses that can deal with tariff barriers. And while it saves unskilled jobs a little longer, it maintains them in their “unskilled” state. Above all, it hampers the development of a middle class of both consumers and businesses. Inequalities will not be reduced through protectionism; instead, the society and the economy will freeze up. Protectionism is not the solution to the

differentiated gains coming from globalization.

In the United States, the effects of globalization have been relatively pronounced, and despite a dynamic labour market, the distribution of the gains from growth has been very uneven. The constraints on skills adjustments have been intense: thus, the 12% of manufacturing value-added, while very honorable, is concentrated mainly in the electronics and information technologies sector (see [Baily and Bosworth, 2016](#)). A recent work by [D. Autor and his co-authors](#) at MIT demonstrates that the exposure to Chinese imports has led to polarizing votes towards candidates at the extremes of the political spectrum. This reveals the strong sensitivity of voters to the hallmarks of globalization.

Yet while the malaise is real, protectionist measures cannot fundamentally heal it because they will diminish the economic wealth of less well-off groups whose consumption basket contains relatively more imported products, whereas few jobs will be created. Let's look once again at the case of the automobile sector, where the American consumer will see car prices go up: the purchasing power of consumers as a whole will go to the benefit of a small minority of workers in the automobile sector. The reduction in corporate taxation will reduce fiscal revenues and the resources for financing the public goods that benefit less well-off strata the most. And it is not at all certain that this reduction in taxation will have a positive impact on business if at the same time the latter also incurs additional customs duties.

In conclusion, industrial employment will not be revived by protectionist measures. Nor will it lessen the economic malaise of the middle class. With an economic and foreign policy that accentuates the present imbalances – isolationism, protectionism, the revival of full employment – Donald Trump is voluntarily taking his mandate into unstable, unknown territory. The cynical pragmatism of the world's economic players will not be stamped out by Trump's rhetoric, which

will instead undoubtedly generate another type of cynicism, one marked by the horizons of an unexpected, personal mandate, with every man for himself.

[\[1\]](#) Manufacturing is a major subset of industry that excludes the energy business. It is common to associate industry with the manufacturing sector.

[\[2\]](#) Branko Milanovic, *Global Inequality*, 2016, HUP.

Balance sheets effects of a euro break-up

By Cédric Durand (Université Paris 13), and [Sébastien Villemot](#)

When it was introduced at the turn of the millennium, the euro was widely perceived as a major achievement for Europe. The apparent economic successes, coupled with cross-country convergence of several economic indicators, fueled this sentiment of success. A couple of years later, the picture looks dramatically different. The world financial crisis has revealed imbalances that have led to the sovereign debt crisis and brought the euro area on the verge of dislocation. The austerity policies that became the norm on the continent in 2011 fueled a protracted stagnation[\[1\]](#), with growth rates that look bleak in comparison to the United States and the United Kingdom.

This economic underperformance has fueled popular resentment against the euro, now seen by a growing number of European people as the problem rather than the solution. The financial community itself seems to be prepared to the possibility of an exit or a dissolution of the single currency by cutting back

on cross-border positions. Greece was on the verge to leave in 2015. And the intellectual mood is also shifting: leading thinkers, such as US economist Joseph Stiglitz, or German Sociologist Wolfgang Streeck are among the most visible figures of a wider change of attitude.

A country exiting the euro, or even the dissolution of the single currency, has therefore become a concrete possibility. Such an event would obviously have a major impact in several dimensions. On the economic side, the most obvious consequence would be the changing conditions in products markets due to the new exchange rates; uncertainty would prevail in the short run, but in the longer run the possibility of adjusting nominal parities would help with the unfolding of current account imbalances.

There however exists another impact, less discussed, but potentially more disruptive: the changes in the balance sheet position of economic actors, resulting from the currency redenomination process. This process could introduce significant currency mismatches between the asset and liability sides. Assessing the unfolding of these balance sheet effects is crucial, because they could affect financial relations, investment and trade, have unexpected redistributive effects and, if not adequately managed, lead to productive disruption.

The concrete questions that we ask are the following. If a country exits the euro and depreciates its new national currency, what will be the consequences for domestic economic agents which have liabilities denominated in euros: will they be able to repay in the new national currency? and if not, will they be able to avoid bankruptcy despite the increase of their debt burden? Conversely, what are the consequences for exiting countries whose new currency appreciates and who have accumulated foreign assets?

In a [recent research paper](#), we propose such an assessment of

the redenomination risk in the euro area, by country and by main institutional sector, for two scenarios: a single country exit and a complete break-up.

Our analysis relies on the concept of “relevant” liabilities and assets: those are the balance sheet items that will not be redenominated into the new currency after the exit, because of legal or economic reasons. In practice, the most important factor for determining which debt or assets are “relevant” is their governing law: if a financial contract is governed by domestic law, the chances are high that the government of the exiting country will be able to redenominate it into the new currency, by simply passing a law in parliament. Conversely, contracts under foreign law (typically English or New York law) will remain in euros—or be redenominated in some other foreign currency if the euro disappears. In the first case, the lender bears the economic loss; in the second case, the risk is borne by the borrower whose debt burden is increased, unless she decides to default and therefore to impose losses on the lender.

Focusing on the liability side, Table 1 presents our estimates for the relevant debt, by country and institutional sector. It therefore gives an estimate of the exposure of the various sectors and countries to a euro-exit followed by a depreciation. Since the first months after a euro exit will be the most critical, potentially with an exchange rate overshooting, the short-term component of the relevant debt is also reported.

