The dilemma of competitiveness

By Jean-Luc Gaffard

The competitiveness of a country is a complex subject. Some people rebel against the very concept on the grounds that it can’t be applied to a nation and is only meaningful for companies. It is true that if a company gains market share, this necessarily comes at the expense of a competitor. And it is no less true that when one country increases its exports to another, then the extra income earned by the first will, in part, fuel demand that then benefits the second. The benefits of one become a condition of benefits for the other. This back-and-forth justifies international trade, whose aim is a better use of resources by everyone, with the benefits being shared by all, on an equitable basis. This story makes sense. And it does indeed indicate that the competitiveness of a nation is not comparable to that of a business.
However, there are global imbalances that result in longer-term surpluses or deficits that reflect differences in the competitiveness of the companies in the countries in question. These require appropriate policy responses to meet the challenge of making possible what some have called the return journey, that is to say, to set in motion the mechanisms through which the income earned by one country is converted into demand on the other.

This is the difficulty facing France today. The country has been building up trade deficits since 2002: it is facing a problem with the competitiveness of its companies on global markets, and is no longer able to use the exchange rate instrument. The persistent trade deficit is clearly of even greater concern than the public deficit, and its absorption should be a priority. This is why calls have been mounting for a competitiveness shock, that is to say, economic policy

measures that are able to make companies more competitive by reducing their production costs.
That said, a competitiveness shock is not easy to implement. Of course, in a developed economy, business competitiveness primarily means non-cost competitiveness that is based on a company’s ability to occupy a technological or market niche. But regaining this type of competitiveness requires investment and time. Furthermore, non-cost competitiveness is not independent of immediate price competitiveness. Quickly rebuilding business margins is a necessary, though probably not sufficient condition for a return to non-cost competitiveness. This requirement is all the more stringent today as obtaining captive markets through differentiation can often be very costly in terms of R&D and exploring customer prospects.
The difficulty facing the French economy is that the restoration of margins needed may come at the expense of household purchasing power and thus of domestic demand. Competitiveness gains could remain a dead letter if final demand were to collapse. Moreover, there is nothing to say that restoring margins *per se* will result in a pick-up in investment if companies face just such a slowdown in demand, if not a fall.

It seems that what is needed is to grasp both ends of the chain: short-term price competitiveness and medium-term non-price competitiveness. Quickly restoring business margins requires transferring the financing of social protection to taxes on households. Enabling companies to re-establish their price competitiveness demands further improvements in the level of infrastructure and support for the establishment of productive ecosystems that combine good local relationships and the internationalization of production processes. In both cases, this involves the question of what fiscal and budget strategy should be implemented.

The difficulty comes from the prioritization of objectives. If

priority is given to immediately restoring the public accounts, then adding another burden due to the transfer of charges onto the tax grabs already taken from households will definitely run the risk of a collapse in demand. This means either admitting that such a transfer is really possible only in conditions of relatively strong growth and thus postponing it, or making the improvement of the trade deficit a priority over the public accounts and thus not tying our hands with a budget target that is too tough.
The government has decided to stay the course of public deficit reduction, and has in fact postponed the competitiveness shock by proposing, after a year or more, business tax credits that are to be offset by hikes in the VAT rate in particular. The underlying rationale is clear. The search for a balanced budget is supposed to guarantee a return to growth, but care is being taken about further weighing down demand by adding to the tax increases already enacted to meet the target of a 3% government deficit by 2013. The prevailing idea is that, aided by a wise budget, a pick-up in activity will take place within two years in line with the supposedly conventional economic cycle, which has the additional advantage of coinciding with the electoral cycle.
The path being chosen is narrow and, quite frankly, dangerous. Fiscal austerity measures are still subjecting domestic demand to heavy pressure. The restoration of business margins has been put off. Would it not be better to stagger the recovery of the public accounts more and ensure more immediate gains in competitiveness by using the appropriate fiscal tools?

The result to be expected from either of these strategies is of course highly dependent on the choices being made at the European level. Persevering on the path of widespread austerity will mean nothing good will happen for anyone.

2013: what impact will the (national) fiscal measures have on growth?

