

The erosion of France's productive base: causes and remedies

[Xavier Ragot](#), President of the OFCE and the CNRS

The deindustrialization of France, and more generally the difficulties facing sectors exposed to international competition, reflects trends that have been at work in France and in Europe for more than a decade. Indeed, while the strictly financial moment when the crisis struck in 2007 was the result of the bursting of the American real estate bubble, the scale of its impact on Europe's economy cannot be understood without looking at vulnerabilities that have previously been neglected.

In "Érosion du tissu productif en France: Causes et remèdes", [OFCE working document no. 2015-04](#), Michel Aglietta and I offer a summary of both the microeconomic and macroeconomic factors behind this productive drift. Such a synthesis is essential. Before proposing any policy changes for France, it is necessary to make a coherent diagnosis of major trends in international trade as well as of the real situation of France's productive fabric.

European divergences

The starting point is the surprising divergence seen in Europe. The euro zone's two largest countries, Germany and France, have diverged in an unprecedented way since the mid-1990s. While property prices remained stable in Germany, in France they increased by a factor of 2.5, hitting the country with two negative consequences: a high cost of living for its employees, and a collapse in property investment by its businesses. Wages in Germany are now 20% lower than in France due to the wage moderation implemented to manage the

former's reunification process. Furthermore, until the crisis, real short-term interest rates (which take into account inflation differentials) were about 1 percentage point lower in France and Spain than in Germany. This change in the price of the production factors (higher real interest rates and lower wages in Germany than in France) did not give rise to a greater substitution of capital for labour in France. There was little difference between the two countries in the investment rate, which was relatively stable in both. Other indicators, such as the number of robots, indicate on the contrary that there was less modernization of France's productive fabric. These changes in factor prices have not therefore translated into an adjustment in the productive fabric, but have instead led to an unsustainable divergence in the current accounts.

Current account balances are crucial concepts for measuring disequilibria within Europe. A positive current account means that a country is lending to the rest of the world, while a negative current account means that it is borrowing from the rest of the world. While European rules have focused attention on the public deficit alone, the proper measure of a country's indebtedness is the current account, the sum of public and private debt. On this measure, Germany's current account is one of the most positive in the world, meaning that it is lending heavily to other countries. While over the last three years the differences between European current accounts have been narrowing, this is the result more of a contraction in activity due to austerity measures than of a modernization of the productive base in countries with negative current accounts. The European framework for analysing macroeconomic imbalances does of course have numerous indicators, including the current account. However, in practice the multiplicity of indicators gives a crucial role to the numerical public deficit targets. So while the framework for European surveillance seems very general in its assessment of economic imbalances, it is the short-term budgetary aspect alone that

dominates analysis. Don't forget that Spain's public debt was less than 40% of GDP in 2007, but over 90% of GDP in 2013. Low public debts are not therefore a sufficient condition for macroeconomic stability, just as public debts that are temporarily high are not necessarily a sign of structural problems.

The fragility of France's productive base

In this sense, corporate data can be used to gain insight into trends in the French economy. French companies did of course experience a fall in margins, but this has mainly affected sectors exposed to international competition. Corporate profitability (which finances the payment of dividends and interest and contributes to investment) fell from 6.2% in 2000 to less than 5% in 2012. Despite this decline, the investment rate held steady in all business categories during the period, in part funded by corporate savings, which declined from a rate of 16% in 2000 to 13% in 2012. The result has been a substantial rise in corporate debt, although up to now this has not led by higher debt costs due to the fall in interest rates. All these factors are inevitably fuelling concern about the health of our productive fabric: France's businesses have responded to economic difficulties, not by innovation, but by financializing their balance sheets and taking on debt.

