

Measuring well-being and sustainability: A special issue of the Revue de l'OFCE

By [Eloi Laurent](#)

This issue of the [Revue de l'OFCE \(no. 145, February 2016\)](#) presents some of the best works that are being produced at a rapid clip on indicators of well-being and sustainability.

Why want to measure well-being? Because the idea that economic growth represents human development, in the sense that growth represents a good summary of its various dimensions, is simply false. GDP growth is not a prerequisite for human development; on the contrary, it is now often an impediment (as is illustrated by the exorbitant health costs of air pollution in India and China, two countries that concentrate one-third of the human population).

Achieving growth is not therefore sufficient in itself for human development; there is a need for specific policies that deal directly with education, health, environmental conditions and democratic quality. If the multiple dimensions of well-being are not taken into account, one dimension, typically the economic dimension, is imposed on and crushes the others, mutilating the human development of both individuals and groups (the example of health in the United States is particularly striking in this regard).

Why want to measure sustainability? Because today's global growth rate of 5% is of little importance if the climate, the ecosystems, the water and air that underpin our well-being have irrevocably deteriorated in two or three decades due to the means deployed to achieve that growth. Or to put it in the words of the Chinese Minister of the Environment, Zhou Shengxian, in 2011: "If our land is ravaged and our health

destroyed, what benefit does our growth bring?" We need to update our understanding of well-being so that it is not a mirage. Our economic and political systems exist only because they are underpinned by a set of resources that make up the biosphere, whose vitality is the condition for the perpetuation of these systems. To put it bluntly, if ecological crises are not measured and controlled, they will eventually do away with human welfare.

Indicators of well-being and sustainability must therefore enter a new, performative age: after measuring in order to understand, we now need to measure in order to make change – to evaluate in order to evolve. Because the change called for by these new visions of the global economy is considerable. This time of action invariably involves choices and trade-offs that are far from simple. This underscores the dual purpose of this issue of the *Revue de l'OFCE*: to show that indicators of well-being and sustainability have reached maturity and that they now can change not only our vision of the economic world but also the economic world itself; they can make clear the types of choices available to public and private decision-makers so as to carry out the change needed. In this respect the two sections of this special issue clearly highlight the issue of the relevant scale for measuring well-being and sustainability.

The first part of this issue is devoted to the relatively new topic of measuring regional well-being in France. Measuring well-being where it is actually lived presupposes moving down the scale to the local level: the need to measure and improve human well-being as close as possible to people's lived reality, along with the scale of spatial inequalities in contemporary France, demands a territorial perspective. There are at least two good reasons why territories (regions, cities, *départements*, towns), more than nation-states, are the vectors of choice for the transition towards well-being and sustainability. The first is that they have grown in

importance due to the impact of globalization and urbanization. The second is their capacity for social innovation. Following on from the late Elinor Ostrom, we talk about a “polycentric transition” to mean that each level of government can seize on the well-being and sustainability transition without waiting for a push from the top.

Monica Brezzi Luiz de Mello and Eloi Laurent (“Beyond GDP, beneath GDP: Measuring regional well-being in the OECD” – *all OFCE Revue articles in French*) gives the initial results of the theoretical and empirical work currently underway in the OECD framework (interactive access on the site <http://www.oecdregionalwellbeing.org/>) that measures certain dimensions of well-being at the regional level and applies these new indicators to the French case in order to draw useful lessons for public policy.

Robert Reynard (“Quality of life in the French regions”) provides an overview of recent findings by the INSEE using regional quality-of-life indicators. These can be used to develop a new typology of French spaces, highlighting eight major types of territories, which are distinguished both by the living conditions of their inhabitants (employment, income, health, education, etc.) and the amenities that these areas provide for their people (living environment, access to services, transport, etc.). The new representation of France that emerges constitutes a valuable decision-making tool for those in charge of policies aimed at promoting equality between the regions.

Kim Antunez, Louise Haran and Vivien Roussez (“Diagnoses of quality of life: Taking into account people’s preferences”) looks back at the approach developed by France’s regional monitoring body (*Observatoire des territoires*) and highlights indicators, offered at appropriate geographical scales, that can be used to account for the multidimensional character of quality of life in France. Here too, regional typologies explore the link between the diverse amenities in people’s

environments and the diverse aspirations of the people who live in them, so as to highlight the imbalances that exist and the public policy levers that can be used to reduce these.

Finally, Florence Jany-Catrice (“Measuring regional well-being: Working *on* or *with* the regions?”) discusses a fundamental aspect of the debate about measuring well-being in the French regions: the participation of citizens in defining their own well-being. She shows in particular that the impact of the indicators depends on whether those who develop them work on the regions or with them – it is only in the latter case that the region and its inhabitants become active players in the development of a common vision.

But, in contrast to these localized approaches, the measurement of sustainability requires moving up the geographical scale to the national or even global level. This is the subject of the articles in the second part of this issue, which deal with a subject whose importance has been emphasized by the recent law on the energy transition: the circular economy. Here there is a crucial difference to be made between a seemingly circular economy, which concerns a product or business, and genuine economic circularity, which can be understood only by enlarging the loop to develop a systemic vision.

This is what Christian Arnsperger and Dominique Bourg aim to demonstrate (“Towards a truly circular economy: Reflections on the foundations of an indicator of circularity”) by examining the main issues and questions that designers of an indicator of a truly circular economy would need to take into account, if it were ever to be developed formally and technically. They conclude in particular that without a systemic vision oriented towards the reduction, rationing and stationarity intrinsic to the permaculture approach, the notion of the circular economy will forever remain vulnerable to misuse that, however well intentioned, is ultimately short-sighted.

Vincent Aures and Laurent Georgeault (“Indicators of the circular economy in China”) attempt to assess the relevance and the actual scope of the assessment tools developed in recent years by China to flesh out an integrated circular economy policy that aims at ensuring the transition to a low-carbon model with a restrained use of resources. These instruments, which in many respects are unique, but still inadequate, are distinguished by their systemic and multidimensional character, and therefore constitute an original contribution to the field of sustainability indicators.

Finally, Stephan Kampelmann (“Measuring the circular economy at the regional level: A systemic analysis of the management of organic matter in Brussels”) draws on the theory of social-ecological systems to carry out a particularly innovative exercise. He uses a battery of indicators to compare the economic, social and environmental impact of two possible pathways for the municipal management of flows of organic matter in Brussels: a centralized treatment using anaerobic digestion, and a process based on decentralized composting.

Thus while well-being is best measured at the local level, to assess sustainability properly, including at the regional level, the impact felt beyond local and national borders has to be taken into account. The trade-offs between these dimensions, including the exploration and possible transformation into synergies at regional and national levels, then turn out to be the most promising projects opened up by the welfare and sustainability transition.

The secular stagnation equilibrium

By [Gilles Le Garrec](#) et [Vincent Touzé](#)

The economic state of slow growth and underemployment, coupled with low inflation or even deflation, has recently been widely discussed, in particular by [Larry Summers](#), under the label of “secular stagnation”. The hypothesis of secular stagnation was expressed for the first time in 1938 in a speech by A. Hansen, which was finally [published in 1939](#). Hansen was worried about insufficient investment and a declining population in the United States, following a long period of strong economic and demographic growth.

