ofce briefing paper

No. 5 / 11 october 2013

France – Germany

Is there a demographic dividend?

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Although an ageing population is primarily good news, since it means that people are living longer, frequently it is also depicted as an economic and social burden. It affects productive capacity (loss in productivity and decline in the workforce) and reduces per capita income (increase in the inactive population). It can also lead to greater social spending on behalf of older people (retirement, health and dependence), and taxation to finance these programmes can seriously undermine incentives to produce wealth. Logically, Germany should be hit by more pronounced ageing than what is seen in France. However, it is not a foregone conclusion that France will reap a demographic dividend. While population trends point to a bright future for France, recent economic developments have nevertheless tended to be very favourable to the German economy, while France is mired in mass unemployment and low growth.

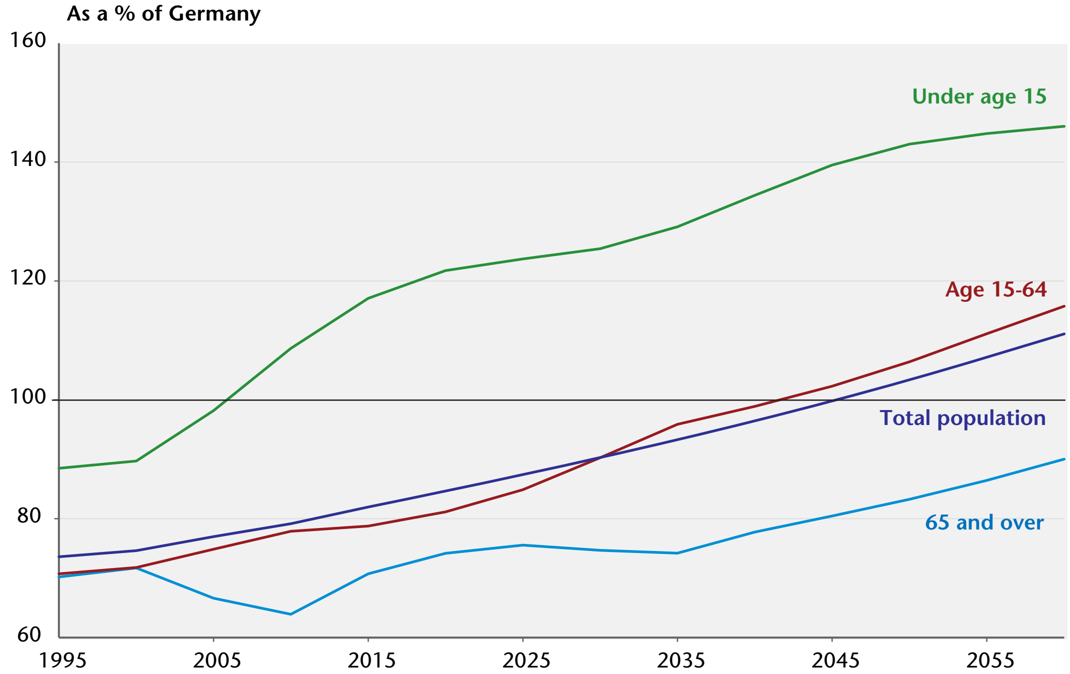
France: A triumphant demographic future…

Eurostat projections (Figure 1) are clear: the size of the French population is expected to surpass Germany's by 2045. From 65.5 million inhabitants in 2012, 25% fewer than in Germany, the French population is expected to reach 73.7 million by 2060, *i.e.* 11% more people than in Germany. As for the German population, it is expected to fall from 80 million to fewer than 66.4 million in 2060.

The main driver of this demographic dynamic is France's higher birth rate. The fertility rate is higher than 2 in France but less than 1.4 in Germany. Since 2005, the French population under age 15 has been larger than that observed in Germany. At the same time, the number of people over age 65 is expected to be smaller over the next 50 years. Germany is ageing faster than France, and its population will inexorably decline, unless there is a very large inflow of migrants, which seems unrealistic.

