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The Declining
Competitiveness of French
Firms Reflects
a Generalised Supply-Side
Problem

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**THE DECLINING COMPETITIVENESS OF FRENCH FIRMS REFLECTS A GENERALISED
SUPPLY-SIDE PROBLEM**

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By Hervé Boulhol and Patrizio Sicari

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ABSTRACT/RESUME

The declining competitiveness of French firms reflects a generalised supply-side problem

This short paper analyses the decline of France's trade balance over the past 15 years. While the loss in export market shares is comparable to that of the major OECD countries except Germany, it is one of the largest among the countries of the euro area. The determinants of this outcome seem to be general (rather than concentrated in the industrial sector) and related to overall supply-side weaknesses.

JEL classification codes: E23; E24; E31; F16; L25

Keywords: France, competitiveness, export shares, unit labour cost, manufacturing sector, profits

Le recul de la compétitivité des entreprises françaises reflète des déficiences générales du côté de l'offre

Ce court document analyse la dégradation de la balance commerciale de la France depuis plus de quinze ans. Alors que la perte de parts de marché à l'exportation est comparable à celle des grands pays de l'OCDE à l'exception de l'Allemagne, elle est une des plus fortes des pays de la zone euro. Les déterminants de cette évolution semblent être généraux (plutôt que concentrés dans le secteur industriel) et refléter des faiblesses générales du côté de l'offre productive.

Classification JEL : E23 ; E24 ; E31 ; F16 ; L25

Mots clefs : France, compétitivité, parts de marché à l'exportation, coût unitaire du travail, secteur manufacturier, profits

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The declining competitiveness of French firms reflects a generalised supply-side problem

By

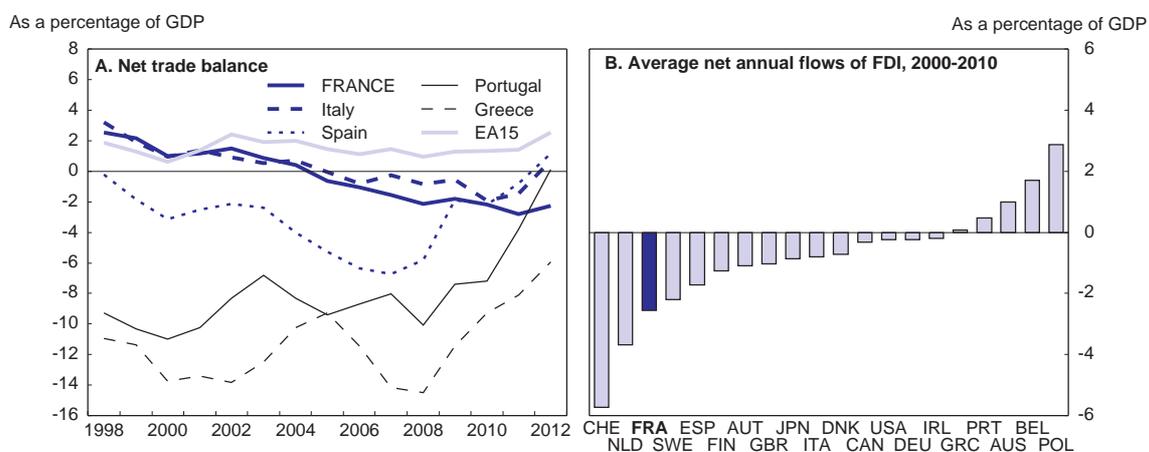
Hervé Boulhol and Patrizio Sicari¹

For the last 15 years France's balance of trade in goods and services has been steadily deteriorating, from a surplus of around 2.5 % of GDP to a deficit of about the same magnitude (Figure 1, Panel A). This deterioration cannot be attributed to any improvement in the country's attractiveness, which might have allowed it to finance the excess of demand over domestic supply: France is in fact one of the OECD countries with the biggest net outflows of foreign direct investment (FDI) (Panel B). More recently, while the deficit countries of the euro area have shown a tendency to correct their imbalances on the trade account, thanks largely to shrinking domestic demand, the French imbalance has persisted. In 2012 (2011) it accounted for around three-quarters (half) of the cumulated deficit of euro area countries recording a deficit (Finland, France and Greece in 2012, whereas Italy, Portugal and Spain had also a deficit in 2011).

