Re-Industrialising the Eurozone

Jean-Luc Gaffard
OFCE Sciences-Po and SKEMA Business School

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- Which difficulties between countries belonging to the Eurozone?
- What kind of industrial policy do firms need?
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WHY INDUSTRIAL POLICY BECOMES AGAIN FASHIONABLE IN THE EUROZONE?

Why in each country

- Delocalisation, deindustrialisation, jobs destruction revived a demand for industrial policy intervention
- Globalisation, increasing competition among firms reduce the *time* and the *margin* they have to gather *the necessary information and mobilise the required resources*

Why in the Eurozone?

- But there is now a new and very dangerous problem in Europe: the increasing real divergence between European countries
- Both in terms of industry development and in terms of trade balance
- Which feeds the obsession of competitiveness

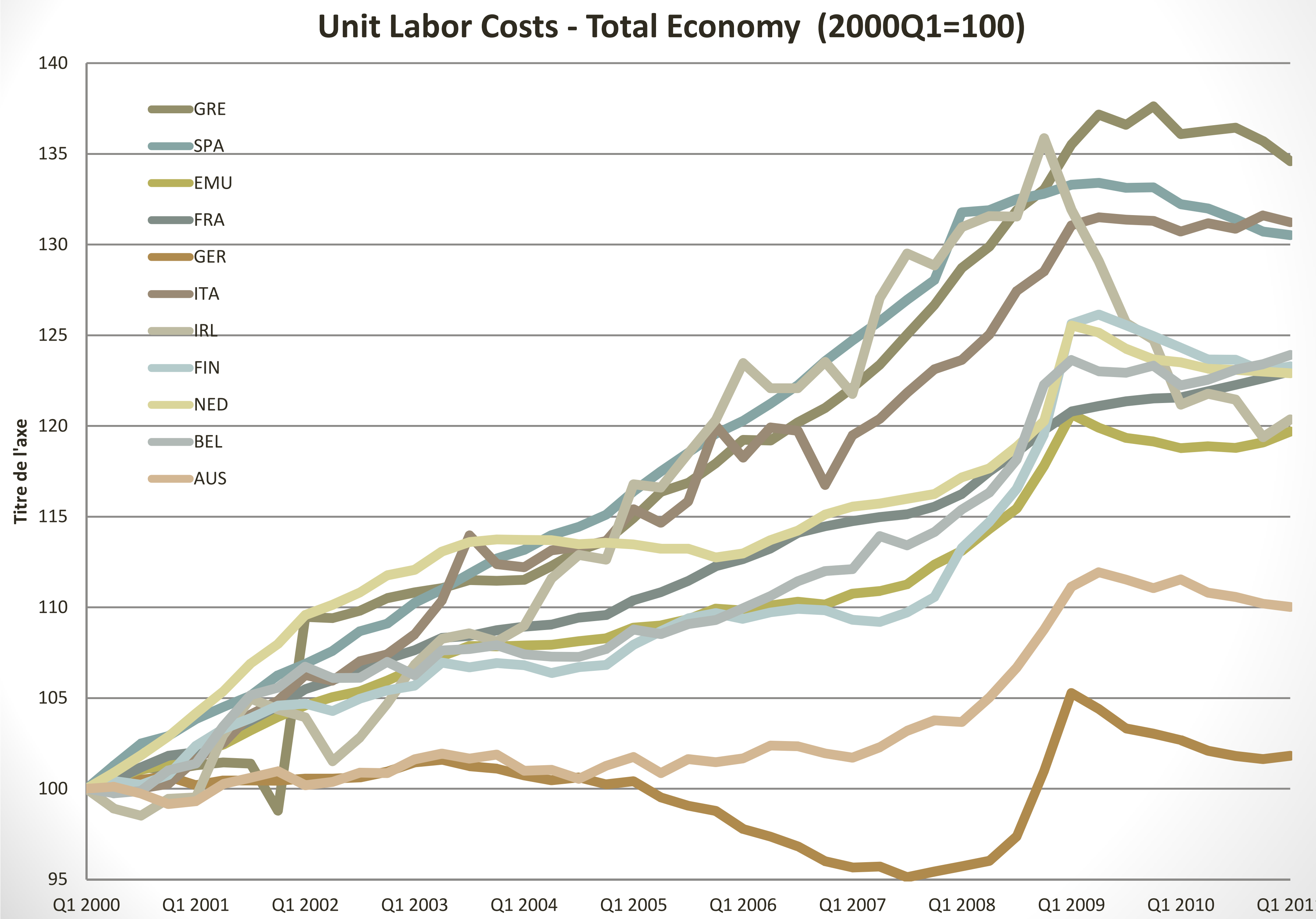
WHICH DIFFICULTIES BETWEEN COUNTRIES BELONGING TO THE EUROZONE?

