

Is nationalization a trap or a tool of industrial policy?

By [Jean-Luc Gaffard](#)

The closure of the Florange blast furnaces in the Moselle region by ArcelorMittal and the French government's hunt for a buyer led it to temporarily consider nationalizing the site, that is, not only the production of crude steel, but also the cold forming line. The threat of nationalization was clearly wielded with a view to forcing the hand of the Mittal group so that it would sell the operations to another firm. If a nationalisation like this had been carried out, it would have been a penalty-nationalization, *i.e.* a sanction of behaviour by the Mittal group deemed contrary to the public interest. Apart from this unusual feature, it would have also raised issues about competition.

The project around the Mittal site is reminiscent in some ways of the nationalization of Renault in 1945. It would be hard to argue, however, that any reproaches would be along the same lines. There would clearly be no question of the nationalized site being made a showcase for a social policy designed to spur the country's growth. The goal was less ambitious. It involved neither more nor less than a transfer of ownership from one private group to another. This would, of course, have been a first in the use of the weapon of nationalization. Any comparison with the French government's support for Alstom in 2004 doesn't hold: in this latter case, the point was to save a company that might go bankrupt as a result of risky acquisitions, and not simply to replace it with another company. Moreover, the problem was confined to the company in question, with no global or even sectoral implications. Comparisons with the support of the Obama administration for the automotive industry in 2009 are also out of place, as that involved saving a company that was being forced into

bankruptcy in an industry generally considered strategic.

The reality in the case of Florange was and remains that no potential buyer thought they would be able to keep the blast furnaces operating in an environment marked by falling demand for steel, in particular in the wake of the crisis in the automobile industry. That is why, whatever happened, the buyer would demand to keep the rolling mill too. This requirement would be in its best interest: the blast furnaces could not be taken over except on the condition that they could supply the activity immediately downstream on the same site. If this condition had been met, it would undoubtedly have posed a problem for the Mittal group, as it currently provides the steel for the mill in Florange from its Dunkirk site, so the new situation would have caused it difficulties, including in terms of jobs. In other words, a temporary nationalization with a view to a transfer of ownership would interfere with competition between private entities. It is far from clear that this was in line with the general interest.

The occasionally argued thesis that Mittal's strategy was the act of managers who were merely obeying the shareholders and who were advocates of an economy without factories or machines does not really hold water in light of the nature of the firm's activity and the degree of integration of the different production sites. One could, however, make the hypothesis that Mittal's strategy involving the closure of the blast furnaces in Florange amounted to a plan to ration supply that was designed to prevent a collapse of steel prices and boost already low margins. This hypothesis might be credible if the demand for steel depended primarily on its price, whereas it is obvious that the decline observed is the result of the global crisis and particularly the slump in sales in the automotive and construction industries. In other words, a fall in steel prices today would not lead to higher demand and ensure the continued operation of all the blast furnaces. It is much more plausible to assume that, in the current

macroeconomic environment, the transfer of ownership that was considered would simply have resulted in changing market shares rather than increasing the market's size.

In fact, there could only be real doubt about both the legitimacy and the capacity of the public authorities to arrange the most appropriate configuration for the market, or even the breakdown of the jobs to be saved or destroyed. Furthermore, if a decision to nationalize had indeed been taken in a situation like this, any determination of fair compensation would have proven difficult and prone to litigation.

In short, the nationalization under consideration could hardly have been an effective tool of industrial policy. It is not for the public authorities to arbitrate between private interests to determine who owns what, including when certain sites are to be closed. This type of arbitration is the responsibility of the competition authorities. Industrial policy, in turn, should interfere as little as possible with the division of market shares between the various competitors. At most it could ensure the survival of companies whose activity is considered strategic and who are going through a difficult period due to the global situation or to industrial choices that have proved erroneous or simply more expensive than expected.

In this situation, it is not surprising that the government did not follow up with the nationalization project and instead supported the compromise of simply requiring that Mittal undertakes to make investments to modernize the site and to maintain the blast furnaces in running order with a view to equipping them with highly efficient technology in terms of carbon dioxide emissions, leading to a gain in competitiveness, as part of the European Ultra-Low Carbon Dioxide Steelmaking project ([UlcOs](#)).