The shrinkage in export market shares over the last 15 years has been similar to that experienced by other major OECD countries, with the exception of Germany (Figure 2, Panel A). However, France has suffered the sharpest retreat among euro area countries, other than Finland. Nor does this poor performance seem to be explained by cost-competitiveness trends of the manufacturing sector (Figure 3, Panel A). Even if there is in fact a negative relationship among countries of the euro area (but only when Luxembourg is excluded) between the trend in unit labour costs and the trend in the trade balance, it does not explain the French situation (nor Finland's) (Panel B).

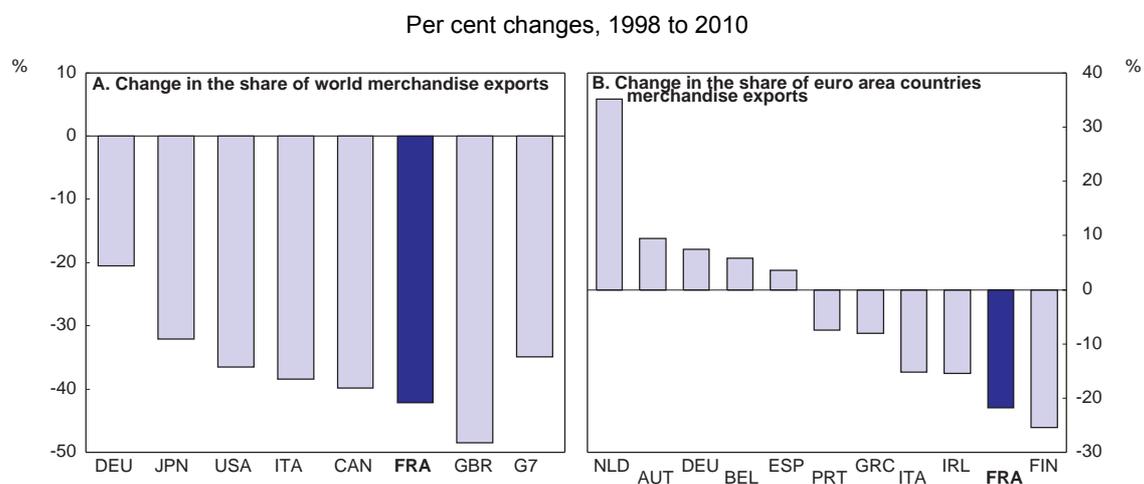
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Figure 1. **The trade balance has steadily deteriorated, which is not due to improved attractiveness of investment in France**



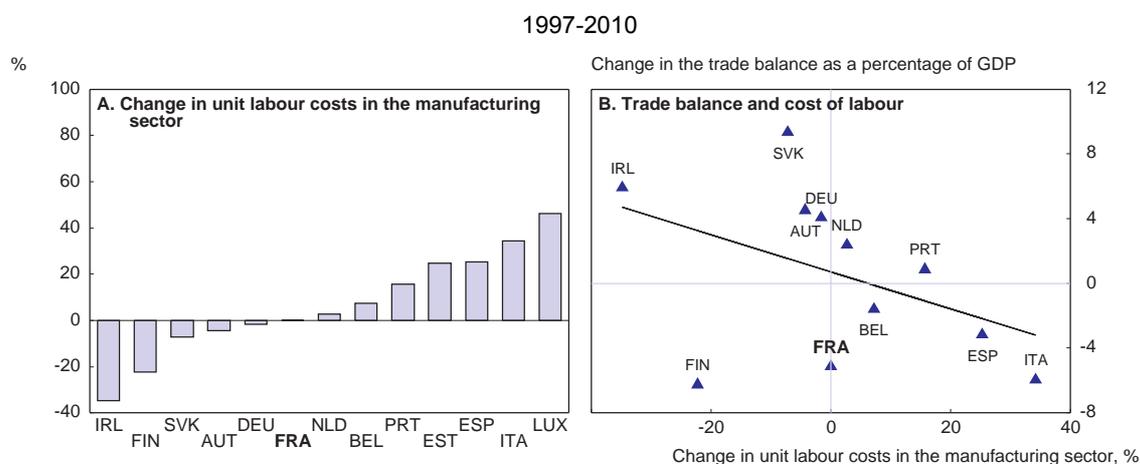
Source: OECD, Economic Outlook 92 database (Panel A), OECD International Direct Investment Statistics (Panel B).