Macroeconomic issues

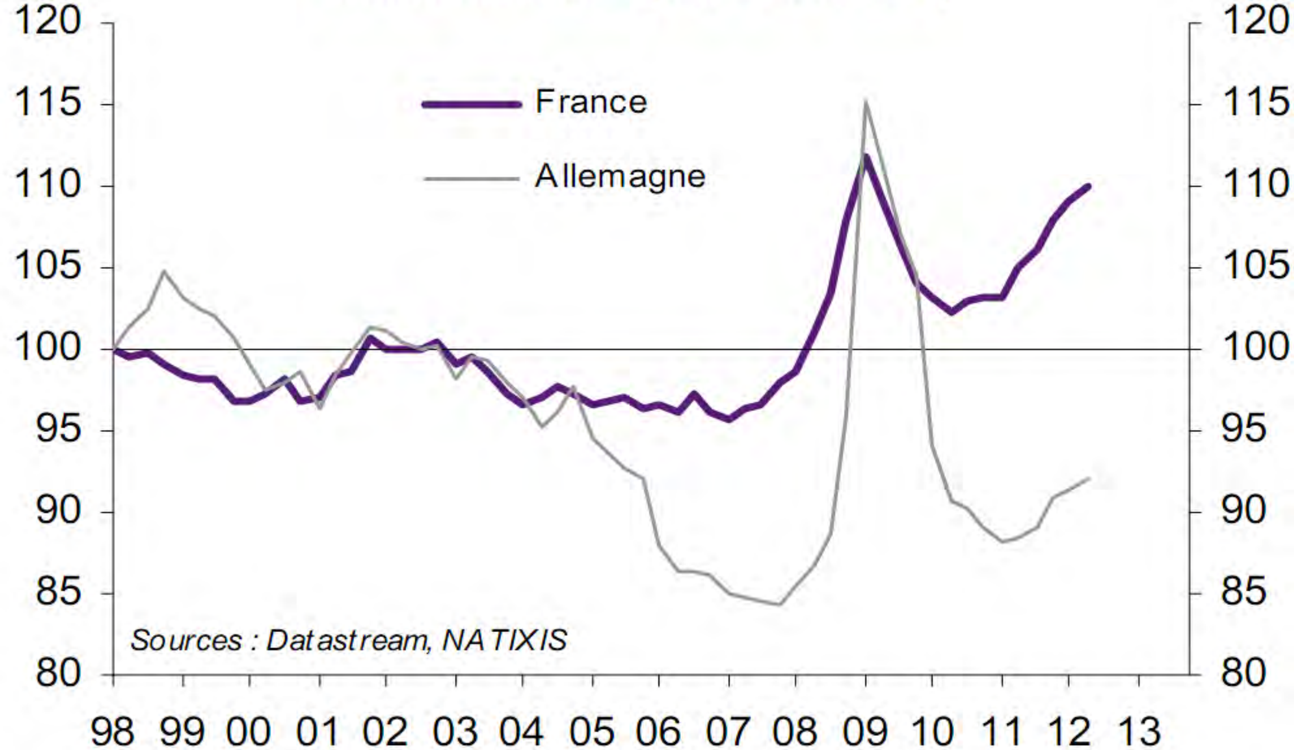
- Real divergences in economic performances (growth rate, unemployment, trade balance) mainly between France and Germany
- In a context characterized by a low final demand, which involves a more intense struggle for market shares among the firms, particularly in the manufacturing sector