In recent publications, Cornilleau (2012) and Krugman (2013a, 2013b) have argued that French population growth would be a positive factor for the country's potential production. Based on this criterion, France could become a European champion. The idea of the French economy making a comeback clearly seems interesting, and worth further discussion.

Figure 1. Population : France's relative performance



Sources : Eurostat, author's calculations.

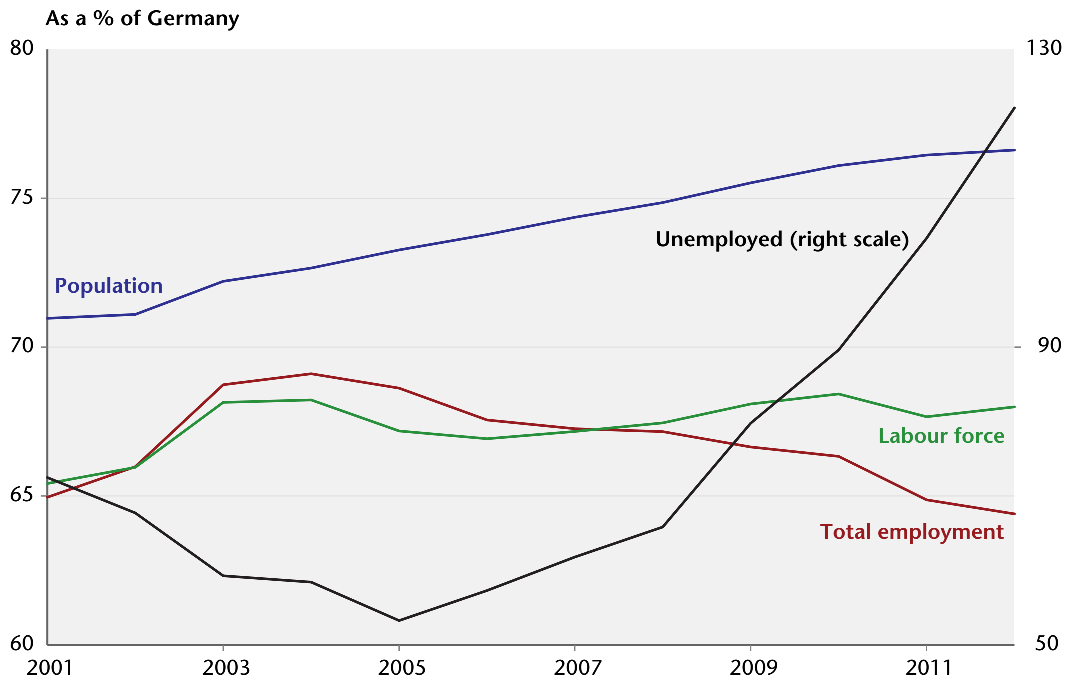
… but the country's economic performance is lagging behind Germany…

Over the past decade, French demographic growth has not produced a dividend in terms of economic growth. The German economy has, it is true, been in strangely rude health: the unemployment rate is low, with high economic growth and sound public finances. Over the period 2001-2012, a comparison of relative changes in the various criteria used to measure the success of France versus Germany (labour market, national income, public debt and competitiveness) show a clear advantage in favour of Germany.

The labour market has not shown any signs of this French demographic dynamism. Figure 2 traces the relative changes in total population, the labour force (labour supply) and the employed population (demand for labour) in France compared to the figures for Germany. Before 2004, there was stronger growth in the supply and demand for labour in France. But since 2004, France's performance has stagnated, and there has even been a decline (relative) in the employed population in France compared with Germany: the number of workers with a job in France represented 64.4% of the total employment in Germany in 2012, compared with 69.1% in 2004. In 2012, the number of unemployed in France was 22.1% greater than in Germany, while in 2001 there were 27.6% fewer. In France, demographic growth has up to now been counted mostly in the number of the unemployed.

