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FRENCH INDUSTRY: A CHALLENGE OF SCALE

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The issue of de-industrialisation is often raised in France. Indeed, manufacturing now represents only 13% of GDP and 12% of payrolls (against 19% and 15% respectively in 2000).

Capacity in French industry peaked in the early 2000s, before experiencing multiple setbacks; in parallel, industrial employment fell, and the trade deficit widened.

Production capacity has reduced further in recent years and is nearly 20% lower than it was in the early 2000s. Although order books are overall the same as in 2018, production capacity is nearly 6% lower, which may explain why French industry is struggling to keep up with demand.

A rebuilding of production capacity would be possible. Two necessary conditions for this are the cost of labour and an environment favourable to corporate investment.

EUROPEAN UNION: SHARE OF THE INDUSTRIAL SECTOR IN % OF GDP

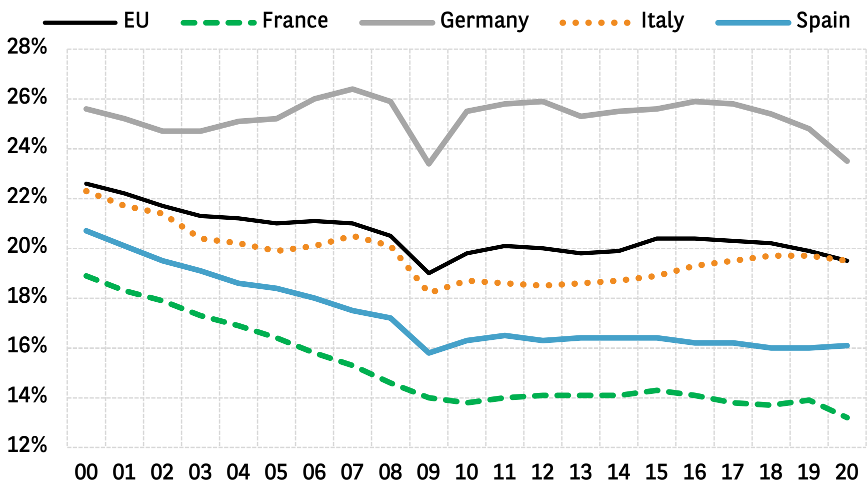

CHART 1

SOURCE: EUROSTAT

INDUSTRY, SYMPTOM OF A FAIRLY LONG-STANDING UNCOUPLING

De-industrialisation is often seen as one of the manifestations of a relative decline of the French economy. The fall in industry's weighting in GDP is completely natural given the development of services. However, industry's share in France has fallen further than those in Germany or in Italy (chart 1): in 20 years the gap has increased from 7 to 10 points and from 3 to 6 points respectively.

Industrial employment also contracted from 2001, although its decline ceased in 2017. That said, industry is amongst the economic sectors to have benefited least from the post-Covid recovery in employment, despite a favourable overall trend in the French labour market. In the 4th quarter of 2021, industrial employment was still nearly 40,000 below its end-2019 level, compared to increases of nearly 65,000 and 220,000 jobs in the construction and market services sectors respectively.

The purpose of this article is to examine whether de-industrialisation has stabilised or resumed in the recent past. It does not exclude an increase of the value added of the sector, as well as productivity gains. However, the size of the manufacturing is likely to have decreased as suggested by the manufacturing output (10% loss compared to 20 years ago).

Production capacity in French industry is an objective indicator in considering the de-industrialisation issue. Capacity can be derived from the utilisation rates of productive capacity and the index of industrial production.

This calculation does indeed show that production capacity has fallen steeply from its peak in the 2000s (chart 2)), although some short-run variations were more driven by transitory factors than permanent destructions. Over the past 20 years, industry has shrunk not only in relative terms (compared to other countries where it has expanded) but in absolute terms too. Crises tend to destroy capacity, which is then only very partially rebuilt. Thus repeated shocks have played their part, with a hysteresis effect each time: the pre-crisis level was not regained. This does not exclude a partial rebuilding of capacity after each crisis, but on each occasion, capacity was not restored in full.

In parallel with these trends, sectors where capacity has fallen have seen an increase in imports and a deterioration of their trade balance, contributing to the slippage in France's overall balance of trade (chart 3). In 2021, the deficit on industrial goods (excluding agricultural and food products) was nearly EUR 50 billion out of a total trade deficit of EUR 85 billion.

