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Export Performances by France and Germany

Report by Lionel Fontagné and Guillaume Gaulier

After a record deficit of €5.4 billion in June, France reported a cumulative year-to-date trade deficit of €28.6 billion. Over the past twelve months, it has edged toward €50 billion. In 2007, there was a negative trade balance of more than €39 million. That meant that France imported more goods than it exported, which has been the case for the fifth consecutive year. For the same period, Germany reported a positive trade balance.

Is this a sign that the French economy is becoming less and less competitive on the world stage? What explains such a poor performance? Which companies are successful at exporting? What special characteristics do they have? Are economic policies necessary? If so, what direction should they take? These are a few of the questions that are addressed directly by the authors of this report, while relying on highly detailed data and drawing up a comparison between France and Germany.

This is not the first time that the issue of French foreign trade has been studied by the CAE. The present report is clearly inspired by an earlier study by Artus and Fontagné (CAE Report no 64, *Evolution récente du commerce extérieur français* (*Recent Trends in French Foreign Trade*) and treats certain questions that were left unanswered. And so, by using new microeconomic data, it offers reasons why conventional microeconomic determinants, which sufficed to clarify trends in French exports, do not elucidate the performance gaps that exist between France and Germany. By using more precise microeconomic data –notably French firm-level customs statistics published by the French Customs and Indirect Tax Department (DGDDI) supplemented by BACI's extensive international trade database, the authors focus their attention on analysing the individual performances of exporters while looking at more than 5,000 product unit values and quantities over a period of about ten years.

The pertinence of a more finely detailed French-German comparison

The report focuses on German and French foreign trade, starting with the basic premise that Germany outperformed France over the period from 2000 to 2005. The interest of comparing these two countries resides in the fact that they share many of the same supply characteristics but have not implemented the same microeconomic policies, nor have they pursued the same venture strategies. Germany is a large European country which, like France, finds itself facing the issue of the appreciating euro and competition from emerging countries. It is also France's most direct competitor, which is why our level of competitiveness is highly dependent on decisions taken in Germany. Thus, a Franco-German comparative analysis is entirely justified.

German and French market shares

The initial observation made in this report is that, relative to Germany, France suffered a loss of market share over the period of 1995-2005, both in terms of inter-EU trade and in terms of trade on outside markets. In that period, France lost 17% of its worldwide market share, as opposed to a mere 2% loss for Germany. By taking a more finely calibrated look at data available for this report, the writers revealed that France performed more poorly than Germany with respect to both high-end products and technological products, especially on the European market. An examination of trade flows at extensive margins (trade creation or trade destruction) and intensive margins (an increase in the value of existing trade flows) suggests that French exporters are creating more new opportunities for themselves on outside markets than are German exporters. However, what they forfeit (by giving up destination markets or product markets where they had established a market presence) effectively wipes out a large part of these gains. German exporters are less mobile than French exporters but have attained unassailable market positions.

Although the authors do not have as highly detailed data regarding the services sector, changes in market share for France and Germany within various service categories between 1995 and 2006 show that, more so than is the case for goods, the erosion of France's market position is striking.

In sum, neither sectoral effects nor the geographic structure of the markets adequately explain the declining performance of French exporters. The explanation is to be found, rather, in the French exporters' dwindling performance, all else being equal.

The role of cost and price competitiveness

To undertake a more detailed examination of the poor results of French exporters, the authors focused on the cost competitiveness of French products while studying, among other things, changes in businesses' labour costs over time. However, such an approach did not entail disregarding the fact that the outsourcing of value-added market segments to low-labour-cost countries (which are then added back into the production process at input level) reduces the price of manufactured goods and automatically raises the apparent productivity of the other factors of production. And so it is outsourcing that reduces unit costs and not the labour costs that drop. Thus the authors' econometric findings suggest that German manufacturers' heavy reliance on outsourcing to low-cost countries is the main reason for out-performance by German firms relative to French firms. Nonetheless, the wage component of labour costs is not negligible. According to the authors, wage restraint, resulting from negotiations on job maintenance at German factories and a reversal of negotiating power between labour and management, due to outsourcing threats, played an important role beyond the cost savings derived directly from outsourcing. Yet they note that French firms may have favoured a strategy aimed at full-scale foreign production, unlike their German counterparts. Unfortunately, available data do not make it possible to reach a conclusion on this point.