It could of course be argued that what matters is the "quality" of jobs, and in that respect, Germany may not be doing as well as France, given the 8 million people in precarious work there ("mini-jobs"). But it should also be noted that in Germany youth training is based to a great extent on apprenticeships, which involves an early entry onto the labour market, and precarious jobs. On the other hand, in France many unemployed youth are unskilled. The demographic dividend depends more on what is done with the young people than on their numbers.

Figure 2. Labour force: France's relative performance



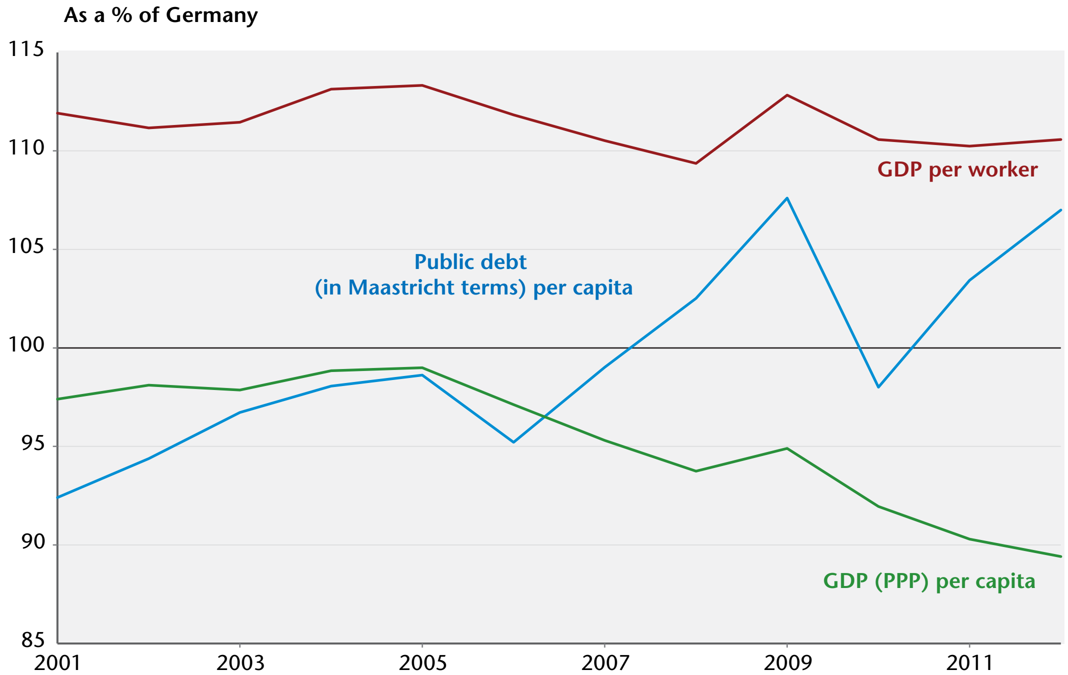
Sources : Eurostat, OECD and author's calculations.

France has paid a heavy price for the economic crisis. In 2012, unemployment affected 9.9% of the work force, against 5.6% in Germany. In addition, individual incentives to work seem to be weaker in France than in Germany, which is reflected in a significantly lower activity rate, with 70.4% of the 15-64 age group in the labour force, versus 77.2% in Germany. France's potential future growth will depend on its ability both to create additional jobs and to encourage participation in the workforce.

Over the period 2001-2012, the productivity level of French workers, as measured by real GDP and purchasing power parities (PPP), has remained on average about 11% higher than the level of German workers (Figure 3). This level remained stable throughout this period. However, the way that GDP per capita has changed is rather unique. Until 2005, GDP (PPP) per capita grew a little faster in France than in Germany, and reached 99% of the German level in 2005 compared with 97.4% in 2001. But the trend has reversed since 2005, and in 2012 per capita French output was only 89.4% of the German level. These results are not surprising, because since 2004 employment has grown more slowly in France than in Germany, which does not correspond with the levels of the total population. Using the criterion of per capita GDP, France has prospered less than Germany.