INDUSTRIAL PRODUCTION CAPACITY HAS FALLEN AGAIN IN RECENT TIMES

After flatlining for a long period in the early 2010s, industrial activity seems to have seen something of an upturn from 2016, which affected both production capacity and employment. This came alongside a rapid acceleration in growth in France (and elsewhere), providing favourable conditions.

However, by the end of 2019 production capacity was already more than 2% lower than at the end of 2018 (chart 4), and the pandemic does seem to have accelerated this decline. The end result is that production capacity is now nearly 6% lower than in 2018.

Notwithstanding this situation, order books in manufacturing industry have increased significantly, reaching 5 months of production, equivalent to their 2018 level (chart 4). Industry therefore appears to be short of capacity to respond to demand. This could contribute to an extension of delivery lead-times, coming on top of other factors such as shortages of semiconductors, plastics, metals and packaging.

Production capacity have peaked after 2018, when problems specific to certain sectors emerged. At the time, consumer demand started to weaken, primarily because of higher oil prices hitting purchasing power. The supply did not adjust immediately, leading to an increase in inventories (chart 5). This phenomenon was particularly noticeable in the automotive sector where, for a number of months, production remained above the level of new registrations.

Regulations added somewhat to the pressure on demand. Most importantly, from September 2018, the introduction of the Worldwide Harmonised Light Vehicle Test Procedure (WLTP) caused German automotive production to dive, with knock-on effects for French companies in the supply chain. Meanwhile, residential construction suffered from the narrowing of the scope of application of government measures (notably the Pinel Law) to cover just those areas under pressure. The metals and plastics/rubber markets were affected by the reduction in demand from these two sectors, which are their main clients. There were also sector-specific issues, such as the crisis in the paper sector.

PRODUCTION CAPACITY IN THE INDUSTRY

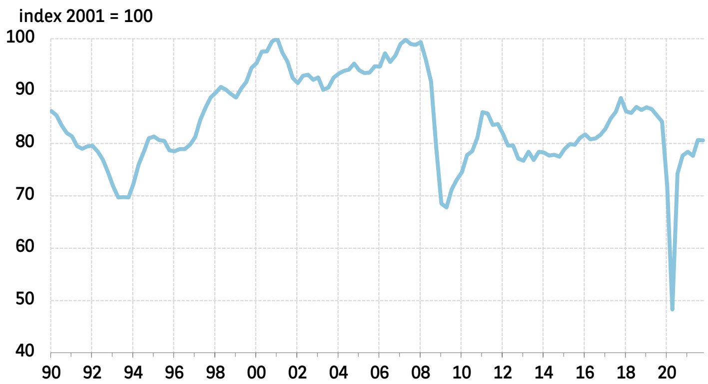

CHART 2

SOURCE: BANQUE DE FRANCE, INSEE, BNP PARIBAS CALCULATIONS

FRANCE: TRADE BALANCE BY SECTOR (EUR BN)