In a [Note by the OFCE \(no. 57 dated 26 January 2016 \[in French\]\)](#), we studied the characteristics and dynamics of a secular stagnation equilibrium.

A state of secular stagnation results when an abundance of savings relative to demand for credit pushes the “natural” real interest rate (what is compatible with full employment) below zero. But if the real interest rate permanently remains above the natural rate, then the result is a chronic shortage of aggregate demand and investment, with a weakened growth potential.

To counter secular stagnation, the monetary authorities first reduced their policy rates, and then, having reached the zero lower bound (ZLB), they implemented non-conventional policies called quantitative easing. The central banks cannot really force interest rates to be very negative, otherwise private agents would have an interest in keeping their savings in the form of banknotes. Beyond quantitative easing, what other policies might potentially help pull the economy out of secular stagnation?

To answer this crucial question, the model developed by [Eggertsson and Mehrotra](#) in 2014 has the great merit of clarifying the mechanisms behind a fall into long-term stagnation, and it is helping macroeconomic analysis to update its understanding of the multiplicity of equilibria and the persistence of the crisis. Their model is based on the consumption and savings behaviour of agents with a finite lifespan in a context of a rationed credit market and nominal wage rigidity. As for the monetary policy conducted by the central bank, this is set at a nominal rate using a [Taylor rule](#).

According to this approach, secular stagnation was initiated by the 2008 economic and financial crisis. This crisis was linked to high household debt, which ultimately led to credit rationing. In this context, credit rationing leads to a fall in demand and excess savings. Consequently, the real interest rate falls. In a situation of full employment, if credit tightens sharply, the equilibrium interest rate becomes negative, which leaves conventional monetary policy toothless. In this case, the economy plunges into a lasting state of underemployment of labour, characterised by output that is below potential and by deflation.

In the model proposed by Eggertsson and Mehrotra, there is no capital accumulation. As a result, the underlying dynamic is characterized by adjustments without transition from one steady state to another (from full employment to secular stagnation if there's a credit crisis, and vice versa if credit doesn't tighten much).

To extend the analysis, we considered the accumulation of physical capital as a prerequisite to any productive activity ([Le Garrec and Touzé, 2015](#)). This highlights an asymmetry in the dynamics of secular stagnation. If the credit constraint is loosened, then capital converges on its pre-crisis level. However, exiting the crisis takes longer than entering it. This property suggests that economic policies used to fight

against secular stagnation must be undertaken as soon as possible.

There are a number of lessons offered by this approach:

- To avoid the ZLB, there is an urgent need to create inflation while avoiding speculative asset “bubbles”, which could require special regulation. The existence of a deflationary equilibrium thus raises the question of the appropriateness of monetary policy rules that are overly focused on inflation.
 - One should be wary of the deflationary effects of policies to boost potential output. The right policy mix is to support structural policies with a sufficiently accommodative monetary policy.
 - Cutting savings to raise the real interest rate (e.g. by facilitating debt) is an interesting possibility, but the negative impact on potential GDP should not be overlooked. There is a clear trade-off between exiting secular stagnation and depressing potential GDP. One interesting solution could be to finance infrastructure, education or R&D (higher productivity) through government borrowing (raising the real equilibrium interest rate). Indeed, an aggressive investment policy (public or private) funded so as to push up the natural interest rate can meet a dual objective: to support aggregate demand and to develop the productive potential.
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How do French people look at equality of opportunity?

By Michel Forsé (CNRS) and [Maxime Parodi](#)

Do the French people believe in equal opportunity? The Dynegal survey asked the question in 2013 to a representative sample of 4,000 individuals, whose responses were very mixed. In a [recent article in the *Revue de l'OFCE* \(no. 146, 2016 \[in French\]\)](#), we show that it is the middle classes who prove to be a little more convinced than others by the idea that schooling gives everyone a chance and that one's success in life does not depend on social origin. This result is in line with the thesis by Simmel that makes the middle-class the site of social mobility.

The survey also raises questions about the link between the belief in equal opportunity and social expectations in terms of recognition of merit and equality of results. As might be expected, the less one believes in equality of opportunity, the less one defends the recognition of merit, and the greater the demand for equality of results. On the other hand, French people who are perfectly convinced that everyone has the same chance of success defend not only the recognition of merit, but also equality of place. This unexpected result highlights, in fact, a risk inherent in a society that is conceived of as totally meritocratic: the risk of completely discrediting the losers and of not finding them a place in society.

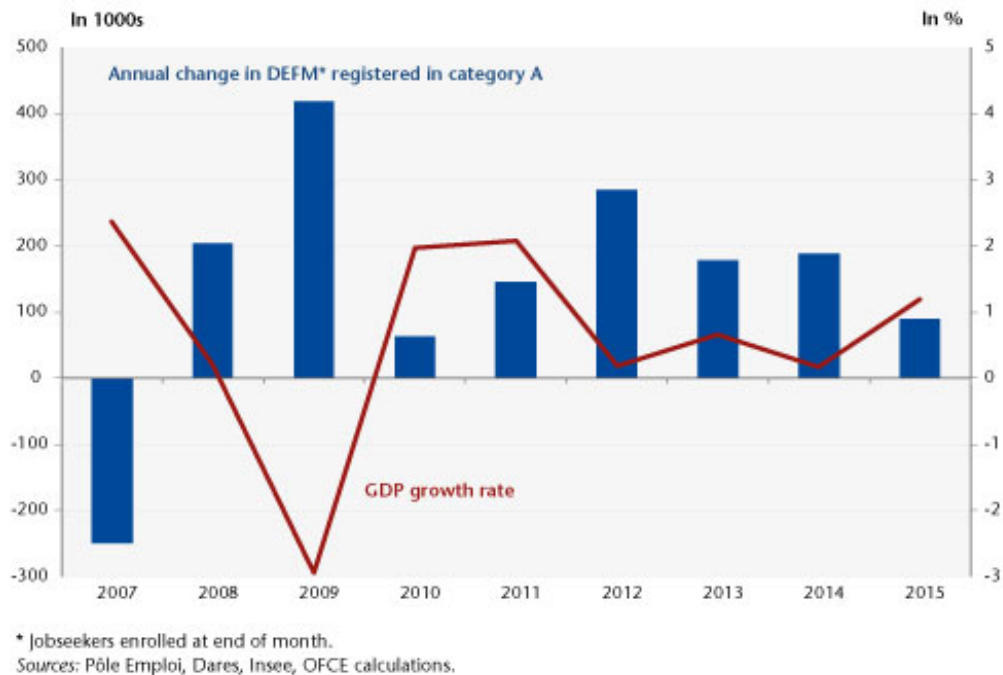
2015: An eighth year of rising unemployment in France

Department of Analysis and Forecasting (France Team)

Since June 2015, the number of job seekers at the end of the month (the number of “DEFM”, in French) in Category A registered with Pôle Emploi has swung from month to month, rising and falling. This high volatility, which reflects a sluggish labour market in which there is insufficient job creation to make a long-term reduction in unemployment, is directly related to the sluggish growth in the French economy overall. So after a relatively favourable November 2015 (15,000 DEFM fewer in category A), December once again saw an increase in the number of unemployed (+15,800), offsetting the previous month's fall. In addition, for the first time since May 2015, all age groups experienced an increase in the number of category A DEFM in December.