The performance of French public finances has also not been very satisfactory. The level of public debt per capita grew significantly faster in France than in Germany (Figure 3). In 2001, France had a debt of 14,000 euros per capita, *i.e.* a level 7% lower than that observed in Germany (15,100 euros per capita). In 2012, the positions were reversed: 28,340 euros of French debt per capita versus 26,500 euros per German, *i.e.* France's level was 7% higher. While growth in the public debt exceeded population growth in both countries, this phenomenon was more marked in France. However, it should be noted that Germany saw its debt soar sharply in 2010 due to its financial support of the banking sector (recapitalization, takeover of risky assets). Even so, the trend has not reversed, as since then the French economy has been mired in unemployment and deficit spending. The OECD forecasts a deficit of 4% in 2013 and 3.5% in 2014. Germany's public finances are, on the other hand, en route to a healthier state, with a deficit of 0.2% forecast for 2013 and a return to a balanced budget in 2014. This means that the debt gap between France and Germany is expected to widen.

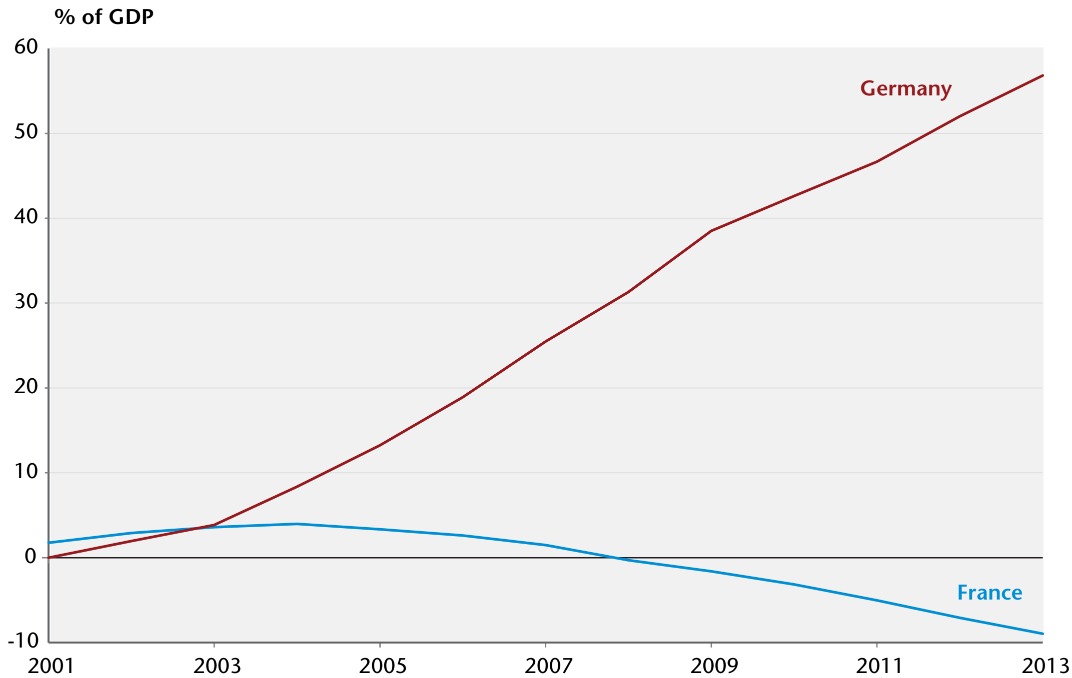
Figure 3. Household income and public debt: France's relative performance



Note: In 2010, German public debt soared in the wake of the State's support for the banking sector – this was treated as public debt.
Sources : OECD, author's calculations.

Due to Germany's better control over production costs, based both on a policy of competitive wage deflation in a context of a relatively strong euro and on careful decisions about maintaining its industrial fabric (massive recourse to part-time unemployment at the height of the crisis, and only partial outsourcing of the production chain), it has been the big winner over the last ten years in terms of competitiveness. Since 2001, Germany has accumulated almost 60% of its GDP in current account surpluses. By contrast, France has run a current account deficit since 2004, which has resulted in an accumulated deficit of around 8% of GDP. The French demographic advantage has, for the time being, clearly been difficult to export.