Figure 2. **Shrinkage in export market shares**



Source: United Nations, Comtrade database.

Figure 3. Cost competitiveness in the manufacturing sector



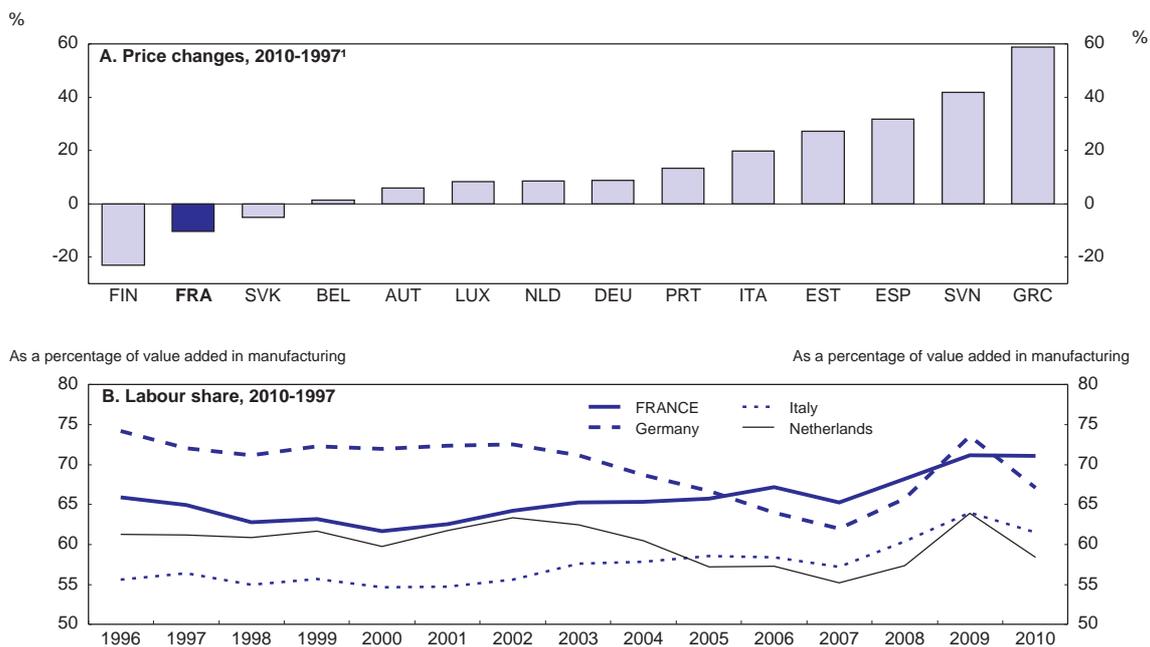
Source: OECD, Economic Outlook 92 database

Given France's insufficient positioning at the upper end of the market in terms of quality, however, it may be that the relatively high level of wage costs is a greater disadvantage than it was in the past: with stiffer international competition, the price-elasticity of demand for middle- and lower-range products has likely increased. In fact, manufactures' prices have declined in France (and in Finland), as firms have had to trim their margins (Figure 4, Panel A) and the share of wages in value-added has risen substantially in the manufacturing sector (Panel B). This suggests that wage increases in the manufacturing sector have exceeded labour productivity gains to such an extent that profit shares have been crimped.

Taking the economy as a whole, on the other hand, real wages have tracked changes in labour productivity (Figure 5, Panel A), but cost competitiveness has deteriorated substantially relative to Germany and Austria (Panel B). Relative to Germany, the diverging trends in the trade balance seem to be associated more closely with the behaviour of domestic demand and of economy-wide unit labour costs (Figure 6).

