Flash Economics

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Which macroeconomic issues will be the most important?

We believe that, given the macroeconomic and international context, four macroeconomic issues will be very important.

These are:

- The effects on world trade, growth and inflation of introducing specific tariffs on certain imports or global duties, with the possibility of circumventing tariffs and the risk of retaliation ;
- The effects of policies to reduce the public deficit, and in particular the choice between reducing public spending and raising taxes; the aim is for the reduction in the public deficit to have the smallest possible effect on growth and not to increase inequalities;
- The effects of the development of artificial intelligence; analyses differ as to the effects on employment, production, the need for investment and capital intensity;
- Finally, the effects of high levels of income or wealth inequality on investment, incentives in the field of education, incentives to make an effort, and political risk.

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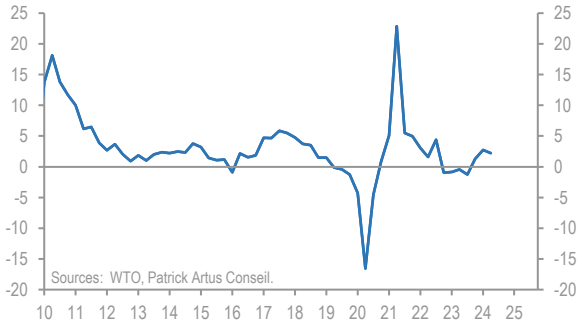
Effects of the increase in tariffs

The United States and the European Union introduced tariffs on imports from China from 2018. In the US, these include tariffs on electric batteries (at a rate of 25%), electric cars (at a rate of 100%), critical metals (at a rate of 25%), semiconductors and solar cells (at a rate of 50%), steel and aluminium (at a rate of 25%). The European Union has asked for Chinese car imports to be taxed at a rate ranging from 29% to 46%, depending on the manufacturer.

These decisions by the United States and Europe raise a number of questions:

- **What is the effect of these tariffs on world trade in goods (Chart 1a)**?

Chart 1A
World: Exports of goods (in volume terms, Y/Y as %)



- If only Chinese products are taxed, to **what extent are these tariffs being circumvented**, with China's exports to the United States passing through third party countries? **Charts 1b/c** show that the decline in China's exports to the United States has been offset by an increase in China's exports to South-East Asian countries and Mexico, and by an increase in exports from South-East Asian countries and Mexico to the United States. It is not clear whether this circumvention of tariffs by Chinese exporters can withstand the tariffs on all US imports that Donald Trump wants to introduce.

Chart 1B
China: Exports to the United States, South-East Asia* and Mexico (monthly, USD bn)

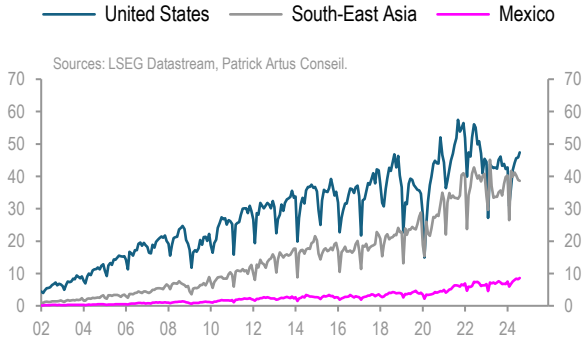
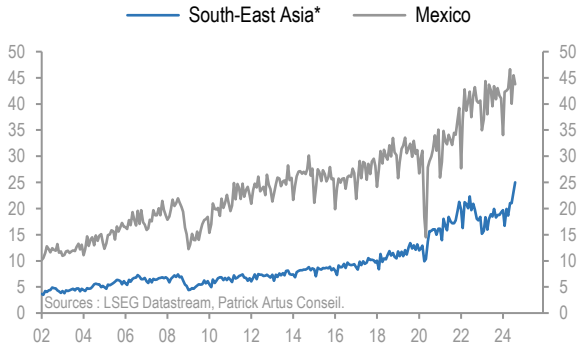


Chart 1C
Exports to the United States (monthly, USD bn)



(*) Indonesia, Malaysia, Philippines, Thailand, Vietnam

- **What is the effect on inflation**, which is all the greater given that exporters (to the United States and the European Union) are not reducing their profit margins in response to the increase in tariffs?