Table 1. Relevant debt by sector (% of GDP, Q3 2015)

In %

	Greece	Italy	Portugal	Spain	Ireland	France
General government	142	8	57	12	35	2
<i>incl. short term</i>	3	1	1	0	2	0
Financial corporations	42	30	18	43	395	42
<i>incl. short term</i>	29	4	2	8	98	8
Non-financial corps. + households	13	18	20	15	312	33
<i>incl. short term</i>	5	8	8	4	53	17

	Germany	Netherlands	Austria	Luxembourg	Belgium	Finland
General government	6	5	35	7	10	17
<i>incl. short term</i>	2	2	4	0	2	6
Financial corporations	28	225	35	876	22	59
<i>incl. short term</i>	9	36	8	135	1	17
Non-financial corps. + households	20	66	23	910	23	20
<i>incl. short term</i>	5	18	6	385	13	4

Sources : BIS, World Bank QEDS, authors' computations.

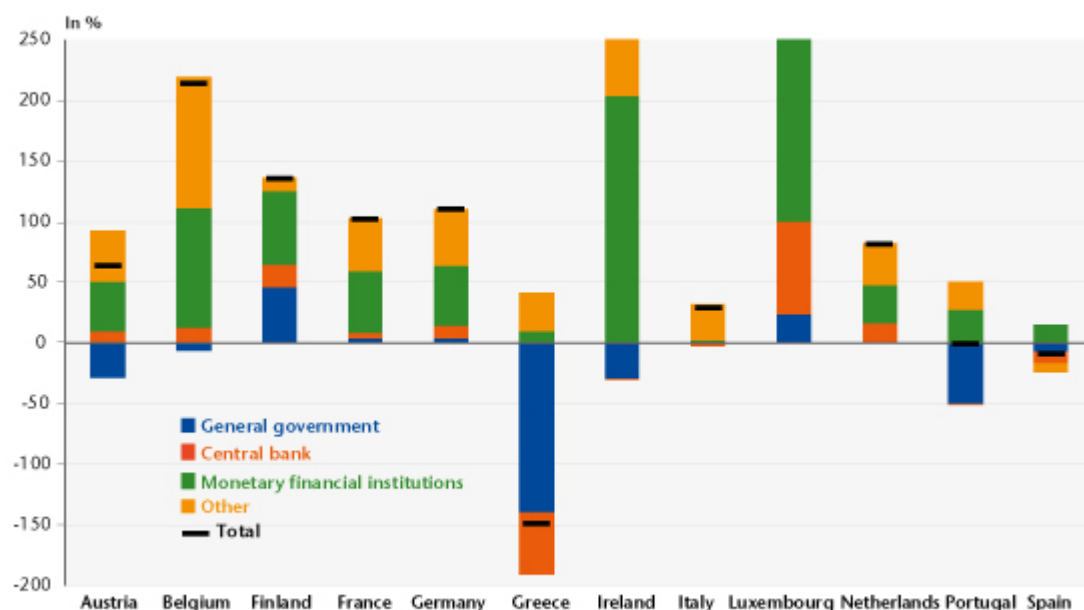
On the side of public debt, the countries most at risk are Greece and Portugal, since they have large external loans that will have to be reimbursed in euros. Conversely, France or Italy are quite safe on their public debt, because almost all of it is under domestic law and can therefore be easily redenominated into Francs or Lira. The financial sector is more exposed, especially in countries acting as financial intermediaries like Luxembourg, the Netherlands or Ireland. The exposure of the non-financial private sector looks much more limited (and due to data limitations, the figures are overestimated in countries with a highly developed non-banking financial system).

However, relevant liabilities are not the whole story. Relevant assets also matter: for countries which are expected to depreciate (typically southern countries including France), those help mitigating the debt problem, since assets in foreign currency will become more valuable in the domestic currency; conversely, in the case of a currency appreciation (typically northern countries), it is from the asset side that difficulties can arise.

The figure shows our estimates for relevant net positions, *i.e.* for the difference between relevant liabilities and assets. A positive number means that a depreciation will

improve the balance sheet, while an appreciation will deteriorate it.

Figure. Relevant net position (% of GDP, excl. fin. derivatives, Q3 2015)



Sources: Eurostat, IMF, BIS, World Bank, Banca d'Italia, Bank of Finland, authors' computations.

The striking fact is that, for most countries and sectors, the relevant net position is positive. This means that northern countries can make a significant loss on their foreign assets if they leave. Conversely, for southern countries and France, there is no aggregate balance sheet risk for the private sector (except for Spain), and even no risk for the public sector in some cases. This does not mean that there is no problem because, at the micro level, the holders of the relevant assets may not be the same as those of the relevant liabilities, but at least there is room for maneuver.

In order to give a broader picture that takes into account the fact that assets can mitigate liabilities problem—but only to some extent—and that short-term debt is the most critical issue, we have constructed a composite risk index that synthesizes all these dimensions, as shown in Table 2. In particular, this indicator was constructed using estimates for the expected exchange rate movements after the exit from the euro.

Table 2. Composite risk index (Q3 2015)

	General government + central bank	Financial corporations	Non-financial corps. + households
Austria	0	1	1
Belgium	1	0	1
Finland	0	2	1
France	0	0	1
Germany	0	1	1
Greece	3	3	1
Ireland	1	3	2
Italy	0	0	0
Luxembourg	1	3	3
Netherlands	0	0	1
Portugal	2	1	1
Spain	1	1	1

Légend:

0 = No risk	2 = Medium risk
1 = Low risk	3 = High risk

Source: authors' computations.