Ultimately, the number of jobseekers registered in category A with the Pôle Emploi job center increased for the eighth consecutive year in metropolitan France. With the return of higher growth, this increase has nevertheless been less than in previous years: +90,000 in 2015, versus +200,000 on average between 2011 and 2014. The increase has massively affected job seekers aged 50 and over (+69,000 in 2015), while the numbers under age 25 were down (22,000 fewer in 2015).

Annual change in the number of jobseekers registered in category A and annual GDP growth



The implementation of successive pension reforms (2003, 2010), coupled with the elimination of exemptions on job-seeking by seniors, has led to a longer duration of economic activity and to putting off the age of retirement. In a context of weak growth, the rise in the employment rate for seniors has been insufficient to absorb the increase in the workforce for that age group, with a consequent increase in unemployment of those over age 50.

The decreasing number of unemployed young people is due to two main factors. First, the employment policies enacted since 2013 have targeted youth in particular through the Jobs of the future (*emplois d'avenir*) programme. Second, the low job creation in the market sector is mainly taking the form of temporary jobs (fixed-term CDD contracts, temping), a type of employment in which young people are heavily represented (34.2% of young people in employment are on CDD contracts or temping versus 8.4% for other age groups). This development can be compared to the observed increase in categories B and C (+170,000 in 2015 against 97,000 on average between 2011 and 2014). Thus, while some return to work has been observed, this has not resulted in exits from unemployment as measured by the

job center, and has not led to halting the continuing rise in the number of long-term unemployed (+9.5% in a year).

The year 2015 therefore did not see a reversal in the unemployment curve. Recall that it takes a GDP growth rate of over 1.4% to create enough jobs to begin to roll back unemployment, and only an extended return to growth over that threshold would be sufficient to lead to a sustained drop in the number of category A jobseekers enrolled in the job center.

Intergenerational inequality in four large EU countries: Does one model fit all?

[Francesco Vona](#)

The extent to which social mobility differ across countries is subject of much debate in political and academic circles. The two poles of the relatively egalitarian Scandinavian countries and the relatively unequal Anglo-Saxon ones have been taken as key examples to corroborate a simple human capital-based explanation of cross-country differences in social mobility. In fact, stark differences in educational systems (e.g. private vs. public financing) and returns to skills well account for the gap in social mobility between Scandinavian and Anglo-Saxon countries. However, in a recent paper using comparable individual data for these four countries (*i.e.* EUSILC), I show that this explanation does not suffice in accounting for differences in social mobility across the four

largest EU economies: Germany, France, Italy and Spain.[\[1\]](#)

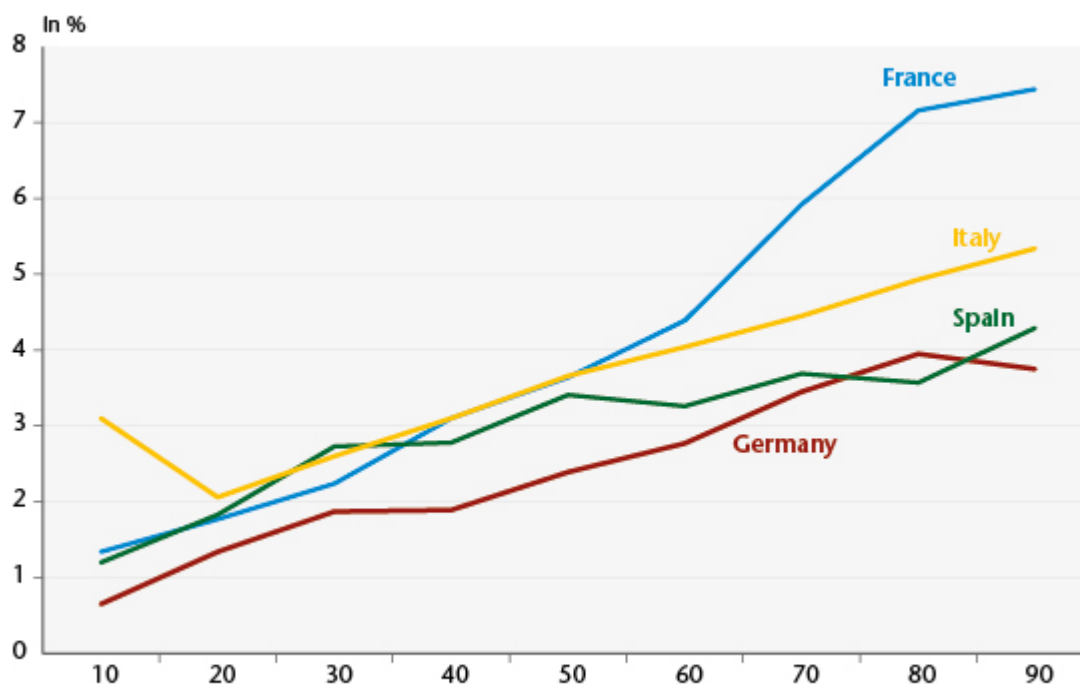
To gauge insight on the validity of the human capital story, we observe that worker's skills on which earnings depend are the result of two inputs: family background (including genetic transmission of intelligence if any) and individual abilities independent on family background. Our working hypothesis is that these two inputs are complements and thus that coming from a good family pays especially for talented individuals who not only don't face any spatial and financial constraint to access best schools but are also exposed to a more stimulating cultural environment (Cunha and Heckman, 2007). We test this hypothesis using regression techniques that allow to estimate returns to family background conditional on individual abilities (Firpo *et al.*, 2009). The figure below shows the effect of family background in correspondence of each decile of the son's earnings distribution, with a higher decile corresponding to higher individual abilities. The parental background coefficient should be interpreted as the percentage increase in earnings following a one-decile increase in the relative social position of the parents.[\[2\]](#)

At a first glance, our results lend to support to the hypothesis of a widespread background-ability complementarity. Returns to family background are higher at the top of the distribution not only in Germany and France, where parental influence on education is particularly important because of, respectively, the early tracking and the *grandes écoles* system, but also in the two Mediterranean countries, where usually non-meritocratic mechanisms are stronger.[\[3\]](#) However, one model does not fully fit all. First, the curve of returns to background is significantly steeper in the two central European countries than in the two Mediterranean countries, consistent with the idea that in Mediterranean countries family background affects children career prospects through social networks and nepotism.[\[4\]](#) Second, the effects of family background are significantly larger in France compared to the

other three countries. While the extremely large effect in the top decile is broadly consistent with the parental influence on the probability of entering *grandes écoles* in France, large returns in the 7th and 8th decile indicate an increasingly polarized distribution of opportunities depending on family origins.[\[5\]](#)

This increasingly high social immobility correlated with children abilities questions the foundation of the French school system and cannot be accounted for by a simple private vs. public school argument. A possible explanation is residential segregation and thus a radical rethinking of school admission policy based on neighborhood of residence is needed. Targeted policies promoting the mixing of students from different socio-economic background in the same school appear in high need to allow the talented but disadvantaged children to benefit from the positive peer effect from the well-off ones. Recent policy experiments carried out in the US show that these policies are particularly effective in increasing the career prospective of disadvantaged students (see Chetty *et al.* 2015).

Figure: Effects of parental background along the income distribution



Note: in France, for children in the last decile of income, an increase of one decile of parental background increases children's income by 7,5%.