Competitiveness issues

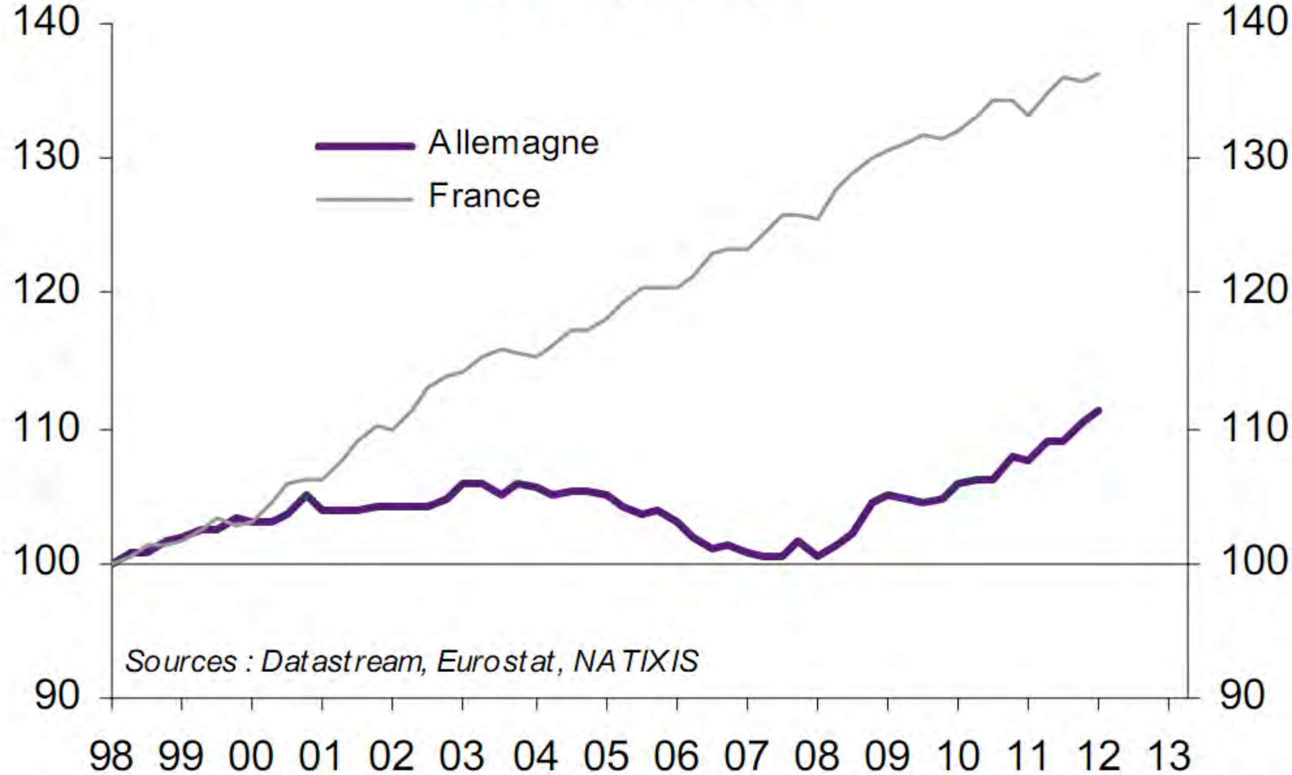
- The unit labour costs rose much faster than average over the past decade in credit boom countries like Greece and Spain.
- In France and Italy, unit labour costs rose when wages grew faster than productivity.
- In Germany, outsourcing in foreign countries, weak domestic demand and wage restraint meant that costs remained more or less flat.

