Comments on "European Productivity Growth Since 2000 and Future Prospects"

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ABSTRACT

These comments provide historical and institutional context for the article "European Productivity Growth Since 2000 and Future Prospects", by Bart Van Ark, Vivian Chen and Kirsten Jäger. They identify and discuss the "financialization" phenomenon whereby easy and creative finance led to speculative booms and busts in a number of countries such as Spain. Labour market reform in Germany, which improved that country's competitiveness and increased resilence to recessions, is also discussed.

RÉSUMÉ

Ces commentaires fournissent le contexte historique et institutionnel de l'article «European Productivity Growth Since 2000 and Future Prospects» de Bart Van Ark, Vivian Chen et Kirsten Jäger. Ils identifient et discutent du phénomène de la «financiarisation», dans lequel la finance facile et créative mène à des surchauffes et des ralentissements spéculatifs dans de nombreux pays tel que l'Espagne. Les réformes du marché du travail en Allemagne, qui ont amélioré la compétitivité du pays et sa résilience aux récessions, sont également discutées.

THE ARTICLE "European Productivity Growth Since 2000 and Future Prospects", by Bart van Ark, Vivian Chen, and Kirsten Jäger represents an ambitious and instructive study encompassing an unusually large set of productivity and competitiveness issues facing Europe and its major member states. The article focuses on the 2001-2011 period and analyzes the sources of growth over two sub-periods (2001-2005 and 2006-2011). It shows how the relative positions of France and Germany have been reversing between the first and the second sub-periods. The same reversal has occurred between Spain (initially remarkably successful) and Poland, which in the second sub- period appeared as the new success story.

Success and failure seem to be tied to the ability of total factor productivity (TFP) in the goods sector to bounce back after the 2009 fall. This is especially true for German industry, where TFP was badly hit in 2009 but by 2010 the losses had been more than offset, showing a remarkable capacity to rebound despite the growth environment still prevailing outside Europe.

An analysis of the factors at work in the developed economies in the first decade of the 21st century reveals some major changes in the economic environment. The 2000s are characterized by the major role played by the financial sector. To put it bluntly, in the 1990s the finance sector seemed to play a Schumpeterian role of intermediation, boosting innovations in all sec-

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tors, be it manufacturing or services, with a key role played by the diffusion of ICTs (of which the internet was a rapidly emerging major component). But the successive financial crisis of 1997 (East Asia), 1998 (Long-Term Capital Management) and 2001 (dot.com crisis) led the financial sector to retreat and to promote its own innovations (including securitization) and to expand its range of operations. The entire decade was thus marked by what has been called a "financialization" of the developed economies, echoing the rising importance of short-term financial criteria in most decisions. The introduction of the euro at the very beginning of the period under view acted as a facilitator of this process of financialization across EU countries. As we shall see, this development is not without important consequences for the evolution of European economies, as captured by the data presented in van Ark, Chen, and Jäger (2013).

This turn of events was not the only structural change occurring in developed economies. Another major change, which largely caused the financialization just mentioned, was the liberalization of trade and capital flows, which gained momentum in the early 1980s. This trend put pressure on developed economies to remain competitive faced with low-wage countries that were rapidly catching up in terms of technological capabilities. The resulting shift of wealth in favour of developing economies has been enormous over the last three decades. Economic growth rates have been roughly halved in major OECD countries while a set of emerging economies enjoyed growth rates of an order of magnitude even bigger than those achieved by the OECD countries during the "golden years of capitalism". Overall the rebalancing of the world wide distribution of wealth has been beneficial in reducing absolute poverty and inequality among nations.

But this global shift has been accompanied by a widespread rise in inequality within countries, closely linked to the manner in which countries adjusted to this new environment of more intense international competition. The challenge for high-wage countries became clear, with adjustments varying by country. Some countries such as Germany fundamentally transformed their labour market, while others like France made much more moderate labour market changes. Whether or not these adjustments have been implemented is thus an important element in the assessment of the competitiveness of EU countries.

In addition to the importance of identifying and analyzing structural changes before any diagnosis of productivity and competitiveness trends, it should be noted that the two sub-periods used in the study are rather heterogeneous. The 2001-2005 sub-period starts with a trough, following the dot.com crisis, and ends with a peak in the mid-2000s while the 2006-2011 sub-period goes from a relative peak to a relative trough, following the major financial and economic crisis that occurred in 2008 and 2009 in the middle of the sub-period.