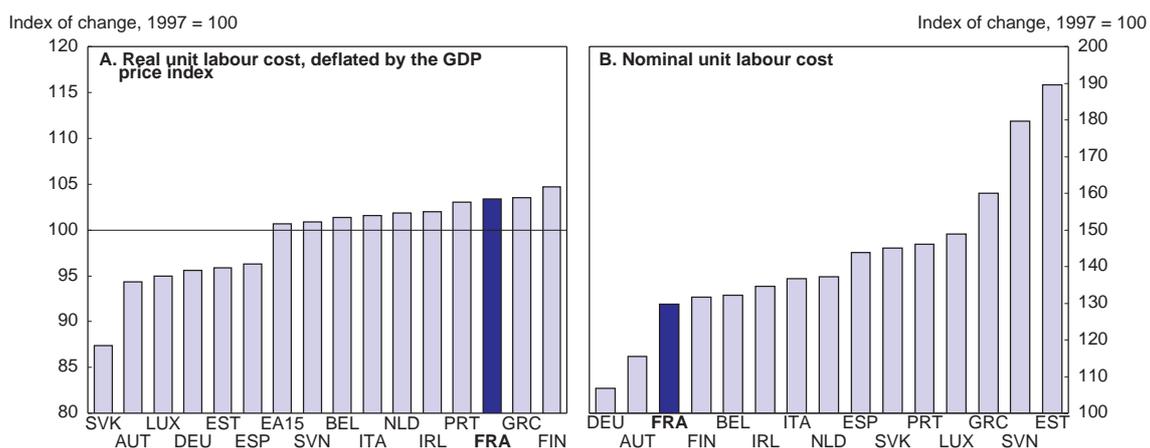
From an accounting viewpoint, the decline in the trade balance has gone hand in hand with profit changes that are inadequate to finance increases in business investment, a rise in non-residential investment and a deterioration in the public finances (Table 1). By international comparison, the profitability level of French firms has for a long time been very weak (Figure 7), but the decline in self-financing rates since the end of the 1990s must be interpreted carefully: it was greatly influenced by a sharp increase in dividend payments, albeit from a very low level (Figure 8). Given the high rate of household saving, to restore the trade balance without dampening private investment will require (at least from an accounting viewpoint) restoring public finances, as well as improving business profits.

Figure 4. Prices have fallen and the labour share has increased in France's manufacturing sector



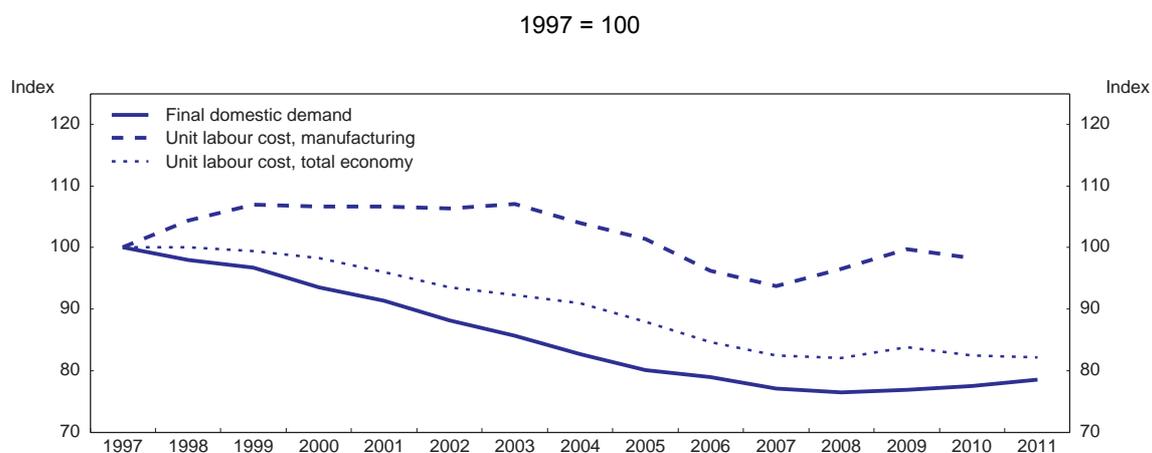
1. 2009-1997 for Belgium, Estonia, Greece, Luxembourg, Slovakia, Slovenia and Spain; 2006-1997 for Portugal.
 Source: OECD, STAN and OECD Economic Outlook 92 databases.

Figure 5. Cost competitiveness of total economy



Source: OECD, STAN database.

Figure 6. Relative domestic demand and unit labour cost, Germany versus France



Note: For each series, Germany appears in the numerator and France in the denominator. For example, final domestic demand fell by more than 20% in Germany relative to France between 1997 and 2011.