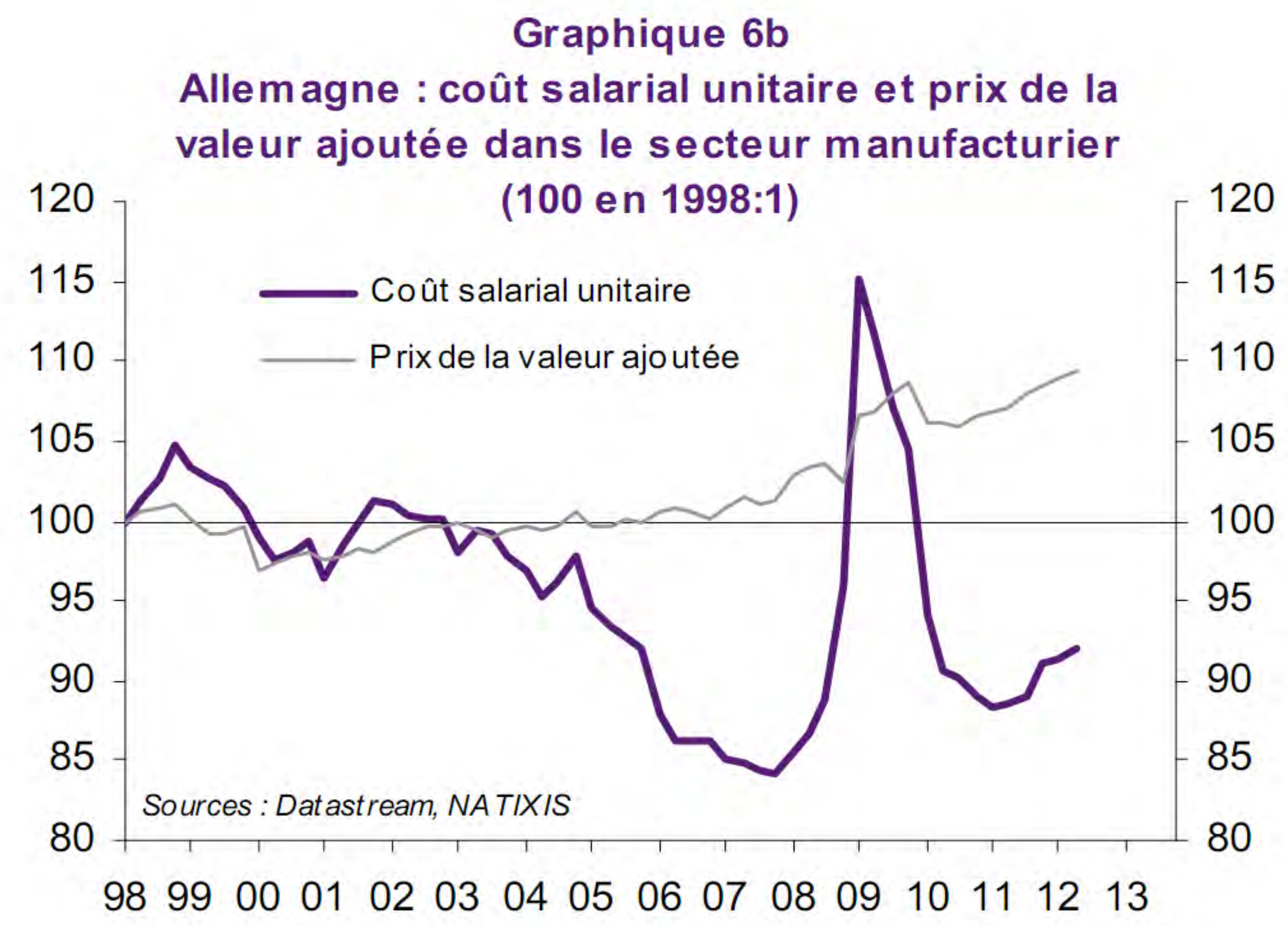

Unit Labor Costs - Total Economy (2000Q1=100)
140
135
130
125
120
115
110
105
100
95
Titre de l'axe
Q1 2000
Q1 2001
Q1 2002
Q1 2003
Q1 2004
Q1 2005
Q1 2006
Q1 2007
Q1 2008
Q1 2009
Q1 2010
Q1 2011
GRE
SPA
EMU
FRA
GER
ITA
IRL
FIN
NED
BEL
AUS

