

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.

Does central bank optimism move financial markets?

By [Paul Hubert](#) and Fabien Labondance

“Animal spirits”, also called “errors of optimism and pessimism” or “sentiments”, contribute to macroeconomic fluctuations, as has been pointed out by Pigou (1927) and Keynes (1936) and more recently by Angeletos and La’O (2013) [\[1\]](#). Quantifying these kinds of unobservable concepts is crucial for understanding how economic agents form their expectations and arrive at decisions that in turn influence the economy. In a recent [working paper](#), “Central Bank Sentiment and Policy Expectations”, we examine this issue by analysing central bank communications and assessing their impact on expectations about interest rate markets.

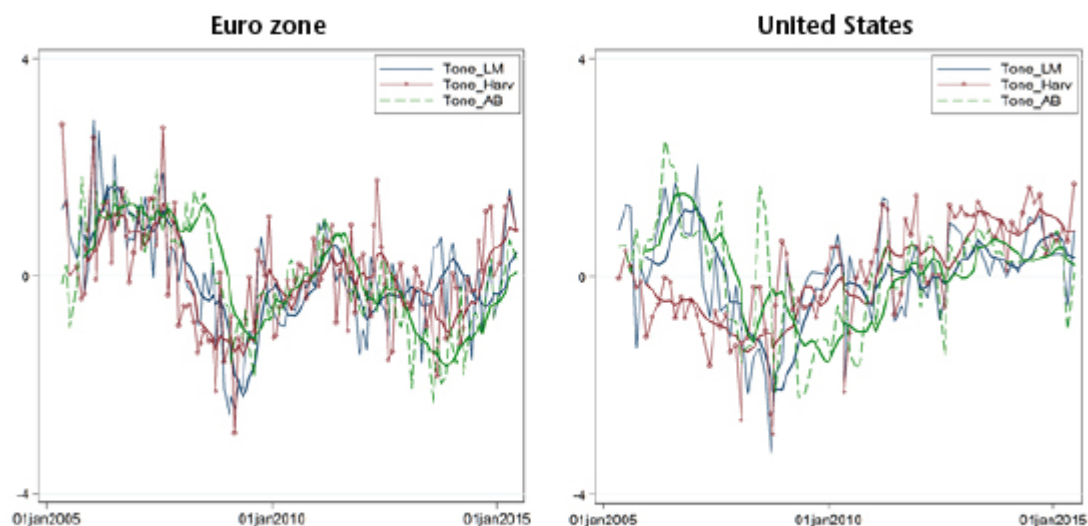
Our study aims to quantify the “sentiment” conveyed by central bank communications using the monetary policy statements of the European Central Bank (ECB) and the US Federal Reserve (Fed). We then test whether the optimism or pessimism transmitted in these statements affects the term structure of short-term interest rate expectations.

The main challenge is measuring a concept like the “sentiment” of a central bank, which is not very tangible. We first quantified the tone used by the ECB and the Fed in their monetary policy statements by using a computational linguistics approach based on three dictionaries of “positive” and “negative” words [\[2\]](#). Note that the goal here is not to measure the orientation of the discourse (whether, for example, expansionary or restrictive) but rather to quantify the use of words with a positive or negative tone in order to measure the overall tonality of the speech, regardless of its ultimate message. Sentiment is thus conceived as a component that is independent of economic fundamentals and the monetary

policy decisions actually taken [3]. In other words, we look at whether the use of certain words rather than others, regardless of the message communicated, affects the financial markets.

Figure 1 shows changes in the tone of central bank statements, calculated on the basis of the three dictionaries, for the ECB and the Fed from 2005 to 2015. The tone is correlated with the economic cycle: the speech is more optimistic (positive tone) during periods of growth and more pessimistic (negative tone) during periods of recession. Using this measure of tonality, we can see the 2008-2009 recession in the euro zone and the US, as well as the sovereign debt crisis in the euro zone in 2012-2013. The tone adopted by central bankers seems therefore to be the product of a combination of the central banks' assessment of the current and future state of the economy and of the sentiment that they are conveying.

Figure 1. Tone of central banker statements



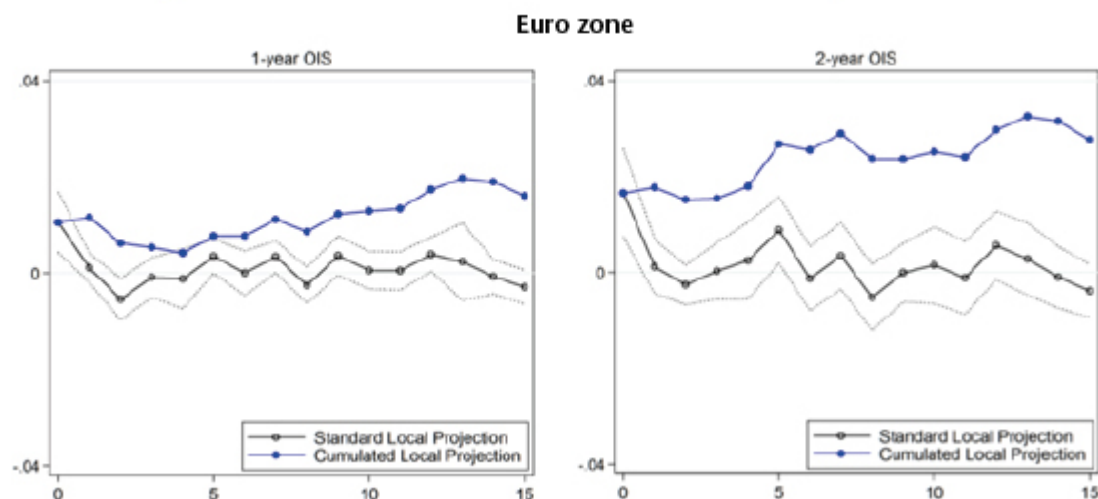
Source: The changes in tone were calculated using three dictionaries: Apel and Blix Grimaldi (2012 – AB); Loughran and McDonald (2011 – LM); and General Inquirer's Harvard IV-4 Psychosocial (Harv). The tone variables were normalized. The bold lines indicate the moving averages of the latest six statements on monetary policy.