Towards partnership in governance

To innovate, invest and upscale, France's companies must make efforts over the long term – this is the only way there will be a process of reconvergence in Europe. The point is not to maximize short-term financial returns, through for example excessive dividend payments, but rather to invest over horizons that are typically considered (too) long by companies. As a result, making improvements to France's productive fabric will require shifting corporate governance towards a model based on stronger partnerships and a more long-term vision in order to invest in employees' skills and

qualifications, in intangible assets, and in new technologies. Social dialogue is not just about income distribution and tax reform but is also essential within companies in order to ensure the mobilization of our only productive wealth, men and women who are putting their all into their work.

Devaluation through wages in the euro zone: a lose-lose adjustment

by Sabine Le Bayon, [Mathieu Plane](#), Christine Rifflart and Raul Sampognaro

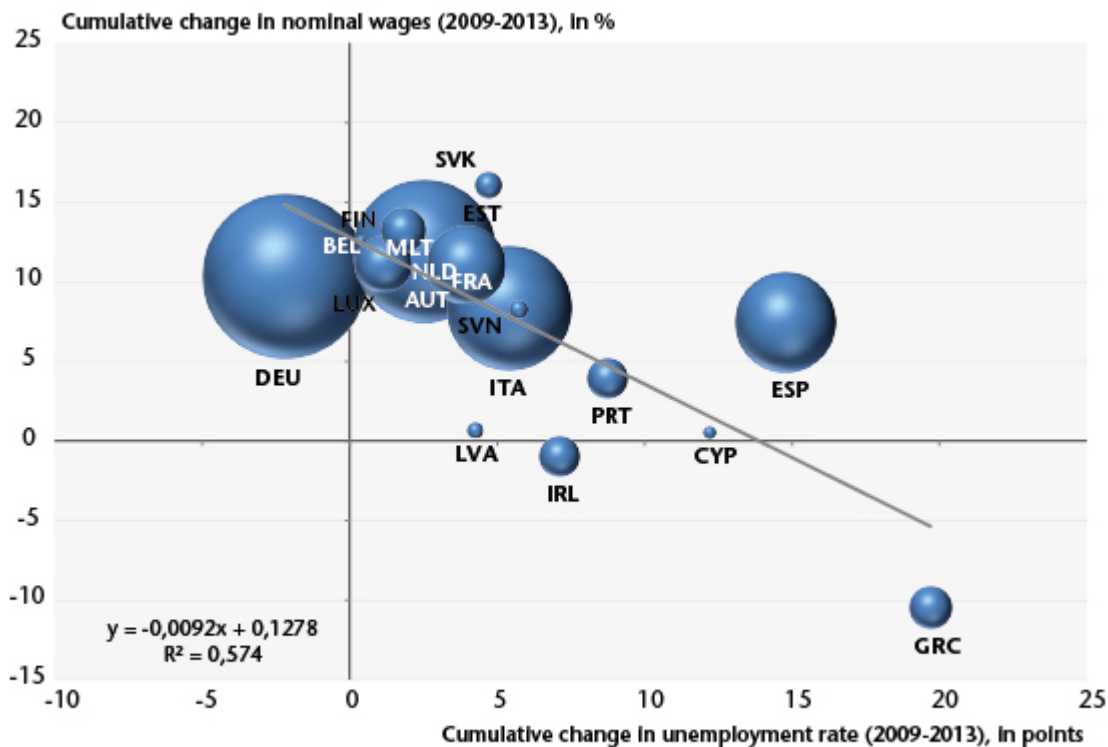
Since the outbreak of the financial crisis in 2008 and the sovereign debt crisis in 2010-2011, the euro zone countries have developed adjustment strategies aimed at restoring market confidence and putting their economies back on the path to growth. The countries hit hardest by the crisis are those that depended heavily on the financial markets and had very high current account deficits (Spain, Italy, but also Ireland, Portugal and Greece). Although the deficits have now been largely resolved, the euro zone is still wallowing in sluggish growth, with deflationary tendencies that could intensify if no changes are made. Without an adjustment in exchange rates, the adjustment is taking place through jobs and wages. The consequences of this devaluation through wages, which we summarize here, are described in greater depth in [the special study published in the dossier on the OFCE's forecasts \(Revue de l'OFCE, no. 136, November 2014\)](#).

