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.

A boost for the minimum wage or for income support?

By Guillaume Allègre

The government has made a commitment to an exceptional, "reasonable" boost to the French minimum wage, the "SMIC", and to indexation based on growth, and no longer just on workers' purchasing power. In *Les Echos*, Martin Hirsch has argued for strengthening the RSA [the French income support scheme] rather than the SMIC. The point is not to oppose the working poor, the target of the RSA, and low wages: redistribution policies need to attack, not just poverty, but inequality throughout the income chain.

In terms of reducing inequalities, there are several strategies: one strategy aims to reduce inequality in individual earnings; a second aims to reduce inequalities in living standards between households, the level at which people are presumed to live in solidarity. There are legitimate grounds for both these strategies. The RSA *activité* [the income supplement for the working poor] and the SMIC are thus not substitutable (see also "le SMIC ou le RSA?" in French). Unlike the RSA, the fight against poverty is not the objective of the SMIC. The SMIC aims "to ensure that employees with the lowest salaries share in the country's economic development".

A high minimum wage has the effect of reducing inequalities across the bottom of the wage scale, with increases in the minimum wage impacting up to two times the SMIC. Given the increase in unemployment, in precarious jobs and in part-time work, full-time employees on the minimum wage are certainly not the poorest in society, but they are far from well-off. The SMIC reduces the income gap between the working class and the middle class, which is an objective in itself (though some in the middle class may take a dim view of this: by its very nature, reducing inequality isn't going to satisfy everyone). In particular, it is not the same thing to receive a high salary or to receive a low salary supplemented by targeted social benefits. These benefits do not confer any rights to a pension or to unemployment benefits. In terms of dignity, the minimum wage level is the value that a society places on work. Social benefits targeted at the poorest people put them in a position of being assisted, which has consequences in terms of social representations (individual and collective). As work is performed by individuals, it is not illegitimate to try to reduce inequalities between employees and not only between the employees' households.

The proposed boost to the RSA is ambiguous, as the term "RSA" designates both the minimum social benefits for the unemployed and the inactive population (the "base" RSA, formerly the RMI and API benefits) and the income supplement for the working poor (RSA *activité*). If the proposal for a boost applies only to the RSA *activité*, it would then be inconsistent with the objective of targeting the most disadvantaged households. If, on the contrary, it concerns the RSA as a whole, which would be legitimate, then it is necessary to be more explicit and to assume that it will benefit mainly the unemployed and the inactive [1]. In March 2012, there were 1.59 million people receiving just the base RSA, and 689,000 the RSA *activité* (all France), *i.e.* only one-third of RSA recipients received the *activité* component.

The implementation of the RSA *activité* has up to now failed in two ways ("The failings of the RSA income support scheme"): according to the final report of the National Evaluation Committee, it has had no discernible impact on employment, and poverty reduction has been severely limited because of a major lack of take-up of the *RSA activité* component. We can move quickly over the first point, as there is little emphasis these days on the incentive aspect of the RSA. The main problem of a boost to the RSA *activité* is indeed the lack of take-up: in the report, take-up for the RSA *activité* component alone is estimated at 68% in December 2010 [2]. And this is not a matter of the programme coming on line: between December 2010 and March 2012, the number of RSA *activité* beneficiaries increased only marginally in mainland France, from 446 000 to 447 000. Linking eligibility for the RSA *activité* to both earned income and family expenses and mixing into a single instrument beneficiaries of a social minimum and the working poor, who are sometimes very well integrated into the labour market, poses problems both in terms of improper assessment of eligibility for the provision and stigmatization. This highlights two causes of the lack-of take-up of the RSA *activité*: insufficient awareness of the scheme, on the one hand, and voluntary lack of take-up, on the other: 42% of non-applications who do not exclude themselves from eligibility declare that they did not file a claim because they "get by financially otherwise", and 30% did not file a claim because they did "not want to depend on welfare, to owe something to the state" (p.61). Better information would not be sufficient to solve the problem of lack of take-up. Increasing the minimum wage, on the contrary, has the great advantage of automatically benefitting those affected without fear of stigmatization, since it involves labour income.

Unlike the RSA, increasing the gross SMIC increases labour costs. However, there are several strategies to raise the minimum wage that would not have a net effect on labour costs: the increase could be offset by a reduction in employers' social contributions. One could also ease employee social security contributions on low wages. But this proposal would probably be censured by the Constitutional Council, which in 2000 knocked down the exemption of the CSG tax on low wages on the grounds that the progressivity of the CSG would then no longer depend on the household's ability to pay [3]. Finally, a more extensive reform aimed at merging the CSG tax and the income tax would make it possible to reduce taxes on low wages and thus increase the net minimum wage. The integration of the PPE in-work negative income tax would also make it possible to show the amounts involved directly on the payslip.