Figure 4. Cumulated current account balance since 2001



Sources : OECD, author's calculations.

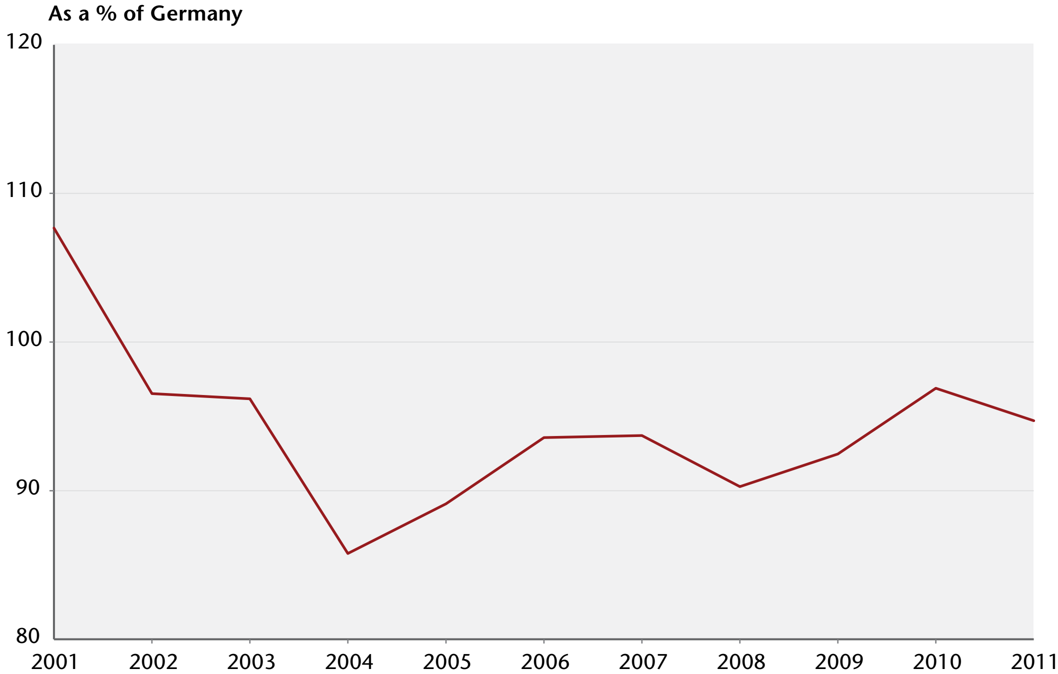
… and a social situation that's not all that great

Under Schroeder and then the Merkel governments, Germany embarked on a number of structural reforms (of the labour market through the Hartz laws; of public finances through the adoption of a "golden rule") that were designed to revive the economy after a period of flat-lining, followed by crisis. These reforms have had a social cost. Inequality rose sharply in Germany (12.4% of the population below the poverty line in 2001, 15.1% in 2011), but far less in France (13.4% in poverty in 2001, 14.3% in 2011). Over the period 2001-2004, the poverty rate actually declined in France, and since 2002 it has been higher in Germany than in France (Figure 5). This process of the singularization of France relative to Germany came to a halt in 2004, and since then the trend has reversed: on average, inequality grew faster in France over the period 2004-2011.

A recent study by the French Treasury (DG Trésor, 2012) comparing the social security systems in France and Germany showed that, "France's socio-fiscal system provides better protection against the risk of poverty … essentially because of the system of tax levies and social security, since the poverty rates prior to social and fiscal transfers are comparable" in the two countries.

The return of poverty in France should not be surprising, as unemployment is a social "disintegrator". And unfortunately, France stands out for its very high unemployment rates compared to Germany. While the absence of a minimum wage in Germany is undoubtedly fuelling wage inequality (in particular due to the turn to underpaid "mini-jobs" that are not subject to social security contributions), it is also true that the primary income of an unemployed worker is zero. Ultimately, high unemployment can be catastrophic for inequality, as the long-term unemployed sink into extreme poverty and social security systems prove incapable of providing massive long-term funding of this level of social dependence. If France wants to take advantage of its demographic dynamism to reduce inequality, it is imperative that its labour market becomes more effective in reducing unemployment.