The nationalization under consideration was indeed a trap in

every sense of the word. The political and media battle about the fate of the Florange site revealed, in fact, an error in the government's analysis. The difficulties being experienced by the French steel industry result from a lack of demand, which is in turn the result of a policy choice of generalized austerity. Trying to resolve this macroeconomic problem with a microeconomic solution was, at a minimum, risky and shows the inconsistency of the short-term and medium-term decisions being taken on economic policy.

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.

The Insolent health of the luxury sector: a false paradox

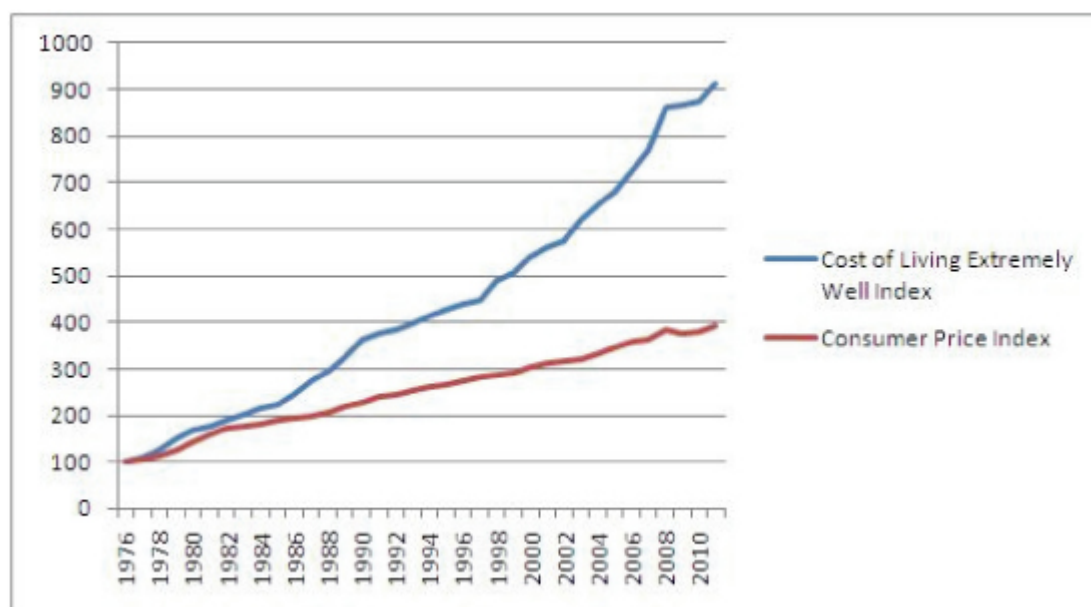
By [Jean-Luc Gaffard](#)

The luxury industry has been spared the spreading crisis, which in the media's eyes seems to be posing a paradox. This situation in fact corroborates the diagnosis that rising inequality is the true breeding ground of the crisis.

LVMH, the global leader in the luxury sector, saw its sales jump 26% in the first half of 2012. Richemont, the global number two and owner of such brands as Cartier, Montblanc, Van Cleef & Arpels and Jaeger-LeCoultre, saw its operating income

increase by 20% during the second half-year ending 30th September. The Italian firm Prada announced a 36.5% increase in its turnover in the first half of 2012 (37.3% in Europe). The luxury division of PPR, the other French company in the sector, saw sales go up by 30.7% in the first half year.

These results contrast sharply with the situation in other industries. They are the result of a rise in prices that is nothing less than staggering. The price index for luxury goods as calculated since 1976 (the "[Forbes Cost of Living Extremely Well](#)") rose 800% in 35 years, compared with 300% for the price index for consumer goods.



In an article on the subject ("The more expensive the product, the more desirable", 8 August 2012), *Le Monde* reported that the price of a Burberry gabardine raincoat has multiplied by 5.6 and that the price of a Rolex YachtMaster has rocketed from 5,488 to 39,100 euros. These soaring prices simply reflect the great and growing willingness to pay of the richest strata, for whom price is simply a mark of differentiation and desirability.

In these circumstances, the stock market success of companies

in the luxury industry is hardly surprising. Nor is it surprising to see the stock market success of companies at the other end of the spectrum, those that produce low-end, cheap goods. This effect, called the hourglass effect, is starkly revealing of the reality of the crisis, which is clearly rooted in widening inequalities in income and wealth.