After isolating the “sentiment” component of the variables quantifying the tone, we measured the impact of this sentiment on changes in short-term interest rate expectations, as measured by interest rate swaps (OIS – Overnight Indexed Swaps) for maturities ranging from 1 month to 10 years. Since

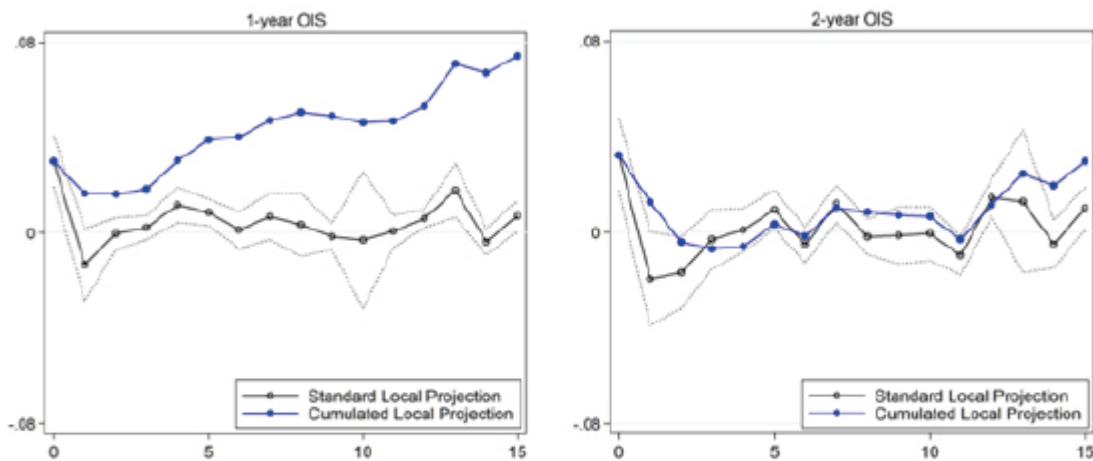
this sentiment is communicated on the day of the monetary policy decision, we also checked that we are not measuring the effect of the decision itself.

Our results show that a discourse with a positive (i.e. optimistic) sentiment has a positive effect on interest rate expectations for maturities ranging from 3 months to 10 years in the euro zone and on maturities from 1 to 3 months and from 1 to 3 years in the United States. The peak effect is for maturities of around 1 to 2 years both in the euro zone and the United States. We also show that this effect is persistent and tends to grow over time (see Figure 2). We also find that the impact of the sentiment depends on the precision of the signal, its size and its sign (the effect of pessimism is stronger than that of optimism, for example), as well as on the level of inflation and growth.

Figure 2. Effect of sentiment on interest rate expectations



United States



Note: Response function to a positive sentiment shock over 15 days using the methodology of Jorda (2005). The figure shows the estimated points, the 90% confidence interval and the cumulative effect.

Source: Jorda, Oscar (2005). "Estimation and Inference of Impulse Responses by Local Projections", *American Economic Review*, 95(1), 161-182.

These results show that market reactions are not due solely to the substance of the message but also to the way that it is expressed by the central bankers. Central bankers' sentiments influence the formation of interest rate expectations and seem to set the future prospects for rate policy. In a context where observers attentively scrutinize the slightest detail that might reveal the date when the Fed will once again raise rates, this study opens new avenues for research and suggests that it might be useful to test whether the sentiment conveyed in the last speech by Janet Yellen might be a good indicator.

[1] Angeletos, George-Marios, and Jennifer La'O (2013), "Sentiments", *Econometrica*, 81(2), 739-780 ; Keynes, John Maynard (1936), *General Theory of Employment, Interest and Money*, London, Palgrave Macmillan; and Pigou, Arthur Cecil (1927), *Industrial Fluctuations*, London, Palgrave MacMillan.

[2] We use three different dictionaries: one by Apel and Blix-Grimaldi (2012) that focuses on the communications of the central banks; one developed by Loughran and McDonald (2011) for a financial context; and the General Inquirer's Harvard dictionary, which lists positive and negative words used in everyday life. These dictionaries list words or phrases with

positive or negative connotations. The difference between the numbers of positive and negative words indicates the tone of the text: if there are more positive than negative expressions, the tone is optimistic, and vice versa. See Apel, Mikael and Marianna Blix-Grimaldi (2012), "The information content of central bank minutes", *Riksbank Research Paper Series*, no. 92; Loughran, Tim and Bill McDonald (2011), "When is a Liability not a Liability? Textual Analysis, Dictionaries, and 10-Ks", *Journal of Finance*, 66 (1), 35-65; and <http://www.wjh.harvard.edu/~inquirer/>.

[3] Cf. Angeletos and La'0 (2013).

Italy and the labour market: improvement, with caveats

By Céline Antonin

Since early 2015, the renewal of growth in Italy, the implementation of Act II of Matteo Renzi's Jobs Act, and the reduction in business charges have undeniably contributed to the improvement on the country's jobs front. Dynamic job creation, particularly with permanent (CDI) contracts, and an increase in the labour force, could give the impression that (partial) liberalization of Italy's labour market has resolved the structural weaknesses it has been facing. Nevertheless, in the first half of 2016, the creation of permanent jobs has severely dried up, and what is driving growth in employment now is an increase in fixed-term (CDD) contracts. Moreover, stagnating labour productivity has accompanied more employment-yielding growth, particularly in the services sector. So in the absence of further action to address Italy's

structural weaknesses, the upturn in the labour market may not last.

