7 Economic Misconceptions about France and Germany

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Executive Summary

- Belief #1: “As the French have more babies, potential growth is higher than in Germany”. Wrong! Having more human capital - a high fertility rate - alone does not help, this human capital has to be put to work - employed - to drive potential growth.
- Belief #2: “Labor productivity is higher in France than in Germany because France has many unemployed people”. Wrong! After correcting for underemployment, France still outperforms Germany’s productivity by 1.4% (5% pre-correction)
- Belief #3: “Fiscal austerity is stronger in Germany than in France”. Wrong! Since 2013 French public spending has grown at less than half the pace seen in Germany (cumulated 6% versus 13.6%).
- Belief #4: “France lost the competitiveness battle to Germany.” Wrong! Between 2012 and 2017, the increase in German Unit Labor Cost – ULC – (+9%) has been nearly three times as great as the increase in French ULC (+3.4%).
- Belief #5: “German SMEs are performing better than French ones”. Wrong! Profit margins (net income/turnover) stand at 3.1% in France and only 2% among German SMEs. The return on capital employed (ROCE) is 22.4% for French SMEs, and 15.3% for German ones. The cash position is also higher in France, with 4.9% (cash flow/turnover), when it is only 4.1% in Germany.
- Belief #6: “France is Germany's main trading partner." Wrong! Though Germany is #1 trade partner for France (16.5% of goods exports and imports), France is the second trading partner after China, the second destination after the US, and the third supplier after China and the Netherlands.
- Belief #7: “Because it grows faster, Germany should invest more than France.” Wrong! In 2016, the investment-to-GDP ratio was 22% in France, while it was only 20% in Germany. Both the French public and corporate sectors have higher investment ratios than their German counterparts (+1.3 pp and +1.0 pp, respectively).

Belief #1: "As the French have more babies, potential growth is higher than in Germany". Wrong!

Figures released by the Federal Statistical Office recently showed that in 2015 the German fertility rate climbed to 1.5 babies per woman – its highest level since reunification and close to the EMU average of 1.56. With a birth rate of 1.96, France is still the front-runner. Fertility is an important determinant of potential growth. However, in its latest Economic Forecast, the European Commission puts German potential GDP growth at 1.9% for this year and next, whereas the respective estimates for France are lower: 1.2% for both 2017 and 2018.

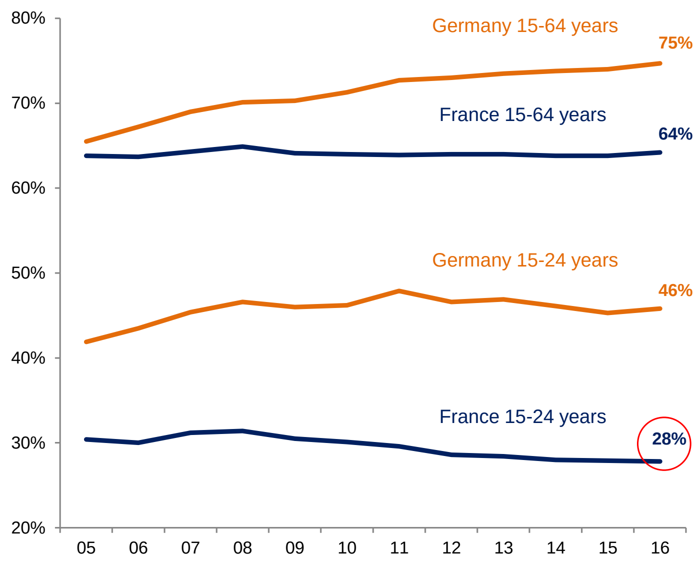
28%
French youth employment rate in 2016

One explanation for this apparent contradiction is population growth which has picked up markedly in Germany from 0.4% in 2014 to 0.9% in 2015 and 1.3% in 2016, influenced by migration. By contrast, population growth in France remained contained around 0.4% in the last two years.