The fight against inequality clearly should not stop with inequalities in wages between full-time workers. It is also necessary to attack involuntary part-time work, by enabling the workers concerned to move into full-time work and/or by making part-time work more costly by lowering the rate of general tax relief on employer social contributions.

Basically, there is no reason to want to vary the level of the base RSA relative to the minimum wage. However, since the base RSA is indexed to prices, its level has fallen sharply relative to the minimum wage since the early 1990s (see Périvier, 2007). It would therefore be legitimate to significantly raise the base RSA (even if this means reducing the rate of accumulation of the RSA *activité* component) and to index it to the minimum wage level. This would definitively solve the question of whether to boost the minimum wage or the RSA.

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[1] Here it can be seen that the "simplification", which consists of combining two instruments into one, is not facilitating public debate.

[2] This lack of take-up is partially due to the fact that, for some of those who are eligible (about a third), the

potential gains are very low or even non-existent due to the deduction of the sums paid under the RSA *activité* from the PPE in-work negative income tax. But the lack of take-up is nevertheless high even when looking at the potential gainers (and not simply all those eligible).

[3] Decision No. 2000–437 DC dated 19 December 2000: "Whereas, while the legislature has the right to change the base of the general social contribution to alleviate the burden on the poorest taxpayers, this is subject to the condition that it does not undermine the existence of conditions of equality between taxpayers; that the provision in question does not take account of the taxpayer's income other than from an activity or of income of other household members or of dependents within it; that the choice made by the legislature to not take into consideration all the contributory capacities does not create, between the taxpayers concerned, a manifest inequality that violates Article 13 of the Declaration of 1789."

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.

Should tax breaks on overtime be reversed?

By Eric Heyer

Among the savings plans announced on 24 August 2011 by French Prime Minister François Fillon figures a change to the system of tax reductions on overtime hours and their exemption from social contributions,[1] a scheme that has been in force in France since 1 October 2007. This provides an opportunity to take another look at some of the main conclusions of the work carried out by the OFCE (French version) on this subject.

1 – An article to be published soon in the *Oxford Review of Economic Policy*[2] explains how the impact of this scheme will differ depending on the position of the economy in the cycle at the time the measure is applied.

- In a favourable economic climate, an increase in working hours prompted by lower labour costs and the elimination of payroll taxes would seem appropriate. The measure is of course not funded (the public deficit deteriorates), and financing it through higher levies would radically change its nature, even though this would not call into question its positive impact on employment and unemployment.
- However, this measure is poorly suited to the kind of economic downturn that the French economy is going through today. In a situation of mass unemployment, an

> increase of 1% in working hours has a negative impact on employment (-58,000 jobs at 5 years and -87,000 at 10 years). The unemployment rate would increase slightly (0.2 point at 5 years, 0.3 point at 10 years). The measure would have a small impact on growth (0.2 point at 5 years and 0.3 point at 10 years) and is not funded: the deficit would deteriorate by 0.5 point at 5 years (0.4 point at 10 years).

2 – This corroborates the results of a recent study published in *Economie et Statistique*[3]. The authors examined data on 35 sectors of the French economy and estimated that a 1% increase in overtime would destroy about 6,500 jobs in the commercial sector (*i.e.*, 0.04% of commercial jobs), three-quarters of which would be temporary jobs.

Thus, in a context of a severe economic crisis, it seems that an incentive to work longer hours would hurt employment, especially temporary employment.

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[1] The government decided to reintegrate overtime hours into the general schedule of tax reductions while maintaining specific advantages on taxes and social welfare charges. Concretely, this measure will not change anything for employees: net remuneration will not be reduced, and income tax will not be increased. As for employers, they will continue to benefit from exemptions on charges for declared overtime hours, but will see smaller breaks on charges on low wages. This will take effect next January 1st and, according to the government, will generate 600 million euros in revenue from additional social contributions.

[2] Heyer É. (2011), “The effectiveness of economic policy and position in the cycle: The case of tax reductions on overtime in France”, *Oxford Review of Economic Policy*, forthcoming.

[3] Cochard M., G. Cornilleau and É. Heyer (2011): “Les marchés du travail dans la crise”, *Economie et Statistiques*, no. 438-440, June.