Source: OECD, Economic Outlook 92 database.

Table 1. Accounting breakdown of the trade balance, 1997-2011 and 1997-2008

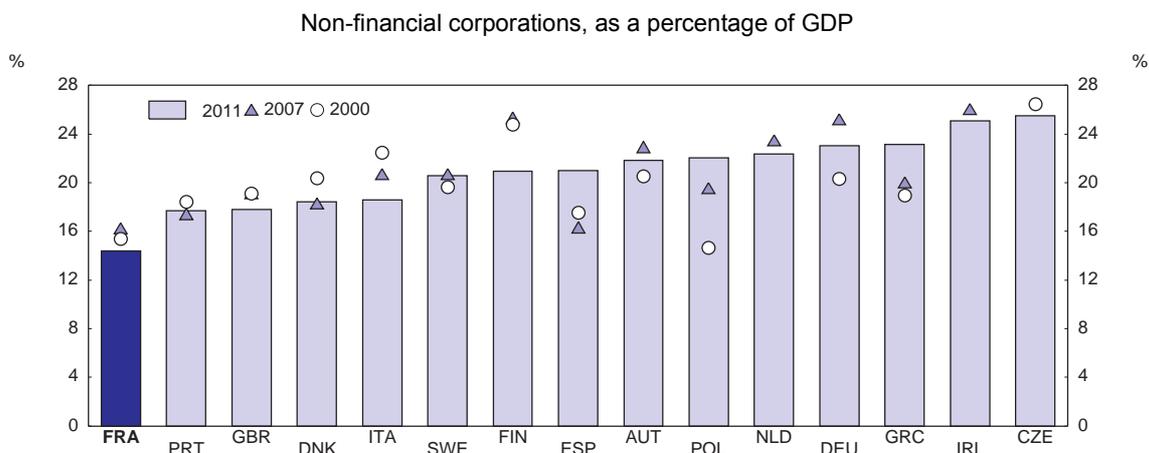
Percentage points of GDP

Trend	Trade balance	Household saving rate	Business saving rate	Fiscal balance of general government	Residential investment	Non-residential investment
2011-1997	-5.7	0.2	-1.0	-1.9	1.9	1.0
2008-1997	-5.0	-0.4	-0.5	0.0	2.5	1.5

Note: From an accounting viewpoint, the increase of the trade deficit by 5.7 percentage points of GDP between 1997 and 2011 is equal to the increase of residential investment by 1.9 p.p., of non-residential investment by 1 p.p., the deterioration of the general government deficit by 1.9 p.p. and the decrease in the business saving rate by 1.0 p.p., all this very slightly offset by an increase in household saving rate by 0.2 p.p.

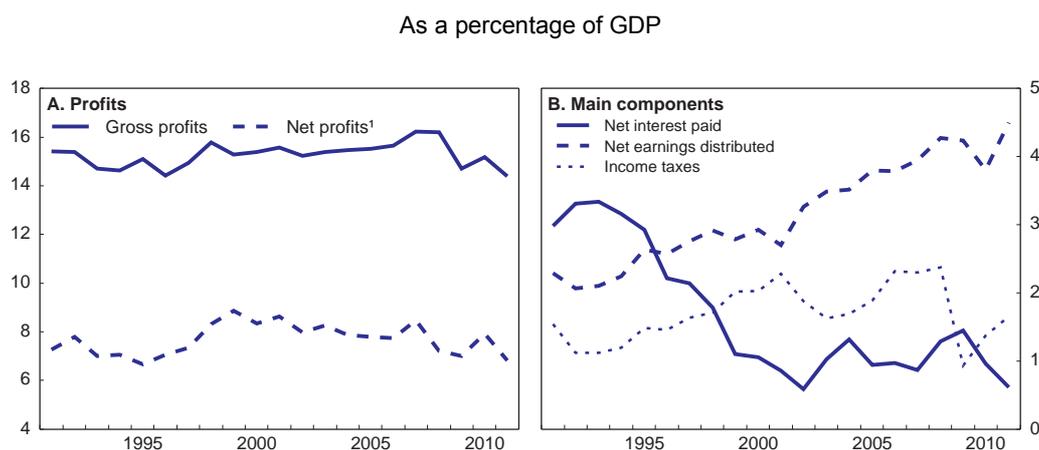
Source: OECD calculations, data taken from the OECD Economic Outlook 92 database.

