
Growth and unemployment hysteresis in Europe: An empirical analysis of the rate of capacity utilization in European countries

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Résumé

The development of the new-Keynesian concept of Non-Accelerating Inflation Rate of Unemployment (NAIRU) brought about a radical change of the concept of *potential output*, the level of output consistent with full employment (Okun, 1962). According to the new-Keynesian view, there is a unique level of output consistent with inflation stability, and any other level of output would generate either inflationary or deflationary pressures that are unsustainable in the long term (Layard et al, 1991). Policy makers should therefore properly estimate this level of output, which is unobservable, in order to adjust real output to this theoretical "equilibrium" level and stabilize inflation. There exist different methods to estimate potential output (Cerra & Saxena, 2000). All these methods share a common property: they ignore the possibility that demand shocks might affect potential output permanently (hysteresis effects) and they assume that real output naturally gravitates around potential output (without ever questioning nor testing the validity of this assumptions). In this paper, we try to elaborate an empirical model to estimate the rate of capacity utilization in European countries, without assuming the existence of a Non Accelerating Inflation Rate of Capacity Utilization (Gordon 1997; Nauhis, 2003) as a center of gravity. To estimate the rate of capacity utilization, we assume the validity of some theoretical assumptions that belong to the Keynesian tradition, and test whether this measure of capacity utilization can compete with standard estimates of potential output to provide a correct analysis of the unemployment/inflation trade-off and analyze the effects of demand policies on growth. Results show that this measure of capacity utilization correlates well with most macroeconomic variables and confirm the existence of hysteresis effects in Europe after the 2008 crisis. In some countries, the shock generated by the recession and the austerity policies that followed structuralized the unemployment rate on higher levels. In these countries, the rate of capacity utilization is converging towards a "normal" utilization not because of positive demand growth but because of massive capital destruction. The margins for an economic recovery are therefore extremely tight due to low investments, low productivity but high rates of capacity utilization. Expansionary demand policies are unlikely to generate inflationary spiral, as potential output estimates would suggest, but they would rather imply a deterioration of the balance of payments due to a faster increase in imports. A sectoral analysis of the rates of capacity utilization in different industries is necessary to analyze the margins of recovery and the effectiveness of expansionary demand policies. Industrial policies are key to drive European countries out of this secular stagnation.

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Mots-Clés: Path dependence, Hysteresis, Capacity utilization, Potential output, Output gap