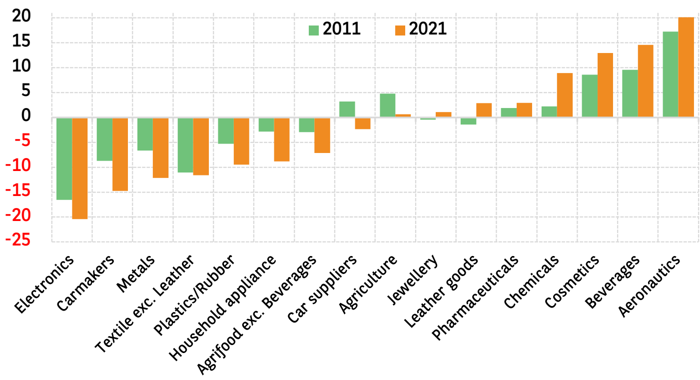

CHART 3

SOURCE: CUSTOMS, BNP PARIBAS CALCULATIONS

FRANCE: BACKLOG OF ORDERS VS. PRODUCTION CAPACITY IN THE INDUSTRY

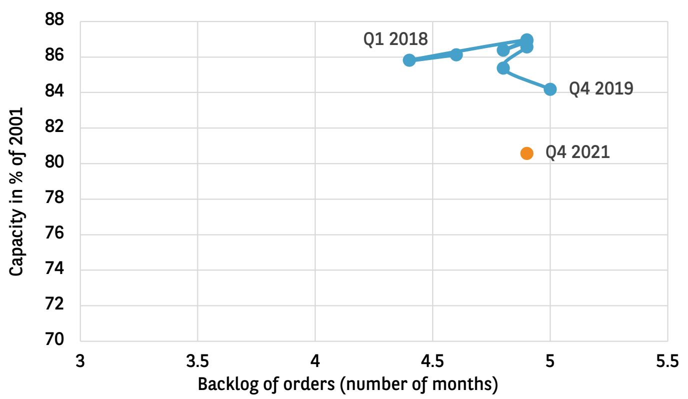

CHART 4

SOURCE: BANQUE DE FRANCE, INSEE, BNP PARIBAS CALCULATIONS

Business insolvencies in these sectors increased and production capacity was lost as a result. Subsequently, the issues in the automotive sector increased in early 2020, which resulted in car-makers scaling back production. Shortly afterwards, the Covid-19 crisis increased economic uncertainty, resulting in companies further scaling back production capacity, notably in the aeronautics sector.

However, demand recovered faster and more strongly than expected, something companies were unprepared for. GDP in 2021, for example, was nearly 3% higher than the IMF predicted in October 2020. The lag created by overly conservative expectations was exacerbated by an international context of shortages and extended delivery times. This has all resulted in a persistent shortage of inventories of finished products (chart 5).

Since then, companies have invested heavily in a bid to make up for this shortfall in capacity. This has been one of the drivers of their gross fixed capital formation in recent quarters, under the headings of 'goods' and 'construction' (chart 6). However, this has made up only a very small share of the capacity lost since 2018.

LABOUR COSTS: THE USUAL SUSPECT, BUT NOT THE ONLY ONE

The deterioration of the trade balance over the 2000s and the parallel reduction in the weight of industry in GDP began during a period of growth.

Relocations of business activity to Central European countries took place during the same period, following their accession to the European Union, from which they benefited in terms of EU funds and a marked increase in foreign investment.

More generally, one of the causes for the slippage of French industry has been the increase in labour costs, which were significant up until 2012 (chart 7).

The increase was bigger than in Germany, where labour cost growth was moderated by the Schröder administration's labour market reforms (notably the Hartz measures).

In the subsequent decade, wage trends have gone in the opposite direction. Germany has seen wage growth accelerate due to its low unemployment rate. Conversely, persistent unemployment limited wage growth in France, whilst various measures were introduced to reduce employment costs (Crédit d'Impôt Compétitivité Emploi, Pacte de Responsabilité), leading to a relative stability of labour costs (including social security costs) between 2012 and 2017, closing the gap in terms of unit labour costs that had opened to Germany.

This period saw a rebuilding of productive capacity in industry of nearly 10% between 2015 and 2018. Underpinning this trend, and that in employment, company investment received two additional sources of support that helped revitalise investment: the low level of interest rates, as a result of the ECB's Quantitative Easing programme, and the extra depreciation allowed for productive investment that helped companies to cut their tax bills.

When one looks for causes for the stabilisation of productive capacity since 2018, it is harder to pin the blame on the cost of labour; apart from anything else, the period before the Covid-19 crisis hit was fairly short. This said, growth in industrial employment had already ground to a halt in the second half of 2019, even before it took a further hit from the pandemic.

In comparison with Germany, it seems clear that France suffers more from international competition than does its neighbour. Its exports are

