

“Investment in France: gearing up momentum” – Conference report

Introduction

The Banque de France and the European Investment Bank (EIB) organised the conference “Investment in France: gearing up momentum” on May 3, 2018 in Paris. This is the second time the EIB and the Banque de France jointly organise an event on investment, following the conference “Investment in France: reactivating the investment channel” held on March 10, 2017.

The conference “Investment in France: gearing up momentum” was an opportunity to share views and identify obstacles that need to be addressed to increase productive investment and foster the recovery of the economy. The role and activities of the EIB Group and the European Fund for Strategic Investment (EFSI) to support investment in France were also discussed. The speakers at the event included the Governor of the Banque de France, the Vice-President of the EIB, several economists of the two institutions, a member of the French parliament, representatives of the financial sector and University professors. The presentations of the speakers were followed by a discussion with the audience, which also included representatives of the business sector and journalists.

Main interventions

In his opening remarks, **François Villeroy de Galhau**, Governor of the Banque de France, set the stage for the discussion by asking five key questions on investment.

1. What is the level of investment in France? **The investment rate of the corporate sector is now higher than before the crisis.** It is higher in France than in Germany and Italy. Investment has also been more resilient to the crisis and less volatile than in Spain. Even though investment in the construction sector was historically high in France, productive investment (in machinery, R&D and intellectual property rights) is driving the investment recovery. The level of intangible investment and public investment are also relatively high in France compared to other countries of the euro area and the EU.
2. What are the determinants of corporate investment growth? The investment recovery is supporting economic growth, due notably to the better outlook for economic activity and increased capacity utilisation rate. **Profit margins were deteriorating until 2013 but they have been recovering and are now making a positive contribution to corporate investment.** In 2014 and 15, investment has been supported by the CICE and

PRS as well as the decrease in oil prices.¹ The extra depreciation for capital investment has also contributed to the investment recovery in 2016 and 2017.

3. How is investment financed? **The cost of debt finance has been falling with the accommodative monetary policy of the Euro system.** The growth rate of bank loans, at 6%, indicates that financial intermediation in France is working. The cost of equity has decreased but remains high (close to the average of the euro area and slightly below the US). Innovation is typically financed by internal funds.
4. What is the contribution of capital to long-term growth? **France needs to further raise potential output** – the output that the economy could produce if all resources were employed at their long-term sustainable rate. Potential growth has been improving in recent years but remains at around 1.25% - 1.3%, which is relatively low compared to other countries of the euro area.
5. What policy measures need to be taken? Savings in the EU exceed investment by about EUR 400bn but the financial market is fragmented. **The priority is to reinforce risk sharing in the euro area and use European savings to invest in Europe.** In this context, it is critical to develop a financing union for investment and innovation, which would include the capital market union – by giving incentives for more cross-border investments in equity through accounting, taxes and insolvency laws and a pan-European venture capital – and the banking union – through the consolidation of European banks and the control of financial activities and risks. The CMU and the banking union are complementary, not substitutes, as capital markets are not necessarily less risky and are often more volatile than bank loans (especially for SMEs). The aim of the financing union for investment and innovation is to support innovation and digitalisation, the scaling-up of SMEs, as well as green finance and the energy transition.

François Villeroy de Galhau concluded his intervention by stressing that investment is a consensual topic as there are no political obstacles to foster stabilisation and economic growth in the euro area.

Ambroise Fayolle, Vice-President of the EIB, started his intervention by indicating that it would be complementary to the remarks of the Governor and that he would highlight two main points.

1. Investment is clearly recovering in France, which is also reflected in improvements in labour market conditions. **Investment by non-financial corporations, especially the manufacturing sector, supports the recovery. However, public infrastructure investment – and investment by local authorities in particular – continues to fall since 2013**, which has affected investment in transport and education. Ambroise Fayolle also discussed the results of the 2017 EIB Investment Survey and stressed the strong confidence of the French corporate sector in the improvement of the regulatory and political environment – unlike the rest of the EU where the majority of firms consider that recent regulatory and political changes have a negative impact on the investment outlook.

