Conseil national de productivité

SUMMARY

Productivity and competitiveness: where does France stand in the euro zone?

First report of the French National Productivity Board

SUMMARY

Following a recommendation of the European Council in September 2016, all EU Member States sharing the euro must set up a National Productivity Board. These boards are in charge of analysing the developments and determinants of productivity and competitiveness within their respective countries, while taking into account the interactions with other Member States with the aim of improving economic policy coordination within the euro area. This first report clarifies some questions and clearly establishes that productivity and competitiveness are two different concepts with very different implications, in particular within the context of a monetary union. Productivity gains are the main source of growth in industrialised countries. Understanding the sources of its slowdown over the past twenty years is therefore a fundamental issue. This slowdown constitutes a puzzle which is not completely understood today, and which has given rise to a debate around the concept of "secular stagnation". If the low productivity gains scenario were to become persistent, it would imply a stagnation in purchasing power for most people as well as difficulties in financing the ecological transition and social protection for instance, in a context of growing ageing-related needs.

While the two concepts are sometimes confused, competitiveness raises a different set of questions than does productivity. Competitiveness takes on a particular dimension in a monetary union. It is defined here as a country's ability to balance its flows of resources with the rest of the world. Measured by the current account, this external balance depends largely on the ability to sell one's goods and services internationally, which in turn is mainly determined by cost-competitiveness and non-cost competitiveness (e.g. product quality). As opposed to productivity, competitiveness is necessarily defined relative to our partners. From an accounting point of view, a national current

account surplus can only exist if partner countries are running a current account deficit. Unlike productivity improvements, an increase in competitiveness happens necessarily at the expense of other countries. Thus, productivity gains are a positive-sum game at the global level, whereas it is necessarily a zero-sum game for competitiveness.

Hence, the accumulation of current account surpluses cannot in itself be considered an economic policy objective. Still, monitoring the current account balance, the trade balance, and the evolution of market shares, remains legitimate. Indeed, accumulating external deficits over too many periods can eventually put at risk the external debt financing and take the form of a balance of payments crisis with a large fall in wages, consumption, investment and employment. External debt sustainability is particularly relevant within the euro area, as cost-competitiveness can no longer be rapidly restored through exchange rate movements between euro area partners and requires an adjustment in relative wages. which can be particularly painful from a social and economic point of view for deficit countries. The accumulation of current account surpluses is not risk-free either.

As far as productivity is concerned, all countries in the area, both individually and collectively, have an interest in its improvement because it is a guarantee of prosperity. With respect to competitiveness – particularly between euro area countries – the purely national dimension of determining labour costs is not sufficient. It must be part of a cooperative framework under which imbalances that could endanger the area as a whole are mutually monitored. Current rules have failed to correct the serious imbalances of current-account surplus countries, which have severely damaging consequences for all euro area countries.

This first report of the National Productivity Board (NPB) is organised in two parts. The first part presents a fairly broad overview of the factors, which may be common to OECD countries or specific to France, that can be behind the national productivity slowdown. In the second part, the report focuses on the link between the country's competitiveness and current account imbalances in the particular context of the euro area.

SPECIFIC FACTORS HAVE ACCENTUATED THE PRODUCTIVITY SLOWDOWN IN FRANCE

Productivity is slowing down in developed countries…

Productivity measures a country's productive efficiency and can be evaluated either by estimating labour productivity, measured as value added per worker (or per hours worked), or by quantifying total factor productivity (TFP) which measures the combined efficiency of labour and capital. In this sense, TFP corresponds to the increase in production that cannot be attributed to the increase in the quantity of production factors in use. France is a country with a high level of productivity, which is similar to that of Germany. However, both productivity measures have slowed down in France and in the OECD since the late 1990s. Some consider this slowdown as an indication of a persistent weakness in demand or of excess savings at the global level, while others view it as a simple slowdown in technological progress, which some consider to be only temporary. The common thread in these divergent positions is that the slowdown in productivity in France is mainly due to factors that are common to all developed countries.

First of all, the structure of production has shifted towards sectors with lower productivity levels, namely services as compared to industry. However, since the 2000s, it has rather been the productivity slowdown *within* sectors that has contributed to the overall slowdown.

Second, the contribution to growth of information and communication technologies (ICTs) has been weakening since the early 2000s. This is primarily due to the slowdown of progress within the ICT sector itself, but it also reflects the fact that gains from organisational changes brought by these new technologies, and the reallocation of activity towards firms that are best able to use them, have become less pronounced. It may well be the case that productivity will rebound as a result of new technologies such as artificial intelligence, quantum computing or the use of 3D chips, or as the gains associated to current ICTs, which may take some time to be fully exploited, ramp up.

Third, productivity dispersion between firms has increased at the same time as aggregate productivity has declined. Productivity growth has been weaker within industries displaying the largest divergences in productivity. This may reflect a poor allocation of resources between firms. A weakening of technological diffusion, which could be due to a growing difficulty in harnessing technological progress, may be part of the explanation for this increasing divergence.