The healthy state of luxury firms, which are creating jobs at a time of rising unemployment, is obviously a source for rejoicing. But if we simply left things at this remark about the sector, we would be missing the essential point. First, it must be recognized that the industries in question are responding to higher demand much more by raising prices, and not the quantities produced, for the simple reason that the number of wealthy people, even if growing significantly with the arrival of the nouveaux riches in China and elsewhere, is still limited. We are a long way from the fundamental mechanism driving growth, whereby gains in productivity push prices down and have an impact on income that is substantial enough to stimulate demand on an ever increasing scale. We also have to recognize the other side of the coin of this genuine increase in inequality, namely, the fall in median income and the corresponding weakening of the large middle class, whose demand for midrange products and services was a foundation for growth.

It is also worth noting recent trends in the luxury industry, which has successfully striven to produce brands that are lower cost versions of goods that were previously reserved for the rich. As shown by some studies, the diversification of the luxury industry is being accompanied by a sociological change indicating that middle-class households are developing a greater preference for these types of goods (see J. Hoffmann and I. Coste-Manière, *2012 Luxury Strategy in Action*, Palgrave Macmillan). This might be a long-term development if it is remembered that preferences are not homothetic, in other words, that lower incomes are not leading back to the map of

preferences as it existed previously (before incomes had increased). Many households are trying to maintain the kind of consumption that they have become accustomed to, ultimately at the cost of higher indebtedness, if by chance that is permitted by the financial system. However, the business segment preserved in this way may prove to be fragile, and the performance of the luxury industry could continue to be driven by the conspicuous consumption of genuine luxury products. It is not surprising, then, to observe that, with the continuation of the crisis and its consequent impact on the consumption of the middle class, a company like PPR is planning [to hive off certain brands](#), notably FNAC, in order to focus on the luxury segment.

There is nothing paradoxical about the insolent health of the luxury industry. It goes hand in hand with the heightening difficulties facing industries and companies whose products and services are intended for those on middle-incomes. The constantly increasing divergence in performance between industries and firms depending on their positioning range is merely another sign of a deepening crisis.

The crisis in the automobile industry: shortcomings **strategic shouldn't**

conceal the impact of fiscal austerity

By [Jean-Luc Gaffard](#)

The crisis in the automobile industry, illustrated by the closure of the PSA site in Aulnay, reveals not only structural difficulties but also strategic errors made by the manufacturers with respect to their industrial organization and range positioning. The industry's need to restructure cannot, however, obscure the very real macroeconomic dimensions of the crisis in the short term.

New car registrations in France fell 15.5% in July on an annual basis, after adjusting for working days. In the first seven months of the year, the decline in the automotive market stood at 13.5% in unadjusted data and 14.1% in adjusted data. PSA was down 9.9% in July in terms of unadjusted data. The Renault group has seen its share of registrations fall by 11.2%, with a drop of 26.6% for the Renault brand but a near doubling of registrations for the low-cost Dacia brand. Also in July, the decline in new car sales in Spain accelerated, with a drop of 17.2%. In Italy, new car registrations plummeted 21.4%. Finally, while German production increased by 5% due to exports, new car registrations there fell by 5%.

These catastrophic figures are first and foremost the result of the collapse of aggregate demand in the countries of the European Union as a result of falling revenues combined with greater inequality in distribution. The middle class is maintaining or increasing its savings rate and either deferring purchases in time or buying lower-cost products, particularly cars, while at the same time the increase in inequality has led to growth in the market for luxury vehicles, particularly in Europe and China.

It is not surprising, in this context, that PSA, which has a mid-range positioning, recorded a fall in sales and that Renault limited the damage only thanks to sales of its low-cost brand. Nor is it surprising to see strong growth for the Asian brands, Korean in particular, which are also positioned on the low-cost segment. Finally, it is not surprising that German manufacturers racked up exceptional results, as they are strongly positioned on the top of the range: BMW, Audi and Porsche recorded sales increases in the first half-year of 8%, 22.5% and 12.3%, respectively.

This state of affairs cannot of course absolve manufacturers of their strategic responsibilities, but it should lead the government to prioritize the underlying causes and, even more, to take the measure of what is needed in the short term, even while it continues to provide long-term support for the industry.