A brief review of recent labour market measures

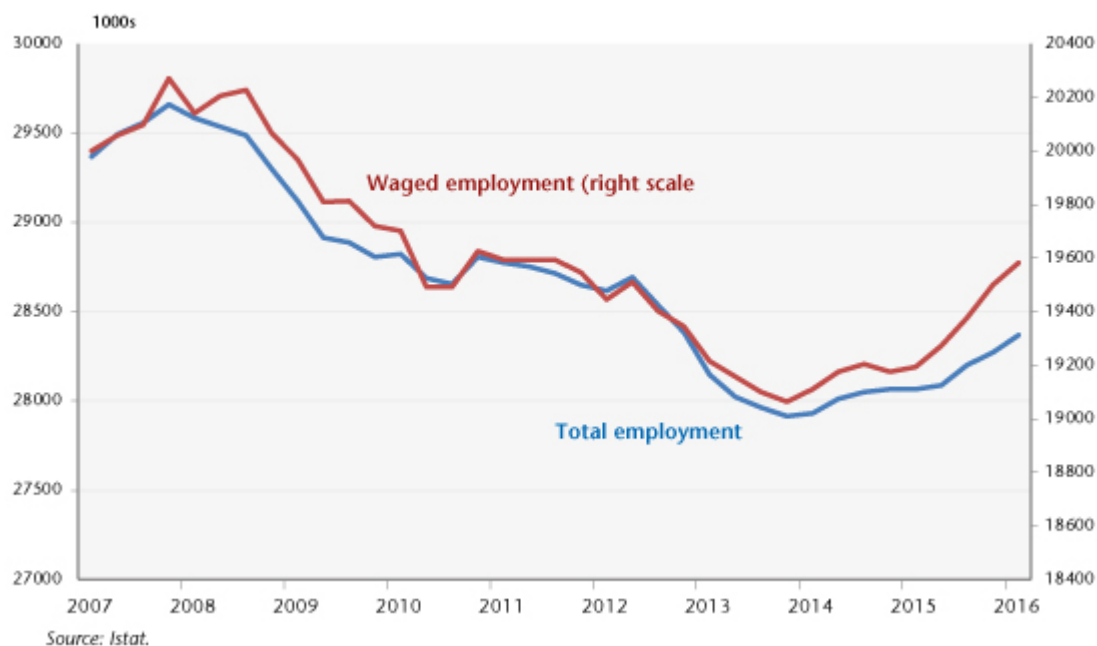
The Jobs Act is a continuation of a series of recent measures put in place since 2012 that are intended to create a more flexible labour market (see [C. Antonin, Matteo Renzi's Jobs Act: A very guarded optimism](#)). In Act I, the Jobs Act led to extending the duration of fixed-term contracts from 12 to 36 months, eliminating waiting periods and allowing more renewal periods, while limiting the proportion of fixed-term contracts within a given company. Act II introduced a new type of permanent contract, with greater protection and severance pay increases in line with seniority. It also abolished the misuse of *contratti di collaborazione*, precarious work contracts often used to disguise an employment relationship. These were to be transformed into employment contracts from 1 January 2016 (1 January 2017 for the public administration).

Furthermore, Italy has opted for cutting the taxation of labour: in 2015, the wage share of the IRAP (regional tax on productive activities) for employees on permanent contracts was removed. Above all, the 2015 Finance Act abolished social security contributions for 3 years on the new form of permanent contracts with greater protection, up to a limit of 8,060 euros per year for new hires between 1 January and 31 December 2015 who had not been on permanent contracts in the six months preceding their employment. The total cost to the budget was 1.8 billion euros. The programme was partially extended in 2016: companies taking on employees on the new permanent contracts in 2016 will be exempted from 40% of their social contributions for 2 years, and the cap on the exemption from contributions was reduced to 3,250 euros per employee.

A sharp increase in the number of jobs created, but stagnation in the creation of permanent jobs in 2016 ...

Since the beginning of 2015, the number of jobs grew strongly in Italy (Figure 1), but still falls far short of the pre-crisis level: between the first quarter of 2015 and the first quarter of 2016, the number of jobs grew by 304,000 (+391,000 permanent jobs).

Figure 1. Waged employment and total employment



A breakdown of these figures (Table 1) reveals a major difference between 2015 and the first half of 2016: the number of new CDI jobs exploded in 2015 (+281,000 between January and December 2015), before drying up in the first half of 2016 (-18,000 from January to June 2016). In 2015, the dramatic increase in the number of CDI contracts is partly explained by the replacement of precarious jobs by permanent jobs with progressive guarantees. Thus, of the 2.0 million CDI jobs created in 2015, there were 1.4 million new CDIs and 575,000 fixed-term (CDD) contracts converted into CDIs (source: INPS). 60.8% of these new contracts benefited from the exemption from social security contributions. However, the number of new CDI contracts dropped by 33% in the first half of 2016 compared to the first half of 2015, as a result of the reduced creation of CDIs *ex nihilo* and a sharp fall in the conversion of CDDs into CDIs (-37%). There was nevertheless a sharp increase in the number of the self-employed in 2016, after two consecutive

years of decline.

Table 1. Creation of jobs by category (flows)

1000s of jobs

	Jan-Dec 2015	Jan-Jun 2015	Jan-Jun 2016
Waged jobs	316	194	61
In CDI	281	143	-18
In CDD	35	51	79
Self-employed	-135	-80	126
Total employment	181	114	187

Source : Istat, Author's calculations.

Thus, the zeal for CDIs mainly occurred in 2015, before withering in 2016. One of the reasons is the following: **the reduction in social contributions for new hires on permanent contracts had a stronger impact than the Jobs Act itself.** In fact, the reduction in social contributions applied only to contracts concluded in 2015. These were renewed for 2016, but on a much more limited scale (two years compared with three, with the cap on the exemption from payroll taxes cut by more than half), which may well explain the decline in enthusiasm. Moreover, an anticipation effect can be seen for the month of December 2015 (Table 2), with a steep increase in the number of CDIs fully exempt (they more than quadrupled compared to the average of the preceding eleven months). In the first half of 2016, there were on average 42,000 people hired per month who benefited from the two-year exemption on contributions, or 31% of total permanent CDI contracts^[1], compared with 128,000 in 2015 (taking into account December). In 2015, the exempt contracts accounted for 61% of the total.