¹ The tax credit for competitiveness and employment (crédit d'impôt pour la compétitivité et l'emploi – CICE) and the additional cuts in employers' social contributions planned under the responsibility and solidarity pact (pacte de responsabilité et de solidarité – PRS) were measures introduced by the Ayrault government to reduce labour costs.

2. **The implementation of the Investment Plan for Europe, supported by EFSI, is a clear success, with a strong increase in the portfolio of new clients**, especially for SMEs, innovation (e.g. biotechnologies) and renewable energy. The Investment Plan for Europe has allowed the EIB Group to take more risk. It also has a positive impact on long-term job creation, both in terms of quantity and quality, by developing the skills of the workforce and supporting employment across different regions. However, the needs of finance for innovation remain large to help young and small firms scale up and foster the industrialisation and commercialisation of new products and services.

As a share of GDP, Greece is the top recipient of operations financed under the Investment Plan for Europe, which has also benefitted countries of Southern Europe as well as Central and Eastern Europe and this enhances economic convergence within the EU. The objective of the Investment Plan for Europe to support investment amounting to EUR 315bn within three years will be met by July 2018. This is why EU member states and the European Commission decided to extend EFSI until 2020, with the objective of supporting EUR 500bn of investment.

Ambroise Fayolle concluded his intervention by explaining that, in France, the Investment Plan for Europe will continue to focus on SMEs, innovation, renewable energy and energy efficiency and support the digital transition – in particular for broadband in regions where the private sector is less active.



Photo credit: P. Jolivel – Banque de France

Discussion

In the discussion that followed the two keynote interventions, the audience asked several questions on recent EIB activities and the investment environment in Europe. For instance, Ambroise Fayolle gave the two main reasons explaining why the lending volume of the EIB Group had decreased in 2017. First, the EIB Group had been particularly active during the crisis – in France, for instance, through the collaboration with the CDC group – but that, in this period of economic recovery, commercial banks are starting to increase their lending activities, and notably to municipalities. Second, the EIB Group focuses on projects with high value added and the lending volume is not a measure of success for the Bank of the EU. Instead, **a clear sign of success of recent EIB activity is the fact that about half of the projects financed contribute to address climate change and that one third of lending volumes support innovation.**

Panel 1 – Beyond the cycle to invest for the next generation

To set the stage for the discussion of the first panel, **Natacha Valla** (EIB) presented the 2017 EIB Investment Survey (EIBIS). EIBIS is the annual survey of the EIB Economics Department with rich qualitative information on investment activities, investment needs and investment finance of more than 12,500 firms in the EU and 600 firms in France. The results of EIBIS confirm that investment activity in France is picking up, driven by the strong performance of the manufacturing sector:

- **In the last financial year, the main purpose of investment was to replace existing buildings, machinery, equipment and IT.** Looking ahead to the next three years, replacement is the most commonly cited priority (by 39% of the firms), followed by new products or services (31%), and capacity expansion (20%). Ten percent of firms in France do not plan any investment. Machinery and equipment remains the main investment area for firms in France (47% of total investment), while the share allocated to employee training is higher in France (16%) than the EU average (10%). Compared to other sectors, firms in the service sector have by far the lowest share of investment in machinery and equipment (at 29%, compared to 53%-55% in the other sectors).
- Natacha Valla stressed that firms in France need to maintain the investment momentum because **the perceived quality of the capital stock is lower in France than in most EU countries.** More specifically, the average share of state-of-the-art machinery and equipment in firms is relatively low in France, at 30%, and is below the EU average (45%). Only a quarter of firms' building stock satisfies high energy efficiency standards (25%) compared to the EU average of 39%. According to EIBIS, around 40% of firms in France report operating at or above maximum capacity in the last financial year and this lags behind the EU average (53%).
- **More than seven in ten firms view uncertainty about the future and labour market regulations as obstacles to investment** (75% and 71% respectively). Business regulation and availability of staff with the right skills are also noteworthy barriers (for 65% and 62% of firms in France). Compared to France, the availability of staff with the right skills is more of a concern across the EU (72%), albeit labour market regulation less of a concern (62% of EU firms).