Though this exercise necessarily entails some arbitrary thresholds, it helps identifying a few specific vulnerabilities: the public debts of Greece and Portugal, for which a substantial restructuring or even a default would be the likely outcome; the financial sectors of Greece, Ireland, Luxembourg, and potentially Finland, which would have to undergo a deep restructuring; and potentially the non-financial sector of Ireland and Luxembourg, though that latter result may be an artifact caused by our data limitations.

The broad conclusion that can be drawn from our analysis is that, even though the problem of balance sheets is real and should be taken seriously, its overall order of magnitude is not as large as some claim. In particular, in the non-financial private sector, the issue should be manageable provided that proper policy measures are implemented, and disruptions should in that case be limited.

Assessing the costs of a euro exit obviously matters for properly dealing *ex post* with the event, if it were to materialize because of some unexpected political or economic shock. But this assessment is also interesting from an *ex ante*

perspective, especially for a country which is considering whether to leave or to stay. In this respect, our analysis leads to a somewhat unexpected conclusion: the costs are probably not so high for some deficit countries (Italy, Spain), while they are higher than usually thought for surplus countries who could suffer capital losses through depreciations or defaults. The awareness of this fact should give a stronger bargaining power to southern countries in their negotiations with northern countries concerning the future of the Eurozone.

[1] See the [independent Annual Growth Survey \(iAGS\) reports](#).

Renew the mix: Carry out the energy transition, at last!

By [Aurélien Saussay](#), [Gissela Landa Rivera](#) and [Paul Malliet](#)

The five-year presidential term in France will have been marked by the success of COP21, which led to the signing in December 2015 of the Paris Agreement to limit the rise in global temperatures to 2°C by the end of the century. Despite this, climate and energy issues do not seem to be priorities in the upcoming presidential debate.

These issues nevertheless deserve to be dealt with in depth, given that the decisions required entail a long-term commitment by France. In order to meet the goals France has set itself in the Law on the energy transition and green growth (LTECV), it is necessary as soon as possible to undertake the changes required in our energy mix and to

improve its efficiency in order to hold down demand from the main energy-consuming sectors, i.e. residential, services, transport and industry.

The recent parliamentary report from the Committee on economic affairs (CAE) and the Commission on sustainable development (CDD) [\[1\]](#) pointedly notes the delay in the implementation of LTECV. In particular, the report highlights the limited progress made in exploiting the main source of energy-savings, the construction sector. It also notes the delay in increasing the share of renewable energies in our energy mix, particularly with regard to the generation of electricity.

To this end, the Multiannual electricity programme (PPE) for the period 2016-2023 does not seem sufficient, in the current situation, to meet the objective set in Article I, Section 3 (L100-4) , Paragraph 5 of the LTECV, which calls for reducing the share of nuclear power to 50% of France's electricity mix by 2025. To achieve this, it will be necessary to revise the PPE at the beginning of the next five-year term.

The main obstacles to the implementation of the ambitious investment plans needed to achieve the law's main objectives – France's transition towards a low-carbon economy – are fear that the economy will become less competitive, particularly energy-intensive industries[\[2\]](#), together with the low acceptability of carbon taxation and the risk that all this will have a recessionary economic impact.

While an analysis of the redistributive impacts of carbon taxation remains a topic for research, work done by the OFCE in partnership with the ADEME has shown that fears of a negative macroeconomic impact are unjustified. Far from weighing on the prospects for an economic recovery, the energy transition could, on the contrary, bring about a resurgence of growth for the French economy over the next thirty years – starting right in the next five-year term.

This result is the macroeconomic translation of the continuous reduction in the cost of the technologies needed for the transition, in all its dimensions: the production of renewable energy, the management of intermittence, and the improvement of energy efficiency. Our analysis shows that changes in the full cost of renewable electricity (i.e. the levelized cost of electricity, LCOE) make a complete change of the energy paradigm possible, without any major additional cost compared to traditional technologies – even in a country with an extensive nuclear power industry like France.

A policy brief recently published by the OFCE, [“Changing the mix: the urgency of an energy transition in France, and the opportunities”](#) [in French], presents the main conclusions of this work. First, it demonstrates that achieving an energy transition corresponding to the LTECV would generate about 0.4% additional GDP and more than 180,000 jobs by 2022, at the end of the next five-year term. While this is a modest effect, our projections indicate an expansionary impact of 3% of additional GDP over the longer term up to 2050 – i.e. additional annual growth of 0.1% over the period.

We have also estimated the impact of a more ambitious forward-looking effort to decarbonize the French economy: increasing the share of renewables to up to 100% of the electricity mix by 2050. This scenario presupposes accelerating the construction of the infrastructures generating renewable electricity – mainly onshore and offshore wind along with solar photovoltaic – starting in the next five-year term. This increased effort would result in a larger gain of 1.3% of GDP by 2022, reaching 3.9% by 2050.

This last exercise shows that an energy transition comparable in magnitude to Germany’s *Energiewende* is definitely achievable in France, both technologically and economically.

Accelerating the energy transition in France during the next five-year term would meet a threefold objective: it would give

the economy an additional boost to growth; meet the goals for the reduction of CO2 emissions and energy consumption set by the LTECV; and achieve France's contribution to the goal endorsed by COP21 of limiting global warming to a rise of less than 2°C above pre-industrial temperatures.

[1] Joint information mission on the application of the Law of 17 August 2015 on the energy transition for green growth, 26 October 2016.

[2] See on this topic, « [L'état du tissu productif français : absence de reprise ou véritable décrochage?](#) » [France's production system: absence of a recovery or a genuine take-off?], OFCE Department of innovation and competition, 2016.