The financialization phenomenon calls for caution regarding the analysis of the trajectories of countries like Spain, celebrated as a "model" up to 2008. Easy and creative finance fuelled a speculative boom in construction in this country, which collapsed once the global financial crisis hit. Other "models", such as Iceland or Ireland, had similar short lives (despite praise by economists). But these "models" were rightly kept out of the analysis undertaken in van Ark *et al.* (2013).

The case of the UK has to be looked at with caution because of the importance of the role played by this country's financial sector in global financial activity. Indeed, the reregulation of finance that is on the agenda at various levels of global and regional governance is bound to be a major determinant of the future of the UK finance industry.

This leaves us with the central issue of the comparison between France and Germany. The bottom line is that France showed itself to be much less recession-proof than Germany, or in other words much less fit to compete in world markets outside the OECD area.

Germany aggressively seized the opportunity presented by the expansion of the EU to Eastern Europe (a move that it strongly supported) and moved parts of its manufacturing production to this region while keeping at home many service activities used to monitor the international value chain thus constituted. This mode of adjustment, which has been called the Bazar economy, is certainly part of the explanation of the shifts we see in the response to foreign demand. The benefits it brought to German manufacturing industries certainly helped these industries develop markets in the faster growing developing world. This development also contributed to Poland's strong economic performance during the 2006-2011 period.

But this is not the end of the story of the comparison between the French and German dynamics in competitiveness in the aftermath of the 2008 financial crisis. Financialization seems to have played a greater role than outlined so far in the differentiation of the two dynamics. A recent study by the Directorate General for Economic and Financial Affairs (DG–ECFIN) on trade surplus countries (European Commission, 2012) is rather telling in that respect. The study examines the factors that explain why after the mid-2000s one group of countries enjoyed a continuously growing trade surplus while another group countries experienced the opposite development. Most analyses of this situation concluded that a permanent competitive advantage enjoyed by the surplus countries accounted for this steady divergence.

This was not exactly the conclusion reached by the DG-ECFIN study, which found both trade deficit and trade surplus countries registered relatively good results in terms of exports. Over the 1999-2007 period trade surplus countries saw exports grow an average of 8.0 per cent per year, only slightly above the 7.5 per cent for trade deficit countries. Rather, the difference that generated the trade gap between surplus and deficits countries came mainly from imports, which grew 7.5 per annum in surplus countries versus 10.0 per cent in deficit countries over the same period.

Thus, the difference between the two groups is much more due to lower domestic demand than export performance, a feature very pronounced in Germany where the contribution of domestic demand to growth was below the contribution of exports. This reflects the pressure on wages induced by the Hartz reform of the German labour market.[2]

The results of the EC study change our understanding of the relative dynamics of developments in manufacturing competitiveness in France and Germany. When one takes into account a broader picture of the context in which the changes in productivity and trade took place over the last decade, the conclusions explaining the different trajectories of major EU members do not boil down to a clear hierarchy of manufacturing competitiveness.

To take the case of Germany, part of its competitiveness in manufacturing owes much to the one-shot opportunity of outsourcing and investing in Eastern Europe. Conversely, buoyant access to the markets of emerging economies may also be a limited opportunity for Germany, resulting from the rapidity of their emergence and of the strong reputation of German products, a non-price competitive-

2 Also referred to as the Agenda 2010 proposed by the Chancellor Schröder in 2003.

ness that the rapid technological catch-up of these countries may erode. The reform of the German labour market may still fall short of allowing sufficient price competitiveness improvement. Not to forget that this labour market reform, which fueled the trade surplus, has a cost. It implied a trade-off between GDP growth and welfare which in the long run could affect worker commitment, which is at the root of the efficiency of the German production system. This observation does not aim to downplay the contribution of the German "model" .

Attention to conditioning factors is essential for the analysis of EU productivity performance. One should identify the general importance of the policy measures that will be taken, regarding the role of finance and how countries adjust to the permanent trend of trade and capital flows liberalization. Thus the outcomes of reregulation of finance at various levels (whether international, regional or national) matter. Conversely, policies to adjust to external competition, according to the place given to solidarity schemes at the regional level, are likely to affect the future of EU member states. The role of the euro is bound to be a decisive factor.

In the race to adjust to a rapidly changing world economy, countries are often led to seek a balance between welfare and growth, choices that have fueled in the past widespread rises in income inequality. Moreover, poor performances in welfare may jeopardize a future where issues of environmental sustainability may call for major collective efforts.

In other words, a focus on the relative competitiveness and productivity of the major EU member states highlights the numerous challenges that these countries will have to face and how their collective policy measures will condition this future.

References

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