The erosion of France's relative cost competitiveness is not very visible based on price-competitiveness indicators: the impact is limited, first, by margin squeezes applied by French exporters, and, secondly, by a selection effect whereby the most cost-competitive companies are overrepresented among exporting businesses and, thirdly, by the fact that price-competitiveness indicators do not concentrate on the Franco-German bilateral relationship but consider, rather, all competitors of a given country. Therefore, the report demonstrates that the relative price erosion in France shows up more clearly in bilateral price comparisons done on a market-by-market basis. In particular, variations in French relative Unit Wage Costs (UWC) are, for the most part, passed through to prices. The inverse correlation between relative UWCs and relative market share is striking.

French Exporting companies

The second part of the report deals with the performances of French exporting companies examined using finely detailed product-level data in order to gain better insight into how exporting firms contribute to export flows.

Export concentration

A drop in the number of exporting companies has been observed since 2003; and while there is a trend toward the concentration of exports has persisted, it is not linked to the drop in exporters: the top 1% of the largest exporters (Top 1000) account for approximately 70% of total exported goods from France, with more than 20,000 new-to-export firms appearing each year. Nonetheless, fewer than 20% of these first-time exporters have a three-year survival rate. This more finely-tuned analysis reveals that France's mediocre performance relative to Germany from 2000 through 2005 is due to the confluence of two factors: first and foremost, a decline on the intensive margin, and, secondly, the entry of fewer new-to-export firms. Export market exits remained stable.

Firm size and export performance

Between 1995 and 2000, export performance grew with firm size, although the inverse was true for the period from 2000 to 2005. The logical conclusion that the authors drew from this was that the largest French exporters have often failed to sustain their export performance in recent years. An explanation offered by the authors is that French exporters shed their market share owing to their inability to match German export competitors in terms of cost and quality, notably because outsourcing to low-wage countries was insufficiently developed in France. Another possible explanation is that large French exporters relied on a strategy consisting of relocating abroad production facilities serving foreign markets. However, no final conclusion could be reached on this point using the data available for this report.

The role of experience in export market entry

An examination of exporting firms, concentrating on more than merely size-related factors, also reveals other interesting conclusions. First, the econometric findings suggest that, during the period from 2000 to 2005, emerging exporters had difficulty enduring over the long haul in the international market. In addition, the findings show a correlation between the number of markets served by an exporter (mainly markets outside the EU, indicating that there was a premium associated with exporting to nearby countries) and its performance. In sum, the dwindling performance of exporting firms between 1995 and 2000 and between 2000 and 2005 is explained by weaker contributions by new-to-export firms, weaker growth by such firms after entering foreign markets, and less robust sales by incumbent firms in the face of unfavourable changes in relative costs, which they cannot pass through into prices, owing to head-to-head competition with German firms. As a result of insourced production strategies developed by large companies, the most dynamic exporters are no longer Top 1000 leaders but, rather, mid-sized firms able to export to a larger number of destinations outside the EU.

The authors make a comparison against German performances. A comparative study of size-based distribution of exporters indicates that, in recent times, mid-sized French firms have reported weaker relative performances than their German competitors. This poor showing is confirmed by a study of trends involving the export of services, which serve as further evidence that France's export difficulties do not emanate from problems of industrial competitiveness but, rather, from a more broad-based problem (even though, much more so than is the case with goods, the export of services requires on-site production and presence, which cannot be monitored with the authors' data.)