Inflationary pressures are mounting

By [Hervé Péléraux](#)

The publication of the price index by the INSEE on November 15 confirmed the return of inflation to positive territory, +0.4%, in October and September, after it oscillated around 0 since the end of 2014. The deflationary phase experienced over the past two years has in part replicated the trajectory of the energy price index, which saw the price of oil fall in early 2016 to one-third of its price in mid-2014. With a weighting of almost 8% in the all-items index, the energy price index, which incorporates the price of fuel but also of

oil-indexed products such as gas and electricity, automatically pushed down inflation. This phase of energy-related disinflation now seems to have come to an end, with crude oil prices rising to between USD 45 and 50 a barrel since the low in mid-January 2016 at under USD 30. The gradual rise in the year-on-year change in the energy price index since spring has in fact pulled along the overall index.

Figure 1. Inflation in France



Source : INSEE.

However, the euro's depreciation against the dollar, which paralleled the fall in oil prices (from 1.35 dollars per euro on average in the first half of 2014 to 1.10 on average since spring 2015), has had a contrary inflationary effect, first by moderating the fall in the prices of energy imports after

their conversion from dollars to euros, and second by increasing the price of non-energy imports. Changes in the underlying price index, which excludes products with volatile prices (energy, some fresh food products) and products with administered prices (health care, tobacco, public prices) from the overall index, reflected this second effect by rebounding from early 2015. This increase in underlying inflation was not, however, due solely to the depreciation of the euro. The gradual end of the period of stagnation that marked the French economy between Q2 2011 and Q2 2014 reactivated inflationary mechanisms that had previously been thwarted by the easing of tension and the rise in unemployment.

The inflationary upturn begun in the last few months is expected to continue until 2018. The exhaustion of the disinflationary impact of the oil counter-shock and the rise in the price of crude oil, which has already largely occurred but will continue through the forecasting horizon up to 52 euros per barrel from its low point in early 2016 (31 euros per barrel) should mark the end of the disinflationary phase linked to energy prices. On top of this, the depreciation of the European currency, also already accomplished in large part, will continue, with a fall from 1.10 euros per dollar in mid-October 2016 to 1.05 according to our forecast. This will contribute to higher import prices. Inflation should therefore have hit a low point in the second quarter of 2016 before becoming positive again in the second half of 2016. By 2017, price increases will be close to 2% year-on-year, partly due to the effect of the recovery in oil prices and the depreciation of the euro. Excluding these two effects, inflation would just exceed 1% by end 2017 and then reach 1.5% the following year.

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The price-wage loop

Inflation forecasts are based on the modelling of a price-wage loop that estimates the parameters of the relationship between employees and companies: employers pass wage increases on to prices to preserve their margins, while employees respond to price increases by trying to obtain higher wages to preserve their purchasing power. Two equations model this process.

The wage formation equation (1) has terms for indexing wages to prices (PC), labour productivity (π), a part of which is redistributed in the form of wages, the unemployment rate (U), which governs workers' bargaining power, and the minimum wage (SMIC), which can have impacts on the scale of adjacent wages.

Equation (2) gives the prices of value added (PVA), a function of unit wage costs, which can be broken down into the difference between wages (W) and labour productivity. The elasticity between the value-added prices and the unit wage cost ($W - \pi$) is set to 1, which means that, in the long run, fluctuations in unit labour costs do not affect companies' target margin rate. Since there is inflationary pressure on the productive apparatus, the rate of utilization of production capacity (TU) is added to the unit labour costs.

$$W_t = f_1 [P_t^C (+), \pi_t (+), U_t (-), SMIC_t (+)] \quad (1)$$

$$P_t^{VA} = f_2 [(W_t - \pi_t) (+), TU_t (+)] \quad (2)$$

The formation of prices in the domestic market also depends on the prices of imported goods excluding taxes (MP), which are a function of the price of oil expressed in euros (PPétrole) and the nominal effective exchange rate (TCEN).

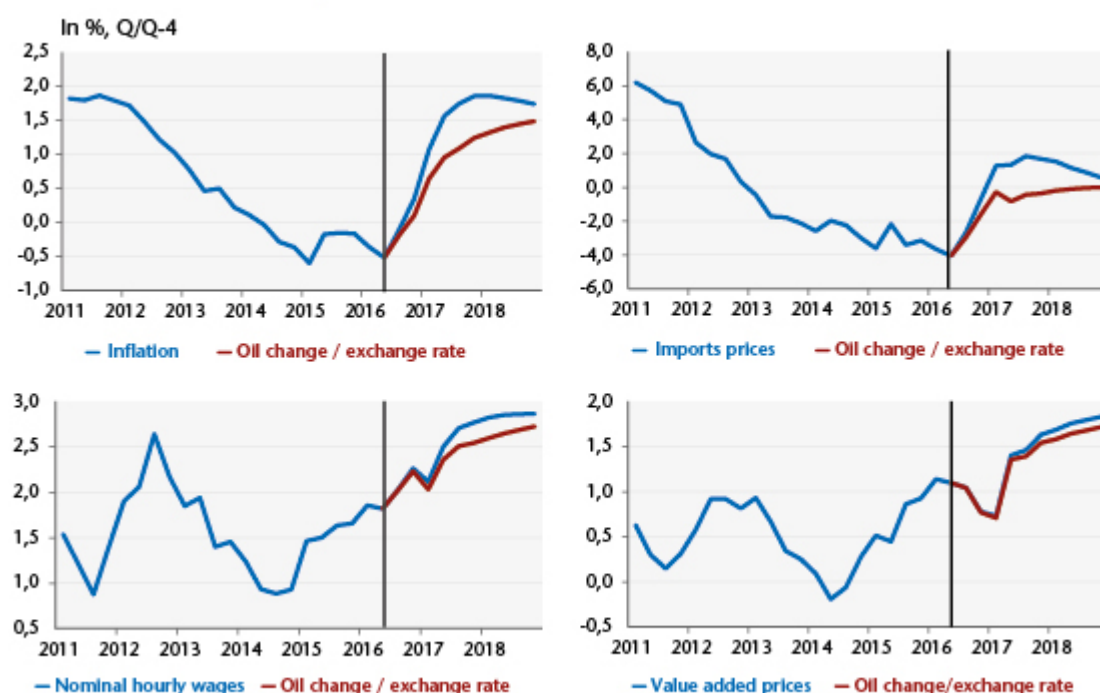
$$P_t^M = f_3 [P_t^{PETROLE} (+), TCEN_t (-)] \quad (3)$$