Table 2. New CDIs by category (exempt from charges or not)

In monthly average

	Average Jan-Nov 2015	Dec. 2015	Average Jan-Jun 2016
New exempt CDIs (a)	78 324	248 919	32 802
Converted from CDD into exempt CDIs (b)	27 921	130 324	9 205
Total CDIs exempt (a+b)	106 245	379 243	42 008
Total CDIs created	186 495	450 186	133 532
% CDIs exempt of total CDIs	57 %	84 %	31 %

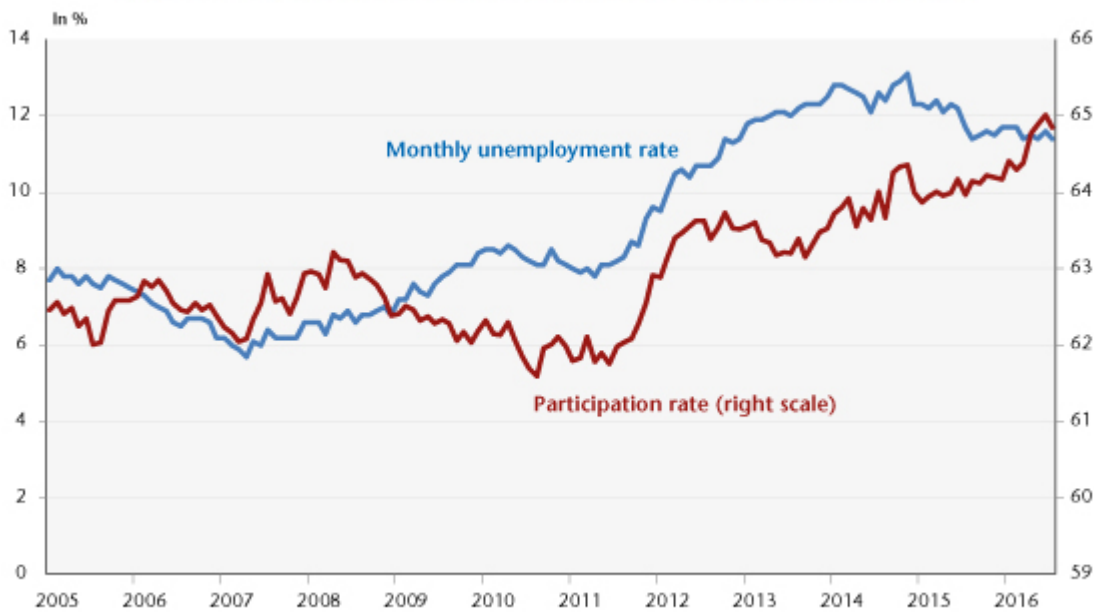
Note: The month of December was considered separately due to the sharp increase in the number of CDIs signed in that period.
Source: INPS, author's calculations.

... but stagnation in the number of jobless due to the growth in the workforce ...

Despite the dynamic jobs market, unemployment has stagnated in Italy since mid-2015 at a level of 11.6% (Figure 2). This paradox is explained by the increase in the active population: between July 2015 and July 2016, the workforce expanded by 307,000 people. Several phenomena are behind this:

1. The pension reform, which has led to seniors staying in their jobs;
2. A “flexion” or bending effect: with the return of growth and the improvement in the labour market, discouraged workers have begun looking for jobs again;
3. Immigration: positive net migration has had an impact on the labour market. The share of foreigners in Italy’s labour force rose from 10.7% to 11.1% between first quarter 2014 and first quarter 2016.

Figure 2. Unemployment rate and participation rate, 2005-June 2016



Source: Istat.

In conclusion, although it is not reflected in the unemployment figures, there has been an undeniable improvement in Italy's labour market, with a great deal of job creation and marked growth in the workforce. This improvement is attributable not just to the Jobs Act, but to three combined factors: 1) the return of growth since 2015, driven by the ultra-accommodative policy of the European Central Bank, less fiscal austerity and falling oil prices; 2) the reduction in labour taxes introduced in 2015 and extended in part in 2016; and 3) the implementation of the Jobs Act. In the light of Table 2, it can also be assumed that the reduction of business social charges had a stronger impact than the Jobs Act per se.

After the upturn in 2015, the figures for the first half of 2016 call for caution. The drying up of the creation of permanent jobs in 2016 shows that the Renzi reform did not resolve the underlying problem, namely the structural weaknesses of Italy's labour market, in particular labour productivity. To restore growth and employment, Italy really needs to address the issue of structural reform, including the poor level of innovation, research and development, the low level of competitiveness and the undercapitalization of its SMEs.

[1] including the conversion of CDD contracts into CDIs.

Britain's referendum of 23 June 2016: The leap into the unknown

By Catherine Mathieu

On 23 June 2016, the British people decided (by 52% to 48%) to leave the European Union. After having long criticized the functioning of the EU and the constraints that it placed on the United Kingdom, on 19 February 2016 David Cameron obtained an agreement intended to allow the UK to remain in the EU – but it was not enough to convince the voters. In an [OFCE Policy Brief](#) (No. 1 of 13 July), we analyze how the British people's concerns went beyond economic issues and that what counted was their desire to maintain (or regain) their political sovereignty.

The departure from the EU is, in the words of David Cameron, “a leap into the unknown”, and all that is possible now is to develop scenarios based on hypotheses about the outcome of the negotiations to be undertaken with the EU: from a rosy scenario in which both sides want to maintain as much as possible of the existing relations, to a dark scenario where the EU wants to set an example and the UK becomes a tax and regulatory haven.

As of early July, the UK clearly had not yet decided to

formally leave the EU (by triggering Article 50), and will probably not do so before September. The resignations of the Brexit camp's leaders and continuing changes in the political situation are leaving a fog over the establishment of negotiations: the pound has lost more than 10% against the euro and 12% against the dollar, and may not stabilize until the UK's situation is clarified. It seems that we are entering into a grey scenario where the various shades are still unknown.

In the short term, depending on the hypotheses adopted, the impact of a Brexit could be slightly negative for the British economy, on the order of 0.2 point of GDP in 2016 according to the National Institute of Economic and Social Research (NIESR), but this could reach several percentage points of GDP after two years depending on the scenario, with the UK Treasury entertaining the gloomiest prospects (-3.6% to -6%).

In the long term, again depending on the hypotheses adopted, the economic impact of the UK's exit would be decidedly negative, especially according to the British Treasury, but the assumptions of a sharp decline in British trade are undoubtedly exaggerated.