Graphique 1
Coût salarial unitaire dans le secteur manufacturier (100 en 1998:1)



Graphique 2a
Coût salarial unitaire hors manufacturier
(100 en 1998:1)

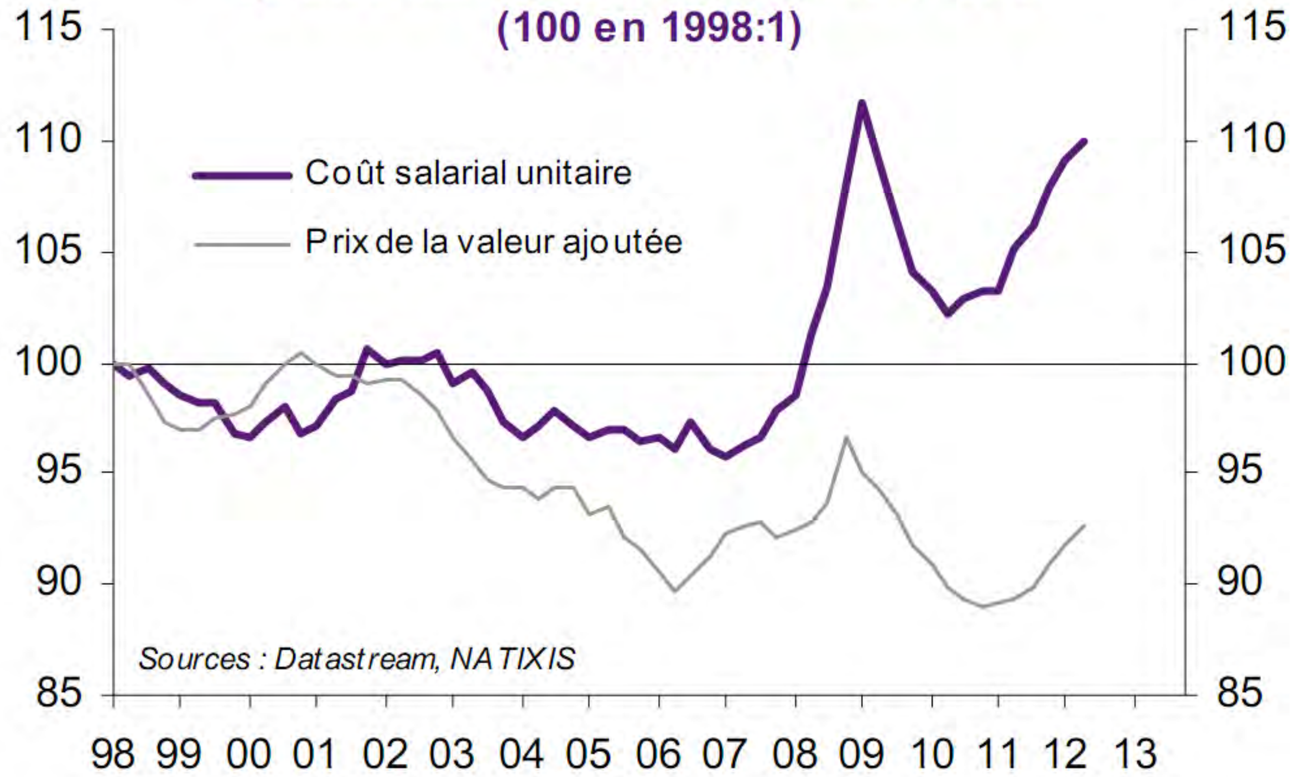



Graphique 6b
Allemagne : coût salarial unitaire et prix de la valeur ajoutée dans le secteur manufacturier
(100 en 1998:1)
120
115
110
105
100
95
90
85
80
Coût salarial unitaire
Prix de la valeur ajoutée
Sources : Datastream, NATIXIS
98 99 00 01 02 03 04 05 06 07 08 09 10 11 12 13