Finally, an accounting equation for the formation of domestic prices combines the value-added prices and the pre-tax import prices, with the total being increased by the rate of VAT to simulate the after-tax price index on the domestic market (here the deflator of household consumption from the national

accounts). The different equations are estimated using error correction models.

In accordance with this model, the trajectory of inflation by 2018 will be affected both by external impulses, namely changes in the effective exchange rate and in oil prices, and by internal impulses, namely the response of wages to these external shocks through indexation and the fall in unemployment. The renewed rise in oil prices and the depreciation of the effective exchange rate will revive imported inflation. Import prices will thus once again begin to rise in the first quarter of 2017, and will therefore contribute accounting-wise to the rebound in inflation. The indexing mechanisms will then push up wages, due to the added inflation. The fall in the unemployment rate begun at the end of 2015 will add to this impulse. Nevertheless, the rebound in inflation in the second half of 2016 cannot be reduced solely to the impact of external shocks. By neutralizing these effects and holding the nominal effective exchange rate and oil prices constant at their mid-2016 values, the rebound in inflation would not disappear, but it would be 0.6 percentage point lower at end 2017 (and 0.2 point lower at end 2018) relative to what comes from the central accounts (Figure 2).

Figure 2. Inflation and its determinants



Sources : INSEE, OFCE estimates and forecasts.

An end to growth?

Analysis and Forecasting Department (international team)

This text relies on the 2016-2018 forecast for the global economy and the euro zone, the full version of which [is available here, in French](#).

After avoiding a Grexit in the summer of 2015, Europeans will now have to face a Brexit. In addition to what should be a significant impact on the UK economy lies the question of the effect this shock will have on other countries. Given that all the indicators seemed to be green for finally allowing the euro zone to recover from the double-dip recession following the 2007-2008 financial crisis and then the sovereign debt crisis, will a Brexit risk interrupting the trend towards a recovery? This fear is all the more credible as the delayed

recovery was not sufficient to absorb all the imbalances that built up over the years of crisis. The unemployment rate for the euro zone was still over 10% in the second quarter of 2016. A halt to growth would only exacerbate the social crisis and in turn fuel doubt – and therefore mistrust – about Europe's ability to live up to the ambitions set out in the preamble to the [Treaty on the Functioning of the European Union](#) and reiterated in [Lisbon in 2000](#).

Nevertheless, despite fears of a new financial shock, it is clear that it hasn't happened. Brexit will of course be the fruit of a long process that has not yet started, but it seems that the worst has been avoided for now. The British economy will see growth halved in 2017. But the short-term negative effects on other euro zone countries should be fairly limited, except perhaps Ireland which is more interdependent on the United Kingdom. In any case the global recovery should continue, but growth will be down in the euro zone from 1.9% in 2015 to 1.3% in 2018.

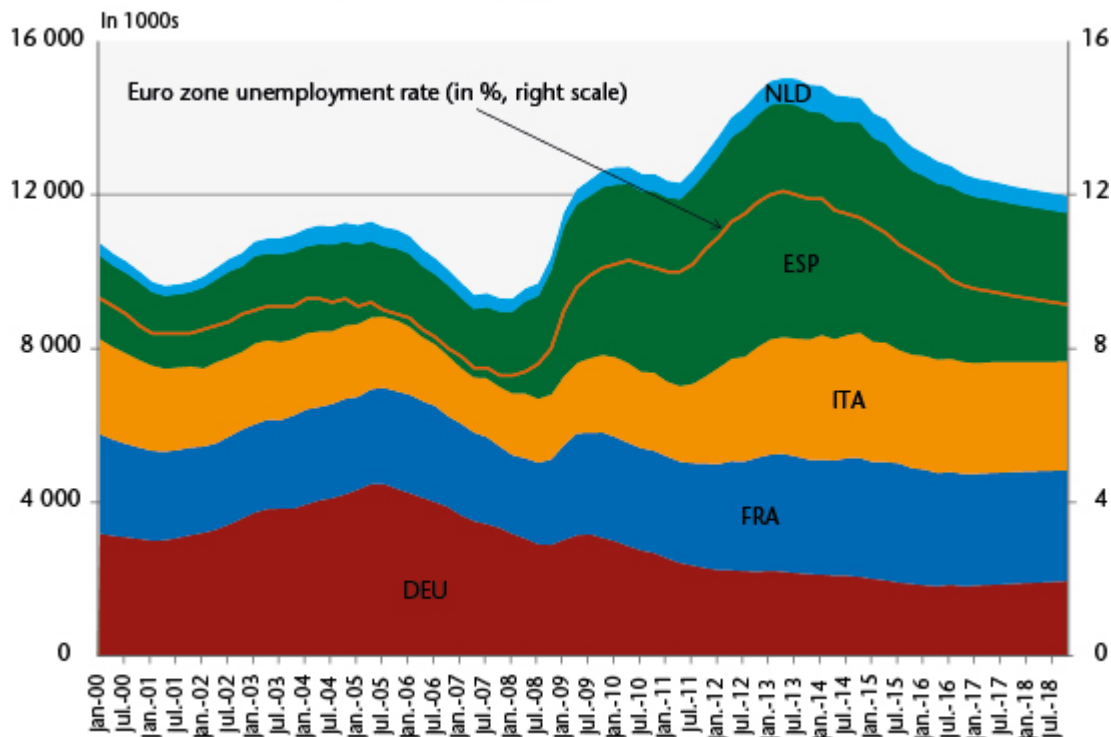
The many factors that helped initiate the recovery^[1] will to some extent lose steam. The price of oil has already begun to rise after hitting a low of under USD 30 in January 2016. It is now once again over 50 dollars a barrel. As for the euro, it has fluctuated since the beginning of the year at around 1.10 dollar, while in 2014 and 2015 it depreciated by 12.5% and 11.3%, respectively. In contrast, the European Central Bank has stuck to its expansionary monetary policy, and fiscal policy is much less restrictive than from 2011 to 2014. In 2015 and 2016, the aggregate fiscal impulse was even slightly positive.