Another explanation comes from the differences in employment rates. In Germany the employment rate for the age group of 15-64 years is 10 percentage points higher than in France (2016: 74.7% compared to 64.2%). The gap is even bigger for the age group of 15-24 years: In France the youth employment rate stood at only 27.8% in 2016, in Germany it reached 45.8%.

Having more human capital - a high fertility rate - alone does not help, this human capital has to be put to work - employed - to drive potential growth.

Figure 1: Significant and widening gaps between German/French employment rates
(employment ratio, % of working age population)



Sources: Eurostat, Allianz, Euler Hermes

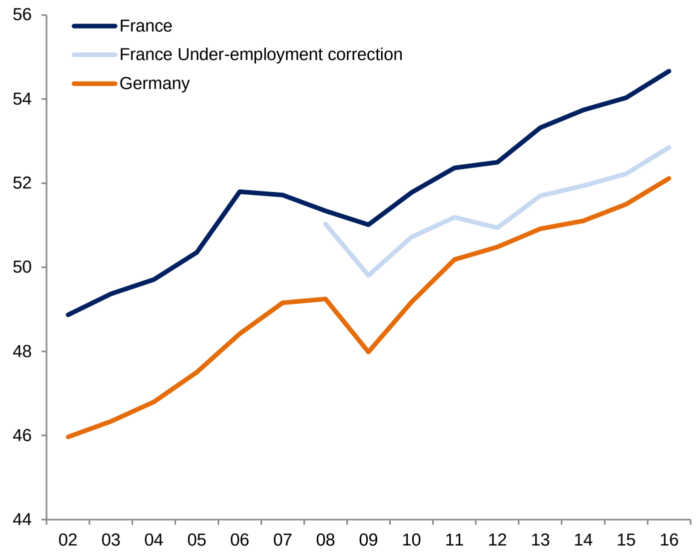
Belief #2: "Labor productivity is higher in France than in Germany because France has many unemployed people". Wrong!

+1.4%
French labor productivity lead in 2016, from +5% pre-crisis

Labor productivity in France is among the highest in the world: the average output produced per hour is typically stronger in France than in other economies. Recent crises (2008 and 2011) have not changed anything to that performance. In 2016 labor productivity was +5% higher than in Germany, roughly on par with 2008.

In 2008, the unemployment rate was about 7% in both France and Germany, but in 2016 the gap was 6pp: 10.1% in France and 4.1% in Germany. Even if we added 1 million people to the workforce (that would lead to unemployment as in 2008) labor productivity is still somewhat higher than in Germany by 1.4%.

Figure 2: Labor Productivity in France and Germany
(Output per employee, constant EUR prices)



Sources: OECD, Allianz, Euler Hermes

Belief #3: "Fiscal austerity is stronger in Germany than in France". Wrong!

The belief that the German government is always more thrifty than the French government was recently reaffirmed by former finance minister Wolfgang Schäuble while defending his "black zero" legacy (slightly positive budget balance). On the other hand, we see France still struggling with the EU's Excessive Deficit Procedure rules.

