

## François Villeroy de Galhau: Productivity - a collective enigma?

Speech by Mr François Villeroy de Galhau, Governor of the Bank of France, at the Bank of France - France Stratégie Conference, Paris, 1 February 2017.

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Welcome to all of you. It gives me great pleasure to be able to open this conference on French productivity, organised in conjunction with France Stratégie. The subject is one that is both topical and of great importance to central banks: productivity is one of the principal drivers of growth, and its dynamics are a strong determinant of potential growth, that which is compatible with price stability. As you can see [slide], after the major wave of expansion witnessed during *Les Trente Glorieuses*, which was particularly marked in the case of France, productivity growth in advanced countries has slowed in successive stages since the 1970s. Today, it has fallen back to a pace that is historically weak. What are the common factors behind this slowdown in productivity? And is there anything specific to France? I don't believe so: if there is one thing that is specific to France, it is the high level of hourly productivity – one of the highest in the world, alongside that of the United States and Germany. So, rather than being a French enigma, the enigma we are looking at this morning seems to me to be more of a collective phenomenon. By way of introduction, I would just like to go back over the three collective hypotheses at the heart of today's debate, before nonetheless going on to examine a few factors that are indeed specific to France.

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### **1. Does the problem lie in the measurement of growth?**

The first theory is that there is in fact no slowdown, as we are not measuring growth properly due to the rise of the digital economy. On 16 January this year, the Banque de France held a conference<sup>1</sup> that notably discussed this issue in relation to the US economy. The main sources of measurement errors were: first, the estimation of quality-adjusted prices for new technology, as falls in prices tend to be underestimated in US national accounts; and second, product entry and exit, which makes it difficult to estimate changes in prices over time. This could lead to a significant upward revision to US productivity since 1983: by 1.1 percentage points per year at the top end of estimates, according to Philippe Aghion and his co-authors. Nevertheless, even allowing for these corrections, there has still been a slowdown since the mid-2000s. Indeed, the measurement errors were just as significant before this period. That said, this work does provide some grounds for optimism. First, growth in hi-tech sectors, and therefore technological progress, is stronger than we previously thought. Second, some of the gains in well-being linked to new technologies fall outside the scope of the market economy and, as a result, are not recognised in national accounts. The digital economy has delivered huge gains in leisure time, for example, by simplifying certain administrative tasks, and led to the development of free services, without any of these benefits appearing in conventional measures of output. It has also prompted the rise of the informal economy (C to C services), which is particularly tricky to recognise in the accounts. Our conference today will provide an opportunity to look specifically at the case of France, thanks to a presentation by INSEE.

### **1. Are we witnessing a permanent slowdown in the contribution of technical progress to productivity growth?**

Assuming that there has been a slowdown in productivity, the second hypothesis is that it stems from a slowdown in innovation and in its contribution to productivity. The great wave of productivity growth during *Les Trente Glorieuses* in France was fuelled by advances in a large number of domains: technical progress with electricity, the combustion engine, chemicals and telecommunications, but also the emergence of new methods of labour organisation and new

management practices. Today, what potential contribution can information and communication technologies (ICTs) make to growth? The first ICT wave has been limited in duration and in scale, and has only been felt to a small extent in many countries, including France. This has prompted some economists, such as Robert Gordon, to doubt that technology can make a significant contribution in the future. But in a country such as France, which already enjoys a high productivity level, there is still plenty of room for progress in the diffusion of ICTs, both in terms of the speed and quantity [slide]. The share of ICT capital stock in GDP is markedly lower in France than in the United States and the United Kingdom. Getting rid of this lag would deliver substantial gains in growth for France.

### **1. Third hypothesis, a dearth of investment?**

Catching up to the technological frontier will require investment in ICTs as well as in research and development. This investment is vital in order to incorporate innovation into production processes. Yet it is also a lot riskier than other types of investment, for example in construction. Indeed, it notably combines a low or non-existent resale value with uncertain future revenue flows. Like the rest of the innovation economy, therefore, it needs an appropriate form of financing – one that relies more on equity as opposed to debt. However, the cost of capital remains high despite the sharp drop in interest rates over the past 20 years. According to Banque de France calculations, the nominal cost of capital for France's major listed companies is still between 8% and 9%, whereas the risk-free rate is currently around 0%. This particularly high cost places a drag on investment, and hence on innovation and productivity growth.

#### **1. Are there any factors that are specific to France?**

There are nonetheless a number of French specificities that could be playing a part in slowing productivity. Let me just cite three:

- ♦ First, failings in our system of initial and lifelong training, as highlighted by the OECD's PISA and PIAAC surveys [slide]. France stands out as scoring only average overall among OECD countries, and, most importantly, as having high levels of inequality linked to parents' social background.
- ♦ Second, corporate investment tends to be weighted more towards construction at the expense of equipment machinery and intangible assets. And while we're on that subject, it is essential that French banks finance intangible assets better than they do today.
- ♦ Lastly, the specific features of the French labour market and the associated policies. A number of studies have highlighted factors such as the shortening of the duration of temporary contracts. Questions have also been raised as to the impact of labour policies. How can we strike the right balance between supporting productivity and supporting jobs? Policies aimed at reducing the cost of low-skilled labour – be they targeted cuts in employers' social charges or the CICE – all have a positive effect on GDP per capita via an increase in the employment rate; but they can also have a detrimental effect on productivity, especially when targeted at sectors with low productivity. Put another way, these policies make it all the more necessary that we improve our system of initial and lifelong learning – failing this, we risk fuelling a downwards spiral in labour skills and productivity.

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These questions aside, one thing is clear in the case of France – and 2016's too-feeble growth of 1.1%, as published yesterday, confirms it: estimates from national and international institutions all point to low levels of potential growth, at around 1.2%, and relatively high levels of structural unemployment (the equivalent of the NAIRU in English-speaking countries), at around 9%. Clearly, we cannot be content with these levels. All of which brings us back, overwhelmingly, to our four key focuses for reform: Enterprise, Education, Employment and Expenditure reduction (public sector). Our northern European neighbours have shown by example that these reforms

are not incompatible with our shared European social model. Studies by the Banque de France show in particular that reforms to the goods and services market could boost the productivity of the French economy by between 3% and 5% in the long-term. Without further ado then, let me pass the floor to Fabrice Lengart, and I wish you all a fruitful and enjoyable conference.

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<sup>1</sup> [www.banque-france.fr/en/secular-stagnation-and-growth-measurement-conference-organised-banque-de-france-and-college-de](http://www.banque-france.fr/en/secular-stagnation-and-growth-measurement-conference-organised-banque-de-france-and-college-de)