- Out of the eight areas of public investment that should be the priority over the next three years, **around one in three firms consider professional training and higher education to be the main priority** (32%). This was followed by transport infrastructure (selected by 16%) and ICT infrastructure (11%). All other areas were selected by less than 10% of the firms. This is different from the EU average, where around one in four perceived professional training (and higher education) and transport infrastructure to be the key priority areas (24% and 23% respectively).
- **External finance, especially bank loans, accounts for a larger share of investment finance in France than in the EU.** In France, external finance accounts for a greater share of investment finance than internal funds (51% versus 46%). This is different from the EU average, where external finance makes up a much lower share than internal funds (35% versus 62%). Bank loans account for a higher share of external finance in France (70%) than in the EU on average (56%). The highest proportion of dissatisfaction with external finance in France and the EU is related to collateral requirements.

Natacha Valla also presented the results of the EIB survey on municipality infrastructure investment. Local government accounts for half of public investment but it has decreased with cuts in transfers from the State since 2014. Compared to the EU average, French municipalities report a smaller infrastructure investment gap, due to relatively higher infrastructure quality. **Municipalities perceive health and education as the areas where the infrastructure gaps are the most difficult to close in the next 5 years.** Compared to the EU average, French municipalities tend to rely more on external finance, especially from banks.

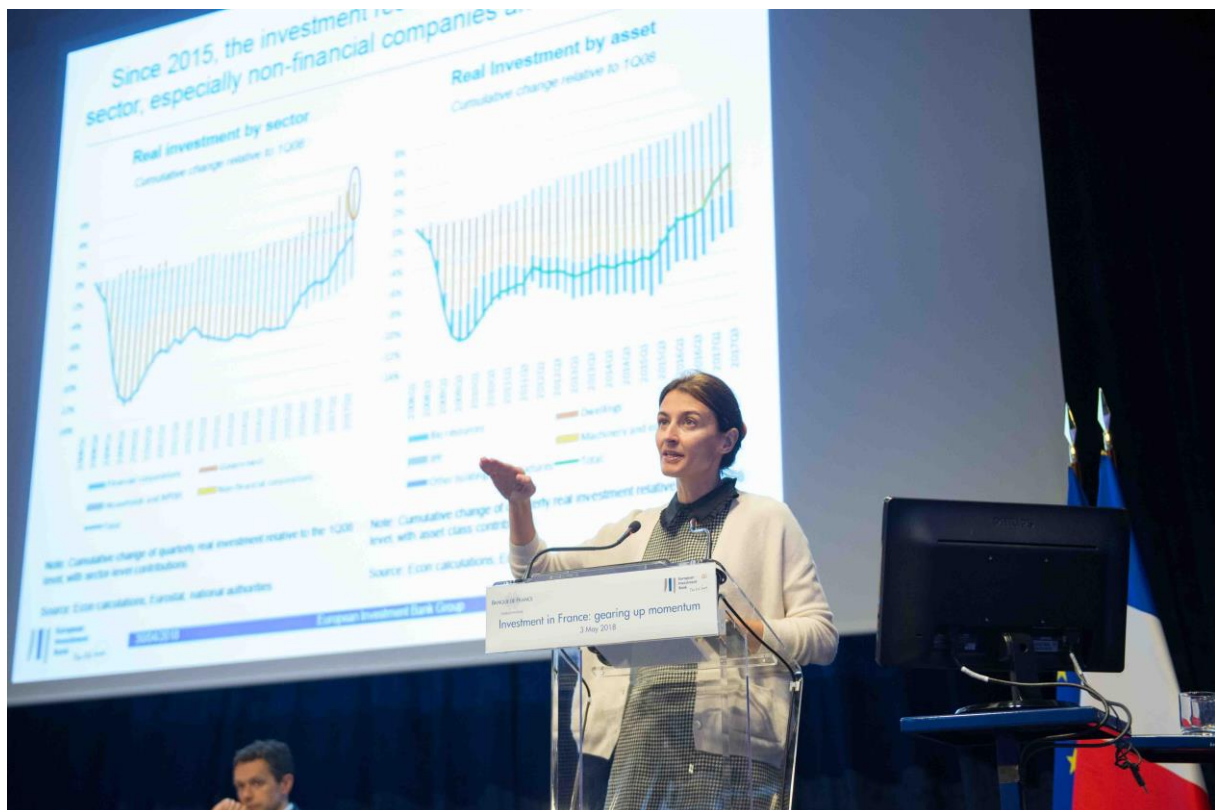


Photo credit: P. Jolivel – Banque de France

Xavier Ragot (OFCE) stressed that since 2011 (and unlike before the crisis) the corporate investment rate in France is higher than in most countries of the euro area. However, the investment rate in machinery and equipment remains lower in France (fluctuating between 5% and 7% of GDP since 1995) than in Germany, Italy and Spain, where it has been fluctuating between 6% and more than 9% since 1995. **The investment recovery in France and the rest of the euro area is reflected in the strong increase of the capacity utilisation rate since early 2015** – after a period of sharp decrease between 2009 and 2014. In France, the recent improvements in profit margins, in particular for manufacturing firms and exporters, is one of the drivers of this recovery. Xavier Ragot also highlighted the falling contribution of public investment to fixed asset accumulation.



Photo credit: P. Jolivel – Banque de France