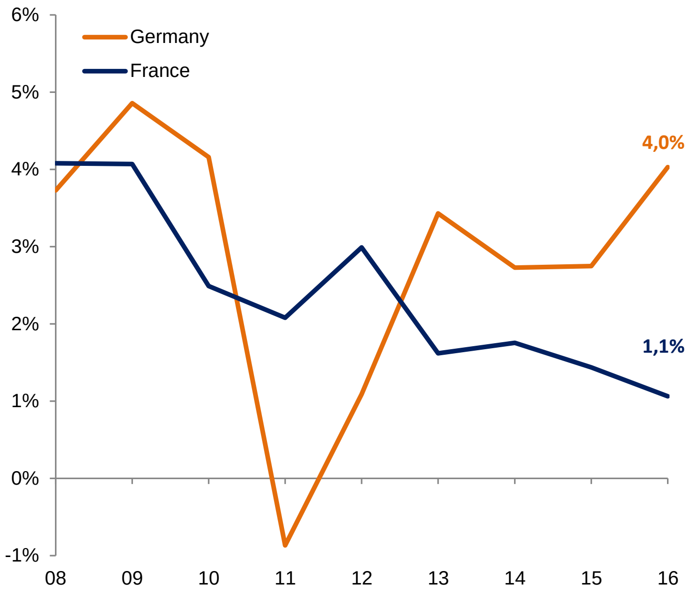
+4%
German public spending in 2016

However, if we look at the trend in government expenditure, France turns out to be more prudent. Since 2013 French public spending has grown at less than half the pace seen in Germany (cumulated 6% versus 13.6%). Last year, German government expenditure surged by 4.0% (partly due to the refugee influx) compared to a mere 1.1% in France.

This does not affect yet the gap in the level of public spending in relation to GDP, which in 2016 was 44.3% in German, and 56.2% in France.

But the different patterns in public spending growth highlight two things: 1) Germany, often under pressure to use its fiscal leeway in order to contribute to a more supportive policy stance in Europe, has already switched to an expansionary fiscal course; and 2) although France is subject to the Excessive Deficit Procedure, the country comfortably meets the expenditure benchmark requiring government spending growth at or below a country's medium-term potential economic growth rate.

Figure 3: Over the last 4 years public spending growth in France has been much lower than in Germany
(Government expenditure, y-o-y change %)



Sources: Eurostat, Allianz, Euler Hermes

Belief #4: "France lost the competitiveness battle to Germany." Wrong!

The cost of labor is often blamed for France's waning competitiveness vis-a-vis Germany. However when we take a look at both countries' unit labor cost (ULC), we see that the gap has been narrowing in recent years. Policies explain most of the differential.

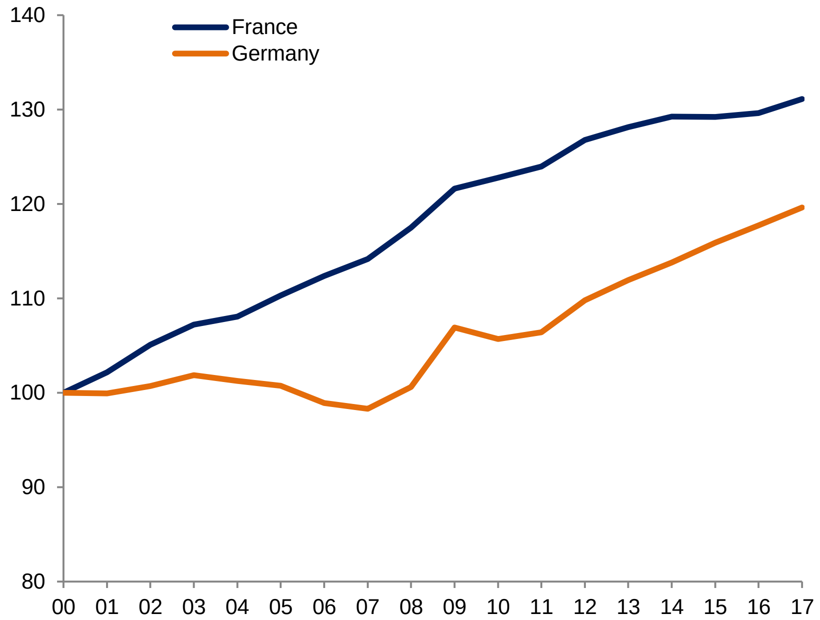
In Germany, though the 2002-2006 Hartz reforms moderated labor costs, German ULC began to increase during the crisis and has continued to grow ever since. All in all, ULC increased respectively by +9% for Germany and +21% in France over the decade 2002-2012.