2015: An eighth year of rising unemployment in France

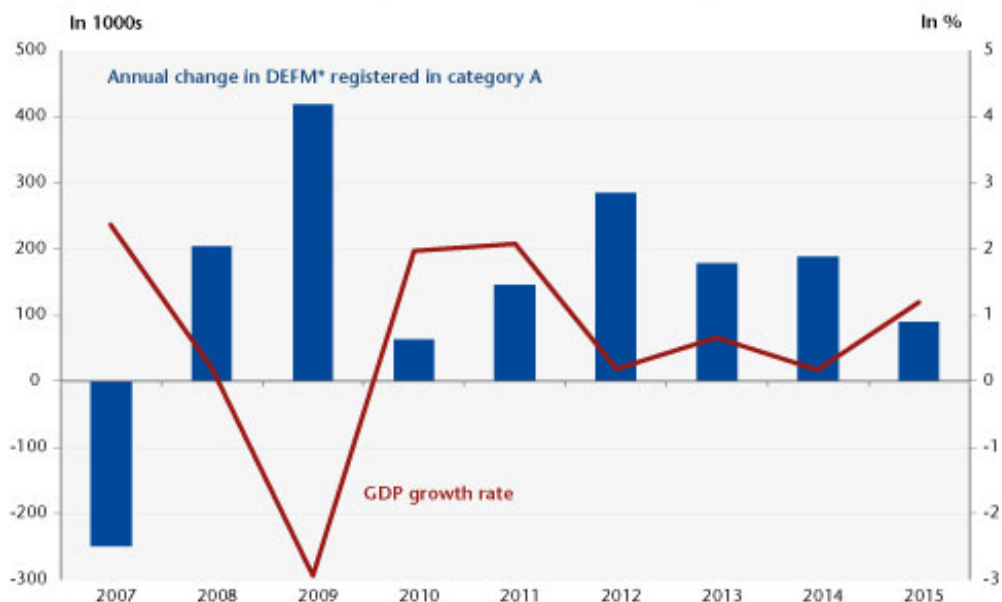
Department of Analysis and Forecasting (France Team)

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



* Jobseekers enrolled at end of month.
Sources: Pôle Emploi, Dares, Insee, OFCE calculations.

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).

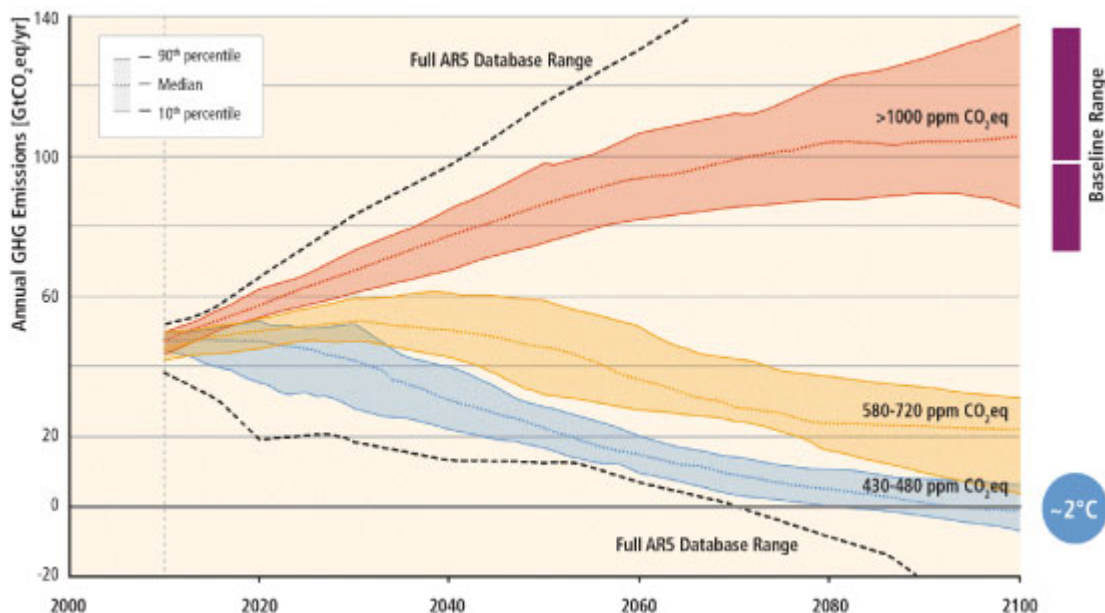
The year 2015 therefore did not see a reversal in the unemployment curve. Recall that it takes a GDP growth rate of over 1.4% to create enough jobs to begin to roll back unemployment, and only an extended return to growth over that threshold would be sufficient to lead to a sustained drop in the number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

The end of oil and coal

By [Xavier Timbeau](#)

The idea that we must put an end to the use of oil and coal is not new. It has been pushed for a long time by NGOs like [350.org](#) and its [gofossilfree](#) campaign. What is more striking is that the Democratic primary candidate Senator Bernie Sanders has put [the proposal](#) at the heart of the US presidential election debate. Institutional investors and large fund holders have also announced their intention to limit or terminate their investments in coal (for example, Allianz and ING) and oil (the Dutch pension fund ABP). The urban development policies of some large cities are also leaning in that direction. Asked about this option, the head of the US Environmental Protection Agency (EPA), Gina McCarthy, noted (cautiously) that this [option](#) was not irrational.

Figure: Scenarios of CO₂ emissions



Source: Figure SMP 11, AR5, IPCC, p. 21.