Distinctive characteristics of French exporting firms

The first part of the report presents a finely-detailed comparison of the differences between French exporting and non-exporting firms, as well as giving a comparative analysis of French and German firm demographics. In so doing, the authors offer econometric evidence that, all else being equal, French exporting firms tend to be larger, realise higher margins, and perform better (in terms of productivity) than their non-exporting counterparts. This observed correlation raises the question of causality: exportation can be seen either as the reward earned by the most efficient firms or it can be seen as the impetus for efficiency. By comparing annual growth achieved by exporting firms before and after their entry into export markets, the report stresses that, before entering such markets, firms tend to be driven by a dynamic trend in terms of investment spending, hiring and growth in productivity. Although the trend gains momentum up until the time the firm begins exporting, it gradually tapers off once the export markets have been developed. The authors interpret these results as showing that exportation marks the successful culmination of a coherent growth strategy. Moreover, they speculate that a drop in export performance by the largest, yet very profitable, firms is due to the fact that local sales partially replace exports. A comparison between French and German data bolsters the authors' findings by bringing to light the trade deficit incurred by mid-sized French exporters.

Implications for economic policy

In sum, the authors argue that the place occupied by French foreign trade in debates on economic policy misses the real issues. Exploring questions about French and German export performances is meaningful only if by doing so it is possible to identify the specific characteristics of the export sectors of both countries. But a country's export capabilities do not tell the full story of its propensity to create wealth. Nonetheless, the report also offers observations and gives specific politico-economic recommendations in support of exporting activities, thanks to the considerable wealth of data drawn upon by the authors and the statistical and econometric methods used to exploit these figures. One important finding in the report is the fact that France's exporting difficulties involve not only goods but services as well. France's problem is not so much about industry as it is about supply. In addition, the report shows that neither the sectoral structural effects nor the geographical structural effects of the markets explain the downturn experienced by French exporters. The explanation is to be found, rather, in the waning performance of French exporters, all else being equal. On this point, the authors stress that an interesting aspect of the competition between France and Germany relates to outsourcing strategies. Large French firms have opted to set up business and production facilities abroad. Conversely, Germany has staked out its competitive position by favouring supplies of intermediate goods and components from abroad. There is an intrinsic limit to the German strategy: one can rely on outsourcing upstream production only so far; and the consistency of the industrial process might ultimately be called into question (quality control problems, sensitivity to supply interruptions, etc.). It is difficult, of course, to know whether or not German firms are approaching this limit; but it is clear that French firms are farther off. Closing this gap would offer a significant competitive margin.

The above remarks take on their full relevance when considering export-supporting measures. The authors essentially present two findings in their report, which might lead to economic policy recommendations.

The first finding of the report is that French firms need not so much export subsidies as they need more horizontal policies directed at raising efficiency levels of French firms as a whole, thereby enhancing growth potential and, incidentally, enabling a larger number of them to export more products or aim at more destinations. As has been demonstrated by the downturn in the high-tech sector, innovation is at the heart of these policies.

The second finding of the report is that a policy in support of firms seeking entry onto their first foreign market, especially if it is a European Union market, could have two undesirable effects. First, there could be a windfall effect for firms sufficiently efficient to succeed without outside help. At worst, it could enable firms to begin exporting, without efficiency, firm-size, employment or profitability premiums being truly crucial, but with the sizeable risk that the export strategy might fail.

The authors noted that, all things considered, if an exporter-oriented policy is favoured, it should be aimed at exporters having progressed beyond this initial stage and having managed to export to more than one market outside the European Union. That would mean turning to medium-to-large-sized firms and not small firms or first-time exporters. In sum, greater discernment in using assistance, and a more broadly based policy not necessarily aimed at exporters, should be encouraged.

Commentaries

Michel Didier has backed the main findings of the report and has stated that it perfectly illustrates the fact that Ricardo's classical theory on specialised trade, such as wine exchanged for cloth, is largely a thing of the past. From now on, an examination of trade specialisations and trade performance must be carried out using more finely detailed trade data. Exporting countries compete across all sectors and that competition is played out in the choice of exported varieties. We have moved far beyond the simplified view where advanced countries are to be seen as competing in certain industrial sectors and abandoning other sectors to developing countries.

One of the most interesting findings to come from this report, in his view, is the reminder that cost competitiveness must take into account not only the wage and salary component (i.e. unit wage costs) but also input costs, and, more specifically, low-cost country sourcing (representing a price variance of approximately 40% between industrial goods imported from the North and those imported from the South). Thus, this report offers interesting insights into the role of outsourcing: import more in order to reduce costs and in order to export better or more.