3X
Greater German ULC growth vs France, 2012-2017

In 2012, France decided to tackle its lagging competitiveness with a temporary tax credit for companies (*Credit pour la Competitivité et l'Emploi or CICE*) which helped reduce the hourly labor costs – but did not support external trade. Between 2012 and 2017, the increase in German ULC (+9%) has been nearly three times as great as the increase in French ULC (+3.4%). In addition, the introduction (01/01/15) and recent increase (01/01/17) of the minimum wage in Germany (EUR1498/month, above the French minimum wage EUR1480.27 for the first time) also explain the convergence.

Looking ahead, though there is no expectation of major wage acceleration in Germany, France could surprise with a further reduction in ULC. The new Government has planned to transform the temporary tax credit into an actual 6% tax cut on low-income earners – on top of a larger labor law reform to decrease, inter alia hiring and firing costs.

Figure 4: The gap in competitiveness between France and Germany is narrowing
(ULC, 2000=100)



Sources: Euromonitor, Allianz, Euler Hermes

Belief #5: "German SMEs are performing better than French ones". Wrong!

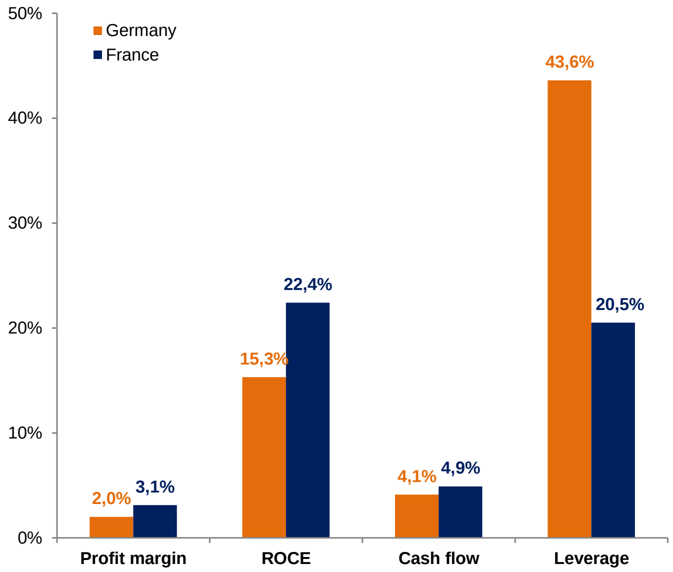
German Small and Medium Enterprises (SMEs) are strong enough to contribute to an impressive export engine (300,000 of exporters in Germany, 125,000 in France). But the financial strength of these companies is a bit counterintuitive.

Profit margins (net income/turnover) stand at 3.1% in France, and only 2% among German SMEs. The return on capital employed (ROCE) is 22.4% for French SMEs, and 15.3% for German ones. The cash position is also higher in France, with 4.9% (cash flow/turnover), when it is only 4.1% in Germany.

+1.1pp of additional margins for French SMEs In 2016

There are several explanations for this result. First, a structure and size effect: In Germany, the *Mittelstand* are most commonly suggested to be SMEs with annual revenues of up to €50 million and a maximum of 499 employees while in France, *Petites et Moyennes Entreprises (PME)* are companies with revenues up to €50 million and a maximum of 250 employees. Secondly, financial information is available for only 47% of French corporates (100% in Germany), so that French SMEs have to exhibit more soundness to access credit. The leverage ratio (financial debt in % of financial debt plus equity) is consistent with this evidence: 43.6% in German SMEs and 20.5% in French ones.

Figure 5: SME financial ratios in France and Germany in 2016



Note: ROCE = Return On Capital Employed, Leverage = Debt/Equity.

Sources: Allianz, Euler Hermes

Belief #6: "France is Germany's main trading partner." Wrong!

For German exporters and importers in particular, the relevance of France has declined. Since the 1960s France had been the most important customer for German goods exports. This has changed. In the last two years – 2015 and 2016 – the United States emerged as the most important country of destination, a sensitive issue in times of unabashed protectionism in the US.