That said, [Figure SPM 11 of the 5th IPCC report](#) says much the same thing. If global warming is to be kept to 2 degrees, our

carbon budget since 1870 amounts to 2900 ± 250 GtCO₂e; we have consumed around 1900 GtCO₂e up to now. So staying below the 2°C level (relative to pre-industrial times) with a probability of 66% leaves about 1000 GtCO₂e. Given an annual flow of emissions of about 50 GtCO₂e, a simple rule of three give us 40 years of linearly decreasing emissions. The inclusion of carbon sinks, climate inertia and negative [radiative forcings](#) on the climate extends the time horizon to 2090 ± 10 years, but it would be prudent to get down to zero emissions earlier. For the record, there are still about 5000 ± 1400 GtCO₂ of recoverable reserves in coal alone, enough to greatly exceed our current carbon budget. Note that stopping the use of fossil fuels does not solve everything. A portion of current greenhouse gas emissions (of CO₂, but also of methane and other gases) is not linked to fossil fuels but to farming, deforestation and industrial processes. In the case of a nearly 100% system of renewable energy, the gas would be necessary during consumption peaks. These non-fossil emissions can be cut down, but not eliminated. It is possible to have negative emissions, but the only “technology” available today is reforestation, which can help lower emissions by only 2 GtCO₂ annually. Carbon capture and storage is also a way to conserve the use of fossil fuels provided that it works and that it has enough storage capacity (once the storage capacity is depleted, the problem remains).

The principle of “common but differentiated responsibility” would lead the developed countries to apply constraints more quickly (by say around 2050). Some see this prospect as the explanation for the fall in oil prices. Since not all fossil fuel reserves will be burned, the only ones worth anything are those that will be exploited before 2050, meaning that this price is lower than what would result from rising demand. Saudi Arabia therefore has an interest in increasing production rather than keeping worthless reserves. Mark Carney, Governor of the Bank of England and Chairman of the Financial Stability Board, has [evoked “stranded reserves”](#) in

the same way that a coal plant is a “stranded asset”, i.e. a blocked asset that has to be depreciated prematurely.

The end of oil and coal is no longer just a fad of a handful of green activists. This is also seen in the [persistent and nearly convergent calls of many economists about a carbon price](#). A high and rising price of carbon would force economic agents to disinvest in the capital that emits carbon or even to prematurely depreciate existing facilities. When a high carbon price is demanded (say between 50 and 100 € / tCO₂, with the price of carbon steadily increasing over time as the carbon budget runs out), the point is that this sends a strong price signal to economic agents, with the consequence of this price being that emissions are reduced in an amount consistent with warming of less than 2°C compared to pre-industrial times. So, from this viewpoint, saying that “the price of carbon should be 50 € / tCO₂ or more” is equivalent to saying “everything must be done so that we stop using coal and oil within the next half century”. The price of carbon thus gives us valuable information about the cost of the transition. It will be on the order of (a few) 1000 billion euros per year (on the scale of the global economy). Proposing a price means proposing the “polluter pays” principle (carbon emitters must pay), even though it is not clear exactly whom the polluters must pay. Hence the debate on the Green Fund and climate justice that is at the centre of COP21.

It would be a shame to focus on the carbon price and make it the central issue of COP21. A zero-carbon economy is our future, and we will have no excuses if we continue to burn fossil fuels. As Oscar Wilde remarked: “Nowadays people know the price of everything and the value of nothing.”

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](#)

Investing in the zero carbon economy in order to escape secular stagnation

By [Xavier Timbeau](#)

What the downward revisions of various forecasts ([IMF](#), [OECD](#), [OFCE](#)) presented in early autumn 2015 tell us about the euro zone is not very comforting. A recovery is underway, but it is both sluggish and fragile (see: "[A very fragile recovery](#)"). The unemployment rate in the euro zone is still very high (almost 11% of the labour force in the second quarter), and a sluggish recovery means such a slow fall (0.6 point per year) that it will take more than seven years to return to the 2007 level. Meanwhile, the European Central Bank's unconventional monetary policy is having difficulty re-anchoring inflation expectations. The announcement of quantitative easing in early 2015 pushed up the 5-year/5-year forward inflation rate [\[1\]](#), but since July 2015 the soufflé has collapsed once again and medium-term expectations are 0.8% per year, below the ECB target (2% per year). Underlying inflation has settled in at a low level ([0.9% per year](#)), and

there is a high risk that the euro zone will be frozen in a state of low inflation or deflation, strangely resembling what Japan has experienced from the mid-1990s to today. Low inflation is not good news because it is triggered by high unemployment and slowly rising nominal wages. The result is real wages growing more slowly than productivity. Little or no inflation means both real interest rates that remain high, which increases the burden of debt and paralyzes investment, but also an unconventional monetary policy that undermines the ability to measure risks and which gradually loses its credibility for maintaining price stability, i.e. to keep inflation within declared targets. At the [Jackson Hole Symposium](#) in August 2014, Mario Draghi announced that, in the face of persistent unemployment, monetary policy cannot do everything. Structural reforms are necessary (what else could a central banker say?). But a demand policy is also needed. Not having one means [running the risk of secular stagnation](#), as was formulated by Hansen in the late 1930s and recently brought up to date by Larry Summers.

Europe does not, however, lack investment opportunities. The [COP21 commitments](#), though timid, assume a reduction in CO2 emissions (equivalent) per capita from 9 tons to 6 tons within 15 years, and investment will need to pick up pace in a big way if the change in global temperature is not to exceed 2°C. This means aiming to put an end to the use of petroleum and coal (or the large-scale development of carbon capture and storage) within 35 years. Achieving this will require investment on a massive scale, which is estimated in the [European Commission's Energy Road Map](#) at over 260 billion euros (nearly 2% of GDP) per year by 2050. The social profitability of such investments is substantial (since it helps to avoid climate catastrophe and makes it possible to meet the EU's commitments to the world's other countries), but – and this is the problem posed by our sluggish recovery – their private profitability is low, and uncertainty about future demand together with poor coordination could give pause

to the “animal spirits” of our entrepreneurs. Secular stagnation results from the very low profitability of investments, particularly after taking into account the real rates anticipated and the risk of a more serious depression. To avoid this trap, the social returns on investment in a zero carbon economy need to become evident to all, and in particular they need to coincide with private returns. There are numerous tools that can do this. We can use carbon pricing and markets for trading in emission rights; we can use a carbon tax; we can develop certificates for new investments (assuming we know how to ensure that they reduce CO2 emissions compared to an opposing counterfactual) or impose standards (if these are followed!). The difficulties of the transition and the acceptance of a relatively painful change in prices can be eased by compensatory measures (which have a budgetary cost, [see Chapter 4 of the IAGS 2015 report](#), but are part of the stimulation package). It might also be desirable to draw on monetary policy to amplify the stimulus (see [this proposal by Michel Aglietta and Etienne Spain](#)). The implementation of artillery like this to reduce emissions and boost the European economy is not straightforward and would require wrenching the institutional framework. But that’s the price to pay in order to avoid sinking into a long period of stagnation which, with the inequalities and impoverishment that it would generate, would certainly break up the European project.