Finally, world trade is slowing significantly, well beyond what would be expected simply from the change in China's economic model, which is resulting in a deceleration of imports. There were hopes that after the recovery kicked off, a virtuous cycle of growth would be triggered in the euro zone. Higher growth partly driven by exogenous factors would

lead to job creation, higher incomes and better prospects for households and businesses. These elements would be conducive to a return of confidence and in turn stimulate investment and consumption. The dynamics of productive investment in France and Spain in the last quarter have given credence to this scenario.

The recovery will certainly not be aborted, but this rate of growth seems insufficient to reduce the imbalances brought about by long years of recession and low growth. At the end of 2018, the unemployment rate in the euro zone will still be nearly 2 percentage points higher than at end 2007 (graphic). For the five largest countries in the euro zone, this represents nearly 2.7 million additional people without jobs. In these conditions, it is undoubtedly the social situation of the euro zone which, even more than Brexit, is putting the European project in jeopardy. Europe certainly cannot be held solely responsible for low growth and high unemployment in the various countries, but the current forecast indicates that we have undoubtedly not achieved the goals that were set in Lisbon in 2000, i.e. making the European Union “the most competitive and dynamic knowledge-based economy in the world capable of sustainable economic growth with more and better jobs and greater social cohesion”.

Figure: Unemployment in the euro zone



Source: Eurostat, OFCE forecasts – October 2016.

[1] View See the OFCE's earlier [synthesis](#) (in French) of the international outlook (summarized [here](#) in English).

France's battered growth

By the Analysis and Forecasting Department

This text summarizes the 2016-2017 forecast for the French economy. [Click here to consult the full version, in French.](#)

The news on 28 October that French economic growth came to 0.2% in the third quarter of 2016 constitutes a cyclical signal that is consistent with our analysis of the state of France's economy. This figure is close to our latest forecast (+0.3% forecast for the third quarter) and in line with our

growth scenario up to 2018.

After three years of sluggish growth (0.5% on average over the period 2012-14), activity picked up moderately in France in 2015 (1.2%), driven by falling oil prices, the depreciation of the euro and a lowered level of fiscal consolidation. For the first time since 2011, the French economy has begun to create jobs in the private sector (98,000 for the year as a whole), which has been encouraged by tax measures that cut labour costs. Combined with an increase in the number of employees in the public sector (+49,000) and the creation of non-salaried jobs (+56,000), the number of unemployed according to the ILO fell in 2015 (-63,000, or -0.2 percentage point of the active population). Meanwhile, boosted by additional tax cuts on industrial equipment, business investment has revived in 2015 (+3.9% yoy).

French growth has been below that of the rest of the euro zone since 2014; in addition to the fact that it did better over the period 2008-2013, this is due to two major factors: first, France made greater fiscal adjustments than its European neighbours over the period 2014-16, and second, exports did not contribute much to growth, even though the fiscal approach to supply policy aimed to restore the competitiveness of French business. It seems, however, that since 2015 French exporters have chosen to improve their margins rather than to reduce their export prices, with no impact on their export volumes. While for a number of quarters now this behaviour has resulted in falling market share, this might still turn out to be an asset in the longer term due to strengthening the financial position of the country's exporters, especially if these margins are reinvested in non-cost competitiveness and lead to upgrading the products manufactured in France.

In 2016, despite a strong first quarter (+0.7%) driven by exceptionally strong domestic demand excluding stock (+0.9%), GDP growth will peak at 1.4% on average over the year (see table). The mid-year air pocket, which was marked by strikes,

floods, terrorist attacks and the originally scheduled end of the investment tax reduction, partly explains the weak recovery in 2016. As a result of the pick-up in margin rates, the historically low cost of capital and the extension of the investment tax cut, investment should continue to grow in 2016 (+2.7% yoy). The creation of private sector jobs should be relatively dynamic (+149,000), due to support from the CICE competitiveness tax credit, the Responsibility Pact and the *prime à l'embauche* hiring bonus. In total, taking into account unwaged employees and the workforce in the public sector, 219,000 jobs will be created in 2016. The unemployment rate will fall by 0.5 point over the year, of which 0.1 point is linked to the implementation of the "training 500,000" programme, so at year end will come to 9.4% of the workforce. Meanwhile the public deficit will drop to 3.3% of GDP in 2016, after a level of 3.5% in 2015 and 4% in 2014.