Source: EUSILC, 2011.

[1] See Raitano, M., Vittori, C., Vona, F., 2015, 'The effect of parental background along the sons' earnings distribution: does one model fit for all?', *OFCE working paper*, n° 2015-18 and *Applied Economic Letters*, forthcoming. We use the information provided by the 2011 EU-SILC wave that includes a specific section with information on family characteristics when the interviewed was around 14 years old.

[2] We build a comprehensive measure of family background combining various family characteristics (mainly educational and occupational attainments of the parents) to obtain a distribution of parental social positions and associate each child to a given social position ranked from one to ten for convenience.

[3] Note that the parental background coefficient is always statistically different from zero, apart from in the first decile in Germany and Spain.

[4] Raitano, M., Vona, F., (2015). "[Measuring the link between intergenerational occupational mobility and earnings: evidence from eight European countries](#)", *Journal of Economic Inequality*, vol. 13(1), 83-102.

[5] Note that in the previous wave of the EU-SILC survey on intergenerational mobility, France displayed lower intergenerational inequality than Italy, Spain and the UK.

The American dream (finally) proven?

By [Maxime Parodi](#)

In a recently published short article, Thomas Hirsch and Mark Rank (2015) give us some astonishing figures about American society – numbers that, taken seriously, would lead to a significantly more nuanced view of income inequality in the United States. Indeed, their study suggests that American society is much more fluid than we think. While Americans undoubtedly live in a very unequal society, most of them would experience wealth at some point in their lifetimes. There is, in reality, a high turnover between rich and poor, which would explain why Americans are not very critical of inequality.

According to this study, during their working lives (age 25 to 60), 69.8% of Americans have enjoyed at least one year of household income sufficient to be included among the richest 20%. And 53.1% of Americans have made it – for at least one year – into the richest 10%. An even more exclusive 11.1% of Americans have spent at least one year in the illustrious club

of the wealthiest 1%.

But before accepting these outlandish figures, a more serious look needs to be taken of the study by Hirschl and Rank. It turns out that the numbers do not in fact offer a simple description of American society, but are rather the result of a modelling exercise. Behind these figures lie certain assumptions and methods that have been adopted, and which deserve discussion.

In the latest [*Note de l'OFCE \(no. 56 of 12 January 2015\)*](#), I show that the assumptions made are unrealistic and that the method used does not support the presence of missing data in the biography of the respondents. All in all, the results are heavily biased in favour of the American dream. It is possible, however, to partially correct this bias, yielding the results in the table below.

Table. Cumulative percentage by age and averages, after correction for bias, of belonging at least once in one's life to the richest 20%, 10%, 5% or 1% of households

In %

H* age	Q20		Q10		Q5		Q1	
	Graduate	Non-Graduate	Graduate	Non-Graduate	Graduate	Non-Graduate	Graduate	Non-Graduate
25	7,6	3,4	4,1	1,4	2,4	0,7	0,4	0,1
30	19,1	8,6	10,8	3,8	6,1	1,8	1,0	0,2
35	27,6	12,7	17,2	6,1	10,2	3,0	2,4	0,6
40	33,1	15,5	22,6	8,2	14,5	4,3	4,0	0,9
45	37,2	17,6	26,9	9,9	18,4	5,6	5,4	1,3
50	39,6	18,9	30,8	11,5	21,7	6,6	6,6	1,6
55	41,0	19,7	33,2	12,5	24,3	7,5	7,9	1,9
60	41,3	19,8	34,4	13,0	25,6	7,9	8,7	2,1
Average	31		24		17		5	

Source : Author's calculations.

Basically, the Hirschl & Rank figures are cut in half! Thus, 31% of Americans will have a sufficient household income for at least one year (between age 25 and 60) to be among the richest 20%. And 5% of Americans will have a sufficient household income for one year to be in the richest 1%.

Given the magnitude of this correction, it is clear that the study by Hirschl and Rank distorts reality by suggesting that social destinies in the United States are very chaotic – as if the entire society were at the roulette table. Other articles by Hirschl and Rank further fill out the picture. It is not in fact the first time that these authors have come up with such figures using this method. In 2001, they examined the other end of the income distribution, evaluating the percentage of Americans who have experienced an episode of poverty during their lifetime (Hirschl and Rank, 2001). They again came up with striking figures. For example, 54% of Americans experienced an episode of poverty [\[1\]](#) before age 40. In 2005, they again applied this method to recipients of food stamps (food vouchers), and estimated that 50% of Americans will have made use of food stamps at least once in their lives (before age 65). This order of magnitude is, yet again, barely credible. A less costly and more direct method would certainly be revealing: it would suffice to ask Americans whether they have ever received food stamps. While some Americans may prefer to hide such an event, this bias of omission will never be as large as that of the preceding survival analyses. Let's be clear: their method is a machine for producing the outlandish.

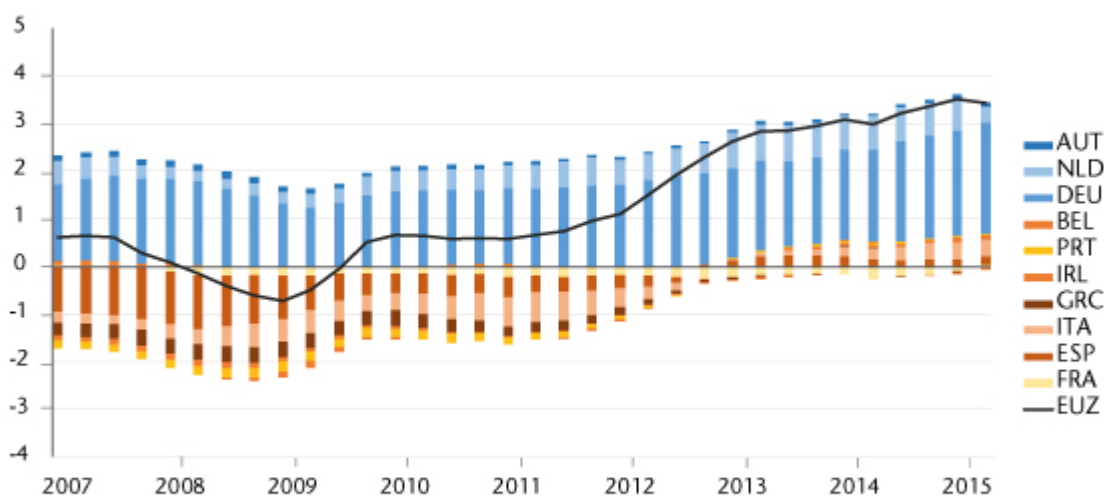
[\[1\]](#) The poverty threshold adopted here is 1.5 times the value of the basket of goods needed to meet basic needs.

What strategy for internally rebalancing the euro zone?

By [Sébastien Villemot](#) and [Bruno Ducoudré](#)

The euro zone has made significant efforts to reduce its trade imbalances since the outbreak of the financial crisis. In 2009, only Germany, the Netherlands and Austria had a current account surplus, while all the other countries, in particular France, Italy and Spain, ran current account deficits, resulting in a deficit for the zone as a whole (-0.7% of GDP). Five years later, in 2014, the situation had changed radically. The euro zone had a large current account surplus -3.4% of GDP – with almost all the countries running a surplus (figure).