This text was published on *Alterecoplus* on 22 October 2015.

Financialisation **and**

financial crisis: vulnerability and traumatic shock

By Jérôme Creel, Paul Hubert, Fabien Labondance

Since the mini-crash that took place in the Shanghai stock market in August, financial instability has resurfaced in the markets and the media and, once again, the link with financialisation has been evoked. The Chinese crisis resulted from a combination of real estate and stock market bubbles that were fed by the abundant savings of a middle class in search of high-yield investments. It feels like we've gone back almost ten years when what is considered the excessive financialisation of the US economy – with abundant savings from the emerging countries enabling the build-up of widespread US consumer debt – is treated as the cause of the financial instability and crisis that was triggered in the summer of 2007.

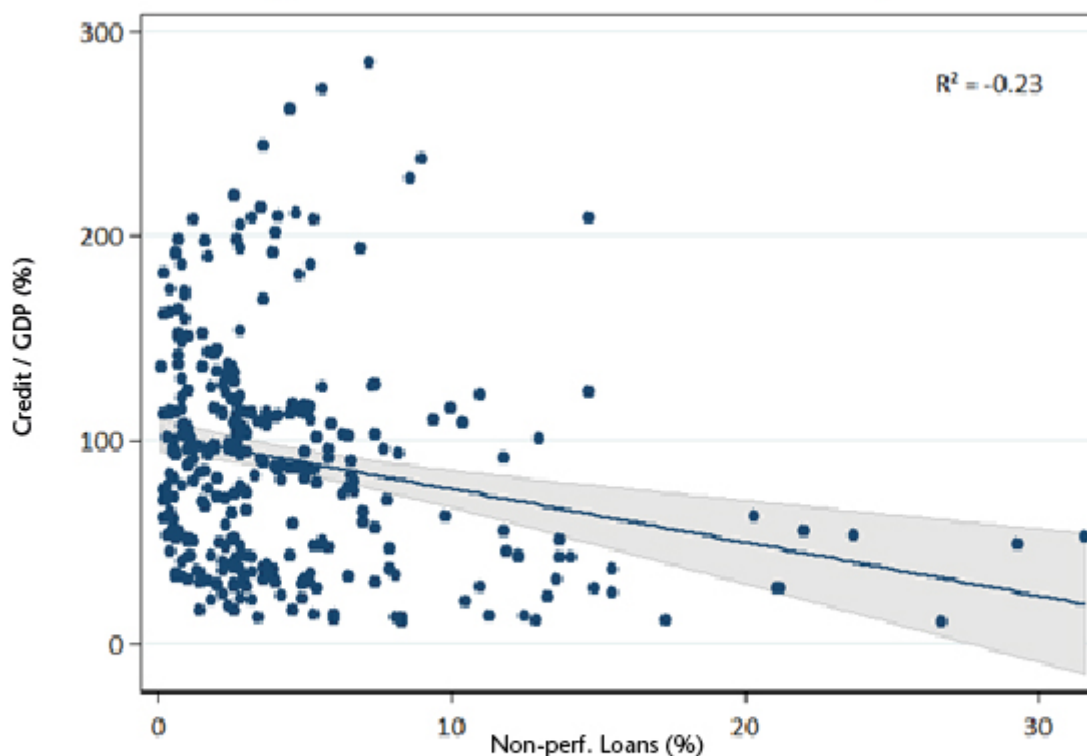
Is there really a link between, on the one side, increasing indebtedness and the great variety of financial investments, and on the other, volatile stock prices and a deterioration in the quality of bank loans? And if there is, what is the direction of the dynamics: from financialisation to financial instability, from financial instability to financialisation, or both at once? A rise in indebtedness could well lead to increasingly risky lending to agents who will not be able to repay them, which would then lead to a financial crisis: this is one possible case. The occurrence of a crisis would change the behaviour of households and firms, causing them to reduce debt: this is the second case, in which financial instability reduces the financialisation of the economy. Depending on which is the case, the public policies needed differ. In the first, we need to monitor the degree of the

economy's financialisation and target, for example, a maximum ratio of bank credit to GDP in order to prevent the rise and bursting of speculative bubbles. In the second case, there are two possibilities: to treat the causes, and thus to monitor the quality of loans to households and business so as to ensure the proper allocation of capital in the economy; or to treat the consequences by supporting productive investment to annihilate any rationing of credit.

In the course of the debate on the links between financialisation and financial instability, and on the consequences to be drawn in terms of public policy, the European situation is interesting for two reasons: the European Union has set up a system for monitoring external imbalances, including financial ones, from 2011, and a banking union since 2014. In a recent [working paper](#), we look at this debate for several groups of countries in the European Union over the period 1998-2012.

At first glance, the relationship between these two concepts is not easy to demonstrate, as can be seen in the graph below. It shows a scatter plot that for each year and for each European country gives the levels of financialisation (approximated here by the share of credits / GDP) and of financial instability (approximated here by non-performing loans). The correlation between these variables is -0.23 .

Figure. Financialisation and financial instability



Note: Non-performing loans, or bad debt, expressed as a percentage of total loans granted by banks.
Credit/GDP: total amount of bank credit expressed as a percentage of GDP.

Source : Creel et al. (2015) based on GFDD databases.