Nobody can doubt the relevance and effectiveness of the strategy adopted by Germany's firms, which is based on the international fragmentation of their production process, the conservation and development in the home country of their technological capacity and a better analysis of market expectations in the emerging economies, first of all China. This strategy proved to be especially successful as competitive devaluations became impossible with the advent of the single currency, an impossibility that has wound up exposing the errors in the positioning of their French competitors, including PSA, in light of the reality of global markets. The intensified rivalry between firms due to the steady weakening in European domestic demand, which has recently accelerated, could only lead to widening gaps in performance in terms of sales volumes, market share and ultimately profit margins.

There is certainly no question but that the future of the French automobile industry requires a substantial effort at organizational and technological innovation together with the

internationalization of production and the strengthening of local production relationships, as well as a search for market niches to make competition less price-sensitive. Public measures aimed at strengthening the production network through a site policy and support for outsourcing respond to this strategic challenge. The emphasis on the development of electric and hybrid vehicles is, however, questionable. The electric vehicle market could well remain marginal, and this will not change as a result of heavily subsidized prices to boost sales among specific urban groups. As for the market for hybrid vehicles, this is still limited in volume, and foreign (Japanese) competition already has a solid footing. Shouldn't we worry about the fate of mid-range vehicles: while their market is clearly suffering from the crisis in Europe, might it not thrive in Europe as it emerges from the crisis and even develop in the emerging economies as a genuine middle class emerges there? In other words, a productive recovery in the automotive sector, while it must involve improvements in quality, is still a matter of demand – and demand needs to be considered at a global level, with as a consequence the corresponding strategic choices concerning the location and segmentation of production activities.

In any event, a recovery in production in one direction or another will take time, and time is likely to be lacking if in the short term there is no pick-up in demand. In other words, the immediate problem is as much if not more macroeconomic rather than microeconomic. The surest way to bury the French automotive industry, thus losing an important accumulation of human capital, is to pursue a fiscal austerity policy that merely depresses demand without addressing the issue of sovereign debt.

Competitiveness and industrial demand: The difficulties facing the French-German couple

[Jean-Luc Gaffard](#)

The obsession with competitiveness has returned to centre stage with the election campaign. This reflects the reality that French companies are indeed suffering a loss of competitiveness, which is behind the deterioration in foreign trade for almost a decade. This loss is clear vis-à-vis the emerging markets and explains the trend towards relocating abroad. It is also clear vis-à-vis firms from other developed countries, mainly in the euro zone and in particular German companies. This latter situation is especially serious, as it challenges the coherence of European construction ([cf. OFCE, note 19: Competitiveness and industrial development: a European challenge in French](#)).

The gap in competitiveness that has emerged with Germany is clearly based on non-price competition. One of the reasons for this is Germany's superior business model, which is characterized by the maintenance of a network of local businesses of all sizes that focus on their core business and on the international fragmentation of production. This model is especially suitable for business development that is targeted at global markets, and it largely protects the countries hosting these companies from the risk of deindustrialization.

It would, nevertheless, be a mistake to ignore that this

development is also the product of an adverse change in price competitiveness. This reflects labour market reforms in Germany, which lowered the relative cost of labour, as well as strategies that are based on the segmentation of production and the outsourcing of intermediate segments, which have also contributed to lowering production costs.

Germany has thus managed to virtually stabilize its market share of global exports by increasing their level in the European Union (+1.7% in the 2000s) and even more so in the euro zone (+2.3%), while France has lost market share in these same areas (3.1% and 3.4%, respectively).

Two developments have particularly hurt France's industry. Its network of industrial SMEs has fallen apart. They were hit less by barriers to entry than by barriers to growth. All too often SME managers have been inclined or encouraged to sell the enterprises to large corporations rather than to ensure their growth. This is due both to the lack of genuine partnerships with these corporations and to the difficulties experienced in obtaining permanent financing from the banks and markets. For their part, the large industrial firms, both those operating on a multitude of local markets and those in the international markets, have chosen to focus on acquisitions and on the geographical decentralization of both their operations and their equipment and services suppliers. This strategy has been designed to meet geographical shifts in demand and to deal with the demand for immediate profitability set by volatile shareholders, but this has come in part at the expense of the development of local production networks. This process involved a vast movement of mergers and acquisitions that primarily drew on financial skills. The financial institutions were, in turn, converted to the universal banking model, abandoning some of their traditional role of being lending banks and investment banks. These concomitant developments have proved disastrous for overall competitiveness, particularly as hourly labour costs in industry were rising simultaneously.