Other factors might have played a role in the productivity slowdown but their relevance is still open to debate. For instance, the structural decline in interest rates may have contributed to the productivity slowdown by making less productive firms or investments more profitable than before. Likewise, the evolutions in the levels of market concentration and competition may have had an impact on productivity by reducing incentives to innovate or invest.

The productivity slowdown that has been observed in France is thus primarily the result of several factors that are common to advanced economies. Still, there exist additional factors that are more specific to our country.

… but some specific characteristics may explain a more pronounced slowdown in France

First, we emphasise the fact that the skills of the French workforce are below the OECD average and that there is hardly any sign of improvement. This is particularly problematic given the growing requirements related to technological change. The French education system is characterised by a greater skills gap between people from different social backgrounds relative to other countries. Adult skills are lower than the average of the countries participating in the OECD surveys. In addition, those skills appear to decline over the working life, in particular due to a lack of lifelong learning opportunities which is particularly prevalent among the most vulnerable employees. France also lags behind other countries in terms of soft skills.

Additionally, France exhibits a significant mismatch between workers' skills and those required for their jobs. Surveys on the quality of management and organisational practices within firms also show an average score for France in this area. In particular, the *World Management Survey* suggests that French firms are relatively less efficient on the "human" dimensions of management as opposed to the production techniques.

Second, the French production system may have some characteristics that are likely to hinder productivity. In France, the gap between firms at the technological frontier and the rest is more pronounced for low skilled services that are not exposed to international competition. Besides, the productivity level of the most efficient firms in low skilled services in France is lower than that of the best performing countries while this is not the case in the manufacturing sector and in skilled services.

Furthermore, French firms are lagging behind in ICT adoption and diffusion, which could, in particular, be explained by these very deficiencies in management quality and professional skills. Additionally, a stronger rigidity in the labour market may also be a contributing factor, as well as the greater prevalence of regulatory barriers in the product market. These barriers, by limiting competitive pressure, might reduce the incentives for mobilising the best performing technologies, and for investing.

More generally, the French performance in terms of innovation appears to be significantly lower than that of the main leading European countries. A possible explanation could be that domestic expenditure on R&D is lower than the Lisbon Strategy objectives. In particular, this shortfall comes from weak private investment, which in turn mainly stems from a structure of production that is relatively less oriented towards industry compared to our partners. The efficiency of France's expenditure on R&D is being questioned, and some discussions have pointed in particular the lack of interactions between public and private research.

Finally, other idiosyncratic factors could also contribute to explain the French specificities, although their consequences have not yet been clearly identified. Employment protection could constrain firms' ability to adapt to technological renewal, but it could in turn foster worker productivity and firms' investment in human capital. Higher taxes on production might have also weighed on productivity growth. Finally, French multinationals' decision to locate their production facilities abroad could undermine the productivity gains measured on the national territory. These issues will be assessed in future work by the National Productivity Board.

THE CURRENT ACCOUNT DEFICIT IN FRANCE POINTS TO A COMPETITIVENESS PROBLEM BUT MORE GENERALLY REFLECTS A DEFICIENCY IN ADJUSTMENT MECHANISMS WITHIN THE EURO AREA.

French competitiveness, as measured by the current account, has worsened in the early 2000s

Productivity is often confused with competitiveness. In this sense, a productivity slowdown would then explain why France's trade performance is relatively poor. Yet this equivalence is of limited relevance. All other things being equal, it is true that productivity improvements reduce unit costs of production and may then result in increased market shares. However, if production costs (e.g. wages) were to follow productivity gains (which should be the case in the long run), these gains would not necessarily translate into competitiveness gains through lower prices. Likewise, a country's trade "performance" depends on a variety of factors that go beyond productivity, such as sectoral specialisation or the level of domestic demand.

Competitiveness is assessed here mainly on the basis of the current account, i.e. the sum of trade flows in goods and services and income transfers between the country and the rest of the world. The current account balance is the result of multiple factors, and deficits or surpluses are not inherently "good" or "bad": an ageing society may benefit from accumulating assets, while a developing country may seek to finance some of its numerous profitable investment opportunities with a current deficit. In theory, the aim is thus to compare the current account balance with a certain "norm" that is dependent on all these factors. This is an exercise carried out in particular by international institutions, including the IMF in its assessment of external balances. Thus, in the second part of the report, the macroeconomic situation in France is first assessed through the evolution of its current account and then by examining its determinants.

The French current account balance worsened in the early 2000s and then stabilised around a deficit of -1% of GDP after the crisis. Given that France is close to its potential output level, this deficit cannot be explained by its position in the business cycle. More generally, the IMF estimates that the current account balance norm for France was a surplus of 0.9% of GDP in 2017 while the realised balance was a deficit of 0.6%.

The French current account deficit may therefore be moderate, but hides a large trade deficit – which reflects a worsened trade balance in goods – partly offset by a surplus in primary income (net income from foreign investment). According to the CEPII[1], France distinguishes itself within the eurozone by the prominence of its multinationals, which has increased further after the crisis. The combination of the surplus in the primary income balance and the trade deficit suggests that France remains an attractive location for activities related to innovation and design, while its competitiveness as a location for manufacturing has worsened. In this sense, its modest current account deficit hides a competitiveness deficit as a manufacturing location for tradable goods. This could not only generate fewer employment opportunities within the country, but could also hinder productivity growth if it led to a loss of technological control over the key stages of production.