We test the two typical cases discussed above. We call the first case the vulnerability effect. As financialisation develops, it engenders a sort of euphoria that leads to granting loans that are increasingly risky, which fosters financial instability. This hypothesis derives from the work of Minsky (1995) [1]. We simultaneously test the potentially negative relationship between financial instability and financialisation, which we call the trauma effect. The very occurrence of financial instability as well as its impact encourages economic agents to take less risk and to shed debt. Our estimates show that the link between financial instability and financialisation is not uni-directional. Contrary to what is suggested by the simple correlation coefficient, the sign of the relationship is not the same when looking at the effect of one variable on the other, and vice versa. Both the vulnerability and the trauma effect have been at work in the European countries. A macro-prudential policy intended to

monitor the policy on granting bank loans, in terms of their volume and quality, therefore does indeed seem necessary in Europe.

We also tested the possibility that these effects are non-linear, that is to say, that they depend on reference values. The vulnerability hypothesis depends both on the level of financialisation (the higher it is, the stronger the relationship) and on time. This last point shows us that the positive relationship between financialisation and financial instability shows up at the moment of crisis for countries that are already heavily financialised. Finally, in the countries on the EU periphery [\[2\]](#), long-term interest rates and inflation rates greatly influence the financial instability variable. Consequently, it seems that for these countries there is a need for strong coordination between banking supervision and macroeconomic surveillance.

[\[1\]](#) Minsky H. P. (1995), "Sources of Financial Fragility: Financial Factors in the Economics of Capitalism", paper prepared for the conference, *Coping with Financial Fragility: A Global Perspective*, 7-9 September 1994, Maastricht, available at Hyman P. Minsky Archive. Paper 69.

[\[2\]](#) This group consists of Spain, Ireland, Italy, Greece, Portugal and the countries from the Eastern enlargements in 2004 and 2007. The establishment of this group is explained in the working paper.

Unemployment: a fall by temping

by Analysis and Forecasting Department (France team)

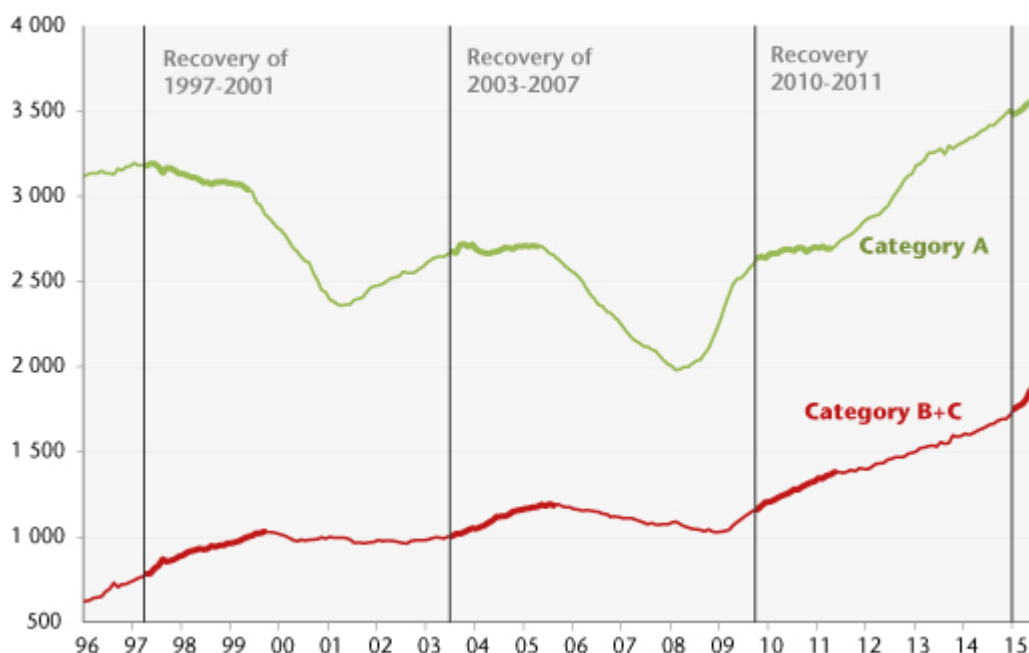
The unemployment figures for the month of July 2015 indicate a slight fall (-1900) in the number of people registering in category A. There is still too much uncertainty about monthly changes in enrolment at France's Pôle Emploi job centre to conclude that there has been a lasting improvement in the state of the labour market. However, the increase observed since January 2015 (+50,900 registered in category A) is smaller in scale than the figures recorded for this same period during the past three years (+128,500 on average for the first seven months of the previous three years). It is comparable to the situation in 2010-2011 (+44,300 on average in the first seven months of both years), which were years of renewed growth.

Seen in the context of the first buds of recovery, this trend in unemployment is not surprising. First, the pick-up in GDP growth observed in the first six months (+0.7% according to [preliminary accounts published by the INSEE](#)) is expected to gain pace in the coming quarters. For now, [this recovery has meant a rise in salaried employment of +26,600 in the competitive sector during the first six months of 2015](#). This has been sufficient to limit the increase in unemployment, without however reversing it, as labour force numbers have increased by about 75,000 during the half year.

Furthermore, the increase in registrations in categories B and C [\[1\]](#) has been more marked than for category A (+145,600 since the year's start). This is due partly to some switching by the jobless in category A into these other categories, which reflects an increase in precarious employment that is consistent with the increase in temporary jobs in the first

half year (+11,600): historically, an improvement in the labour market starts with an increase in precarious jobs (fixed term, temporary). This is also coinciding with an increase in job offers collected by Pôle Emploi, as well as with exits from the job centre due to a return to work, a figure that reflects a return to levels comparable to those observed in 2010-2011.

Figure. Enrolment in the Pôle Emploi job centre by category



Source : Pôle Emploi.

Finally, the trends differ by age group: the number of people under age 25 registered in category A is 4,600 lower than its level at year-end 2014. In fact, the young, who are over-represented in so-called temporary jobs ([34.2% of young people in work are on fixed-term CDD contracts or are temping, compared with 8.4% of those in other age groups](#)), benefit from the creation of this type of job, and from the increase in subsidized jobs that are targeted specifically at their age group. Conversely, the enrolment in category A of people aged 50 and over is rising steadily (+36,100 since the year started). 62% of those aged 50 and older have been enrolled in the job centre for over a year, versus an average of 39% for other age groups.

[\[1\]](#) These categories group people who have worked on reduced hours during the month, but are still registered at Pôle emploi.