In 2017, France's economy will grow at a 1.5% rate, which will be slightly above its potential rate (1.3%), as the country's fiscal policy will not hold down GDP for the first time in seven years. On the other hand, in contrast to the forecast last spring, France will have to confront two new shocks: the negative impact of Brexit on foreign trade and the terrorist attacks' influence on the number of tourists. These two shocks will cut 0.2 percentage point off GDP growth in 2017 (following 0.1 point in 2016). The French economy will create 180,000 jobs, including 145,000 in the private sector, reducing the unemployment rate by "only" 0.1 point, due to the rebound in the labour force as people who benefit from the training programme gradually re-join the workforce. The renewed rise in oil prices and the depreciation of the euro will see inflation rising to 1.5% in 2017 (after 0.4% in 2016). Finally, the government deficit will be 2.9% of GDP in 2017, back below the 3% threshold for the first time in ten years. After stabilizing at 96.1% of GDP in 2015 and 2016, the public debt will fall slightly, down to 95.8% in 2017.

The French economy though battered by new shocks and with the wounds from the crisis far from having healed, is recovering gradually, as can be seen by the gradual improvement in economic agents' financial position: business margins are up, household purchasing power has rebounded, the deficit is down and the public debt has stabilized.

Table. Summary of the forecast for France

Change from the preceding period, in %

	2016				2017				2015	2016	2017	2018
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4				
GDP	0.7	-0.1	0.3	0.5	0.4	0.4	0.4	0.4	1.2	1.4	1.5	1.5
GDP / capital	0.6	-0.2	0.2	0.4	0.3	0.3	0.2	0.3	0.8	0.9	1.0	1.0
Household consumption	1.1	-0.1	0.2	0.5	0.3	0.3	0.3	0.3	1.5	1.5	1.3	1.3
Public consumption	0.4	0.4	0.2	0.2	0.2	0.2	0.3	0.3	1.4	1.5	1.0	1.2
Total GFCF, of which:	1.3	-0.2	0.4	0.6	0.7	0.4	0.4	0.4	0.9	2.7	1.9	1.4
<i>Private production</i>	2.1	-0.4	0.4	0.6	0.8	0.4	0.4	0.4	2.7	3.7	1.9	1.4
<i>Housing</i>	0.1	-0.3	0.3	0.6	0.6	0.7	0.5	0.4	-0.8	0.4	2.0	1.5
<i>Public</i>	0.1	0.7	0.4	0.5	0.5	0.5	0.4	0.4	-3.9	2.5	1.9	1.2
Exports of goods and services	-0.4	0.2	0.5	0.5	0.6	0.6	0.6	0.6	6.0	0.8	2.2	2.5
Imports of goods and services	0.2	-1.8	0.5	0.4	0.5	0.5	0.5	0.5	6.4	1.8	1.3	2.0
Contributions :												
Non-inventory domestic demand	0.9	0.0	0.2	0.5	0.4	0.3	0.3	0.3	1.4	1.8	1.4	1.3
Change in inventory	-0.1	-0.8	0.1	0.0	0.0	0.0	0.0	0.0	0.1	-0.1	-0.1	0.1
Foreign trade	-0.2	0.6	0.0	0.0	0.0	0.0	0.0	0.0	-0.3	-0.3	0.2	0.1
Consumer prices (HICP), Q/Q-4	0.0	0.1	0.4	0.9	1.8	1.1	1.5	1.6	0.1	0.4	1.5	1.6
Unemployment rate	9.9	9.6	9.5	9.4	9.4	9.4	9.4	9.3	10.1	9.6	9.4	9.3
Household savings rate (% of GDI)	14.5	14.8	14.9	14.7	14.6	14.5	14.6	14.7	14.5	14.7	14.6	14.6
Margin rate of non-fin corp. (% of VA)	32.2	31.7	31.8	31.8	31.9	31.8	31.8	31.7	31.4	31.9	31.8	31.8
Public deficit (% of GDP)									-3.5	-3.3	-2.9	-2.4
Public debt (% of GDP)									95.8	96.1	95.8	95.3

Sources: INSEE, OFCE forecasts 2016-2018.

How negative can interest rates get?

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

On 11 June 2014, the European Central Bank decided to set a negative rate on deposit facilities and on the excess reserves held by credit institutions in the euro zone. This rate was then lowered several times, and has been -0.40% as of March