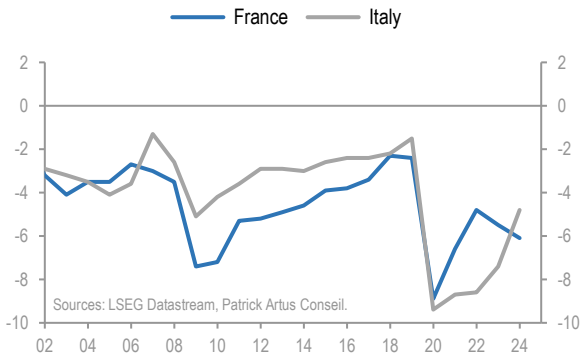
- **Is there a risk of retaliation by China**, with tariffs imposed by China on imports from the United States or the EU, which could be the case on imports of European agri-food products by China, with export restrictions by China on strategic products (as has been done with rare earth extraction and separation techniques and with several rare metals - gallium and germanium)?

How can the public deficit be reduced?

This question mainly concerns European countries that are subject to an excessive deficit procedure opened by the European Commission (Belgium, France, Italy, Hungary, Malta, Poland and Slovakia).

We will concentrate on the cases of France and Italy 5 (**Chart 2a**).

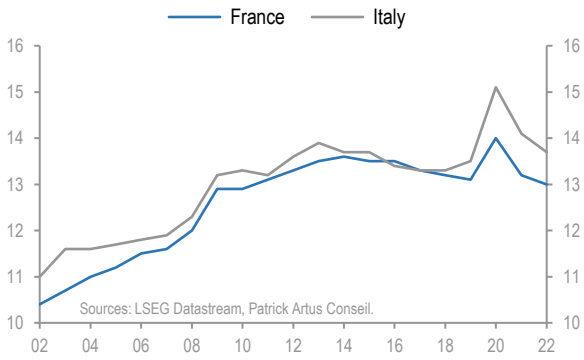
Chart 2A
Fiscal deficit (as % of nominal GDP)



These countries have a choice between :

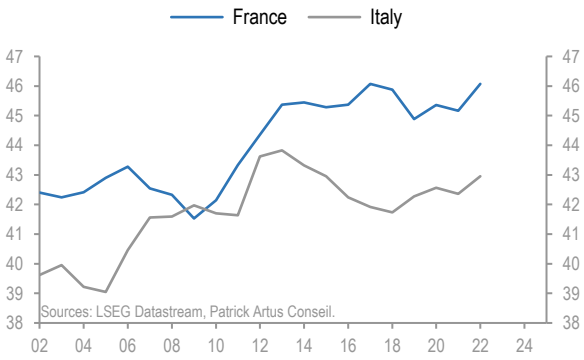
- **Reduce public spending**, particularly pension spending (**Chart 2b**) ;

Chart 2B
Public spending on pensions (as % of nominal GDP)



- Increase the tax burden (**Chart 2c**).

Chart 2C
Tax burden (as % of nominal GDP)



Spending on healthcare, education, police, justice and the military is difficult to reduce, which is why, on the expenditure side, we are concentrating on spending on pensions, which can be reduced, for example, by temporarily removing inflation-indexing of pensions.

On the tax side, we can use VAT, social security contributions, taxation of income and wealth, and taxation of profits.

We need to consider the effects of each type of tax on demand and its redistributive effects. An increase in the taxation of high incomes and wealth should not have a very negative effect on demand; we could also combine a reduction in social security contributions with an increase in VAT, which would put more of the burden of taxation on all incomes and less on wages.

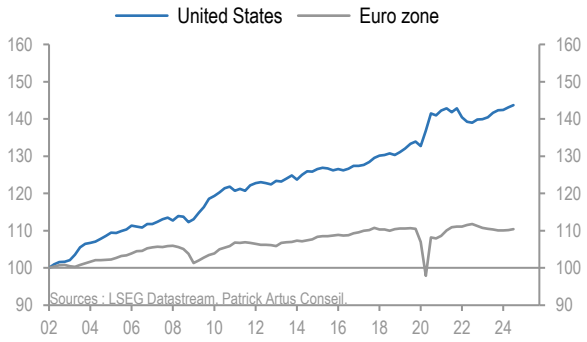
Effects of the development of artificial intelligence

Opinions on the effects of the development of artificial intelligence differ considerably. Some are very optimistic (mainly in the finance and consultancy sectors, such as PwC[1] or the McKinsey Global Institute, which expects a 1.2 point increase in world growth due to artificial intelligence) about the impact of artificial intelligence on technical progress and growth. Others (e.g. D. Acemoglu[2]) believe that the proportion of tasks that will be improved by artificial intelligence is too small for AI to have a major effect on productivity.