In his intervention, **Jean Pisani-Ferry** (Hertie School of Governance and Sciences Po) argued that it is difficult to measure the stock of capital in the EU: this suggests that it is not clear what could be the contribution of public support to the stock and quality of capital in France. Firms in France need to invest more in innovation, human capital and digital technologies. **Because of relatively traditional and conservative management, investment in digital technologies by French firms is below the EU average.** In this context, structural obstacles that prevent firms from benefitting from the better cyclical conditions need to be addressed, including the possibility to reallocate labour and capital to firms that perform better. Jean Pisani-Ferry insisted that firms should invest more in new technologies – and not only to replace machinery and equipment. This requires more finance for innovation: is the financing gap due to market failures that can be addressed by public intervention or simply to lower returns to innovation in France (and Europe) compared to other regions of the world?

Julien Marcilly (Coface) stressed that the bankruptcy rate of companies in France has been falling from its peak of 2009. The decrease between 2016 and 2017 was particularly large, indicating that the economy is improving and fewer firms are filing for bankruptcy. The fall in bankruptcy filings is observed across all regions of France and all sectors. Compared to the services sector, industry and construction are the sectors where the situation has been improving the most during the last twelve months, which is also reflected in the strong investment recovery in manufacturing. However, despite the overall fall in bankruptcy filings, credit risk remains significant for some specific firms in France, in particular “zombie” firms that are not profitable and heavily indebted. The obstacles facing exporting firms in France also need to be addressed – as they typically export less than their European neighbours do and they did not increase market shares in the EU despite the strong recovery of their profit margins.



Photo credit: P. Jolivel – Banque de France

Tanguy Desrousseaux (EIB) discussed recent EIB activity in France to address current investment needs. The EIB Group maintains sustained level of lending in France with a focus on education (secondary education and higher education), R&D and innovation (in particular for manufacturing companies) and the financing of broadband with operators and local authorities. The EIB Group continues its special effort to support climate action and adaptation through renewable energy (photovoltaic, windfarms and biogas) and energy efficiency of buildings (social housing and public buildings). The Investment Plan for Europe and the European Fund for Strategic Investments (EFSI) made it possible to work with new, smaller and riskier counterparts, using notably new risk-sharing products with financial intermediaries (national promotional banks and commercial banks). The visibility of the EIB Group has improved in France because lending activities have a tangible impact on job creation and long-term competitiveness of the economy.