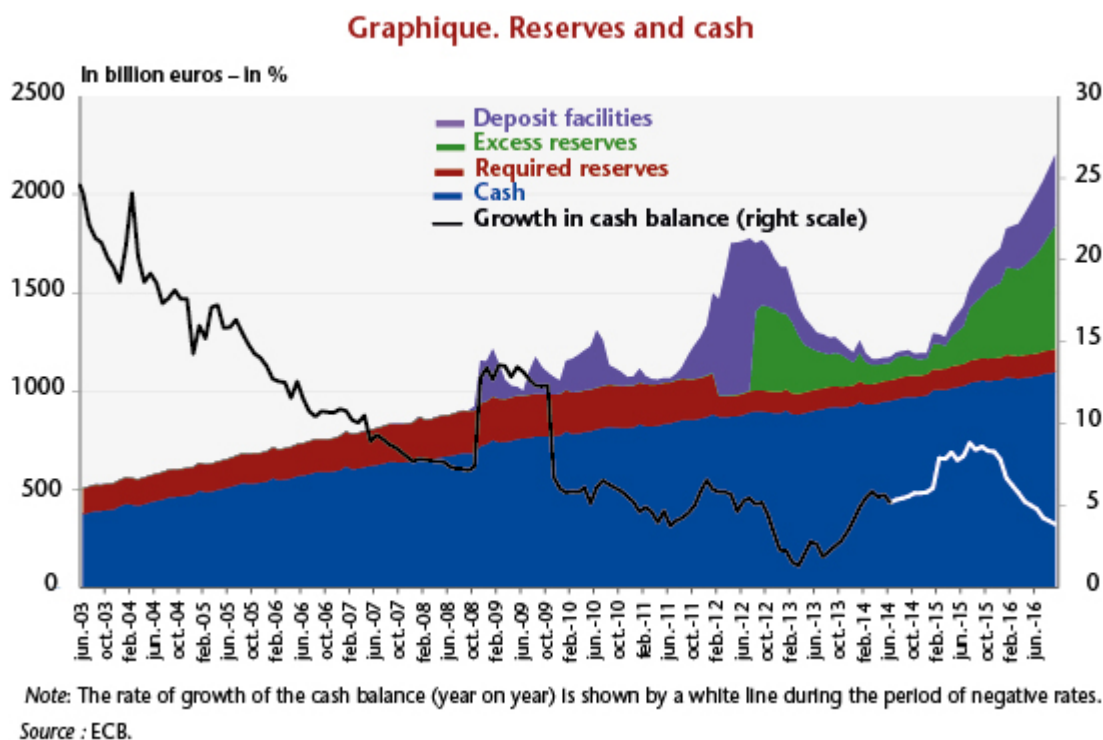
2016. This raises questions about the reasons why agents, in this case the commercial banks, agree to pay interest on deposits left with the ECB. In an [article](#) on the causes and consequences of negative rates, we explain how the central bank has come to impose negative rates and how far they can go, and then we discuss the costs of this policy for the banks.

To conduct its monetary policy, the ECB requires commercial banks in the euro zone to have an account with the Bank, which is used to meet the minimum reserve requirements[\[1\]](#) and to participate in operations to provide liquidity. This account can also be used to perform clearing transactions between commercial banks. The required reserves are remunerated at a rate set by the ECB. Beyond this amount, in normal circumstances the banks do not receive any other compensation. Moreover, the ECB also provides a deposit facility allowing the banks to deposit cash with the ECB for a period of 24 hours, with remuneration paid at a deposit facility rate.

Prior to 2008, the commercial banks held only the reserves that they needed to meet the minimum reserve requirements (see the graph). Any stock of excess reserves[\[2\]](#) was very small: less than 1 billion euros on average until 2008. The same was true for the balance of deposit facilities, which was 321 million euros on average. Since the crisis, the ECB has replaced the interbank market and has intervened to provide a large amount of liquidity. Through the banks' participation in various ECB programmes to purchase securities (quantitative easing, QE), they also receive liquidities that are placed in their reserve account, to such an extent that by September 2016 the accumulated stock of excess reserves and deposit facilities reached 987 billion euros. The negative rates do not apply to all monetary policy operations but only to the portion of the cash left on deposit by the banks (total assets of the euro zone banks are 31 trillion euros). At the current rate, the direct annual cost to the banks is thus 3.9 billion

euros.

Given that the banks are not required to hold these excess reserves, it is reasonable to ask why they accept to bear this cost. To answer this question, it is necessary to examine the possibilities for trade-offs with other assets that could be used as a substitute for the excess reserves. The reserves are in fact money [\[3\]](#) issued by the central banks solely for the commercial banks and are therefore a very liquid asset. But the rates on the money market are also negative, to such an extent that it is a matter of indifference to the banks whether they have excess reserves and place their liquidities on the interbank market for a week or buy Treasury securities issued by the French or German government, for example, with yields that are also negative.



Actually, the best substitute for the reserves would be to hold the cash directly. The substitution could therefore take place within the monetary base if the banks called for the conversion of their excess reserves and deposit facilities

into cash, which has the same properties in terms of liquidity and zero nominal interest. Currently this would mean converting 987 billion euros of reserves into banknotes, nearly doubling the amount outstanding, as the volume of notes in circulation in September 2016 was 1,096 billion euros.

The fact that these agents can have an asset that is not interest-bearing is the argument for why nominal rates cannot be negative. In practice, because there are costs to holding currency in the form of notes, this trade-off does not take place when the threshold for negative rates is exceeded. The nominal rate can therefore be negative. It is clear however that there is a threshold at which holding cash would be preferable. The cost of holding large amounts of cash is not known precisely, but it seems that it is not insignificant, and in any case is higher than the 0.4% currently charged by the ECB.

It seems that in practice there has not yet been any such substitution, since the volume of outstanding notes in circulation has not risen particularly since negative rates were first set (graph). [Jackson \(2015\)](#) has made an assessment indicating that the various costs of holding money in the form of notes and coins could be up to 2%, which would act as an effective lower bound (ELB) for a reduction in rates.

Beyond the costs that negative rates represent for banks, the expected benefits of such a policy need to be considered, as well as the overall context in which they have been set. Together with negative rates, the ECB is using its targeted long-term refinancing operations (TLTRO II) to enable the banks to finance themselves at negative rates, and is thus urging them doubly (via the cost of their excess reserves and via the rate at which they are financed) to grant credit to the real economy.

[1] Credit institutions are in practice required to leave reserves in this account in the amount of a certain fraction of deposits collected from the non-financial sector. See [here](#) for more details.

[2] Amount of reserves beyond the required reserves.

[3] Together with the banknotes issued, these form what is called the monetary or money base, M_0 .