Figure 7. Profits before taxes, interest and dividends, 2011



Source: OECD, National accounts 2012 database.

Figure 8. Profits of non-financial corporations in France



1. After interest, dividends, income taxes, current transfers and other residual transfers.

Source: INSEE, non-financial corporate accounts.

This poor performance on world markets is not confined to certain problem sectors or even to industry in general. France's difficulties also relate to services (Fontagné and Gaulier, 2008). The deterioration in the trade balance for goods has occurred virtually across the board, although energy and the automotive industry have been particularly important contributors (Table 2).

Table 2. Net trade balance by sector

As a percentage of GDP

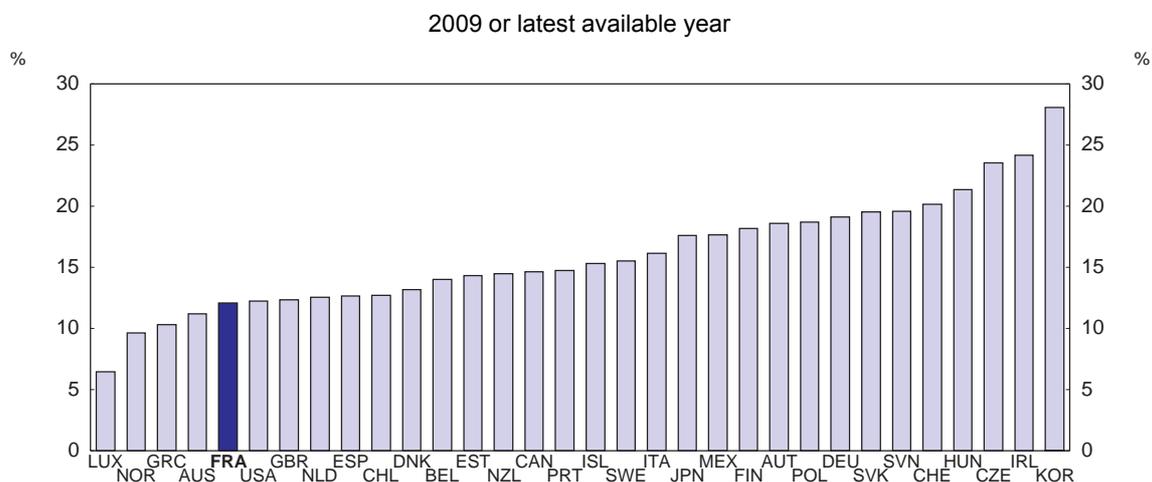
	1997	2011	Δ
Petroleum, petrol product	-0.93	-2.48	-1.54
Road vehicles	0.62	-0.40	-1.01
Gas, natural, manufactured	-0.25	-0.72	-0.47
Telecommunication, sound equipment, etc.	0.05	-0.41	-0.45
Organic chemicals	0.08	-0.26	-0.34
Electric machine, apparatus, parts, nes	0.21	-0.11	-0.32
Metals manufactures, nes	0.00	-0.20	-0.20
Office machines, adp machines	-0.24	-0.41	-0.17
Furniture, bedding, etc.	-0.06	-0.21	-0.15
General industrial machines, nes	0.13	-0.02	-0.15
Non-metal mineral manufactures	0.03	-0.11	-0.14
Iron and steel	0.13	-0.01	-0.14
Rubber manufactures, nes	0.14	0.01	-0.13
Miscellaneous manufactured goods, nes	-0.12	-0.25	-0.13
Inorganic chemicals	0.01	-0.12	-0.13
Clothing and accessories	-0.38	-0.48	-0.10
Plastic, non-primary form	0.00	-0.10	-0.10
Miscellaneous edible products, etc.	0.11	0.02	-0.09
Electric current	0.21	0.13	-0.08
Non-ferrous metals	-0.11	-0.18	-0.07
Coal, coke, briquettes	-0.06	-0.12	-0.05
Vegetables and fruit	-0.14	-0.19	-0.05
Paper, paperboard, etc.	-0.06	-0.10	-0.04
Fish, crustaceans, mollusc	-0.14	-0.17	-0.04
Footwear	-0.13	-0.15	-0.03
Beverages	0.47	0.46	-0.02
Coffee, tea, cocoa, spices	-0.10	-0.11	-0.01
Dairy products, bird eggs	0.16	0.15	-0.01
Medicinal, pharmaceutical products	0.14	0.15	0.00
Essential oils, perfume, etc.	0.36	0.40	0.04
Chemical materials, nes	0.10	0.15	0.05
Cereals, cereal preparations	0.33	0.38	0.05
Power generating machines	0.10	0.16	0.07
Other transport equipment	0.62	0.81	0.19
Specific transact not classified	0.00	0.52	0.52
Total of above sectors	1.26	-3.98	-5.24
Overall trade balance in goods	1.87	-3.69	-5.56
Overall trade balance in goods and services	3.04	-2.48	-5.52