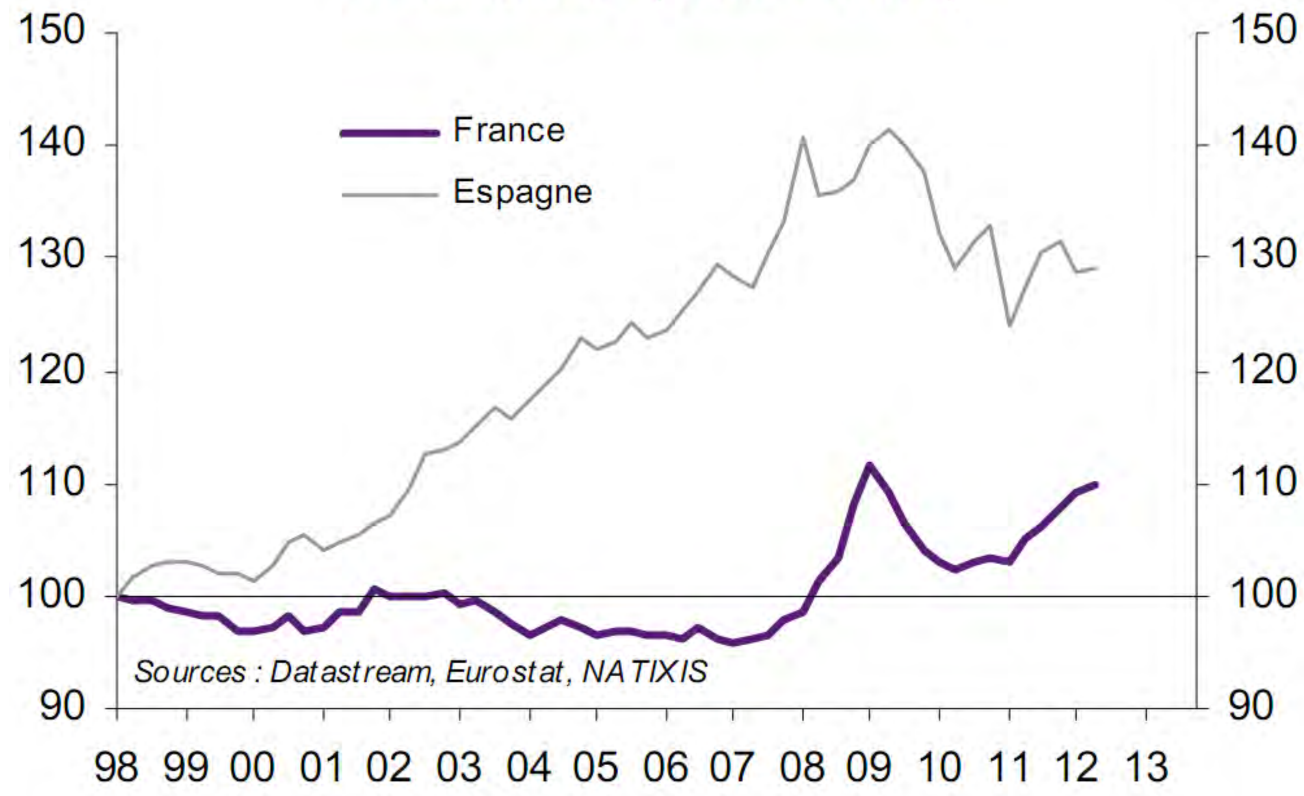
Graphique 6a

France : coût salarial unitaire et prix de la valeur ajoutée dans le secteur manufacturier

(100 en 1998:1)



Graphique 4
Coût salarial unitaire dans le secteur manufacturier (100 en 1998:1)



Industrial issues: a new polarization Germany …

- Dense and stable group of medium-sized firms (16,000 firms from 500 to 5000 employees)
- Production segments outsourced in low-cost countries with highly qualified employees
- Real wage costs (taking into account the labour costs of countries in Eastern Europe) are about 20% lower than those of other countries in the euro area
- As many industrial jobs created as outsourced jobs

… France

- Large firms, high performances on global markets, specialized in some specific business (energy, environment, luxury goods …)
- Relocation of large parts of final production in countries with low costs and low qualifications
- Too low number of medium-sized firms (4000 firms between 500 and 5000 employees)
- SME are too rapidly sold and acquired by large firms when they succeed