An adjustment driven by moderation in wage increases ...

Faced with falling demand, companies have adapted by making heavy cutbacks in employment in order to cut costs, which has led to a steep rise in unemployment. The number of jobless in the euro zone was 7 million higher in September 2014 than in March 2008. The situation is especially glum in countries like Greece, where the unemployment rate is 26.9%, Spain (24.2%), Portugal (13.8%) and Italy (12.5%). Only Germany has experienced a reduction in unemployment, with a rate of 5.0% of the active population.

As is suggested by the Phillips curve, runaway unemployment has eventually affected the conditions governing wage increases, especially in the most crisis-ridden countries (Figure 1). While between 2000 and 2009 wage growth was more dynamic in the peripheral countries (3.8% annually) than in the countries in the euro zone core (+2.3%) [\[1\]](#), the situation reversed after 2010. Nominal wage growth slowed in the peripheral countries (0.8%), but stayed close to the pre-crisis rate (+2.6%) in the core countries. This heterogeneity is due to differences in how much unemployment has worsened in the different countries. According to Buti and Turrini (2012) [\[2\]](#) from the European Commission, reversing the trend in wage dynamics will be a major factor driving the rebalancing of current account positions in the euro zone.

Figure 1. Changes in unemployment rates and nominal compensation per employee



Note: The size of the bubble is proportional to the GDP of each country in the euro zone.
Sources : Eurostat, OFCE calculations.

Furthermore, an analysis at the macroeconomic data level masks the extent of the ongoing wage moderation, as the effects of the crisis are concentrated on the most vulnerable populations (young, non-graduate employees) earning the lowest wages. The deformation of the structure of employment in favour of more skilled and more experienced workers ([see the OFCE post: On the difficulty of carrying out structural reforms in a context of high unemployment](#)) is also pushing up mid-level wages. As can be seen in a number of studies based on an analysis of the macroeconomic data [3], wage growth after correcting for these composition effects is below the increase in the average salary.

... that compresses domestic demand and is not very effective in terms of competitiveness

Underlying this policy of deflationary adjustment through wages, what is important for companies is to improve

competitiveness and regain market share. Thus, compared with the beginning of 2008, unit labour costs (ULC) [4] fell in the countries deepest in crisis (Spain, Portugal and Ireland), slowed in Italy and continued their upward progression in the countries in the euro zone core, *i.e.* those facing the least financial pressure (Germany, France, Belgium and the Netherlands).