By Mathieu Plane

This text supplements the October 2012 forecasts for the French economy

After having detailed the multiplier effects expected for the different fiscal policy instruments, the average domestic fiscal multiplier associated with the austerity measures being implemented in France in 2013 will be 0.9. This policy will cut GDP by 1.7% in one year alone. After a cumulative fiscal effort of 66 billion euros in 2011 and 2012, the structural saving expected for 2013 represents about 36 billion euros (1.8 GDP points) if we include both the measures in the 2013 budget bill (*Projet de loi de finances* – PLF) and the various measures adopted previously (Table). The fiscal shock resulting from the PLF for 2013 comes to 28 billion euros, of which 20 billion is solely on tax and social security contributions (*prélèvements obligatoires* – PO). Of the remaining 8 billion, an increase of nearly 5 billion euros in tax and social security contributions is from the second supplementary budget (*Loi de finances rectificative* – LFR) for the summer of 2012, the rest being mainly due to the first LFR for 2012 and to the hike in contributions resulting from the revision of the pension reform in summer 2012.

In total, the fiscal effort in 2013 can be broken down between tax and social contributions of about 28 billion euros (1.4 GDP points) and structural savings on primary public expenditure of 8 billion (0.4 GDP point). The burden of higher taxes and social contributions breaks down to nearly 16 billion euros for households and more than 12 billion for business. This breakdown does not take into account the competitiveness measures announced on 6 November by the Prime Minister. The tax credits for competitiveness and employment (CICE) will not have any fiscal impact in 2013, with the exception of the possible establishment in 2013 of an advance on their future tax credits for some companies short of cash.

Based on the variants in the fiscal multiplier, made with e-mod.fr according to the economy's position in the cycle, for the main taxes and social security contributions as well as for the key components of public expenditure [1] and based on the different evaluations we were able to carry out, particularly in the context of the assessment of the Five-year economic programme, we applied a specific fiscal multiplier to each measure for 2013 (Table). The short-term multipliers take into account only the direct effects of the measures on domestic activity, regardless of the fiscal policies of our trading partners, which amplify the impact of national policy. It is also assumed that monetary policy remains unchanged. The long-term multiplier values differ from the short-term ones, being generally lower unless a long-term negative output gap is maintained.

Of the 16 billion euro increase in tax and social security contributions on households in 2013, the discretionary increase in personal income tax (IR) will be 6.4 billion, including 3.2 billion from the 2013 Budget Act (*Loi de finances*) – against 4 billion in the PLF, as the proposal to tax capital gains on securities at the income tax scale will be largely amended, and the yield from the measure could decrease by about 0.8 billion, with the shortfall being able to be offset by the extension of the exceptional 5% contribution from the IS tax on large corporations), and with the rest coming from the supplemental LFR for 2012 (including

1.7 billion solely from the de-indexation of the personal income tax schedule). While the increase in personal income tax from the 2013 PLF is targeted at high earners, the amount this will contribute (3.2 billion) represents only 11% of the increase in tax and social security contributions (20% if we limit ourselves to households) in 2013, and less than 9% of the total fiscal effort. According to our calculations, the average fiscal multiplier associated with the different measures that increase personal income tax will be 0.7 in 2013.

The increase in taxes and social contributions from households will come mainly from the increase in payroll taxes and social security contributions (8.7 billion euros) set out in the Social Security budget act (PLF) for 2013 (2.9 billion) and the measures in the supplemental LFR for 2013 (5.3 billion, which includes changes to the tax exemption on overtime, a limitation on tax breaks and employee savings, a higher CSG wealth tax on income from capital, etc.) and pension reform, with an increase in the contribution rate (0.5 billion). The average fiscal multiplier related to these measures is 0.9. Finally, the reform of inheritance tax will raise a further 1.1 billion in tax and social contributions. On the other hand, the revenue from the ISF wealth tax will be 1.3 billion lower than in 2012. Indeed, the yield from the one-off wealth tax contribution set up under the supplemental LFR for 2012 will be greater than from the one set up under the new reform in 2013. The fiscal multiplier for these two measures is 0.3.

In total, according to our calculations, the increase in levies on households in 2013 will on average have a multiplier of 0.8 and will amputate growth by 0.6 GDP point.

For business, the measures adopted mainly involve an increase in the corporate income tax as provided in the budget bill (PLF) for 2013 (8 billion euros, of which 4 billion is related to the reform of the deductibility of financial expenses). The average multiplier for the increase in the corporate income tax (IS) is estimated at 0.7 in 2013. 2.3 billion euros will come from a rise in social security contributions and payroll taxes with a fiscal multiplier of unity. Finally, other measures such as the sectoral measures on the taxation of insurance or the exceptional contribution of the oil industry will increase the tax burden on business by 1.9 billion in 2013, with an average fiscal multiplier estimated at 0.5.