… and Spain

- As a consequence of the crisis and fiscal consolidation, there is a drop in real wages
- This drop and the substantial increase in productivity have made Spain more competitive by comparison with its European partners, particularly with France
- The country’s trade deficit has been substantially reduced in part because rising exports

Lessons from a comparison

- Before the crisis, in the manufacturing sector, the total firm turnover (entry + exit) is about 3% in Germany while it is about 11% in France
- Moreover, firm exit outpaced firm entry in France (6.5% against 4.5%) while a balanced pattern is found in Germany
- Entry and exit are positively correlated in Germany while negatively correlated in France

Lessons from a comparison

- If we look at the orientation of industrial policies in each country, strong differences can be observed
- The state aid as a percentage of x100 GDP is much more important in Germany than in France (54.4 against 33.5 for horizontal objectives; 90.5 against 56.4 for the total less railways);
- And is more oriented to environment (31.7 against 0.6), and regional aid (11.8 against 6.3), less oriented to employment (0.6 against 6.7), R&D (6.7 against 8.0), and SME (2.0 against 7.9).

Lessons from a comparison

- Both environment and regional aids are aimed at creating market information and market conditions that help firm to invest by reducing uncertainty.
- By the way, the successful areas of German economy are successful because they do not have flexible labour markets in the conventional sense
- France has not elaborated a fully coherent industrial policy framework
- The nature of aid and the size of regions are the main differences between the two countries

WHAT KIND OF INDUSTRIAL POLICY DO FIRMS NEED?

Sector-based policies

- Sector-based policies are policies aimed at protecting sectors (and firms) from market forces and current competition.
- They consist in entry barriers, trade barriers, employment subsidies or import- substitution policies

Horizontal policies

- Horizontal policies correspond to a broader interpretation of industrial policy
- They are aimed at supporting firms engaged in competition on free markets, and favouring market selection
- They include anti-trust and regulation policies, but also supply-side policies that are concerned with the labour and the financial markets

Industrial policy deficiencies

- According to the standard theory, market failures must be eliminated or compensated:
- Thus, how government ought to intervene depends on the characteristics of the industry (technology, preferences, information)
- But these characteristics are not really known by policy makers
- As a consequence many subsidies could be inefficient, when they do not turn into waste

Industrial policy deficiencies

- This is true, by definition, for sector-based policies. This is also true for some horizontal policies
- Fixing R&D subsidies requires to know the real content of knowledge spillovers
- Subsidising human capital accumulation requires to know the market failures that affect the training of human capital
- Reducing the gap between the existing market structure and the optimal one, requires to precisely identify the former

Towards a market-friendly policy?

- Therefore, the only eligible policy would be the policy that focuses on the working of markets and consists in reforms that liberalise these markets
- This option is questionable: believing that full competition might be a benchmark is a dangerous obsession, which may also turn into waste
- Facilitate the working of market forces is not the same thing that looking for the conditions of full (perfect) competition

Competition: a new view

- Firms are not only concerned with incentives in industries well co-ordinated
- They have to face co-ordination failures: market imbalances and resources constraints
- Market connexions or market imperfections are required as means of co-ordination
- These imperfections are in the nature of a market economy and do not prevent competition as rivalry

The co-ordination issue

- A specific co-ordination problem is involved due to the existence of two delays
- On the one hand, investment represents a firm commitment, and this commitment give rise to an additional output only after a certain interval of time elapsed
- On the other hand, entrepreneurs will learn about the commitments of others, and also about the needs of customers only after a certain period of time

The need of restrictive practices

- Thus, co-ordination through market transactions is only possible by virtue of existence of circumstances which set bounds to what happen, in particular to investment behaviours.
- This is provided by natural or contrived restraints, which permit industry converging towards a coordinated state
- and which orientate instruments and objective of industrial policies.