Panel 2 – Investment finance beyond bank debt: between market and policy impulses

Olivier Garnier (Banque de France) discussed the global corporate “saving glut”. Corporate savings have been increasing at a fast pace since the mid-1990s (increasing from some 10% of GDP to almost 15% of GDP over the last 20 years). At the same time, the savings of households have continued to fall. Government savings have been much more volatile over the same period and have been negative since the beginning of the crisis. Corporate savings are higher than corporate investment (which are at about 12% of GDP). The corporate “saving glut” is associated with the falling labour share in global value added. In the US, corporate debt has been used to buy back stock shares instead of financing investment and capacity expansion (which are mainly financed using internal funds), leading to a negative net increase in liabilities.

The situation in France is different as it is among the very few advanced economies where the nonfinancial corporate sector is a net borrower (as opposed to a net lender, such as Germany, Italy, Spain and the UK). France is also one of the very few economies where the debt-to-GDP ratio of the non-financial corporate sector has continued to increase in the post-crisis period. A substantial part of the increase in corporate debt has taken the form of market debt (instead of bank credit): at the end of 2017, outstanding bonds represented 30% of total non-financial corporate debt in France, compared to 13% in Germany, 11% in Italy and 4% in Spain. In fact, outstanding bonds by French non-financial companies amounted to about EUR 500bn in early 2018, corresponding to almost 50% of the total euro area market. Oliver Garnier argued that France is thus ahead of the curve in terms of corporate debt disintermediation. However, as in most other euro area economies, equity financing remains insufficiently developed, especially compared to the US.



Photo credit: P. Jolivel – Banque de France

Thomas Friedberger (Tiekhau Capital) discussed the role of non-bank financial institutions and the complementarity of different sources of finance to support investment in France. The financing needs of non-financial corporations are diverse and should be accompanied by a variety of financial products – from the more traditional to alternative products, such as private equity, private debt and crowdfunding. The emergence of alternative financial instruments is relatively recent in Europe compared to the US. The development of private debt is significant in Europe but remains less important than in the US. However, the US experience indicates that it can be efficient to propose financial diversification to non-financial corporations, in particular to support innovation. This dynamic could be better supported in Europe, in particular through the regulatory framework and the possibility to rely on life insurance savings.

Amélie de Montchalin (member of the National Assembly, LRM) highlighted policy reforms to better mobilise capital in France. **The recent fiscal reform had a visible impact on investment finance, in particular through internal funds.** However, further stimulus will be needed to increase the mobilisation of savings to finance investment for SMEs, from EUR 5bn to EUR 10bn; this will be supported by constructive dialogue between the French parliament and financial intermediaries. Financial intermediaries also need to have a longer-term view on savings and investment, instead of focusing on short-term speculation, to better finance corporate projects and enhance sustainable economic activity – in particular through the digital transition (with a horizon of 6 to 8 years), climate transition (horizon of 15 to 20 years) and employment transition. In France, SMEs rely on external finance to buy or renovate buildings instead of investing in digitalisation, where the *Banque publique d'investissement* (Bpifrance) can support them.

Concluding remarks

Debora Revoltella (EIB) started her intervention by thanking the Banque de France for the organisation of the conference and the opportunity to discuss and better understand the investment outlook in France. Extraordinary monetary policy has played a key role to provide liquidity to the financial market in recent years. However, in order to raise potential growth above 1.3%, structural investment and financing needs for the economy should be addressed. **With its broad range of financial products, the EIB Group can provide policy support and give incentives to the private sector to finance innovation, climate change and other projects that have a positive impact on sustainable economic growth.** In this context, Debora Revoltella argued that public policy should make it more attractive for firms to focus on three points: upgrade the skills of their workers, foster innovation and increase the diversification of financial instruments – in particular for SMEs.