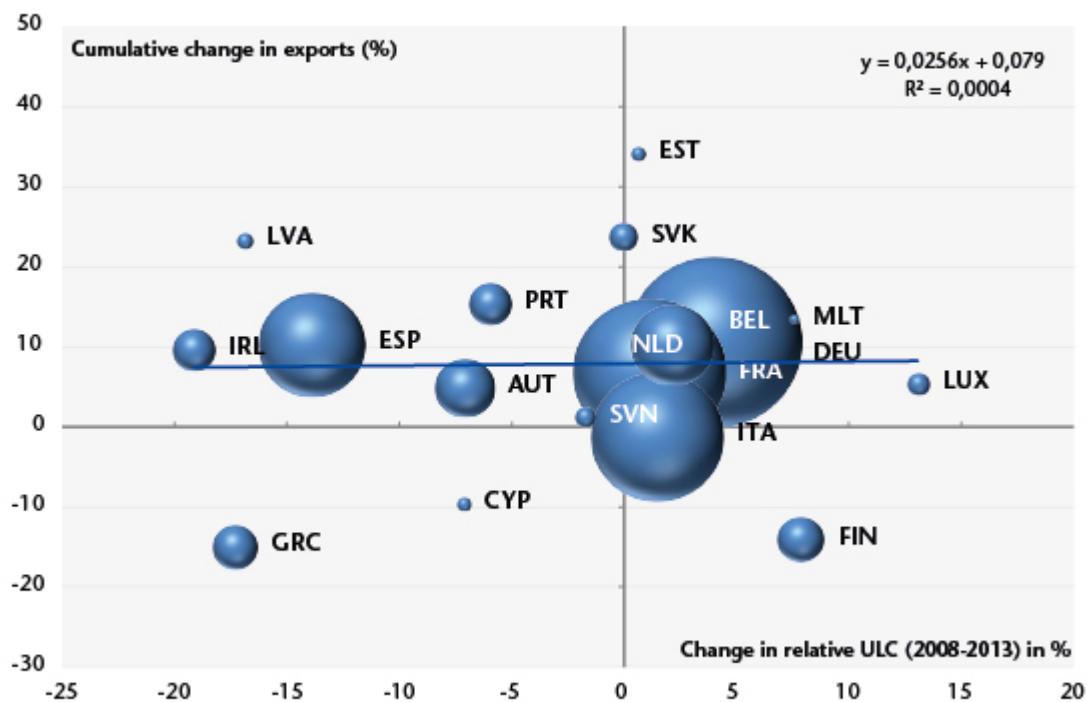
The most significant adjustment took place in Spain. Deflated by inflation, its ULC has fallen by 14% since 2008, 13 points of which are explained by the recovery in productivity, which was achieved at the expense of massive cuts in employment. Real wages increased only 1% over the period. Conversely, in Italy, the adjustment has focused on wages, whose purchasing power has fallen by 5%. However, this decline was not sufficient to offset the fall in productivity, and thus to prevent an increase in the real ULC. In Germany, after the real ULC rose in 2008, real wages continued to rise, but less than gains in productivity. In France, real wages and productivity have risen in tandem at a moderate pace. The ULC, deflated by inflation, has thus been stable since 2009 but has still worsened compared to 2008.

Even though this deflationary strategy is intended to restore business competitiveness, it is a double loser. First, as the strategy is being implemented jointly in all the countries in the euro zone, these efforts wind up neutralizing each other. Ultimately, it is the countries that carry the strategy furthest that win the "bonus". Thus, among the euro zone's larger economies, only Spain can really benefit due to the sharp reduction in its ULC, which reflects not only its own efforts but also some continued wage growth among its key partners. France and Italy are not experiencing any gain, and Germany has seen a deterioration in its ULC of about 3% between 2008 and 2013. Moreover, while the wage devaluation might have helped to boost activity, this will have been accomplished through a rebound in exports. But it is difficult

to find any correlation between exports and wage adjustments during the crisis (Figure 2). These results have already been pointed out by [Gaulier and Vicard \(2012\)](#). Even if the countries facing the deepest crisis (Spain, Greece, Portugal) might gain market share, the volumes exported by each of them are in the short/medium term not very sensitive to changes in labour costs. This might be explained by companies' preference to rebuild their margins rather than to lower export prices. Even in countries where the relative ULC fell sharply, the prices of exports rose significantly (6.2% in Greece, 3.2% in Ireland since 2008, etc.).

