



**Speech by François Villeroy de Galhau,
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French competitiveness: new challenges, new measures

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Ladies and gentlemen,

I'm very pleased to welcome you to this joint Banque de France-France Stratégie conference and I would like to thank you all for coming. Competitiveness is one of the key challenges currently facing the euro area.

Of course, the issue of competitiveness is not unrelated to the core mission of central banking, which is the definition and conduct of monetary policy. **Monetary policy and competitiveness policy are indeed complementary, but it is important to remember that one cannot replace the other.**

It is true that monetary policy can do a lot, and indeed we have done a great deal. Let me just sum up recent events. On 3 December, the ECB Governing Council stepped up its monetary stimulus, lowering the interest rate on the deposit facility to -0.30%, and announcing that it would extend its asset purchase programme (APP) by six months – or by EUR 360 billion – and reinvest the principal payments on securities purchased under the APP as they mature – providing an additional injection of EUR 320 billion up to 2019. The sheer size of these amounts shows just how much the markets overreacted in the immediate aftermath of the announcement. In parallel, the Federal Reserve will adapt its own policy decisions to the state of the US economy: like ours, its mandate is first and foremost domestic. There is thus no

“great divergence”, and the exchange rate is not a monetary policy target; although it is true that the current euro-dollar exchange rate is having a positive impact on our price competitiveness.

The efficiency of monetary policy will be judged over the long term, and not by the episodes of market volatility or jitters that we have seen in recent days. With the hindsight we have gained since June 2014 when the non-standard measures were announced, we now have some reliable and concurrent indicators of the effectiveness of these policies. In the past 18 months, interest rates on bank lending to corporates have fallen by around 80 basis points in the euro area, and we’ve gone from a 3.1% contraction in the outstanding amount of these loans to 0.6% growth. It’s rare to see that much of a turnaround. Non-standard monetary policy has increased the euro area’s growth prospects by 1% for the period 2015-2017, and is expected to boost inflation by 0.5% in 2016 and 0.3% in 2017.

Monetary policy has indeed achieved a great deal. **But we need to be careful not to expect it to do everything.** The introduction of the single currency in Europe eliminated the option of national devaluations and made competitiveness “the rule of the game”. This is as true today as it was at the advent of the euro. However, here in France, as well as in our partner countries in southern Europe, we seem to have forgotten about this over the past decade. The success of Germany since the onset of the euro area crisis in 2010 has served as a stark reminder.

In 2015, alongside Italy and Portugal, France was one of the three euro area states singled out by the European Commission as having excessive macroeconomic imbalances. In France’s case, the imbalances stem from the deterioration in the trade balance and in competitiveness, as well as from the high level of public sector debt. All this underscores the importance of this conference on competitiveness, which will focus on three main objectives:

- First, **measuring** competitiveness: we will discuss some of the new measurement methods available;
- Second, **diagnosing** the causes of France’s competitiveness lag;
- Next, **reinforcing** competitiveness: this afternoon’s round table will look at possible ways of making France more competitive;
- I shall finish by looking at a fourth objective: **extending** our debate on competitiveness to Europe.

I. Finding better ways to measure competitiveness

The first session of this conference will be devoted to new ways of measuring competitiveness. As the computer pioneer Grace Hopper¹ once said, “A precise measurement is worth a thousand expert opinions”. The new methods and indicators that are becoming available is testament to the wealth of research being conducted in this area. During the breaks, there will be a presentation on some of the databases currently available online.

These new measurement methods have helped shed some light on France’s competitiveness lag. For example, a study by the Banque de France, which will be presented this morning, proposes a new way of measuring competitiveness, stripping out sectoral and geographical effects, in order to explain changes in export market shares.² The study shows that, since 2006, the value of France’s market shares has fallen by an annual average of 3.2%, compared with a decline of just 1.2% for the euro area as a whole. This loss in market share cannot be attributed to poor sectoral or geographical specialisation in France. Indeed, all European countries are experiencing a negative geographical effect, as their main trading partners are other European countries and Europe is growing at a slower pace than the rest of the world. Moreover, contrary to opinion, product specialisation has little impact on changes in market share and is not a disadvantage for France.

II. Diagnosing the causes: What are the factors behind France’s loss of competitiveness?

The euro exchange rate, which affects both France and Germany equally and has been trending downwards since 2008, does not explain why France has been losing competitiveness relative to its European partners. To find an answer, we need to look first at **the trend in unit labour costs** in the 2000s. From 1999 to 2007, French labour costs grew at a faster pace than those in Germany, outstripping the latter by an aggregate 17%. Things were even worse in Spain and Italy, where labour costs outstripped those in Germany by 30%.

In addition, as outlined in the Gallois report, to keep pace with international competition, “French industry focused on keeping its prices competitive, at the expense of its non-price

¹ Grace Hopper was an American computer scientist who developed the first compiler for a computer language and the COBOL computer code. In 1991, she was awarded the National Medal of Technology for her contributions to programming languages.

² See Gaulier G., Santoni, G., Taglioni, D. and Zignago, S., “Parts de marché mondiales en temps de crise : une décomposition trimestrielle”, Banque de France Working Paper No 472, and the World Bank/ Banque de France joint website, Measuring Export Competitiveness.

competitiveness”.³ Margin erosion in the industrial sector in turn meant there was less money available to improve non-price competitiveness. So does this price/non-price vicious circle explain why France lost export market shares to Germany? You will be able to discuss this issue in the second session.

Another question that comes up less frequently is that of the **demographics of France’s exporting companies**. The number of exporting SMEs in France has averaged around 100,000 over the past few years compared with more than 300,000 in Germany. A study by the Banque de France shows that these firms are heterogeneous.⁴ Fewer than 30% of those entering a foreign market are still present there a year later. Some only trade occasionally on international markets. And the contribution of firms to export growth varies according to size and age.