Figure. Current account in % of euro area GDP



Note: The upward shift in the current account is the result of lower prices for raw materials, low internal demand, and unconventional monetary policy.

Source: National accounts, ECB, iAGS 2016 calculations. The current account is cumulated over 4 quarters.

It should nevertheless not be concluded that the euro zone has corrected its trade imbalances, as there are still several reasons for concern. Firstly, some of the current account surplus is cyclical, particularly in southern Europe, due to depressed domestic demand. Secondly, the magnitude of the euro zone's current account surplus comes with deflationary risks: while for the moment the ECB's expansionary monetary policy is

helping to contain upward pressure on the euro, this pressure will eventually materialize once the monetary cycle enters a phase of normalization, leading to imported deflation and losses in competitiveness vis-à-vis the rest of the world.

More importantly, the reversal of the euro zone's current account position vis-à-vis the rest of the world does not mean that the zone's internal imbalances have been corrected. The analysis that we made in the [2016 iAGS report](#) shows that there are still significant imbalances, although they have diminished since the start of the crisis.

Based on a model to simulate changes in the current accounts of the euro zone countries in terms of price competitiveness differentials [1], we calculated the nominal adjustments within the euro zone needed to achieve balanced current accounts for all the countries. A balanced position is defined here as stabilization of the net external position, at a level compatible with EU procedures (i.e. greater than -35% of GDP), and with the output gaps closed in all the countries.

The table below shows the results of these simulations and helps to take stock of the adjustments made since the beginning of the crisis as well as the adjustments still needed relative to Germany, which is used as a reference point.

Table. Nominal adjustments needed to achieve balanced current accounts relative to Germany

	2008	2009	2010	2011	2012	2013	2014
Germany	0,0	0,0	0,0	0,0	0,0	0,0	0,0
Austria	20,2	15,9	13,3	1,0	2,8	6,5	1,4
Belgium	-32,9	-29,9	-15,7	-30,7	-23,8	-22,2	-23,2
Spain	-46,8	-32,8	-30,6	-29,9	-21,9	-15,3	-18,5
Finland	4,8	-1,2	-7,9	-29,0	-30,7	28,4	-24,7
France	-18,9	-16,1	-16,6	-19,1	-19,8	-15,2	-19,1
Greece	-89,1	-87,9	-80,8	-73,0	-48,5	-39,7	-39,8
Ireland	-26,8	-28,7	-25,6	-26,9	-28,7	-19,8	-14,9
Italy	-29,2	-25,2	-32,7	-31,9	-19,9	-12,0	-9,9
Netherlands	-4,5	6,1	6,2	4,4	5,1	6,8	0,8
Portugal	-68,5	-65,3	-59,2	-43,1	-30,9	-17,1	-21,4

Source: Authors' calculations.

There were still significant nominal misalignments in the euro zone in 2014. Several groupings of countries can be identified. Austria and the Netherlands are on level footing with Germany. In contrast, Greece must undergo a nearly 40% depreciation compared to Germany, despite its previous sacrifices; even if the Greek current account is close to balanced today, this is due to the output gap that has widened considerably (-12.6% in 2014 according to the OECD) and artificially improved the external trade balance by shrinking domestic demand. Between these two extremes lies a group of countries, including France, Spain, Portugal, Belgium and Finland, which need a depreciation of about 20% relative to Germany. Italy meanwhile is in a somewhat better position, with a relative depreciation of about 10% required, thanks to its current account surplus (1.9% of GDP in 2014) and a relatively favourable net international investment position (-27.9% of GDP).

These nominal imbalances cannot be solved by changes in exchange rates, since the countries all share the same currency. The adjustment thus has to be made through relative price movements, i.e. by differentials in inflation rates between countries. Thus, inflation in Germany (and the Netherlands and Austria) needs to stay higher for a while than in the intermediate group, which itself needs to be higher than in Greece. And, given the importance of wages in determining the price of value added, this outcome will be achieved mainly by differential changes in nominal unit labour costs.

There are several possible ways to achieve this goal. The one that has been followed so far has been to make the reduction of labour costs the norm, based on a non-cooperative race for competitiveness. With Germany making extensive efforts to hold down its prices and wages, other countries could adjust only by cutting their own costs, whether through wage cuts (as in Greece and Spain) or by lowering corporate tax (as in France).

While these strategies have indeed helped to reduce imbalances in the zone since 2008, as our table shows, the adjustment is still far from complete, and the economic cost has been high. Lowering wages in the southern European countries undermined demand, and therefore business, while deflationary pressures were strengthened and are still threatening, despite the ECB's energetic policies.

Another approach would be to coordinate wage developments in the euro zone countries in order to allow the ECB to meet its inflation target of 2%, while making nominal readjustments. Each country would set a target for changes in its unit labour costs. Countries that are currently undervalued (Germany, Netherlands, Austria) would set a target of over 2%, while overvalued countries would set a target that was positive, but below 2%. Once the imbalances were absorbed, which would require a number of years, the targets could be harmonized to 2%.

The relative adjustment of unit labour costs could also be made through differential gains in productivity. This point highlights the importance of investment stimulus policies in the euro zone, so as to improve the productivity and competitiveness of countries that need to make significant nominal adjustments. Using this approach to adjust unit labour costs would release some of the downward pressure on wages and domestic demand in the euro zone.

A policy like this would represent a profound change in the economic governance of the euro zone, and would call for enhanced cooperation. This is, however, the price for maintaining the cohesion of the monetary union.

[\[1\]](#) Although non-price competitiveness also plays a role in trade dynamics, we have ignored it due to lack of an adequate quantitative measure.

Give Recovery a Chance

By iAGS team, under the direction of [Xavier Timbeau](#)

The ongoing recovery of the Euro Area (EA) economy is too slow to achieve a prompt return to full employment. Despite apparent improvement in the labour market, the crisis is still developing under the covers, with the risk of leaving long-lasting “scars”, or a “scarification” of the social fabric in the EA. Moreover, the EA is lagging behind other developed economies and regardless of a relatively better performance in terms of public debt and current account, the current low rate of private investment is preparing a future of reduced potential growth and damaged competitiveness. So far, the Juncker Plan has not achieved the promised boost to investment. The internal rebalancing of the EA may fuel deflationary pressure if it is not dealt with through faster wage growth in surplus countries. Failure to use fiscal space where it is available will continue to weigh down on internal demand. Monetary policy may not succeed in the future in avoiding a sharp appreciation of the Euro against our trade partners’ currencies. Such an appreciation of the real effective exchange rate of the Euro would lock the EA in a prolonged period of stagnation and low inflation, if not deflation.

A window of opportunity has been opened by monetary policy since 2012. Active demand management aimed at reducing the EA current account combined with internal rebalancing of the EA is needed to avoid a worrying “new normal”. Financial fragmentation has to be limited and compensated by a reduction of sovereign spreads inside the euro area. Active policies against growing inequalities should complement this approach. Public investment and the use of all policy levers to foster a

transition toward a zero carbon economy are ways to stimulate demand and respect the golden rules of public finance stability.