There are two requirements for restoring the competitiveness of French companies and thereby encouraging the country's re-industrialization. The first is to allow immediate control of labour costs and the restoration of profit margins; this could be helped in particular by tax measures that would adjust the financing of a portion of social protection. The second requirement is to promote the reorganization of industry through the creation of a network of stable relationships between all those involved in the industrial process, especially by the use of aid that is conditioned on cooperation between large and small firms in "competitiveness clusters".

This medium-term effort will nevertheless largely remain ineffective if cooperative policies are not implemented across Europe. These policies need both to stimulate supply through the implementation of technology development programmes and to boost internal demand wherever it is clearly insufficient to satisfy production capacity.

Plea for a growth pact: the sound and fury hiding a persistent disagreement

By [Jean-Luc Gaffard](#) and [Francesco Saraceno](#)

The emphasis on the need to complement fiscal restraint by measures to boost growth, which is rising in part due to the electoral debate in France, is good news, not least because it represents a belated recognition that austerity is imposing an excessively high price on the countries of southern Europe.

Nevertheless, there is nothing new about invoking growth, and this may remain without consequence. In 1997, as a result of a French government intervention, the Stability Pact became the Stability and Growth Pact, but this had no significant impact on the nature of strategy, which remained fully oriented towards the implementation of strict monetary and fiscal rules and a constant search for more flexible markets.

Last week, [Mario Draghi](#), along with [Manuel Barroso and Mario Monti](#), were worried not only about the recession taking place in Spain, Portugal, the Netherlands and Great Britain but also about the need to respond formally to a request that may come from a new French government. They too are arguing for a negotiated Growth Pact, while taking care to note that it must consist of a common commitment to carry out structural reforms wherever they have not yet been made. This position echoes the February [letter](#) of the eleven Prime Ministers to the European authorities. In other words, nothing is to change in the doctrine that determines the choice of Europe's economic policy: growth can be achieved only through structural reform, in particular of the labour markets.

There are two grounds for criticizing this position. [It is far from sure](#) that structural reform is effective, unless, that is, it is wielded in a non-cooperative spirit to improve the competitiveness of the country that undertakes the reform at the expense of its trading partners, as Germany was able to do with the Hartz reforms. Secondly, widespread reform, including where this is justified in terms of long-term growth, would initially have a recessionary impact on demand [\[1\]](#), and hence on activity. Reform cannot therefore deal with what is actually the immediate top-priority requirement, namely stemming the spreading recession.

The real challenge facing Europeans is to reconcile the short term and the long term. The solution proposed so far, general fiscal austerity aimed at [restoring the confidence of private actors](#), which would be complemented by structural reforms

intended to increase the potential growth rate, just doesn't work. This can be seen by developments in Greece, as well as in Portugal and Ireland, which are model students of Europe's bailout plans, and also in Britain, Italy and Spain. The fiscal multipliers remain firmly Keynesian (see [Christina Romer](#), and [Creel, Heyer and Plane](#)), and any "non-Keynesian" effects on expectations are limited or nonexistent.

Growth can neither be decreed nor established instantly, unlike the deflationary austerity spiral in which more and more European countries are currently trapped.

Growth is likely to materialize only if fiscal consolidation is neither immediate nor drastic – in fact, only if the consolidation required of countries in difficulty is spread over time (beyond the year 2013, which in any case will be impossible to achieve) and if the countries that are able to carry out a more expansionary fiscal policy actually do this in such a way that at the European level the overall impact is neutral or, even better, expansionary. This strategy would not necessarily be punished by the markets, which have shown recently that they are sensitive to the requirement for growth. Otherwise, steps should be taken by the ECB to deal with the constraints imposed by the markets. This short-term support must be accompanied by substantial medium-term investment made through European industrial programs financed by the issuance of Eurobonds – which would mean, finally, a European budget on a scale large enough to handle the tasks facing the Union. This method of coordinating short- and medium-term choices would be an important step towards the establishment of the kind of federal structure that alone will allow the resolution of the "European question".

[1] R.M. Solow, Introduction to Solow, R.M. Ed. (2004),

Structural Reforms and Macroeconomic Policy, London:
Macmillan).