Regarding Germany's imports, France already slipped from top spot about ten years ago. China and the Netherlands are now the leading suppliers. By contrast, Germany is still by far France's most important trading partner.

+7.7%
France is no 2 trading partner of Germany In 2016

Not only France but the Eurozone as a whole has lost importance for Germany's foreign trade. In 2000 around 46% of German exports went to the Eurozone, by 2016 the ratio had declined to around 37% , as Europe was in muddle-through mode and German companies were going after new outlets.

The renewed economic momentum in France – though in line with a global pick up - could very well make France great again… for Germany.

Germany: Key trading partners (2016 in %)					
Exports (goods)		Imports (goods)		Trade (export + import)	
1. USA	8.9%	1. China	9.8%	1. China	7.9%
2. France	8.4%	2. Netherlands	8.8%	2. France	7.7%
3. UK	7.1%	3. France	6.9%	3. USA	7.6%

France: Key trading partners (2016 in %)					
Exports (goods)		Imports (goods)		Trade (export + import)	
1. Germany	16.1%	1. Germany	16.9%	1. Germany	16.5%
2. Spain	7.5%	2. China	9.1%	2. Italy	7.4%
3. United States	7.4%	3. Italy	7.5%	3. United States	7.2%

Sources: German Federal Statistical Office, UN Comtrade Database, Allianz, Euler Hermes

Belief #7: "Because it grows faster, Germany should invest more than France." Wrong!

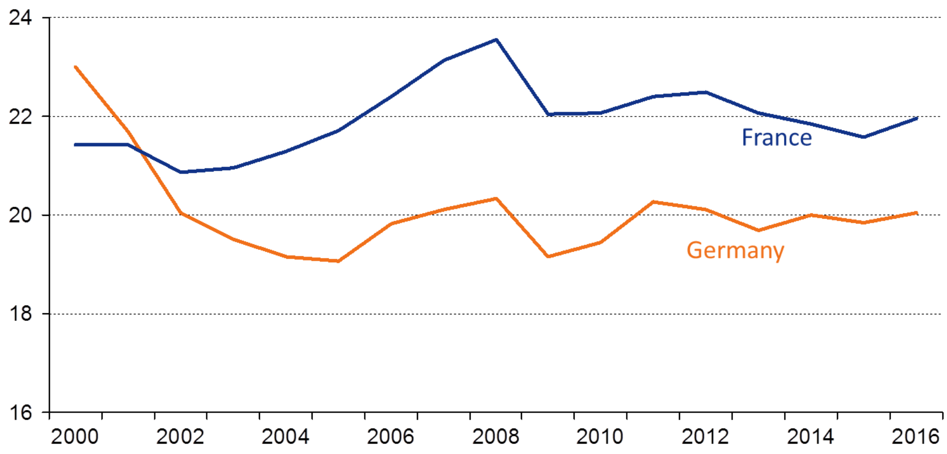
Considering that the German economy has outperformed the French economy in recent years and taking into account that capacity utilization in the German manufacturing sector has been above its long-term average of about 84% since Q4, investment activity should be higher in Germany than in France.

+2pp
French lead in total Investment ratio v. Germany in 2016

The opposite is true. Since 2002 the total investment-to-GDP ratio in France has been consistently above that in Germany. In 2016, the investment ratio of France was at 22%, while it was only 20% in Germany. Both the French public and corporate sectors have higher investment ratios than their German counterparts (+1.3 pp and +1.0 pp, respectively).

Germany outpaces France only in terms of household sector investment activity (by 0.6 pp). These figures would suggest that the investment backlog in Germany seems to be substantially higher than in France.

Figure 8: Investment ratio in France has outpaced Germany's since the early 2000s
(Total investment as % of GDP)



Sources: Eurostat, Allianz, Euler Hermes

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