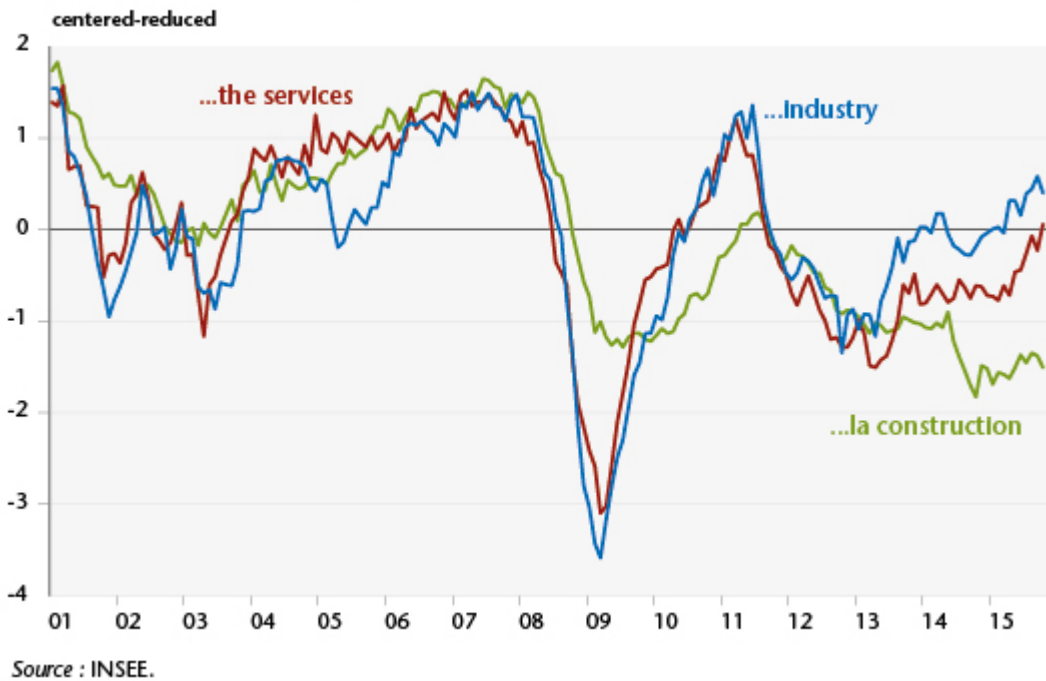
For further information, see [iAGS 2016 report](#)

The French economy on the road to recovery

by Hervé Péléraux

The publication of the INSEE's business surveys on October 22 confirms the French economy's positive situation in the second half of 2015, suggesting that the negative performance in the second quarter of 2015 (0%) will turn out to have been merely "an air pocket" after the strong growth seen in the first quarter (+0.7%). The business climate in industry has exceeded its long-term average for the seventh month in a row, and the service sector has been recovering rapidly since May 2015 and has climbed back to its average, the highest level in four years (Figure 1). The business climate in the construction sector nevertheless is still suffering from the crisis that hit it, but its downward trend halted at the end of 2014; despite monthly hiccups, the sector has begun a slow recovery that could signal the end of its woes in the coming quarters.

Figure 1. Business climate in ...



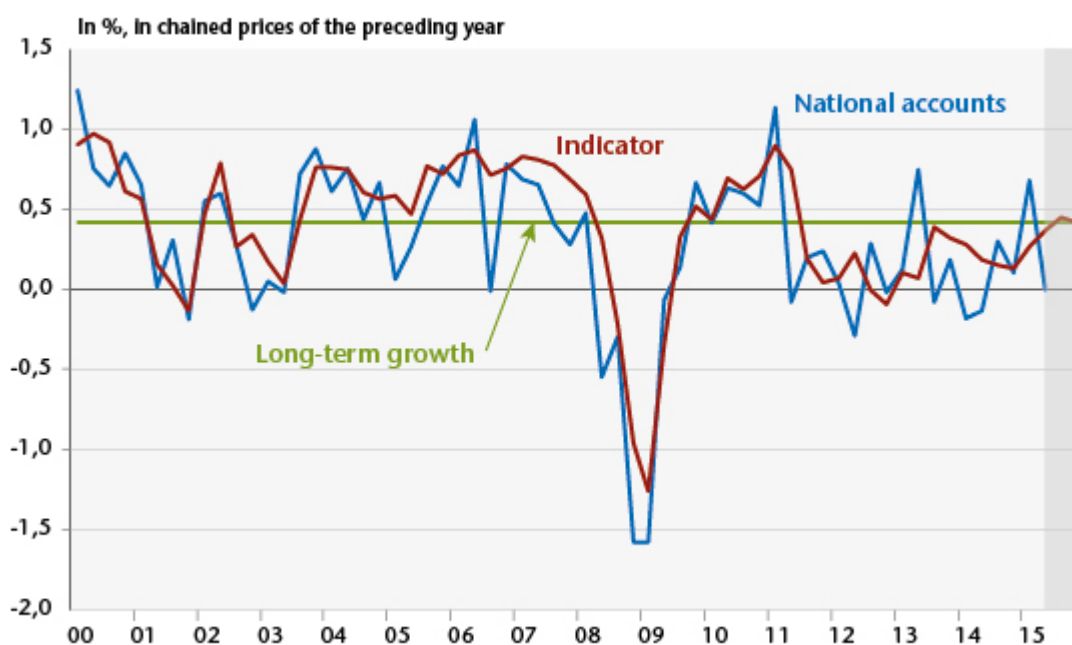
The confidence indicators, which provide qualitative information summarizing the balance of opinion on the various questions posed about business activity, consumer confidence and the situation in commerce, can be converted into quantitative information by means of an econometric equation linking these to the quarterly GDP growth rate^[1]. Doing this makes it possible to use these purely qualitative data to estimate the GDP growth rate in the past and near future (two quarters), given that the publication of the surveys precede that for GDP. Among the sectoral indicators available, only the business climate in industry, services and construction provide econometrically useful information to trace the trajectory of the GDP growth rate. The other series are not significant, in particular the indexes for consumer confidence and for confidence in the retail and wholesale trade.

The leading index, which has a significantly more smoothed profile than GDP growth rates, cannot fully capture the volatility of activity and therefore should not strictly speaking be considered a predictor of growth (Figure 2). On the other hand, from a more qualitative viewpoint, it manages to delineate quite correctly the phases during which growth is

above or below average (or the long-term) determined by the estimate. From this perspective, the indicator can be seen as marking a turning point in the economic cycle. Since the second quarter 2011, the indicator has not depicted any crossing of the long-term growth rate, despite the false signs of recovery raised by the quarterly GDP figures for Q2 2013 and Q1 2015.

Based on the survey data available up to October, the growth foreseen by the indicator is 0.4% in the third and fourth quarter of 2015, exactly equal to long-term growth^[2]. While a signal of recovery is not yet clearly given by the indicator, it should be noted that the information on the fourth quarter, which is limited to the October surveys, is quite partial. The confidence climates, which are extrapolated to the end of the year, are based on conservative assumptions and are likely to be upgraded if the surveys continue to improve from now to December.