III. How can we enhance France’s competitiveness?

The government’s recent reforms - the CICE and Responsibility and Solidarity Pact – are aimed at boosting cost-competitiveness and are primarily targeted at the labour market. They should allow France to reduce its cost differential relative to other countries – French unit labour costs are expected to remain stable over the period 2014-2017, compared with a rise of 1% per year for the overall euro area and 2% per year in Germany. They should also help to improve corporate profit margins – the average profit share is projected to rise from 29.5% in 2014 to 32.3% in 2017. This is particularly beneficial for French exporters. In conjunction with the tax credit for research, the reforms are also expected to deliver further benefits over the longer term, by fostering investment in R&D.⁵

Nonetheless, all these reforms have a cost and they are still only partial. This can be seen in the difficulties the government is encountering in changing the rules for revaluing the minimum wage – rules which are in part behind the rise in France’s relative wage costs and the weakness in employment. The single most important change we can make to enhance our competitiveness is to reform our education and training system, starting with our system of **apprenticeships**. A recent study by the Eurosystem⁶ found that, over the period 2010-2013, corresponding to the height of the crisis, more than 70% of French businesses said they found it

³ [Pact for the Competitiveness of French Industry: Report for the Prime Minister, 5 November 2012.](#)

⁴ [See Berthou A. and Vicard V. \(2013\) “Firms’ export dynamics: experience vs. size”, Banque de France Working Paper No. 445.](#)

⁵ A study by Banque de France highlights the positive impact of the research tax credit on French R&D. See Bozio A., Irac D. and Py L. (2014), “The impact of the research tax credit on R&D and innovation: evidence from the 2008 French reform”, Banque de France DT-532.

⁶ See “Companies in the crisis – initial findings from a European survey”, Banque de France *Quarterly Selection of Articles*, No. 39, Autumn 2015.

hard to recruit qualified labour: that's the highest percentage in Europe, and this French exception is even more shocking when we consider that, at the same time, millions of adults and young people are struggling under the burden of unemployment.

We also need to extend the debate to look at price competitiveness from a broader, more structural perspective, **and find ways to improve efficiency in those sectors currently sheltered from international competition**. Domestic services value added accounts for a high share of manufacturing exports in rich economies, and notably in France where it exceeds 30%.⁷ Protectionist regulations can ease competitive pressures and increase the bargaining power of firms in regulated sectors that are sheltered from international competition. These protected firms can in turn take a share of their clients' value added and thus make their prices less competitive.

The Macron law has eased regulations in certain professions. However, a lot remains to be done. On the whole, reforms aimed at liberalising markets – be they goods, services or labour markets – can provide a strong stimulus to foreign trade and to economic growth prospects. A study by the Banque de France, based on reforms carried out in other countries, shows that measures to open up markets in France could boost productivity by as much as 6% over the long term.⁸

IV. Extending the debate on competitiveness to the rest of Europe

The challenge of strengthening our economies is made even more difficult by the fact that we are currently at the bottom of the business cycle. Which is why we need **to coordinate our efforts at European level**. And this is precisely the aim of the Macroeconomic Imbalances Procedure (MIP), implemented within the framework of the European Semester. The new system should provide a more efficient tool for tracking and limiting divergences in competitiveness between member states.

The overall **euro area recorded a current account surplus of 2.5% of GDP** for the 12 months ending April 2015.⁹ But this figure only looks good on the surface. It is far too high for an economy that is lagging behind in terms of growth and investment, and it masks significant disparities

⁷ See Vicard V., Le Saux L., "[Les coûts du travail des services domestiques incorporés aux exportations pèsent-ils sur la compétitivité-coût ?](#)", *Bulletin de la Banque de France*, Q3 2014.

⁸ A study by the Banque de France predicts that the reforms to goods and labour markets could deliver productivity gains of around 6% over the long term in France, of which 2.5% would come from labour market reforms and 1.5% from goods market reforms. See [Cette G., Lopez I. and Mairesse J., "Product and labor market regulations, production prices, wages and productivity", NBER Working Paper 20563, 2014.](#)

⁹ Source: ECB.

between countries. The surplus is in fact largely attributable to Germany and the Netherlands and to the downturn in demand during the crisis, notably in southern Europe. However, in the case of Spain in particular, it also reflects the success of the structural reforms implemented during the crisis, which helped to drive trade balances back into positive territory in 2013, after more than 40 years of deficits. As well as highlighting gaps in competitiveness, these disparities within the euro area point to a lack of coordination between demand policies. The introduction of a minimum wage in Germany and the country's courageous decision to welcome large numbers of migrants will - at least in part - lessen the impact of this lack of coordination.

On 21 October 2015 the European Commission adopted a recommendation – which didn't attract anywhere near enough attention – calling for the establishment of national competitiveness boards in the euro area, potentially as part of a European network. The boards would be charged with monitoring the evolution of wages, prices, employment, growth and external balances, and would then formulate recommendations for national authorities and social partners. According to the *Five Presidents' Report*,¹⁰ these boards, together with other elements, should contribute towards the creation of a European Union of convergence, growth and jobs. I think it is important that we achieve this. But let's be clear: contrary to what we sometimes like to believe in France, **this coordination at European level is no substitute for much-needed domestic reforms.** Domestic reforms are an absolute prerequisite if we are to enhance our competitiveness and bolster our credibility in the forthcoming European debate.

I shall hand over now to our first session's participants, and wish you a very enjoyable conference. Thank you for your attention.

¹⁰ *Five Presidents' Report*, 2015, Jeroen Dijsselbloem, Mario Draghi, Jean-Claude Juncker, Martin Schulz, Donald Tusk.