In recent times, concerns have arisen about the considerable need for investment (data centres, cloud, microprocessors, energy) and the question is increasingly being asked about the profitability of investment in AI and the ratio between the potential turnover linked to AI and the amount of investment. Investment has already reached €90 billion a year from 2021 to 2023, with a very sharp rise expected to take it to $160 billion in 2025. So we have to consider that there is enormous uncertainty about what to expect from AI in terms of efficiency gains relative to the huge need for investment, and therefore in terms of:

- **Additional productivity growth** (**Chart 3a** shows that productivity has fallen in the euro area since 2018);

Chart 3A
Productivity per capita (2002.Q1 = 100)



[1] Pwc (2018), *The macroeconomic impact of artificial intelligence.*

[2] Acemoglu, D. (2024). *The Simple Macroeconomics of AI* (No. w32487). National Bureau of Economic Research.

- The stock market valuation of companies linked to artificial intelligence (Chart 3b).

Chart 3B
Stock market index of the Magnificent Seven*
(01.06.2012 = 100)



* Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia, Tesla

The effects of income and wealth inequality

Income and wealth inequalities are much higher in the US than in Europe (Charts 4a/b).

Chart 4a
Gini index of income inequalities (after redistribution)

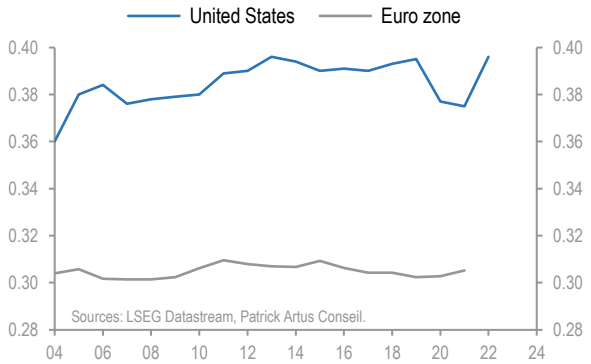
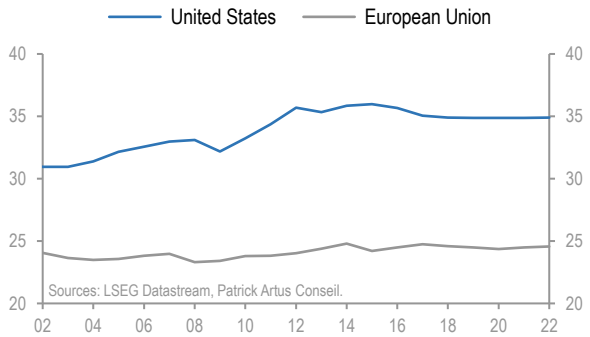


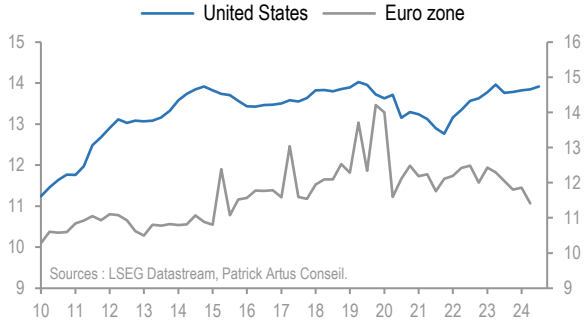
Chart 4B
Share of national wealth held by the 1% of individuals with the highest wealth (as %)



In a country where inequality is high (because income distribution favours profits, because social protection spending is low) we would expect:

- A higher rate of investment than in a country with low inequality, because high corporate profitability encourages investment; this is indeed the case (Chart 4c);

Chart 4C
Investment of non-financial corporations
(in value terms, as % of nominal GDP)



- **The presence of incentives** to obtain **a high level of education**, since inequalities are linked to the level of education; this is also effectively the case (**Table 1**);

Table 1 : Adults' educational attainment distribution (2023)

Educational attainment level	United States	European Union (25 countries)
Below upper secondary education	**8.0**	**16.4**
Upper secondary or post-secondary non-tertiary education	**41.3**	**46.3**
Tertiary education	**50.7**	**37.3**

Source: OECD

- **The presence of incentives** for effort, which may explain the faster rise in productivity (Chart 3a above);
- **The existence of a high political risk**, with a large proportion of the population likely to revolt against its impoverishment.

Summary: four important macroeconomic questions today

These questions concern the effects of protectionism, policies to reduce the public deficit, the effects of the development of artificial intelligence, and the consequences of high levels of inequality.

We have confined ourselves to **macroeconomic issues**, but the speed of the energy transition, the deficiencies of education systems in many countries, the consequences of demographic ageing, etc.., must of course also be included among the important questions.

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