Source: UN, COMTRADE database.

The share of manufacturing industry in total economy value-added has been declining gradually and is now among the lowest in OECD countries, comparable to that in Denmark, the Netherlands and the United Kingdom (Figure 9). Yet, the performance in volume terms has been relatively good (Figure 10, Panel A), and the shrinkage in the manufacturing share of GDP in value terms (Panel B) can be ascribed essentially to price effects, reflecting both the inability of industrial firms to preserve their margins as well as insufficient competition in services, which increases their relative prices. Bourlès *et al.* (2010) indeed showed that regulation in upstream sectors contributes to weak productivity in the downstream sectors. In fact, there is no correlation for OECD countries between the share of industry in employment and the total employment rate, nor between the manufacturing share in value-added and the growth of real GDP (Figure 11). The real difficulties facing French industrial firms are a reflection of more generalised

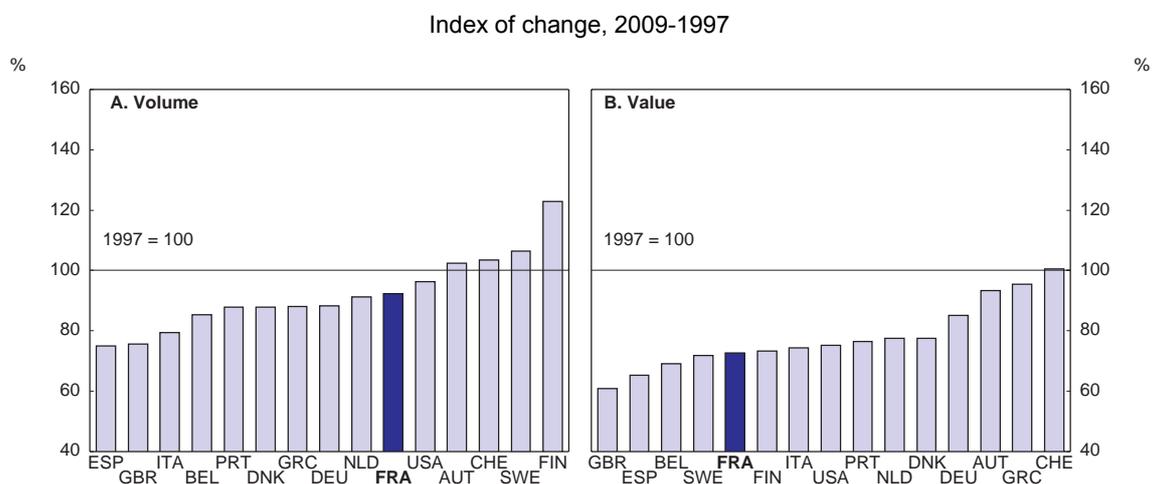
structural weaknesses on the supply side (relating to taxation, labour markets, competition, education, etc.), which are at the core of the weak growth in real GDP over the last two decades (Figure 12).