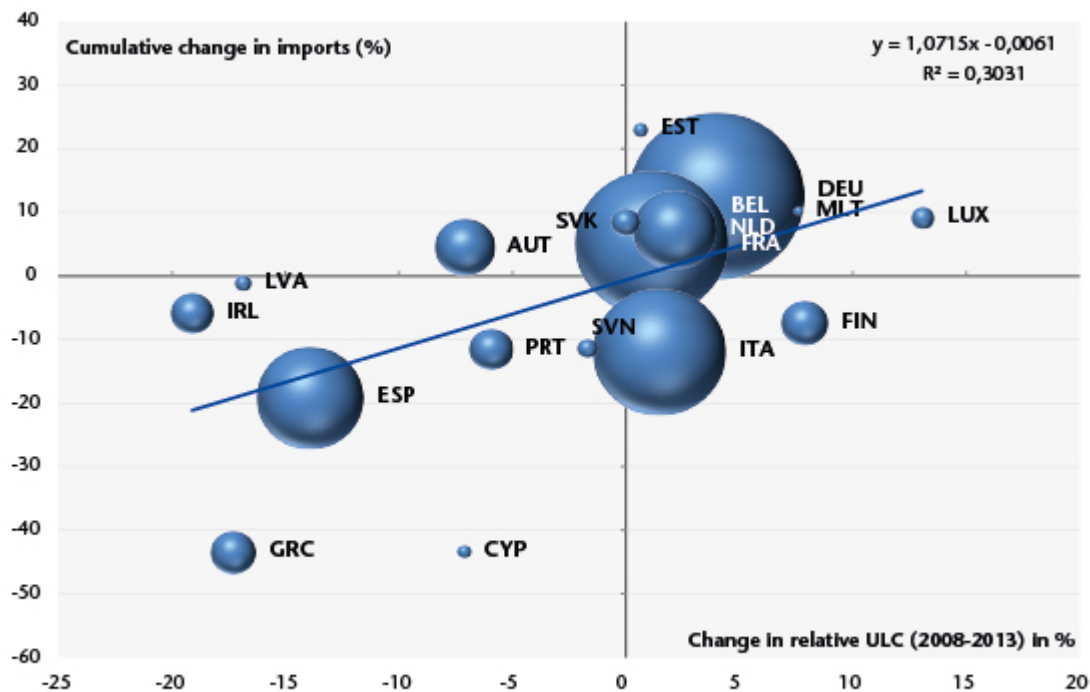
Finally, in an effort to improve their cost competitiveness, companies reduced their payroll by cutting employment and / or wages. This strategy of competitive disinflation results in pressure on household incomes and thus on their demand for goods, which slows the growth of imports. Indeed, in contrast to what is observed for exports, there is a close and positive relationship between changes in the relative ULC and in import volumes over the period 2008-2009 (Figure 3). In other words, the greater the adjustment effort in the ULC with respect to competitor countries, the slower the growth in import volumes.

Figure 2 : Change in relative ULC and exports, in volume



Note: The size of the bubble is proportional to the GDP of each country in the euro zone.
Sources : Eurostat, OFCE calculations.

Figure 3. Change in relative ULC and imports, in volume



Note: The size of the bubble is proportional to the GDP of each country in the euro zone.
Sources : Eurostat, OFCE calculations.

This non-cooperative strategy to rebalance the current account can permanently affect an economic recovery in a context where reducing the debt of both private and public agents will become even more difficult if deflationary pressures are felt in an ongoing way (due to increases in real terms in debt and interest rates). The imbalances in the current accounts of the various euro zone countries will thus be dealt with *mainly* by a contraction of imports. The correction of such imbalances by means of a wage devaluation, as was the case in 2010-2011, is therefore doubly expensive: a low impact on competitiveness, relative to competitors, due to the simultaneous implementation of the strategy in the various euro zone countries, and an increased risk of deflation, making it more difficult to shed debt, thereby fuelling the possibility of a scenario of prolonged stagnation in the euro zone.

[1] Germany, France, Belgium and the Netherlands. The peripheral countries include Spain, Italy, Portugal and Greece.

[2] Buti and Turrini (2012), "[Slow but steady? Achievements and shortcomings of competitive disinflation within the Euro Area](#)".

[3] For a comparison of a number of euro zone countries at the start of the crisis, see ECB (2012), "[Euro Area Labor Markets and the Crisis](#)". For the case of Spain, see Puente and Galan (2014), "[Un analisis de los efectos composición sobre la evolución de los salarios](#)". Finally, for the French case, see Verdugo (2013) "[Les salaires réels ont-ils été affectés par les évolutions du chômage en France avant et pendant la crise?](#)" and Audenaert, Bardaji, Lardeux, Orand and Sicsic (2014), "[Wage resilience in France since the Great Recession](#)".