1. A third of firms in France consider that the public sector should invest more in professional training and higher education. **Workers with better skills will help support the investment recovery and will have more flexibility to adapt to a changing competitive environment.** Debora Revoltella explained that investing in people is critical – through the education system, firm training and lifelong learning – at the cyclical, structural and technological level. Policy support should come in different forms and at all levels: from the national government but also from the EU and local authorities. In order to have a positive on long-term growth, it should also focus on the quality and efficiency of public expenditure and targeted investments.

2. To foster innovation in the EU, public policy should encourage firms to invest in R&D and in other intangibles so that all firms (even the less innovative firms) adopt new technologies. **There are important complementarities between the public support for R&D and investments by the private sector as innovations can have large positive spillovers.** However, the focus should not only be on incentives to invest in R&D as complementarities between different types of intangibles matter: for instance, investing in both training and R&D tends to have a larger impact on firm productivity. Against this background, the diversity and complementarities of intangibles should be highlighted as they can increase the value of the existing stock of capital.
3. **The diversification of financial instruments is crucial to support innovation in the EU:** not only through the supply of equity, but also with measures to changes incentives for firms so that they use more equity. The results of the EIB Investment Survey suggest that only 1% of EU firms want external equity to play a more important role in their financing mix. Many companies believe they can invest and grow without diluting their ownership through external equity financing; they rely instead on internal finance and bank debt but cannot grow fast.

Debora Revoltella also discussed falling public infrastructure investment in France and measures to relaunch investment in the EU. **The fact that savings exceed corporate investment by several hundreds of billions of euro in the EU reflects the fragmentation of the financial market.** In some EU countries, excess savings also put pressure on real estate and the price of equity. New financial instruments need to be developed at the EU level to complement the banking union and the capital market union and address structural needs – such as innovation, long-term infrastructure and climate change. The EIB Group can play a key role in this context. Recent EIB activities, also through EFSI, are considered increasingly more using an “impact lens” (rather than simply focusing on lending volumes). This will help to understand the additionality of EIB finance to address investment gaps and market failures in both the short-term and long-term.

Report prepared by Christoph Weiss

Investment in France: gearing up momentum

3 May 2018

Banque de France Conference Center
31 rue Croix-des-Petits-Champs – 75001 Paris

AGENDA

8:30-9:00 Registration and welcome coffee

9:00-9:20 **KEYNOTE SPEECH**

François Villeroy de Galhau - Governor, Banque de France

9:20-9:40 **KEYNOTE SPEECH**

Ambroise Fayolle - Vice-President, European Investment Bank

9:40-10:00 **Q&A with Ambroise Fayolle and François Villeroy de Galhau**

10:00-11:15 **BEYOND THE CYCLE TO INVEST FOR THE NEXT GENERATION**

Insights from the EIB Investment survey on France – **Natacha Valla**, European Investment Bank

Panel discussion:

Xavier Ragot, OFCE

Jean Pisani-Ferry, Hertie School of Governance and Sciences-Po

Julien Marcilly, Coface

Tanguy Desrousseaux, European Investment Bank

Moderation: **Christoph Weiss**, European Investment Bank

11:15-11:45 Coffee Break

11:45-12:45 **INVESTMENT FINANCE BEYOND BANK DEBT: BETWEEN MARKET AND POLICY IMPULSES**

Olivier Garnier, Banque de France

Amélie de Montchalin, MP, LREM

Thomas Friedberger, Tikehau Capital Management

Moderation: **Marc-Olivier Strauss-Kahn**, Banque de France

12:45-13:00 **CLOSING REMARKS**

Debora Revoltella, European Investment Bank