Figure 9. Share of manufacturing value-added in total value added



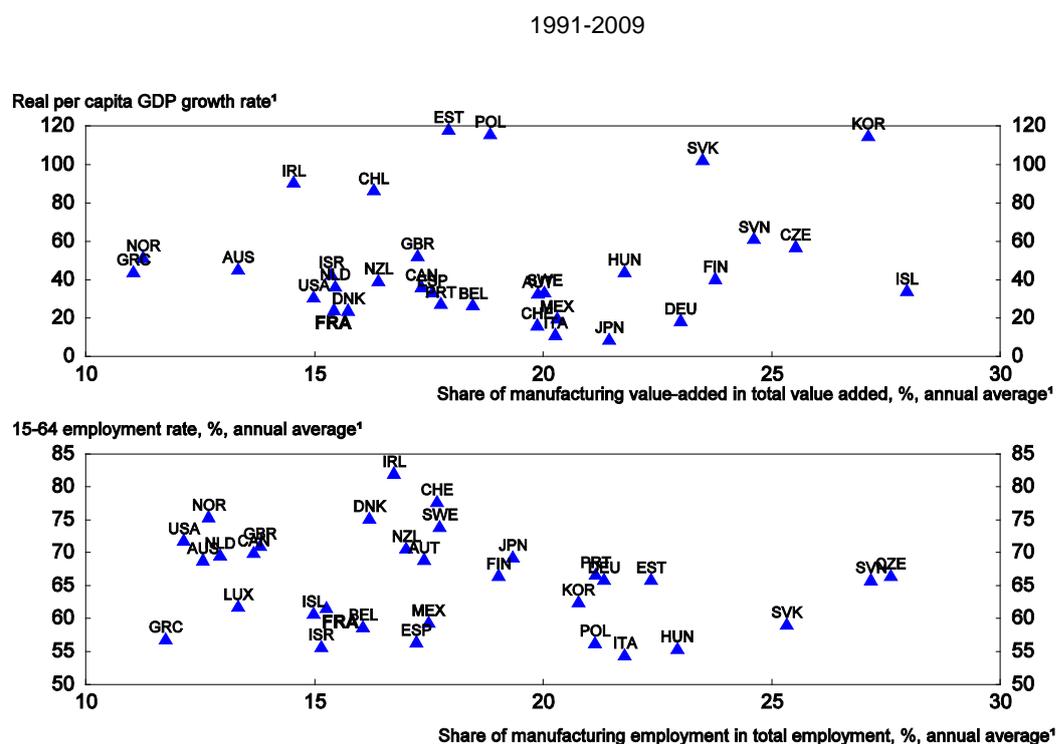
Source: OECD, STAN database.

Figure 10. Share of manufacturing value-added in total value added



Source: OECD, STAN database.

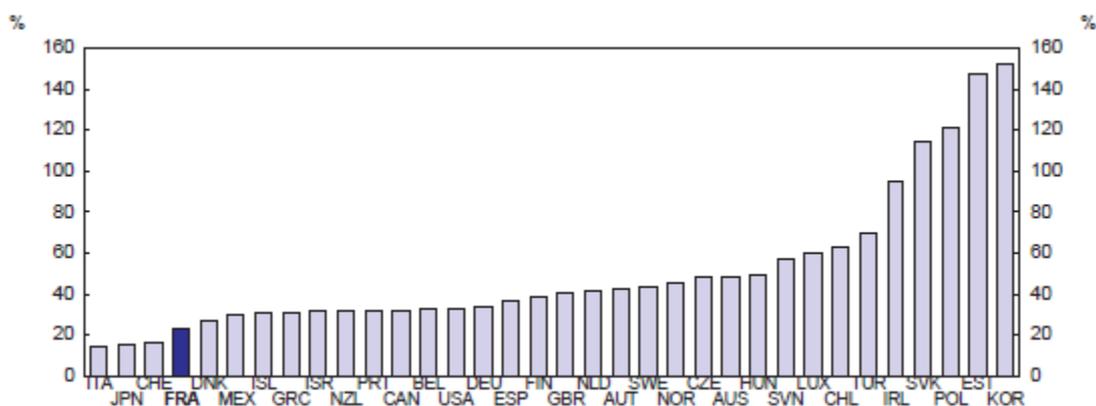
Figure 11. Lack of positive correlation between the relative weight of industry and total economic performance



1. Or nearest year.

Source: OECD, STAN, National Accounts and Workforce Statistics databases.

Figure 12. Growth of real GDP per capita has been structurally weak, 1990-2011



Source: OECD, Economic Outlook 92 database.

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