Figure 2. GDP growth rate observed and estimated by the indicator

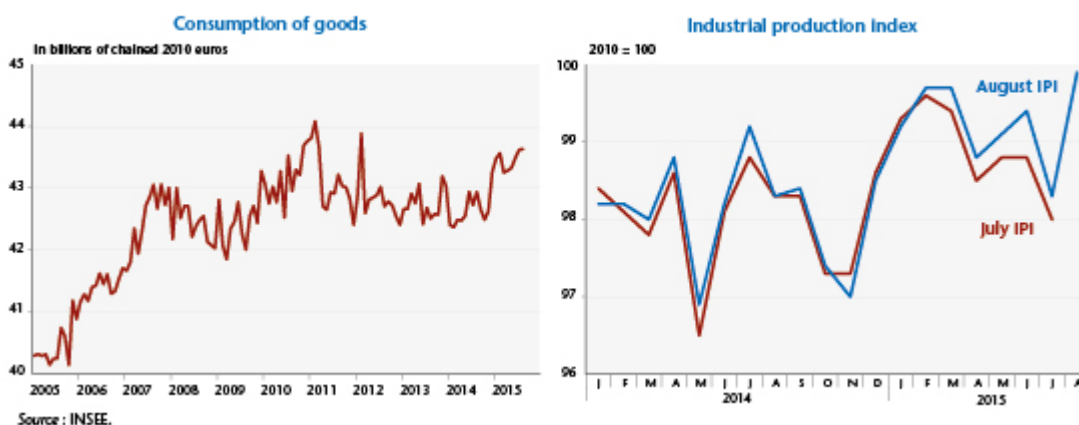


Source : INSEE, OFCE calculations and forecasts.

The quantitative information available at this time for the third quarter of 2015 also gives cause for optimism, after the disappointment of the second quarter. Under the impact of the

disinflation brought on by lower energy prices, which enabled a sharp rebound in purchasing power, household consumption of goods recovered sharply at the beginning of the year (Figure 3). The rise was interrupted in the second quarter, due to poor sales in March, which pulled down the figures, but consumption has resumed its upward trajectory continually since then. The carry-over in August for the third quarter was clearly positive (+0.6%), which suggests that the consumption of goods will again contribute positively to GDP growth for the quarter.

Figure 3. Household consumption of goods and Industrial production Index



The projection of a return to growth in the third quarter is also confirmed by trends in the industrial production index (IPI), which rose sharply in August (+1.6% for the total IPI, and +2.2% for the manufacturing index itself). This rebound followed a drop in production after the peak in February-March 2015 [\[3\]](#), which contributed to the poor performance of GDP in the second quarter (Figure 3), and nourished the idea that the second quarter was not an “air pocket” but the continuation of a long phase of stagnation for a France that was unable to take advantage of the favourable winds blowing from outside [\[4\]](#). The carry-over in industrial production in August now stands at 0.3%, while it was -0.7% in the old series available in July.

The recent trends in the monthly indicators augur a renewal of growth in the third quarter of 2015. The extrapolation of GDP

growth using the leading indicator, supplemented by the already available quantitative data, also points to a 0.4% increase in activity in the third quarter, which, if it is realized, would then put the economy on a firm track to finally initiate a recovery.

[1] For greater detail, see: « [France : retour sur désinvestissement, Perspectives 2015-2017 pour l'économie française](#) » [The 2015-2017 forecast for the French economy], pp. 34-37.

[2] The long-term growth considered here is not the potential growth estimated by its structural determinants using a production function, but the average GDP growth rate as reflected in the estimate of the indicator.

[3] It should be noted that the statistical revisions can change the perception of the economy's dynamics in the very short term. The IPI series published on 9 October 2015 by the INSEE has revised the level of the index significantly upwards compared to the previous publication. The IPI is still on a downward trend between February and July 2015, but the trajectory described is less negative, and the quarterly average of the index in the second quarter of 2015 is affected: according to the old series, it stood at -0.7%, compared with -0.4% according to the revised series.

[4] See Heyer E. and R. Sampognaro, 2015, « [L'impact des chocs économiques sur la croissance des pays développés depuis 2011](#) », [The impact of economic shocks on the growth of the developed countries since 2011], *Revue de l'OFCE*, no. 138, June 2015.

The labour market on the road to recovery

By [Bruno Ducoudré](#)

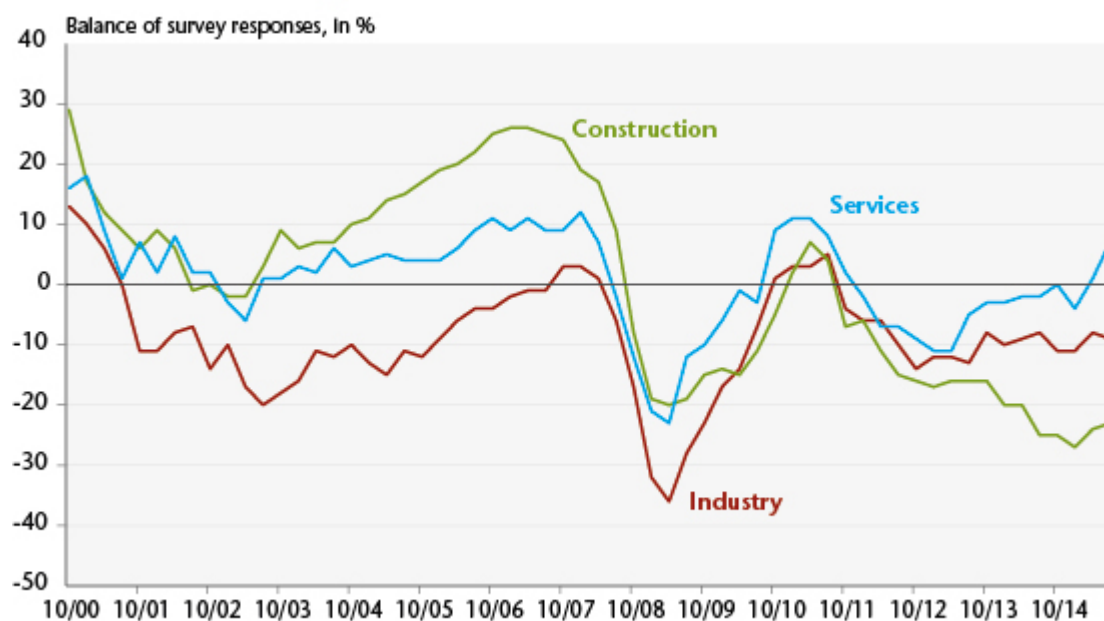
A look at the figures just published by France's Pôle Emploi job centre for the month of September 2015 shows that the number of job seekers who were registered and inactive (category A) has declined significantly (-23,800), following an increase in August (+20,000). While this is encouraging news, the decrease has to be compared with the increases seen in categories B and C (+25,600). So while employment has indeed picked up, this has not resulted in the numbers of people exiting unemployment as measured by the job centre, *i.e.* it has not put a stop to the continuing rise in the number of long-term unemployed (+10.4% in one year). Nevertheless, these trends do support the conclusions drawn from current analysis which indicate that [a recovery has indeed begun](#).

After seeing 76,000 jobs created in France in 2014 due to growth in non-commercial jobs, the first half of 2015 was marked by an increase in the workforce in the commercial sector (+26,000), which resulted in an acceleration of job creation in the economy overall (+45,000) over the first half of the year. The recently released statistics on employment confirm the accelerating trend in the third quarter of 2015: hence, over a year, declarations on job hires of over one month recorded by ACOSS rose by 3.7%, following 0.7% in the previous quarter. Business surveys also point to an increase in hiring intentions in the third quarter; these have turned positive in the service sector since the year started, which is also when the low point seen in construction was probably

reached (see Figure 1).