FRANCE: INDEX OF INVENTORIES IN THE INDUSTRIAL SECTOR

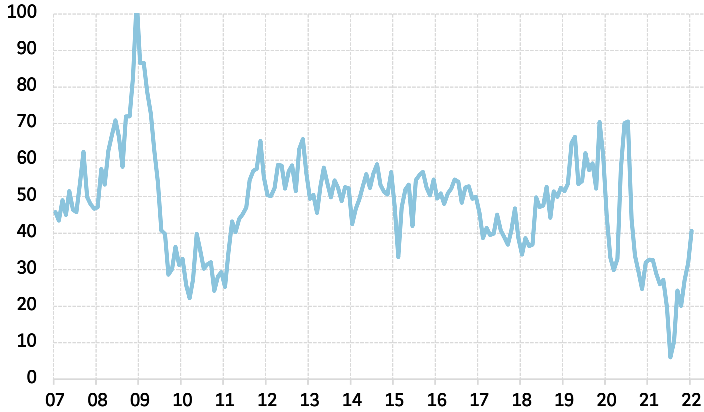

CHART 5 SOURCE: INSEE, BNP PARIBAS CALCULATIONS

FRANCE: CONTRIBUTIONS TO GROWTH OF THE INVESTMENT OF NON-FINANCIAL CORPORATIONS

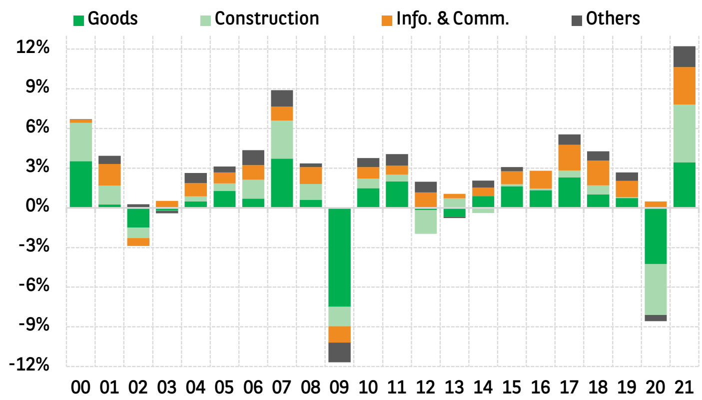

CHART 6 SOURCE: INSEE

FRANCE: LABOR COST INDEX PER HOUR IN THE INDUSTRY (INCL. SOCIAL CONTRIBUTION)

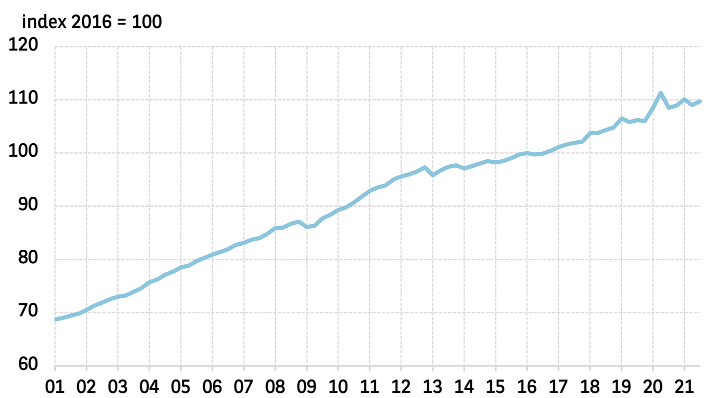

CHART 7 SOURCE : INSEE

less complex and thus relate to goods (or levels in the range) where this competition is from a larger number of countries (chart 8). The issue of cost competitiveness thus acquires greater importance, making cost control a necessary condition of re-industrialisation.

Since mid-2020, corporate investment effort has increased, suggesting a positive future for French industrial production capacity. The fact remains that in a period when interest rates look set to rise, this effort is set to become more costly. In order to avoid breaking the momentum, measures to encourage investment and, more generally, to attract business to France could be helpful.

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COMPLEXITY INDEX OF EXPORTS
A HIGH INDEX MEANS MORE COMPLEX EXPORTS

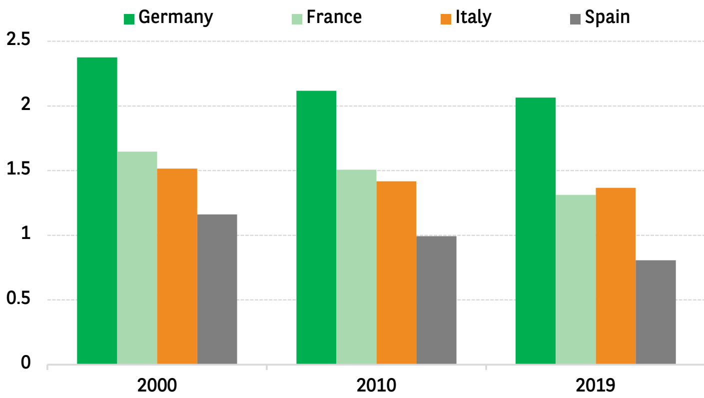

CHART 8

SOURCE: HARVARD GROWTH LAB

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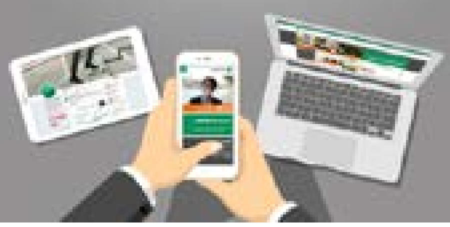

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