In our assessment, the increase in taxes and social contributions from companies will on average have a multiplier of 0.8 and will reduce GDP by 0.5 GDP point in 2013.

In addition, the short-term fiscal multiplier associated with public expenditure in a low phase of the cycle is, in our model, 1.3, so it is higher than that associated with tax and social contributions. This result is consistent with the most recent empirical literature (for details, see the box, "Fiscal multipliers: size matters!" The estimated loss of activity resulting from tightening up on public expenditure will come to 0.5 GDP point in 2013.

In total, the average domestic fiscal multiplier associated with the austerity policy being implemented in France in 2013 will be 0.9, and this policy will reduce GDP by 1.7%. This result is in the lower range of the latest work of the IMF; using recent data on 28 countries, it has estimated the actual multipliers at between 0.9 and 1.7 since the beginning of the Great Recession.

Main measures affecting the structural public deficit in 2013

	Measures (in bn)	*Fiscal multiplier estimated in the short term*	Impact on GDP (%)
Households	**15.7**	***0.8***	**-0.6**
Income tax	**6.4**	***0.7***	**-0.2**
PLF 2013 (taxation of capital income at IR tax rate, new brackets, etc.)*	3.2	*0.6*	-0.1
LFR II 2012 (reversal of tax exemption of overtime)	0.5	*0.4*	0.0
LFR I 2012 (de-indexation of IR brackets, suppression tax breaks and Scellier scheme, etc.)	2.7	*0.8*	-0.1
ISF wealth tax	**-1.3**	***0.3***	**0.0**
PPLF 2013 (reform of ISF wealth tax)	1.0	*0.3*	0.0
LFR II 2012 (repercussions from one-off 2012 contribution)	-2.3	*0.3*	0.0
Inheritance tax	**1.1**	***0.3***	**0.0**
LFR II 2012 (reversal of breaks on inheritance tax)	1.1	*0.3*	0.0
Social contributions and payroll tax	**8.7**	***0,9***	**-0.4**
Social security PLF 2013 (reform of self-employed payroll tax, higher tax on beer and tobacco, etc.)	2.9	*1.0*	-0.1
LFR II 2012 (reversal of overtime exemption, limitation of tax breaks and employee savings, higher CSG wealth tax, capital income, etc.)	5.3	*0.8*	-0.2
Pension reform (higher contributions)	0.5	*1.0*	0.0
Other	**0.8**	***0.6***	**0.0**
PLF 2013 (higher tax on vacant housing, tougher "automobile malus", etc.)	0.9	*0.6*	0.0
LFR II 2012 (lower VAT on books)	-0.1	*1.0*	0.0
Business**	**12.2**	***0.8***	**-0.5**
Corporate income tax	**8**	***0.7***	**-0.3**
PLF 2013 (limits on financial expenses deductibility, reform of the "cinquième acompte", etc.)	8	*0.7*	-0.3
Payroll tax and social contributions	**2.3**	***1.0***	**-0.1**
Social security PLF 2013 (higher CNRACL contribution rate, reform on wage tax, etc.)	1.8	*1.0*	-0.1
Pension reform	0.5	*1.0*	0.0
Other	**1.9**	***0.5***	**-0.1**
PLF 2013 (sectoral measures on taxation of business insurance) (sectoral measures on taxation of business insurance)	1.3	*0.8*	-0.1
LFR II 2012 (one-off contribution of oil industry, taxation of financial transactions, etc.)	0.6	*0.2*	0.0
Total Business and Household Taxes and Contributions	**27.9**	***0,8***	**-1,1**
Structural saving on primary public expenditure	**8.0**	***1.3***	**-0.5**
Total fiscal impulse	**35.9**	***0.9***	**-1.7**

* This amount incorporates the downward revision of the yield initially foreseen in the PLF 2013 of the measure taxing capital gains at the personal income tax rate, which is to be offset by the extension of the exceptional 5% corporate income tax contribution for large corporations.

** This breakdown does not measure the final fiscal impact that is to be borne by households if the increase in business taxes is passed on in prices.

Sources : PLF 2013, Social security PLF 2013, LFR I and II 2012, OFCE calculations.

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[1] For more on this, see Creel, Heyer, Plane, 2011, "Petit précis de politique budgétaire par tous les temps", *Revue de l'OFCE*, no. 116, January 2011.