Our analysis of the labour market up to 2017, which was spelled out in the latest OFCE forecasts of October 2015, indicates that the commercial sector will continue to generate jobs up to the end of 2015 (+0.1% in the third and fourth quarters). The pace of job creation will nevertheless remain too low to foresee a fall in the unemployment rate by year end, particularly in light of our forecast for the GDP growth rate (0.3% in Q3 2015 and 0.4% in Q4) and the existence of overstaffing in companies, which we estimate at 100,000 in Q2 2015. The unemployment rate should remain stable at 10% until year end. With GDP growth of 1.8% in 2016, job creation will pick up markedly in the commercial sector once the overstaffing has been absorbed by companies, allowing the unemployment rate to fall starting in the second quarter of 2016. This decline will continue until the end of 2017.

Figure 1. Forecast of labour force trends



The last three years of weak growth have hurt employment in the commercial sector (-73,000 jobs between the start of 2012 and the end of 2014, cf. the Table). The strength of employment in the non-commercial sector, supported by the ramp-up of subsidized contracts (the “jobs for the future”

programme and non-commercial job integration contracts) helped to offset the loss of commercial sector jobs, with total employment rising by 164,000 over the same period, which slowed the increase in the ILO unemployment rate: this figure for mainland France rose from 9% of the labour force in late 2011 to 10.1% at end 2014, i.e. a 1.1 point increase.

Tableau. Employment and unemployment

Annual change in 1000s, at last quarter

Year on year	2012	2013	2014	2015*	2016*	2017*
Observed labour force	265	46	203	62	134	139
Total employment	31	57	76	103	193	242
– Commercial sector	0	-38	-35	73	238	245
Employed	-63	-58	-43	60	209	216
Unemployed	63	20	8	14	28	29
– Non commercial sector	31	95	111	29	-45	-3
Subsidized jobs	5	60	21	17	-54	-4
Non-subsidized jobs	26	35	90	12	10	1
Unemployment	234	-11	127	-41	-58	-103
Unemployment rate at Q4 (%)	9,7	9,7	10,1	10,0	9,8	9,4
GDP growth rate (%)	0,3	0,8	0,2	1,1	1,8	2,0

* OFCE forecast

Sources : INSEE and Ministry of Labour, OFCE forecasts, e-mod.fr 2015-2017, October 2015.

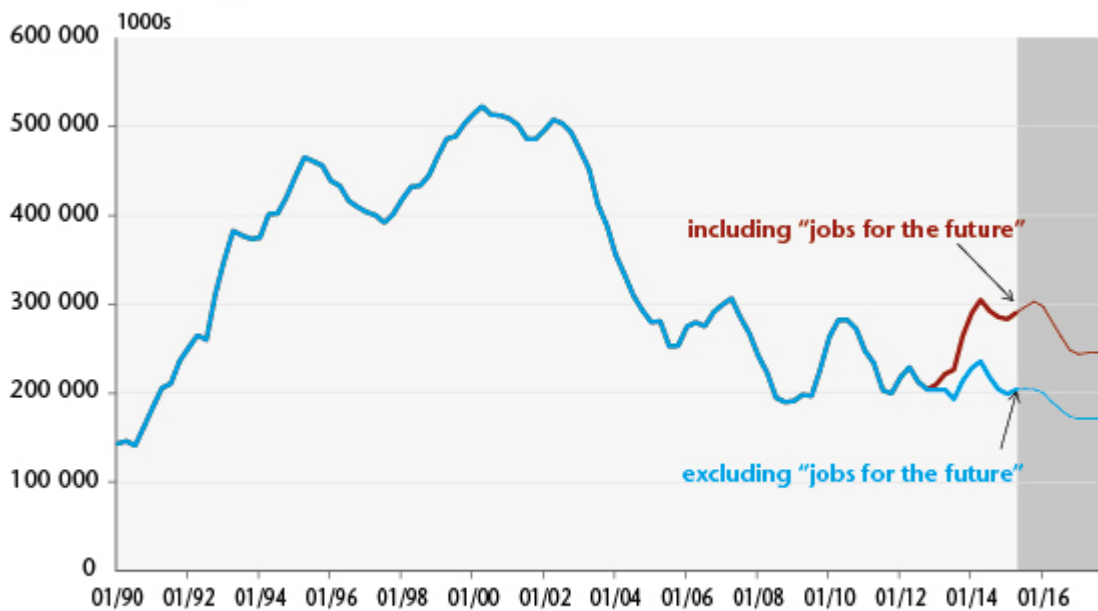
2015 is a year of transition, with a resumption of job creation in the commercial sector (+73,000 expected for the year as a whole) but less dynamic job creation in the non-commercial sector. For the full year, job creation will be boosted by the acceleration of growth (an annual average of +1.1% expected in 2015 but 1.4% yoy) and the implementation of policies to cut labour costs (CICE tax credit and the Responsibility Pact). The cumulative impact of the CICE and the Responsibility Pact, after taking into account the effect of financing, will create or save 42,000 jobs in 2015. However, job creation will be hampered by the presence of overstaffing^[11]: as economic activity picks up pace, companies typically absorb underutilized labour before increasing the volume of employment.

As for the non-commercial sector, employment policy is continuing to support the labour market in 2015 through the increase in subsidized job contracts. This increase has

nevertheless been slower than in previous years, with the number of “jobs for the future” contracts peaking in 2015 (Figure 2). Ultimately, total employment will increase by 103,000 in 2015, with the unemployment rate remaining stable at 10% till year end.

For 2016 and 2017, the acceleration of growth (at respectively 1.8% and 2%) combined with the ongoing implementation of policies to cut labour costs and the closing of the productivity cycle in the course of 2016 will lead to accelerating job creation in the commercial sector. This will increase, year on year, to 238,000 in 2016 and 245,000 in 2017 for the commercial sector alone, a rate comparable to what was seen between mid-2010 and mid-2011 (234,000 jobs created). However, in 2016, the number of subsidized contracts in the non-commercial sector set out in the 2016 Finance Bill will be down from previous years (200,000 CUI-CAE jobs and 25,000 “jobs for the future” in 2016, compared with 270,000 and 65,000 respectively for 2015). For 2017, we are assuming stability in the stock of subsidized non-commercial job contracts (see Figure 2). Overall, the long-term return of job creation by business will trigger a decline in the unemployment rate starting in the second quarter of 2016. Although sluggish, this fall should be sustainable, with the unemployment rate down to 9.8% of the labour force at end 2016 and 9.4% by end 2017.

Figure 2. Subsidized contracts in the non-commercial sector



Note : The fall in CUI-CAE contracts seen in the second half of 2014 comes from the switch from CAE job integration contracts to CDD fixed-term contracts.

Scope: Mainland France.

Sources : DARES, OFCE forecasts *emod.fr* 2015-2017, October 2015.

[1] The presence of overstaffing in businesses derives from the gap between labour productivity and its long-term trend, called the productivity cycle. This reflects the time employment takes to adjust to economic activity. See Ducoudré and Plane, 2015, « [Les demandes de facteurs de production en France](#) » [The demand for production factors in France], *Revue de l'OFCE*, no.142.