Natural and contrived restraints

- There are natural restraints: indeed, the differences among firms in the ability either to foresee a profit opportunity or to increase production in response to it
- There are contrived restraints: indeed, agreements between firms that compete with each other or between firms and their customers
- Typically R&D agreements that allow firms sharing heavy costs, but also and mainly sharing the market information, which is made available only step by step, with the effect of coordinating competitive investments

Industrial policy targets

- Policies oriented to ameliorate industry performances must be aimed at giving more *information about market conditions* to firms, and helping them to innovate and grow,
- They must be aimed at creating a *more stable environment* for them, and then should help industries converging towards a dynamic equilibrium.

Industrial policy means

- Rather than to be sector or technology based *per se*, industrial policy must be an array of horizontal interventions that *target the relations* between firms, between firms and their employees, between firms and financial intermediaries, between firms and public research institutions
- Subsidies must not devoted at supporting national champions or high tech sectors, but at *encouraging cooperation* among firms, including firms that compete with each other.

Competition policy

- Competition is not only aimed at equalising supply and demand in a given environment. It has also to adapt both structure and and technology to fresh opportunities created by expanding markets
- Therefore, competition policy cannot be conducted without considering the distortions that are in the nature of the growth process, and the necessity of agreeing with some market connections or imperfections.

Competition policy

- Market imperfections are necessary to convince firms to carry out innovative investment and, as such, they are not something to be systematically condemned.
- Competition and regulation policies have to take into account the possible divorce between static and dynamic efficiency, and support restrictive practices that enhance innovation and growth
- As industrial policies, they must be *discretionary* policies rather than to be reduced to the enforcement of given rules.

Labour markets policies

- The prevailing view is that the possibility of hiring and firing freely, and offering wages at a freely chosen level, is an incentive to invest and hence to favour innovation and growth.
- The argument is that the higher levels of productivity are obtained by firms operating in high tech sectors and that these sectors are characterised by strong rates of creation and destruction of jobs
- Dismissal costs (employment protection) would reduce incentive to invest

Labour markets policies

- However, because it increases job tenure and, through this channel, favours on the job training, employment protection also affects human capital accumulation, and hence productivity
- Thus labour markets policies, far from being oriented to the dismantlement of the welfare state, should promote creation of skills through forms of bargaining between employers and employees that help adaptation to technological and market changes.

Regional policies

- Industrial policies have a territorial dimension insofar as there are local learning processes; they have to promote the development of clusters
- But local governments are not better informed than the national government, can also be easily captured by lobbyists, and have not a higher degree of competences
- Moreover, competition among regions can be wasteful, enhancing inequalities and affecting global efficiency

Regional policies

- We can make the conjecture that the smaller is the region size, the more wasteful competition among them will be.
- This might be because small regions are more inclined to compete with each other by promoting generic advantages such as tax reductions or set-up subsidies, which reduce the sunk costs but make setting-ups more instable
- While larger regions would be more inclined to promote cooperation between firms within and outside the territory, and to pay subsidies, aimed at sustaining large public programmes such as environmental programmes

WHICH INDUSTRIAL POLICY FOR THE EUROZONE?

The European challenge

- Re-establishing the conditions of a real convergence
- Which means re-establishing a balanced trade between the large European countries
- And, thus, re-industrialising some parts of the Eurozone
- This requires reconsidering both national and European policies that are growth enhancing, that is, competition policy, labour policy, regional policy, but also industrial policy *stricto sensu*.

An industrial policy for the Eurozone

- Giving-up the idea that supply reforms that would make the labour market more flexible in each country would reinforce the competitiveness of each one without damage for global demand and growth at the European level.
- Introducing an industrial cooperation that would take the form of technological programmes in the field of environment, energy and applied research.
- The main reason for developing such programmes is that they are transversal both in regard of activities, firms and countries. They make it credible for firms to invest
- Each country could benefit from such programmes in terms of development of some industry segment.

Why reconsidering macroeconomic policy?

- Any change in the industry landscape in Europe will be possible only if a new macroeconomic policy is under way
- As a matter of fact generalised austerity is going to destroy large segments of industry in Europe
- Even if fiscal consolidation is a necessary part of a rebalancing strategy, it is vital that countries with large surpluses take action to stimulate demand