Nonetheless, Michel Didier is surprised that the report barely mentions the supply shock arising from working time restrictions implemented in France, coming precisely at a time when the authors have pointed out the differences separating France from Germany. He finds regrettable, too, that the report makes practically no mention of the competition policy expressly put in place in Germany in recent years (labour market policy, the transfer of social insurance contributions to VAT, etc.).

Michel Bouyoux also backs the main findings of the report. He notes, however, that the string of disappointing figures spelled out by the authors—French exporters' loss of price competitiveness, margin slides, drop in profitability, reduced investment capacity, notably in the area of research and development—must be nuanced because the high earning capacity of foreign-based subsidiaries bolsters the profits of French companies. Other indicators, such as return on capital, which factor in capital return, or capital yield which takes into account the cost of debt, do not show that France and Germany are out of sync. Hence, the link established to investment power is precarious: investment has been especially robust in France since 2004, with return on investment in 2007 surpassing the level attained in the beginning of the 2000s, although it remains still lower in Germany. Also, the causal relationship between earning power, innovation and exports, which is addressed in Appendix A «Externalisation à l'étranger et performances à l'exporation de la France et de l'Allemagne» («Foreign outsourcing and export performances of France and Germany») warrant further development. First of all, although trends in mark-up rates can be used to explain part of the divergence in export performance between France and Germany observed since 2000, the finding is not valid for the prior period. And so, in Bouyoux's view, these factors have more to do with coincidence than with causality.

Michael Bouyoux also notes the predominant role that the report's authors have attributed to collective bargaining to explain wage restraint in Germany. That point does not seem adequately supported, in his view, and requires analysis in further detail before being accepted as established fact.

As regards one of the major contributions of the report, namely, its highlighting of the causal relationship between company performance and econometrically tested export in Appendix D «Plus grandes, plus fortes, plus loin: performances relatives des firmes exportatrices françaises» (Bigger, Faster, Farther: relative performances of French exporting firms»), Philippe Bouyoux states that findings derived from econometric estimates should undoubtedly be interpreted with caution, insofar as the productivity growth differential between exporting firms and non-exporting firms is significant only for the year preceding engagement into export activities.

As regards the authors' recommendations on economic policy, those pertaining to the need to give precedence to supporting exporters who have moved beyond the initial stage of first-time export market entry and who have succeeded in exporting to more than one market requires further nuance, in Bouyoux's view. He believes that it would be difficult, in fact, not to lend support to more modestly-sized SMEs wishing to embark on an export initiative—and thus aimed at an initial export market—and exclude them *ex ante* from taking advantage of the planned measures. Developing an initial export activity in nearby countries, where risk is low, also serves a means for small companies to grow and attain a critical mass that would allow them to export farther away and tap into more export markets. Conversely, Bouyoux affirms the authors' recommendations particularly as regards the need to support «medium-sized» firms and also foster the long-term viability of SME export activity, regardless of their size.

Mathilde Lemoine argues, for her part, that the development of the automobile industry probably goes a long way toward explaining the productivity growth differential between France and Germany. Thus, a sectoral approach must not be disregarded. Specifically, the automobile industry's poor export performance alone could presumably account for nearly 42% of France's market share slump in the Euro Zone since 2004, and 37% of France's decline in market share in Germany. In that light, France's underperformance can be seen as stemming, in part, from the end of the automobile cycle characterised by automobiles reaching the end of their useful life. Such an analysis thus points up the cyclical nature of its export underperformance without underestimating the negative consequences. Indeed, Mathilde Lemoine has remarked that although she shares the authors' belief that an analysis of market share trends is «interesting in that it gives a good picture of the economy's performance in terms of supply,» it has to be supplemented by an analysis of terms of trade. However, the latter have tended to be unfavourable for France since 2004, and the country has grown poorer. Lastly, she notes that her observations and the findings obtained in this report suggest a necessary interrelatedness between horizontal and sectoral economic policies.

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113 rue de Grenelle 75007 Paris (FRANCE) Ph.: (33-0)1 42 75 53 00 – Fax: (33-0)1 42 75 51 27
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