[4] The unit labour cost is defined as the cost of labour per

unit produced. This is calculated as the ratio between compensation per capita and average labour productivity.

Replacing the “Prime pour l’emploi” benefit by a reduction in employee social security contributions on low wages

By [Guillaume Allègre](#)

Nicolas Sarkozy has announced plans to replace the “prime pour l’emploi” benefit (“PPE”) by lowering the social security contributions of workers earning between 1 and 1.3 times the minimum wage (“SMIC”). The reduction on contributions would amount to 4 billion euros and would benefit 7 million low-wage workers. The gain announced (just under 1,000 euros per year) would necessarily be regressive. The elimination of the PPE (2.8 billion euros according to the [2012 Budget Bill](#), p. 76) would be supplemented by higher taxes on financial income.

This proposal is very similar to the original proposal of the Jospin government in 2000 that provided for a reduction on the CSG social contribution for workers earning less than 1.4 times the SMIC. That reform, which was passed by Parliament, was blocked by the Conseil constitutionnel because the decline in the CSG provided to low-income earners depended on wages alone, and not on individual family circumstances. As the CSG

is considered a tax, the high court held that progressivity required taking into account taxpayers' ability to pay, and therefore their family responsibilities. To deal with this ruling, the Jospin government created a new instrument, the PPE benefit, which closely resembled the CSG reduction, but which was calculated, to a very small extent, on the family situation (high income ceiling at the household level, with a small increase for children). But unlike the CSG reduction, the impact of the PPE does not show up on the pay-slip: the benefit is calculated from income tax returns and reduces the tax payable by the household, with households who do not pay tax receiving a cheque from the Treasury. This means that there is a one-year lag in the receipt of the benefit. The PPE was approved by the Jospin government and then increased under the Villepin and Raffarin governments, and by 2008 amounted to 4.5 billion euros ([2010 Budget Bill](#), p. 53). At that point a full-time employee on the minimum wage received 1,040 euros per year. The PPE was then frozen by the Fillon government. This freeze, together with the fact that the RSA benefit was deductible from the PPE benefit, led to a 1.7 billion euro reduction in the value of the PPE between 2008 and 2012, from 4.4 billion euros to 2.8 billion. By 2012, a full-time employee on the minimum wage now received only 825 euros a year. Moreover, the lack of a boost in the minimum wage has greatly reduced the number of households eligible for the full rate (as well as the number of employees eligible for the full-rate reduction on employer contributions). This effect comes on top of the impact of rising unemployment, which is reducing the number of eligible employees. A 4-billion euro scheme, for which the maximum gain would be just under 1,000 euros, would amount to a little less than the PPE did in 2008. If we add in the cost of the RSA income supplement (1.6 billion in 2012), and if we take into account the previous RMI and API-related incentive schemes (600 million), we conclude that these various support mechanisms for low-income employees would total 5.6 billion euros in 2012, against 5.1 billion in 2008, an increase that barely exceeds inflation: the new

policies that have been proposed since 2008 have been funded mainly by shuffling instruments targeted at the same population.

The replacement of the PPE by a reduction in social contributions would represent progress in administrative terms, since the government would cease to levy contributions and then repay a smaller tax credit to the same people 6 to 12 months later. The benefit of lowering contributions would be immediate and strongly linked to employment. This would also clarify the fact that low-paid employees are contributors to and not beneficiaries of social assistance. The proposed merger of the CSG tax and income tax (with the PPE as one element) has precisely the same goal. This reform nevertheless raises several questions. What would happen if the Constitutional Council were approached? And, employees working part-time currently benefit from an increase in the PPE; will this be renewed?