Figure 5. Poverty rate (60% of the average wage): France's relative performance



Sources : INSEE for France; German statistical office (Destatis) and retropolation using IMK data before 2005 for Germany and author's calculations.

Why such anomalies?

During the last decade, French demographic growth does not seem to have brought the dividends expected. What should have been an advantage may have been a handicap, as evidenced by the poor capacity of the labour market to take in the country's newly educated young graduates: 23.8% of the 15-24 age group are unemployed in France, versus 8.1% in Germany, while 50.7% of young Germans are already in the workforce, compared with 37.8% of young French.

Two points for analysis need to be considered: the Malthusian effect and structural policies.

First, it is important to keep in mind that population growth is usually accompanied by a major deleterious side effect: the dilution of wealth (Malthusian effect). In a world where resources are available only in finite quantities (scarcity and decreasing returns to scale), the phenomenon of dilution translates into fewer resources per capita: productive capital, job positions and income. We can also see the impact of this at the level of public services and environmental goods in congestion and pollution. Up to now, the German economy has undoubtedly benefited from the virtuous effects of lower population growth: competition is attenuated on the labour market, which is favourable to employment and wages; the number of households is decreasing, which reduces pressure on the cost of housing; with fewer pupils per class, it is easier to improve the quality of education; and so on. However, demographic decline is not a solution, as running an economy requires workers most of all, and population ageing increases the ratio of inactive dependents to the workforce. And once labour productivity is not rising at a sufficient level, this increase in dependency in turn fuels impoverishment. Demographic growth then becomes a necessity.

Second, Germany has taken non-demographic measures by implementing structural reforms. Since 2003, the Hartz laws have had three major objectives (Conseil d'Analyse Economique, 2012): encouraging a return to employment; promoting the demand for labour; and increasing the effectiveness of its employment services. Encouraging a return to work was accompanied by tighter control on granting unemployment benefits. In addition, a programme to support the creation of individual start-ups was established. Temporary jobs have also been proposed for social welfare recipients so as to maintain their employability. These are community service jobs that are paid one to two euros per hour, in addition to the benefits. Temporary bonuses for any return to employment or for starting a company were also established. During the crisis, companies could easily turn to partial unemployment. This practice greatly reduces hysteresis effects, because it helps to preserve jobs and to maintain skills.

It is also necessary to distinguish between the long term and the medium term. In the medium term, the German economy has been very successful. In the long term, Germany will have fewer people than France, and an older population. The political weight of Germany in Europe will also weaken. Germany cannot escape a decline in its labour force, which will eventually be detrimental to its productive capacity and its ability to finance public expenditure on behalf of its elderly population. Germany could, it is true, rely on immigration to benefit from the demographics of its European partners. Indeed, migration is possible and is being encouraged in Europe. The call for young engineers and physicians from southern Europe issued by Germany's national employment agency in March 2013 was in this respect no mistake.

Germany's arguments are rather persuasive:

— It has a state-of-the-art productive system that is attractive to skilled labour;

— Its unemployment rate is low;

— It is easy to find housing;

— The tax burden is relatively low: the rate of mandatory taxation is approximately 40% (46% in France), and its good control of public finances is a guarantee of fiscal stability;

— The pension system is balanced and its future funding is not based on unlimited hikes in contribution rates. In fact, in 2004 a law capped this rate at 22%, which gives employees a guarantee. In France, the rate is already over 25% and it may increase further in the years to come, which means there is no guarantee for the younger generations entering the labour market.

In this context, it might be wise for Europe's younger generations to learn German. While English is a must in the field of finance, German could very well become the language of engineering, and, more generally, of industry. This would be good news for German language teachers, who for many years have suffered from a lack of students. This is a demographic dividend that they might really appreciate....