The worsening trade balance in France can no longer be attributed to differences in production costs with respect to other European countries

A comparison of French trade dynamics with European and global trends allows for a better understanding of its trade balance deficit and its deterioration. French market shares for tradable goods have sharply declined since the early 2000s, at a rate above 2% per year until 2016, while they were stable in Germany and Spain. Yet France's sectoral specialisation actually contributed positively to the change in market shares, while the geographical breakdown of its export markets is similar to the major euro area countries. Therefore, the downward trend in its market shares can be attributed to the lower growth in "market by market" exports (defined at the country-product level).

Although France's price-competitiveness deteriorated with respect to OECD countries between 2000 and 2010, it is mainly "non-price" competitiveness that accounts for the difference between France's performance and its euro area partners'. Cost-competitiveness, as measured by unit labour costs (ULC), has worsened before the crisis. Along with a stable trend in price-competitiveness, this may have produced a sizeable effort on operating margins, which in turn may have adversely affected non-price

1. Emlinger C., Jean S. and Vicard V. (2019), « L'étonnante atonie des exportations françaises », *La Lettre du Cepii*, January.

competitiveness after the crisis. Still, the weakening of French trade "performance" can hardly be accounted for by the difference in production costs between France and its neighbours. Indeed, in comparison to the euro area, capital or intermediate consumption costs are not particularly high in France. In the early 2000s, Germany has been the outlier in terms of labour costs among the main Eurozone countries with a unique stabilisation of nominal ULC in non-tradable sectors. Lastly, France features high taxes on production compared to other European countries. Even if these have not significantly increased since 2000, an increased openness to international competition may have intensified their impact on productivity, competitiveness and the country's attractiveness.

The euro area current account surplus reflects a persistent demand deficit within the monetary union

The trajectory of the French current account, and more broadly the development of a current account surplus in the euro area after the crisis, could also be the result of changes in savings and investment behaviour of economic actors which mirror the relative price and cost developments between the economies of the area. Indeed, the accounting counterpart of a current account deficit is an investment surplus over national savings. In France, this surplus appeared in an increased public deficit and higher corporate investment before the crisis; while the current account balance stabilisation post-crisis is due to a reduction in the public deficit in tandem with private disinvestment. In Germany, low wage growth in the 2000s translated into improved competitiveness and contributed to a current account surplus. At the same time, the peripheral countries were on an opposite trend, with sharp increases in demand from the private or public sector. This contrasted situation produced a balanced current account at the level of the euro area with important imbalances between countries. The crisis and the sudden stop in the financing of deficit countries forced a sharp adjustment within these economies, while Germany maintained a tight fiscal policy without sufficiently adjusting wages, prices, and its current account surplus. This adjustment asymmetry has led to an excessively low demand within the area (in particular, non-financial firms' net savings appear to be relatively high compared to their pre-crisis level), an increase in its surplus and a deflationary pressure. The latter has pushed the European Central Bank to implement a highly expansionary monetary policy, with a depreciation of the euro, which in turn reinforces the area's current account surpluses vis-à-vis the rest of the world.

In contrast to the French case, the IMF considers the 3.5% euro area current account balance in 2017 to be above its "norm", which is estimated at 1.5% of GDP. This current account surplus hides larger imbalances, particularly Germany's surplus of 7.3% of GDP (in 2018), which are a problematic issue in a monetary union. Given that adjustments of imbalances within the euro zone can no longer be achieved through nominal exchange rates, they must be achieved either through decreases in prices and wages in countries in deficit or close to balance, or through increases in prices and wages in large surplus countries. The aggregate imbalance of the euro area is due to the fact that the adjustment has almost entirely happened through the first mechanism. Existing studies suggest that a gap of 2 percentage points in inflation rates between Germany and the rest of the euro area would be required in order to rebalance current accounts over a 10-year horizon. This requires higher inflation in surplus countries, which in practice amounts to a real appreciation in these economies. It constitutes the normal adjustment mechanism that economic policies are not supposed to thwart. On the contrary, it is important that economic policies support this adjustment mechanism. This is an argument that also emphasizes the relevance of a more

expansionary fiscal policy for countries with surpluses and fiscal space. This would contribute to a rebalancing of savings and investment, as well as relative prices within the Eurozone. It would also help in reducing unemployment in the euro area countries where it is still high, without this decline (which must involve a mix of structural reforms and increasing demand) resulting in a return to current account deficits in these countries. In addition, it would help with the normalisation of the ECB's monetary policy, which is currently overburdened, and would lead to an appreciation of the euro, which in turn would contribute to a reduction of the current account surplus vis-à-vis the rest of the world. More broadly, the dramatic adjustments that occurred after the crisis due to the mismanaged imbalances have shown the need for a thoughtful consideration of the required mechanisms to put in place in order to reduce those imbalances. We consider that the very integrity of the euro area is at stake.